

## 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.

## Author

### Michiel Tukker

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

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