

## Rates Spark: Still a near-term holding pattern

Market rates still test lower with curves flattening. It's not a conviction move yet ahead of Friday's key US jobs data, rather a reaction to an aggregate of global headlines also surrounding US regional banks. Powell reiterated the Fed needs more evidence to justify cuts. The ECB may pave the way for a cut in June, but ultimately it's also a holding pattern



### Yields are testing lower, but it is no conviction move yet

10Y Bund yields started Wednesday testing higher but were later dragged lower by developments in the UK and US. Notable was another tightening in eurozone periphery bond spreads, which has taken the key spread of 10Y Italian sovereign bonds over Germany towards 130bp.

Gilts outperformed as UK Chancellor Hunt's budget statement was largely in line with the prior day's newspaper reports and contained no big surprises such as larger tax cuts. Gilt issuance plans for 2024/25 came in at £265bn, up from £237bn for 2023/24 but only slightly above primary dealer expectations.

In the US, fears of a somewhat more hawkish Fed tone were alleviated. [Fed Chairman Powell provided a similar message to other Fed officials](#): they are inclined to cut rates later this year but need more evidence to justify that action. Corroborating that view, the Fed's Beige Book, which was published later in the day, pointed to economic activity having increased slightly on balance and to persisting price pressures, though with some degree of moderation.

More volatility came from headlines surrounding New York Community Bankcorp, which saw its share price drop on news that it was exploring a possible equity sale. The 10Y US Treasury yield briefly dipped below 4.09%. While wider risk sentiment still looks robust, the reaction in Treasuries highlights heightened sensitivities to any signs of stress - or downward data surprises as seen in recent days.

## ECB on hold, but could start paving the way for a first cut in June

There are no expectations that the ECB will change policy today. This is a bit stating the obvious, but recall late last year, markets were seeing a 75% chance for a cut already this month. With no change in policy, the focus is on the ECB's communication, which our economists think could pave the way for a first cut in June. The [key things our economists are watching](#) are:

- **New staff forecasts:** The last forecast was relatively optimistic about growth and saw inflation returning to 2% by the third quarter of 2025. Any downward revision to the growth profile and any signs that inflation could reach 2% sooner would open the door to earlier rate cuts.
- **Changes to communication:** The meeting could mark another cautious and gradual shift in its inflation assessment, opening the door to rate cuts in June. This could come via hints at a readiness to discuss future cuts. But the ECB could also adjust its risk assessment to both the inflation and growth forecasts. A "balanced" risk assessment to the inflation outlook would be a strong signal in favour of rate cuts. Lastly, further clarification of the central bank's reaction function, e.g., which piece of data the ECB wants to see before deciding on rate cuts, could also help firm up market expectations.

The market has taken a more cautious stance towards expected easing from the ECB. In early February, the market had fully discounted two cuts by June. Now, it is not even fully discounting a first cut in June – although with 22bp priced, it still remains the base case. With 90bp of easing priced for the year as a whole, the market is now not too far from what our economists are expecting from the ECB – a first cut in June with 75bp of easing delivered in total this year.

If our economists are right, today's meeting could be seen as mildly dovish against the backdrop of the more cautious market pricing. A modest re-flattening of the money market curve could be in store as an impact reaction as conviction for the eventual start of the cutting cycle grows again.

### Today's events and market view

The ECB meeting is clearly today's key event. It could have a mildly dovish outcome when benchmarked against market pricing that has become much less aggressive. In the end, though, it would still mean another central bank holding rates in the next few months for lack of conviction that inflation has been tackled for good.

Volatility from US data is still to be expected, though with the official jobs report looming on

Friday, markets may refrain from conviction moves in either direction for now. To watch are the US challenger job cuts numbers and the initial jobless claims. We will also get the trade balance as well as the second day of Chairman Powell's testimony to Congress.

Primary markets will get busier today again with long-end auctions from France for up to €13bn and Spanish auctions in the 5Y, 7Y, and 10Y segments, as well as inflation-linked bonds for a total of up to €7.25bn.

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