

Rates Spark: Back to tariff headlines, but fiscals still matter

Long-end yields are experiencing some relief, but we think US yields will find it particularly difficult to shake off a bearish taint over the coming weeks and months. While tariff headlines have taken over, the fiscal trajectory still matters. Euro rates may feel a greater pinch from the 50% tariff threat, even after the deadline was delayed



Back from the brink, but a 50% tariff level for the EU now looms large

While the UK and the US were off for a holiday, risk sentiment was able to recover. Over the weekend, US President Donald Trump extended the deadline for the newly threatened 50% tariffs on the EU to 9 July. The turnaround had been preceded by a “good call” between the EU’s Ursula von der Leyen and Trump.

The recovery in risk assets also included a tightening of EGB/Bund spreads, which received a further tailwind from the decision by Moody’s to lift the outlook for Italy’s sovereign rating to positive. Bunds themselves briefly traded flat to swaps again but are slower to retreat back to levels more noticeable above swaps. Outright levels of longer Bund yield also faded their initial brief uptick to a

greater degree, with the 10y Bund yield slipping back below 2.6%. While Trump moved the deadline back to 9 July, easing immediate tensions, the threat is now less abstract with the concrete 50%-tariff figure looming large.

On the front end of the EUR curve, the market's pricing of the European Central Bank moderated again after prospects of a 1.5% terminal rate had initially gained traction on Friday's trade escalation. Recall that markets had staked out a 2% to 1.5% range over the past months, the top after Germany announced its spending plans and the bottom following "Liberation Day".

The OIS forward rate for the end of the year had dipped to 1.55%, but has now edged back to around 1.6%. The first May CPI readings, up for release later this week, should give the ECB the backing to cut rates if needed, so that pricing should be able to remain in the lower half of the aforementioned range.

US rates will struggle to shake off the bearish taint

Over in the US, a benign PCE deflator will do little to dispel a bearish tilt in long-end US Treasuries if a spike in tariffs remains a real threat. With the passage of the tax bill through the House, the focus is now on the changes as it makes its way through the Senate to alleviate market concerns around the fiscal trajectory. There is also ongoing hope for regulatory relief over the summer, given renewed comments from Treasury Secretary Scott Bessent on the topic.

Meanwhile, long-end rates have also experienced some relief as the Japanese Ministry of Finance sounded out the market regarding appropriate issuance amounts in government bonds. A weak 20y JGB auction last week had additionally fuelled the global bear steepening of yield curves.

To note, 10y UST yields had gone into the extended weekend above 4.5% despite the risk-off sentiment, with spreads over SOFR even widening. Resuming trading in Asia, they slipped below that threshold, but US Treasuries will still have to go through a round of supply this week to test the investor appetite, starting with new 2y Treasury notes today and followed by new 5y and 7y notes over the following days.

Tuesday's events and market view

EUR rates will have few data points to work with as the eurozone consumer confidence for May is the only release of note for the day. ECB officials François Villeroy de Galhau and Joachim Nagel will be speaking.

The focus is likely to turn to US data with the release of durable goods orders and the Conference Board's consumer confidence indicator. The latter should rebound given the temporary China trade agreement that saw tariffs cut from 145% to 30% and the recovery in equities. But it might be seen as less relevant given the latest news on tariffs putting a 50% tariff level on the table. Other events of the day will be the release of house price data and public appearances of the Federal Reserve's Thomas Barkin and Neel Kashkari.

In primary markets, the Netherlands will sell 5y bonds for up to €2.5bn. Italy will auction 2y bonds and inflation-linked notes for up to €4.75bn while also commencing the subscription period of its retail-focused BTP Italia bond. The US will sell US\$69bn in new 2y notes.

Author

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

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