Interest Rates Focus

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Haven demand, supply, mid-terms

- AI jitters and volatility in French government bonds have created safe haven demand for Treasuries, taking the 10Y yield back towards 5.00%, 30bp from the peak traded in early October.
- Markets will focus on the October FOMC meeting, PCE data, month-end auctions and extension trade next week. Our house view is for the FOMC to hold rates next week, followed by a hike in December.
- We expect the Treasury to maintain stable coupon auction sizes at the November Treasury Refunding Announcement (QRA) on Wednesday 4 November, totalling USD125bn.
- The fact that long-end yields have remained elevated despite increased long-end buybacks raises the likelihood of supply cuts in 20Y or 30Y bonds, although the timing remains uncertain.
- Issuance guidance will be under the spotlight, particularly regarding the timing of any changes in coupon supply. If the Treasury reduces long-end auction sizes, we expect bill or short-end coupon supply to increase.
- Mid-term elections are approaching. Democrats are likely to regain control of the House. Under this scenario, legislative gridlock is likely regardless of which party controls the Senate.
- A divided government would reduce the likelihood of major spending programmes and tax cuts, easing upward pressure on Treasury term premium and long-term interest rates.
- Regardless of the election outcome, the federal budget deficit is likely to continue rising over the coming years, leading to higher Treasury issuance. While strong economic growth can help, it is unlikely to materially alter the fiscal trajectory.



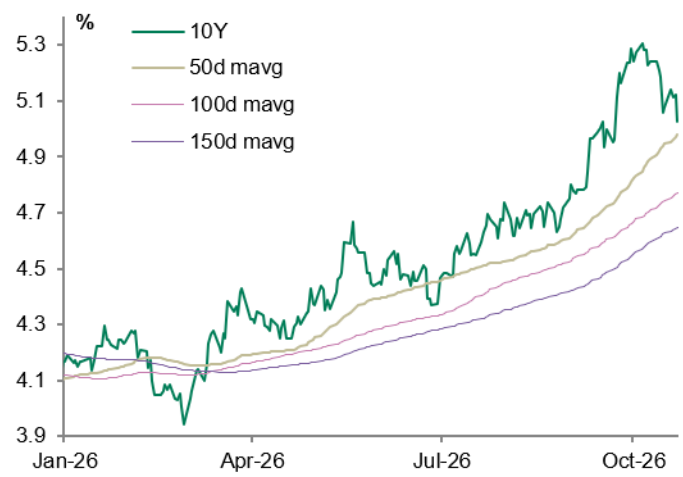
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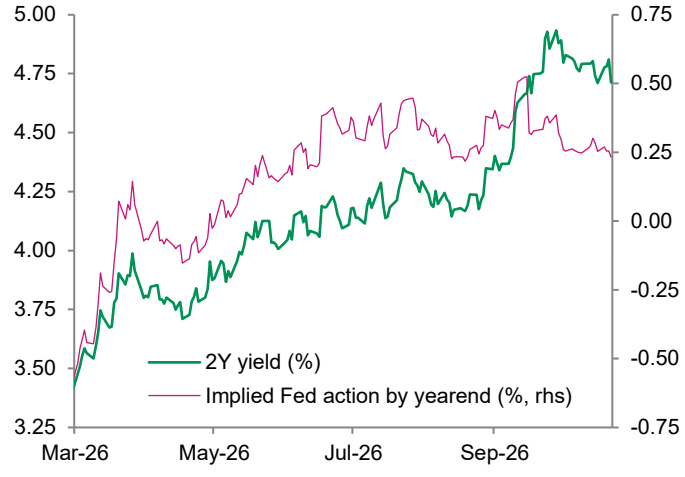
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Fig 1. 10Y Treasury yield drops 30bp from peak



Source: Bloomberg, Crédit Agricole CIB

Fig 2. Market prices an October Fed skip



Source: Bloomberg, Crédit Agricole CIB

Haven demand

AI jitters and volatility in French government bonds have created safe haven demand for Treasuries, taking the 10Y yield back towards 5.00%, 30bp from the peak traded in early October and right on top of its 50-day moving average (Figure 1). Markets will focus on the October FOMC meeting, PCE data, month-end auctions and extension trade next week. Our house view is for the FOMC to hold rates next week, followed by a hike in December, in line with market pricing (Figure 2).

