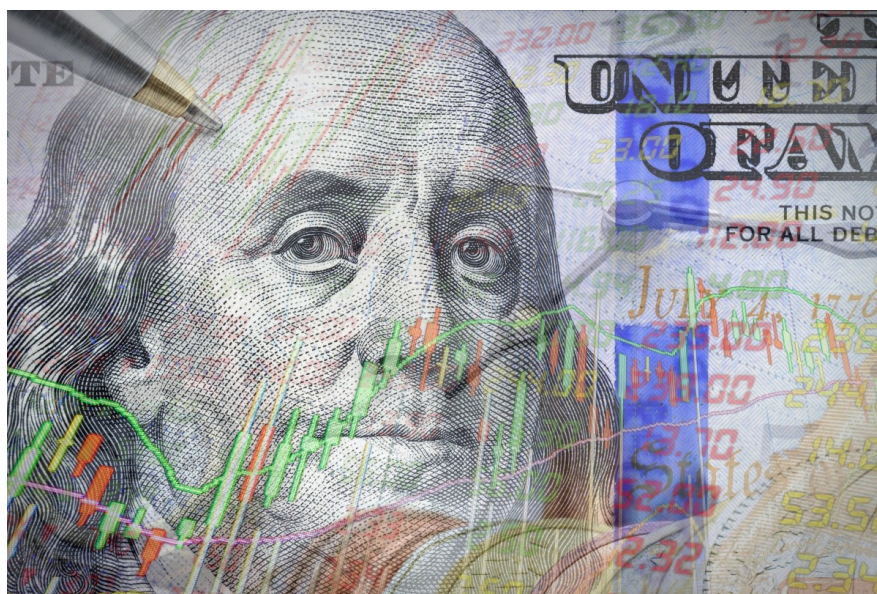


Rates Spark: We still like the fade here

For players that are over-fixed, or feel they've missed the boat on receiving higher rates, consider some swap to floating strategies between here and 4.5% on the 10yr Treasury yield (or approximately 4.25% on 10yr SOFR). Fade the upside to yields ahead, or just average in from here with fixed rate receivers



US 10yr tamed on touching 4.33%, but not a clear-cut buy just yet

The initial reaction to the 0.4% US core consumer price inflation surprise for January was spot on. The 10yr Treasury yield gapped away from 4.15%, to north of 4.25%. It's tamed a tad since, having tapped out on kissing 4.33% (a key technical level). It may well be that that is the top for this week, as Thursday likely sees a tame theme from retail sales and industrial production, and then we're into a Friday that will feature sub-2% producer price inflation and confirmation of sub-3% inflation expectations.

The question for subsequent days and the coming week is whether the trend lower in yields has legs beyond the pullback from the highs hit at 4.33%. To rationalise that, there would need to be a re-build in the rate-cut expectation narrative. So far in 2024, that rate cut narrative has been battered by a selection of events. These include, more recently, a 353k non-far payrolls outcome,

the afore-mentioned 0.4% month-on-month on core inflation, and things like the nudge up on consumer confidence see a few weeks back. And a big issuance remainder, one that may have topped, but remains heavy for the foreseeable.

These have not gone away. They have been interlaced by survey evidence pointing to pockets of weakness, and we do believe there is a material slowdown brewing, but the big hitting data is still not where it needs to be to make an imminent rate cut a no brainer. Even though it was fully priced for March, it was never a no-brainer. And as that got priced out, market yields re-traced higher.

This process can't continue in a relentless fashion, as enough pricing out of cuts has likely taken place already. But at the same time, there needs to be a catalyst in the other direction, where market rates can not just nudge lower, but gap lower. That requires a reversal of the items mentioned here. So, say, from the likes of the next CPI report (a month away) or the next payrolls report (3 weeks away). In the meantime, the issuance pressure won't slow. So, the bond bulls do need something to happen.

We continue to advocate using the space between 4.25% and 4.5% on the 10yr Treasury yield as an opportunity to fade in some longs. We've been tactically short since the beginning of the year till we hit the highs on Tuesday. We remain of the view that there is still a residual resilient upside left for market rates.

We're threading the needle here though, as we do expect to see rate cuts by the summer. So, fade the upside to yields ahead, or just average in from here with receivers.

Thursday's events and market view

Again a busy data release calendar for the UK. We will have a range of growth indicators, including the preliminary GDP estimate for fourth quarter 2023. Then from the ECB we have a well filled speakers agenda including Lagarde, Lane and Nagel. In the US, retail sales figures, together with jobless claims and industrial production will show us whether the growth momentum can continue.

Auctions by Spain will total EUR6bn (3y, 5y and 9y SPGB maturities). France will auction 3y, 5y and 7y OATs for a total of EUR12bn, in addition to EUR2.5bn of OATei.

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