SEB FI & FX Strategy

02 October 2026

Higher for longer priced in

At a glance:

In market focus. Oil and the Middle East; Inflation data; Long-end yields; France.

Global macro and risk appetite. Global bond yields have risen sharply in recent weeks, with the 10Y Treasury yield at a two-decade high. Equities have so far proved resilient, while credit has been under pressure since September. Strategically, the most damaging transmission channel from rates to risk appetite is a rise in interest rates large enough to slow GDP growth sharply. Neither the level of bond yields nor rates volatility looks high enough yet to threaten a significant slowdown, but there are warning signals for a possible equity correction. Bond yields have been moving in sync with oil prices, and positioning is heavily skewed towards higher yields. A reopening of the Strait of Hormuz or weaker macro data could therefore trigger a move lower in yields. We think risk assets are unlikely to move higher until the uptrend in rates is broken.

US macro: Strong growth, inflation relief. The underlying inflation trend is looking better after the larger than expected downward effect from revised methods for core PCE. Annualized monthly change in line with the target over the past three months has eased the pressure for another near-term rate increase. However, strong growth – with upward revisions to total GDP, firm underlying demand in Q2 and strong spending in August – support that current policy is not restrictive and raises risks for companies passing through rising energy costs to consumers. AI build-out is seen by most of the Fed as a near-term upside risk to both growth and inflation. Rising real yields pose new downside risks for growth and especially through any adverse equity market reactions, given the importance of positive wealth effects for consumers. Markets are pricing less than a 40% probability for an October rate hike (9bp) and a full rate hike in December – which we see as reasonable – followed by two to three additional hikes in 2027 – which we see as excessive.

USD short rates: Waiting for new impetus. Terminal SOFR has risen by around 185bp, to 4.85%, since the Iran conflict began at the end of February, and the past week has shown tentative signs of stabilisation. We think policy rate expectations have risen enough for now and see scope for consolidation, with markets waiting for a trigger for the next move.

USD bonds: Higher for longer increasingly priced in. The 10Y Treasury yield is above 5.30% after a sharp sell off, driven mainly by higher policy rate expectations, not inflation expectations or term premium. Fed pricing and market positioning are stretched, but the sell off needs a catalyst to fade. Conflict de-escalation or weaker growth data may be the likely triggers, and a correction lower in long yields could be rapid once momentum turns.

France: Rising fiscal concern. PM Lecornu's government presented its 2027 draft budget on 1 October, ahead of formal submission on 6 October. Large savings needs and opposition discontent threaten the minority government, while fiscal worries and a lack of reforms are pushing French yields higher. Next year's presidential election adds uncertainty, with candidates at both political extremes gaining in the polls (read more here).

EUR short rates: Policy rate pricing looks complete for now. Forwards discounting more than 80bp of additional hikes by next autumn, and we think it will be hard for markets to push pricing materially further at this point. At the same time, markets are likely to resist pricing fewer than 75bp of hikes without a decisive breakthrough that brings a substantial, sustained decline in energy prices.

EUR bonds: France in focus. With short positioning stretched and ECB and Fed pricing sufficiently aggressive to account for inflation prospects, we maintain our base case that the 10Y Bund yield will trade predominantly in a 3.40-3.60% range in the near term. The rapid widening of OAT vs. Bund spreads looks concerning and is increasingly spilling over to other markets, but it is unlikely to affect ECB actions materially just yet.

EURUSD: Market already short, but the downside risk is growing. The wider US–EUR 2Y differential has driven EURUSD lower, but that driver now looks close to exhausted: US policy pricing is stretched and positioning is skewed toward higher yields. The market is also already short EURUSD, which helps explain why spot has held up better than the backdrop suggests. The risk has shifted lower over the past week, though. French stress is spreading to Italy and Spain, and options are pricing more protection against a weaker euro. A sustained break below support would confirm that the euro-area premium is reaching FX and open 1.10–1.11. The upside risk is a positioning-driven squeeze.

