Rates Spark: Higher PCE inflation would keep the 10yr target at 5%

Today, we see the final April reading for US inflation, which is shaping up for confirmation of 0.3% month-on-month as a central outcome. That's too high for (Fed) comfort. Treasuries really need a 0.2% MoM reading, otherwise the path remains in place for a move towards 5% on the 10yr

Direction for US Treasuries all on today's PCE deflator outcome

There is a chance we could see a 0.2% MoM outcome on the PCE deflator. The consensus is for 0.3%, but it's a close call. The details show the average running at 0.26%. Statistically, that's practically just as likely to round down to 0.2% MoM. If it does, it could be pivotal. For the bond market to rid itself of the bear dominance, it needs to see the start of monthly 0.2% outcomes. That can help avert further imminent moves to the upside for longer-dated bond yields.

But if we get what's expected - 0.3% MoM - we remain on a path towards 5% on the 10yr Treasury yield.

If realised, a (surprise) 0.2% MoM outcome could begin a run of them, which could be significantly bullish for bonds. However, a sneak preview of the core CPI reading for May, which is due in a few weeks, has a 0.3% MoM expectation. This wouldn't be good. It would mark a run of five months with 0.3% or higher MoM outcomes. It keeps the pressure on market yields to have a bias to edge higher for another few weeks at the very least.

This week, some tailed auctions have added to the sense of bond market angst. It has not quite unravelled, but it has the potential to do so. Our central premise is that we’re at or about normal yields now for the 10-year. This bond market really needs a break from a decent inflation reading to prevent it from sliding down the slippery slope that could see yields head north.

Eurozone flash CPI is unlikely to alter the picture of a 'hawkish' cut next week

The eurozone has its own piece of inflation data to digest ahead of the policy meeting next week. Given prior country releases, markets normally already have some handle on what to expect. After a slightly hotter Dutch inflation figure, there is still a French reading to take into account this morning. Overall, there remains a bearish undertone for the market as the anticipated eurozone core CPI rate of 2.7% is still high. On top of that, Thursday has again seen somewhat better data with economic confidence in the eurozone rising – typically this has a good correlation with growth – and unemployment also falling to a new record low.

While an ECB cut next week still looks like a done deal in the eyes of the market, the communication surrounding it could turn out more hawkish. The probability for a follow-up cut in July is around 10%, but by October, a second cut is still fully priced in. A third cut before the end of the year is currently hanging in the balance.

Today’s events and market view

We're at the end of the month, which could cause some volatility around rebalancing flows. The key piece of data is the PCE inflation out of the US, where the market consensus is close, split between 0.2% or 0.3% for the crucial month-on-month core reading. Watch out, too, for personal income and spending data. In the eurozone, we will get the flash CPI estimates, where the headline rate is to nudge slightly higher to 2.5% from 2.4% while the core rate stays at a still elevated 2.7% year-on-year. Some focus will be on possible rating action tonight, with S&P having France (AA/Negative) on its review schedule.

Regarding central bank communication, the ECB has already entered its black-out period before next week's policy meeting. The Fed will enter its own at the weekend, allowing for some final messaging. However, no speakers are scheduled for today.

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