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RATES SPARK

Rates Spark: Supply dynamics a global story

Euro, dollar and sterling yield curves are all undergoing steepening pressures. A common theme is that supply worries are playing a role, with fiscal risks adding to the term premium. Our analysis of the demand for European government bonds suggests that yields may have to rise further to absorb the record incoming supply

Supply pressures are keeping upward pressure on rates around the globe

Steeper US curves on a cooling jobs market and UST demand worries

In the US, front-end rates have been weighed down primarily by comments from Kevin Hassett, Director of the National Economic Council, hinting that one should expect smaller job numbers given ongoing population trends. Markets seem to have interpreted this also as a warning ahead of this week's delayed jobs data for January.

But supply concerns also featured, because over the weekend Chinese regulators warned domestic financial institutions about high US Treasury holdings. Such comments underscore ongoing concerns about the declining appetite of foreign investors to finance historically high US deficits. So while the front-end yields came down, the back-end of the curve saw yields rising.

Japan and UK bond markets are both dealing with political risk

While the election outcome in Japan did see 10y Japanese government bonds rise as investors reassessed economic prospects, the 10s30s curve there actually flattened amid easing fiscal concerns. However, the ultra-long steepening dynamic unfolding in the US and Europe highlights that this topic remains on investors' minds elsewhere.

In contrast, the political turmoil in the UK is bringing back upward pressure on gilt yields, and we struggle to see the political risk premium coming down anytime soon. Starmer's position as Prime Minister is under challenge, but an obvious replacement would not be straightforward either. Markets are right to price in higher rates as the Budget last year highlighted the country's fiscal constraints. Reducing the issuance share of 30Y gilts helped ease longer-dated rates lower, but we're already back to significant steepening in the 10s30s since the December lows.

Supply pressures are both a near-term and structural story

Concurrent bond supply themes are amplifying long-end dynamics. The US Treasury is this week auctioning new 3y, 10y and 30y bonds. On top of that, the market was also digesting the news of large tech company issuance in dollars and sterling – out to the 40y maturity in US$ and out to the 100y maturity in sterling.

Also, in the eurozone, we see rates move higher in the coming year on the back of significant supply pressures. We estimate that markets will have to absorb a net supply of around €930bn in government bonds, which is the highest amount ever. Banks should continue to be the most important buyer, followed by foreign investors. More price-sensitive buyers like investment funds may, however, seek higher yields to fill the demand shortfall.

Tuesday's events and market views

No notable data expected from Europe. From the US we first have the NFIB small business survey, which consensus sees improving slightly from 99.5 to 99.9. The retail sales data will also be watched as a gauge of the economy. Later in the day, the export and import prices should tell us more about the impact of tariffs.

In terms of supply, we have the EU tap 6Y and 19Y bonds through a syndication for an estimated €9bn. The Netherlands will auction €1.5-2bn of 18Y green DSLs and Austria has scheduled 5Y and 10Y RAGBs for €1.73bn. From the UK we have a 5Y gilt auction totalling £3.75bn and Germany will auction €5bn of 5Y Bobls.

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