

## Rates Spark: Euro rates rely on US data for guidance

While the European Central Bank is set to cut rates on Thursday, it is data that remains in the driving seat of rates markets. With last week's US PCE data curbing the perceived upside risks to rates, markets were more keen to rally on the weaker US data yesterday with the important jobs data looming at the end of this week



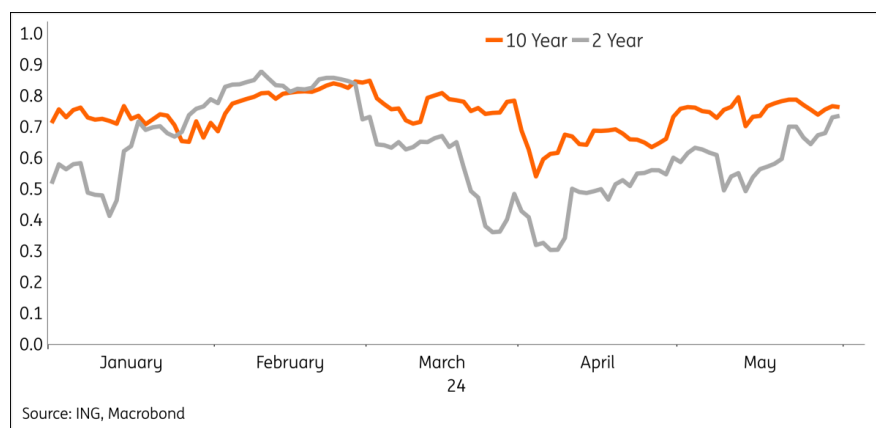
### Weak ISM data pulled down both US and euro rates

The first trigger of the week for lower yields was weaker Italian manufacturing PMIs, which dropped significantly from 47.3 to 45.6. The US manufacturing ISM reading later in the day then came in below consensus and, at 48.7, in contractionary territory. In reaction, both 10y UST and Bund yields fell almost 10bp. The employment component of the ISM was the only positive one, but given the weakness in the other numbers, the sustainability of this number can be questioned. The US JOLTS data later today will therefore be closely watched for signs of weakness. An additional factor helping to push yields lower was the further slide in oil prices, with Brent slipping to 78US\$/bbl yesterday.

The European Central Bank's June cut this week is already priced in for 97% by markets, but the downbeat economic data did raise expectations of ECB rate cuts further out. At 62bp of cuts priced in for 2024, the discount is right between two and three cuts. Our view is that the June cut will be a hawkish one and markets are therefore likely to remain undecided between two and three cuts for now. In our view, a series of better inflation data would be needed for the ECB to provide more forward guidance on the next cut.

While Bund yields had benefitted somewhat less from the recovery of US rates after the PCE figure – the 10Y UST/Bund spread had tightened to 184bp – Monday's strong reaction by euro markets to the weaker US economic data highlights a still-tight correlation between US and eurozone rates, both for the back end and front end of the curve (see figure below). With views on ECB cuts beyond June still up in the air, much of the direction is determined by Fed cut expectations. Interestingly, a Bloomberg survey from last week shows that 35 out of 36 economists believe the ECB should be able to decouple from the Fed – at least partly. Yet it seems markets are strongly driven by US data when deciding on the number of ECB cuts to expect this year.

### Correlation between UST and Bund yields increasing again (1-month rolling correlations)



### Today's events and market views

Today in the eurozone, we have employment numbers from Spain and Germany. But the US will grab more attention from markets with JOLTS job openings, factory orders and durable goods orders – the latter being a final figure, though. Consensus sees job openings decreasing and the growth in factory orders declining from 1.6% to 0.6%. The US economy has been showing some signs of weakness recently and markets will therefore be looking for signs of an economic turnaround.

In terms of issuance, we have a syndicated tap of a German 30y Green Bund of €3bn and a 2y Schatz auction of €4.5bn. Austria will auction 6y and 10y RAGBs totalling €2bn.

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