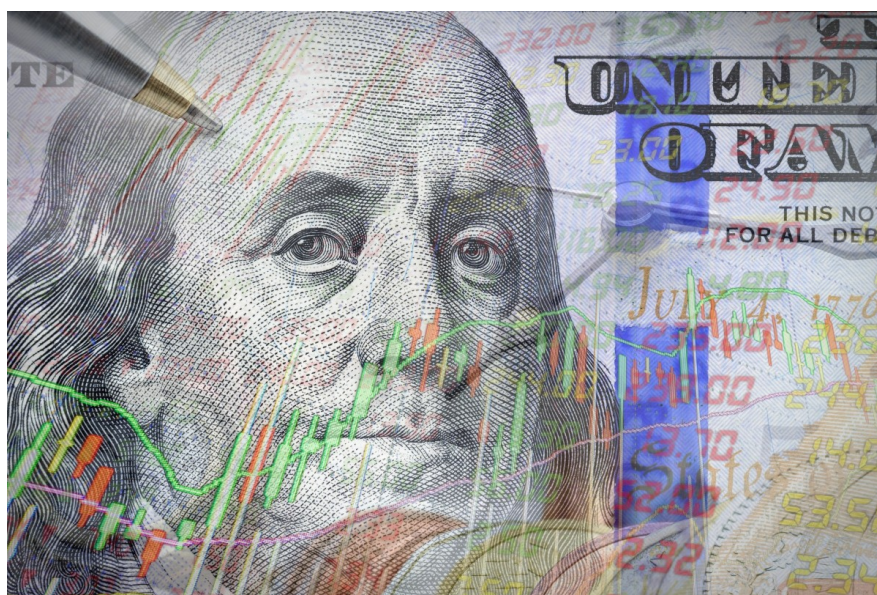


Rates Spark: More reasons for rates to go up

Better-than-expected data from the eurozone and the US, and looser fiscal policies leading to a repricing of Bank of England easing expectations, have pushed rates higher. Long-end levels still don't imply much of a term premium, limiting the downside in rates. Today sees eurozone flash CPI, but a more pivotal data point is tomorrow's US jobs data



Arguments for higher rates still outweigh for now, although Friday's payrolls remain pivotal

Markets are becoming more volatile on the back of data which keeps defying expectations. The first third-quarter GDP reading for the eurozone beat expectations, while the first country flash CPI readings came in above expectations. Both noticeably pushed up front-end rates (although there may well be some spillover from the UK, see below): 4bp was shaved off from December easing expectations with the 31bp priced now reflecting a 20-25% chance of a larger 50bp ECB cut, and further out the 1m rate 1y ahead shot up by almost 13bp to above 1.9% again.

There were also some comments from ECB board member Schnabel to counter any impression

that the hawks had thrown in the towel already – she saw low risks of inflation persistently undershooting. While removing restrictiveness was appropriate, there is no need to move below neutral.

Meanwhile, in the US, third-quarter GDP growth was a touch below expectations, but it contained a surprisingly strong personal consumption contribution. The quarterly PCE rate also notched a little higher pointing to some upside risks for today's September reading, if there are no revisions to July's and August's figures. There was also the ADP payrolls estimate coming in above all expectations.

In sum, there is little room for rates to move lower in the US for now. Not from current data until we get another signal – the upcoming payrolls will still be pivotal – and also not from a more technical perspective. Here, Fed key rate expectations as reflected by the SOFR futures strip bottom-out at just below 3.6%; the 10y SOFR rate is at 3.75%, not much above and implying very little term premium. While the 10Y Treasury sitting another 50bp higher at 4.25% may seem high, that 50bp is a fair reflection of fiscal deficit concerns and is more prone to widening than tightening until there is some form of plan to get the fiscal deficit down.

Gilt yields jump as budget triggers repricing of Bank Rate

Markets (and we too to be honest) went into the UK's budget presentation with a fair amount of confidence that no major surprises would be delivered. Indeed, the first part of Chancellor Reeve's presentation resulted in a relief rally for Gilts. Issuance rose slightly above expectations but was accompanied by a significant increase in taxes to secure fiscal credibility. A Liz Truss moment was averted. But then the move reverted sharply, the 10Y Gilt yield jumped some 20bp to 4.35%, now well above the UST 10Y of 4.25%.

The sell-off in Gilts was triggered by comments from the independent Office for Budget Responsibility (OBR) on the loose fiscal policy. As a result, the OBR increased its near-term growth forecasts significantly, adding 0.5% to GDP growth in the fiscal year 2025-26. Markets rapidly repriced the Bank of England's expected Bank Rate path and now see an endpoint of around 4%. We still believe this is too high and see more room for cutting than currently priced in. Having said that, we first need to see lower inflation or worsening growth numbers before markets will change direction.

Thursday's events and market view

The highlight from the eurozone will be the core CPI for October, which is expected to nudge down slightly from 2.7% to 2.6%, continuing a slow but gradual trend lower. In the morning we'll also see French PMIs. The eurozone unemployment rate is expected to remain stable at 6.4%.

From the US we have the core PCE deflator, which showed a slight upside surprise in the quarterly index on Wednesday. The consensus of 0.3% month-on-month is a bit on the hot side, but markets seem less focused on inflation numbers and more on growth. That's why the initial jobless claims could get more attention, especially with eyes on the labour market given Friday's payroll report.

For issuance, we have the UK auction a 29Y green bond of £2.25bn, which could get some attention after the volatility surrounding the budget.

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