

Rates Spark: Powell pivot makes 5% more probable on the 10yr

Now Chair Powell has caved. Surprising in fact that we've not had a bigger reaction. But we think that's coming, or at least part of a process that will ultimately see the 10yr back in the 5% area



The US 10yr has 5% written all over it

With Chair Powell conceding that the inflation data has not been great, it's a tad surprising that there was not a bigger hit to the rate cut discount. As it is there is a 25bp cut practically discounted for September still, and indeed a lot can happen between now and then to validate a cut by then. But given what we have seen so far from the inflation data, the market would be excused had it decided to downsize the discount for a September cut in a more dramatic fashion.

The 10yr, now in the 4.65% area, has a trend back to the 5% area written all over it. It's where the 2yr already is, reflecting a downgrade of the longer-term rate cut discount too. The funds strip now has the funds rate bottoming in the 4% area, in fact in the 4% to 4.25% area. That's the new implied floor in terms of market discount, and the rest of the curve gets built on top of that. Contextualized against that, the 10yr yield in the 4.65% area and likely heading to 5% is not out of sync.

The route to 5% consists of two components. First is the downsizing of rate cut expectations.

Second is the re-build of a term premium. Remember, the implied term premium in the 10yr yield was some 40bp back in October 2023 when the 10yr yield hit 5%. It's now at around zero. So it comfortably has the capacity to make a 40bp move to the upside. And that's what we think will happen.

See more [here](#) on our call for 5% some weeks back.

How long can the EUR front end withstand the geopolitical and US factors?

As EUR rates get pressured higher from the back end, front-end pricing continues to remain relatively firm. The June discount is at 22bp and markets still price 78bp of easing for the year as a whole while down from discounting around 90bp from late March, it is no sea change with three cuts still very much the base line.

Tuesday yielded numerous comments from ECB speakers including Lagarde herself. While they all pointed to a cut in June, they appeared more reserved. ECB's Rehn singled out geopolitics as the greatest risk to a June cut. Lagarde also pointed out the ECB was monitoring oil prices closely, though there could also be the impact on confidence from geopolitical risks making the overall impact less clear.

The other factor of course are the US dynamics. Independence from the Fed was reiterated, but at the same time Lagarde pointed out the obvious, i.e. that US developments will find their way into the ECB projections and that FX rate changes would have to be closely monitored.

There should be some increasing upside risk to the front-end pricing around the anticipated pace of upcoming ECB cuts move up as well. While this could offset some of the steepening of the broader curve we have seen of late, the pull factor from US rates on the long end could still prevail.

Wednesday's events and market view

In terms of data as key drivers it will be more quiet at least in the US and EUR space. The UK will see the releases of key CPI data for March in the morning after Tuesday's wage data already yielded a hawkish surprise. In EUR we will be watching the final eurozone CPI for March amid more comments from ECB members such as Isabel Schnabel and again President Lagarde. The US see the release of mortgage applications data and from the Fed we will be getting the Beige Book and remarks from Loretta Mester.

In primary markets Germany will reopen a 25Y and 30Y bond for €1bn each. The UK sells £3.75bn in 7Y gilts. Main supply event to look forward to will be the US Treasury's US\$13bn 20Y bond reopening after last week saw the 10Y and 30Y auctions already tailing.

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