Rates Spark: Bonds get some bullish pills

It does seem there is a net bullish Treasuries impulse for now after decent CPI and 10yr auction events, provided the the May PPI bounceback is not overly robust. The bond bulls will be looking for softening in claims data. Euro rates exhibit low volatility and are increasingly detached from the US. In the near term we still see potential for Bunds to perform

US CPI and 10yr auction are good enough to prompt some follow-through

US consumer price inflation came in benign for May. We had suspected as much, but the outcome was even more benign than we had expected. Two 0.1%'s on the month were super. Almost too low in fact. Annualise those and there is no inflation. But we can't do that, as tariffs will push consumer prices back up again, well up, all in the coming months. Tough one for the bond market to interpret. The reaction to this report was about right – yields gapped lower. But we can't, unfortunately, get too carried away with such "positivity". We will have self-inflicted inflation issues in coming months (it would be remarkable if we didn't). And passage of the tax bill adds another layer of bond negativity to the equation. But on the day, the positivity continued, as the 10yr auction was decent. There was a large negative tail (simplistically came through secondary), a low dealer take-down and decent indirect and direct bids.

Looking forward, we are not straying from our preferred bearish tilt on the 10yr Treasury yield. But at the same time we can't ignore bond bullish impulses when we see them. The 10yr yield has slipped to the 4.4% area. If it's in the mood it can of course drift lower. The producer price index is the big one on Thursday. It's typically not a big market mover, but will be interesting. It's expected to show a bounceback from the falls seen in May. Also, jobless claims are a bigger number than usual given talk of labour market weakening. It does seem there is a net bullish Treasuries impulse, unless the PPI bounceback to overly robust.

Bunds may outperform USTs in the near term but not in 2026

The tight range-bound trading in euro rates gives us the opportunity to zoom out and reflect on the long-term picture. Since 'Liberation Day' implied volatility measures have come down significantly and euro rates have increasingly turned indifferent to the moves in USTs. The disentanglement with US markets may be an omen in that over the long term US and euro rates could show more dispersion.

We expect Bunds to outperform USTs in the near term on the back of fragile global risk sentiment and US fiscal concerns, but the tables should turn in 2026. German and EU spending ambitions should start kicking in, supporting both eurozone growth and inflation. We don't expect stellar growth numbers, but the fiscal impulse should be enough for markets to price out the return of secular stagnation. Pricing out the tail risk of an ECB failing to bring inflation to target should help the 10Y swap rate closer to 3%.

Thursday's events and market view

From the UK we first have monthly GDP, industrial production and manufacturing numbers. With the more dovish data earlier this week, these may be more scrutinised by markets than usual. The US will publish the PPI numbers for May, which will be closely watched after the benign CPI. Jobless claims are expected to nudge slightly lower from last week. Other than data we have a long list of ECB speakers on the agenda. With a more hawkish-than-expected press conference last week, we will be listening for nuances in their views.

In terms of supply, we have Italy with a 3Y, 7Y and 29Y BTP auction for a total of €6.75bn. The US will auction 30Y Bonds for a total of $22bn.

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