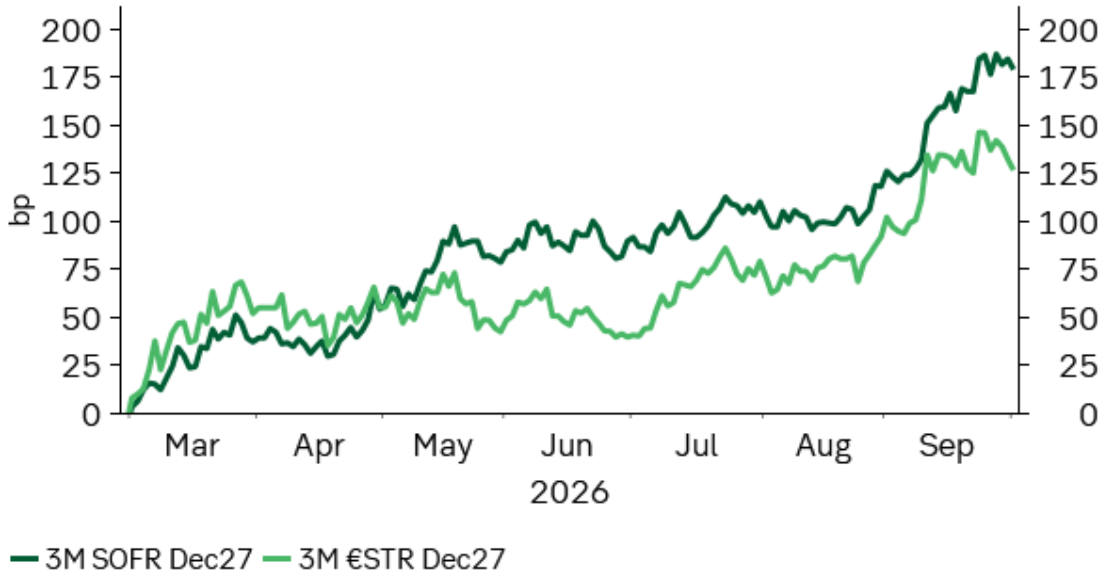
Forecasts. Links to SEB's official macro, central bank and financial forecasts.

USD bonds: Higher for longer increasingly priced in

Two weeks ago, we expected the 10Y Treasury yield to consolidate in the 4.90-5.10% range. With the 10Y now trading above 5.30%, our view of consolidation proved premature. We see yields as stretched, but the sell off needs a catalyst to fade, most likely conflict de-escalation or weaker growth data.

Pricing of rate hikes through end-2027 has risen by around 185bp in the US and 125bp in the euro area versus levels prevailing just before the Iran conflict escalated at the end of February. As argued in the previous SEB FI & FX Strategy, policy rate expectations have reached a level where markets will likely struggle to push them much further without new triggers. Any further rise in yields would therefore more likely have to come from a higher term premium, which has so far remained contained. Conversely, with an already aggressive policy path priced in and positioning heavily skewed towards higher yields, better prospects for conflict de-escalation or disappointing growth data could trigger a rapid unwinding of part of the discounted hikes and a correction lower in long yields.