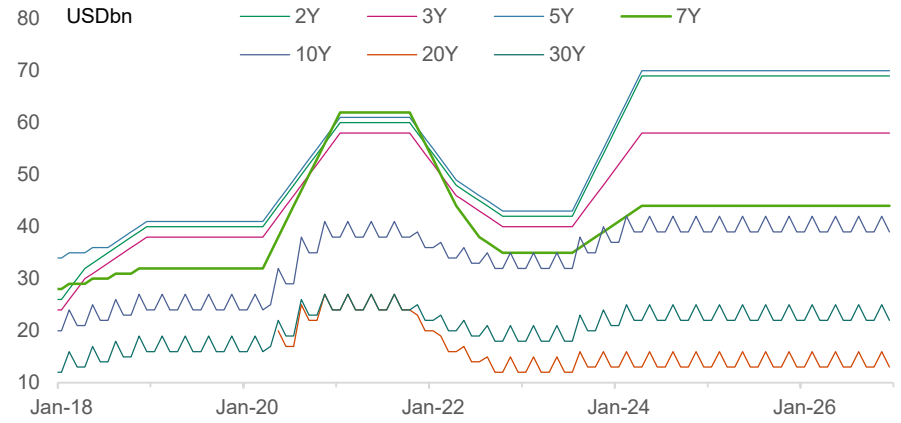
Despite an expected FOMC hold, the stronger-than-expected inflation data in September makes the October meeting more interesting. After CPI and PPI, our economists forecast core PCE tracking at a relatively firm pace in September, with the MoM near the cusp of rounding between 0.3-0.4% MoM with the YoY rate up to 3.1% from 3.0%. This is not ideal for the Fed, though core FOMC members have suggested a bias towards holding in October.

November refunding preview

We expect the Treasury to maintain stable coupon auction sizes at the November Treasury Refunding Announcement (QRA) on Wednesday 4 November, with total nominal coupon supply of USD125bn comprising USD58bn of 3Y notes, USD42bn of 10Y notes and USD25bn of 30Y bonds. We also expect TIPS auction sizes to remain unchanged, consistent with recent refunding announcements.

The Treasury has maintained guidance since February 2024 that nominal coupon and FRN auction sizes would remain unchanged for at least the next several quarters (Figure 3). While rising budget deficits ultimately point to higher coupon issuance over time, we do not expect any immediate changes at the upcoming refunding announcement.

Fig 3. Coupon auction sizes



Source: Credit Agricole CIB, Bloomberg

Instead, bill issuance has been doing most of the adjustment. The Treasury has gradually increased bill auction sizes across the curve since early October, and we expect bill supply to remain elevated through the remainder of 2026. Bills currently account for about 22% of outstanding marketable debt.

Nevertheless, investors will closely scrutinise issuance guidance for any indication of future changes to the maturity composition of Treasury borrowing. If officials decide that additional coupon issuance is required, they may prefer to increase issuance at the front end of the curve. Such an approach would reduce the weighted average maturity (WAM) of Treasury debt and would be consistent with the administration's stated objective of lowering long-term borrowing costs.

The Treasury will also release its quarterly financing estimates on Monday 2 November, including updated guidance on the Treasury General Account (TGA). At USD970bn, the TGA remains above the Treasury's year-end target of USD850bn. Markets may also receive an update on plans to invest excess TGA cash balances in overnight repo facilities to generate additional returns.

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Another key area of focus will be Treasury buybacks. Investors will pay particular attention to buyback operations in the long end of the curve. Despite an increase in long-end buybacks, long-term Treasury yields have remained elevated. This raises the possibility that Treasury officials may eventually consider reducing issuance in the 20Y and 30Y sectors, although the timing of such a move remains uncertain.

As a result, issuance guidance will likely be the most closely watched aspect of the refunding announcement. If the Treasury ultimately reduces long-end coupon supply, we expect the adjustment to be offset through increased issuance of Treasury bills and/or shorter-dated coupon securities.

Deficit and mid-terms

Mid-term elections are approaching and could have important implications for the fiscal outlook and Treasury market. Our base case is that Democrats regain control of the House. Under this scenario, legislative gridlock is likely regardless of which party controls the Senate.

A divided government would reduce the likelihood of major spending programmes and tax cuts, easing upward pressure on Treasury term premium and long-term interest rates. All else equal, this would be supportive of lower long-end yields and a flatter yield curve. Front-end rates, however, are primarily driven by monetary policy expectations. With energy prices remaining elevated and the Fed likely to deliver additional rate hikes, front-end yields such as the 2Y Treasury yield are likely to remain high.

