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Rates Spark: US and France like ships passing in the night at 5%

The US 10yr yield gapped back below 5% with some conviction. We're not convinced it keeps on going. More likely it ultimately reverts up again. Brent oil pushed above $110 for the first time since May, but weaker market sentiment prevented a hawkish repricing. French bond spreads continue to surge, and we struggle to see catalysts to push against this



10-year French government bonds are now yielding above 5%, whereas the US 10-year Treasury has dipped below 5%

The US 10yr back below 5% - let's see how it feels down there

The US 10yr yield broke back below 5% around midday in New York trading on Thursday. And did so with a degree of conviction. We thought 5% could hold, but always acknowledged that a heightened (and still heightening) risk-off tone could in the end dominate, at least for the near term. The fact that the French 10yr has gone the other way and shot above 5% in recent days, and the spread out to 175bp vs Germany, is also of relevance. We also note that Thursday was the first day of pronounced flight into Bunds since the French wobbles took hold. Treasuries have shared in this.

Whether we remain below 5% is a whole other question. We're minded to expect it to snap back above, as we still have inflation / fiscal deficit / AI boom underpinnings to navigate. And we have the US mid-term elections approaching as an excuse for trouble. But it will need some

degree of calm in the risk space first. What happens on Friday is anyone's guess, and it may well be that longs in cash bond duration offer comfort to most through an uncertain weekend. We'll see. We still think the 10yr yield gets back above 5% ultimately. The timing for that is a tougher call.

It's also true that there has been a tendency shown in recent weeks to buy into concessional 5+% levels for the US 10yr. We saw that in spades post the recent poor CPI number, which was followed by an immediate sell-off in Treasuries, but then an even bigger subsequent rally. In a way, the latest break below 5% is a culmination of that move. Now that 5% has been breached below, where next?

More pertinently, can the market find comfort at sub 5% levels given the contemporaneous inflation dynamic. And, can the market really ignore the fact that neither side has a plan for the fiscal deficit as we roll into the mid-term elections in the next couple of weeks. One thing is for sure: the risk-off environment takes pressure off the Fed to hike next week. But even given that, we'd not be loading up on duration here, at least not just yet.

French downgrade lurking and risk sentiment not helping French spreads either

Amid all this, French bonds remain in the line of fire with the spread over Bunds widening at times by 15bp, with the spread touching 177bp. That is still below its late-2011 peak of just under 200bp, but at this pace it is only a matter of days before we see a new high. Although a lot has changed in the eurozone since 2011, some may consider Italy’s spreads during the sovereign debt crisis the better yardstick since it was the country in market focus back then and not France.

That said, the latest widening seems to be more driven by the deteriorating general sentiment, as there were no significant news headlines out of France. But the prospect of ongoing uncertainty until the presidential elections keeps investors sidelined. And French bonds can’t really benefit from any recovery in general sentiment, leaving spreads at wider levels. For now, it feels like watching a train wreck in slow motion where we have not seen the end of the widening yet.

One event that market observers have been looking forward to is the scheduled rating review by Moody’s after markets close on Friday. Moody’s still has France on Aa3 with a negative outlook, and therefore one notch above the other two major rating agencies that place France already at A+, even with stable outlooks for France. A downgrade from Moody’s now looks overdue and should be considered a catch-up. Commentary will be parsed for further downgrade triggers, since the developments in France – in terms of political stability, public resistance and refinancing costs – offer little hope of improvement anytime soon. In terms of timing, note that there is no fixed release time. When Moody’s downgraded France in 2024, the news hit the wires only just after midnight CET.

Having at least this one risk event out of the way might bring about some stabilisation. But any lasting relief would need positive news. A budget for 2027 with at least some semblance of fiscal consolidation would be a start, but might also have to wait until December.

Friday's events and market view

PMI data on Friday will be the next test for markets. So far, both equity markets and economic data point to a resilient economic outlook, but this narrative is challenged by rising rates and higher oil prices. Concerns about AI valuations are a recurring daily theme while energy prices keep drifting higher. If we were to also see headwinds materialising in the economic data, we could face quite a bullish repricing in rates. Especially for euro rates, a more downbeat growth outlook combined with the French turmoil would be reasons for markets to turn more dovish on the ECB.

French PMIs for October are expected to remain above 50, but these numbers will not incorporate the latest unrest. Consensus sees the eurozone aggregate number softening slightly, but a composite index of 52.7 would still be well in positive territory. Also, US PMIs will be watched as these moved markets quite significantly last month with the composite number rising to a strong 58.4.

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