04 September 2026

Has the bond sell-off gone too far?

At a glance:

In market focus. Energy prices; Payrolls (4 Sep); ECB (10 Sep); US CPI (11 Sep).

Global macro and risk appetite. We continue to see the macro backdrop as supportive for equities. Despite the recent rise, oil prices remain at levels the economy can absorb, manufacturing indicators continue to point to an improving cycle, and the rise in real yields has, at least temporarily, stalled. Apparent leakage through the Strait of Hormuz suggests oil prices could ease in coming months even without a formal Iran-US agreement to reopen the Strait to traffic. The principal risk to this constructive backdrop remains the long end of the curve, given persistent pressure from rising US government debt. Had 30Y TIPS real yields continued to rise after breaking above 3% in August – the first time in decades – we would have become more cautious on growth and risk assets. Warsh's Jackson Hole remarks were sufficiently hawkish to protect Fed credibility, but not hawkish enough to drive a meaningful further rise in real yields.

US macro: Moderating? Early data for Q3 (labour market, consumer spending, ISM manufacturing sentiment) suggest a loss of momentum but without fundamentally changing the picture of continued resilience. Stable unemployment – in a low hiring-low firing labour market – means the Fed does not have to worry about job losses. Still, slower payroll growth is a signal of moderating growth after a strong first half. Inflation has softened, but elevated core PCE is a Fed concern. Oil prices remain an upside risk. Our main scenario is still that underlying inflationary pressure will improve as the temporary shocks from tariffs and energy prices passes (see Nordic Outlook, 25 August, for more).

USD short end: Welcome back, Warsh the hawk. At Jackson Hole, the Fed Chair positioned himself among the more hawkish members: The Fed must focus on inflation which has been too high for too long, and the current policy rate is not restrictive, in Warsh's view. Markets swiftly repriced the Fed to a large probability of a September hike, nearly 1.5 hikes before year-end and, accumulated, more than two hikes by summer 2027. We see the repricing as reasonable, but inflation data going forward will be key and we think it would be a mistake to interpret Warsh as sending a clear signal for the September meeting given his opposition to forward guidance. For September, we see the Fed as still split, with some members (Williams, Barr and Waller) willing to wait longer after two months of softer CPI data. August CPI – which will be released on 11 September during the Fed's silent period – will decide the outcome at the September meeting and after yesterday's softer comments from Waller the market is back at pricing 50/50 for a September hike. The consensus view is that the y/y rate edges down again, which we think will be enough for a hold decision. However, if inflation trends do not improve further in H2, the Fed will have no choice but to hike in December. Current market pricing and a hawkish Fed mean risks are clearly skewed to the upside for our view that policy rates have peaked.

USD bonds: Stretched positioning. Macro data, particularly inflation, will remain key for near-term bond-market developments. Increasingly one-sided positioning suggests that even a modest catalyst could trigger meaningful short covering. We maintain our previous view and expect the 10Y Treasury yield to trade mainly within a 4.50-4.80% range over the coming months.

EUR short end: Thee rate hikes now fully discounted. Surging energy prices, resilient growth data and hawkish signals from several Governing Council members have continued to push policy-rate expectations higher. Forwards now discount 75bp of hikes by mid-2027. We regard this as hawkish, but it may take several months before the outlook for 2027 policy becomes materially clearer.

EUR bonds: Energy prices and rising inflation expectations lifting bond yields. Fading hopes of an Iran deal, the implications for European energy markets and the relatively resilient economy have contributed to higher bond yields across the curve. For the 10Y Bund to revert to our previous 3.10-3.30% target range, some positive news on the Iran conflict would likely be required.

Eurosystem: Implications of a possible doubling of the Minimum Reserve Requirement. The ECB is considering doubling minimum reserve requirements (MRR) to 2%. This would reduce excess liquidity and contribute to structural upward pressure on EUR money-market rates and strengthen an existing structural portfolio-reallocation trend from reserves to marketable HQLA.

EUR/USD: stay in range near term, with downside bias into winter. In the coming months, we see modest downside risks for EUR/USD. Europe faces the more immediate risks from energy and French fiscal/political uncertainty, arguing against chasing EUR higher into winter. Further out, into 2027, the asymmetry shifts toward EUR/USD appreciation. Sell-USA portfolio flows and growing concerns around US policy credibility and increased term premia provide increasingly credible USD-negative channels.

