

Rates Spark: Risk sentiment in the eurozone could remain fragile

Implied volatility metrics suggest that eurozone investors see plenty of risks on the horizon. This is not surprising given headlines from French and German politics and rising tensions in the Ukraine. The Bund continues to serve as the safe haven asset of choice as evidenced by the swap spread dynamics



Eurozone markets remain wary of risks on the horizon

At first glance, Wednesday seemed relatively calm, but beneath the surface, there are signs that risk sentiment in the eurozone could remain fragile. Several potential political storms are brewing. This week, politician Marine Le Pen threatened to block the budget and pursue a no-confidence vote, throwing French politics back into uncertainty. The upcoming German elections further contribute to an already uncertain economic outlook. Meanwhile, the situation in Ukraine remains tense, with signs of gradual escalation. Additionally, economic data continues to weaken, and Friday's PMIs could confirm this downward trend.

These domestic risks have not manifested in sharp rate moves, but when looking at implied volatility metrics markets are well aware of what could be ahead. The 1-year MOVE volatility has

returned to the highs seen around Trump's election night, and the 1-month ahead VSTOXX equity volatility indicator remains elevated after the Ukraine headlines earlier this week.

Bund swap spreads in search of a new steady state

The 10Y Bund yield is also back to almost flat versus swaps, with the renewed geopolitical tensions helping close the gap. But there are lingering political dynamics in the eurozone that should also argue for a Bund premium relative to its peers, while the overall weighted average 10Y eurozone sovereign spread versus OIS already looks considerably cheaper than Treasuries or Gilts.

Take France: concerns around the deficit trajectory have rocked French bond spreads since the summer. The new government has vowed to take on the fiscal challenges. But budget negotiations have proved tricky in the legislature and the assumption has been that the government would use a constitutional provision to bypass a vote in parliament – but likely triggering a vote of no confidence. This week Le Pen hinted that she might not play along, even though new elections are not possible before summer next year. On 29 November, France faces another rating review from S&P.

UK inflation ticks up but the underlying trend is still in the right direction

In the UK, a higher inflation reading initially pushed up the front-end of the Gilt curve, but later seemed to agree with [our view](#) that the numbers should not impact the course of the Bank of England (BoE). Importantly, the core services inflation number softened from 4.8% to 4.5%, continuing the trend lower.

A December cut has already been fully priced out and markets see only one 25bp cut in the third quarter of 2025. We think the BoE could accelerate the path of easing and thus expect 50bp of cuts during the first quarter.

Today's events and market views

Data is looking a tad more interesting with the US releasing the weekly initial jobless claims, a more contemporaneous gauge of the jobs market. Rounding off the data are existing home sales as well as the Philadelphia Fed's business outlook. Out of the eurozone, we will get a preliminary consumer confidence reading for November.

The speaker front will also be busier with ECB's Knot, Holzmann and Lane speaking among others. Speakers from the Fed include Goolsbee and Schmid.

In primary markets, France will sell medium-term bonds as well as inflation-linked bonds for up to €13bn in total. Spain will tap bonds across seven to 17 years for up to €5bn.

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