Rates Spark: ECB officials more vocal about summer cuts

While ECB speakers cement their expectations of rate cuts and stress their independence, US data shows a more blurry picture. Post CPI and PPI pops, even if market rates find an excuse from Friday's data for the US 10yr to remain below 4.3%, the pressure can build in subsequent weeks for another attack on the 4.35% area

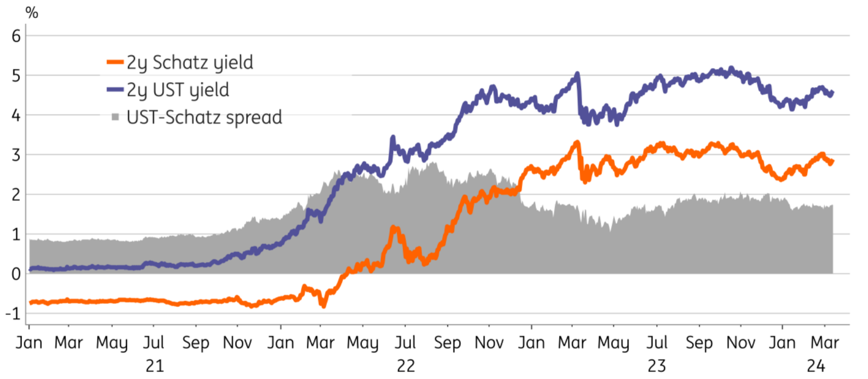
Markets are more certain about ECB rate cuts than the Fed's

ECB officials are sounding more vocal about rate cuts coming this summer, with some suggesting June as the first ECB rate cut. Yannis Stournaras went as far as suggesting two rate cuts by July, while a hawkish Klaas Knot thinks June might be the right timing but sees wage growth as a source of uncertainty. Markets are also converging to June with now an almost 90% rate cut probability priced in.

But at the same time we see that euro rates remain sensitive to the timing of the first rate cut by the Fed, which seems subject to more debate. This was seen Thursday when the 2-year Schatz yield got pulled up by the hotter-than-expected US PPI figure. The spread between the 2y UST and Schatz yields have been surprisingly stable since the beginning of the year (see figure below), building on the expectation that both central banks will move in tandem.

We still expect the ECB and the Fed to both cut in June, but we also foresee that the uncertainty about the US economy could have markets move their pricing for US cuts further outwards. In our view this could lead to some decoupling with euro rates. While ECB speakers cement their expectations of rate cuts and stress their independence, US data shows a more blurry picture – the 2y UST-Schatz spread could be widening in the near term.

Front-end spreads could see some widening in the near term



Source: ING, Macrobond

In the US, February retail sales disappointed, not managing to reverse the January falls (which were also revised down). But the big driver Thursday was PPI, as the MoM at 0.6% continues the run of oversized rises through January/February for inflation readings. Meanwhile, jobless claims and continuing claims remain indicative of a firm labour market. Market yields were net higher from these, which makes sense.

The 10yr is now knocking on the door of 4.3%, and the implied market probability for a June cut ease has moved to being a toss up – a remarkable change from it being discounted as a done deal only a few weeks back. The week ahead has the FOMC meeting, and the tone from the Fed can't be dovish based off recent releases and market movements. And then the following week has the February measure of the core PCE deflator, with the risk for another toppy outcome.

So, even if market rates find an excuse from Friday's data to remain below 4.3%, the pressure can build in subsequent weeks for another attack on the 4.35% area.

Friday’s events and market view

The focus remains on the US, which has shown markets to be sensitive to any indications of hotter-than-hoped price dynamics. Import prices and the University of Michigan consumer sentiment index with its survey of expected inflation will be closely scrutinised. For the former the consensus is looking for easing price growth with the month-on-month figure falling to 0.3% from 0.8%. Consumer inflation expectations over the one-year horizon are seen notching up slightly to 3.1% from 3%, but to remain stable at 2.9% on the long horizon. We will also get industrial production data and the Empire manufacturing index.

In absence of data, euro rates will be looking at ECB speakers where Panetta and Vujcic are slated to speak on Friday. Chief Economist Lane will hold a lecture at London’s Imperial College.

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