

From an inflation scare to a growth scare

US inflation ran hot and yields still fell, because the market stopped worrying about the Fed and started worrying about who pays for the AI build out. Australian credit split cleanly between high grade financials and high beta corporates.

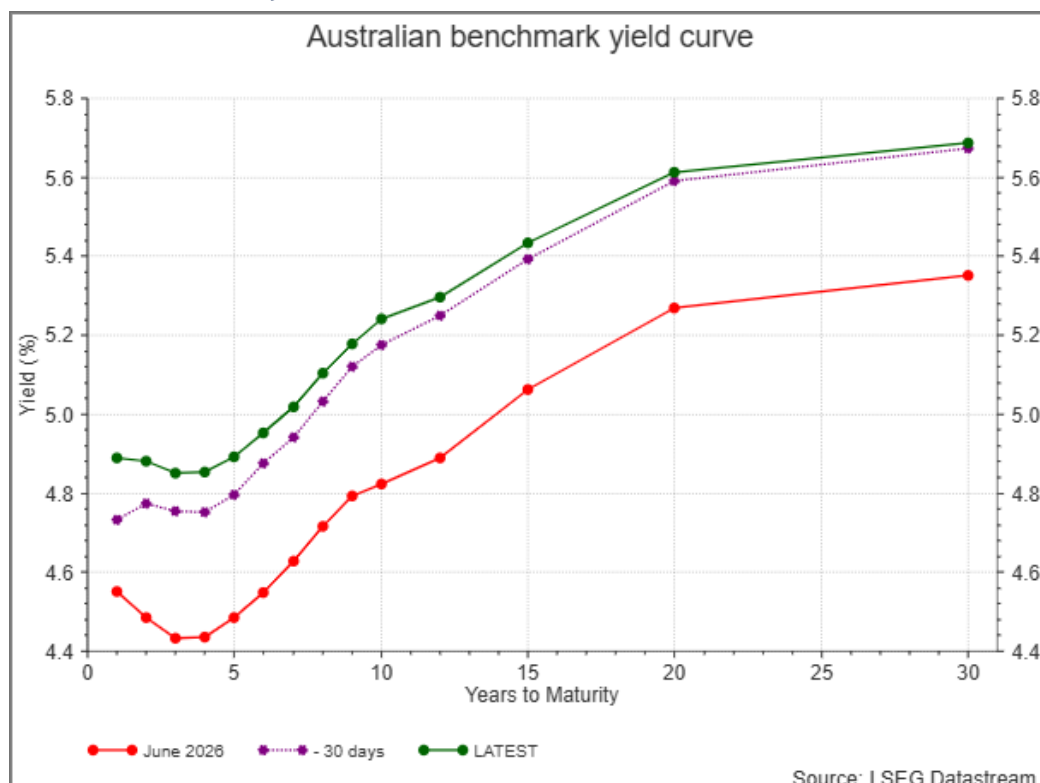
AUST 10-YEAR	US 10-YEAR	FRANCE 10-YEAR	ITALY 10-YEAR	JAPAN 10-YEAR	ITRAXX AUST	90-DAY BBSW
5.24%	5.08%	4.78%	4.48%	2.94%	76	4.76%
-10 on week	-16 on week	-8 on week	-12 on week	-6 on week	+2 on week	-1 on week

Levels at 16 October 2026 with the change on the week in basis points. Source Refinitiv Datastream, Arculus

THE WEEK IN FOUR POINTS

- AI financing stress became the global driver. The Goldman Sachs neocloud basket fell 20% in five sessions and KOSPI fell 8% on 15 October. Curves bull flattened as markets priced a growth shock, and the US 10-year broke below 5.18% to close the week near 5.08%.
- US inflation stayed hot. Core CPI rose 0.33% in September and core PPI 0.70%. We expect inflation to surge in the December quarter and yields to rise again from November.
- Australian rates rallied about 10 basis points on a weak jobs print, with employment down 39,300 and unemployment at 4.7%. Arculus no longer expects another rate increase this year.
- Major bank senior and Tier 2 held firm while corporates leaked wider. iTraxx Australia touched 77 on Thursday, its widest since the start of May, as Asian fast money sold corporate hybrids.

Australian benchmark yield curve



Source LSEG Datastream. Curves for June 2026, 30 days ago and the latest close

RATES

Interest rates

United States

The 10-year Treasury fell 16 basis points on the week to about 5.08%, the 2-year about 7 to 4.72% and the 30-year to about 5.43%. The rally came despite hot inflation. September CPI rose 0.6% for the month and 3.7% for the year, with core up 0.33%, and core PPI rose 0.70%.

