

## Rates Spark: Inflation data next test for bullish euro rates

Eurozone inflation has been stable, but downside surprises could easily trigger the pricing of more ECB cuts. 10Y swap rates can face upward pressure if we continue to see inflation data come in above target. Meanwhile, we think the recent downward pressure on euro rates has gone too far – but risk sentiment fragile, they can remain attractive



We think the recent downward pressure on euro rates has gone too far

### Eurozone inflation stable, but also source of risk

Inflation surprises remain a risk to our rates view, both in terms of upside and downside risks. Markets are positioned for lower inflation with the 2Y inflation swap marking 1.75% now, which is well below the European Central Bank's target. Nevertheless, only 7bp of ECB easing is priced in for 2026, suggesting the probability of another rate cut is just 30%. This means that markets are content with an undershoot and don't see the need for the ECB to respond.

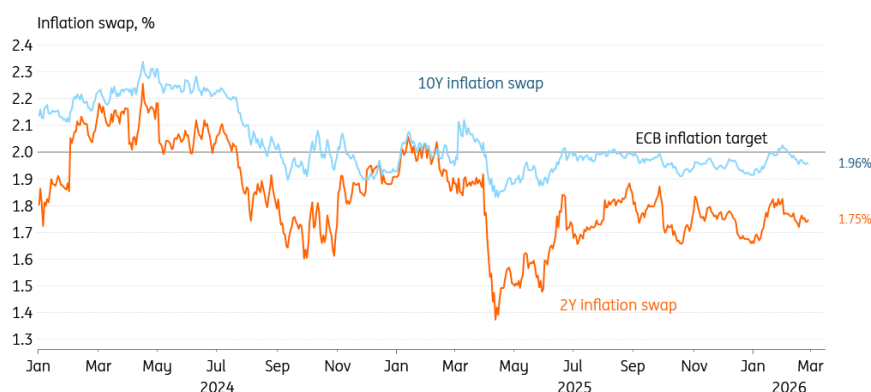
If we get lower CPI readings from the major eurozone countries today, then the case for more ECB cuts could quickly build – especially since rates seem keen to test lower the past few weeks. But also in the other direction, we see upside risks. The long end of the curve is still not fully confident

that the ECB can keep inflation close to target over the long run. The 10Y inflation swap is still below 2%, even though in pre-quantitative easing times this number was usually around 2.2%, suggesting a 20bp risk premium. In effect, if we start seeing a series of strong inflation data in the coming months, then that could also push the back end up materially.

Oil remains one piece of the inflation puzzle, but more recently the euro exchange rate and gas prices are more important driving forces behind rates. Gas prices jumped higher in January but have since lowered again. In the opposite direction, we had a sharp appreciation of the euro, but this has also broadly reverted since its January peak. That means we're in quite a balanced position in terms of inflation expectations now. This is also reflected by the fact that both 2Y and 10Y inflation swaps are trading close to their six-month average.

Meanwhile, we see that global rates markets are holding on to their bullish momentum. The AI jitters continue to keep risk sentiment on edge and private credit concerns don't help either. We still think rates have come down too far, especially when seeing euro equities hitting new records. On the other hand, we don't see much willingness for rates to pop back up again, raising the question of whether investors are becoming more keen to [add some safety](#) to their portfolio in the form of euro bonds.

## Inflation swaps suggest markets are positioned for an undershooting



Source: ING, Macrobond

### Friday's events and market views

Markets will be watching French, Spanish and German CPI numbers, which will help build expectations for the eurozone aggregate number coming on Tuesday. From the US we have PPI data, the MNI Chicago PMI, and construction spending figures.

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