# Rates Spark: Chair Powell's juggle smells like higher yields

Chair Powell is minded to cut rates, but not yet. He was balanced, but markets continue to shave the extent of expected cuts. Significant supply pressures are also pushing Euro rates up. Meanwhile, Dutch pension reforms are awaiting clarity about potential legal changes from politicians, which could have a material swap market impact

We see higher US and Euro rates ahead

## Chair Powell does a balancing act, and Treasuries decide that smells like higher yields

Tuesday saw a decent 3yr auction, coming some 1bp tight to secondary. But that had to be balanced against a Chair Powell not in the mood to touch the funds rate at this juncture. The underlying bias is still to cut rates, as policy is deemed to be still restrictive. But not as restrictive as it was, and in a sense in a sweet spot where it's doing enough to tame inflation but not overly harming activity. At least that's the brief translation of what Chair Powell had to say.

The 10yr Treasury yield has shown a tendency to edge higher in the past few days, effectively since the payrolls report. Wednesday sees the CPI report. The issue here is the report will confirm the US as a 3% CPI inflation economy, and if the 0.3% month-on-month readings are confirmed, it identifies a tendency for inflation to remain quite sticky, in fact with a moderate upside bias. That's not great news for Treasuries, although the silver lining is it's already discounted, so confirmation of that should not be a negative shock.

Still, the US 10yr has been showing a tendency to edge higher. Wednesday's 10yr auction will be an interesting test of sentiment. Mutual funds were net sellers of duration last week, so it does seem like the buying spree, which was sparked from the point the 10yr got to the 4.8% area, has abated. We maintain our view that there is a lot more room to the upside for longer tenor market rates than to the downside, with downside potential limited by the funds rate now discounted to not get much lower than 3.9%. Against that, the current 10yr SOFR rate at 4.1% looks too low (too flat).

## Significant issuance helps euro rates tick higher

EUR rates displayed a notable underperformance on Tuesday with long-end rates rising by up to 7bp. But even the short end rose by a notable 5bp. Market observers mainly blamed supply factors for the rise in yields. On top of the already scheduled supply that included syndicated deals from the EU and Italy, France surprised markets with the announcement of the launch of a new 30y bond. The reaction in spreads such as those of French government bonds over Bunds was quite muted though – the 30y French spread widened by a single basis point and the Italian equivalent by some 2bp.

Underlying, market sentiment still has to come to grips with cross currents from the US, but also mixed domestic data which on Tuesday argued for a more hawkish case with the French decline in unemployment. And the EU gearing up to react to Trump's tariff announcement might also lead at least to a rethink of the prior move lower in front-end rates. Overall though the market is still more inclined to see the European Central Bank cutting to at least 2% and maybe lower by the end of the year.

## Politicians keep Dutch pension reforms in uncertainty

One of the Dutch coalition parties, NSC, has been intensifying its campaign to adjust the rules around the ongoing pension reforms, which could potentially have a material impact on longer-dated swaps. If the proposal gets passed, each fund (150+ total) would have to obtain a vote of approval from its participants before transitioning assets from a defined benefits to a defined contributions model. In effect this could incentivise increased interest rate hedging in the near term and keep longer-dated fixed receivers more relevant for the time being. Dutch pension funds are an especially large player in swap markets for maturities beyond 20 years.

We're still waiting for the final text of the proposed legal amendment, but so far only one other party (BBB) has explicitly expressed support for the change. Two relatively smaller parties stated that while they are not in favour of the new pension system, they doubt requiring votes would improve the situation. If this would be a representative view of other parties in parliament, then the amendment would struggle to find a majority. On the other hand, some of the larger parties have earlier strongly opposed the transition to the new system and have yet to take a stance. The next debate in parliament on the proposal is planned for early March.

## Wednesday's events and market view

The main event for Wednesday is the US CPI data. The expected monthly rate of 0.3% for the core is clearly too hot. And annual inflation rates of still around 3% for both headline and core underpin Powell's message to Congress these days that there is no hurry to cut rates. Apart from Powell's second day of testimony we will also hear from Bostic and Waller, the latter will focus on stablecoins, though. The eurozone data calendars have little to offer, although a lecture by the Bundesbank's Nagel on the neutral interest rate could be good for some headlines.

Primary markets remain busy with the French 30y bond launch which was mandated on Tuesday and the already scheduled long end auction supply from Germany. Portugal is also in the market with tap auctions. Over in the US the Treasury will sell US$42bn in new 10y notes.

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