

Rates Spark: Markets move as predicted

The initial market reactions to the election outcome were confirmed, with Bund underperformance particularly notable amid domestic political turmoil. Today's focus is on the Fed and Bank of England policy meetings. Both are expected to cut, but communication in the wake of the likely Republican clean sweep and the UK budget could be more relevant



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Markets move as expected and finalise the Trump trade

Trump won, and the Republicans are well underway to secure Congress, including the House. The reaction function of US markets was largely in line with expectations, with 10Y UST yields remaining higher and the S&P 500 reaching new record highs. The inflationary impact is also made clear in the front-end of the curve, where the expected terminal Fed rate nudged up by some 10bp to around 3.9%. However, in the grand scheme of things, the moves coming out of the election results were not massive, which shows that much of the Trump trade was already priced in prior weeks. With a view to Treasuries, investors seem content to step back in for now, as indicated by the strong result of the 30y auction with its bid-to-cover ratio the highest in more than five years.

In Europe, the impact was more of a mixed bag. Markets seem keen to price in more ECB cuts and thus the 2Y euro swap rate fell by some 15bp. This makes sense as ECB President Christine Lagarde

explicitly highlighted Trump as a growth risk during the previous press conference. Markets are pricing in a 50bp cut in December with around a 20% probability, though expectations were even more aggressive in late October. We do think with the ECB reaction function more geared towards growth concerns, the chances of a 50bp cut further down the line are more likely now.

Risk sentiment shows resilience, for now

More notable was the initial rise in eurozone equities. The STOXX index opened higher, suggesting that more ECB cuts and Trump's pro-growth agenda would outweigh the potential harm from trade tensions. But the euphoria did not last, and by the end of the day the STOXX index also closed modestly in the red. It shows that risk sentiment still kept up quite well outside of the US. We wonder whether risk sentiment can stay strong once Trump starts commenting more on foreign policy, including the use of his favourite word in the dictionary, "tariffs".

The relatively robust risk sentiment also meant that there was little to keep Bunds from underperforming further versus swaps – over the past session by 4bp to end just 1bp above swaps. Supply concerns may outweigh here, as Germany is particularly exposed to tariffs and might be seen as having to "spend" its way out of any trade tensions with the US. Not helping are Germany's own political turbulences – Chancellor Scholz dismissed the finance minister Lindner on Wednesday night, [opening the door to new elections](#). Lindner was a strong proponent of adhering to strict spending rules and the debt brake that eventually led to the impasse in budget negotiations.

Thursday's events and market view

The main focus in the wake of the elections is the policy-setting meetings of the Fed and the BoE. The [Fed is firmly expected to cut](#) by another 25bp, but the elections have important implications for the longer-run outlook of the Fed. Chair Powell's commentary on the current economic environment and how the next US president could likely influence the outlook will be of huge significance. The [BoE is also very likely to cut rates](#) by 25bp again, but the combination of extra fiscal stimulus and the US election aftermath means officials won't want to comment on its next steps.

We might get some interesting insights from the ECB, including possible implications of the US elections. Additionally, Schnabel will open the ECB's money market conference and may cover repo market dynamics, which have partly driven the cheapening of Bunds. The longer list of speakers over the day and the different events includes Chief Economist Lane and the Dutch central bank's Knot.

Data for the day are the initial jobless claims in the US and retail sales in the eurozone. In primary markets, France (10y to 30y) and Spain (new 5y, 30y and linker) will be active with regular auctions.

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