

Rates Spark: Recovery of market sentiment helps yields nudge up

An improvement in market sentiment stemmed the equity sell-off and helped yields stabilise or nudge higher. Bund yields are likely to remain trading at lower ranges as eurozone recession risk is in the back of the mind of investors. US CPI numbers next week will be the next key data point to decide on the direction for rates



Bund yields stabilising at lower ranges

Market sentiment improved on Tuesday, with first Asian equities retracing some of the losses and later US Treasury yields opening higher than the day before. For Bunds, the 10Y yield traded flat on the day but at 2.2% is close to the level from before the US nonfarm payrolls last Friday. Curves also flattened, with the 2s10s Bund spread now around -20bp again.

Bund yields are likely to continue trading in lower ranges as European Central Bank and Federal Reserve rate cuts are incoming. In the eurozone, the markets' assessment of recession risk will probably stay elevated as the incoming data does not show a marked improvement. Eurozone [retail sales](#) for instance came in at -0.3% year-on-year on Tuesday and thus a strong consumption-driven growth revival looks remote. Add a deterioration in risk sentiment and the

triggers for higher yields are difficult to see at this moment.

US CPI next week key to direction of bonds from here

After a disappointing [jobs report](#), the next important US data we'll be eyeing are the CPI figures next week. Early consensus numbers suggest a 0.2% month-on-month for both headline and core readings, which would help the Fed to push through cuts to support the economy. Nevertheless, the YoY core CPI is expected to come in at 3.2%, which is still hot at face value. A gradual slowdown of the economy instead of a steep decline would not warrant accelerated cuts and could give some pushback on the short end of the curve where 100bp of cuts in 2024 are currently priced in.

The UST 10y yield is now close to 3.9%, which is consistent with a scenario whereby recession risk is mounting and the Fed is ready to cut, but looking over a longer horizon we think yields will eventually settle higher. History shows that a 10Y equilibrium yield of 4.5% or even higher is not far-fetched and going forward there are plenty of reasons to believe US inflation will average above 2%. The 10Y inflation swap is currently priced at 2.4%, which leaves the real rate at only around 1.5%. Such long-term dynamics will not dominate in the near term but are nevertheless important to keep in mind while markets are seeking new equilibria.

Today's events and market views

A data-light day. Germany has [published industrial production](#) numbers for June. From the US, the latest MBA mortgage applications will be the most notable release.

From the UK, we have a £4bn auction of 5Y Gilts. Germany will auction 14Y and 17Y Bunds, totalling €2bn. The US will auction \$42bn of new 10-year notes.

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