Rates Spark: US rates are bracing for volatility

With the US government reopened, markets are bracing for the resumption of data releases. While the Fed discount at the front-end has not changed much, the back end of the curve appears more driven by expectations of regulatory relief for Treasuries and supportive comments made by Treasury Secretary Scott Bessent

US President Donald Trump signs the funding package to re-open the federal government

More volatility ahead for US rates, but for now back end is focused on regulatory changes

US Treasury investors are bracing for more volatility now that the government will start releasing more data again. The implied volatility measures from swaptions were at multi-year lows, but have started picking up again over the past week. Markets are still not fully settled on the next steps of the Fed and now price in a December cut of about 65%. That means any new inflation and jobs data will be able to push around the front end of the curve. That won't be this week, however. With a bit of luck, we may see job numbers starting early next week. However, the White House had indicated that the October jobs and inflation reports might not be released at all.

The back end of the curve seems more driven by expectations of regulatory changes than the optimism stemming from the government reopening. The widely anticipated adjustment of the leverage ratio calculations should increase the capacity of larger banks to hold US Treasuries. Prospects of such changes have already narrowed the spread between the 10Y UST yield and swap rate by more than 10bp over the past few months. Bloomberg's latest reports from this week suggest the regulatory plans are already being finalised. This also explains why longer-dated UST yields have fallen despite the end of the shutdown and the positive risk sentiment reflected in other asset classes.

Tightening in European bond spreads on positve news out of France

The spread of 10y French government bonds over Bunds has tightened to 73bp, its lowest level since late August. The government has signalled increased confidence that a budget for 2026 can be passed, with parliament voting to suspend the pension reform – a precondition for keeping the Socialist party on board – being met. Other positive news came from the Bank of France, which indicated it would raise the country's GDP forecasts as the economy had shown more resilience despite the uncertain political backdrop.

Markets remain more inclined to take on spread positions amid a backdrop of low volatility as the ECB is seen holding rates for the foreseeable future. Too far out for now is the notion that the problems in France are not over yet and are only the beginning of a long-run fiscal consolidation effort that will face further political hurdles as we approach presidential elections in early 2027.

Thursday's events and market views

After first seeing UK GDP numbers, we will receive eurozone industrial production data for September. Plenty of interesting US data would have been published, including CPI and jobless claims, but due to the shutdown, we don't expect these.

For supply, we have Italy with 3Y, 7Y and 30Y BTPs for a total of €8bn. From the US, we have a 30Y Bond for $25bn. Yesterday's 10y auction had tailed slightly, but had overall displayed solid demand.

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