

## Rates Spark: A good place for rates and sentiment

EUR rates and risk sentiment find themselves back in a good place, mirroring the ECB's stance since June. Lingering risks around the outlook instil an easing bias in the near term, adding to arguments for curves to still steepen from here



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### Steady EUR rates and market sentiment with ECB in a good place, but risks of more easing likely understated

EUR rates are staying true to their ranges, even if testing out the upper regions of late, with the 10y swap rate just above 2.7%. Away from the ultra-long end, which had resumed its steepening at the start of this month, the curve also remains more range-bound. In fact, 2s10s is bang on the post-'Liberation Day' average.

Risk perception of broader markets has also returned to a more benign setting, with equities having recouped some of their recent losses. In rates markets, the implied volatilities have edged lower again, which in turn has helped bond spreads to re-tighten. Over the past few days, 10y Italian government bonds have marked their lowest spreads over Bunds since 2010. Even French bonds are seeing their tightest spreads since late August, when political turmoil began to first hit

the market.

Markets could be interpreted as a reflection of the ECB's wait-and-see mode. The ECB minutes of the October meeting just reaffirmed that the central bank sees itself in a “good place”. On closer inspection, the ECB still holds a slight easing bias, and expectations of a gradual recovery are still surrounded by risks and uncertainties, such as around trade or the implementation of government stimulus and investment plans. Our economists also highlight the potential downward impact on inflation projections of the EU's plans to delay the next phase of the emissions trading system.

On the back of this, we also think that short-end rates should move back to incorporate higher chances of more ECB easing in their pricing. For now, the market is looking at around a one-in-three chance of one more ECB cut over the course of next year. For the broader curve, that means a bias to re-steepen in our view. That also remains our longer-run view, if the picture of a gradual recovery is confirmed and longer rates gradually move higher to test above the top of current ranges.

## Friday's events and market view

The US is still off, which should again make for quieter markets. Out of the eurozone, we will get the first country indications for the November CPI, with France, Spain, Italy and Germany reporting their preliminary figures. Overall, eurozone inflation is expected to stay little changed, with the consensus looking for a 2.1% YoY reading next week. Separately, the ECB will also release the results of its consumer survey on longer-run inflation expectations today, where the 1y horizon figure is anticipated to ease lower towards 2.6%.

No issuance is scheduled for today. In terms of scheduled rating reviews, S&P still has France on its calendar, but since it downgraded the rating to A+/Stable just last month, it is likely this data will be skipped.

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