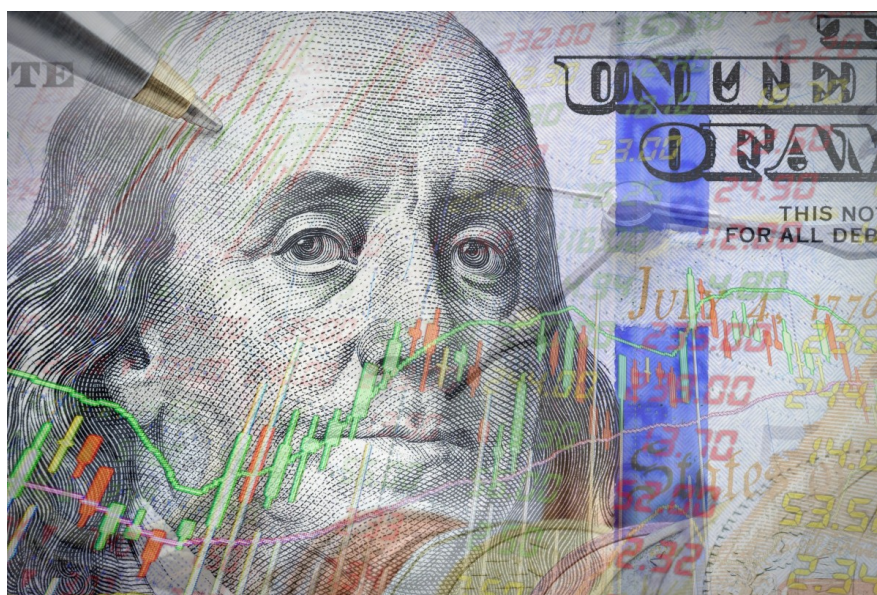


## Rates Spark: Market rates still pressured higher

Even though Monday was a bit risk-off, the bigger picture theme remains risk-on. It's been the way so far in 2024 in fact. Eurozone spreads have narrowed too. And inflation data has been a tad uppity. It's not what could be termed a rate-cutting environment, yet. So we remain tactically bearish. Next big message to come from Friday's payrolls report



### Likely to drift higher in market rates into Friday's payrolls

Reaction to Thursday's PCE deflator (a tad better than expected, but still elevated for January) continued through to the close of last week, but saw some reversal as a theme for Monday. Our central view has not changed, in the sense that we view the totality of circumstances not yet lined up for a capitulation fall in market rates into a rate-cutting theme. Not only have recent inflation prints been a tad uppity, but the mood of the risk asset space remains risk-on.

Monday was not risk-on per se, in fact it was risk-off. But it would take a more impressive moment of risk-off to take away from the wider risk-on theme, one that has in fact dominated so far in 2024. The same theme obtains on credit markets through the ratchet tighter in spreads, and the

continued outperformance of high yield. But also in quite subdued equity market volatility. There's a degree of frothiness about circumstances, but with no evidence of anything about to implode.

Basically this is not a market that is discounting a recession. So if there is one in the offing, then we'd need to see some of the headline data being more illustrative of this. Even when we look ahead this week to Friday's payrolls report, we find an expectation for the creation of 200,000 jobs. That's comfortably above the replacement number of 150k, a rate that is neutral (neither hot nor cold).

If we indeed get a 200k outcome confirmed for February, we'd suggest that would place ongoing upward pressure on market rates. Even though it would be in line with expectations, those expectations themselves are in line with maintenance of a firm macro underpinning when it comes to the labour market. Bond market bulls would need something far more subdued to gain the advantage of the bears.

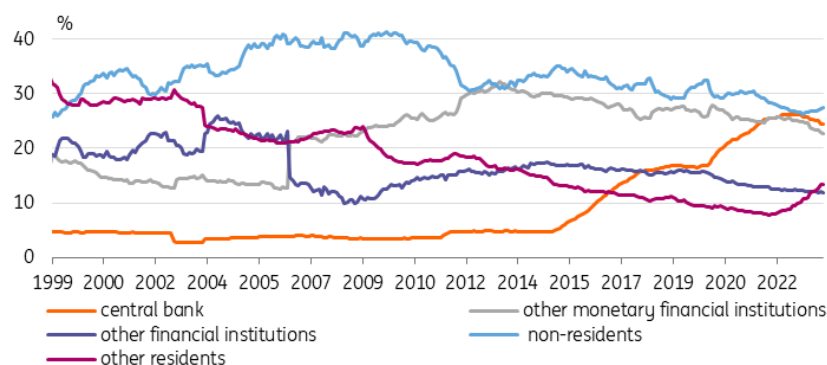
## **Eurozone periphery bond spreads had another good day**

Spreads of eurozone periphery bonds over their German counterparts witnessed another day of strong tightening on Monday. Some of it can be attributed to sentiment having been bolstered by the positive rating action on Portugal by S&P over the weekend. But the outperformer was Italy where the key 10Y spread is closing in on the 140bp threshold. We will have then reached levels which since 2010 have only been undershot more lastingly during times where the ECB was actively buying bonds.

The situation now is clearly different. The ECB is running down its bond portfolios and by the end of the year also the reinvestments for the Pandemic Emergency Purchase Programme will have ended. But Italy has also been diversifying its investor base into the retail segment with another large BTP Valore issue of €18.3bn over the past week. By historical standards Italy still has room to expand that share. At the end of last year the share of Italian debt held by "other residents" – which includes households – was 13.4% coming from a low of 7.8% in early 2022. But in the early 2000s it was closer to 30% and dropped below 20% only in the wake of the global financial crisis.

So far markets have stuck with the positive stories. But headlines like the upward revision of the 2023 deficit to 7.2% of GDP from a previously envisaged 5.3% target highlight remaining risks. The large transfers to come from the EU's resilience fund are also fraught with implementation risks, something rating agencies are following closely. And on the political timeline all eyes are on the EU parliamentary election. Further smooth sailing is not guaranteed. The implication goes beyond periphery spreads and could also pose a headwind to the so far relentless underperformance of Bunds versus swaps.

## Holders of Italian general government debt (in percent)



Source: Bank of Italy, ING

### Tuesday's events and market view

After a quiet start to the week Tuesday's data slate is looking busier. In the eurozone we will get the January PPI figures. We will also get the final February services and composite PMIs, which also means first readings for Italy and Spain.

In data highlights are the factory orders and the ISM services. The latter should also help firm up expectations for Friday's jobs data. US political observers are focused on 'Super Tuesday' where numerous states hold primary elections.

Germany mandated a 30y bond tap via syndication, which should be Tuesday's business. In regular auction supply Germany also reopens a 5Y bond for €4bn, while Austria taps 6Y and 10Y bonds for a total of €2bn.

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