Forecasts. Links to SEB's official macro, central bank and financial forecasts.

Bond market sell-off: Enough for now?

The surge in energy prices and renewed inflation risks stemming from the Iran conflict, alongside increasingly hawkish policy-rate expectations, unsustainable fiscal deficits, competition for capital from debt-financed AI investment and concerns over demand for US Treasuries, has driven US and European government bond yields sharply higher in recent months. Most recently, hawkish remarks by Kevin Warsh at Jackson Hole triggered another leg higher in yields. In the euro area, rising energy prices – particularly natural gas – have pushed market-based inflation expectations sharply higher, helping to lift bond yields across the curve.

Looking ahead, developments in the Iran conflict, alongside the key macro data, most prominently US Payrolls on 7 September and US CPI on 11 September, will remain the key near-term catalysts for bond markets. We believe the policy-rate paths currently discounted in US and euro-area markets have become stretched on the upside; however, a durable decline in yields is likely to require clearer prospects of a sustainable resolution to the conflict. This would need to translate into lower energy prices and easing inflation pressures, allowing policy-rate expectations to turn less hawkish and bond yields to decline.

CTA and systematic players are currently driving bond markets. Positioning has become increasingly one-sided, with systematic investors running their largest short positions on record across G10 rates. As a result, even a modest catalyst could trigger meaningful short covering and amplify bond-market gains.

As regards US yields, we reiterate our view from the previous SEB FI & FX Strategy that the 10Y Treasury yield will trade mainly within a 4.50-4.80% range over the coming months.

In the euro area, fading hopes of an Iran deal, the implications for European energy markets – particularly the recent sharp rise in natural-gas prices – and the relatively resilient economy have triggered a hawkish shift in ECB expectations, contributing to higher bond yields across the curve.

Over the longer term, the ongoing reduction in the Eurosystem balance sheet and broader supply pressures remain structural forces pushing yields higher, particularly at the long end. These factors should limit the downside in long-dated yields, even if ECB policy pricing – which we view as overly aggressive, with three rate hikes fully discounted by next summer – were to soften over time.

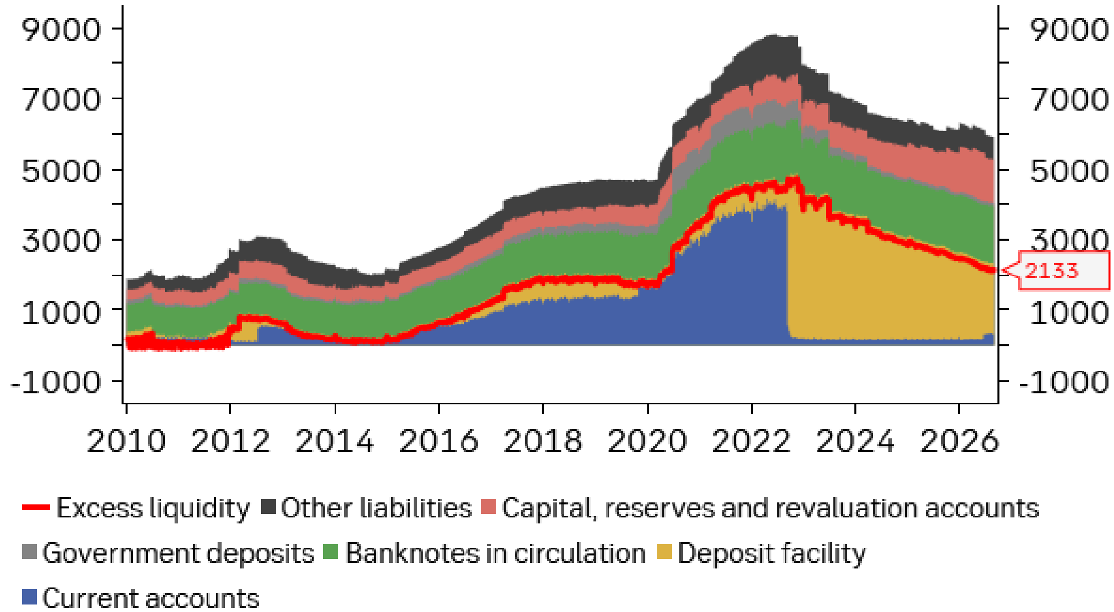
For the 10Y Bund to revert to our 3.10-3.30% target range, some positive news on the Iran conflict would likely be required. In the near term, the risk of further increases in energy prices remains skewed to keep the 10Y Bund yield above that range.

