Rates Spark: Issuance pressure remains on the increase

Germany's fiscal plans will have their first reading in parliament. Despite recent stumbling blocks, yield levels and curves have retraced only very little, and Bunds have even softened again versus swaps. The fiscal story also remains tense in the US, as latest fiscal numbers show an ever-widening deficit. DOGE has quite a task at hand

The latest fiscal numbers in the US show an ever-widening deficit

Germany's fiscal reset goes to parliament

EUR rates levels and curves managed to retrace somewhat on Wednesday with fewer headlines out of Germany to drive the market, but attention turned towards tariffs. It still remains a decoupling theme in the sense that US rates have taken the opposite direction on Wednesday, allowing the 10y UST/Bund spread to climb above 140bp again.

Germany will remain the big driver in the background for EUR rates, though. Parliament will convene in a special session for the first reading regarding the defence and infrastructure plans. This is a first debate of the proposal by the SPD and CDU/CSU, but also of the initiatives by the Greens and FDP. No decisions will be taken in this session, and the proposals will be delegated to the budget committee for deliberation before a second reading and vote in parliament next week.

To recap, the proposals that are on this session's agenda are:

- **SPD and CDU/CSU:** Exempt defence spending greater than 1% of GDP from the debt brake and allow the German federal states to incur deficits of 0.35%. Creation of a €500bn special fund for infrastructure investments of which €100bn would be reserved for the federal states.
- **Greens:** Exempt defence spending greater than 1.5% of GDP from the debt brake with a broader definition of defence spending.
- **FDP:** Increase the existing defence special fund to €300bn, with the condition that it can be tapped only for defence expenditures exceeding 2% of GDP.

The Greens are basically proposing to separate the package into the more pressing defence issue for immediate decision still within the old Bundestag, while leaving it to the next Bundestag to take up the infrastructure plans. Then also the votes of the Left would be needed. On Wednesday the informal conference of the 16 federal heads of state called for the package not to be separated. Eventually, the states will have to pass and decision in the Bundesrat.

German Bunds have been trading gradually softer again over the past sessions with 10y Bunds now yielding 15bp over swaps. That is still off from last week's cheapest levels where the spread was as high as 18bp, but it had temporarily recovered back towards 12bp. In all, the market is eyeing a compromise to a still sizeable package or a least a lasting change in Germany's fiscal attitudes.

US fiscal numbers continue to place pressure on Treasuries

The US fiscal deficit for February came in at $307bn. That's up from $296bn for the same month last year. Not dramatically up, but still up. The running numbers don't look great. Total spending in the current fiscal year is running at 13% above last year, while receipts are only up 2%. The overall fiscal deficit cumulates to $1.15tn for the first five months of the current fiscal year, compared with $0.83tn for the same period last year. No magic DOGE pill here as of yet!

Funding requirements are only under upward pressure here.

Already over 22% of the debt is financed with bills, partly to keep it from pressuring coupon issuance by too much. These data keep the pressure on, even as Scott Bessent has promised no change in the coupon issuance profile in the coming quarters. So that must mean even more bills issuance. Even tougher as we continue to bang against the debt ceiling. The last thing needed now from a sentiment perspective is a government shutdown of some description, which is risk should the Senate decide not to pass the continuation bill in the coming days. Tough days continue. Not great for Treasuries overall.

Thursday's events and market view

German politics could dominate as the fiscal package gets a first reading in parliament. There is also busy slate of European Central Bank speakers across the dove-hawk spectrum including Holzmann, Villeroy and Nagel, but there is very little in terms of guidance policymakers will be willing to give in these highly uncertain times. The only data of note is industrial production for January.

Over in the US producer prices will provide more details to the inflation picture after the cooler-than-expected CPI reading. The jobless claims will provide a more contemporaneous read of labour market conditions, but consensus is looking for only little change.

In primary markets, Greece should be active after having mandated a dual tranche syndication, reopening 13y and 30y bond lines. Italy will auction a new 3y bond alongside taps of a 7y green bond as well as 8y and 30y regular bonds (up to €8.25bn in total). the US Treasury will auction 30y bonds (US$22bn).

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