

Rates Spark: Bunds still rich, Treasuries ponderous

As EUR rates have tested higher, Euribor-based swaps have faced upward pressure, leaving 10y Bunds versus IRS rich in recent weeks. Bund spreads over ESTR OIS have stayed close to their March average. Meanwhile, Treasuries are pausing and will digest benign Wednesday data before turning to PCE



A quickening IRS-OIS basis widening dynamic has helped render Bunds rich versus IRS

EUR rates have remained under upward pressure lately, with the 10-year swap rate testing the 2.8% level. Moreover, since the start of the week, 10y Bunds have started to underperform swaps, taking them off their richest levels in a year (on a closing basis), although they still stand 4bp below the swap rate.

One observation we make, though, is that 10y Bund spreads versus ESTR OIS are actually only slightly richer versus their average level since early March, meaning, in turn, there has been a relative rise of Euribor-based swap rates (IRS) versus OIS over the past two months alone to the tune of 4bp. Since March, the basis has widened by almost 9bp.

This widening dynamic actually gained momentum early in November. And as this also mirrors a dynamic that we witnessed in the 10s30s curve steepening, it adds to the suspicion that the upcoming transition of Dutch pension funds to their new system and the accompanying unwinding of structural long-end receiving positions could be part of the story.

In any case, 10y Bunds versus Euribor swaps appear 'optically' rich, and they have started to correct over the past few sessions. One question is whether the swap leg will be part of this correction. If not, it could leave Bunds at 'optically' richer levels, all else equal. Looking at the spot spread of 6m Euribor fixings versus OIS at 21bp and the 2y IRS versus OIS at 25bp, neither indicates that the 10y spread needs to retighten from a fundamental point of view – even after its widening, it still stands at 'only' 22bp.

Treasuries hover, adopting a wait-and-see stance

Treasuries calmed on Tuesday on a few materially new drivers. The opportunity to break below 4% was shunned last week, and some comfort instead is being found in the hover area at around 4.1%. The market is braced for a mediocre ADP report on Wednesday, but at the same time has come around to the view that weak employment growth is a new feature of the US economy, given the supply-side constraints being shown on immigrants. Manufacturing production is anticipated to be flat for November too. And import prices (Wednesday too) should barely rise at all (anticipated 0.1% month-on-month / 0.4% year-on-year).

It's all very benignly flat, which in fact should be net bullish for Treasuries. But Treasuries are not biting. Instead, the mood music is one of wait and see some more. In our view, the inflation dynamic would need to change dramatically for the better if the 10yr yield is to stand any chance of getting below 4% and staying below. The PCE report due on Thursday is anticipated to be tame on the month, but still much closer to 3% than 2% on the year, with more upside than downside in the coming months. Hence, the reticence to price in much cutting in early 2026. No huge clarity, as Treasuries remain poised.

Wednesday's events and market view

The main focus will be on the US data with the release of the November ADP private payrolls' data. The consensus is looking for 10k new jobs versus 42k in October. The other main release to watch is the ISM services, which is seen slightly softer at 52 versus 52.4. The prices paid component is seen easing to a still elevated 68. Also up for release are industrial production data and import/export prices for September.

In terms of issuance, the UK will sell £4.75bn in 3y Gilts.

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