

Rates Spark: There is still a job to get done

Market expectations of policy easing for the next year are about to get tested tonight with the Federal Reserve likely to signal that there is still a job to get done. Yesterday's CPI was largely in line with forecasts, but with residual strength in some corners of the services sector, the Fed is likely to remain nervous



A 4% core inflation environment with a 200k jobs increase is a valid argument against material falls in market rates

The mere 0.1% increase in headline prices seen in the past two months paints a subdued picture for [US inflation](#). Then again, 4% core and 3% headline inflation readings remain elevated and far too deviant from the preferred 2% rate. There is still a job to get done here. If you combine a 4% core inflation environment and a 200k jobs increase (as we saw in Friday's payrolls), there is a valid argument against material falls in market rates.

Following Monday's tailed US 10yr auction, the 30yr auction on Tuesday went better. Or at least pricing was tidier, which proved a relief for a market that was fearful of another larger tail. Events like those have had a material negative impact on Treasuries. But this auction was followed by a

downward move in market rates. That's the auction test complete, which leaves the market focus now on the FOMC ahead.

The Fed last raised rates in July and we think that marked the peak. If, as we expect, the Fed sticks to the hawkish tilt and does not give the market too much to get excited about, then expect minimal impact. As it is, the structure of the curve, as telegraphed by the richness of the 5yr, is telling us that a rate cut is not yet in the six-month countdown window. That will slowly change, and we'll morph towards a point where we are three months out from a cut and the 2yr yield really collapses lower.

The ongoing deepening inversion theme is in part a result of the Fed's success in telegraphing the outlook for official rates. The 2yr yield does not yet have the green light to really break lower and drastically steepen the curve from the front end. We need to see either material falls in inflation (and we've not yet had enough of this) and/or a heightened sense of labour market vulnerability. And we're still waiting.

One of the issues that the market is looking at is the stress in commercial real estate. While nothing material has come to the fore, we run the risk every day with the funds rate at 5.5% that at some point, something gives. Emerging stories of growing angst in the multifamily residential rental sector are also having an impact, as is the ongoing monitoring of private credit and its nature of leveraged floating financing.

The market thought process here is a rate cut could not come fast enough. If it doesn't, something could well break. Over to Fed policymakers to hear what they have to say.

Today's events and market view

The market is discounting around 110bp of policy easing from the Fed over 2024 with a first rate cut fully priced by May. Pricing has eased off its most aggressive levels but it will likely still remain in stark contrast to the FOMC's own median policy rate estimate as reflected in the new dot plot. Here we expect the Fed to retain the same 50bp of rate cuts in 2024 that it signalled in the September forecasts, albeit from a lower level given the final 25bp December hike forecast last time is not going to happen.

In today's primary markets, Italy will tap 3Y and 7Y bonds. This will also mark the final supply for the current year.

Authors

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.