Rates Spark: Stars align for record Gilt yields

Longer EUR rates face upward pressure, from the US and domestic factors like elevated inflation and a flurry of bond supply. At 5.2% the 30Y gilt yield hit the highest level since 1998, helped by the rally in US rates, sticky inflation and supply pressures. More of the same is probable, with Friday's US payrolls report the next key point of reference

Treasuries to continue testing the upside, with Friday's payrolls the next key reference

Tuesday's US 10yr auction tailed, coming at some 1bp above "secondary" yields. That follows on from a tailed 3yr auction yesterday, but a tailed 10yr auction is more significant given its accepted benchmark status. The 10yr yield had cheapened on the day, following some firm macro data earlier on, which makes the poor auction that much worse, in the sense that absolute yields were running at their highest since May 2024. Based off the auction alone, there is no mad dash in the market-place to pick up paper that has cheapened in a material sense since a local bottom in mid-December, when a low was hit in the 4.13% area. The 10yr yield, now at 4.68%, continues to eye the upside. Expect that to continue unless or until something material happens to negate the up-move.

Looking towards Friday's jobs report both the ISM employment components have been subdued, suggesting a lack of hiring activity, but warmer weather in early December may mean that the usual seasonal temporary lay-offs in sectors such as construction may not have been as severe this year. There may also still be some catch-up coming through from the October hurricane effects. As such we are looking for something in the 150-175k range, but with the risk that the unemployment rate rises to 4.3% from 4.2%. Still there would not be enough from this combination to negate the rise in Treasury yields. Anything north of 150k should be enough to maintain upside momentum for yields.

Longer EUR rates still under upward pressure

EUR rates continue to trade on the back foot at the start of the year. The pattern of a more anchored front-end while long-end rates continue to rise highlight the spillover stemming from the better US data and rising Treasury yields.

But there are also domestic factors at play. Fundamentally the market still has to deal with a cautious European Central Bank keeping an eye on inflation, where the preliminary data for December just showed a still elevated core reading of 2.7% while headline inflation has been tracking higher for the third month now to 2.4% on the back of energy prices. The front-end rise in rates has taken the 1y1y ESTR back to early November levels, but the rise seems to have stalled by now around the 2% landing zone for the ECB.

A more technical factor that is still affecting the longer end of the curve is a flurry of primary market activity at the start of the year which also tends to put upward pressure on rates – at least temporarily. In the eurozone government bond space we had Belgium and Slovenia kick-off this year's early slate of syndicated deals with new 10y and 30y bonds respectively. For Wednesday, Italy has mandated banks for a dual tranche deal to launch a new 10y benchmark and a new 20y (green) bond.

Gilt yields reach new highs as stars align

The 30Y gilt yield hit 5.2%, which is the highest level since 1998. GBP rates have risen significantly since September 2024 as all stars have aligned for higher rates. In terms of politics, Labour presented an ambitious budget in October, whilst on the other side of the pond Trump's win pushed up UST yields. Add global supply pressures and sticky domestic inflation numbers, and Gilt yields found little resistance to hit new highs.

Whilst we don't think such elevated rates are sustainable over the long term, the catalysts for a change in direction are difficult to identify in the near term. Inflation should come down, but markets will need a series of better readings to be convinced. On top of that, concerns about Labour's spending ambitions will continue to linger, whilst bearish US sentiment has strong spillovers to the Gilts market. So unless any of these ingredients turn around, these higher rates may last a bit longer.

Wednesday's events and market views

For the eurozone we have confidence indices coming, of which the economic indicator is expected to nudge down slightly from 95.8 to 95.6. The PPI number for the eurozone aggregate is pencilled in for -1.4% year-on-year, suggesting no price pressures there. From the US we get more jobs data, including ADP employment and jobless claims. With markets prepping for Friday's payroll figures, these numbers could push around USTs. The publication of the FOMC meeting minutes from December could provide some interesting nuances about the Fed's more hawkish stance. In terms of speakers we have the Fed's Waller and the ECB's Villeroy.

Plenty of issuance slated, including an Italian syndication of BTPs for a total of around €12bn and Germany with a €5bn auction of 10Y Bunds. The UK has scheduled £4bn of 5Y gilts. The US will auction $22bn of 30Y bonds.

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