The break below 5.18% matters because it takes the 10-year out of its recent range. The reason was a flight to safety out of an overvalued equity market, not a change in the economics. We still expect the 10-year to peak near 5.84% early next year. The US Fed is not expected to hike rates in October (just before mid terms) but move on rates at the December and March meetings.

Australia

Australian rates rallied about 10 basis points on the labour force survey, and the 10-year closed near 5.24%, about 16 over the US. The 1-year Commonwealth yield sits near 4.89%, while lower 2 and 3-year yields reflect the major banks calling for rate cuts in late 2027.

The RBA's September minutes read hawkish. Holding was only briefly considered, the hike was described as relatively straightforward and the Board appears more willing to accept weaker activity and employment to return inflation to target. A November hike remains the base case at all the major banks. Arculus does not expect one.

Forward interest indicators

Bank bills near their highest since 2014

90-day and 180-day BBSW, daily since 2014



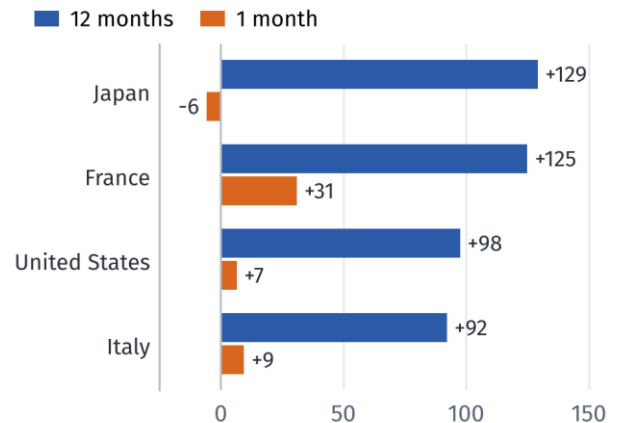
Source Arculus data file to 16 October 2026

90-day BBSW closed the week at 4.76% and 180-day BBSW at 5.12%, both well above the 4.60% cash rate. The bill market is still pricing further tightening, and pricing for November now rests on Q3 CPI and next week's run of RBA speakers.

SOFR held near 3.88% to 3.89% through the week, 87 basis points below 90-day BBSW. The more negative bills to SOFR cross-currency basis keeps Australian dollar paper attractive to Asian buyers on a hedged basis, which supported major bank and SSA demand.

Japan and France lead the selloff

Change in 10-year yield to 16 October, basis points



Source Refinitiv Datastream, Arculus

SOFR has stepped up with the Fed

Secured Overnight Financing Rate, daily



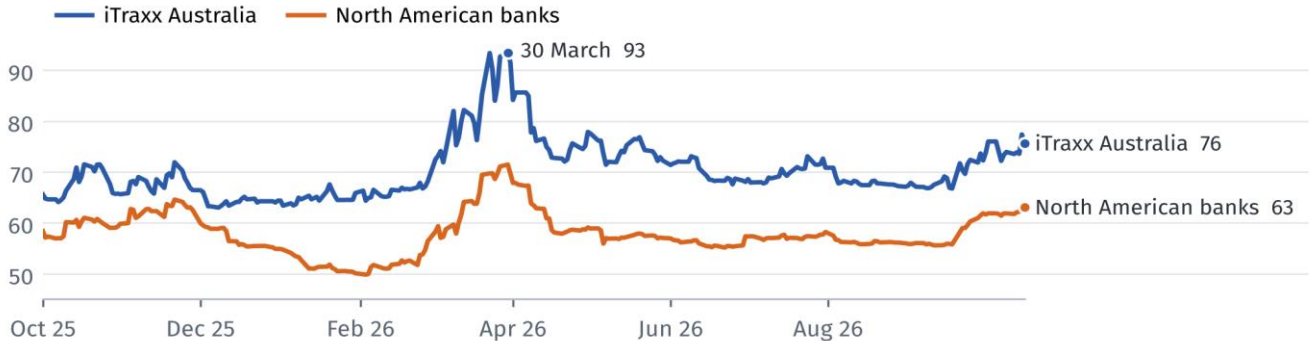
Source Federal Reserve Bank of New York to 15 October 2026

CREDIT

Credit markets

iTraxx Australia touched 77, its widest since the start of May

Five-year CDS indices, basis points, daily, 1 October 2025 to 16 October 2026



Source Refinitiv Datastream, Arculus

Global credit

The stress is concentrated in leveraged hyper-scalers that are building the AI infrastructure, not in index spreads. Equity markets panicked over Core Weave and the AI trade. According to Goldman Sachs, the last time spreads were nearly this high, the underlying equities were 15% lower. The widening across the complex has forced investors to confront what happens as AI spending growth slows. Supply keeps coming. US dollar project finance issuance for AI capex has passed US\$106 billion this year against US\$37 billion in all of 2025. If financing for the build out is constrained, then we will see slower chip demand, less capex and weaker growth, which is how markets are reading it.

