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RATES SPARK

Rates Spark: Gilts too distracted for good news

Prime Minister Burnham presented UK government plans that should help ease gilt investors concerns about political risks. For now, US rates and energy costs continue in the driver s seat, offering little relief for gilt yield levels



UK government plans should ease concerns for gilt investors, but US rates and energy prices remain in the driving seat

Burnham adds comfort to Labour's fiscal discipline

Gilts should find comfort in PM Burnham's Labour conference speech today, but external forces continue to be the bigger force. Plans to reform the pension triple lock show a dedication to fiscal credibility and a willingness to review difficult and controversial topics. Meanwhile, no obvious inflationary policies were presented, which should ease the fear of Labour adding upward price pressures on top of higher energy costs.

Sterling rates budged little intraday, however, and oil dynamics and US rates stayed in the driving seat. We have argued before that high gilt yields are a product of near-term inflation fears and less so about a political risk premium. Nevertheless, we would take Tuesday's policy plans as a positive for gilts as they reduce the tail risk of Labour triggering a more inflationary trajectory. If anything, lower pensions and potential tax rises should confirm the path of a

fiscal consolidation that we foresee in the coming years.

We think a 5.4% yield for the 10yr gilt is attractive, but much will depend on the global macro environment. Energy prices and US rates could still move higher in the near term, which means sterling rates will be dragged higher too. From a structural perspective, we think the 10yr gilt yield should settle closer to 4.5%, but the move lower will likely only gain traction by mid-2027. Until then, inflation risks will keep rates elevated.

Wednesday's events and market view

The eurozone will turn its attention to further CPI releases from individual countries, this time France, Germany and Italy. Spanish inflation came in hotter than anticipated on Tuesday, also in the more relevant core measure. The ECB's Schnabel is speaking in the afternoon.

In the US, the focus is on the personal income and spending data for August and whether it mirrors the subdued consumer confidence readings. The PCE price index is expected to show a 0.3% month-on-month increase on the core measure, which would support the current market leaning towards an October hike. Fed speakers on the day are Barkin, Cook, Goolsbee and Kashkari.

In primary markets, Germany will auction 10y Bunds (€5.5bn).

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