Rates Spark: Treasuries bully direction

The end games for the Fed and ECB continue to pull in different directions. It's been quite the change in sentiment in the past six weeks. The Fed was supposed to be the big cutter on a delayed start. Now the pressure is greater on the ECB. This is manifesting in ongoing widening in the Treasury-Bund spread. And in the end, direction is being bullied by Treasuries

Treasuries continuing to test the upside for yields, and for good reason

The US 10yr yield has had a material breakout to the upside through Monday. And it's not a huge surprise. A number of factors continue to push in that direction. US macro data continues to refuse to lie down. Risk assets did not have a great day on Monday, but new highs were hit on many major indices in the past week or so. Trump doing better in the polls also pushes in the same direction. Neither one of these is in the driving seat, but importantly there is not much impulse out there to push things in the other direction. For example, the Israel war is not having a meaningful impact (but that can change).

And even the inflation data is being viewed with a renewed degree of scrutiny as we face into another round of core PCE data next week, with some murmurings of a 0.3% month-on-month for core PCE. The latest payrolls report also looms. A week ago the consensus was in the 100k region, as the "weather" spiked jobless claims. But payrolls estimates have been edging higher by the day since. The consensus estimate is now in the 140k area, just a smidgen below the 150k level that is bang on neutral for the economy. We think payrolls is primed to be weaker than this, but we need to wait another 12 days before we know either way.

We've argued that a trend towards 4.25% for the 10yr was probable until or unless we see a payrolls wobble. See here. Given the big move through Monday, some stabilisation is likely first. The market moves through Monday sets out the stall for expectations of firmish data next week. Treasury bulls will be looking to negate that presumption. We're fine to switch to bullish on some weak data, but we need to see it first. Till then, we remain tactically bearish on Treasuries.

Repricing of ECB endpoint as recession fears lessen

Euro rates bounced higher again after the prevailing dovish sentiment in the wake of the European Central Bank meeting. But interestingly the very short-end remained relatively anchored, and the expectation of a December cut is still around 20%. Instead, the move could be more characterised as a repricing of the ECB endpoint, which at around 1.8% now, is slowly making its way back to 2%.

The market's trust in the ECB to manage growth issues can bolster the back-end of the curve, particularly if economic data doesn't worsen too quickly. We see the neutral rate of the ECB in the range of 2.0-2.25%, and thus the current 5Y EUR swap rate of 2.1% still has room to drift higher as recession risk fears lessen. Having said that, with the US elections in exactly two weeks, bond markets may want to sit that out before making a more confident move up.

Plenty of speakers to watch at the IMF's annual get-together

Meanwhile, the attention will go to a long list of central bankers speaking at the IMF these days. Given the ECB's cut last week was apparently a unanimous decision, much to the surprise of markets, we'll be listening to the change of tone of the more hawkish speakers, including the Austrian Holzmann and Knot from the Netherlands. Also, the Bank of England's Bailey will be one to watch, since we anticipate a more dovish tone going forward.

Tuesday's events and market views

Plenty of central bankers speaking at various IMF-related events, including Lagarde from the ECB and Bailey from the Bank of England. In terms of data the calendar is light, with US mortgage applications perhaps the highlight. The Richmond manufacturing index is expected to improve slightly from -17 to -21.

Italy announced a syndication for an estimated €13bn, including a new 7Y BTP and a 30Y BTP tap. The UK will auction a 20Y Gilt linker for £0.9bn. From Germany we have €5bn of new 2Y Schatz up for auction.

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