

## Three calls for rates in 2024

Curve disinversion morphs to steepening in both the US and the eurozone through 2024. The bigger moves are on the US curve, and long-end rates in both the US and eurozone ease lower, too. But we identify steepening pressure from the long end closer to 2025, and we prepare for some re-widening in Italian spreads in the eurozone as we progress through 2024



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### 1 The US 2/10yr spread to target a move towards 100bp

US debt dynamics are troubling based on current policy. Both the size of the deficit and debt as a percent of GDP have a meaningful impact and pressure the curve steeper and long rates higher. We argue that the 2/10yr curve should be at least 100bp when the Federal Reserve gets to the bottom of the next cycle. 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. It's 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 for the Fed in the early days of cutting. That tends to drag the whole curve lower. Our baseline view is for this to co-exist with the 2/10yr getting to the 100bp area.

## 2 The US 10yr to target 4%, and likely overshoot to 3.5%

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. 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 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%. The 30yr likely tracks the 10yr to a point, but is unlikely to get much below 4%.

## 3 Italian sovereign spreads to come under some re-widening pressure

The key yield spread between 10yr Italian government bonds and their German counterparts has recently narrowed to 165bp after Moody's raised the outlook of Italy's rating to stable. Near-term, the yield spread can tighten even further as issuance slows into the end of the year. Italian issuance will pick up again in 2024, on higher gross and net bond supply compared to this year – especially when taking into account the European Central Bank potentially also slowing Pandemic Emergency Purchase Programme (PEPP) reinvestments. A re-widening of spreads in the first part of next year looks possible when resuming issuance, a hawkish ECB and weak growth come together. Overall, we would look for the 10Y spread to remain in the 150-200bp area with tightening toward the latter part of next year amid policy easing and a more benign macro backdrop.

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