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RATES SPARK

Rates Spark: Steepening and room for more

German 30-year yields are on the rise, with the curve hinting at more to come. German fiscal plans and Dutch pension fund reform are factors in play. The US is in a similar mode, with fiscal and CPI data followed by upward pressure on long yields



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

US CPI and fiscal deficit readings for July – Net bearish for bonds

The US fiscal deficit for July came in at \$291bn. Customs duties (includes tariffs) were \$27bn, up from \$7bn in June. Not exactly stunning, at least not yet (it's coming). Basically, spending growth continues to run ahead of growth in receipts, with corporate taxes down of note. The overall fiscal deficit is running at \$1.6trn, compared with \$1.5trn for the previous year to date. Overall, we feared a larger deficit than the market had anticipated, and we got exactly that.

The [CPI data](#) came broadly in line, with 0.2% month-on-month headline and 0.3% month-on-month core. But core hit 3.1% year-on-year, which is not a great look, and this in all probability heads towards 4% in the coming months (tariff impacted). There were lots of market movements around the number itself, but in the end the 2yr yield ended lower while the 10yr

yield ended up a tad higher (steeper curve, lower inflation breakevens and higher real yields).

The move higher in the 10yr yield occurred long before the fiscal numbers. It seems that the front end is gunning for a rate cut, while the back end is in a questioning mode. Also, the curve is relatively flat as we face into a rate-cutting run, and the wide swap spread constrains where the 10yr can get to (unless the swap spread narrows, which it won't on fiscal number like we got for July YTD). Overall, these are bearish impulses for the 10yr, despite macro frailties.

EUR curves steepen, and it might not be the end just yet

The US CPI resulted in a twist steepening of US curves, but in the end the large bearish impulse for EUR rates came perhaps more via the [UK jobs data](#) from Tuesday morning. But as we suspected the bearish spillover manifested itself in a EUR curve steepening with front-end rates having less scope to rise further given where they stand now with markets already no longer fully discounting another European Central Bank rate cut.

The long end, however, we think will remain more susceptible to yield increases. While the 30y German Bund yield hit its highest since 2011 on Tuesday, surpassing the previous 2023 high, we think there are enough arguments that this is not the end yet.

From a curve perspective 10s30s at 55bp in Bunds is testing the previous highs of 2021 again, but more common when the ECB rate cycle bottomed were curves of 60bp and beyond. Also, the underlying swap curve is still some 20bp away from even the local highs of 2021.

More fundamentally, we still expect further pressure to materialise for (ultra-) long-end rates coming from German fiscal policies as well as the ongoing transition of Dutch pension funds to the new defined contribution system. And that is on top of any bearish impulses that could still come from outside the eurozone in the near term.

Wednesday's events and market views

There are only a few data points to observe with final July CPIs out of Spain and Germany and the US only reporting mortgage application numbers. Fed speakers to watch after the benign US CPI are Barkin, Goolsbee and Bostic.

The supply side remains calm with only Germany auctioning €5bn in 10y Bunds.

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