

## The significant steepening potential on the US curve

The bond market's obsession with the rate cycle should blind it from fiscal deficit worries. A rate-cutting cycle typically results in positive total returns right out the curve, with the best of those in longer tenors. We're expecting that for much of 2024, but prepare for a heavier long end as we get closer to 2025 and the rate-cutting novelty fades



The last few rate cycles have seen different landing points for the curve once the Fed has cut rates to new lows

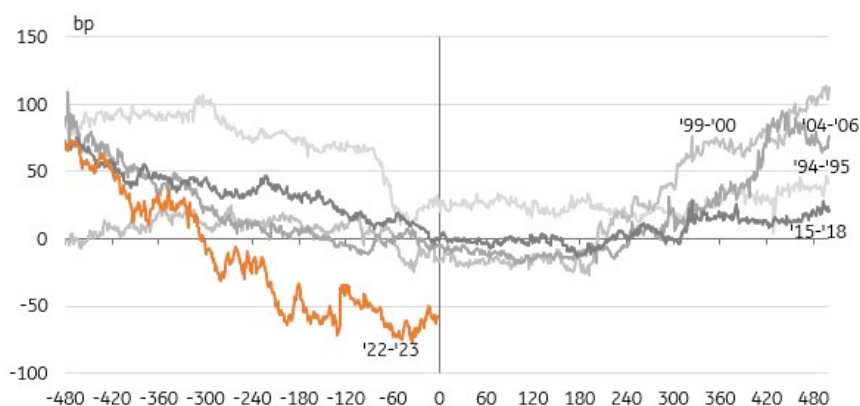
### Recent cycles have seen the 2/10yr get to 50/75bp. This time we expect 100bp

The last few rate cycles have seen different landing points for the curve once the Fed has cut rates to its new low. If we focus on the 2/10yr spread, these curves have ranged from 50bp to 200bp, with the most recent one at the low end of this range. Could the curve stretch to 200bp this time around? Possibly, eventually. But we don't anticipate this as the impact effect of the rate-cutting cycle. A 2025 risk, but not a 2024 one.

The reason for this is the bond market's obsession with the rate cycle, and the outright need to be long interest rate exposure as the Fed is cutting. That tends to drag the whole curve lower. The

theme for 2024 should be a push for lower rates right out the curve. Our baseline view is for this to co-exist with the 2/10yr getting to the 100bp area. A 200bp curve is a risk for 2025 should the deficit pressures persist, but that can also be frustrated by structural buying into the curve, preventing severe steepening. The latter has been thematic in the past few decades as pension funds and insurance companies lock in high long rates when they can.

## The 2/10yr curve (number of days before and after the Fed funds peak)



Source: Macrobond, ING estimates

## Different tenors will move at different paces as we get closer to rate cuts. Watch the 2yr in particular

The sequence that we envisage is as follows:

- Assuming the Fed has peaked, the broad direction of travel for the 10yr yield is down. Not a dramatic gap fall, but likely a gradual one, as the elevated front end curbs the ability of long-end yields to fall by too much too soon.
- The 5yr area of the curve holds on to a degree of richness on the 2/5/10yr fly, mostly reflecting a persistence in the inversion of the 2/5yr segment. The 5yr here is anticipating cuts to come, while the 2yr is held up by the elevation of the funds rate.
- About three months before the Fed actually cuts, the 2yr yield gaps lower by 100bp. Now at around 5%, it heads for 4%. It eventually gets to 3%, but the second 100bp fall will be much slower than the first 100bp one, and needs actual Fed cuts.
- Assuming the 2/10yr curve needs a 100bp valuation when the Fed is done at 3%, that places fair value for the 10yr at around 4%. But the lure of the rate-cutting cycle likely sees the 10yr yield overshoot to the downside, potentially getting down to 3.5%.

That 3.5% to 4% area for the 10yr is a call for 2024. For 2025, we would not be surprised to see the market price in an even steeper curve, to reflect a persistently large fiscal deficit. That pushes the 10yr back into the 4% to 5% range. But that's for much later.

### The curve should stretch from 3% to 4% as we get to the bottom of the next rate cycle

The baseline view is for the 2yr to get to 3% and for the 10yr to get to 4%, with the risk

of an overshoot to the downside, as a call for 2024. The 30yr likely tracks the 10yr to a point, but is unlikely to get much below 4%, resulting in net 10/30yr steepening, likely targeting 30-50bp.

## Author

**Padhraic Garvey, CFA**

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.