Rates Spark: Looking down still

The drivers of market rates here are complex, arbitrating between a Trump-inspired future versus contemporaneous US macro slowing risks. We view the latter as driving just for now. Meanwhile, EUR rates pared back their prospects of larger near-term ECB cuts, although the longer-term outlook remains little changed on subdued levels

We continue to identify a preferred contrarian pressure for lower yields ahead

Following on from Monday's strong 2yr auction, Tuesday's 5yr auction was also taken down on tidy pricing. The latter is of particular note as it's the richest (lowest yield) part of the curve. Still, the dominant theme since Monday's dramatic rally in bond prices has been a mild reversion higher in yields through Tuesday. It still leaves yields well off the highs seen in previous weeks. And we continue to anticipate a market preference to do some more downside testing for yields in the coming weeks. The tariff story coming from Trump tweets needs to be noted of course. But in reality it's the implementation of actual policy measures ahead that will move the market from here.

And in the meantime it's back to data watching. We continue to get soft survey evidence, but with the notable exception of consumer confidence, which if anything has been lifted since the election outcome. That said, we continue to point to the labour market data as the ultimate arbitrator for where the economy, and by extension, where bond yields are heading to. The fact that we have a Trump presidency from 2025 (20th of January to be exact) will have no impact on the next few labour market reports, as these are already written in the stars, and we think with an element of weakness inherent in them.

We continue to mark a floor at 4% for yields along the 2/10yr segment, implicating limited downside potential from a relative value perspective versus the forward funds rate.

EUR investors still cooling on faster near-term cuts despite Trump ramping up the tariff rhetoric

Prospects of a bigger ECB cut continued to recede over Tuesday's session. It means that the initial front-end led rally on the back of last Friday's surprisingly weak PMIs was further pared back with the overall curve reflattening some more. A 50bp cut now gets only a 25% chance as central banks speakers so far have not signalled any change to their immediate outlook given the PMIs. It might be that this Friday's inflation data, expected to rise again, is still giving them some pause.

At the same time Trump ramping up the rhetoric on tariffs sooner than expected is additionally weighing on the outlook, keeping a lid on longer rates. But the impact on overall risk sentiment seems muted so far. The 10Y Bund yield has not budged much from 2.20%, and outperformed swaps only by another 1bp toward almost 5bp through the swap rate now. Spreads of other eurozone governments bonds widened marginally with the generic French 10Y spread over Bunds at 82bp topping the peaks (on a closing basis) of early June when the snap elections were announced. Current concerns remain that Le Pen could bring down the government over the 2025 budget.

Wednesday's key events and market view

The key data release will be the US core PCE deflator for October. Consensus sees a 0.3% month-on-month reading, making for 2.8% year-on-year, just above last month's 2.7%. No economist forecasts a 0.4% MoM reading. The release also comes with the second GDP estimate for the third quarter, wholesale inventories, durable goods orders and initial jobless claims, making for a busy US calendar. From the eurozone we have consumer confidence numbers from Germany and France, and the ECB's chief economist Lane speaking later in the day.

The US has scheduled to auction a new 7Y Note for a total of $44bn.

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