Rates Spark: The dust settles, angst remains

As the tariff-induced chaos subsides, market participants remain alarmed by the dynamics they witnessed. US Treasuries are recovering for now, but they remain tainted by inflation and deficit pressures, painting a sinister backdrop

As the dust settles around USTs, market participants are still alarmed

The volatility in global rates markets seems to have eased somewhat, but the tension in US Treasury bonds can still be felt. So far, nothing in the financial plumbing of markets seems to have broken, which is a sign of resilience after the recent sharp moves. What helps is that the current 10Y UST yield of 4.3% is well within the trading range of the past few years. Remember that the 10Y touched 5% in 2023. Earlier that year, SVB Bank collapsed due to losses in its bond portfolio. Now, financial institutions have got used to the new yield levels for a prolonged period.

Whilst leveraged players in the bond market may have suffered from the sharp swings in USTs, no lasting damage has emerged. The most recently available data on futures positioning did not suggest that the basis trade using USTs was unwinding to a greater degree. The higher volatility in

UST swap spreads suggests that a popular trade has suffered here.

Still spooked by recent dynamics, US government officials are trying to appease Treasury markets. The question is whether markets are susceptible to this type of rhetoric against the current risk sentiment with larger macro factors such as inflation and deficit pressures in the backdrop. After Treasury Secretary Scott Bessent assured markets on Monday about the Treasury's ability to intervene in the UST market if needed, Deputy Treasury Secretary Michael Faulkender mentioned ongoing discussions about the Supplementary Leverage Ratio on Tuesday. Before the tariff announcements, USTs were sensitive to such remarks as these regulatory changes were expected to materially ease dealer intermediation costs in the UST market, if not boost demand itself. By now 10y USTs are back to yielding 50bp above SOFR OIS; amid the recent turmoil, this spread went above 60bp. However, before that, the hopes of regulatory change had already helped push it below 40bp.

When diving into the market plumbing of the eurozone, few signs of stress are visible. The spread on riskier eurozone government bonds such as Italian BTPs are slightly elevated compared to pre-liberation day but still below January's levels. A recent rating upgrade of Italy has certainly helped. The yield on the 10Y Bund at 2.5% is in the middle of the trading range from the past year. The stability of euro markets compared to the US may make it an attractive safe haven to hedge against global uncertainty. As such, we think that Bunds could see healthy demand from global investors in preparation for future turmoil. The latest Bloomberg headlines suggest that EU trade negotiations were making only "scant progress".

Wednesday's events and market view

The main data focus today is on the US. March retail sales numbers should be very strong as consumers anecdotally went out and made major purchases ahead of the imposition of tariffs. Auto volumes jumped 10.6% month-on-month based on Wards data while credit card spending figures also suggest firm demand for appliances and electronics.

With regards to industrial production, this is also closely watched. But business surveys suggest the lack of clarity on the trading environment due to tariffs and fears of potential foreign reprisals and potential consumer boycotts of US exports is causing nervousness. Closely watched will be the speech by Fed Chair Jerome Powell later in the day.

The eurozone will release the final CPI data for March ahead of Thursday's European Central Bank meeting.

On the heels of a rating upgrade at the end of last week, Italy has mandated banks for the sale of a new 7y bond and a new 30y inflation-linked bond. Germany auctions two 30y Bund lines for €2.5bn.

Outside the eurozone, the UK sells 3y gilts (£1.5bn). The main focus later in the day is on the US Treasury which auctions US$13bn in 20y bonds with metrics again eyed closely for any hints of waning demand from foreign investors.

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