Rates Spark: Issuance pressure versus safety flight

Germany's fiscal package was subject to a first debate in the Bundestag, but whilst the Greens are not yet satisfied, Bund yields continue to trade well above swaps. Meanwhile, a Fitch rating review can bring France's fiscal challenges back into focus. US Treasuries continue to do their own thing, mostly struggling to make sense of its surroundings

There is still no compromise in Germany on its big spending bill

No compromise in Germany yet, but the market is not losing hope entirely

As trade tensions start to escalate risk assets continue to be on the back foot. The EUR curve bull steepened with 2y German bond yields down by 4bp and outperforming swaps.10y Bund yields came off 2bp while also outperforming swaps by 1bp.

Meanwhile, Germany's fiscal package was subject to a first heated debate in the Bundestag on Thursday. The Bund outperformance would chime with the Greens not yet being satisfied with the concessions that the CDU and SPD have been willing to make, especially on the condition that a new infrastructure fund should only cover "additional" investments. But overall Bund yields are still relatively elevated versus swaps.

There are good reasons for more concessions and good reasons for the Greens to give in, keeping hopes of a compromise alive. Time is limited, however, with the next debate and vote set for next Tuesday. For the SPD the infrastructure package is the basis for the coalition with the CDU. The CDU in turn has no viable alternative to the SPD to form a government. The Greens could still profit from a debt brake reform for Laender specifically ahead of regional elections next year. Meanwhile in the Bundesrat a defence-only solution would likely have a lower chance of passing – and one would risk ending up with nothing at all.

French spreads in focus with a scheduled review from Fitch

One remarkable development over the past weeks has been the resilience of eurozone government bonds over Bunds. Since Fitch has provided its last opinion early in February after a budget was passed, the fiscal challenges will only have increased if anything. Not just the added need for defence spending, but also given the rising trade tensions weighing on the near-term growth outlook. The negative outlook that Fitch attached to France's AA- dates back to October and is as such not that old. France may therefore skirt a downgrade this time, but the pressure is on the rise.

Treasuries continue to get whiplashed – here's the latest drivers

Three things going on for Treasuries. First, the ongoing risk-off theme. The impact is a flight away from risk and into the safety of bonds. Second, the inflation story. PPI was softer than expected, as was CPI (previous day). But the underlying data were firm (CPI ex airline prices) and the components that feed into PCE (from PPI) were pointing to a 0.3% month-on-month outcome (so, firm). Third, the 30yr auction tailed. No huge surprise here, as a poor 30yr often follows a good 10yr auction, for no reason that makes any sense. The latter aspect reminds us of the underlying supply pressure, which remains on the increase based off the latest fiscal data for February released this week.

In the background, it looks like the US government is heading for a "shutdown", as the Democrats don't seem prepared to support the continuation package that had been passed by the House earlier this week. Of course the government does not actually shut down, but some parts might have to, in order to help pay for the overall functioning of the important bits. This won't persist. But the symbolism of it is not great.

Directionally, our view has not changed. We're ranging between 4% and 5% for the 10yr in the coming months, with a break below 4% only making sense should we track towards a recession. So far that's not the central thesis. We could swing in that direction, but even the market pricing for the funds rate does not flash that as the central outcome.

Friday's events and market view

The UK will publish the monthly GDP growth reading for January and is expected to come in at 0.1% MoM. The monthly readings can be quite noisy, however, so only a significant surprise would be able to budge markets. The UK will also publish industrial production figures as will Italy. More interesting may be the University of Michigan indices from the US later in the day. The inflation expectations component shot up since Trump's election so seeing whether that trend continues could be of interest.

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