Rates Spark: A sniff of positive US fiscal data in the air

Eurozone yields have decided to chime in with the rising trend as we progress towards the end of week. US yields are more conflicted. The 10yr and 30yr auctions were fine, and there is a sniff of a positive "surprise" from the June fiscal deficit data due on Friday afternoon, helped in part by tarif income (but and also from timing issues)

US rates are taking the lead as EUR rates followed the bullish mood in US Treasuries

The US deficit number for June is shaping up to be better than expected

The 30yr auction went well enough. It was helped by a cheapening process into the auction event, and in the end got done at a slight price premium to secondary. It was also rewarded by a positive market in the wake of that auction, as yields drifted back down toward the lows of the day. The 10yr has settled back in the 4.35% area. It's been a quiet data week, and Friday serves up a release that typically does not garner huge attention, but it is a key one to monitor as we progress through the coming months - the monthly budget balance. Friday's release is for June.

The market survey is braced for a $30bn fiscal deficit on the month. But it's a volatile series. There was a $316bn deficit for May. A useful reference was the $71bn deficit recorded for June last year.

The CBO, however, estimates that June will see a moderate surplus of $24bn. This partly reflects timing issues on the spending side, and large reductions in Department of Education and FDIC costs. It also reflects higher revenues from tariffs, with customs duties projected at up some 90% for fiscal year 2025 compared with 2024 (in cash terms, up $50bn on the year).

If realised these data will be supportive for Treasuries. One thing is true, the revenue benefits from tariffs and the cost cutting from Department of Government Efficiency should act up front to calm the deficit data. It's in 2026 when the tax cutting bill hits revenues. The market should of course be taking both into account as a basic discount, but the better news does come first.

EUR should still look for gradually higher long-end rates

If anything, markets have learned to look through the daily headlines coming out the White House and focus on actual impact. That means less volatile markets, not least because it may take a while before that impact can be observed. In the case of the EUR market, it also allows paying attention to other themes such as the incoming fiscal stimulus out of Germany.

This is likely part of the reason why 10y Bund yields have started to rise again of late, reaching 2.7%. That is not the high point of the year yet. We saw that in early March at just above 2.9% when Germany first announced its fiscal U-turn. More notably, 10y real OIS rates have returned to that peak initially reached in early March. What has happened since then is that the inflation component has declined by more than 10bp as well as the Bund vs OIS spread component which also receded by 10bp from its peak of close to 30bp when funding fears were at their peak.

The receding inflation component is driven by the current more benign dynamics also on the back of the stronger EUR exchange rate. In theory longer-term inflation expectations should look past this, but inflation markets show some correlation with short-term dynamics.

We would also argue that for Bund yields, especially that latter component vs OIS, will likely have to increase once the planned debt increase of €850bn until 2029 fully feeds through into the debt agencies debt plans. There are still implementation risks of course, especially given that defence spending, as one of the main drivers of the debt increase, is prone to long procurement processes and delays.

In sum there are still good reasons in our view to look for a further gradual increase in longer rates.

Friday's events and market view

There are not many data releases for the day. The European morning will see monthly UK GDP data for May as well as industrial production data. Thereafter the focus is on ECB speakers with Panetta, Vujcic and Cipollone. The US releases the monthly budget figures for June.

Italy will auction a new 2y bond while also reopening 7y and 15y bonds (up to €8.75bn in total).

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