

Rates Spark: A 25bp cut this time, but will they pause in January?

From Wednesday's FOMC meeting, a key question is whether the Fed shows a tendency to pause the rate cutting from the January FOMC meeting. We think they'll indeed pause; the question is whether they want to telegraph that. Meanwhile, Germany's issuance plan confirms plenty of supply to absorb in 2025. And, Gilt yields are set to remain elevated



We expect the Federal Reserve to cut rates by 25 basis points and introduce a possible technical adjustment to the Fed's repo rate (5bp lower)

A 25bp cut, plus a likely technical adjustment in the works for the Fed's reverse repo rate

The FOMC will deliver a 25bp cut from Wednesday's meeting. While there are arguments for the Fed to pause (inflation hiccups plus Trump policy intentions), this Fed has consistently delivered on the market discount. And where it does not like the discount, it has managed to telegraph it to the markets ahead of time. Nothing like that has happened, so expect delivery of a 25bp cut. A full preview can be found [here](#). The key element the market will be looking for is any indication that the Fed has a tendency to pause on the rate cutting at the January FOMC meeting. We think they will; pause that is. It's unlikely they telegraph that intention explicitly. If they did it would be quite a

big deal. More likely they point to a more balanced set of risks, and choose to keep their options open.

On a separate issue, the minutes from the last FOMC meeting made reference to a possible technical adjustment to the Fed's reverse repo rate. It's currently at 4.55%, and so 5bp above the Fed funds floor at 4.5% (with the ceiling at 4.75%). The suggestion is for the reverse repo rate to be cut by 5bp, bringing it flat to the funds rate floor. Technically what would happen is the Fed funds floor and ceiling rates would be cut by 25bp, and the reverse repo rate cut by 30bp, thus pitching the Fed funds floor and reverse repo rate flat at 4.25%. The other key rate, the interest on reserves, is currently at 4.65%, and so 15bp above the floor. This is projected to also be cut by 25bp, thus keeping spreads versus the floor and ceiling rates unchanged.

So what are the implications of all of this? There are a few moving parts here. First and foremost, the Fed's main job here is to manage the effective Fed funds rate. This is currently at 4.58%. It generally sits between the reverse repo rate and the rate on reserves. The interest on reserves has been the most impactful factor driving the effective funds rate, which is in turn driven by the overnight cash activity of Federal Home Loan Banks. This spread has been steady at 7bp, and is likely to remain so, although if anything, the effect could be to tempt the effective funds rate lower. But on balance, we'd expect the spread to the rate on reserves to hold. That would pitch the effective funds rate 25bp lower at 4.33%.

The main outcome here is a reduced compensation for cash going back to the Fed via the reverse repo facility, which makes that facility less attractive at the margin. In turn, this continues to drive the decline in the use of the facility. That's been the direction of travel in any case. The added benefit is the reverse repo balances head towards zero before eating into bank reserves. Ultimately as bank reserves then fall, the Fed's quantitative tightening programme would be called to a halt. Not something to worry about though until the second quarter of 2025 at the earliest, we think.

German issuance plan confirms supply pressures in 2025

Germany announced its issuance plan for next year, which includes €240bn via regular auction issuance, €13-15bn via green bonds and two syndicated deals including a new 30Y bond. In total this could result in a bond issuance of up to €265bn for 2025 after €276.5bn issued this year. With the finance agency flagging €191bn in redemptions, net issuance will amount to €74bn, which compares to €80bn this year.

Largely in line with expectations, the market reaction was muted, although 10y Bunds yields did slip back below the swap rate outperforming around 1bp. The bigger picture is little changed though. Overall [issuance remains on elevated levels](#) and markets will additionally have to absorb what rolls off from the ECB's balance sheet.

Gilt yields to remain high until inflation turns softer

[UK wage growth numbers](#) caught us and the market by surprise, rising from 4.3% to 5.2% year-on-year, reflecting a continuation of the elevated price pressures. Gilt yields, which in our view are already on the high side, rose further, with the 10Y now at 4.5%, above the UST equivalent. The push higher in yields was led by the front end of the curve, where 15bp less cuts are now priced in by mid-2025. And the upcoming CPI numbers will likely enforce the hawkish sentiment.

The pricing out of rate cuts in the UK stands in stark contrast with the dovish sentiment in the eurozone. Earlier we noted that 10Y gilt yields should find themselves lower in comparison to US rates, but also that this likely [won't happen in the near-term](#). Only once we see a couple of softer inflation numbers will markets be willing to calibrate the terminal Bank of England rate lower. Current pricing suggests just 50bp of cuts by mid-2025, keeping the Bank Rate at a (too) high 4.25%.

Wednesday's events and market views

UK CPI numbers will be closely watched in the morning, whereby core is expected to nudge higher from 3.3% to 3.6% YoY. Then from the eurozone the ECB's speakers Muller, Lane and Nagel are of interest. But of course the FOMC meeting will be the likely market mover of the day.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@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>.