Eurosystem: Implications of a possible doubling of the ECB's Minimum Reserve Requirement

The ECB is considering whether to raise the minimum reserve requirement (MRR) for euro area banks. While it remains under discussion and market participants have so far shown limited conviction that it will be adopted, it has re-emerged as the Eurosystem manages both a declining stock of excess liquidity and the financial consequences of its earlier asset-purchase programmes. Required reserves have been unremunerated since September 2023; increasing their share would reduce the volume of reserves remunerated at the deposit facility rate (DFR), thereby lowering the Eurosystem's interest expense.

For banks, a higher MRR would withdraw liquidity at a point when quantitative tightening is already reducing reserve balances and when the system is gradually moving towards a more balanced liquidity environment. Because required reserves do not qualify as high-quality liquid assets (HQLA) under the EU Liquidity Coverage Ratio (LCR) framework, an increase in the MRR could reinforce banks' incentive to substitute cash reserves with marketable HQLA – including government bonds, supranationals, agencies and covered bonds.

Eurosystem balance sheet: Liabilities & excess liquidity (EUR bn)

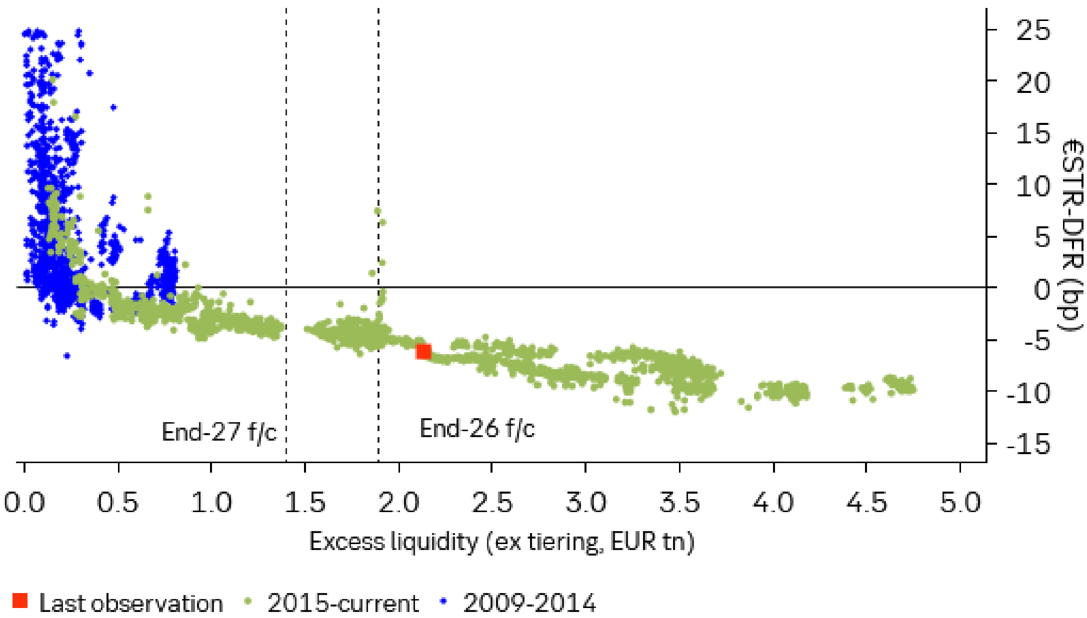


Source: ECB, Bloomberg, SEB.

A EUR 175bn reduction in excess liquidity. According to Reuters on 30 June, the ECB is considering doubling the MRR from 1% to 2%. Eurosystem minimum reserves have recently stood at around EUR 175bn. A doubling would therefore increase required reserves to approximately EUR 350bn and reduce excess liquidity by a corresponding EUR 175bn, from around EUR 2,140bn currently.

If implemented during the autumn, we estimate that the higher requirement would lower Eurosystem excess liquidity to around EUR 1,840bn by year-end 2026. This estimate incorporates the continued maturity and run-off of Eurosystem securities, together with a modest increase in banks' borrowing from the ECB.

€STR vs. DFR & Excess liquidity (note: end-26 and end-27 forecasts assume unchanged MRR)



Source: ECB, Bloomberg, SEB.

