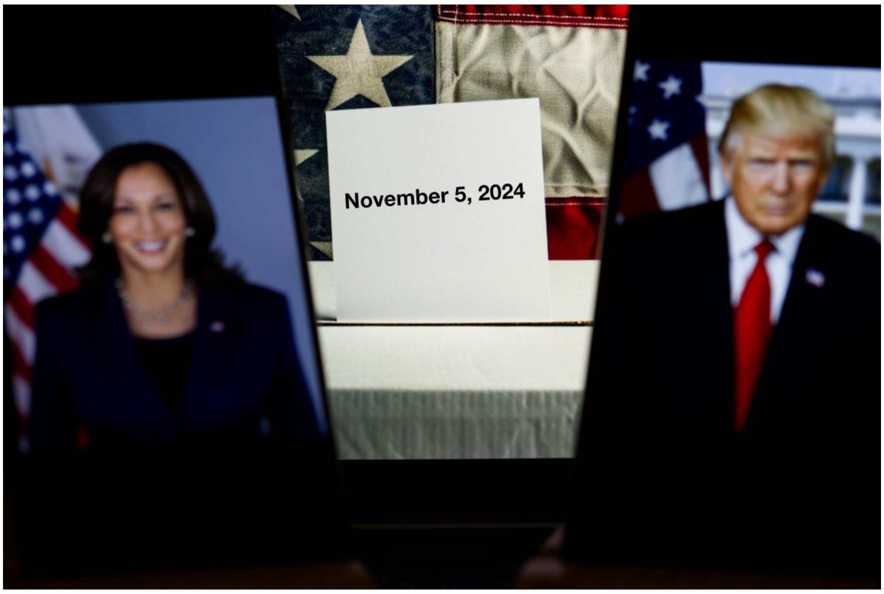
Rates Spark: Minor adjustment in Trump trade

The market's response to the changing odds reflected in weekend polling confirmed the expected reaction to the US election results. A Trump win suggests higher yields, while a Harris win indicates more downside potential, with intermediate outcomes depending on Congressional control. Volatility is likely, as it may take days to finalise the results



Today is Election Day in the US with a Trump win pointing to higher yields and a Harris win opening more downside

Markets bracing for significant volatility going into the US elections

The latest news headlines seem to favour a Harris win and markets have decided to trim down the Trump trade somewhat. Yesterday, the 10Y UST yield fell by almost 10bp on the day, down to 4.3%. The front end of the UST curve remains more anchored, showing that most election positions can be found at the back end of the curve. But the race is still too close to call and we can expect a lot more rates volatility once the election outcome becomes clear. The implied rates volatility from the MOVE index is now on par with the inflation spikes in 2022 and the 2008 Global Financial Crisis.

The big moves in US rates did not spill over to European rates. A lower chance of a Trump presidency is a relief to the eurozone and should be net positive for bond yields, but at the same time lower UST yields push in the opposite direction. Spanish and Italian manufacturing PMIs also didn't manage to budge rates. All eyes are on the US elections and until the results are in we expect little impact from data releases. We must also consider a scenario where the voting results are not clear-cut and the winner is only announced later this year, leaving markets in limbo for longer.

Broader risk-off episode in Europe possible under Trump win

For euro rates, we could see a broader risk-off move dominating in the case of a Trump win, with flows towards Bunds and longer-duration bonds as a result. European government bond spreads versus Bunds could widen, although the extent may be more limited than in other risk-off events. Germany is deemed one of the more exposed economies to potential trade tensions with the US, and thus Bunds may not benefit as much from safe-haven flows as usual. This may also be a supporting factor helping the Bund ASW spread narrow over the past few weeks.

The spillovers to the eurozone may also depend on whether Trump manages to secure Congress. In the case of a clean sweep, Trump may prioritise domestic policies, such as taxes, before implementing tariffs. In such a scenario, the economic impact on the eurozone may be delayed, reducing the near-term impact.

Tuesday's events and market view

The US election takes centre stage today, although even in the best-case scenario some clarity about who leads the race will not be available until Wednesday morning. More likely it will take longer given the closeness of the race. Still, there may be enough headlines to move sentiment around. In this environment, a data release such as the ISM services might go under the radar, though it would also be unlikely to move the needle concerning the market expectations for this week's FOMC meeting – those sit firmly on a 25bp cut. The consensus for the ISM is a bit softer at 53.8, but the main focus could be the employment component that had dipped back into contractionary territory already the last time around.

In primary markets, Austria is selling 10y and 20y RAGBs for €1.7bn in total. The US Treasury sells US$42bn of new 10y notes.

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