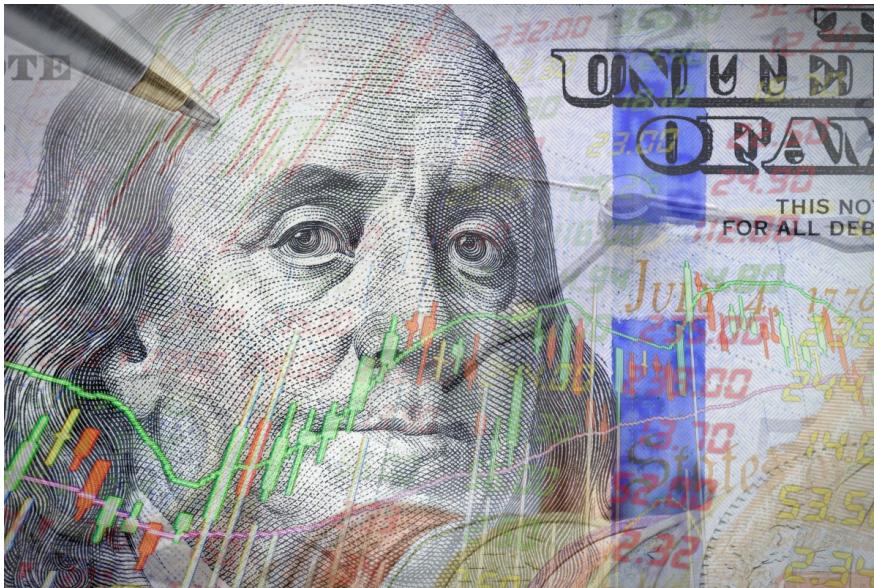


Rates Spark: Starting the week with pushback

The dovish momentum of last week is starting to see some pushback. Supply and a likely still too hot core-PCE reading looming on Friday can justify it. But they were well flagged and the consensus for the PCE sits relatively firm. It is likely that market conditions ahead of Easter and a long month-end are behind some of the market movement



US directional update post the FOMC and pre the next batches of inflation

The 20 March FOMC outcome allowed the market to worry less on the January and February inflation readings that had been a tad too hot for comfort. They tended to cluster in the 0.3% month-on-month to 0.4% MoM area, which annualise to the region of 5%. But Chair Powell's assertion that they are likely one-offs calmed nerves. In that respect the CPI number for March due on 10th April will be really important, and if that is also in the 0.3% MoM area or higher it could generate doubt that these data are a one-off. Upcoming data ahead of that is unlikely to be immediately conducive for the build for a material rate cut discount, as labour market and other

inflation data is liable to be still a tad hot.

Because of this, the directional view is for market rates to drift higher in the coming few weeks. The 10yr Treasury yield managed to drift down to below 4.2% post the FOMC meeting, but is now back in the 4.25% area, and could well trend in the direction of 4.5%. The 5yr and the 7yr yields are in similar territory around 4.25% currently, and should see similar moves to the 10yr.

The curve is very directional, meaning that the front end is more anchored for now and waiting for the Fed to give a clearer nod for an imminent cut, so the changes in the shape of the curve are coming from longer maturities, starting with the 5yr, which as noted is not far off the 10yr levels. Currently the market is discounting a 25bp cut from the Fed at the 12th June meeting with about an 80% probability. If we were to get a 0.2% MoM (or lower) reading from the 10th April CPI report, that discount would harden. And if so, the 10yr yield should peak out (at between 4.25% to 4.5%). If the market really begins to position for an actual cut, market rates should fall as the bond market gets excited about imminent rate cuts. The 5yr, 7yr and 10yr rates should all be primed to break below 4%, and can commence a path towards 3.5% through the summer.

However, our view is that a move towards 3.5% for medium-to-longer tenor market rates would be an overshoot to the downside. We say that as we doubt the Fed can get the funds rate below 3%. And if so, longer tenor rates should not be getting down to that level either, and moreover should trade with a decent term premium, of about 100bp. That pitches fair value for the 10yr at a handle of 4% (not far off where we are now).

The dovish momentum of last week sees pushback

The week kicked off with rates nudging higher again. One could cite several factors to justify that bearish undertone. A likely hot US core CPI release looms large on Friday. This time around the consensus looks pretty firm around 0.3% for the month-on-month figure, so markets should have largely discounted this already. Supply is the other factor in US Treasuries this week. While shorter duration, the 2Y auction did come with mixed results – tailing half a basis point but with a high indirect bid.

EUR rates have their own flash CPI release for the bloc to look forward to next. This time country flash readings out of Portugal, Spain and France starting already Wednesday to firm up initial estimates. Perhaps the outlook for another round of relatively high month-on-month readings is reason enough for markets to pare back some of their hike expectations. On the other hand, Chief Economist Lane – known to be a dove – flagged good progress on inflation and also expressed confidence that the crucial wage normalisation process was on track.

Looking at the market discount for expected ECB easing over 2024, we see that this has been pared back to somewhat less than 88bp. But this discount has been oscillating around an average of roughly 90bp since mid-March. By itself Monday's move looks more like noise than signal, though if we look at the broader curve we did observe the 2s10s Bund extending last Friday's bullish flattening now in a bearish fashion at the start of this week – also contrasting with the steepening observed in the US on Monday.

Overall the market moves at the start of this week appeared to be a push back against last week's dovishness. But it was a start with little data and also only shorter duration supply to work off. In fact, we had initially suspected that some of last week's dovish momentum could be retained, at least early this week. Tuesday should get busier on the US data front and supply gets a little

longer. Yet with the pre-Easter trading conditions likely somewhat subdued already and an extended month-end looming, we are wary not to draw quick conclusions from one day market moves, even if they fit our still near-term bearish bias especially for US Treasuries.

Tuesday's events and market view

There are not noteworthy data releases scheduled in the eurozone. From the ECB only Estonia's Muller, usually a moderate hawk, is scheduled to speak.

The US data calendar looks more interesting with durable goods orders, the Conference Board consumer confidence index and house price data up for release.

In primary markets the Netherlands taps a 5y bond for up to €2bn, Germany taps two of its green bonds for €2bn. The UK sees a 5Y gilt auction for £3bn while in the US the Treasury will auction US\$67bn in a new 5Y note, which follows on the heels of Monday's somewhat mixed 2Y auction results.

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