Rates Spark: A storm is coming

EUR rates are have seen the dovish end of messaging ahead of the next ECB meeting, but some of the heavyweights have yet to chip in. US rates are looking ahead at a data heavy week where supply constraints continue to overshadow the underlying recovery dynamic. But the President's budget proposal highlights the fiscal push still in the offing.

Source: Shutterstock

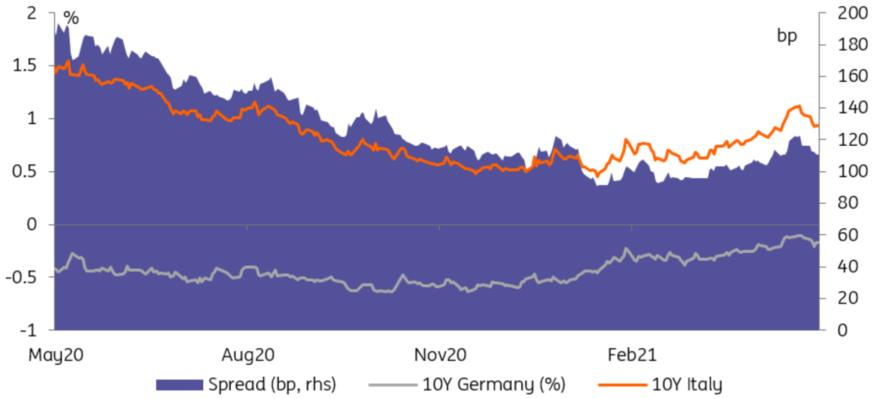
Setting the stage for the June ECB meeting

Today's French CPI kicks off a series of Eurozone inflation releases that will stretch into next week. These releases will coincide with the last week ECB officials can make public comments about monetary policy before a self-imposed quiet period starting one week before its June 10th meeting. So far, the doves have been out in force, with three governing council members voicing (or suggesting) their preference for maintaining purchases at €80bn/month, compared to closer to €60bn/month in Q1.

The question is whether hawks will make their voice heard ahead *of the meeting*

Whoever wins the argument, we doubt the dovish view is unanimously shared, but it might still win the day. The question is more whether hawks will make their voice heard ahead of the meeting, and introduce more two-way risk into EUR markets. As far as we can tell, there aren't that many interventions scheduled by the 'big three' (composed of president Christine Lagarde, chief economist Philip Lane, and board member Isabel Schnabel) by next Thursday, but not all interventions are flagged in advance.

Dovish ECB talk has stopped the rise in sovereign yields in its tracks



Source: Refinitiv, ING

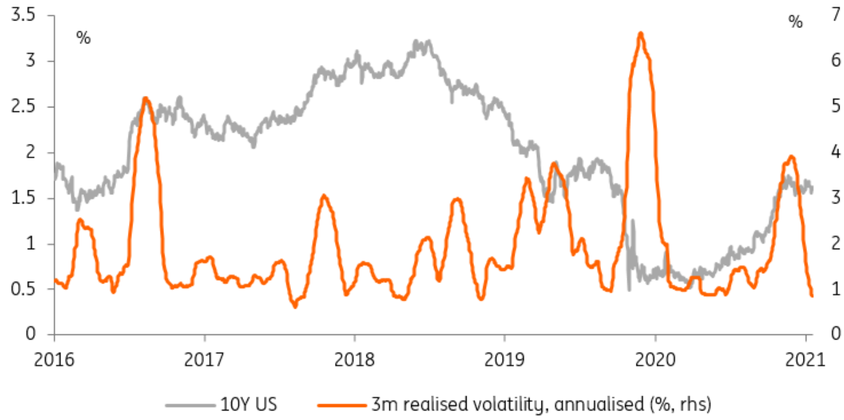
0% 10Y Bund yields is definitely a reasonable target over the summer

The interplay with inflation releases in the coming days is interesting. Base effects, and other factors, should push CPI roughly at the ECB's target. Lagarde et al. have been at pains to explain that the rise is temporary but a number of forward-looking indicators (such as commodity prices) have been fanning inflation fears. This, and more justified inflation fears in other jurisdictions, will make the ECB's message harder to hear. As more market participants move their expectations towards continued PEPP purchases at €80bn/month, the scope for EUR rates to pause on their way up is limited in our view. 0% 10Y Bund yields may be harder to achieve this quarter, but it is definitely a reasonable target over the summer.

US rates are looking ahead at a data-heavy week culminating in the May jobs report

The calendar over the next few days is also liable to shake the current status quo on USD markets. Next week brings no less than the May employment report and ISMs. The theme of the moment in the US is whether supply constraints, 'bottlenecks' in the Fed's parlance, risk causing a jump in prices, and depress the medium term economic outlook. More job gains than last month\'s puny releases would go some way towards alleviating those concerns.

10Y Treasuries: stable but a storm is coming



Source: Refinitiv, ING

Taper talk, fiscal push, and another barrage of strong economic data would unsettle the current status quo

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While there are good explanations as to why macro data is losing momentum, and perhaps not a true reflection of the underlying recovery dynamic, it has been enough for rates markets to maintain their cautious tone. Yet, yesterday's headline that President Biden will today present a US$6trn budget proposal for 2022 comes as a reminder of the strong fiscal push that is still in the offing. So maybe not that surprising that some at the Fed have started to raise the topic of tapering. The latest - though not his first time - to do so was Dallas Fed's Kaplan yesterday, making the point that "gently taking the foot of the accelerator" was warranted to manage the risks of falling behind the curve.

USD rates have been a stalwart of stability in the past two month, but the combined effect of taper talk, fiscal push, and another barrage of strong economic data would unsettle the current status quo.

Today's events and market view

For US and UK markets it is the final trading day of the month given Monday's holiday. US President Biden's bold budget proposal to be presented today was already outlined in news reports, but the infrastructure plans in particular should continue to be a hot topic with Republicans having presented counterproposals to kick off talks next week. The focus in US data today is on the April personal income and spending report. Headline incomes are likely to plunge after the March stimulus payments as our economist points out, but

In data Eurozone rates will follow the first CPI flash release from France as outlined above and the Economic Sentiment data. But perhaps a better gauge for investor sentiment with regards to the upcoming ECB meeting are today's Italian bond auctions. Usually Italian spreads over Bunds have proven quite sensitive to the prospects of ECB policy changes. Yesterday's overall move higher in rates has seen spreads tighten, a positive sign for investor risk appetite after the previous episodes of rising rates had seen spreads move wider.

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