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RATES SPARK

Rates Spark: Different parts of the curve, different dynamics

In the eurozone, long-end rates have felt the spillover from the US, which has helped push 10y EUR swap rates to close to 3.4%, their highest since autumn 2023

With oil prices drifting higher, long-end yields continue to remain elevated

The hawks now have the upper hand for September's Fed meeting

After the hawkish tone out of Jackson Hole, the market is still increasingly leaning towards a rate hike in September as the burden of proof has switched to the doves. While the focus is now on the upcoming jobs report and then CPI release, the bar for the data to move the needle has been raised.

Still, as bond yields have reached lofty heights, we are starting to see more sensitivity to the data. But less as to what it means for the near-term tightening, but with its longer-run implications. The softer ISM and JOLTS reports of Tuesday have left front-end yields still higher on the day, whereas 30y US Treasury bonds managed to edge back from the peak, thus flattening the curve.

We think it is only part of the story though, as long-end bonds are also driven by a mix of deficit and supply concerns and tech-related growth expectations. They are also more persistent and maintain an underlying upward pressure on long-end yields.

As far as equity valuations are concerned, geopolitical headlines and the feedback from the higher rates seems to have finally found its way back into softer stock markets. But nothing really to change the narrative just yet.

The euro short end is set on 2-3 ECB hikes, but the long-end is less anchored

In the eurozone, long-end rates have felt the spillover from the US, which has helped push 10y EUR swap rates to close to 3.4%, their highest since autumn 2023.

But there also remains a closer link to geopolitics and price dynamics, with the latest headlines pushing oil prices above US$90/bbl again and gas prices close to the March price peaks of the Iran war. While there was an encouraging drop in the core inflation rate on Tuesday, signalling that second-round effects remain contained, this does not take away the pressure looking ahead.

There indeed are more calls out of the European Central Bank that a September hike might not be sufficient. To be fair, the market is already discounting 50bp of tightening by February next year. Such comments merely confirm the hawkish pricing rather than pushing it further comment.

That leaves front-end pricing of the EUR curve more anchored, but gives the long end the leeway to move more with the US for now, seeing some reprieve and getting pulled back from the peaks. That reprieve could still prove to be temporary.

Wednesday’s events and market view

There are no data releases of note out of the eurozone. The ECB’s Wunsch, usually with a hawkish lean, is scheduled to speak. It is the last day ahead of the ECB’s pre-meeting quiet period.

In the US, the ADP employment change data tends to offer little guidance for the jobs report later on Friday. Other releases are factory orders and the final durable goods orders data for July.

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