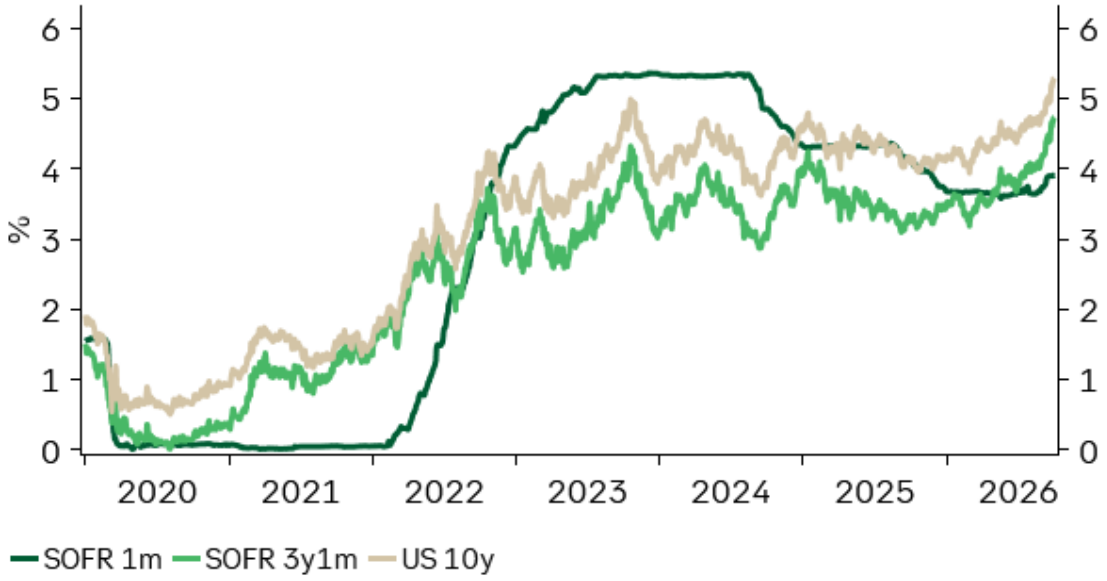
Cumulative rate hikes from inception of the Iran conflict to end-2027 discounted by futures: Fed and ECB



Source: Bloomberg, SEB

Policy rate expectations remain the key driver. The rise in the 10Y Treasury yield has continued to track policy rate expectations (illustrated by the 3Y forward on the 1M SOFR rate in the chart below), in line with our conclusion on the Bund yield in the previous report.

Policy rate expectations (SOFR) and 10Y Treasury yield

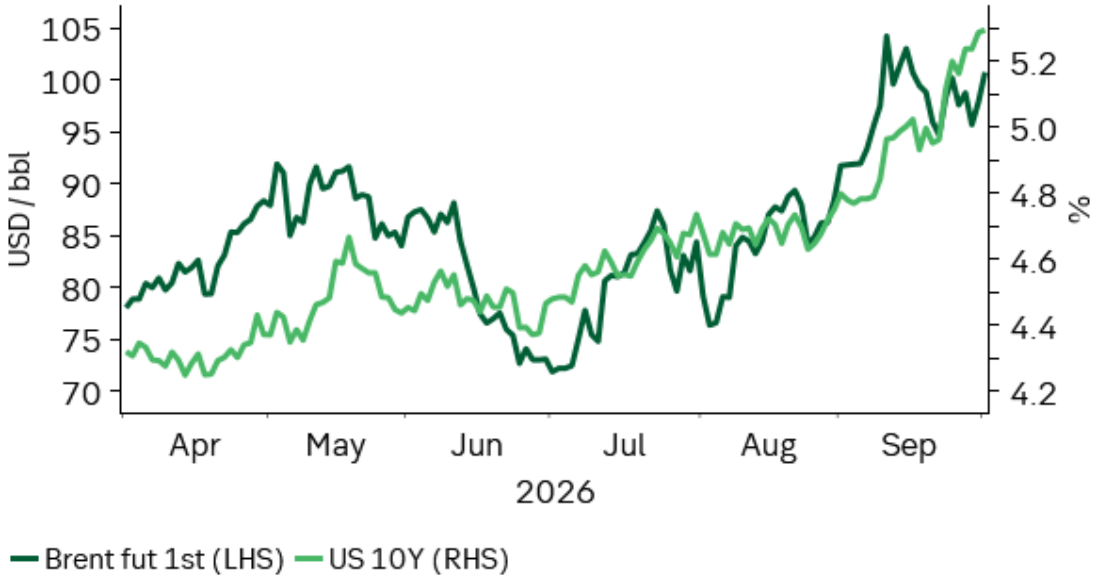


Source: Bloomberg, SEB

Long US rates have tracked oil prices closely since the start of the conflict until recently. Since mid-September, however, yields have kept rising, despite some pullback in oil. The deviation probably reflects

higher-for-longer policy rate expectations, but we think developments that bring oil prices lower would help to ease pressure on bond markets.

