Rates Spark: Global markets brace for US payrolls

This week's highlight may be May's US payrolls number, which consensus sees falling from 177k to 125k. A bad number will lower US rates, but near-term inflation fears and fiscal concerns push in the opposite direction. The next ECB cut, following yesterday's meeting, is difficult to predict. But the bigger picture hasn't changed, and we still see a landing at 1.75%

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Friday is all about the US payroll numbers, which consensus expects to fall from 177k to 125k, thereby already positioning for a cooling jobs market. The whisper number on *Bloomberg* turned more pessimistic after this week's data, with only 111k expected. US rate dynamics are more complex than in the eurozone, with different forces acting in opposing directions. Apart from growth worries, there are also inflation and fiscal pressures to consider.

A weak US payroll number should place more emphasis on the recession risk narrative and push yields down across the curve. But both the front end of the curve and the back end can only go so far. Inflation risks limit the Fed's ability to ease in the near term, and the ongoing discussions on

Trump's tax bill keep the back end higher. Whilst the spillovers to euro rates from the US seemed limited this week, we do think a bad US payroll number can hit global market sentiment and weigh down the back end of the euro curve.

The belly of the curve can outperform amid uncertainty

The European Central Bank cut by 25bp on Thursday, as widely expected, but left markets guessing about the timing of the next move. The press conference had a more hawkish tone than markets were positioned for, and now the next cut is only fully priced in by the fourth quarter. The bigger picture hasn't changed, however, and in our base case we expect more range-bound trading centred around a landing zone of 1.75% for the ECB.

The belly of the curve could play an important role ahead, as also signified by the 5Y point underperforming other tenors yesterday. The fact is that inflation still remains above target, which means the ECB's hands are not entirely free to cut rates if things turn for the worse. Meanwhile, the price impact due to Trump's trade policies is hard to predict. As such, we could see the belly of the curve outperform if eurozone growth concerns flare up again. The long end of the curve is more anchored due to German spending expectations and has less room to come down.

Friday's events and market views

US payroll numbers later in the day will be the highlight, whereby the unemployment rate is expected to remain stable at 4.2%. From the eurozone, we first get retail sales, but given the numbers are from April, we don't expect these to be a market mover.

More interesting may be the various ECB speakers slated. Holzmann from Austria will undoubtedly voice more hawkish comments, whilst Portugal's Centeno may voice more dovish sounds. Going forward, we could see more disagreement within the Governing Council about the ECB's next steps.

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