Rates Spark: Bonds are cheaper now, but does anyone want them?

Rates are struggling to break above important levels, noses are being turned up at US auctions that are much cheaper then they were, and markets' central bank hike expectations appear maxed out for now. We think next week's data stands a better chance to provide that final nudge, though we also have technical factors from supply to month-end to contend with

US auctions being shunned on 50bp concession to those of a few weeks ago

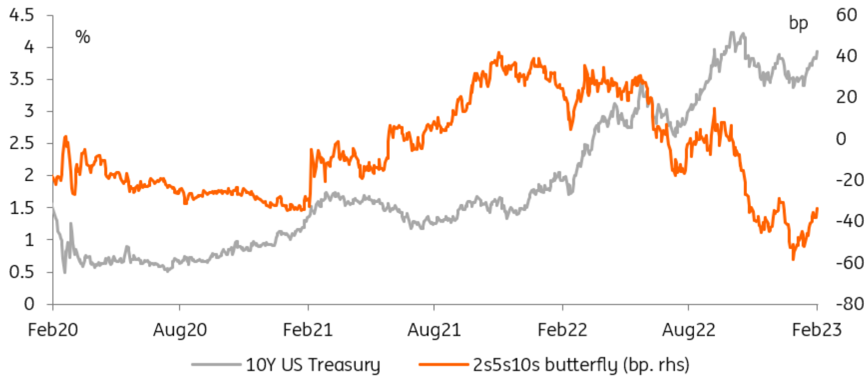
US auctions have been a tough sell this week. Both the 5yr and the 7yr tailed, meaning that the awarded yield was above the when-isssued (market) one. Not by much, but enough to show that the market is in no mood to take down extra interest rate risk. No doubt longer duration supply would have been an even tougher ask. Interestingly this happens in the wake of a significant concession built into the curve in the past number of weeks. Clearly the market is not convinced that the move higher in yields is behind us.

The market is in no mood to take down extra interest rate risk

It's in stark contrast to the stellar long duration auctions of a number of weeks back when the US 10yr was in the region of 3.4% (and lower). That was a time when the market was looking for any excuse to test the downside in yield. We noted back then that the best option was to cosy up to the ultra-front end, take the 4% handles on offer (on zero risk) and sleep easy at night. That thinking remains, but as noted we'd also be slowly averaging into the higher yields now attainable further out the curve, with the 10yr 50bp higher.

So, we were cautious on Treasuries around the auctions that went ultra-well some weeks back, and we'd be more constructive into the more recent ones this week that have not gone well. The 4% area for the 10yr is now offering some duration at better levels, and for corporates that are over-fixed to look to swap some liabilities to floating. The latter is carry negative on impact (that's the tough bit), but cumulative carry positive, provided the Fed does some decent interest rate cutting as we venture closer and through 2024.

US yields are back at their highs but not high enough to entice buyers at auctions



Source: Refinitiv, ING

Of data drivers...

Data remains crucial. It is being tracked closely by central banks which have reverted to a meeting-by-meeting approach. It has become a main driver of rates direction as markets try to second-guess central bankers' actions in the months ahead.

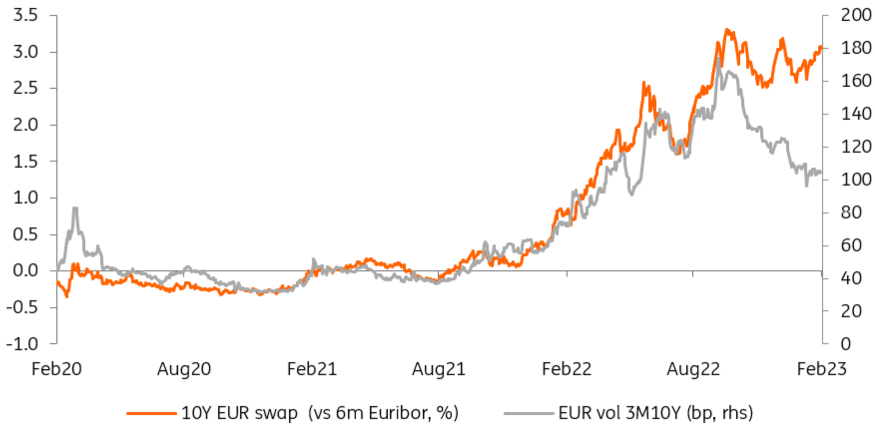
Ahead lies another data-heavy week. Highlight, certainly for EUR rates, will be the eurozone CPI flash estimate for February. The markets' sensitivity was highlighted by the reaction to the upward revisions in the final inflation rate for January just yesterday, to 8.6% year-on-year in headline and 5.3% YoY in core. Energy price development should bring down the headline rate from that level, but it is core inflation that remains the main concern. We have heard from European Central Bank officials that they see the peak in underlying inflation still ahead, so an unchanged rate is probably the best one can expect next week.

It is core inflation that remains the main concern

A sticky core rate means no relief for central bankers and thus also little reason for markets to budge from their pricing of 125bp of further rates increases from the ECB. However, we also have the feeling that given how far the EUR front-end pricing has already evolved, the further upside appears limited for now with even the ECB hawks already 'out-hawked' by the market.

Outside the eurozone it had been the resilience of the US jobs market that gave the starting shot to the current leg higher in rates – and giving the Fed more reason to fret about sticky inflation. That jobs resilience is for now also reflected in the weekly initial jobless claims data seen again yesterday. But other data had also come in better, with one outsized surprise being the ISM services which had surged back from below 50 to 55.2. We will get the February reading next week, and while the consensus is looking for some moderation, certainly not of the sort to change the current narrative.

EUR rates are also back at their highs but volatility suggests less impetus than in 2022



Source: Refinitiv, ING

… and temporary technical factors

Primary market activity in Eurozone sovereign space should moderate next week, but it will have a notable ultra-long flavour again. The Netherlands and Germany will be in the market with 15Y bond taps, while France will have its auction geared at 10Y and longer tenors as well. Also on the slate are Spanish auctions and another tap from Germany in the 2Y maturity.

That said the impact of auctions is usually fleeting. Case in point just yesterday was the reversal of the long end curve steepening on the back of the syndicated 30Y Bund tap. To note, the large order book of that particular deal provided another hint for ongoing demand in the sector.

Another factor to take into consideration is the rebalancing around month end. The long end deals over the last month should imply duration buying from index trackers to match the index extension.

US Treasury supply will take a break next week after last night's 7Y note auction.

Short-end EUR rates have been driving the long-end, but ECB hikes pricing seems to have peaked

Source: Refinitiv, ING

Today's events and market view

Rates are struggling to break above the highs staked out in previous months. We doubt that today's data alone can nudge rates higher given that markets should already have a good feel for them. We think next week's data slate stands a better chance to offer fresh impetus.

Today we will get more headlines on US inflation to under pin the Fed hike narrative with the monthly series of the PCE deflator up for release. After yesterday's quarterly data release, the December month-on-month core rate should see an upward revision to 0.4% and we will likely see another 0.4% print for January. Personal income and spending data should reflect the increase in activity already seen in the bumper retail sales release for January.

In today's primary market Italy launches a new 7Y floating rate note alongside 5Y and 10Y bond taps.

We will hear from the Fed's Jefferson and Mester, as well as Bullard.

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