Rates Spark: Eurozone growth recovery not to be ignored

US and euro rates opened the week lower, continuing the dovish sentiment from the week before. Markets are pricing in 75bp of ECB rate cuts for 2024 – our baseline forecast – but two cuts are also still on the table, and thus market pricing should be lower. A growth recovery, as also reflected by Monday's PMIs, reduces the need for a steep path of cuts

Week opens with lower rates despite eurozone growth recovery

Bonds opened the week with higher prices, fed by the ongoing dovish sentiment from lower US nonfarm payroll numbers on Friday. And with both ISM manufacturing and services indices falling below 50 last week, markets are increasingly seeing signs of a US economic slowdown. In contrast, the eurozone PMIs on Monday morning reflected a continuation of the gradual recovery, with the final composite PMI of April now at 51.7. Keep in mind, however, that the quarter-on-quarter growth rate in the US was 1.6% whilst only 0.3% in the eurozone for the first quarter of the year.

Markets were not moved by the various eurozone PMI numbers, despite most exceeding expectations, and euro rates traded lower on the day. Instead, attention seems more dedicated to European Central Bank speakers, including comments from Chief Economist Lane expressing confidence about a June cut. Some of the more dovish ECB Governing Council members hinted at a total of four cuts in 2024, but in our view the improving growth numbers do not warrant such a steep path of cuts. While still our base case forecast, we don't even see a total of 75bp as the market is currently pricing as a done deal given the data so far – pricing between two and three cuts this year would be more justified in our view.

In the short run the trigger for higher yields can still come from the US. This week the US will be testing demand for duration after the recent more dovish data and Fed comments with three UST auctions lined up: a new 3y note on Tuesday, a new 10y on Wednesday and a new 30y bond on Thursday. Yields have come down considerably over the past week so $125bn of issuance should provide a good health check of current levels. And even if easily absorbed by markets, we think the real test will be next week's US CPI number for April. Consensus still sees 0.3% month-on-month for core, which is not a good number on an annualised basis.

Today's events and market views

The data calendar for the day holds little of note other than the retail sales figures for the eurozone. Central banker comments could be more interesting with Spain's de Cos and Germany's Nagel slated to speak today. From the Fed only Kashkari is scheduled to speak later tonight.

Primary markets see Austria tapping 10Y and 50Y bonds for €2bn in total. Alongside, Italy is in the process of selling a BTP Valore retail bond this week with yesterday's sales at €3bn, well below the average first days of past tranches. In the US the focus is on the quarterly refunding round kicking off with the sale of US$58bn in a new 3Y note.

Author

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com