Rates Spark: Patience needed for next data guidance

Some upward drift in 10y UST yields was observed on Thursday but at 4.37% it remains still well below the 4.5% handle. The market focus is already on the next inflation readings, but first, PMI data next week will guide sentiment about US and eurozone growth. Diverging PMI directions of the two regions could narrow UST-Bund spreads

Yields biased higher without other impetus

Rates drifted higher with little added directional impetus coming from the data to follow up on the CPI and retail sales releases, although the current 10Y UST yield of 4.37% is still well clear of the 4.5% level above which it had last been catapulted by the March CPI print.

Fed speakers were leaning slightly hawkish on Thursday, but coming from speakers with a known bias. But even Fed officials like John Williams stated that while certainly a positive development after the string of disappointing inflation data, he would not read too much into one release.

For the overarching market theme, the next key data point is obviously the PCE data at the end of May, but markets should have a relatively firm grip on what to expect given the PPI and CPI releases, so that the more pressing question on the inflation front is what happens to the CPI release next month. With little other data to digest in the early part of next week, we think that leaves market rates vulnerable to drift higher again.

But the softening macro outlook could become a driver later next week. The preliminary S&P PMIs for May will provide a read on sentiment after the April ISMs slipped below the 50 threshold two weeks ago, signalling contraction. That may weigh more on yields in the 5Y to 10Y belly of the curve which had seen 2s10s flatten over the past days. The 2s10s Treasury curve slipped below -40bp yesterday, the flattest/most inverted since directly after the too-hot March CPI release – it is a reminder that inflation holds the key to the Federal Reserve's rate cut ambitions.

Bund yields at least over the past few days have tracked Treasury dynamics, leaving the 10Y spread between the two at just above 190bp despite the large outright moves. The spread could see more movement as the PMIs get released next week. The eurozone had seen some rebound albeit from low levels, but a dynamic where a cyclical recovery slowly gains traction could be seen as limiting the ECB's room to cut rates beyond June. For now, the market has moved closer to pricing three full cuts again in the wake of the US data, but with little domestic news to validate the repricing.

Today's events and market view

There is no noteworthy data report for today. We have the Leading Index in the US and a few Fed speakers scheduled, but not necessarily on monetary policy-related topics. Quite a few ECB officials will be on the wires, though, including Luis de Guidos and Robert Holzmann.

Author

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

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

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com