Rates Spark: Moves may be amplified by thinning liquidity

Markets may become more nervous with the 1 August tariff deadlines, and low summer liquidity could amplify rate moves. Fiscal concerns in many large economies add to the volatility from the back end of the curve. Challenges to the Fed's independence are also not helping US rates

We think the recent downward pressure on euro rates has gone too far

Low market liquidity can add to sharp moves in the near term

The week started with a strong bullish move in euro rates, which could happen again if markets become more focused on the bumpy trade negotiations. Over the past few weeks, markets have largely treated tariff headlines as background noise, but with the August 1 deadline approaching, we may start to see more volatility. And with market liquidity thinning during the summer, any such moves may be amplified. The sharp decline in 30Y yields on Monday, for example, was difficult to justify from the news flow alone.

The very long end of global yield curves will remain a source of volatility as the themes driving those moves are likely to linger. In Japan, there were elections over the weekend, but the fiscal outlook remains uncertain. Also, in the UK and numerous EU countries, government finances are at risk. Meanwhile, in the US, the independence of the Fed is being challenged, making the long end of the curve look more vulnerable and creating sharp rate moves like we saw last week. Part of the rally in long-dated bonds on Monday may therefore be linked to headlines about Treasury Secretary Scott Bessent's opposition to firing Fed Chair Jerome Powell. All these drivers are unlikely to disappear overnight, which is a reason to remain more bearish on longer-dated rates.

Tuesday's events and market views

We will get the Bank Lending Survey results from the European Central Bank, which will give insight into financial market conditions.

The UK will auction £1.7bn worth of 10Y Gilt Linkers, while Germany will have an 8Y and 10Y green Bund auction for a total of €1.5bn.

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