Rates Spark: Holding up amid tumultuous times

Recent headlines from France offer cautious optimism, with markets showing unexpected resilience despite domestic turmoil and broader uncertainties like the US shutdown. In European bonds, recouping the foreign investor shares after QE is not yet complete, although it can be a source of volatility

Outgoing French Prime Minister Sebastien Lecornu delivers a statement in Paris on 8 October 2025

Macron remains determined, while foreign investors in French bonds could become a source of volatility

Wednesday evening's news could see some tentative optimism returning to the situation in France after Lecornu explicitly said a parliamentary majority opposes dissolution. President Macron followed this by saying that a new prime minister would be named within two days. The far right, though, continues to push for new elections, while the biggest stumbling block for any new government, as stated by Lecornu, will be the pension reform, which the left in particular wants to reverse. This still means a high degree of uncertainty and, importantly, slim hopes for any budget to show meaningful consolidation. To be fair, that notion is not entirely unexpected, as even Fitch, which was the first agency to downgrade France into single-A territory last month, attaching an 'A+/Stable', does not expect deficits below 5% in the next two years.

Overall, it has been somewhat surprising how well broader markets have straddled the renewed political turmoil in France over the past days. In rates, although the spread of 10y French government bonds over Bunds remained elevated at 84bp, the spread of 10y Italian bonds over Bunds was back below 80bp on Wednesday. In an environment of still low (implied) volatility and with the notion of the ECB as a backstop, such spreads appear too attractive to forego.

We do see that 10y Bunds are at around 1-2bp over swaps. These are the richest levels since July, and Bunds have stood as high as 7bp above swaps since then. One would think that the current environment would have justified even richer levels – not just given the political situation in France. We have the uncertainty around the US shutdown and lingering risks of an escalation on the trade front as sectoral tariffs test current compromises. Growing safe-haven demand on the back of recent Russian incursions on the EU’s eastern border would also not be a surprise.

Foreign investors may be playing an important role in the direction of French and German bond spreads. Since the ECB's quantitative tightening started in 2023, foreigners have taken up a significant portion of the additional supply. 24% of eurozone government bonds are already held outside, but we see more upside as the share was 30% in 2015. A cross-sectional snapshot shows that higher-rated government bonds are popular abroad, with Bunds showing the largest share of foreign ownership. This also has a flip side, as the (prospective) downgrade of France could lead to increased selling pressures by foreigners, who also hold a relatively large share of outstanding French bonds.

Thursday's events and market view

Politics aside and with no data releases of note, markets are left to look towards central banks for guidance. In Europe, the ECB releases the minutes of the September meeting, where rates were kept on hold. We will also hear from the ECB's Villeroy and Escriva.

The Thursday staple of initial claims data will likely fall victim to the ongoing US government shutdown. That will leave the market focusing on Fed speakers again, which today include Chair Powell. Wednesday night's FOMC minutes from the September meeting, when the Fed cut by 25bp, were somewhat hawkish in the headlines, with a "few" members supporting the idea of a 'no change' decision. However, our economist notes that the body of the minutes is more nuanced, with participants judging "that downside risks to employment had risen," while "most participants" observed that upside risks to inflation "had either diminished or not increased."

In primary markets, Ireland will be reopening 10y and 30y bonds for €1.5bn in total. The US Treasury will auction US$22bn in 30y bonds.

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