Rates Spark: Buffeted by ongoing sequence of macro data

Eurozone data continues to challenge the European Central Bank, with German economic contraction and sticky CPI complicating matters. Meanwhile, the Bund-UST 10Y spread has widened further due to lower Bund yields amid deteriorating risk sentiment. US data this week is refusing to move into a panic mode where rate cuts are demanded immediately

Mixed eurozone data highlights challenge for ECB

Eurozone data has not been giving the ECB an easy time and Tuesday's data is no different. Germany is clearly the problem child here, with an economic contraction in the second quarter whilst CPI and wage growth refuse to give in. Markets are struggling to decide on a direction and instead seem to resort to US data instead. The GDP and inflation readings did little to move the 2Y EUR swap rate, whereas the disappointing US house price index seemed to trigger the dip lower on the day.

EUR investors will be treated to more macro data from the eurozone, with CPI numbers on Wednesday and unemployment on Thursday. But looking at these initial figures, it's clear that the jobs numbers from the US on Friday will likely have more impact. Unless we see a significant downside surprise for eurozone core CPI, rates markets are unlikely to move towards more ECB cuts before Friday.

The Bund-UST 10Y spread widened to 183bp, well above this year's low of 170bp earlier in July. The recent widening was mostly driven by Bund yields moving lower, now having breached the 2.4% handle by some 6bp. German recession risk has added to the broader deterioration in risk sentiment and has helped shift the entire yield curve lower. A weakening of US jobs data on Friday would help tighten the Bund-UST spread again.

The US data stream continues as we gear up to payrolls on Friday

US house price data nationally was unchanged for May, weaker than expected. This is not particularly meaningful unless it's the beginning of a series of zeros. City house price inflation 'slows' to 6.8%, and the S&P CoreLogic national measure slowed too. But either way, home prices on that measure are inflating in the area of 6-7% year-on-year. The 10yr and 30yr yield dipped post the number, and the 2yr thought about reacting to it. But the data should not be particularly impactful, and in the end, there is something to support both sides of the directional debate for bonds from them.

The Fed will be pleased with the 0.0% month-on-month on the FHFA house price measure. But house prices still pose a risk to the whole rate-cut narrative. While the talk is that rate cuts will create supply through lower mortgage rates for existing homeowners minded to move, you can also see that that might not be so straightforward. Market yields just want to test lower in any case.

Also, the Conference Board reading for July came in at 100.3, practically bang on the long-run reference level at 100. The only issue is the downward revision for June to 97.8. But still, the July reading has popped higher again, back above 100. This has come from an improvement in expectations, even if they remain well below 100 (78.2). The perception of current circumstances remains (remarkably) positive though, at 133.6, even if down from the prior 141.5. Overall, the consumer sees current conditions as good but future conditions as poor.

Meanwhile, the JOLTS data showed job openings at 8.18 million for July. This is down from upwardly revised June levels, but still relatively elevated (even if down from the remarkable 12 million high seen in 2022). Market rates backed up again on this data. They were on aggregate firmer than expected, and are not giving enough of a panic signal for rate cuts.

Today's events and market view

The eurozone headline CPI should remain at 2.5% YoY whilst the core CPI reading is expected to come down from 2.9% to 2.8%. The ECB is especially concerned about the sticky services inflation and thus the breakdown will also be watched. From the US, besides the FOMC and refunding announcement, we have MBA mortgage applications, ADP employment and home sales data.

In terms of auctions, we have Germany with €3bn of 6y Bunds.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Disclaimer