Rates Spark: Markets are still digesting Biden's departure

We continue to grapple with the implications of Biden's exit on markets. There have been some jumpy movements, but the big picture has not changed much. Weaker growth data later this week should help the EUR curve do some steepening. The ECB's Survey of Monetary Analysts shows a well-anchored ECB terminal rate (2.25%), as reflected in market pricing

Markets are so far unfazed by President Biden's exit

Biden exit reaction is complex

The path ahead for the Democratic ticket remains uncertain, but Vice President Kamala Harris remains the presumptive nominee unless negated by events. The biggest impact reaction for Treasuries was a late-in-the-day rise in yields, coinciding with a tech-heavy risk-on theme. The front end of the curve has taken a mild hit too, pulling lower the probability of a rate cut in September. A September rate cut is still practically discounted, but an element of doubt has been introduced as some believe the Fed might prefer not to add to the rise in volatility seen in the past few weeks. We don't find much substance to this notion.

Also, risk has been on since November 2023 and is arguably vulnerable to coming off. The announcement that Biden will not run would seem to end uncertainty, but it can also create doubts for risk-takers. A vacuum like this would be as good an excuse as any for risk to come off, and if that happens, US Treasuries are likely to rally, and yields will fall. That would be sustained by a lesser 'growth oomph discount' as the probability of a Trump victory is downsized – but not by much, as a Trump victory remains broadly discounted.

These are fine margins, and hence, elevation in volatility has been the most sensible outcome.

EUR steepening lags the US

Biden’s withdrawal did not have a material impact on EUR rates. The 10Y Bund yield is 2.5%, a level it has been trading around since March. The short end has come down a bit since peaking in June, mostly driven by Fed expectations, but also with more ECB cuts in sight. So far economic data has shown modest resilience, yet this week’s PMIs could be foreboding if the downticks from last month turn out to be the start of a broader weakening. In that case, EUR curves could see more steepening after having lagged the US.

On Monday, the European Central Bank published the outcome of July’s Survey of Monetary Analysts, which has shown an expected terminal ECB rate of 2.25% in all surveys this year. Markets’ outlook based on the ESTR 3Y1M forward shows a convergence to that level since April. As Fed and ECB cuts start materialising, we expect yields to go lower, but a well-anchored terminal ECB rate means that the scope for lower rates could be limited in the eurozone.

Today’s events and market views

Consumer confidence in the eurozone is expected to continue to improve, but at -14 it remains below the historical average.

From the US, we have the Richmond Fed indices and existing home sales. Home sales have been slowing down lately and are expected to have contracted by -3.0% month-on-month in June.

Issuance includes a UK 15Y Gilt Linker of £1bn, a new €5bn 2Y Schatz from Germany and a US auction of $69bn of new 2Y Notes.

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