

Rates Spark: Safer in Bunds than Treasuries

Even if US yields do slip into the weekend, as is quite possible, there are elements next week that will keep the bear phase element to the fore for bonds (watch core PCE carefully). The ECB simply seems to be on a steadier path towards target inflation than the Fed, suppressing uncertainty around the timing of eurozone rate cuts



US Treasuries remain driven by a narrow focus on inflation and supply

The US 10yr yield peppering the 4.33% area as we track towards the end of the week is quite a statement, and quite a different feel from the sub-4% area seen at the beginning of the year. Resistance to a move above 4.33% has in consequence been significantly downsized.

Looking to the week ahead there are two data sets that really interest us. The first is consumer confidence on Tuesday. Despite all of the macro scare stories, this index has managed to journey from 100 (neutral) to the 115 area in the past four months. It's been a quiet but relentless move.

Confirmation of a hold in the 115 area is a factor that supports maintenance of elevated yields.

The second one to watch is the core Personal Consumer Expenditure deflator. The market expectation is for this to fall from 2.9% to 2.8% YoY – so good. However, that incorporates another 0.4% month-on-month reading for January 2024. That annualises to 6.2%. Or 4.8% on an arithmetic calculation. Either way, it's too high. There is an element of confirmation bias here on our part. But that's what the market is focused on (we think).

So even if market yields do slip into the weekend, as is quite possible, there are elements next week that will keep the bear phase element to the fore for bonds. Supply is worth watching too next week, although 2's, 5's and 7's are typically not a huge ask.

Euro yields should see less volatility than US yields

The volatility in global yields since early February has been predominantly driven by the US but going forward euro rates could start enjoying a smoother ride. The 3-month MOVE index for euro rates – which calculates implied volatilities from swaptions – actually showed a decline since the beginning of this month, whilst the same measure for dollar markets rose. This divergence of USD and EUR markets is not a common occurrence as the implied volatilities tend to move in tandem.

After relatively tame data for wage growth and PMIs, the ECB simply seems to be on a steadier path towards target inflation than the Fed, suppressing uncertainty around the timing of rate cuts. Friday's ECB CPI expectations are likely to confirm that inflation expectations are well-anchored, further bolstering the prospect that the ECB can proceed with cuts this summer. Next week's CPI figures from Germany and France would have to really come with some unexpected upside surprises to change that narrative.

Lower yield volatility in the euro space should benefit the risk profile of holding duration and is also in line with our expectation that euro and dollar rates could see some decoupling. The recent high correlation between the two seems excessive.

Friday's events and market view

After some very disappointing manufacturing PMIs for Germany, the Ifo numbers will be watched. For the ECB's 3-year CPI expectations the consensus is a slight decrease from 2.5% to 2.4%, down again to last year's November reading.

Schnabel will be giving a lecture about whether “the fight against inflation has been won”. The answer will undoubtedly be “not yet”, but as an influential Governing Council member with a hawkish bias her words will be weighed carefully by markets. Other ECB speakers for the day include Nagel and de Cos.

Not much issuance for the day, apart from Italy auctioning a 2y BTP, a 5y BTPei and a 17y BTPei for a total of EUR 5.5bn.

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