The proposal would not fundamentally change the outlook for liquidity conditions. Excess liquidity has already been declining as the APP and PEPP portfolios run off and the Eurosystem transitions away from the abundant-reserves environment created by quantitative easing. However, a higher MRR would bring forward the reduction in reserves and marginally accelerate the point at which banks need to rely more actively on market funding and Eurosystem credit operations.

LCR implications: required reserves are not HQLA. The main transmission channel to bank portfolios arises through the LCR. The ratio requires banks to hold sufficient unencumbered HQLA to cover 30 days of stressed net cash outflows. Under the EU implementation of the LCR, required minimum reserves are not HQLA-eligible; only excess reserves held at central banks qualify.

Consequently, a doubling of the MRR to approximately EUR 350bn would reduce the euro area banking system's stock of HQLA-eligible reserves by around EUR 175bn. It would remove a portion of banks' liquid central-bank balances from the LCR numerator and convert it into required, non-eligible reserves.

As reserve balances continue to decline, banks will become more dependent on money markets and Eurosystem refinancing operations to manage day-to-day liquidity. The first banks to adjust are likely to be those nearing their preferred reserve holdings, internal LCR targets or other regulatory liquidity thresholds. For these institutions, the reduction in excess reserves may create an immediate need either to raise funding, increase holdings of marketable HQLA or release collateral currently tied up elsewhere on the balance sheet.

Banks may defend elevated liquidity ratios. Euro area LCR portfolios have remained broadly stable at around EUR 6.1tn, despite the substantial decline in cash and reserve balances from their 2022 peak. The composition of those portfolios has nevertheless changed: as excess reserves have fallen, banks have shifted towards bonds – primarily sovereign debt – to maintain their liquidity buffers.

This behaviour is consistent with the ECB's latest bank lending and liquidity-related survey evidence. Bank treasurers generally maintain internal LCR and NSFR targets comfortably above the 100% regulatory minimum and indicate a preference to preserve these buffers. The implication is that banks are unlikely to allow LCRs to fall materially simply because HQLA-eligible reserves decline.

By end-2026, banks representing around half of total euro area banking-sector assets are expected to have reached their preferred reserve levels, according to the same survey. This suggests that the system's adjustment to declining reserves may become more market-relevant over the coming quarters, even without a change in the MRR. A reserve-requirement increase would amplify this dynamic for banks that are already close to their internal liquidity targets.

Potential substitution into marketable HQLA. The immediate impact of a higher MRR will vary substantially across banks. Institutions that remain comfortably above their internal LCR targets may be able to absorb a reduction in excess reserves within their existing excess HQLA buffers, in which case the liquidity withdrawal would not automatically translate into an increased demand for bonds.

At the aggregate level, however, a banking system seeking to preserve stable LCRs must offset lower HQLA-eligible reserves with an increase in other HQLA, assuming stressed net cash outflows in the LCR calculation are unchanged. This creates a structural incentive to substitute away from central-bank cash towards marketable liquid assets, notably euro area government bonds, SSA paper and covered bonds.

Banks have several potential routes to maintain their LCRs as excess reserves decline. Assuming net cash outflows in the LCR formula remain unchanged, banks can accomplish this in several ways:

- **Buy HQLA outright.** They can purchase unencumbered Level 1 or Level 2 securities outright, financed through term funding. This raises the LCR numerator directly and supports demand for eligible government, SSA and covered-bond assets.
- **Upgrade or free up existing assets.** They can upgrade the quality of their asset holdings by replacing non-HQLA exposures with eligible securities. Alternatively, they can release HQLA already on the balance sheet but encumbered in collateral arrangements, structured transactions or cover pools. This raises available HQLA without necessarily expanding the balance sheet.
- **Transform non-HQLA into HQLA via secured funding.** They can use secured funding to transform non-HQLA assets into cash. For example, a bank may post non-HQLA collateral in a market repo or Eurosystem operation, then retain or reinvest the resulting cash in Level 1 HQLA. The effectiveness of this channel depends on collateral availability, funding costs and the operational willingness to use central-bank facilities.