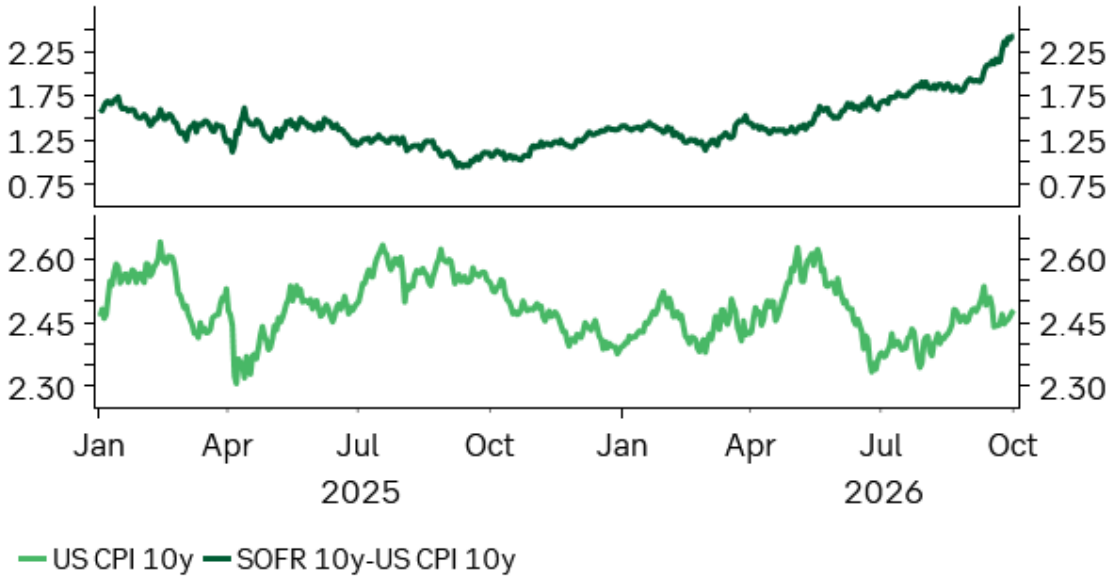
Oil prices and 10Y Treasury yield



Source: Bloomberg, SEB

Inflation expectations remain anchored. Despite higher oil and other commodity prices, long-term inflation expectations are well anchored. Both 10Y and 5Y5Y CPI swaps trade at the levels seen in February. The 10Y real rate, however, has climbed from around 1.15% at the end of February to nearly 2.40% currently. A substantial repricing of the policy path (higher for longer) combined with stable inflation expectations suggests markets trust the Fed's commitment to its inflation target.

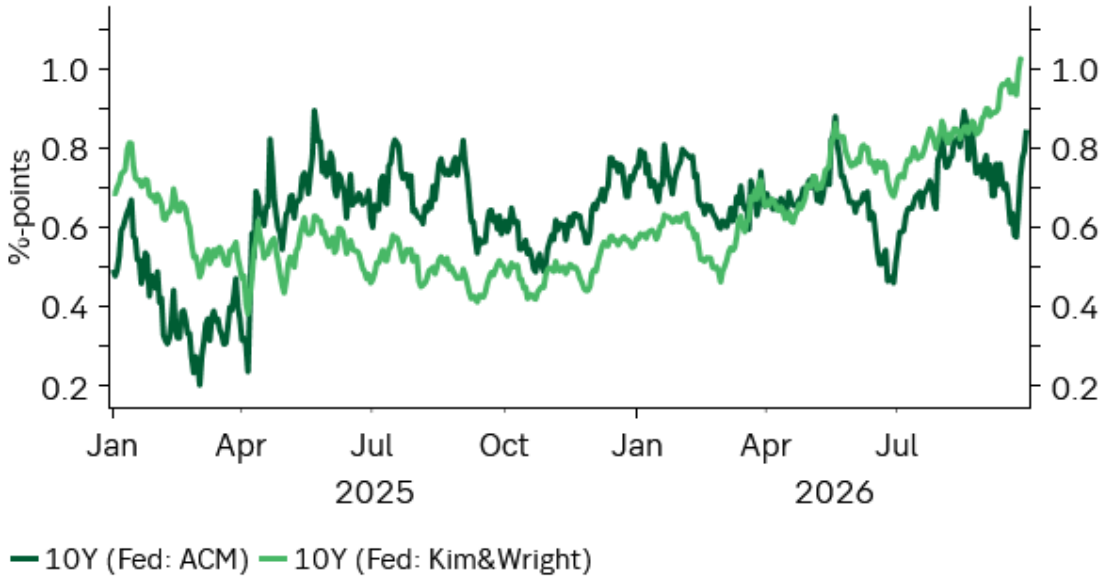
Inflation expectations (10Y CPI swap) and 10Y real rate (SOFR-CPI swap), %



