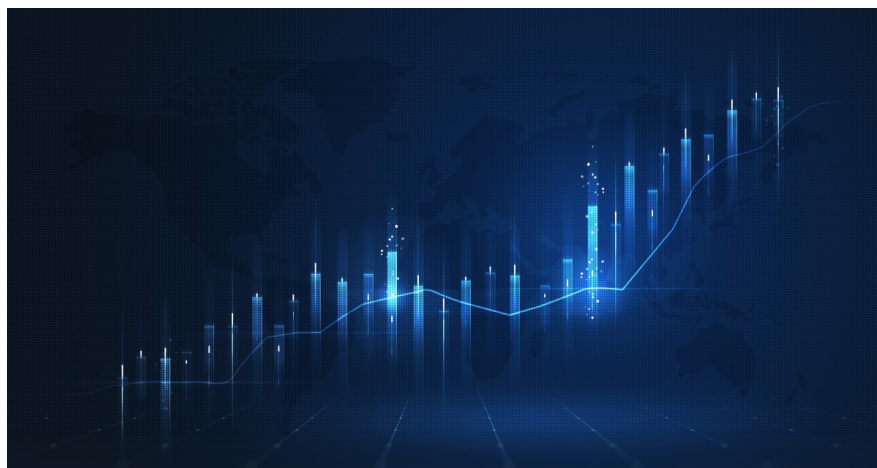


## Rates Spark: A path to 4.5%

Expectations for upcoming key jobs and CPI releases are enough to place pressure for a move towards 4.5% for the US 10yr yield. These developments contrast with eurozone rates where inflation data has cemented June cut expectations. The 10Y UST-Bund briefly hit 200bp on the divergent paths. That will re-tighten eventually, but for now it's only wider



### Tough to stand in the way of the 10yr heading towards 4.5%

As we roll towards the March payrolls report (to be released on Friday), there is a practical acceptance that the number will be decent. Wednesday's ADP employment report was firm, and the momentum so far in 2024 is matching that of the second half of 2023. On top of that, the CPI report due next week is showing market expectations of 0.3% and 0.4% month-on-month, which if confirmed would suggest that the US is not a 3% inflation economy but is in fact closer to being a 4% one.

These inflation data are not only slashing expectations for the number of cuts in 2024, they are also ratcheting higher the market estimate for the terminal funds rate. Now that's in the area of 4%, or more correctly in the 3.75% to 4% area. This is an important line in the sand, as it effectively represents a floor for market rates. More succinctly, longer dated market rates really have no business going below 4% for as long as that discount for the funds rate is in place.

So, when we look at the 10yr yield at 4.35%, it's not particularly elevated, when viewed relative to the notional 4% floor as described. The 10yr should in fact trade with a positive term premium, and

thus trade comfortably above such a floor. As we look forward, it's tough to argue that 10yr Treasuries are a glaring buy. Sure, they are cheaper than they were at the beginning of the year. But the question is can they get cheaper. And the answer is still yes. If we get a firm payrolls report on Friday, and the discount for another pop in CPI hardens into next week, then the conversation revolves around heading to the 4.5% area.

## 10Y UST-Bund touches 200bp as the possibility of divergent policy paths is contemplated

This all still contrasts with developments in EUR rates where Wednesday's data showed inflation cooling faster than forecast – both headline and core inflation are now back at a 2% handle – even if only barely so for core. Conviction for a June cut remains strong, with pricing for overall easing this year still closer to 90bp even as EUR rates are also feeling some spillover from the US.

The divergence is nicely illustrated by the 10Y UST-Bund spread, which briefly moved above 200bp on Wednesday. This level was last breached for a short period in autumn last year when markets felt pressure from rising Treasury supply prospects, however, it has basically been a cap throughout the pandemic years. The last structural move beyond that level was when Fed and ECB policies started to materially diverge from 2017 onwards.

### Thursday's events and market view

Spanish and Italian PMIs are expected to come out strong, which would contrast the relatively weaker PMIs from France and Germany reported last week. For the eurozone as a whole we have PPI numbers coming in, likely remaining in deflationary territory. Lastly, the ECB minutes from the March meeting will be released, but given markets seem convinced about June cuts, these are unlikely to have much impact.

From the US we have jobless claims. Initial jobless claims are expected to only increase slightly from 210k to 214k. Later in the day a number of Fed speakers could add some nuances to the debate about June rate cuts.

In terms of supply we have Spanish auctions worth €7.25bn, including 5y, 10y and 15y SPGBs and a 15y SPGBi. France will auction a 9y, 31y and 36y OAT together with a 15y Green OAT, amounting to a total of €12.5bn. From the UK we have GBP 3.75bn of 10y Gilts.

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