

## Rates Spark: Messy it remains

The most severe concerns around the spreading market turmoil have ebbed somewhat, allowing long-end rates to move higher again. But uncertainty lingers, keeping risk appetite at bay and markets positioned for more central bank cuts – we maintain a bullish bias in rates for now. The plumbing of financial markets is holding despite some signs of stress



Markets continue to remain volatile

### Dollar exposure's getting pushed and pulled in a still whippy market

We make the argumentation for the US 10yr to break down to 3.5% [here](#), and why it's likely to revert then higher again. Beyond that, there are three factors to latch on to.

- The first is the fall in breakeven inflation. This was unexpected, as tariffs are generally accepted as placing upward pressure on prices, even if the debate as to whether it's inflationary is not settled. The breakeven profile does settle it though, as it suggests tariffs are not 'inflationary'. The only way to square this circle is for macro malaise to dominate, resulting in subsequent dis-inflation. This supports the bull case for Treasuries, even if just for a few months (as we still think there is an inflation / fiscal reaction to come, pulling market rates back up).

- The second factor of note is the widening in the 10yr swap spread. That's now back out to 50bp, and we read that as a de-rating of the Treasury product. It's minor so far, but has been an ongoing factor in the background, as Treasuries remain pressured by supply (while SOFR, the risk free rate, is not).
- A third but semi-related factor is the re-emergence of a dollar premium on cross currency swaps. It had been zero versus the euro. It's now back up at nearly 10bp. That presents the perception of a positive valuation on dollar product, but is likely more on account of elevated volatility and the qualities of having access to dollars during such periods.

Lots of moving parts here, but we summarise as a more dour macro discount, that values dollar access as volatility rises, but still contains a tint of rating negativity on Treasuries.

## EUR rates twist steeper as ECB cuts are priced, but longer rates ease higher again

The week kicked off with a bull steepening in EUR rates as the global impact of tariffs is digested. The picture turned amid reports that many countries were willing to negotiate and speculation around potential tariff delays, later dismissed by the White House though. Meanwhile EU ministers have signalled readiness to retaliate, but also want to give more time for negotiations.

Still, most severe concerns around the spreading market turmoil had ebbed somewhat over the course of Monday. Markets do think the European Central Bank will now very likely cut rates in April, as OIS forwards indicate an implied probability of close to 90%. But longer rates have moved higher again more noticeably with the 10y Bund yield rising from close to 2.4% back to above 2.6% and keeping curves steeper. What sticks is an environment of higher volatility, which in itself will continue to weigh on risk appetite.

## 10y Bunds briefly trade below swaps as concerns linger, but the financial markets plumbing holds

More remarkable though, 10y Bund yields briefly traded below swap rates. It was the first time since the very beginning of the year. It highlights that Bunds still have a role to play as a safe haven. That is especially true as it might not take much to shift the focus back to still worrying fiscal trajectories in Europe if growth outlooks get pared back more noticeably. Political uncertainty also lingers in France for instance where the far right is toying with the idea of bringing down the government – again. 10y French government bonds have widened to a yield spread of around 78bp from close to 70bp versus German Bunds, marking their widest levels since January. Italian bonds have widened to now 124bp from close to 110bp.

For now the market turmoil has not spilled over to any larger degree into the plumbing of the financial system. Money market spreads like the Euribor-OIS spreads have widened, although the moves still look relatively contained when looked at in the futures markets. There has been a more noticeable move in the EUR USD cross currency basis denoting increased demand for dollar liquidity, but also not signalling any severe stress to the system. More importantly, repo markets have not seen any major impact and remain in a wait-and-see mode. Still, these indicators along with recourse to the ECB liquidity operations will likely be watched more closely in coming weeks and months.

## Tuesday's events and market view

We can expect another headline-driven market, especially since the data calendar is practically empty. Wednesday will likely be the more eventful day with the US tariffs being enacted and the EU voting on a retaliatory package. We therefore don't expect much easing in sentiment unless Trump shows more willingness to negotiate.

Plenty of supply is scheduled. The EU has announced a syndication of a new 3Y and a tap of a 27Y for an estimated total of €10bn. The Netherlands will auction a 7Y DSL for €2.5bn and Austria 6Y and 10Y RAGBs for a total of €2.3bn. From the UK we have a 29Y gilt for £2.25bn and from Germany a new 10Y Green Bund for €3bn. Lastly, the US is set to auction a 3Y note for a total of \$58bn.

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