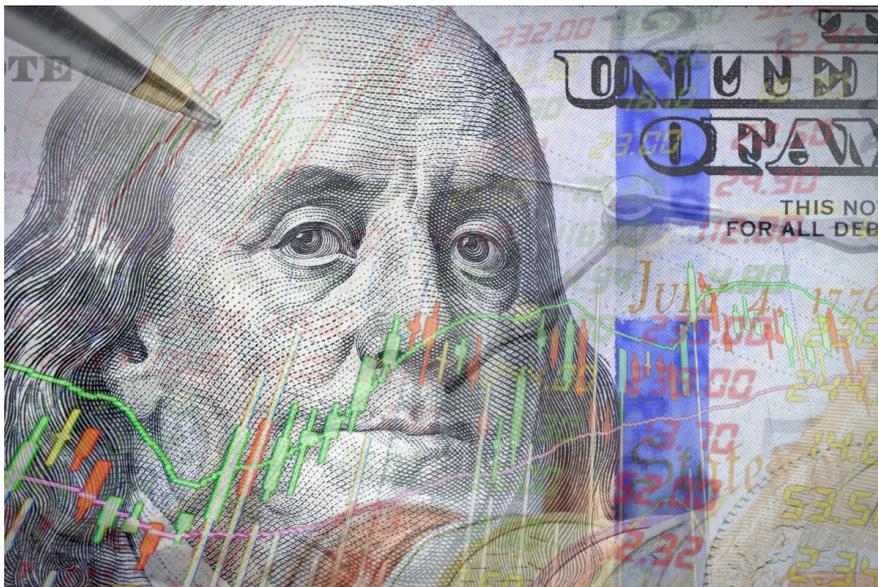


Rates Spark: Hot inflation already baked in

US rates have been trading sideways for the past few sessions, but the core PCE on Thursday could offer some direction. Consensus expects a hot 0.4% month-on-month reading, but we don't think the release will give an excuse to rally. CPI figures in the eurozone are also likely to show falling year-on-year numbers, so the MoM momentum is the one that counts



Hot PCE, but how much is already baked into that cake?

US rates have been trading sideways for the past few sessions, at arguably elevated levels with the 10Y UST yield around the 4.3% mark. Downward drifts have been ended by data surprises, but on the other hand negative releases have also not been used as an excuse to rally.

The sense that one has reached a level to take some pause may have also stemmed from the fact that money market pricing of the Fed had come to be aligned with the Fed's dot plot, but the more obvious reason we think was that one of the crucial data points was still looming: today's core PCE, the Fed's favoured inflation measure.

The month-on-month core PCE reading is expected to come in at a hot 0.4%, which annualises to an uncomfortably high 4.8%. Insurance costs and portfolio management fees are seen as the drivers and may also correct again in coming months. But for the time being that figure would stand and make it difficult for the Fed to sway from a more hawkish game in the near term.

What makes the PCE release and the market reaction interesting is that the 0.4% is already the consensus expectation. Will it be enough to move markets higher? Recall in pricing we are already near the Fed's dot plot. At least we think it should not provide an excuse to rally but leave the door open for rates to drift higher. Things look differently if the realised data deviates from expectations. And then there are other releases today which have in the past been able to flick markets around – the initial jobless claims release as a more contemporaneous gauge of the state of the jobs market.

Worries about short-term inflation momentum in the eurozone

The eurozone will also be all about inflation today with first country estimates for February inflation out today. While the year-on-year headline inflation is set to drop further, the ECB and, by extension, markets might be more worried about the rising momentum reflected in the monthly readings. As such today's data may not provide markets with an excuse to rally from elevated levels.

Rather cautionary tones coming from ECB speakers including Lagarde on the importance of having enough conviction that inflation dynamics will take us to the 2% target before contemplating rate cuts will ring in investors' ears.

Thursday's events and market view

Main highlight on Thursday is the personal consumer expenditure deflator where the core rate is expected by the consensus to post a 0.4% MoM increase. The same personal income and spending report will likely show that consumer spending started the year on a weak footing after retail sales fell more than expected. Also watch the jobless claims numbers, where both initial and continuing claims are anticipated to nudge slightly higher.

Inflation is also the focus in the eurozone with first country inflation estimates for February coming out of Germany, France and Spain ahead of Friday's main release. The year-on-year headline rates are expected to decline further, but short-term momentum should increase again.

Primary markets are quiet today. Ongoing is Italy's sale of the BTP Valore retail bond. After the third day total sales are now at over €14bn.

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