# Rates Spark: Eurozone PMIs will test positive macro sentiment

Recent positive data surprises for the eurozone have improved macro sentiment and the PMI readings today will be watched. The downside risk for the front end of the curve is relatively limited, though. On Sunday we have German elections. Even if a majority is found for debt reforms, the impact of the actual reforms risks being overestimated

Eurozone PMIs are out today but we think downside risks for the front end of the curve are limited

## PMIs have less influence over the front end than before

Data surprises have turned more positive for the eurozone recently and the round of PMIs today will be the next test. The last reading of the eurozone PMI composite index edged above the 50 break-even level again thanks to an uptick in manufacturing. But overall, the manufacturing industry continues to show signs of weakness with the German index in contractionary territory for over two years now.

Markets seem in good spirits in terms of the growth outlook and would not be happy to see a turn lower in PMIs. Equities have shown an exceptionally strong performance this year and credit spreads have tightened further. Yet we shouldn't forget how quickly sentiment can turn. November last year saw rates significantly below today on the back of mounting growth concerns, both in the US and eurozone. One round of weak PMIs was enough to justify an additional rate cut by the European Central Bank in October.

Since the lows in November the ECB has cut the policy rate by another 50bp, limiting the potential impact from PMIs on the front end of the curve. Recent hawkish comments by the ECB have pushed back against the idea of cutting below 2%. Markets have stuck to the view that the ECB will land between 1.75% and 2% for some months now and breaking that range would need more than one bad PMI reading. And if the weakness were to be driven by Germany, the usual suspect as of late, then the foresight of elections this Sunday may overshadow a downside surprise.

## Sunday's German elections are also a reality check on market's spending expectations

The expected ramping up of  military spending has pushed bond yields higher, and in the case of Bunds, the relative pricing to swaps is at its cheapest levels. The uncertainty ahead of the German elections and the implications for the constitutional debt brake were another factor pressuring Bund valuations. The outcome, and in particular the performance of smaller parties, will determine whether those in favour of – or at least open to – reforms of the brake will have the necessary votes. Looming large is also a fear that the right wing AfD could perform better than polls suggest.

Even if a majority for reforms is obtained, we have the feeling that after all the headlines also surrounding the military spending, markets might overestimate the extent of the reform and also the timelines that might still be involved – starting with the formation of the government and then moving to the actual topic itself. Remarks from the election front-runner CDU suggest that other options of finding the financing, such as savings, should be prioritised first. The initial market reaction might be to still cheapen Bunds relatively, but we see a chance that such a move could be short-lived.

## Today’s events and market view

From the eurozone we first have French and German PMIs and then the aggregate indices. The composite index for France is expected at 48, still in contractionary territory. For Germany consensus sees a 50.8 composite reading, dragged down by a 45.5 for manufacturing. The eurozone aggregate composite index is expected to remain close to 50. UK PMIs are also expected to remain close to 50 and for the US a relatively stronger 53.2 is pencilled in for the composite component. From the US we will also see the University of Michigan indices and existing home sales.

Italy will open subscriptions for an 8Y BTP Volare retail bond for the last day.

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