

## Rates Spark: Volatility calms – we'll take it

US Treasury yields look like they want to nudge higher when they can. And why not, as corporate earnings are firm, and hard macro data is being kept under shutdown wraps. New lows in euro rate volatility help spreads on European government bonds (EGBs) tighten further. Given the spread tightness, Bunds look increasingly attractive as a risk hedge



Treasury International Capital data for April showed net selling of US assets by foreigners, but it was not a dramatic amount

### US Treasuries continue to trade in a heavy manner

It appears to us that US Treasuries remain open to testing higher yields. Monday's Institute of Supply Management (ISM) data were mixed enough and, in fact, net negative on the economy. However, it provided just enough to support higher yields, so yields increased. The rise in yields is right along the curve, but not dramatic – just a nudge. It's not the path that Treasuries should traditionally be on, at least not under a narrative of a slowing economy. However, the bulls would need more credible evidence of a macroeconomic slowdown to offset the dominant positivity emanating from corporate earnings for the latest quarter.

The US Treasury announced its updated borrowing plans. For October-December 2025, the

Treasury expects to borrow \$569bn in marketable debt, which is \$21bn lower than the projection made in July, primarily due to the US starting the quarter with more cash than expected. However, if you ignore that extra cash, the borrowing estimate is actually \$20bn higher than July's forecast due to changes in cash flow projections.

Overall, there is not much new impetus in Wednesday's refunding announcement, which is broadly expected to be a copy and repeat of the previous quarter's volumes and profile. Meanwhile, the bills program continues its heavy net issuance profile. The Treasury cash balance now tops \$1tr, and is a factor behind the accelerated slide in bank reserves.

## Low volatility environment is a breeding ground for complacency

In euro rates, almost all daily movements are dictated by the US, as domestic drivers provide little reason to change course. The European Central Bank (ECB) has fabricated a soft landing, and so far, none of the (many) geopolitical risks seem to materialise. As a result, we also see implied volatility measures hit new lows. Markets are now positioned for the lowest 10Y yield volatility over the next three months since 2021. Even the implied volatility measure for 30Y yields came down again, after peaking in early October in anticipation of large flows from [Dutch pension reforms](#) in January 2026.

The low volatility environment is fertile ground for carry trades. This helps explain why European government bond (EGB) spreads continue their tightening spree. The 10Y Italian bond (BTP) spread now consistently trades below France and is at its tightest level since 2010. Be warned, though, the additional annual return on a 10Y BTP versus a Bund would be wiped out if spreads widened just 10bp. In that regard, 10Y Bunds still look attractive, which might explain why their yields appear tight compared to swaps.

The low-volatility environment, therefore, warrants caution regarding the risk of complacency. The list of risks is extensive. Consider the French budget, tensions with Russia, and President Trump reopening trade deals. Yet none of these risks seem concrete enough to price in, perhaps simply because their impact is difficult, if not impossible, to quantify. Nevertheless, at some point, we will face some economic headwinds. In that regard, the risk-reward of a 10Y Bund may not look that bad.

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