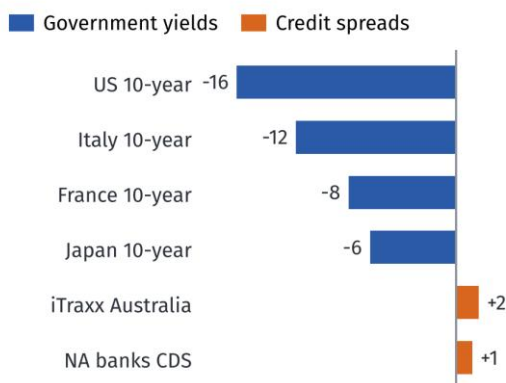
Australian dollar credit

Australian dollar credit bifurcated. Bank senior, Tier 2 and covered bonds held or tightened on a haven bid, while corporates and corporate hybrids drifted wider on full dealer books and offshore fast money selling. Corporate hybrids closed 3 to 4 basis points wider on 15 October, with VZ and NXTAU underperforming.

Data centre credit is being sorted by quality. The failed Firmus IPO put NXTDC under pressure while CDC paper kept a strong bid in senior and hybrid format, an odd result given CDC's past partnership with Firmus. Boral priced A\$300 million of seven-year fixed at 165 over swap and State Grid launched a five-year deal at about 75 over.

Yields fell, credit spreads widened

Change over the week to 16 October, basis points



Source Refinitiv Datastream, Arculus

Major bank line	Margin (bp)	Since 12 Oct	Running yield
Senior FRN 1 year	42.5	+1	5.19%
Senior FRN 5 year	69.5	0	5.46%
Tier 2 FRN 2031-26	70	-5	5.46%
Tier 2 FRN 2032-27	80	-7	5.56%
Tier 2 FRN 2036-31	131	-1	6.07%
Tier 2 FRN 2041-36	161.5	+0.5	6.38%

Source ANZ Credit Trading indicative mids over BBSW at 15 October 2026, Arculus. Running yield is 90-day BBSW of 4.76% plus margin

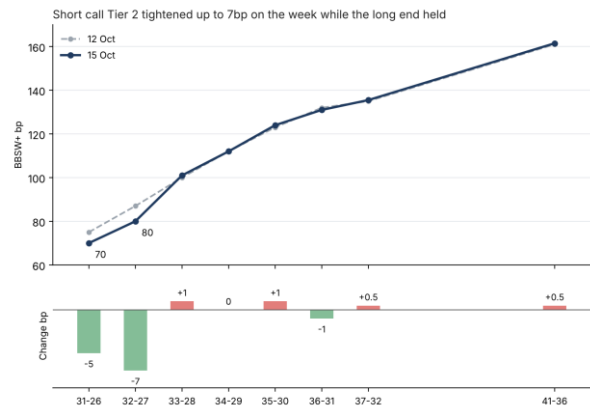
Bank capital and listed hybrids

Major bank senior mids moved 1 basis point or less on the week, with real money shortening into the 2-year sector for carry and roll. A bid returned for 10NC5 and 15NC10 Tier 2 FRNs after several weeks of widening, and short-call Tier 2 tightened 5 to 7 basis points, with street inventory in the 32-27s now light. Subordinated paper held up well in the 15 October selloff.

Fixed rate Tier 2 drew demand in the 41-36 sector, and ANZ 6.749% 2046s offered a yield above 7%. Good value appeared in Barclays fixed perps with sellers at 8.04%, a good yield to capture given the five-year term to first call. The selling was not about the bank. It came as French and Italian bank spreads widened and several principle bank books in Australia were caught with excess Barclays paper,. They were happy switching into the new MUFG AT1 just above par.