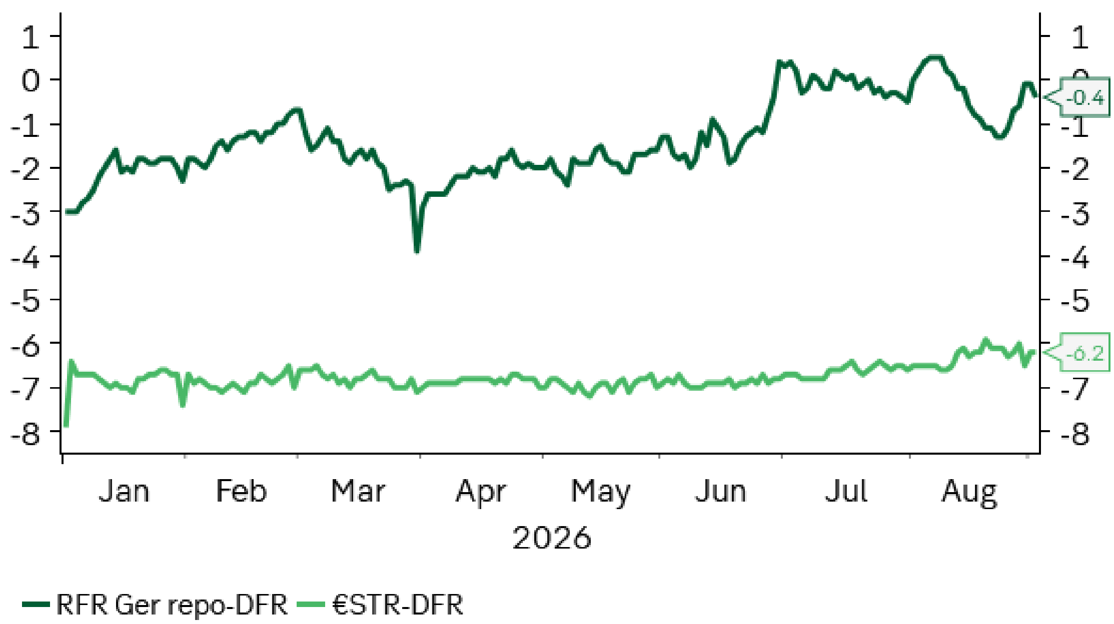
The relevant conclusion is that as central-bank liquidity becomes scarcer, the relative importance of marketable HQLA in bank treasury portfolios should increase. This is most supportive for highly liquid, unencumbered securities that offer reliable repoability and clear regulatory treatment.

Modest acceleration of money-market repricing. We estimate that Eurosystem excess liquidity will decline from around EUR 2,140bn currently to approximately EUR 1,840bn at end-2026 and EUR 1,460bn at end-2027. The projected reduction is driven mainly by the passive roll-off of APP and PEPP holdings. Any offsetting increase in the Eurosystem balance sheet through greater bank borrowing is likely to be gradual, as banks adjust their use of refinancing operations.

This decline in excess liquidity should contribute to structural upward pressure on euro money-market rates, initially most visibly in secured funding markets and particularly in repo. As banks move closer to their preferred reserve levels, the marginal value of reserves rises and the pricing of secured cash becomes more sensitive to liquidity conditions.

We expect overnight euro repo to trade around 5-8bp above the DFR in 2027-28. A possible increase in the MRR would be directionally consistent with this view, but its effect should be understood as an acceleration rather than any structural change in money-market repricing. The broader driver remains the steady decline in excess liquidity resulting from the Eurosystem's balance-sheet normalisation.

€STR & German overnight repo vs. DFR (bp)



Source: Bloomberg, SEB.

EUR/USD: stay in the range near term, with downside bias into winter

We remain reluctant to call a structural break from the 1.15–1.18 range. Near term, however, the bias is for some EUR downside into winter. Europe faces the more immediate risks from energy and France: gas sensitivity remains high, the winter supply balance is tighter than usual and French fiscal/political uncertainty could widen spreads further. That argues against chasing EUR/USD higher tactically.

