

Rates Spark: Euro rates almost back to normality

Softer data from the US is paving the path to a September Fed cut, but more is needed to see 10Y UST yields breaking out of the current trading range. Friday's payroll numbers could confirm a weakening labour market. Except for French bond spreads, eurozone rates markets are returning to normality from before the start of the French election turmoil



Softer US data an omen for weaker payrolls on Friday

Softer data stacks up in the US, shifting the focus somewhat away from politics and back on the Federal Reserve and its ability to cut rates later this year. The rise in initial and continuing claims delivered more evidence of a cooling jobs market, but it was the dismal ISM services that pushed market rates lower yesterday, taking the 10Y Treasury yield back down to 4.35% after having come close to 4.5% at the start of this week. However, this still means we are well within the recent trading ranges. Not just in outright terms, but also when it comes to the curve. 2s10s has actually reflattened over the past sessions, which given the data may seem somewhat counterintuitive, but may speak more to the reasons behind the latest steepening leg which was

driven by longer rates.

Our view remains that over the coming months the pieces should fall into place for the Fed to start cutting rates in September. The market has been discounting between 16bp to 19bp for the September meeting and 40bp to 45bp for December since mid-June, and now back towards the lower ends of that range. To see a more material steepening of the entire yield curve, the data would have to be such as to warrant a material repricing of that front end discount. The more gradual cooling we are witnessing now still argues for more range bound markets near term.

The next piece of important data will come from Friday's nonfarm payrolls report, which consensus sees coming in at 190k, well below the 272k from last month. Yesterday's poor ISM services numbers together with the earlier weakness in ISM manufacturing would actually [imply nonfarm payrolls to fall](#) by 175k rather than increase. As many indicators point at a weakening of US labour markets, we continue to see three rate cuts this year in our baseline view as opposed to just the two priced in by markets.

Markets outside France returning to normality

Tensions related to the French elections have eased further, with the 10Y spread of French bonds versus Bunds having tightened by almost 5bp to now stand at just below 70bp. Another wider market risk measure, the Bund ASW spread, has tightened to reach levels seen before the announcement of the French snap elections. So have implied bond volatility measures. As such, the still somewhat elevated French spreads now appear to reflect risks largely contained to the country. We think such wider levels are justified, as even the baseline outcome of a hung parliament does not bode well for the country's fiscal problems.

Today's events and market views

We have a light calendar today. From the eurozone we have Germany's factory orders for May and the minutes from the European Central Bank's June meeting. The latter could be especially interesting given that the notes are from the meeting of the first rate cut. With little forward guidance from the official statement, the minutes may provide some insights in conditions needed for another cut later this year.

For issuance we have Spain auctioning 3Y, 7Y and 11Y SPGBs and a 9Y SPGBei for a total of €6.75bn. France has scheduled 9Y, 10Y, 29Y, and 42Y OATs totaling €10.5bn, an amount below what would usually be targeted for a similar OAT auction.

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