

Rates Spark: The game of tariff poker dominates

Tariffs have forced yields lower on risk angst. But tariffs are a double-edged sword. This thing could easily swing in the other direction quickly. The complex also keeps ECB pricing more anchored. But further out, the EU's spending rethink is still playing out and steepening the curve despite German plans hitting stumbling blocks



Deep tariff angst – where now for US rates?

Treasuries don't know what to do with themselves here. Additional tariffs on Canadian imports, and more threatened from 2 April, act to intensify the war of words between the two. It's also an illustration of what's to come elsewhere, including Europe a.o. Treasuries see the price rise / inflation threat front and centre. But they also see the threat to economic activity, and the doubling down aspect that threatens more wobbles in risk asset space. Given that, the net impact reaction should be lower yields. The 10yr has an excuse to head towards 4%.

Beyond the flight to safety, there will be a subsequent negative kickback for Treasuries, as higher prices erode the value of fixed rate coupons, whether the Fed cuts or not. And America PLC risks a negative tarnish, one that's already being seen through the prism of a basis discount on the USD XCCY vs EUR, and a widening 10yr swap spread (Treasuries cheapening to the risk free rate). These aren't big moves, but are a metaphor for trouble.

Right now, the knee-jerk should be bullish for Treasuries. But you can see how this could also flip the other way. Timing on the latter bit is not easy. Far easier to stick with Treasuries as a safe haven, at least for as long as that tag is applicable. See more [here](#) on this whole issue.

EUR curves continue to steepen as near-term uncertainty keeps ECB pricing anchored

The markets' cautious pricing of the European Central Bank is validated by Trump's latest hawkish tariffs comments on Canada. EUR markets are pondering what Trump will have in store for the European Union. EUR long-end rates, however, remain under upward pressure with the 10y Bund yield closing in on 2.9% even as the German fiscal plans are currently subject to heated negotiations amid a tight schedule.

While the tariffs story helps to keep risk assets on the back foot, eurozone sovereign bond spreads over Bunds tightened more noticeably again despite the prospect of significantly higher defence spending requirements ahead and already higher borrowing costs.

There are joint EU efforts in the making, but more concrete plans so far only foresee a €150bn EU instrument for defence-related loans to individual countries. There may be some hope that a still broader effort will emerge as the changing geopolitical landscape has instilled a new sense of unity and urgency.

While we think the market is too optimistic, the overall timelines involved in the rearming effort and especially a quick ramp-up in German defence spending could give fiscally more restrained countries time to reprioritise towards defence spending targets more gradually without stretching their budgets to more worrisome extents. Eventually, the hope is that there will also be an economic confidence boost and a more growth positive impact over time (especially when also incorporating some spill-over effects from the German infrastructure investment plans). Finally, the ECB itself could also be seen as never-a-step-too-far from ending quantitative tightening or even buying bonds again should stress emerge.

Wednesday's events and market view

Main data highlight is the US CPI release in which the market is looking for a 0.3% month-on-month core reading. While easing back from 0.4% last month, that level would still be too hot and keep at least the front end from pricing a much more aggressive Fed in the near term.

EUR markets will be listening to ECB speakers as the Watchers' conference kicks off in Frankfurt. Speakers include President Lagarde and Chief Economist Lane. The ECB will also release its forward-looking wage indicator after Lagarde pointed at "continued moderation in labour cost pressures" at the latest press conference.

In primary markets Germany auctions 10y Bunds (€4.5bn). In the same tenor, the UK sells 10y gilts (£4bn) and the US 10y notes (US\$39bn).

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