

Rates Spark: Cuts underpin bullish sentiment

Softer data and now a cut by the Bank of Canada yesterday, followed very likely by a cut from the European Central Bank today, underpin the bullish sentiment in rates. But we caution that the ECB has reason enough to sound more hawkish in its press conference today



Rate cuts and softer data still underpin bullish sentiment

Sentiment for rates is still leaning bullish against the backdrop of major central banks beginning to lower rates. The [Bank of Canada](#) was the first G7 central bank to cut rates yesterday, today it is the ECB's turn to start easing policies.

To a great extent those cuts were or are already baked into the market pricing. A main driver continues to be the data, especially those related to the US jobs market with the official data still looming large on Friday. The indications all continue to point to some cooling of the jobs market. Yesterday the ADP payrolls report came in lower, though it has not been a good predictor of the later official number. While the [ISM services](#) rebounded stronger than anticipated, the employment component remained in contractionary territory. The spike higher in rates was quickly bought into.

Overall, markets do seem to be prepositioned for a softer payrolls figure with 10Y US Treasury

yields just below 4.30%, and are now testing the lowest levels since early April. The 10Y Bund yield at 2.50% has not come down as far, though we would argue that the current pricing of a ECB terminal rate not much below should also provide some resistance to a further downside in yields.

ECB: a cut very likely today, but don't expect much guidance on what will follow

That is unless the ECB changes tack in its policy meeting today. A rate cut is widely anticipated so markets will be more focused on the guidance provided by the updated macro projections and by the president herself in the press conference.

Our [economist expects](#) only minor upward revisions to growth and inflation for this year in the new staff forecasts, but crucially no changes to the profile and the timing of inflation dropping below 2%.

Still recent data has pointed out the risks of inflation remaining sticky. When combined with improving confidence indicators the urgency to actually cut today purely on the back of the data is not given, but from a communications angle the ECB has already painted itself into a corner. But one can argue that the ECB should sound a little a more hawkish and refrain from repeating the error and not provide much guidance on the next steps this time around.

The market, however, has increased the cut discount in the wake of the US data. A second cut is fully priced by October and chances for three cuts this year are seen at 60% again.

Today's events and market view

We would not be surprised if the take-away from Lagarde's press conference will be a somewhat hawkish one. While the ECB takes centre stage, other data to watch from the eurozone are the retail sales figures for April. Markets will have another set of job market indicators to contemplate ahead of tomorrow's official data – the Challenger job cuts as well as the weekly initial and continuous jobless claims.

Primary markets will be busier ahead of the ECB with Spain selling bonds from 3Y out to 30Y as well as tapping a linker, all in all for up to €6.75bn. France auctions longer-dated bonds, including a new 10Y benchmark for a total of up to €12bn.

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