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Feels normal, but bounded by extremes: 3 calls for rates

In our base case, we hit mythical normal levels for rates in 2026. We end at around 4.25% on the 10yr. We expand on two variations. One, where the Fed cuts to 2% on macro angst. The other is where the Fed does something similar, but purely on a super dovish tilt

The Fed's rate-cutting agenda is set to be completed in early 2026

ING's base call: It's unusual to get to a normal curve, but we might just see it

What we call normal levels for rates typically derive from long-run averages, to avoid us just making them up. In our base case, we hit the mythical normal rate levels through 2026. Even Japanese rates are moving in that direction.

In fact, we are practically there in the eurozone. The ECB's deposit rate is pitched at 2%, consistent with an "around 2%" inflation expectation and a zero (to low) real rate. Currently, we have the 10yr Euribor rate at 2.7%. For 2026, our call is for this to head to the 3% area. The add-on of heavier issuance (defence spending) should lift government yields by more than the rise in the ESTR 10yr, thereby widening the Bund swap spread.

In the US, the Fed's rate-cutting agenda is set to be completed in the early months of 2026.

The market discount has the funds rate bottoming in the 3% area. The 10yr swap rate, now at 3.65%, looks a tad low against a backdrop where US inflation is at 3%, and prone to rising in the coming months. We see 10yr SOFR edging up to the 3.75% to 4% area. That pitches the 10yr Treasury yield in the 4.25% to 4.5% area, assuming a deficit-impacted re-widening in the swap spread to the 50+bp area.

Our risky call: The Fed cuts for justifiable reasons

Following the 'Risky Call' outlined in the US section, we ask here what happens to bonds when the picture morphs to corrections in the tech and housing markets, squeezing confidence and spending, necessitating Fed cuts to 2%. This would be at 1% to 1.5% below what we consider neutral (3 to 3.5%).

In this "non-inflationary" scenario, the US 10yr yield is quickly pulled structurally below 4%, and has the potential to get all the way down to 3%. We'd have a central tendency in the 3% to 3.5% area on the assumption that the Fed is actually done cutting at 2% and there is an ambition for the next move then to be a hike, even if eventually.

This would impact eurozone rates too, with the 10yr Bund yield liable to find comfort in the sub-2.5% area, likely 2.25% to 2.5%, as the eurozone would be unable to shrug off the effects of US angst.

Our bold call: What happens if the Fed slashes for unjustifiable reasons

Again, following the lead from the US section, the 'Bold Scenario' is where the Trump administration manages to secure the required turnover so that the Fed executes rate cuts far in excess of what's required, all in an attempt to juice the economy in good time for the midterms. While there are some positive outcomes for Treasuries from higher tax receipts, the bigger negative is the rise in inflation risks. Add to that the notion that the Fed is doing things it really should not be doing, thereby tarnishing credibility.

While Treasuries love rate cuts, they won't like them much given this cocktail. Here, there is a material risk that finally things begin to unravel for longer tenors, with the 10yr yield hitting 5%, and the 30yr risks hitting 6%.

In the eurozone, the 10yr Bund yield structurally moves above 3%, and likely settles in the lower half of the 3% to 3.5% area, looking at a 150bp to 200bp spread to Treasuries.

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