Hybrids were firmer last week as investors positioned ahead of the \$1.2 billion CBAPJ redemption proceeds due to hit accounts on Tuesday, 20 October. Average major bank hybrid margins contracted by 7 basis points to 1.69%, with buying interest extending to other CBA hybrids and, interestingly, most Macquarie Bank and Macquarie Group issues. Demand was evident across the curve, although redemption-driven reinvestment typically favours longer-dated securities as investors seek to replace lost income.

Credit LITs had a more challenging week. The Metrics funds were all weaker, as expected, with the negative sentiment spilling over into most other credit LITs, regardless of whether they had meaningful private credit exposure or not. Retail advisers do tend to move in herds, and this week was no exception. Kapstream's KIT declined 2.28% to \$1.715, while Revolution's REV attracted some late-week buying to finish 3.6% higher at \$1.96. Interestingly, both funds reported NTAs above \$2.00 per unit this week, highlighting the disconnect between market prices and underlying asset values.



Source ANZ Credit Trading closing mids 12 and 15 October 2026, Arculus

CALENDAR

Week ahead

A week of RBA speakers at home and inflation offshore. Assistant Governor Kent speaks on Sunday and Monday, Payments Policy Head Connolly on Tuesday and Deputy Governor Hauser on Wednesday, the last guidance before Q3 CPI. Offshore, China's Q3 GDP opens the week, UK and Japanese CPI follow and Moody's reviews France on Friday. US earnings pick up, with Netflix, Tesla and Meta among those reporting.

Day	Australia	United States	Europe and Asia
Monday 19 October	RBA Assistant Governor Kent at the CBA Global Markets Conference, after his News 24 interview on Sunday.	Earnings pick up through the week.	China Q3 GDP, expected at 4.3% by ANZ against 4.4% consensus, with September industrial production, retail sales and investment. Canada CPI.
Tuesday 20 October	ANZ-Roy Morgan consumer confidence. RBA Head of Payments Policy Connolly at the AFIA conference.	Housing starts and building permits for September.	China loan prime rate, expected unchanged at 3.00%. UK labour market data and the German ZEW survey.
Wednesday 21 October	RBA Deputy Governor Hauser at the Citi ANZ investment conference.	Earnings continue.	UK CPI for September, expected to rise to 3.4% from 3.1%. Japan trade balance. Bank Indonesia expected to hold at 5.75%.
Thursday 22 October	Flash PMIs for October.	Jobless claims.	New Zealand Q3 CPI. The Bank of Korea is expected to hold at 3.00% and the Philippine central bank to hike 25 basis points to 5.25%.
Friday 23 October	No major domestic releases.	Flash PMIs for October.	Japan CPI for September, expected near 2.8% to 3.0% from 1.9%, the last print before the BoJ. Moody's reviews France, rated Aa3 with a negative outlook. Eurozone and UK flash PMIs.

Further out, Australia's Q3 CPI late in October and the RBA's November meeting, the Fed on 27 and 28 October, the UK budget on 28 October, the US midterms on 3 November and the Victorian State election on 28 November.

THE VIEW

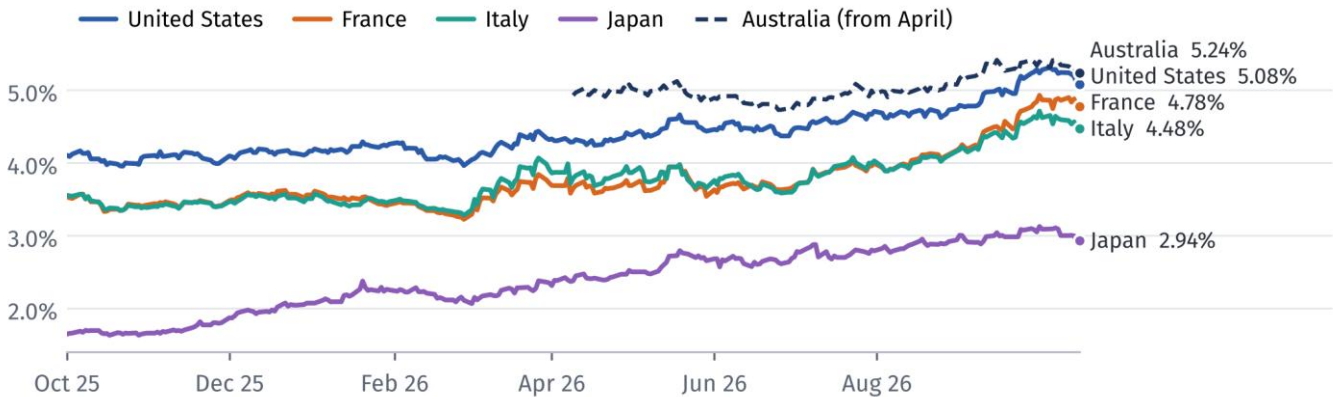
Macro

Hot inflation, falling yields

The week turned from an inflation scare into a growth and financing scare. US core CPI and core PPI both beat consensus and broader services inflation picked up, suggesting second-round effects from energy. Yields still fell, because higher rates have exposed the funding needs of the AI build out and markets are now pricing a growth shock. Global curves bull flattened.

