Rates Spark: It’s about bigger buybacks, not how its financed

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Deployment of the Treasury General Account as a financing mechanism for buybacks is an option. But really, it's no different to structural financing through bills, especially as the buffer is re-built. It's all about timing. That apart, eurozone growth may not grab headlines, but is beating consensus, adding to the upward pressure on euro rates

The Treasury buyback story gets ballooned by talk of TGA deployment

We opined on talk that the US Treasury could deploy its deposit balances to finance buybacks of Treasuries here. We make the basic point that deployment of financing from the Treasury General Account (TGA) does not have a material effect on the potential for buybacks. They could just as easily be financed through bills issuance. The key messaging here is not on how the buybacks are financed, but on the threat that the buybacks could be increased again, and again, in the future should the US Treasury deem it a suitable policy. It kicks off from 9 September, and is liable to be more than double to begin with in any case, as already intimated by the Treasury Secretary.

Has the policy been effective? The absolute level of Treasury yields is of course relevant, but is only part of the story. The best way to view the effect of the buyback policy is through swap spreads. As Treasury yields fall relative to SOFR rates, the swap spread narrows, and that is what has happened. The 30yr swap spread tightened by 4bp when the doubling of long-end buybacks was announced. And narrowed by a further 3bp through Monday. In our opinion, this outcome is not because of talk of financing buybacks through the TGA. It's because such talk gives the clear impression that the buyback programme could be further expanded in the months ahead.

Improving eurozone growth adds to upward rates pressure

US headlines continue to grab markets’ attention, but the underlying growth story in the eurozone should not be ignored, albeit the signals are more subtle. The eurozone’s economic data have consistently beat consensus expectations over the past few months. In fact, the last time economic surprises were this much tilted into positive territory was in 2023. Of course, one could argue that expectations are also more subdued given the ongoing geopolitical turmoil and the consequential higher energy costs. But still, even in absolute terms, data such as PMIs are mostly well in positive growth territory.

An improving growth picture combined with still very positive market sentiment means more upside risk for euro rates. Even the release of Germany’s Ifo survey outcomes on Tuesday could contribute to the drift higher. A further improvement in the German economic outlook would give confidence to the European Central Bank regarding a potential rate hike in September. So unless oil and gas prices make a significant turn lower, euro rates are unlikely to ease for now.

Tuesday’s events and market view

In terms of data, EUR rates will mainly focus on Germany’s Ifo business sentiment indicator. Last week’s flash PMI had seen the services sector disappoint, but it saw a surprisingly strong reading for manufacturing.

In the US, we will be getting the Conference Board’s consumer confidence index for August, along with the July new home sales and building permit numbers. The Fed’s Barkin will be speaking on two occasions.

In the government bond primary markets, Germany will auction €5bn in 2y bonds while the UK sells £4bn in 7y gilts. The US auctions US$69bn of new 2y notes.

The broader Sovereign, Supranational and Agency (SSA) market also remains active. We have seen mandates from German Land Berlin (10Y) and French Ile de France Mobilites (10y EuGB) at the start of the week. From the Supras, the World Bank mandated a new EUR bond (10y sustainable) while the ESM is in the market for a new 5y US$ bond.

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