Source: Bloomberg, SEB

Term premium up only modestly since the conflict began. The term premium has trended higher in recent years, as investors demand greater compensation for holding long-duration Treasuries amid uncertainty over inflation and the Fed's policy path, fiscal supply, long-term debt sustainability, and a marginal buyer base shifting towards more price-sensitive investors. The Fed's ACM model, the measure most widely followed by markets, has moved broadly sideways since mid-2025 and risen only modestly since the end of February. It supports the view that the rise in yields has been driven mainly by higher-for-longer policy rate expectations.

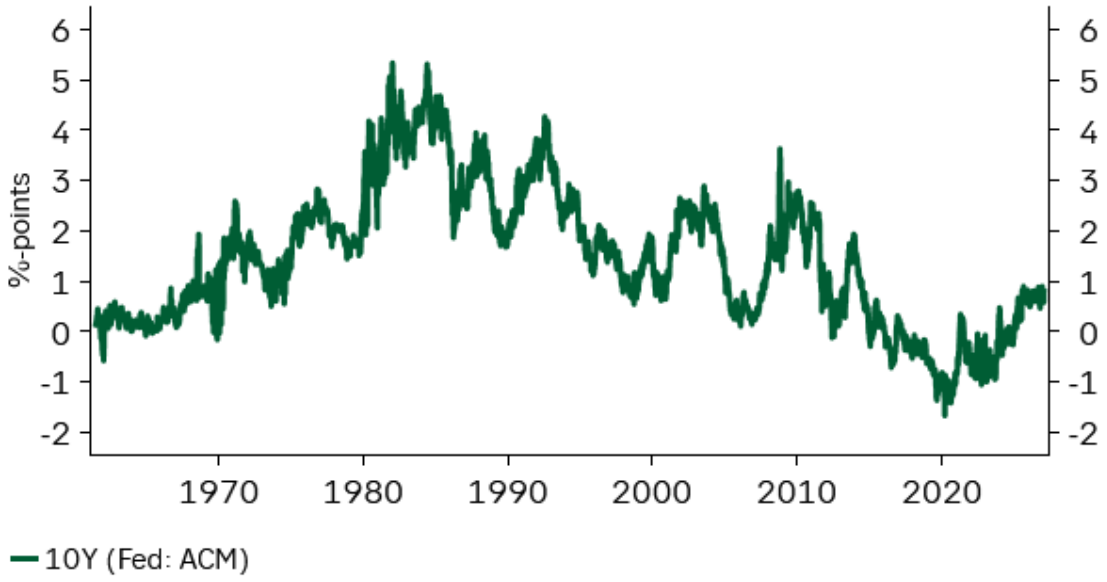
US: Term premium in 10Y tenor according to the ACM and Kim&Wright models



Source: Fed, Bloomberg, SEB

Structural term premium risks skewed higher. The term premium in Treasury yields is still relatively low in a long-term perspective, and we see risks skewed towards a structural increase in the coming years. Investors are likely to demand higher compensation for duration, particularly if the hedging qualities of Treasuries against shocks are seen weakening, for example on (geo)political or structural grounds.

