

Rates Spark: The tariff on/off switch

Deals on no US tariffs for Mexico and Canada helped mark Monday as a positive step away from the brink, at least for another month. Treasuries have been all over the place, but going nowhere fast. Refunding and Payrolls next. We see euro rates continuing to be sensitive to growth risks and especially the front end may find itself even lower in the near term



Tariff story trumping payrolls as a driver so far this week

Market rates continue to get pushed and pulled by the Trump tariff on/off switch. The peso is now back to where it was post the off switch on Mexico. Treasuries in the big scheme of things have not had huge reactions to the news flow. It's more been a story of a pull pressure from lower eurozone rates. And now that's unwound a tad. Hard to get a clear steer here of what's driving what. But there is still a short-term feeling that this still does not end well, even as the latest news on Mexico is certainly glass half full (no tariffs for now). And the same for Canada. Both have managed to extend the tariff drama for another month.

So far the market is confirming that deals done to help avoid tariffs are good for risk exposure and growth. And that is resulting in downward pressure on the US dollar and upward pressure on US

Treasury yields. The reverse obtains when tariff threats are deemed a real and present danger. But don't assume that these simple correlations will hold as a constant. Markets are treating the pushes and pulls on the tariff story as best they can, but actual outcomes can result in very different outcomes. As it is we are basically back to square one, and awaiting the next moves from the Trump administration. It's payrolls week though, so that should garner more attention as we get closer to it (Friday).

Long list of eurozone growth concerns

The question of US tariffs on the eurozone does not have an answer as of yet. While the implications for the eurozone economy remain difficult to foresee, markets are simply adding tariff threats to the already long list of downside risks to growth. The upside risks are more difficult to see and thus we maintain the view that markets may well move to pricing a European Central Bank landing zone closer to 1.5% in the near term.

Whereas inflation risks made a bit of a comeback in early January, the upside surprise of the eurozone core CPI reading did little to change markets' course. We are clearly back in a market regime where growth concerns have taken the forefront and the ECB last week did not give any pushback to that sentiment either. At least for this week, growth concerns on the back of Trump's policies will continue to drive markets and we can therefore expect more volatility. The last-minute postponement of Mexican tariffs, for instance, highlighted how fast things can change; the Mexican peso recovered its losses almost instantly.

Besides increased ECB easing expectations pushing down the front end, the tariffs threats also pushed down interest rates on the back end of the curve. The broader hit to sentiment triggered lower euro equities, whilst gold prices benefitted from safe-haven flows. Within European sovereign bond space Bunds outperformed across the board versus its peers – at least initially.

Political developments in play in France directed initial safe-haven flows more towards German Bunds. PM Bayrou pushed through the new government's budget using a constitutional emergency measure – one that had triggered the fall of the prior government, only this time around the Socialist party declared that it would not support a no-confidence motion that could be voted on.

Tuesday's events and market views

From the US we will have JOLTS numbers, which will be watched given payroll numbers will be released later this week. Other data includes factory and durable goods orders. The Fed's Daly and Jefferson are scheduled to speak including Q&A sessions, and thus they will likely be asked for the latest views on tariffs.

Austria is scheduled to auction 6Y and 14Y RAGBs for a total of €1.7bn. From the UK we have £4.25bn of 5Y Gilts on the calendar.

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