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RATES SPARK

Rates Spark: US long-end under increasing scrutiny

US and EUR long-end yields remain under pressure from fiscal concerns, resilient growth, energy risks and renewed supply, keeping bearish steepening risks intact even as benign US inflation supports the front end

Long-end yields remain under pressure amid fiscal concerns

US: A bearish steepening theme is more likely to persist

The US long end will remain under scrutiny. The US Treasury's attempt to dampen the rise under the guise of scaled-up liquidity operations has only drawn more attention to the underlying issue, the growing debt load and the limited ability or willingness to rein in the US deficit. While it has been signalled that some announcements to cut back on wasteful spending will be made in coming days, without a big rethink coming from Congress, we are only looking at trimming the edges.

There are other factors aggravating the situation in bond markets, such as the tech-related issuance (markets will be paying attention to this week's earnings) and, on the monetary policy side, the ongoing concern with inflation. On the latter, some of the heat has come off though. The market will be looking to the Federal Reserve's favoured inflation measure, the core PCE, this Wednesday. But the CPI release has already been benign alongside other indicators, e.g. producer prices.

That means Fed Chair Kevin Warsh might be under less pressure to provide the clarity the market is seeking when he delivers his speech at this year's Jackson Hole conference on Friday. The market is down to discounting 10bp of tightening for September, which translates into the implied probability of a hike of 40%. At the start of this month, we were above 70%.

Overall, the front end might stay better supported, but the issues plaguing the long end are not going away. We think this leaves a curve twisting steeper or even outright bearish steepening theme intact as our base case. We had flagged last week that 10y US Treasury yields could well test beyond the 4.75% towards 5%.

EUR: The long-end has been an issue, but there is no letup in short-end pressure

Elevated deficits and high debt loads are not only a US issue, but something European bond markets have grappled with for some time already. France and Italy are the main concern currently, but even Germany is facing scrutiny with record-high issuance planned also in the years ahead. 10y Bund yields have risen to above 3.25% over the past week, the highest since 2011, albeit in a less volatile fashion.

The underlying energy situation, with increasing concerns surrounding gas prices, remains a more meaningful driver in the near term that keeps the market's pricing of the European Central Bank aggressive even beyond the September meeting. And we are likely to see an energy-related rise in the flash CPIs coming from the individual countries this week, keeping that pressure alive. On the growth side, the latest round of flash PMIs pointed to an economy staying surprisingly resilient, offering the rates market little relief. We will be looking to Germany's Ifo release on Tuesday, but even here, the consensus is looking for a small improvement.

A more technical driver that has perhaps played more into the timing of the rise in bond yields is the resumption of issuance activities after the summer break. We have seen the first government bond syndicated issuances, including a German 30y tap. But the broader SSA market has also gained steam with German issuers testing the waters.

Monday's events and market view

It will be a slow start to the week in terms of scheduled calendar events. We will be mainly looking for headlines around the US deficit, with officials having touted coming announcements to curb spending. On the geopolitical front, Treasury Secretary Scott Bessent will provide more detail on US plans to increase the economic pressure on Iran in a press conference today.

In the primary government bond markets, Belgium will auction 5y, 10y and 20y bonds for a total of €2.6-3bn.

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