US: Term premium in 10Y tenor, long-term perspective



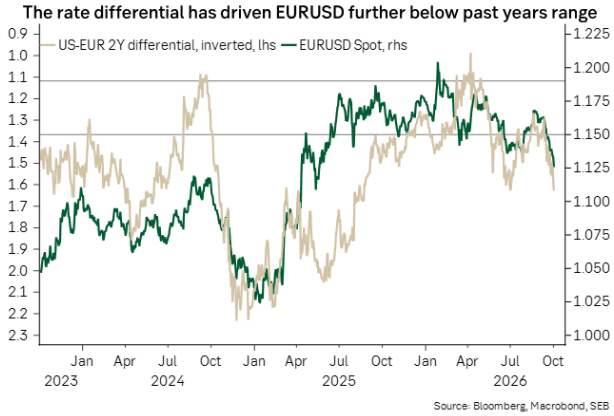
Source: Fed, Bloomberg, SEB

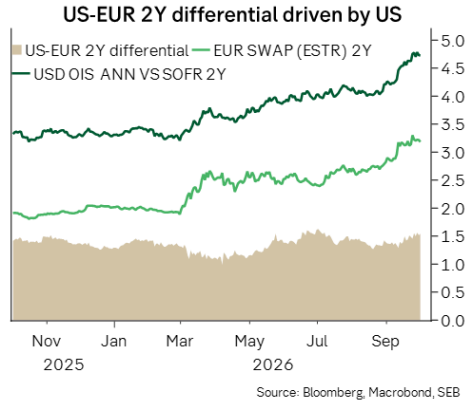
Even with a structural rise in term premium, other factors will likely matter more for Treasury yields over the next 6-12 months, notably inflation and growth prospects, which in turn hinge on conflict resolution. With positioning stretched, a correction lower could be rapid once upside momentum fades. Historically, however, a sustained decline in long yields has emerged only near the end of hiking cycles.

EURUSD: Market already short, but downside risks are growing. The wider US–euro-area two-year differential has driven EURUSD lower, but further US policy repricing looks increasingly difficult to sustain. European fiscal stress is becoming the more important downside risk. French spreads have widened sharply, Italy and Spain have begun to follow, and options are pricing more expensive protection against a weaker euro. Short CTA positioning leaves room for a squeeze, but we need to give weight to the risk that fiscal stress broadens and puts further pressure on EURUSD. A sustained break below support, accompanied by broader European stress, would open the way towards 1.10–1.11.

The rate differential has driven EURUSD lower, but that driver looks increasingly mature. Since the Iran conflict escalated, the implied end-2027 US rate has risen by around 185bp, compared with roughly 125bp in the euro area. The larger US repricing has widened the two-year differential and weighed on EURUSD. As argued in the USD rates section, however, US policy pricing looks stretched and positioning is skewed towards higher yields. A further sell-off increasingly requires a fresh catalyst, while additional upward pressure on long yields may come from term premium rather than policy expectations.

The risks to the differential are therefore becoming more two-sided. We see the hawkish US repricing as excessive, while ECB expectations may remain sticky unless energy prices fall decisively. A correction driven by softer US data could narrow the differential and support EURUSD. That would weaken one source of downward pressure on the pair, but would not necessarily offset a growing European fiscal risk premium

