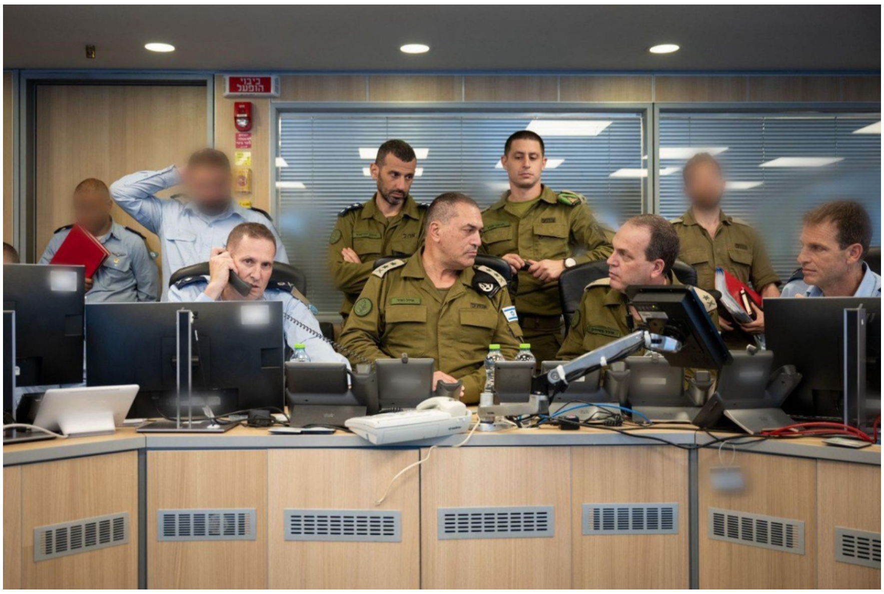
Rates Spark: Geopolitics add to bullish impulses

Israel striking nuclear sites in Iran only adds to a tactically bullish backdrop in Treasuries underpinned by recent auction and inflation data. Longer EUR rates are also somewhat more susceptible to bullish impulses from abroad again, but these alone have not been enough to push the 10y swap below its key 2.5% threshold



Israel Defense Forces overseeing strikes against Iran at the Israeli Air Force situation room

The impulse for Treasuries remains tactically bullish

Another strong auction on Thursday as the 30yr went very well. It saw a negative tail of -1.5bp (simplistically 1.5bp through secondary), and the overall auction metrics were good. This is a further bullish impulse for the bond market, as the mini-bull run continues. Certainly, it remains a tactically bullish Treasury market here. The PPI report helped, too. The 0.1% month-on-month outcome shows a clear containment in prices, at least for now. There is no denying that these headlines are bond bullish. We have a bearish view on bonds based on the tax-cutting / fiscal story, but when we see a tactically bullish impulse, we can't ignore it.

But note for later - if the market is going to react to inflation data like this as it has been, the question is how it will react when we get tariff-impacted inflation ahead and CPI heads for 4% year-on-year. Enjoy the bond bull phase while it lasts, but there are limits...

Bullish impulses from abroad not enough to take EUR rates below key levels

Even with correlations between US and EUR rates lower than usual over the past weeks, with little data to work off in recent days, EUR rates have been somewhat more susceptible to bullish impulses from abroad again. More so on the long end, starting off with the disappointing GDP figures out of the UK in the morning and later the lower PPI in the US. Overall though, by itself, this is not enough to move rates beyond recent ranges, and the 10y EUR swap rate bounced off the 2.5% level.

European Central Bank officials like Isabel Schnabel reiterated that the central bank's tightening cycle is coming to an end. Now that rates are seen at a neutral level, a pause looks very likely, though some officials do not want to take another cut explicitly off the table. The market will likely remain geared to at least one more cut given the benign inflation picture. It could be inclined to look at more cuts given remarks from the ECB’s vice president that the central bank is now more concerned about threats to growth than about inflation, but it would probably take clearer signals from the domestic data for that to happen in a way that the short end outperforms the long end.

The notable outperformance of Bunds versus swaps over Thursday’s session already hinted at a flight to safety as headlines pointed to tensions building around Iran.

Friday’s events and market view

After the final inflation prints for May from Germany, France and Spain in the morning, industrial production data for the bloc covering the month of April is expected to show a month-on-month decline while the trade balance for the same month is also seen dropping back from a March spike.

Probably more relevant for near-term direction is the US data. The University of Michigan consumer sentiment index is seen improving somewhat in June from 52.2 to a consensus of 53.6. That would still leave it at a relatively subdued level, reflecting the still elevated inflation expectations component – the 1y inflation rate is seen coming at 6.4%.

Friday evening has scheduled rating reviews in the eurozone for Germany, Belgium, Finland and Slovakia. The one that stands out is Fitch’s AA- for Belgium as it carries a negative outlook, but it was last affirmed only this February.

Author

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

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

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