

Rates Spark: Hard to see a ceiling for gilt yields

Gilt yields can continue to rise, not just because of political risks, but also on the back of the [Bank of England's quantitative tightening](#). Meanwhile, US Treasuries continue to feel pain from the never-ending shuttering of the Strait, with April CPI data already high, and set to rise further in the coming months. Not great for core bonds generally



Rates in the US (higher inflation) and the UK (political angst) continue to drift upwards

Politics are adding to the long list of bearish gilt forces

Gilt yields continue to rise on the back of the political turmoil around Labour's leadership and yields can still push higher. The fear is that a new prime minister would have a looser hand when it comes to fiscal policy. If this is the case, then increased near-term government spending would make further Bank of England easing even less likely whilst adding to the issuance of government bonds.

Besides political and inflation risks, we also identify increasing gilt supply as [a slow-moving force pushing up yields](#). Whereas the Fed has significantly reduced the pace of quantitative easing, the Bank of England still reduces its bond portfolio by around £70bn per year. We estimate that this has steepened the GBP swap curve by some 60bp more relative to the USD curve. And with bank reserves stabilised, the Bank of England does not necessarily need to taper quantitative tightening on the back of financial stability concerns.

For gilt yields to make a material push lower, we would first need to see inflation risks come down. Higher oil prices are the main culprit, but the additional political risks make the picture even more complex. So, unless oil makes a significant move lower – which we're sceptical about even if a deal were to be found in the near term – then gilt yields are likely to remain higher for the time being.

US inflation added to the pain for Treasuries

Tuesday saw headline US CPI inflation come in at 3.8% year-on-year for April. It was 2.4% before the war. That's a 140bp uplift, and it's not done. As it is, we're set to hit 4% in May. Core hits 3% down the line. A persistence to the war and we risk adding to that. Getting to 5% inflation is quite probable if it goes on and on. From here, we likely have another week of waiting and watching the war given the China summit distraction, with the Strait remaining shut tight. All the while, Treasury yields are pressured higher.

The 10yr, now at 4.45%, has 4.5% in its sights. And once there, it will meet buyers, as that's a level that flags a structural buy for many players. That said, it can just as easily sail on higher, especially as there is no easing in price pressures to help calm things down. The rise in yields post the CPI release was through higher inflation expectations and higher real yields, and there was also an edge higher in the swap spread. All quite tame so far. More re-pricing rather than outright selling.

But it risks getting less tame ahead. The Fed can't cut here. And risk assets are pushing the boundaries of positivity (or have been). It's a cocktail that Treasuries really should not feel comfortable with. Tuesday saw a 10yr auction test. There was a slight tail, which is never great, but no big issue. This, and the 30yr auction on Wednesday, are being helped by the concession built in the past couple of weeks (even if that concession is set to build further, in our view).

Wednesday's events and market views

In terms of data, we have second estimates of first quarter 2026 eurozone GDP growth, which earlier came in lower than expected at 0.1% quarter-on-quarter growth. The eurozone industrial production numbers from March are expected to come in lower, but still showing month-on-month growth when seasonally adjusted. From the US we have PPI numbers for April.

From the ECB we have Chief Economist Lane and President Lagarde speaking in the evening.

In terms of supply, Ireland plans a €2bn tap of its Green October 2043 bond via syndication. Italy will auction 3y, 7y and 12y BTPs for a total of €7.5bn. Portugal is set to auction 4y and 10y OTs for a total of €1.5bn. Germany will auction 21y and 28y Bunds totalling €2.5bn. The US will auction a new 30y bond for a total size of \$25bn.

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