Rates Spark: Bullish sentiment carries on for now

With little data to drive direction, the bullish momentum from last week's events continues. A first cut from Riksbank today could add to this sentiment while the real test from data will come next week. In the eurozone, the momentum behind the future inclusion of EU bonds in sovereign indices is gaining pace as MSCI has now launched a consultation

Bullish momentum carries on for now

The bullish momentum was carried forward into the second day of the week with the 10Y US Treasury yield approaching 4.43% yesterday. Bunds traded closely aligned with the 10Y yield falling towards 2.42%.

Curves flattened as front ends traded more stable, especially in the eurozone. There was little news in terms of data or official comments to drive direction, and if anything the comments did sound more guarded. The European Central Bank's Pablo De Cos followed the common line that June was likely to see a cut but with little commitment to a path beyond that. The Bundesbank's Joachim Nagel went on to highlight structural factors that could keep inflation higher in the coming years. Over in the US, the Fed's Neel Kashkari still would not entirely rule out a hike though the bar was high, and said multiple positive inflation readings would be necessary before a cut, but a weakening labour situation could also spur cuts. The market is sticking with a first Fed cut either in

September or November at the latest.

With regards to the broader bullish sentiment in developed markets, all eyes today should turn to the Swedish central bank. The economists' consensus is for a cut today, though markets are only pricing 16bp out of a possible 25bp cut. More relevant might be what will be signalled for policy further down the road with concerns over a weak krona likely meaning that officials will push back against the idea of back-to-back cuts.

MSCI follows ICE with proposal to include EU bonds in its sovereign indices

When the EU surveyed investors last year, they responded that the inclusion in sovereign bond indices was the "single-most important remaining step" to further align EU bonds with the eurozone government bond market. After ICE started a consultation about the inclusion of EU bonds in its sovereign indices last month, benchmark index provider MSCI has now followed suit. The consultation is open for feedback until 24 May with a decision to be announced by the end of the month. Investors are also asked about a one-off or phased-in inclusion over September, October and/or November. This means that MSCI's timeline is somewhat faster than ICE's, where the consultation runs until 30 June with any adopted changes taking effect at the end of October.

According to MSCI, eligible EU bonds total around €467bn, which would result in a 5.4% weight in the MSCI eurozone government bond index and a 1.4% weighting in the developed markets government bond index. The prospective demand from investors tracking the indices is already seen as driving the tightening of EU bonds versus their French peers. In the 10Y maturity segment, the average spread has collapsed by around 8bp late in March with EU bonds here now trading largely aligned with French bonds.

Today's events and market view

The data calendar for today remains light with industrial output data for Spain and retail sales for Italy. In the US we get mortgage application numbers and wholesale inventories for March. That leaves more focus again on central bank speakers with the ECB's Pierre Wunsch and De Cos speaking. From the Fed, we have Philip Jefferson, Susan Collins and Lisa Cook scheduled. Broader dovish sentiment could be supported as Sweden's Riksbank is expected to cut policy rates this morning.

In primary markets, Portugal taps the 10Y and 14Y bonds for up to €1.25bn in total, while Italy enters the third day of the BTP Valore retail bond sale. The UK will sell 30Y green gilts and in the US, the focus is on the US$42bn new 10Y UST note auction.

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