

Rates Spark: ECB meets as US CPI casts a long shadow

US rate-cut talk has been cut to shreds by pops in inflation data, and Wednesday's CPI reading will continue to reverberate. Thursday's 30yr auction will be interesting in this respect, especially after the 3bp tail on Wednesday's 10yr auction. For EUR rates the ECB meeting will be key, but it could be more about how the ECB can detach itself from the Fed



We think the case for a growing divergence between an immobile FOMC and a bunch of dovish central banks is getting stronger

US market rates remain under pressure post the March CPI reading

It's not often we see a 20bp rise in the US 10yr, but it's also not often that a market whisper for CPI is traded practically as if it was a pre-release certainty. Not only was the 0.2% month-on-month whisper not delivered, but the actual 0.4% MoM was above the 0.3% MoM official expectation. A 0.2% MoM outcome was required to help validate the prior fall in yields. So, no surprise that the 0.4% MoM delivered took the 10yr yield back up to the 4.5% area in a flash. A 3bp tail on the subsequent 10yr auction showed that even at around 4.5% there was no concessional feel to things. We sent out a bearish note last week hypothesizing a return to 5% for the 10yr, and

it remains very much in play. See it [here](#).

The Fed minutes were interesting on two counts. First, there is an undercurrent of acknowledgement of disappointment on latest inflation readings. This was interesting as Chair Powell had been downplaying this point, both at the FOMC press conference and since then. Second, the Fed is clearly paving the way for a slowing in its QT programme. Nothing has been decided yet, but it looks like they will cut the roll-off of Treasuries by half from \$60bn to \$30bn, while leaving the MBS roll-off as is at \$35bn as that has been undershooting anyway on account of slower pre-payments than usual. They are also insistent that this is separate from interest rate policy, which will be more responsive to the macro numbers.

The bottom line outcome is the emergence of severe doubt that the Fed will be cutting in the summer, with September now the month being discounted for a 25bp cut with any degree of conviction. Even as the ECB is expected to cut in June, this prevents eurozone rates from having a material pre-rate-cut move lower in market rates. It also pressures spreads from the eurozone to US rates wider, and places steepening pressures on the eurozone curve from both ends.

ECB: Looking beyond June

Markets are discounting only a minuscule chance that the ECB will cut rates on Thursday, but even after the high US CPI print they seem relatively sure that June will see the first rate cut – more than 21bp out of a 25bp cut are still discounted. But given the dynamics in the US, markets will be even more interested in how the ECB communicates about its plans beyond June. Here the market is now looking for around 80bp of overall easing over the course of 2024, down from an average closer to 90bp over for the past couple of weeks. It is still slightly more than the 75bp of easing we foresee for the ECB in our own baseline scenario.

For now the impact of markets reassessing their Fed outlook remains relatively muted at the EUR front end, even as Fed cuts are seen delayed to September. However, the Fed's ability to cut rates anytime soon could be further questioned in the near term if official data remains robust – and more importantly – if US inflation dynamics refuse to point towards the Fed's target again. Important for EUR rates will be how the ECB is perceived as distancing itself from these dynamics.

Yield levels further out the curve have seen spill over from US dynamics already. 10Y Bund yields at currently 2.43% post CPI are actually below the peak seen earlier this week. At the same time 10Y UST-Bund spreads have now widened noticeably, rising above 200bp again on the back of the US CPI. It is a level that has been topped more lastingly and structurally only when Fed and ECB policy paths diverged. Near term, we think market expectations have room to head into this direction, if only temporarily.

If the ECB can credibly maintain its current cutting bias independent of the Fed, then this can have implications for the EUR curve, where we could see more steepening via the back end. Rate cuts should at least anchor short rates, while longer rates could get pulled higher by the US.

Thursday's events and market view

The ECB meeting will take the spotlight in the eurozone, with the only other notable data release in the region being Italian industrial production. From the US the PPI numbers from March should grab some attention given that these also seem at some risk of upward momentum looking at recent readings. Consensus for the jobless claims data sees them

climbing slightly above last month's figure, but nothing yet that would signal a material deterioration. From the Fed we have several speakers, including Williams, Barkin and Bostic. Markets will certainly be listening how their tone has changed with this CPI release in mind.

The US has a €22bn 30y Bond auction lined up and Italy will auction 3y, 7y and 15y BTPs totaling €8.25bn.

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