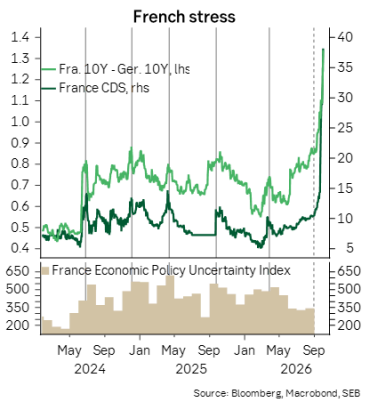


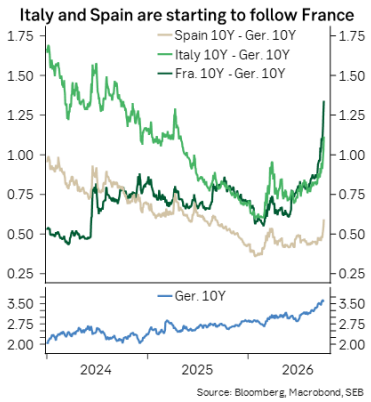


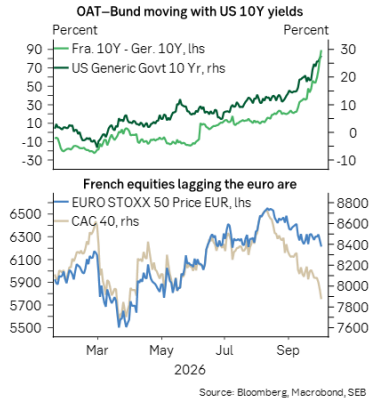
Fiscal stress is broadening across the euro area, although markets are still differentiating. OAT–Bund widening has been accompanied by a sharp rise in French CDS and French equity underperformance. Italy has followed, and Spain has now widened too. France remains under the greatest pressure and Spain the least, suggesting that investors are still distinguishing between sovereign risks. Nevertheless, the widening beyond France raises the risk that fiscal concerns become a broader euro-area problem.

Part of the move has tracked the global rise in long-end yields, led by US Treasuries. Higher financing costs amplify fiscal vulnerabilities, and a turn lower in US yields could therefore ease some pressure. If French spreads fail to narrow alongside that relief, it would strengthen the case that domestic fiscal concerns are sustaining the repricing.

For EURUSD, the escalation test is whether peripheral widening exceeds what global yields and the usual relationships with France would explain, and whether European banks begin to underperform. Those developments would strengthen the case that sovereign stress is becoming an independent driver of euro weakness.

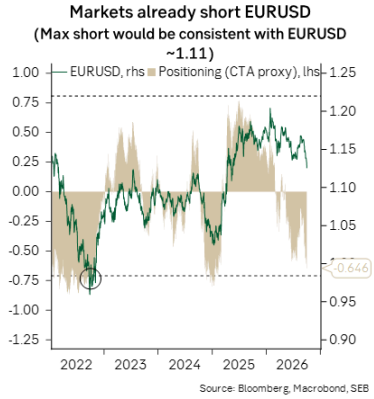


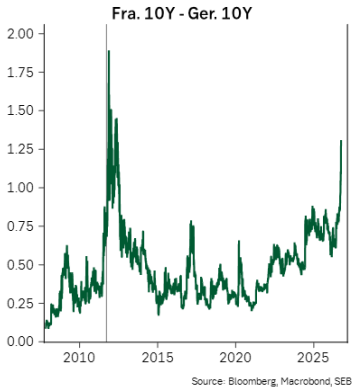




EURUSD's resilience is increasingly vulnerable to broader fiscal stress. Spot has weakened, but has not shown the same degree of stress as French sovereign markets. Our CTA proxy already indicates short EURUSD positioning, which may dampen additional selling from trend-following investors and leaves the pair exposed to short covering. FX may also still be treating French spread widening partly as an extension of the global rates move.

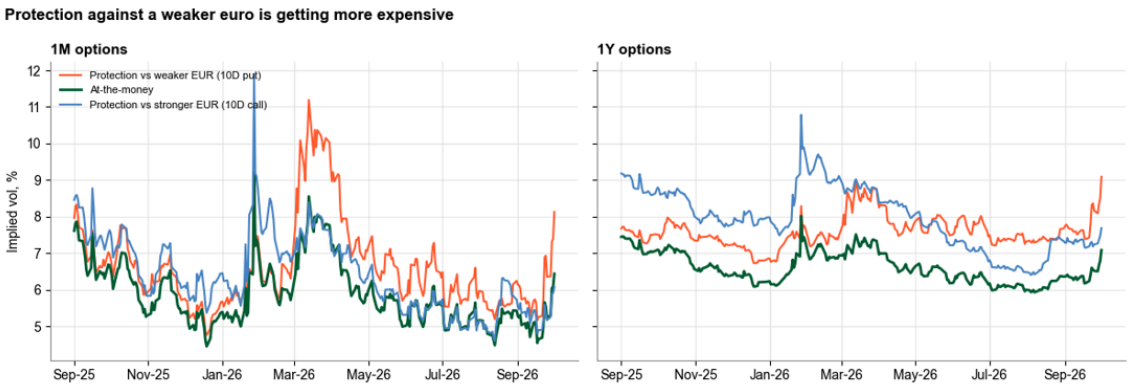
We see a growing risk that this resilience is challenged. The French spread to Bunds is at its widest since the euro-area debt crisis. Although it remains below the 2012 peak and does not imply the same systemic risks, the scale and speed of the repricing warrant attention. Italy and Spain beginning to follow increases the risk that the pressure extends beyond France. Existing shorts may slow the adjustment, but do not provide a floor if the underlying outlook deteriorates.

