

Rates Spark: Presumption of resilience

The new quarter started with a rise in yields led by US markets. Still hot inflation, resilient data and a Fed in no rush to ease are bringing a June cut into question – and importantly the overall easing to be delivered this cycle. EUR rates caught on to the bear steepening, but conviction for a June ECB cut remains. Today's flash CPI won't change that



Markets question the Fed June cut and overall easing to be delivered

US yields continued their move up on Tuesday and the 10-year US Treasury yield has now hit 4.36%, a level last seen in 2023. The move upwards started on Monday when European markets were still on their Easter break. Good Friday had shown us a 0.3% PCE deflator – well flagged but still hot – and a Chairman Jerome Powell who signalled a Fed in no rush to cut. Monday then brought a strong manufacturing ISM reading. Before these events markets seemed dedicated to a Fed cut in June, but now that conviction is down to a 60% probability.

Monday had seen yields rise more uniformly across the curve, but Tuesday's price action was

marked by a noticeable bear steepening. One way to interpret this is that speculation about the endpoint of Fed cuts took the foreground. Tuesday's data added to the notion that the economy keeps cruising forward with JOLTS job openings (despite some weakness beyond the headline figure) and factory orders still not conveying a material slowdown. Investors will start to question not only when but also how much the Fed will need to cut.

While there are indications that point to pockets of weakness, official data that the Fed relies on has kept up. But crucially, (core) inflation will have to come down again to the 0.2% month-on-month readings that would give the Fed room to finally cut rates. We still expect this to happen – a June cut is still our base case for now, meaning also lower market rates ahead. In the near term, we don't dismiss UST 10-year yields staying in elevated ranges on the presumption of macro resilience – until proven otherwise. But we have earlier also flagged the broader 4.25-4.50% range as an area where market participants could begin to think about getting long the market more strategically.

EUR rates dragged higher, but conviction for a June ECB cut is unfazed

Eurozone yields had some catching up to do on Tuesday. Also here yields were pushed up starting from the back end, albeit the UST-Bund 10y spread still widened overall by 5bp since last week to 196bp, the widest level year to date. US yields are the clear driver here since the eurozone data does not show the same strength that would argue for a revaluation of long run rates. Spanish and French PMI numbers may have exceeded expectations, but the overall picture for the eurozone remains one of stagnation with only careful signs of a recovery. If anything, German CPI coming in below expectations at 2.3% would have had a dampening effect on yields.

Whether those higher eurozone yields can withstand today's eurozone CPI release will be the next question. Headline inflation is expected to come down to 2.5% and core still a bit sticky at 3.0%. We think the ECB will start cutting in June, at a steady pace, and for a total of three cuts this year. If core comes in below the symbolic 3.0% markets may get excited and price in more than this. However, we don't think the ECB will be in a rush to cut faster given a recession does not seem imminent and rushing could convey a sense of panic.

Today's event and market view

The eurozone flash CPI will be key for EUR rates. While some country indications have surprised with cooler inflation, the consensus is still looking for the headline to fall to 2.5% year-on-year from 2.6% and the core rate to slow to 3% from 3.1%.

The US calendar holds a few nuggets. Today's busy slate of Fed speakers includes Chairman Powell. In data, the focus is on the ISM services which is seen inching higher. With an eye to Friday's official jobs data markets will scrutinise the ISM's employment component. It is expected to rise slightly to 49, thus still in contractionary territory. The ADP payrolls estimate is expected to show 150k jobs added after 140k last month, but its predictive power for the official data remains questionable.

In primary markets, Germany will auction €4.5bn in 10y Bunds.

Authors

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.