Rates Spark: Looking down, just about

Nothing like a few auctions to help test the temperature. Yields sailed lower yesterday through the 2yr and 5yr UST auctions, which did not help their stats. Today's 7yr auction might be a better test. EUR rates retraced late last week's move higher as pushback from the European Central Bank appears tame so far

US market rates finding an excuse to test lower again. Auction and key data ahead

On the one hand, there was a material fall in yields seen across the curve yesterday, led by the US. On the other hand, it just took us back to where we were pre-Thanksgiving. The auctions were interesting.

The 2yr auction struggled, with the indirect bid (includes central banks) underwhelming. Hence the paper got awarded at concessional levels. This is surprising, as the 2yr is a good place to be if the market place is of the view that rates will be cut next year. Being out the curve will be better from a returns basis, but the 2yr has a comfort value to it.

Part of the issue is concern on dollar exposure, as that really needs to go right for front-end exposure to work for foreign players. We'd be a tad concerned on that account too. Although for domestics, that should not be the same issue.

The 5yr auction went better, which is also interesting, as there is a material inversion along the 2/5yr segment. Also, the 5yr looks rich when viewed between the 2yr and 10yr. Structurally we should be looking for the 5yr to underperform versus the straight combination of the 2yr and 10yr going forward. Right here we'd prefer to be short the 5yr and long the 2yr (for yield) and 10yr (for direction exposure).

Directionally it's tough to argue against falling yields for now. The data is lining up in support of it, or at least swaying in that direction. It does seem that inflation worries have been downsized, with lower delivered inflation helping. Expectations have eased off too. US consumer confidence is just about hanging in, but is now teetering on the verge of a break below 100 (key breakeven reference). That will be a key reading ahead.

We have the 7yr auction in the day ahead too to help take the market pulse. So far though, the break below 4.5% has been pivotal. It still feels like we don't have enough to gap lower just yet. But far less reason to gap back higher given what we know.

EUR rates retrace late last week's move higher as ECB pushback remains tame

With the US returning from the Thanksgiving holiday, EUR rates more than retraced the move higher from late last week. 10Y Bund yields rallied by almost 10bp to 2.55%, being slightly overtaken only by the belly of the curve. An ECB insider story that was published by Econostream yesterday talking about the next move of the ECB being a rate cut fits the pattern, and so do the somewhat more dovish tones from ECB President Lagarde when she pointed to signs of softening labour markets and a continuation of weakening inflation pressures.

But she also said that the Pandemic Emergency Purchase Programme reinvestment policy would be discussed in the not too distant future – a comment which chimes with remarks from some of the more hawkish ECB members of late and which at least briefly widened sovereign bond spreads over Bunds. It certainly did little to dissuade markets from pricing in 100bp of rate cuts over the next year.

Today's events and market view

Markets are eyeing the close to 100bp in rate cuts priced in over the next year from both the ECB and Fed, which creates some tension with the official high-for-longer narrative. That could be the focus today on ECB speakers such as the Bundesbank's Nagel, Chief Economist Lane and also Lagarde again. There is also a busy slate of Fed officials lined up for today, including Governors Waller and Bowman.

In the US we will also get house price data and, more importantly for the importance of the consumer to the US resilience story, the Conference Board's confidence index.

There is no eurozone government bond supply today, but we will see a 30Y Gilt auction and a new 7Y note sale by the US Treasury tonight.

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