Rates Spark: National first!

Recent headlines about new tariff threats add a bullish bias to rates, while clarity on defence funding and debt brake reforms is crucial for Bund spreads. We believe that establishing a dedicated fund is the most likely solution at this point. As markets focus on the ECB, the first inflation readings today could counterbalance recent hawkish comments

National funding sources could be the fastest path towards broader EU defence spending

National funding could be the fastest path to European defence spending

With time running out in Germany to leverage the old majorities before the new Bundestag convenes on 25 March, the headlines are providing little additional clarity. A €200bn defence special fund still looks like the more probable avenue for now, as was indicated by the current caretaker finance minister at the sidelines of the G20 gathering in Cape Town. If decided, a fund could potentially lessen the pressure for a quick reform of the debt brake, which in turn could alleviate some of the market's supply fears, but at the same time dampen any hopes that bigger stimulus from Germany could pull the eurozone out of its economic rut.

The G20 meeting will also be used to discuss European common defence financing, but the Irish finance minister, who also chairs the Eurogroup, has said that national defence spending will have to rise first when speed is of the essence – this is also in line with our initial thinking.

The Bund spread over swaps, which is also a good measure of Germany's fiscal concerns, has widened out to 7bp over the past days, though has come off the cheapest levels yesterday. More clarity will likely be needed before there is a chance to move off these levels more notably. We do have the feeling that the demand for safe-haven assets could come back if the fiscal positions of other eurozone members shift back into focus when the onus remains on the individual countries to finance rising defence costs, and this all amid still elevated macro and tariff uncertainty. For now, eurozone government bond spread over Bunds spreads remain at their relatively tight levels.

Eurozone inflation could steer discussion about an April ECB cut

The ECB has been dropping more hawkish hints ahead of the pre-meeting black-out period. Press reports backed by ECB sources indicate that the inflation forecast for 2025 could be nudged up. While likely seen as a temporary factor it plays into the hand of the more cautious camp. Closely watch therefore the first inflation data for February starting today with readings out of Spain and Belgium as there are some expectations of a retreat in the core measure.

The market remains fully priced for a 25bp cut next week, but they see another cut in April already with only a 60% probability. Since the middle of last week, the forward for the December meeting has been tracking towards the lower end of the 1.75% to 2% range, still deemed as the most probable landing zone for the ECB since around October last year.

Today's events and market view

With key deadlines nearing headlines around US trade, such as Trump's latest threats to impose 25% tariffs on the EU can add a bullish undertone to rates direction. US data releases today include the second reading of fourth quarter GDP, durable goods orders and the weekly jobless claims data. There is also a busy slate of Fed speakers, including Barkin, Bowman and Harker.

The eurozone calendar holds the first preliminary country inflation data for February from Spain and Belgium. Other releases to watch are the ECB's money supply data and the eurozone economic confidence indicators. The ECB will also publish the minutes of the January meeting in which it cut rates by 25bp.

In primary markets Italy will auction a new 5Y bond alongside taps of a 10Y bond and a 8Y floater, in total for up to €9.5bn. The UK will auction £3.25bn in 15Y gilts.

Author

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

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