

Rates Spark: Let the spending begin

Bunds are coming under bear steepening pressure as the focus shifts back to defence spending pledges coming from the NATO summit. Meanwhile, US Treasuries see bull steepening on the back of dovish Fed comments and growing macro concerns



Government leaders pose for a photo during the NATO Summit in The Netherlands

Let the defence spending begin?

The new 5% of GDP defence target, now confirmed by NATO members, was what it took to win over US President Trump. “The trajectory and balance of spending” will be reviewed in 2029.

With calm oil prices as tensions in the Middle East stabilise, the upward push in longer EUR rates, with the 10y Bund hitting 2.57% again, was probably a mix of improving risk sentiment and a foreshadowing of rising borrowing requirements. Earlier this week, Germany unveiled its financing plans, which aim to achieve a 3.5% target for defence spending by 2029, resulting in a defence budget of nearly €170bn for that year.

Whether other European members will be able to keep pace looks less likely. France has also committed to the new target, and in 2024, the gap between the current 2% spending and the new 3.5% target amounts to over €40bn. But France is already facing a high debt pile and a deficit of 5.8% in 2024 that it needs to bring back in line with the EU's fiscal rules over the coming years – for next year's budget, the government needs to find €40bn in savings to keep it on track. That leaves

little room for any additional spending, and President Macron has indicated that “tough choices and courage” are needed.

US Treasuries bull steepening amid more dovish Fed voices

US Treasuries are taking on a more positive dynamic over the past session, with the bull steepening contrasting with the bear steepening of the Bund curve.

Over the past few days, dovish voices from Fed members Waller and Bowman have made the case for a potential rate cut in July, where the market has now gone back to pricing in a non-negligible probability of 25%. By the end of the year, the market is discounting more than 60bp of easing from the Fed.

The dovish tones have found fertile ground amid softer data, such as the weaker consumer confidence and growing job market concerns. That puts some focus on Friday's personal spending data next to an expected still benign PCE. And when it comes to the jobs market, the trends in the weekly jobless claims data (coming again today) will also be closely watched, though the main event will be next week's official jobs numbers.

Thursday's events and market view

While the eurozone is not seeing any notable releases, we will have appearances of European Central Bank officials Isabel Schnabel and de Guindos. From the Bank of England, Breeden and Governor Bailey are scheduled to speak.

It will be a much busier day for US data. The main focus will likely be on the weekly jobless claims figures that have been trending higher of late. Durable goods orders are seen rising 8.5%, though only flat once excluding transportation. Rounding off the day's data slate are pending home sales data as well as the final first-quarter GDP figures. It will also be a busy day for Fed speakers with appearances from Barkin, Barr, Daly and Hammack

In primary markets, we will see the UK selling 20y gilts (£1bn) and the US Treasury selling new 7y notes (US\$44bn).

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