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Rates: The glass half empty trade

The Department of Government Efficiency, Treasury Secretary Scott Bessent, and the supplementary liquidity ratio have been the drivers of lower Treasury yields, compounded by weaker consumer confidence and lowered expectations for the terminal rate. The market is now weighing potential downsides. Can this trend continue? Yes, for a while...

It remains unclear how realistic the doge spending cut goal is

US Treasuries see a glass half empty version of the Trump cocktail

We point again to some of the impulses out there that have been driving Treasury yields lower.

First, the Department of Government Efficiency (DOGE); the doge-tracker.com site has recorded US$55bn of "tax dollars saved" so far, 2.75% of the US$2tr goal. The feasibility of the DOGE spending cut goal remains uncertain. However, it cannot be ignored as a potential factor in containing the fiscal deficit and, by extension, Treasury issuance requirements. In extreme cases, it could negatively impact GDP, especially if even half of the target is achieved.

Second, while Treasury Secretary Scott Bessent cannot directly control the 10-year yield, it is clear he has an overt ambition to get it lower.

Third, potential adjustments to the supplementary liquidity ratio (SLR), particularly the exclusion of Treasuries from the measure, would free up bank balance sheets, ultimately increasing liquidity in US Treasuries. This, in turn, helps Treasury yields to trade lower than they otherwise would.

From 4.8% to 4.3% on the 10yr – a 50bp swing from all amazing to some material doubts

We believe that these three factors have already been somewhat impactful, as we see on the spread from 10yr SOFR to the 10yr Treasury yield, which has tightened from 55bp to 40bp since the turn of the year. The US 10yr Treasury yield at around 4.5% was flat to our estimate of neutrality. It has since broken down to 4.3% in the past 24 hours driven by a dip in consumer confidence, and a ratcheting down in the terminal Fed funds rate.

When the 10yr hit 4.8% in mid-January, the market distilled a net upward risk coming from the Trumpian mix of policies. The reversion back below 4.5% to now 4.3% represents the distillation of a different outcome, one where the mix of policies is net negative. It's tough to resist this move for now. The implied floor from the funds strip has shifted down to 3.5%, mostly on a whim. But that's all that's needed to make some room for the 10yr yield.

The tactical bullish impulse we identified some weeks back has turned more sinister. Still tactically bullish, or at least neutral given the size of the move. Expect the unexpected though, as this market can just as easily decide that the glass is half full again, and that's when the structural view of the 10yr getting to 5% can be latched on to. Clearly not the mood music right now though.

The eurozone remains caught in the cross hairs, with lower yields the outcome for now

Meanwhile, the concerns coming out of Europe are contributing to the same trend. The expectation that the European Central Bank will continue cutting rates in the coming months is likely to push longer-term rates lower or at least keep them contained. In the eurozone, the ECB aims to reduce deposit rates to 1.75%. That's below the 2% area that we deem to be neutral.

The rationale for the ECB landing below neutrality while the US lands above largely centres on relative fundamentals. Germany continues to act as a drag in the eurozone – and typically when Germany is not working, the eurozone is in trouble. On top of that, the US tariff bullets aimed at Europe are the last thing that the eurozone needs – partly because they would be rebuffed by counter-tariffs, so everyone loses.

But still, the contrast between the two regions is stark as US growth remains more lively, and the Trump administration has stimulus at its core even if the market is currently questioning

this. On balance, there is pressure to the downside for yields. But we're not convinced this will be a structural move. Pressure for a reversion higher in longer tenor rates remains a theme that is likely to come back onto the radar screen in the months ahead.

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