Ten-year yields eased this week but sit 90 to 130 basis points above a year ago

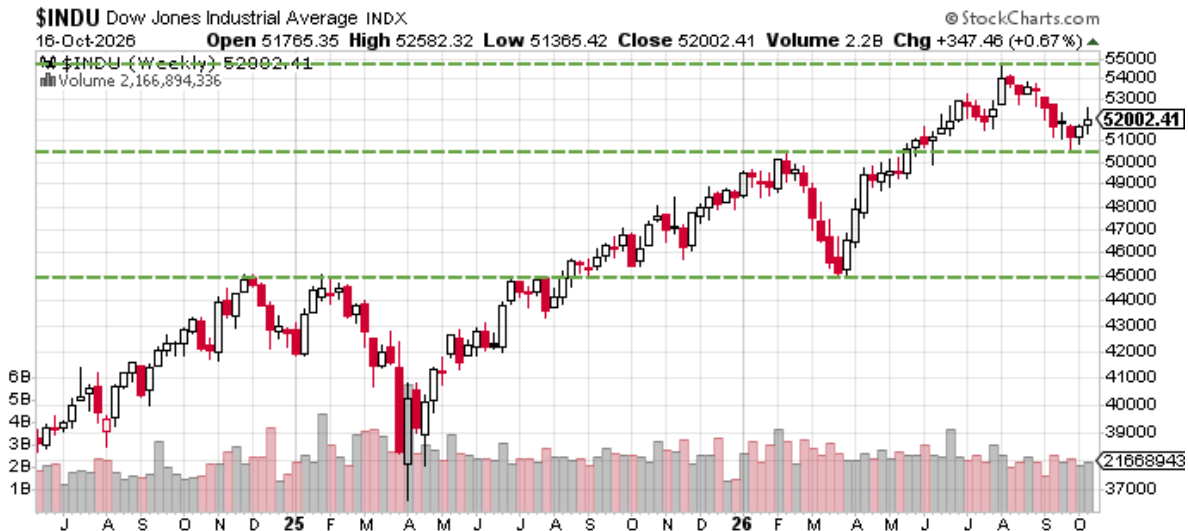
10-year government benchmark yields, daily, 1 October 2025 to 16 October 2026



