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RATES SPARK

Rates Spark: Don’t expect a break back below 5%

We think the US 10yr stays above 5%, and in fact heads back up to 5.25%. That won't help the eurozone, which continues to grapple with the problem that is France. Probably overdone, but far from over



We think the 10-year yield on US Treasuries will remain above 5.00% and head back up to 5.25%

The mood for US Treasuries has calmed. But don't get too comfortable

Treasury market moves of late have been quite something. There were buyers in the 5.3% area post the CPI release on Wednesday. Then the Asian open coincided with some large falls in equities, with a particular focus on Korean equities, which prompted some follow-on buying of Treasuries. Note, however, that there have been decent buyers of Treasuries on an ongoing basis in the past number of weeks. It just has not translated into a meaningful move lower in yields, mostly as it had been offset by net shorts on Treasury futures. We've been overdue a reversal.

That said, we're not convinced this is a structural move, and we'd be quite surprised if we were to break below 5% on the 10yr yield. Treasuries did not react much to Thursday's data, but market participants will be aware that we had another good (low) jobless claims number, retail sales were firm and PPI inflation uncomfortably high. The market will likely use this as a platform from which to rebuild higher in yields over the weeks ahead, and into the mid-terms; especially with neither side voicing an intention to take action on the fiscal deficit. The issues of high printed inflation and a high deficit remain.

The balance of probabilities suggests there is at least one more leg of long-end weakness still to play out. This could take the US 10-year yield back into the 5.25% to 5.5% range. Other markets would likely move in tandem, mapping out similar, albeit less dramatic, blow-outs. With 5.25% looking like a mean-reversion level, we think the US 10-year yield could overshoot towards 5.5% and remain elevated for a number of months as bond market jitters persist. This could quite easily extend into the first quarter of 2027. Our views here are unchanged, despite recent moves.

The eurozone remains in the throes of an uneasy holding pattern at dodgy levels

The focus in the eurozone is increasingly insular, with France front and centre and setting the mood. Here too, there has been some market stability – but at uncomfortable levels. The standout move has been a doubling of the French 10yr swap spread from the 60bp area to the 120bp area. And French spreads to Germany are practically as wide as they've ever been since the dawn of the euro, even versus the immediate pre-EMU years. The safe narrative to reach for is the debt dynamics one, and the lack of ambition to correct it. Made worse, in fact, by the political options being offered for 2028.

This is probably overdone, as a swing to the right (should it occur) could have some tail positives that aren't currently properly discounted. Look at the improvement seen in Italian spreads following the rise of Prime Minister Giorgia Meloni. It's been gradual but persistent, and has not been overly impacted by French concerns. In that sense, the Italian response has been low beta in characterisation, which is good.

In fact, the first real bout of widening in French spreads can be traced back to President Emmanuel Macron's election gamble of mid-2024. Things subsequently calmed, but were not forgotten. The recent spike is an amplification and extension of an underlying tension that has not gone away. So, overdone? Probably, yes. But we also remain in a danger zone for bonds generally. Just like in the US, more overshoots to the upside are entirely foreseeable.

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