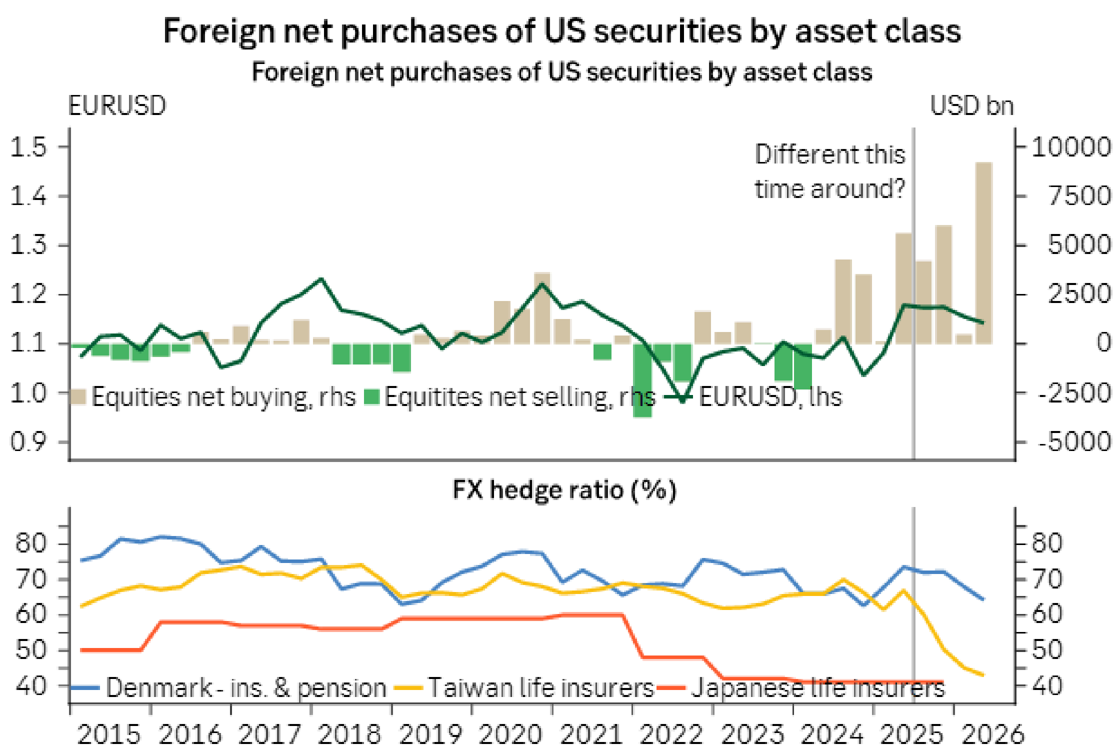
Beyond winter, the balance of risks becomes more EUR/USD-positive. Europe does not need to become strong. Lower US inflation and Fed repricing, a Sell-USA portfolio adjustment and rising concerns around Treasury policy/debasement all provide credible channels for USD weakness.

Source: Bloomberg, Macrobond, SEB

Examples: shocks to generate a 10% broad USD move

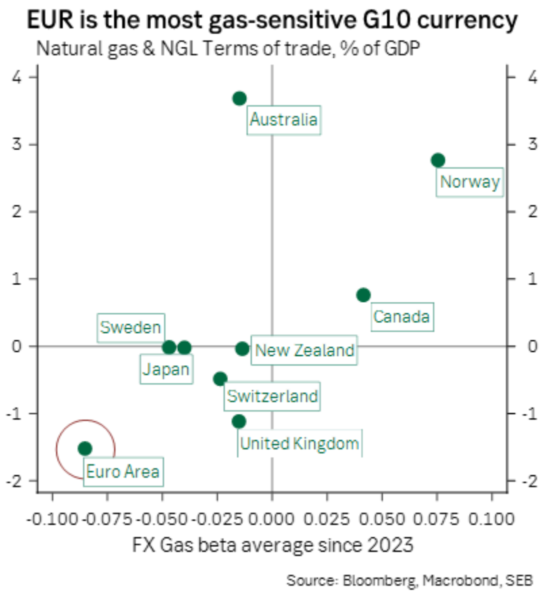
Factor driver:	Theme:	Move:
US 5Y +100bps Oil near 120Usd	Geopolitical escalation: Hormuz or Russia	Usd (+)
US 5Y -100bps Oil near 60Usd	Geopolitical normalization: Oil glut	Usd (-)
Equities -30%	AI theme correction	Usd (-?)
US curve steeper & equities lower	Sell USA theme: Japan capital repatriation, higher FX hedge ratios, AI theme deflating	Usd (-)

