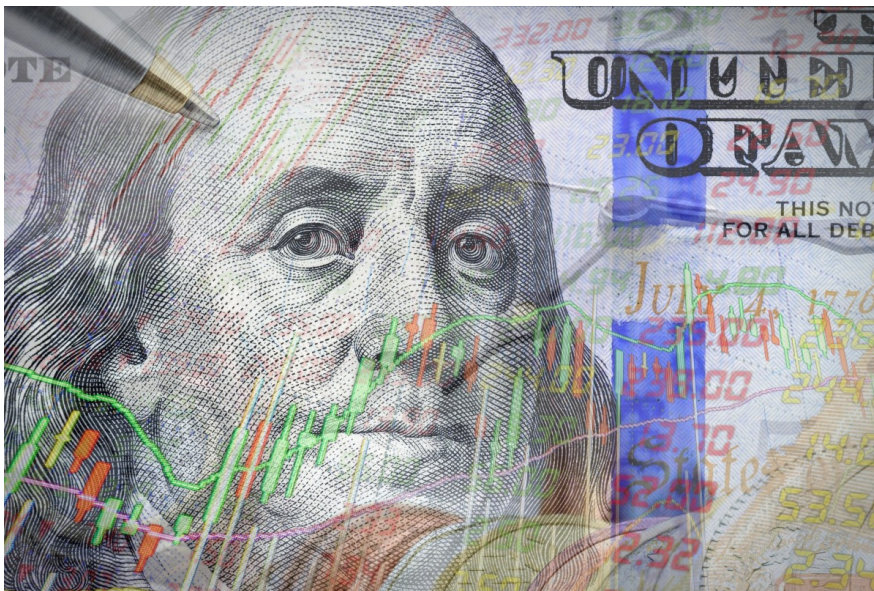


Rates Spark: Lower yield test, but there are limits

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Treasuries up and down, but in the end unchanged. Some big weeks ahead

US Treasuries may have gone through quite a day on Thursday – down and back up in yield – but they've ended back where they started. We maintain our view that the FOMC outcome was effectively a one-day move, with minimal legacy in terms of immediate direction. That said, we also view the FOMC outcome as a whole as nodding towards dovishness, but with numerous caveats. When we look ahead, we do so nervously. 2 April will see reciprocal tariffs coming from the US, and we'll need to see where the chips fall after that. The macro data seems biased to be weak in the coming weeks too, but the PCE inflation data will likely show some stubbornness, remaining a tad elevated in nature.

When we look at the market discount, we see rate cuts anticipated. But we don't see a recession discounted. For as long as the latter remains true, there is a minimal path for the US 10yr yield to get below 4%. We say that as 1mth SOFR "floors" in the area of 3.5% ahead (forwards). Add to that a 40-50bp swap spread, and that churns out a base in the 4% area to reference the 10yr Treasury yield against. The 10yr yield could of course conceivably dip below briefly. But if no change in where the 1mth SOFR rate is expected to floor, then the 10yr yield would look very rich at 4%. That's the dynamic in play in the coming few weeks.

Not now, but in the medium-term (still 2025), a path to 5% subsequently has not gone away. We still have too much Treasury issuance, sticky inflation and an ongoing (potential) threat to "America Inc". Risk assets are currently tending to take the heat, with Treasuries as a safe haven. But that safety play is not that obvious should the aforementioned issues persist.

Growing concerns around tariffs outweigh the prospects of a German spending splurge

EUR rates ended Thursday slightly lower but this was largely reflective of the lower opening as the prior night's Fed was digested. Even as the [Bank of England surprised markets with a more hawkish hold](#) than anticipated, the bear flattening of the UK curve did not spill over into the EUR rates.

The latter saw little reason to rise as European Central Bank President Lagarde also touched upon one of the main looming concerns for European investors – that of the looming tariffs. Although the EU is trying to allow for more talks by delaying the proposed counter tariffs, the ECB president highlighted what is at stake, citing the bank's own impact analysis. The US imposing 25% of tariffs on EU imports would lower the Eurozone's GDP growth by 0.3 percentage points in the first year, and by 0.5 in the case of EU retaliatory measures. Markets are starting to lean again in favour of an April ECB rate cut with close to 15bp priced in OSI forwards – an implied probability of almost 60%.

In Germany, the amendments to the constitution that pave the way to a fiscal spending splurge should pass their final hurdle in the upper house. But it becomes also clear that a lot of the impact will hinge on the coalition agreement and then on the actual implementation. That already puts the plans on a timeline unlikely to offset the more immediate tariff effects. Perhaps reflective of a more sober and realistic take on the timelines around the German spending plans, the valuations of 10y Bunds versus swaps have gradually reclaimed further ground over the past days, now back to yielding around 11bp over swaps.

Friday's events and market view

In Germany the upper house representing the states will provide the final vote on the defence- and fiscal-spending plans. It is widely expected to pass, with courts in Germany also having dismissed last ditch injunctions against a vote by the states.

There is little other data of note on the calendar apart from the preliminary eurozone consumer confidence reading. The ECB's Escriva is scheduled to speak on AI in finance and from the Fed we will hear from Goolsbee and Williams.

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