Rates Spark: Limited potential for higher Bund yields

Yields are likely to remain elevated, with the prospects of a 0.3% US core CPI print on Wednesday. One of the market's – and the Fed's – challenges remains the discrepancy between strength in official data and weakness in other survey data. For Bunds the potential for yields to drift higher alongside USTs is held back by a lack of domestic drivers

Consensus US CPI reading would be no reason to celebrate

10y UST yields are stuck above 4.4% at the start of the week following the strong US payrolls number on Friday. Yields are likely to maintain their elevation with the prospects of a 0.3% core inflation print on Wednesday and the realisation that if confirmed the Fed is running out of runway for a June start of its easing cycle.

And indeed pricing for June is being pared back with the forward now around 13bp, i.e. only discounting the June cut by slightly more than halfway. Even July is now being questioned. Still 22bp are discounted, but ahead of the jobs data, markets had fully expected that by July the Fed would have had cut at least once.

Tuesday's data will highlight one of the nagging issues for markets – and the Fed alike. While official data continues to signal strength, other survey data is already pointing to a noticeable softness. The National Federation of Independent Business' (NFIB) index for small businesses hiring plans for which we will get the update has been pointing downwards for the past months at the same time that US payrolls have posted solid gains. Before that there had been a better fit between the two series.

US yields can drag euro rates higher, but potential is limited

Eurozone rates are preparing for Thursday's ECB meeting but first – and possibly more impactful – the US CPI numbers the day before. In the meantime Bund yields have been creeping up, with the 10y yield just short of 2.46%, which is the highest level seen this year. But whereas in the US the catalysts for higher yields are clear, for the eurozone the domestic drivers that would pave the path to higher yields in the near term are not evident.

For one, with stagflationary growth figures in the eurozone there is little reason to believe that the natural rate should be much higher than previously believed. Our current estimate of the terminal policy rate is 2.5%, approximating a real rate of 0.25 to 0.5% and an inflation target of 2.0%. With the most recent GDP growth numbers still below the 0.5% real rate, an upward revision of such assumptions seems premature.

Secondly, the ECB is expected to move closer to a June cut after this week's meeting. The back end of the yield curve is unlikely to move up in the anticipation of lower short-end rates coming soon. We do expect the term premium to increase in the future, but this is not likely to happen before the first cuts materialise.

Today's events and market views

Overall a light calendar in terms of data releases. In the US we have the aforementioned outcomes from the NFIB survey about small business optimism. The ECB Bank Lending Survey from the first quarter should be of interest as this will provide indications about both the economy's resilience and the pass-through of the restrictive monetary policy.

In terms of supply we have Germany auctioning a 5y bond for €4bn and Austria 5y and 10y bonds worth €2bn. From Belgium we have a syndication of a new 5y benchmark bond which is estimated at up to €8bn. The UK has GBP 2.25bn of 19y Gilts sales lined up and the US an auction of $58bn in new 3y Notes.

Authors

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

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