

Rates Spark: Politics everywhere all at once

The first-round results from the French elections have reduced some of the tail risks in bond markets. Eurozone CPI data today are likely to come in softer, but the expected core reading remains elevated at 2.8% year-on-year. US markets are assigning a larger probability to a Trump win, helping push up 10Y UST yields by almost 20bp over the past days



Limited relief after the first round of French legislative elections

French bond spreads versus Bunds tightened some 5bp in the 10Y area following the results of the first election round. Notably French bonds traded only slightly tighter versus swaps, so that the main driver of the tightening versus Germany was actually the cheapening of Bunds. It does gel with the narrative that the tail risks are reduced, especially that of an even market unfriendlier far-left win, but uncertainty still lingers ahead of Sunday's second round – candidates will have until Tuesday evening to decide whether to retreat from three-way races which would further scupper the National Rally's chances to win an absolute majority.

More importantly, one outcome looks already more certain, and that is that France's structural

problems and fiscal issues will only get more difficult to tackle in the years ahead. We think the spread tightening potential for French bonds still remains limited.

Eurozone inflation eases further, but don't expect too much policy guidance

The political backdrop may have distracted markets somewhat from the monetary policy outlook. Here today's eurozone flash CPI will provide another key input for policymakers. If the core reading comes in at 2.8% YoY it would be another slight improvement, but still an overall elevated level nonetheless. That said, country data so far points on balance to some downward risk versus consensus at least for the headline reading.

So far policymakers have refrained from providing any clearer guidance on what will happen after the June cut. While they have been non-committal, the ECB Forum on Central Banking in Sintra will make for a flurry of headlines with all eyes on the policy panel attended by European Central Bank President Lagarde and the Federal Reserve's Powell today.

Also in the US politics are driving the curve

Global bond markets are watching US rates for signs of direction, but whereas a lot of the price action was previously found on the short end of the curve, now the back end is playing a larger role. The latest inflation numbers in the US were supportive of a Fed cut and until data proves otherwise markets are fixed on pricing in between 15-20bp of cuts for September, keeping the short end anchored.

In contrast, the 10Y UST yield rose sharply the past few days, jumping from below 4.3% to almost 4.5%, thereby steepening the curve. Most of the move can be tracked to the upcoming US elections, whereby markets are assigning an increasing probability of a Trump win. First we had the weak performance of Biden in last week's debate and just yesterday the Supreme Court ruled that Trump may have had immunity for actions within his Presidential authority during the previous elections. Although the ruling may not eventually impact the outcome, this does likely delay the case against Trump further reducing the chance of a courtroom session before election day. As the election day comes closer we can expect to see more politically-driven rates volatility.

Today's events and market views

Focus of today will be eurozone CPI data and ECB speak from the Sintra Forum. From the US we have JOLTS job openings data for May, which is expected to continue the gradual downwards trend.

A light issuance calendar. The UK will auction £4bn of 3Y Gilts and Germany 6Y and 26Y Green Bunds totalling €1bn.

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