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Rates Spark: That's how to sell a 50bp cut!

Fed Chair Powell was confident with that 50bp cut. He sold it well. Remarkably, with no material macro fears, more to prevent macro strain. But if that means a greater probability attached to a soft landing, it also reduces room for long rates to fall. We think they can edge higher, at least for now. We saw some of that post the FOMC. Prepare for a bit more ahead

Fed Chair Jerome Powell is bullish about the US economy

For market rates, a steeper curve is the most meaningful follow-on move

Market reaction to the 50bp rate cut has been a steeper curve, from the front end. Inflation expectations are up a tad as measured through the 10yr inflation breakeven rate. Reaction in risk space is positive as spreads tighten. Impact reaction had market rates net lower right along the curve. Ahead of the cut, there had been a drift higher in market rates. The 50bp move facilitated the reverse reaction lower, but longer end rates did end the day slightly higher.

We've noted before that rates have made quite some headway in recent weeks, and there is always a risk of a pullback, especially as yields are already quite low relative to the likely terminal rate. The Fed pitches that at 3.4% for 2025, versus 10yr SOFR now at 3.2%.

The steepener makes the most sense here, potentially from both ends, as the 10yr can still decide to baulk at a material move lower from here, and indeed the risk for a further move higher in rates cannot be ruled out. Perverse yes, on a 50bp move, but not so perverse from a relative value perspective.

Remember, the 10yr Treasury yield is constrained by the spread to 10yr SOFR, currently around 45bp (and for good reason given the supply pressure in Treasuries). Hence, 3.70% on Treasuries coincides with 3.25% on SOFR, and the latter is already through the Fed's end game dot for 2025 (albeit slightly above the 2.9% dot for 2026).

Finally, listening to how Powell finished his press conference – he's net bullish on the economy. This is not a Fed that is in fear of a material slowdown. He just sees the risks as being balanced between inflation and the labour market. The Fed is not fearing a recession, and will only cut to ease restrictive policy. That poses upward pressure on longer tenor rates, as they are verging on pricing in a much more severe degree of easing.

Thursday's events and market views

European markets will be digesting the Fed decision given this took place after the market close. The Bank of England has its meeting today, but with just 4bp of cuts priced in, consensus doesn't see now as the time for another cut (and we agree). More interesting may be an update on the pace of quantitative easing which currently stands at £100bn per year.

Little data is expected from the eurozone, but with the ECB's Knot, Schnabel, Panetta and Nagel all scheduled to speak, markets will have plenty of ECB commentary to process post-Fed. From the US we have jobless claims, the leading index and existing home sales data. Jobless claims are expected to remain stable at 230k.

In terms of issuance, we have Spain with 4Y, 7Y and 19Y SPGBs for a total of €6bn. France will auction 3Y, 5Y and 8Y OATs totalling €12bn, in addition to 6Y, 8Y 16Y and 19Y OATeis for a total of €2bn. From the US we have a 10Y TIPS for $17bn.

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