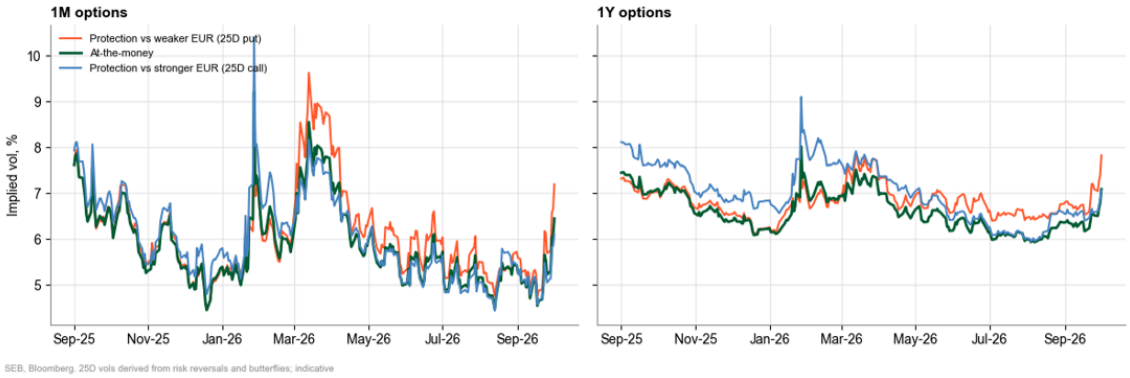






Protection is building in both directions, but most of all against a weaker euro. Implied vol has risen across the curve, lifting the cost of hedging both a stronger and a weaker EUR, so the market is pricing larger moves either way. The put side has led, though. One-month 10-delta put vol has jumped from around 5.5 to 8, and in 1Y, put vol has risen to its highest level in a year while the premium over at-the-money has widened. The market is not just hedging a break in the range: it is starting to pay for a more persistent EUR downside, while keeping upside convexity on the table.





Energy: still a risk, but with room for optimism. With the injection season over and the threat of a US diesel export ban receding, near-term energy pressure on Europe may ease. Winter and next year's refill season remain tight, so the risk has not gone away, but it is less likely to be the trigger for EUR weakness.

The downside risk for EURUSD has grown over the past week. French stress has spread to Italy and Spain, spot is testing the bottom of its 2026 range, and options are pricing more protection against a weaker euro. But positioning remains stretched, so the upside has not gone away.

Scenarios:

Downside: French stress reaching FX. The main downside risk is euro-area fiscal stress spreading beyond France. Watch for spreads widening beyond the move in global yields, together with European banks underperforming. In a market this short positioned, and but a sustained break lower, breaking resistant levels, would open 1.10–1.11. Even if there have been some energy relief, a persistent winter premium would still reinforce a break.

Upside, short term: a positioning-driven squeeze. The most likely upside trigger is US yields peaking. As argued in the USD rates section, policy pricing looks stretched and positioning is skewed toward higher yields. With more hikes priced in the US than in the euro area, a correction would likely narrow the 2Y differential, and short positions in Treasuries and EURUSD could unwind together. A manageable outcome to the French budget votes on 20 October and 17 November, together with easing diesel stress, would remove two euro-area brakes. That could lift EURUSD back above 1.15. Because the rally would be driven by positioning rather than fundamentals, we would treat it as a correction, not a turn.

Upside, longer term: disinflation and conflict resolution. A sustained EUR recovery needs global disinflation that lets markets lower rate expectations, that would most likely follow from an end to the conflict that brings oil prices down. That is more likely a 2027 story than a Q4 one.

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