

Rates Spark: Data and not dot plots will decide Fed cuts

Bonds were in a good mood on Tuesday, but the mood from Wednesday on will be set by the FOMC outcome. Any fiddling with the dot plot will have an impact. Beyond that we're still in this inflation pop period that continues to pressure yields higher. It likely won't last, but it's the dominant driver for now



Bonds up their mood into the FOMC outcome

Three things moving markets Tuesday. First, the reaction of Japanese government bonds to the Bank of Japan decision to unshackle the 10yr ultimately saw its yield ease lower. Part of this is a still upward sloping curve relative to many others that are inverted, and the other part is what can only be described as quite a dovish hike from the BoJ, laced with plenty of caution on the macro prognosis.

Second, Canada had a positive inflation surprise. A big bounce for February following a subdued January reading morphed to a small bounce, and inflation eased further below 3% (to 2.8%). This sets a bit of a change of tone for North America from an inflation perspective. It does not tell us anything material about US inflation, but it's a stand-alone bond positive observation.

Third, the US 20yr auction was very strong. It came over 2bp through the when-issued market yield, indicative of strong pricing at auction. The indirect bid was strong, with 73.5% awarded to this segment, which takes pressure off the dealers to do the take-down. And the cover was also

impressive. The 20yr is not a benchmark leader, but again this was a positive data point.

The above has been enough to take the 10yr Treasury yield back below 4.3% over the course of the US trading day. And this despite earlier data showing that the US housing market is showing material evidence of returning activity.

But the big event lies in wait on Wednesday as the Fed concludes its two-day meeting. Any shift in the dots that result in either less implied cuts in 2024 or a higher terminal rate would be quite damaging for the bond market. We're assuming no material change in the dots, and if so, focus will shift to next week's core PCE deflator reading. As it is, it's discounted as a 0.3% or 0.4% MoM combo for headline and core. Neither of these is good. Hence the ongoing pressure for an edge higher trend in yields still.

The ECB still primed to cut first based off the market discount

The market pricing of ECB cuts this year is close to US pricing at around 85bp and in line with our own forecasts. On the face of it the ECB has more reason to cut rates currently and officials themselves have converged around a clear possibility of a first cut before the summer break. But eurozone growth dynamics seem to be bottoming out and a very subtle recovery is pencilled in by our economists. This macro backdrop should allow for a more gradual easing of its policy stance. Having said that, euro rates will clearly feel any market impact of the FOMC meeting outcomes, but the effect should be dampened given the path towards rate cuts seems more anchored in the eurozone.

Wednesday's events and market view

The [FOMC meeting](#) will be the centre of attention on Wednesday, but in the UK a range of [inflation releases](#) will also attract interest ahead of Thursday's BoE policy meeting. In the eurozone we don't have much data to look out for, but we do have Lagarde, Schnabel and Nagel amongst the speakers as the ECB Watchers' conference kicks off in Frankfurt.

For auctions we have Germany with 20y and 28y Bunds, totaling EUR2bn.

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