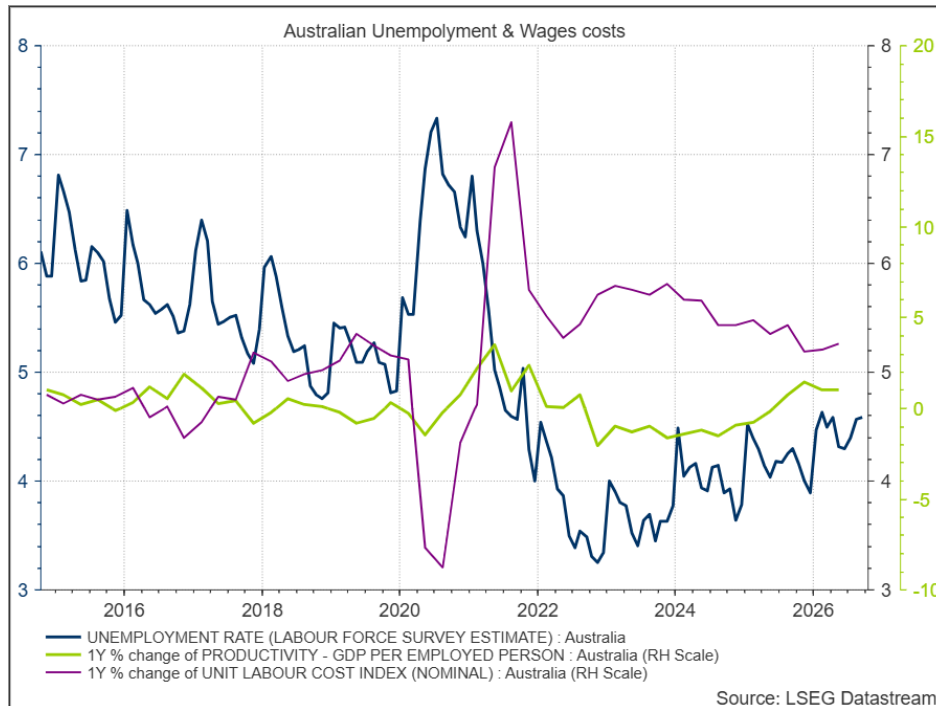
Source Refinitiv Datastream, Arculus

We view the fall in the US 10-year below 5.18% as significant because it breaks the yield out of its recent range. The reason was a flight to safety from an overvalued equity market rather than a shift in the economics. If the October curve continues to weigh on equities, rates may keep falling. Once into November we expect rising inflation to push yields higher again.

The S&P 500 had its first 1% fall since July, while the S&P 500 excluding AI rose 0.61% on the same day. The index has traced out a broad top above a 7,600 support line, and a fall below it may see selling momentum increase. The technical position is clearer on the Dow Jones, where 50,500 is support that must hold.



Australia, a labour market in transition



Source LSEG Datastream, Arculus

September employment fell 39,300 against 20,000 expected, unemployment rose to 4.7% and participation slipped to 66.8%. A degree of caution is warranted. Between April and August the ABS rolled out its Labour Force Modernisation program, collecting industry and occupation data monthly, replacing the old supplementary surveys, moving to the new OSCA occupation standard and redefining short-term unemployment from four weeks to one month.

It is too early to judge the impact, but we suspect the changes will record less family and small business employment and pull participation down from around 67%, which is extraordinarily high by international standards. We have long suspected there is more labour slack in the economy than the headline suggests. The ABS puts underemployment at 6.3%.

Composition matters too. Part-time employment fell 73,700 in September while full-time rose 34,400, which may itself reflect the new definitions, and some of the part-time fall may show up in full-time next month. On a trend basis national unemployment is 4.6%, not 4.7%, and Tasmania and Victoria now sit meaningfully above the other States.

State or Territory	Trend unemployment
Tasmania	5.2%
Victoria	5.1%
Northern Territory	4.8%
New South Wales	4.7%
Queensland	4.4%
South Australia	4.4%
Western Australia	4.4%
Australian Capital Territory	4.2%

Source ABS, September 2026 trend estimates

Our view on the RBA

Arculus does not expect the RBA to raise rates in November, and expects a move in February only if unemployment is still below 4.80%, against our estimate of NAIRU at 4.75%. That view rests on our thesis that the real inflationary shock from the Iran conflict will arrive in the December quarter. The RBA will need to tread a difficult path, because poor lending by some private credit funds will have a considerable impact on the household sector.

The Victorian State election on 28 November may matter more than many expect. If Labor retains government we still expect a mild economic contraction. If the Liberals win, we expect a sharper contraction with substantial cuts to the size of the public sector. The RBA will need to weigh that outcome in its February decision.

Europe and Japan

France now pays 30 basis points more than Italy to borrow for ten years

French 10-year yield minus Italian 10-year yield, basis points



Source Refinitiv Datastream, Arculus

Energy dominated the EU leaders' summit on 15 October. European gas prices are up roughly 140% and diesel has doubled since the US and Israel war with Iran began in February. France's bond crisis has spilled into its equities, which lag European peers by the widest margin since 2010, and France now pays about 30 basis points more than Italy for ten-year money. Moody's reviews France on Friday.

USD/JPY sits near 158, with US yields outweighing Japanese data. A soft September PPI supports the view that the BoJ waits until December, with intervention risk building towards 160. For Australian duration, a BoJ on hold keeps the yen carry and repatriation channel quiet for now, leaving US yields as the dominant offshore driver.

MONITOR

- The US 10-year. If the October curse keeps weighing on equities, yields may keep falling. Once into November we expect rising inflation to push them higher, towards a peak near 5.84% early next year.
- The S&P 500 at 7,600 and the Dow Jones at 50,500. A break of either support may see selling momentum increase.
- Q3 CPI late in October. We expect the larger inflation shock in the December quarter, so a soft Q3 would not change our view.
- Unemployment against 4.80%. Below it, a February hike stays live. Above it, the RBA stays on hold.
- iTraxx Australia through 80 basis points, and Moody's on France on Friday.

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