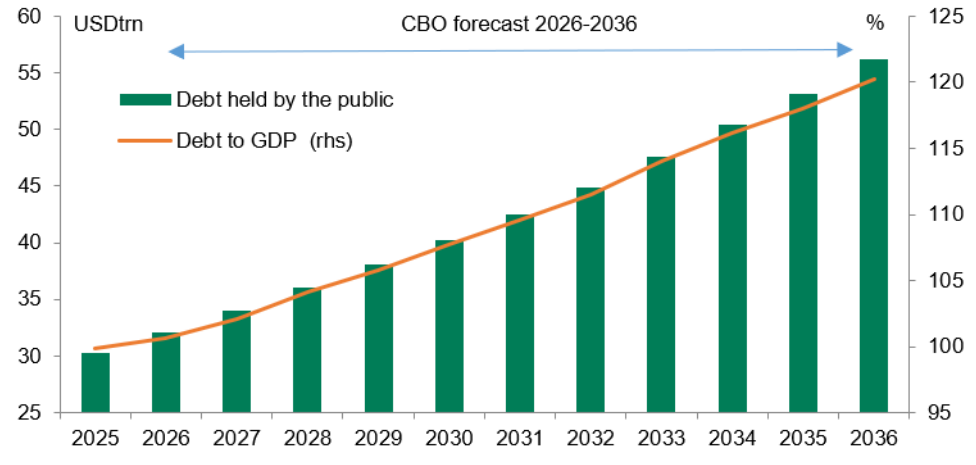
The impact of the mid-term elections is therefore likely to be greater on lawmaking than on monetary policy or broader macroeconomic trends. If Democrats gain control of the House, passing major fiscal legislation would become more difficult regardless of Senate control. Senate procedures and presidential veto authority generally require a degree of bipartisan support to enact significant policy changes.

There would nonetheless be meaningful implications beyond legislation. Senate control would remain important for judicial appointments and the confirmation of senior government officials. Changes in congressional control could also lead to increased oversight through hearings and investigations, potentially affecting the administration's policy agenda and political priorities.

Government funding negotiations are likely to remain a recurring source of tension, meaning the risk of future shutdown episodes cannot be ruled out. In contrast, trade and foreign policy are likely to be less sensitive to election outcomes because these areas remain largely directed by the executive branch.

Regardless of the election outcome, the fiscal trajectory remains challenging. Federal budget deficits are likely to continue expanding over the coming years, requiring higher Treasury issuance and increasing the overall supply of government debt.

Fig 4. Deficit as far as the eye can see



Source: Credit Agricole CIB, Bloomberg

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The federal budget deficit reached USD1.99trn in fiscal year 2026, which ended 30 September, reflecting USD7.4trn of spending (up 6% from the prior year) and USD5.4trn of revenue (up 3%). This compares with deficits of USD1.775trn in fiscal year 2025 and USD1.817trn in fiscal year 2024. At approximately 6% of GDP, the deficit remains unusually large for a period that is not characterised by recession or a major economic shock such as the Global Financial Crisis or the Covid-19 pandemic.

The CBO forecasts the debt-to-GDP ratio to rise from 100% this year to 120% in ten years (Figure 4). While stronger economic growth can improve the fiscal outlook at the margin, it is unlikely to fundamentally alter the trajectory of federal debt accumulation. According to Congressional Budget Office analysis, real GDP growth would need to reach approximately 6% to stabilise federal debt levels assuming interest rates around 5%.

Taken together, the outcome of the mid-term elections may influence the pace of future fiscal expansion, but it is unlikely to materially change the long-term debt trajectory. The more important implication for Treasury markets remains the continued rise in borrowing needs and the resulting increase in Treasury issuance over time.

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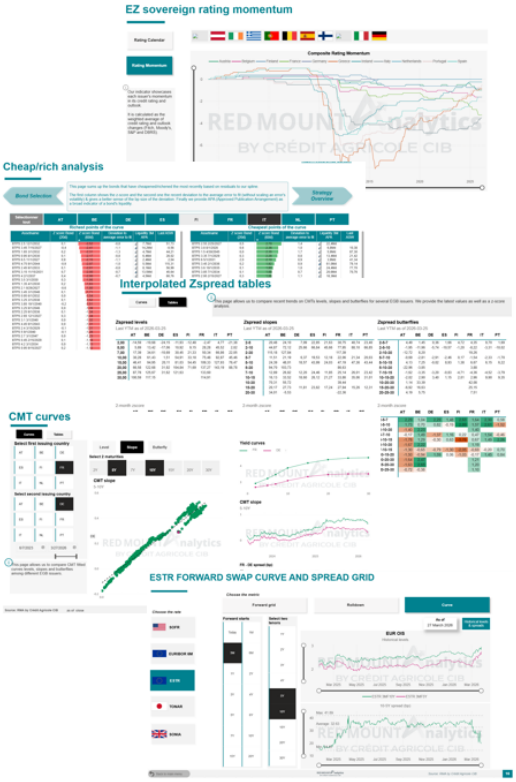
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Source: RMA by Crédit Agricole CIB

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