Rates Spark: Rates markets unmoved by Lagarde

The ECB opened the possibility of a rate cut, but provided little forward guidance for thereafter. Rates ended close to open, but the non-committal stance is a clear reflection of spill-over from US rate moves. There is a push and pull from both ends here in the eurozone, as the ECB pulls the front end down while back end moves are muted by Treasuries

ECB President Christine Lagarde

ECB has door open for June cut, but thereafter still uncertain

For the first time this cycle the ECB has referenced the possibility of a rate cut in their press statement, paving the way for a rate cut in June. While Lagarde revealed that some council members had been in favour of a cut already at this meeting, the guidance about a June cut took the mildest possible form, hinting at some disagreement within the Governing Council. More important, the statement was reluctant to provide any guidance on the path beyond June.

Still strong domestic price pressures seem to have become the ECB's biggest inflation concern. While Lagarde sought to underscore a decoupling of eurozone inflation dynamics from those in the US, she continued elaborating that anything that matters would find its way through the upcoming projections in June. Our economists pointed out that the US inflation did have a good six-month lead on the broader direction of eurozone inflation developments.

The market is still pricing around 20bp of easing for the June meeting and around 75bp for the year as a whole. The little change in pricing on the back of the meeting suggests that markets didn't glean anything particularly new from the ECB's decisions and communication, but we would think that if anything a non-committal stance has raised the risk of greater spill-over from the US.

That said, this won't change the notion that we could see a policy divergence between the ECB and Fed in coming months, putting further widening pressure on the 10Y UST-Bund spread, which widened to 210bp after the meeting. But the spread widening could be a tad milder than had the ECB signalled more confidence about domestic inflation dynamics and potential easing beyond June.

US market rates remain under upward pressure

The good news out of the US on Thursday was the tame PPI reading. Readings of 0.3%'s and 0.4%'s month-on-month are not acceptable from the Fed's perspective. We need to see falls to 0.2%'s MoM. The PPI report showed that for March. But we need to see that in the CPI and PCE inflation reports ahead.

The bad news is the 30yr auction tailed by 1bp (effectively a concesion versus the secondary market, albeit in a moving market). It was not as bad as the 3bp tail seen on the 10yr auction. But it still shows that market yields have an underlying bias to test higher.

Even the rate cut talk out of the eurozone was not enough to really shake the bearish tilt to Treasuries. The only thing holding Treasuries together here is the speed of the up move in yields in recent days. Typically there is a period of pull back before a procession higher in yields occurs, and we are overdue that. Room for that between now and the PCE deflator report on 26 April.

Friday's events and market view

The UK will publish industrial production, manufacturing production and the index of services, together with the monthly GDP estimate for February, but these monthly readings tend to be quite noisy. From the eurozone we have a number of final CPI inflation numbers for March from Germany, France and Italy, but these usually don't change much from the preliminary figures released earlier and thus are unlikely to have a noticable market impact. Of more interest will be the ECB Survey of Professional Forecasters. US events includes data for import prices and the Michigan sentiment measures and a few Fed speakers.

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