Rates Spark: The shutdown is not all that pains

With the end of the US government shutdown in sight, we could soon see a high concentration of important directional cues within a short timeframe. But even if job numbers deteriorate further, the downside for US rates may be limited by lingering inflation concerns. Euro rates follow US rates closely and will need more upside surprises to break higher

The US federal government shutdown started on 1 October

The anticipated end of the shutdown boosts optimism, but other worries remain

Risk sentiment improved as the US Senate advanced a bill to end the government shutdown. Expectations are now that the government will reopen starting next week, which would also imply working through a backlog of data releases over the subsequent days and weeks, beginning with the September jobs report. Other reports may take longer as data hasn't been collected and surveys haven't been conducted. In any case, the market implication is that a lot of potentially important directional cues will be packed into a relatively short timeframe.

For now, markets have reacted to the positive news with a slight flattening of curves as rate cut bets were pared back slightly. Looking at a longer history chart, though, the reaction to the news would be hard to spot. The 10y UST yield is now at 4.11%, but has spanned a range of 4.05% to 4.16% over the past week.

The shutdown had exacerbated concerns about sentiment and the job market, but these concerns already existed before and will continue to linger after the shutdown is resolved. Similarly, concerns about persistently too high inflation still linger, with a somewhat hawkish comment by the Fed's Musalem adding to the bear flattening as we started the week.

In this context, we still think that the downside for longer rates remains limited as long as the Fed is only priced to take policy rates to the 3% area. Building up a curve from there, the 10y SOFR OIS at still below 3.7%, and stacked on to that, a 10y Treasury in the 4.1% area, do not seem particularly high. The 10y and 30y auction supply this week should give us a better sense of near-term investor appetite at these levels.

EUR rates are largely caught in the US dynamics, with the 10y swap rate briefly topping 2.7% starting the week. But keep in mind, we topped out just below 2.8% after Germany announced its fiscal package in March ahead of 'Liberation Day', and over the summer we peaked close to 2.75% multiple times. Sure enough, the data has come in better than anticipated over the past few weeks, as the various surprise indicators suggest. But to get us above the recent ranges likely requires more time and confidence in the outlook.

Tuesday's events and market view

Although we will still get the NFIB business sentiment index, the US Veterans Day should make for a more European-focussed session. After the UK jobs data in the morning, the German ZEW takes the spotlight on the data front. The question remains to what extent expectations can remain supported amid further reports that good parts of the German additional borrowing are likely to be used for areas that should be funded out of the regular budget, as the *FT* wrote this morning, citing, among others, the Bundesbank. ECB speakers for the day include Lagarde, Vujcic, Sleijpen, Kocher and Escriva.

The Netherlands will auction a 10Y DSL for an estimated €2-2.5bn.

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