

Rates Spark: Bumpy! But back to where we started

In the Eurozone, ECB's Schnabel sees money market rates rising as system reserves decline, with banks then turning to the ECB for liquidity. It is part of the plan and could happen in mid-2026, but is more likely to happen later. Meanwhile, US Treasuries are being buffeted by contrasting impulses. It's been quite a week, but we broadly end where we started



Treasuries whip-saw on contrasting reads on the economy on consecutive days

On Thursday morning, the Challenger job cuts data showed a spike to 175k (lay-offs) for October. We've been here before. We had 200k in lay-offs in March this year. And lay-offs in the area of 200k-400k for many months at the end of 2022 and through much of 2023. That was a period when there were numerous calls that the US risked tipping into recession. We didn't, partly because those who were laid off found jobs. The question now is whether we can see the same -- or not.

It seems to us that the stakes are higher this time around, as economic stress continues to build.

Treasuries are hanging in, though. The 10yr remains comfortably above 4%. The data vacuum means clarity is tough to find, as illustrated by contrasting survey data from Wednesday and Thursday. Friday should see the US payrolls report for October, which would have given us both sides of the equation (lay-offs versus jobs gained). But the shutdown means we'll miss it; the second payroll report that we've missed. The same goes for jobless claims, which would have been an interesting barometer as to whether lay-offs were a structural thing or a wash within the wider labour market.

Risk assets have also given Treasuries a bit of a bid. But in the end, it seems we end this week not too deviant from where we started, with the 10yr not too deviant from 4.1%.

EUR money markets will also see tightening conditions, but not for now

ECB executive board member [Schnabel outlined her thinking on the future of the ECB balance sheet](#). The topic has received more attention since global money markets have shown increased signs of tightness (we have written about it [here](#)). In EUR money markets, euro short-term rate (ESTR) fixings for unsecured overnight borrowing have reached their highest levels relative to the deposit facility rate since 2021.

Overall, the latest developments remain within the realm of the gradual upward pressure already present for the past couple of years. And perhaps more importantly, the secured funding rates, which are banks' preferred markets to redistribute liquidity within the system, have not shown an accelerated drift higher. Since summer, for instance, the GC pooling overnight rate has largely come in a band of +/-1bp around the deposit facility rate outside month-ends.

But as Schnabel outlined, at some point these repo rates are likely to start rising also here as the roll-off from the monetary policy portfolio reduces reserves in the system. Part of the plan in transitioning to the new operational framework is that this will steer banks to the ECB liquidity-providing operations. This, in turn, will see very little take-up. Keep in mind that the ECB provides liquidity at 15bp above the deposit rate, which is still an expensive option for now.

When will banks start to turn to the ECB for liquidity? Timing depends on the level of reserves banks want to hold, which is difficult to measure. Based on scenarios around future banks' desired liquidity coverage ratios and the share of reserves of banks' highly liquid assets to back these, ECB staff estimates imply that we could reach that point even as early as mid-2026, while a middle scenario puts it more toward the end of 2027.

That appears to give EUR markets a bit more time to prepare, but it indicates that there is still an upside stemming from the transition, which can also have implications for something like Bund spreads over OIS which also show a close link to repo funding markets. Relief from a structural ECB bond portfolio could be even more distant, as Schnabel indicated, as it is likely only at the bottom of the list of the structural operations to be introduced stepwise, and further out the curve as the portfolio could be focused on shorter dated paper. As is, the current bond portfolio still depresses 10y bond yield by 60bp by the ECB's estimates.

Friday's events and market view

Given the US government shutdown, the market will be spared the US official jobs report, leaving them to look to the University of Michigan consumer sentiment indicator. The

consensus is looking for a slightly softer 53.6 index reading – and also the consumer credit release in terms of main data drivers for the day. It will still be a busy day in terms of central bank speakers. From the ECB, these include Nagel and Villeroy. From the BoE chief economist Pill will speak after [Thursday's BoE meeting](#) that left a December cut looking more likely in our view. The Fed is sending Williams and Miran into the field.

Issuance in the government bond sector is limited to a small optional reverse inquiry auction by Belgium.

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