

Rates Spark: PMIs are unlikely to impact the next two ECB cuts

The composite eurozone PMI is expected to remain in contractionary territory and a close-to-consensus reading shouldn't impact the European Central Bank's next two cuts. Dutch pension funds were caught by surprise when two coalition parties proposed adjusting the rules of the upcoming transition. This could have implications for swap markets given the material footprint of the funds



With the next two ECB cuts seen as done deals, consensus PMIs won't move the needle

Data has a chance to make a return as a driver of markets today with the eurozone flash PMIs offering a fresh take on economic sentiment amid the politically changing winds. While the market sees the composite PMI remaining in contraction territory, a larger disappointment might still be needed to move the needle. But it might offer a bullish tinge after market rates gradually backed up following the initial reaction to the Trump inauguration. The data we are watching for the US next week is the core PCE.

Staying with EUR rates for now, the market is discounting the next two ECB cuts as nearly a done

deal and remarks by ECB officials over the past days have largely justified that view. We do think that markets are more likely to price in more cuts than fewer going forward. However, energy price dynamics are still adding to concerns around the inflation outlook. We think the conviction around further rate cuts beyond the next two will remain lower for now as the ECB heads toward neutral rate territory.

Dutch pension fund reforms under threat, with possible implications for swap markets

Dutch pension funds are in the middle of [major reforms](#) and were caught by surprise when two coalition parties proposed changes to the transition rules. The proposal would require participants to vote for an approval before a fund can proceed with the transition, which in essence is one from a Defined Benefits to a Defined Contributions model. A majority would be needed and the participation rate would have to be at least 30%. The initial reactions are pessimistic given this adds another source of uncertainty in an already incredibly complex process.

Dutch pension funds are a large player in swap markets to hedge interest rate risks and thus the reform process can have a [material impact](#) on the curve. With more than €1tn assets under management and relatively long-dated liabilities, we think the impact will be noted among longer-dated maturities (20Y+). If this law gets adopted in parliament (which we think is unlikely in its current form), then funds would be even more incentivised to protect the downside risk to their funding ratios through interest rate hedges. A low funding ratio makes the benefits of a Defined Contributions model appear less obvious to participants, reducing the chance of approval votes.

Today's events and market view

The focus shifts to the data as the eurozone flash PMIs for January will show whether the gloomy outlook for the start of the year is confirmed. The composite PMI for the bloc has not been above 50 – the neutral level – since September, which leads our economists to believe that even the sluggish growth pace of the first three quarters of 2024 is too ambitious for the winter months.

UK and US PMIs will be released a little later. The US also sees the final University of Michigan consumer confidence release. On the speakers front, we will also see ECB President Christine Lagarde participating at another Davos panel again, though the blackout period means any remarks on monetary policy should remain vague.

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