

## Rates Spark: Eurozone bond spreads immune to deficit woes

Another test higher in market rates was ended by a stronger 5y UST sale. EUR rates proved more stable, but we will get first country inflation data on Wednesday. Meanwhile, eurozone government bond spreads continue to largely shrug off deficit woes



### Test higher in rates ended by stronger 5Y UST auction

Tuesday saw US rates testing the upside again, this time on the back of a better durable goods report. The 10Y Treasury yield came as high as 4.27% before turning the corner to rally back below Monday's 4.25% close. This was supported by a strong 5Y auction this time around after the prior 2Y sale had tailed slightly. But with the PCE release on Good Friday and month-end over the long Easter weekend, there is a reluctance against any bigger directional bets just yet. Overall though, we believe that a lack of confidence around the temporary nature of latest hotter inflation dynamics leaves market rates prone to drift higher.

The 5yr auction pleasantly surprised us. The 5yr is rich to the curve, simplistically trading some 20bp through an interpolated line between the 2yr and the 10yr. We thought the market might struggle to get interested in the paper on offer. But in the event there was a strong indirect bid and strong pricing, at about a basis point rich to the secondary market when issued. There is a tint here of getting long bonds into the long weekend, but that has to be in the knowledge that Friday's US core PCE number won't be pretty. It's clearly quite complicated, and we've not broken any significant level on the back of it.

Euro rates proved a little more stable, but Wednesday's data could give them a bearish tilt. While it is only a the first country indicator ahead of next week's eurozone flash CPI, the consensus for the Spanish data has headline CPI accelerating and core CPI decelerating only slightly. Pre-Easter conditions might amplify the reaction to bigger surprises.

## European government bond spreads continue to shrug off fiscal concerns

The spread volatility around the [steep French deficit numbers](#) on Tuesday was contained, not least because some of the official numbers were already leaked before. But it also chimed with markets earlier this year shrugging off dismal deficit figures out of Italy, only to see Italian bond spreads tighten to new long-term lows.

But looking forward such fiscal events could bring volatility to bond markets. Many eurozone countries continue to face fiscal pressure and upcoming elections pose political uncertainties. We therefore shouldn't entirely bank on the idea that spreads will have a smooth ride throughout the upcoming rate-cutting cycle.

An [analysis from the ECB](#) points out that foreign investors showed strong demand for EGBs over 2023, which helped digest considerable supply from new issuance and the ECB balance sheet reduction. Although the ECB does not identify the type of foreign investor, an [investigation from Reuters](#) suggests that hedge funds may have played an important role. Hedge funds are typically leveraged investors and therefore more likely to amplify any unexpected rise of volatility.

### Wednesday's events and market view

Wednesday's US calendar is lighter with only mortgage application numbers and an appearance by the Fed's Waller, who will speak on the economic outlook. One market highlight is the Treasury's auction of a new 7Y note.

The eurozone also has a lighter slate, but the Spanish flash CPI will still be closely eyed ahead of next week's figure for the bloc. Regarding Spain, the consensus is for the headline rate to bounce above 3% year-on-year again. The core rate could decelerate a tad to 3.4% from 3.5% YoY. Thursday we will see figures from Italy, Portugal and Belgium, Friday from France. There is no consensus yet for next week's eurozone flash CPI. In terms of ECB officials' appearances, Italy's Cipollone will speak on the economic outlook and monetary policy.

European government bond primary markets will see Germany reopening a 7Y bond for €3bn and Italy selling bonds across 5-to-10 year maturities for up to €9.25bn.

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