

Rates Spark: Can Christine sound as calm as Jerome?

The more Chair Powell spoke yesterday, the more he meandered into less hawkish territory. But he did not stray too far. Next up is the ECB's Lagarde, who is more prone to deviate. The 25bp hike is not the point. The tone is. We show that the US 10yr yield looks low relative to the strip, while in fact the 10yr Euribor rate looks if anything high versus its strip



Christine Lagarde,
president of the
European Central Bank

The Fed cements a mild rate cutting discount ahead, keep upward pressure on Treasury yields

From a market rates perspective one of the key things to watch from the Federal Open Market Committee (FOMC) outcome was how the Fed decision and subsequent commentary might affect the Fed funds strip. In particular, beyond the hiking and into the discounting completion of the rate cutting phase. This is important, as where the fed funds strip sits in 2025 has a material effect on longer-dated Treasury yields, as, say the 10yr yield, really should not trade much through the longer dates on the strip. In fact they should trade at a 30bp premium to it (above it).

The US 10yr is still low to the terminal funds rate

We went into the FOMC with the Jan 2025 implied rate at just under 4%. It's still there post the meeting, but closer to 3.9% now (as it jumps around, typically on low volumes). Remember this was down in the 3% area when Silicon Valley Bank went down. The fact that it's some 100bp higher now limits the extent to which the 10yr Treasury yield can fall. In fact it should rise, and we continue to target it to get to the 4% area in the coming weeks, versus a current level of around 3.9%. That is broadly flat to the implied funds rate in Jan 2025. That's too low for the 10yr yield, as it implies no curve just as the Fed has completed its rate cutting cycle.

Front-end rates up, with the reverse repo at 5.3% now at the level of bills

We are not agreeing with the market discount per se, but where it sits is important in terms of framing the here and now for the 10yr Treasury yield, and in that way helps to add context to the immediate few weeks ahead. Meanwhile, the Fed continues to gradually tighten through its bond roll-off programme. Most of the impact of this has been in lower volumes going back to the Fed on the reverse repo facility. Bank reserves have in fact held steady. This allows the Fed to keep the tightening pressure on. It also keeps bills rates under elevation pressure, and prevents the bills curve from moving to a state of material inversion. At least not just yet. And, all other key rates are up by 25bp too, including the reverse repo rate now at 5.3%.

The ECB to match the Fed, but the 10yr Euribor rate trade with more of a cushion

It's the European Central Bank's turn on Thursday, with a 25bp hike anticipated. Delivery will see the Refi rate get to 4.5% and the Deposit rate to 3.75%, with the latter still heavily influential with respect to where front end Euribor rates are actually pitched. The current 3mth Euribor rate is pitched at just over 3.7%, at or about the level of the deposit rate. And the Euribor strip has it extending up to 3.9%, and so just about discounting one more 25bp hike.

Phraseology from Lagarde is key

The biggest attention will be centered on the words coming from President Lagarde. Chair Powell post the FOMC outcome started off sticking to script, but slowly morphs to an acknowledgement that inflation has indeed fallen, the real rate had risen and was indeed in a restrictive state. As the conference went on he was almost on the verge of a nod towards an eventual rate cutting track down the line. Lagarde will need to be a bit more careful. Chair Powell tends not to stray too far from script, while Lagarde can deviate far more.

10yr Euribor at least is comfortably above the implied strip

If we look out along the Euribor strip, the 3mth rate is discounted to be below 3% by the middle of 2025, and it stays below, getting down to 2.7%. There is a gap between that and where the 10yr Euribor rate currently sits at around 3.6%. Here there is a difference relative to the US, there the 10yr Treasury yield is already flat to or below where the fed funds strip is pitched. Part of this is reflective of the tendency of the deposit rate to have an outsized influence, but it's not all that. Optically there is more value in 10yr Euribor on this simple measure.

Today's events and market views

Ahead of the ECB meeting, we'll have some regional consumer confidence, producer price inflation and retail sales. But nothing that is likely to move the market in any material fashion.

More influential will be the US data. US GDP data for the second quarter is expected to confirm that the US economy continued to grow at a pace of almost 2%, while the GDP price index is set to fall to about 3%. The latter is a good look, and a reminder of the recent CPI number at the same rate. The core PCE index should be more influential though. It too should fall, but to a still elevated 4%.

We'll also get durable orders, which should see a calming in the ex-transportation reading. But still far from a recessionary-type number. The headline should remain elevated, in the area of 1.3% helped by airline orders. We'll also get another helping of weekly jobless claims, expected to be still in the 230k area, and still well below average.

And then there are inventories data which should not be very market moving. Home sales data is expected to be weak, but has had a tendency to surprise to the upside of late. And the the Kansas City Fed Index should be weak too, especially given its aimed at the manufacturing sector where weakness has been in the waters for quite some time now.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@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>.