

Rates Spark: Supply sidelines geopolitics

A hotter US CPI initially pushed short rates higher, but the long end later followed with a sell-off in 30Y bonds last seen in March 2020 amid the Covid market turmoil. Triggered by a weak auction, that leg higher underscored the markets' ongoing concerns about the US fiscal outlook and for now is also sidelining geopolitical concerns



Different playbooks for the US front and back-end

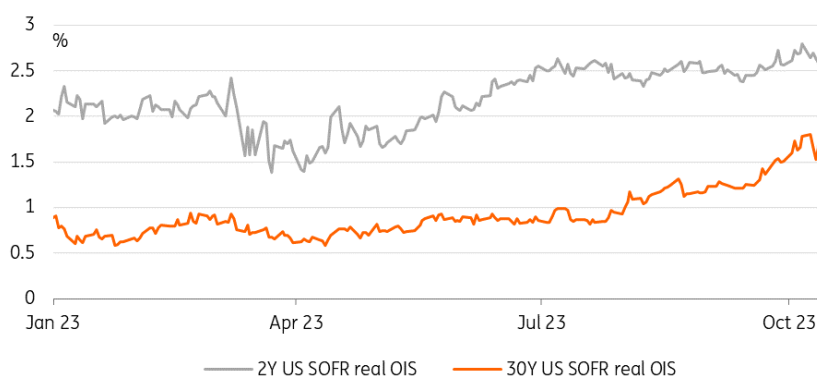
US [CPI came in hotter than expected](#) and pushed up front-end yields as a first reaction. The 2Y yield jumped by 8bp on the data and steadied just above 5.05%, still a tad lower than where it ended just after the stronger payrolls report last week.

The long end was slower to react, but with oil prices eventually signalling to some extent easing concerns surrounding a further escalation of the Middle East situation, investors also started to shed the longer end. The initial bear flattening turned into a vicious bear steepening later in the day. A run of soft Treasury auctions was topped by a very weak 30Y auction and handed the long end the final blow. From the trough at the beginning of the European session through the peak in the wake of the auction, it was a rise of more than 21bp for the 30Y bond yield, pushing it above 4.85% to end 17bp higher on the day. It is the highest jump since March 2020 when liquidity dried up surrounding the coronavirus turmoil.

There is also another important distinction between the drivers of the front versus the back end. Front-end rates saw the inflation component rising 8bp, i.e., the real rate was little changed. The back end, however, was almost entirely driven by the real rate component today, highlighting the higher premium investors demand in light of higher issuance and deficit prospects rather than being a story of just macro resilience.

We still heard Fed officials such as Susan Collins yesterday pushing the notion that higher yields may reduce the need to hike rates. While that may cap the front end – which briefly got back to discounting a 50% chance of another Fed hike – the long end is driven by different factors.

Different playbooks for the short- and long-end



Source: Refinitiv, ING

Today's events and market view

Geopolitics in the Middle East have added another entry to an already long list of risks. But it appears markets are ready to move on quicker than we anticipated and would feel comfortable with. But if we resort back to our rough guide of where the 10Y yield now trades relative to the trough in the market's projected Fed funds rate – now 4.7% in the 10Y versus just below 4.1% in the Fed funds – we would conclude that there is still a path open to 5%. Under current circumstances, it looks to be more erratic and still less certain, and some of the sharp move has already faded overnight.

Following the US CPI, import prices and then the University of Michigan consumer survey including inflation expectations will move into focus. It will be quieter on the Fed speaker front with only Patrick Harker scheduled to speak, but we will hear from ECB President Christine Lagarde, who speaks in Marrakesh today.

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