Rates Spark: Eurozone to US gap to keep on widening

In the US, the 2yr auction was not great, and had evidence of a worringly low official interest. Treasury yields remain biased to test higher. It's the opposite in the eurozone where we identify room for long end yields to fall further. Watch the Dutch parliament; it will discuss upcoming pension fund reforms – transition could be pushed back years

US 2yr auction not great, and contains some evidence of reduced official interest in Treasuries

The US 2yr auction tailed, by 0.5bp. Effectively a concession to secondary, but not a dramatic concession. What is interesting is the tepid indirect bid, which saw a 56% takedown. That may sound like a lot, but it's well below the 6mth average at 73%. The interesting thing about the indirect bid is it a barometer of central bank interest, and may be indicative of less official foreign demand.

In the current environment that's not good, given the acknowledged risk that some foreign central banks might hold back on their interest in Treasuries, as a kick back protest for the tariff angst. This is purely speculative on our part, as we don't know for sure.

The direct bid took up the slack, coming at 30%, which is much higher than normal. This would typically include real money investors. So that's good; and understandable, given the stress risk assets have been under lately. The fact that dealers took down a tad more than normal in the end points to it not being an amazing auction.

More than ever, we need to separate Treasury yields from SOFR rates. Treasury yields can come under upward pressure for reasons related to the perception of America. Dollar weakness and the “sell America Inc.” trade can drive this, with relation back to tariffs as the driver.

The SOFR curve, however, should be regarded as a pure reflection of interest rate expectations into the future. The latter should protect SOFR rates from being pulled dramatically higher should Treasury yields rise

Euro rates may want to test lower on downside data surprises

In Europe, markets will be closely eyeing any data releases that gauge the potential impact from Trump’s tariffs and therefore the upcoming PMIs have the potential to trigger significant market moves. Lagarde reinforced this feeling by underlining the European Central Bank’s “extreme” data dependency in the current environment. Don’t forget that a single disappointing PMI reading last year was enough to add another rate cut last October. Tuesday’s eurozone consumer confidence already came in lower than expected and may be an omen for what is to come.

Our thought is that the rates impact from data surprises can be quite asymmetrical, in the sense that downside surprises could trigger larger swings than vice versa. By dialling down the inflation risk narrative last Thursday, the ECB has opened the door for rates to test new lows. A rate cut for the June meeting is fully priced in, but for July markets have not decided yet. Whilst we don’t expect the ECB to cut to 1.5% as markets now imply, we don’t see reasons to push against that pricing just yet. Nevertheless, we especially see more room for the back end of the curve to come down on global risk-off events, and thus a flattener in euro space has our preference in the very near term.

Debate about Dutch pension reforms could trigger delays

A proposed legal change to the Dutch pension reforms has the potential to delay associated flows in swap markets by years. On Wednesday the proposed changes will be debated in parliament. If a majority for the amendment can be found in both parliament and the senate, then pension funds would need to offer participants an opt-out clause. As it currently stands, more than €500bn of assets would be moved from a defined benefits system to a defined contributions systems as of 1 January 2026. Around that transition date we would therefore expect significant swap flows as longer-dated fixed receivers would be unwound.

But if this change in rules makes it through parliament and the senate, then transitioning in just a few months’ time would be unrealistic. No framework currently exists for splitting the pension pots between a defined benefits system and defined contributions system, which would then have to be invented from scratch. The Dutch central bank even warns that the delay could take many years. Whilst we deem the chance of passing the law through parliament significant, we doubt it can make it through the senate. As such, we still maintain the baseline that the majority of funds will transition on 1 January 2026 or 2027.

Wednesday's events and market view

The April PMIs for France and Germany are all expected to come in weaker, but the eurozone aggregate PMI is still expected to remain just above 50. Consensus sees a moderate weakening of the US PMIs, with the composite index coming down from 53.5 to 52.2. From the ECB we also expect the wage tracker readings, but with focus back to growth concerns, these numbers may not get much attention. Other data from the US includes the Fed's Beige Book, which could give insights into possible price hikes by businesses in reaction to tariffs.

Plenty of prominent central bankers are scheduled for speeches and discussions in Washington at the Institute of International Finance. Chief economist Lane from the ECB will speak, as will Knot and Villeroy. From the Fed we have Goolsbee, Musalem, Hammack and Waller. Bailey and Breeden from the Bank of England will speak.

Germany will auction €4bn of 10Y Bunds, and the US a new 5Y Note and 2Y FRN for a total of $100bn.

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