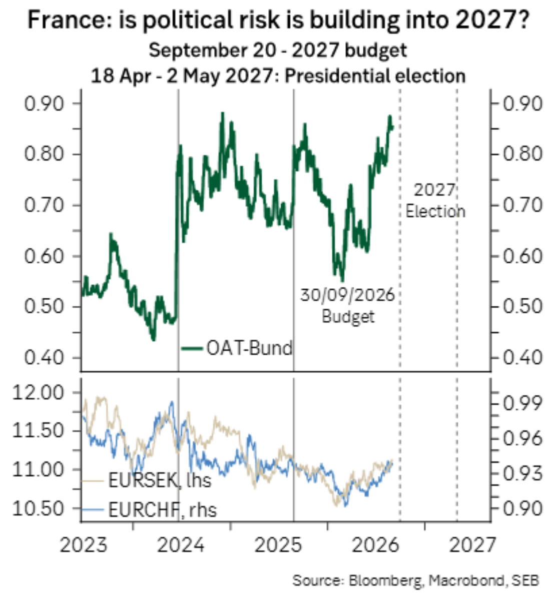
A US risk-off shock may no longer be straightforwardly USD-positive. Speculative USD longs have already been reduced, while foreign investors remain relatively under-hedged on large US asset exposures. A US-led equity correction could therefore generate asset selling and/or higher FX hedge ratios, creating USD supply rather than safe-haven demand.



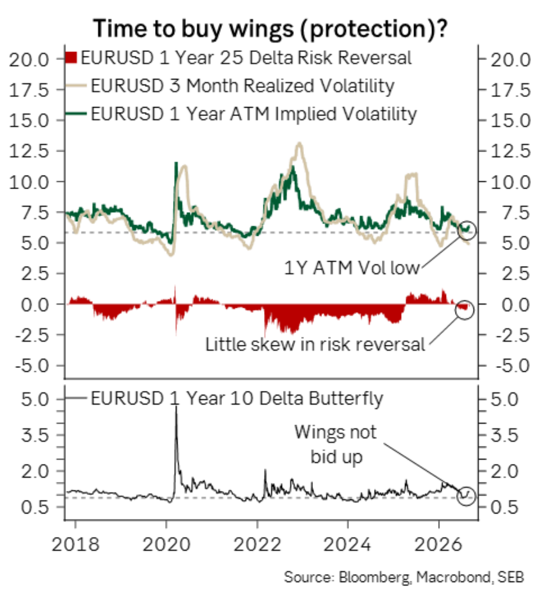
Source: Bloomberg, Macrobond, SEB

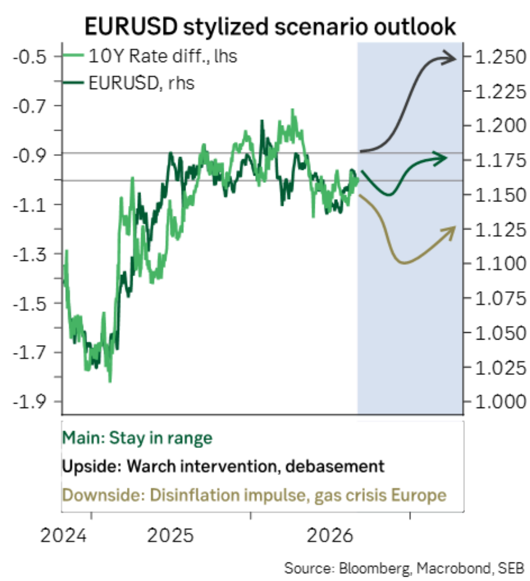
Europe still provides some downside tail. EUR remains the most gas-sensitive G10 currency, while French fiscal/political uncertainty could trigger further spread widening. These risks dominate the short-term outlook, but if Europe avoids renewed energy or political shock, the medium-term asymmetry increasingly shifts toward EUR/USD appreciation.





Implementation: respect the range, but optionality looks attractive. One-year EUR/USD vol is low, risk reversal only mildly favors EUR calls and wings are relatively cheap. Rather than chase spot higher, we prefer keeping upside exposure/convexity while retaining protection against a renewed European energy shock.





Jussi Hiljanen
Chief Strategist, USD & EUR rates
jussi.hiljanen@seb.fi
+46707723167

Filip Carlsson
Quantitative Strategist
filip.carlsson@seb.se
+46704622042

Elisabet Kopelman
US Economist & Fed Watcher
elisabet.kopelman@seb.se
@EKopelman