Rates Spark: Unchanged 2024 Fed dot, BoE to sit tight

The UST curve bull steepened as fears of a higher 2024 median Fed projection did not materialise, even if longer dots nudged higher. Yields are likely to stay flat to higher near term if core PCE stays too hot. The BoE should sit tight today, with more focus on the voting split rather than a likely unchanged forward guidance

Treasury curve bull steepens as 2024 dots don't change, but the longer dots nudge up

As predicted the FOMC stuck to its narrative and wants to see more data before cutting rates. More importantly, the 2024 dot plot stayed the same, but the median for 2025 included one less cut and the long run forecast was nudged up by 10bp to 2.6%.

The market reaction was a notable 7bp bull steepening of the 2s10s Treasury curve as the 2Y rallied. The 10Y yield settled only a little lower around 4.27% while 30Y yields rose slightly. The market's implied probability for a June cut rose toward 80% with 21bp discounted versus as little as 15bp at the start of the week. The discount for the year deepened back to over 80bp.

Now the focus point for rates will be next week's core PCE deflator, which will be a key input for the Fed's policy going forward. Last night's FOMC satisfied markets by not moving up this year's dots, yet a consensus core PCE of 0.3% month-on-month is still too hot and thus a lot less appealing to bond markets in our view. If these inflation figures indeed materialise, we see risks that yields stay flat to slightly higher in the near term.

BoE to sight tight today, but more convergence with peers further down the road

Inflation data ahead of today's Bank of England meeting has moved in the right direction with the closely watched services component being very much in line with the BoE's own projections at 6.1% year-on-year for February with the projection being for a further decline to 5% by early summer. On the back of this our economist expects the BoE to sit tight today, with the key things to watch:

- **Rates will remain on hold:** Practically nothing is discounted for today, but the voting split could be more revealing of any shifting sentiment in the 9-member policy setting committee. Our economist looks for a 1-7-1 (hike/hold/cut) vote split after a 2-6-1 in February after data showing both wage growth and services CPI falling since then.
- **Forward guidance should not change:** The BoE had removed the "hiking bias" the last time, but is unlikely to open the door any further this time around. The BoE is likely to reiterate that policy will "remain restrictive for sufficiently long" and for "an extended period".

Market pricing has nudged towards slightly higher rate cut probabilities after the latest CPI release with the probability for a June cut moving slightly above 50%. For August a cut is then more than fully discounted with the market looking for 70bp of easing over this year. This is up from just 60bp around the start of this month, but still well behind what our economist expects for this year. And it is also noticeably less easing as discounted for peers like the European Central Bank.

This argues for more tightening in spreads such as Gilts over Bunds on a more structural basis as inflation outlooks and macro backdrops converge – 10y Gilt over Bunds for example should converge towards 135bp later this year in our view. What we find, though, is that the premium above our 10Y Gilt FV value model incorporating also UST and Bund peers has largely diminished, coming from double digits at the start of this month.

Today's events and market view

The BoE meeting may generate some volatility, especially for Bunds. In the broader picture the other data today is likely to be more relevant for markets. Key in the eurozone are the flash PMIs that are anticipated to show a further bottoming out of the economy. The focus here is probably more on the perceived price pressure in the services sector, which continues to be a concern for the ECB.

We will also get the PMIs for the US, though they tend to have less of an impact than their ISM peers unless they show a larger shift – the outlook for today is a subtle softening. Under more scrutiny are the initial jobless claims, which so far still point to a robust, albeit cooling jobs market.

In primary markets the focus is on French, Spanish and Irish bond auctions. France sells shorter dated bonds and linkers for up to €14.5bn in total, Spain sells 2Y to 20Y bonds for up to €6.5bn and Ireland sells 10Y and 20Y bonds for €1bn. The US Treasury sells US$16bn of 10Y TIPS.

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