Rates Spark: Eyes on France

European markets will be watching closely as the French government faces a no-confidence vote. A fall of the government looks likely, and while it has added to the market's dovish pricing the overall fallout is remarkably muted. US rates will be watching Fed Chair Powell's speech and we update on the Fed's reverse repo facility as it's at or about new lows

All eyes are on France as Parliament is set to vote on a no-confidence motion, with the government likely to fall

French government faces no-confidence vote

In Europe all eyes are on France where parliament is set to vote on a no-confidence motion with the debate starting at 4:00pm local time on Wednesday. The right- and left-wings of parliament should have the votes to bring down the government and each have signalled their intention do so. Our economist has outlined on Tuesday what could come next.

French spreads have retreated from their peak on Tuesday, with the 10Y tightening 3bp versus Bunds to end the day at 85bp. But it was Bunds themselves rising in yield and underperforming 3bp versus swaps as the safe-haven bid faded. Overall, we think the current spread levels already reflect quite a bit of pessimism with regards to the French credit outlook, though that itself does not preclude further widening in adverse market conditions and potentially overall lower market liquidity going into the end of the year.

US rates downtrend faces more data noise – and Powell – ahead of Friday's key payrolls report

US data will become more relevant as we move towards the payrolls report on Friday, but we get to digest other labour market indicators in the run-up for added flavour. On Tuesday rates nudged back up on the back of slightly better JOLTS data with the 10Y yield just above 4.20%. Wednesday will then see the ADP and ISM services employment component. These readings should be more noise than signal, though.

What has helped the front end come down were some more dovish comments from Fed speakers, with Daly on Tuesday indicating that a cut in December was still on the table and that the neutral rate should be closer to 3%. This comes after we heard Waller leaning for a December cut on Monday. The main focus for the market will be any comment from Fed Chair Powell when he speaks at the New York Times Dealbook summit. Currently the SOFR futures strip prices the Fed taking rates down to 3.5-3.75%, which we think in itself should have the 2Y rate gradually gravitate to below 4%.

Fed reverse repo balances running at or close to new lows

Monday saw cash parked at the Fed's reverse repo window drop to $135bn, a new cycle low. Tuesday saw it pop back up to $161bn, but it's now trending in sub-$200bn territory. By January 2025 it is likely to be in sub-$100bn territory, and once there it's getting close to being statistically close to zero. By the second quarter of 2025 it could well be there, at or around zero.

These are important months as the progress towards zero for reverse repo balances will hasten the prospect for bank reserves to be pulled lower. They are currently at $3.2tn, and a drop of $250bn there would bring them to what is considered the key $3tn level, below which the market can start to feel tighter from a liquidity perspective. It may not be till bank reserves get to $2.5tn before tightness becomes a real thing, but it's likely the Federal Reserve will not wait to hit the wall. They did this in 2019 and it caused a headache or two that is best not repeated.

That said, the Fed has this covered on both sides, where any liquidity shortage can be dealt with through their permanent repo facility. And at the same time some usage of the reverse repo facility will continue, to be taken up around month ends in particular when repo access thins as banks tend to window dress.

We continue to watch this space, as the next key move from the Fed on this front would be to end its quantitative tightening programme. Something more applicable for the second quarter of 2025, but also something to be monitored from now and in the coming few months.

Wednesday's key events and market view

US data will become more important again with the ADP employment change and the ISM services up for release. ADP is seen coming down to 150k from 233k, and the services index is anticipated to nudge slightly lower to 55.7 from 56. Later Fed Chair Powell participates in a discussion organised by the New York Times, which is followed by the Fed releasing its latest Beige Book.

French politics aside, out of the eurozone we will get the final Services and Composite PMIs for November. These come after the downward revision to the manufacturing reading on

Monday. ECB president Lagarde will speak to the EU parliament.

In primary markets Germany will auction €3.5bn in 10Y Bunds, while the UK sells £4bn in 7Y gilts.

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