

Rates Spark: Trump assassination attempt contributes to steeper curves

The UST curve steepened on the back of Trump's assassination attempt, which was deemed likely to increase his chances of a win. The rate-cutting narrative for the European Central Bank has been building less than for the Fed, leading to the tightest 2Y USD-EUR spread since January



Donald Trump's first appearance since his assassination attempt last week

Trump another cause for steeper curves

Markets see an increased chance of a Trump presidency after last weekend's assassination attempt. Again, the move was most pronounced on the back end of the UST curve, whereby the 30Y point led the increase by around 5bp. The front end came down a bit, twisting the curve, and now prices in around 60bp of Federal Reserve cuts for this year.

The steepening of the UST curve should also be seen in the wider context of incoming Fed cuts. With inflation numbers lining up for a September cut, the front end will find itself coming down. Past cutting cycles also show that the term risk premium should start building again, which is still considered close to zero. Add concerns about the US deficit and all the ingredients for steeper curves come together.

Direction for EUR rates less obvious

The spillovers from a Trump presidency to EUR rates are more muddled. On the one hand, the rise in UST yields tends to have an upward effect elsewhere. On the other hand, a protectionist agenda could depress the eurozone growth outlook. Having said that, EUR rates are still more driven by short-term Fed policy than the political outlook.

Eurozone rates have been helped down by the recent improvement of US inflation data and the rebuilding of the Fed cutting narrative. At the same time, the backdrop for ECB cuts is not as clear-cut. Earlier this month, Chief Economist Philip Lane underlined sticky services inflation as a concern and the ECB has been very careful not to commit to a future date. This all means that EUR rates are lagging behind the US, and the 2Y USD-EUR OIS spread is now at its tightest level since January.

The uncertainty from political events adds to the difficulty in giving direction to EUR rate markets. In France, the presidency of the National Assembly is up for decision this Thursday, which will be of political significance about a possible prime minister and government coalition. Internal disagreements within the left-wing coalition National Front Populaire about the presidency highlight the almost impossible puzzle that France needs to solve.

Today's events and market views

Today's ECB bank lending survey will shed some light on how rate hikes are still impacting the economy. Absent of bigger deviations from recent trends that point to a modest recovery, this release is unlikely to move the needle on coming ECB rate cuts. Germany will release the ZEW survey which is anticipated to weaken.

The main release in the US is retail sales figures, which should provide more insight into the consumers' ability to bolster growth. The headline figure is expected to contract, while the control group is expected to eke out 0.2% month-on-month growth. Import prices are seen falling 0.2% month-on-month; welcome news as some import price components enter the core PCE measure. Federal Reserve Governor Adriana Kugler will speak later tonight. Monday's appearance by Fed Chair Jerome Powell yielded no new insights for markets.

In primary markets, Germany will sell a new 5Y bond for €4bn while the UK sells £2.25bn in 20Y gilts.

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