

Rates Spark: Key data tests to bullish sentiment coming up

The US PPI is the first key test for the bullish sentiment that had built in rates following the dovish Fed and weaker US jobs report. If this month's data doesn't show a decline, rates have room to drift higher again. In the eurozone, ECB cut expectations beyond June are pared back with that dynamic having room to run further



US PPI is the first key test for bullish sentiment since the dovish Fed and weaker jobs data

US yields have been more range-bound over the past few sessions as the bullish run following the more dovish Fed and the relatively weaker payrolls report has now petered out with 10Y UST yields just below 4.5%. Overall however, investors still seem more confident about bullish bets as also highlighted by bond fund inflows over the past few week as data in aggregate, apart from inflation, has been coming in softer.

But inflation remains key for any wider rally we think with current sentiment about to be tested by this week's price data. Main focus of course is Wednesday's CPI release, expected to come in at a still too hot 0.3% month-on-month for the core rate. But already Tuesday we will see the PPI release where the details are important as a lot of them feed through into the core PCE deflator that the Fed watches more closely.

Markets gradually pare back post June ECB cut expectations

In the eurozone, rates are a little stickier with the 10Y Bund yield still close to 2.5%. One could point to more active primary markets this week, foremost with the EU having mandated a new 30Y bond on Monday. But the underlying is also a story where over the past week markets have started to gradually pare back their rate cut expectations for the ECB beyond June. It will take a lot before the ECB backs away from a first cut in June with communication having cemented market expectations – some 24bp have been priced consistently. But for the year as a whole pricing has slipped gradually away toward 70bp again over the past week.

We think in the near term at least that dynamic has further to run as data has started to turn the corner and more questions about the extent to which the ECB can detach from the Fed despite policymakers' vows of policy independence. Tuesday's German ZEW index is seen improving and prospects of stronger economic activity would be seen limiting the ECB's room for cuts after June.

Tuesday's events and market view

In the eurozone we will be looking at outcomes from the German ZEW survey. Germany's poor economic performance continues to drag down eurozone growth and thus any upside surprise beyond the improvement already pencilled in from consensus would nudge yields higher. UK weekly earnings data in the morning will be watched by the BoE and could move rates. In the US core PPI is seen coming in at an unchanged 0.2% month-on-month, though there are some calls for an increase to 0.3% given that we had seen the price components of the ISMs ticking higher. Also watch the NFIB's small business optimism and its employment component. Fed Chair Powell will be speaking today at an event alongside the ECB's Knot. From the ECB, Schnabel is also scheduled to deliver a speech on "setting the course for competitiveness and growth".

In terms of issuance, the EU has mandated a new 30y bond via syndication which should be Tuesday's business and is estimated to raise €7-8bn. A syndication by Italy for new 12y green BTPs is expected to raise €6bn. Furthermore, the Netherlands will auction €2bn for 5y DSLs, Germany €5bn of 2y Schatz, and the UK a £0.6bn 50y Gilt linker.

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