We’ve changed our 5.5% call for the US 10yr

We've taken a cold look at our 5.5% call for the US 10yr and have on balance decided to trim it, to 5%. A combination of Doge, Bessent and talk of SLR adjustment(s) have managed to tame the prior de-rating of Treasuries versus the risk free rate. As tempting as it sometimes is, we can't blame everything on Donald Trump. So we won't. Some of this is actually good

Treasury Secretary Bessent's laser focus on the 10yr yield is one reason why our call goes from 5.50% to 5.00%

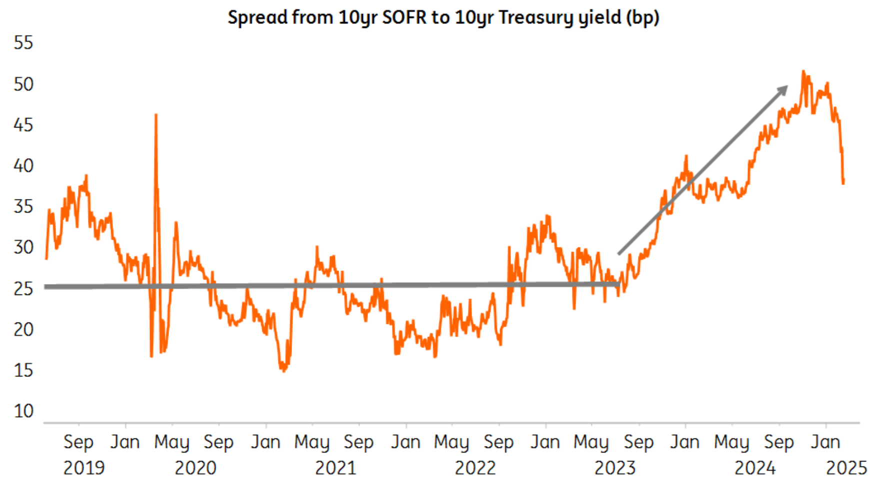
Doge, Bessent and SLR talk contribute to a taming of extent of likely Treasury yield rises ahead

We don’t make calls on politics. But politics absolutely impact our calls on rates. When Donald Trump was elected president of the United States it marked a seismic shift, versus the previous regime, and even relative to the first Trump one. Once the dust settled on the outcome, we posed the question (here) – “Can the US 10yr yield top 5.5%?”. We answered “yes”. Of course it still could, but we’ve decided to tame the call to 5% area, removing 5.5% as the official call for end-2025.

We’ve done that for a two main reasons, and one minor but important one.

- **First**, the Department of Government Efficiency; the doge-tracker.com site has logged US$55bn of "tax dollars saved" so far, 2.75% of the US$2tn goal. While it is true that we knew about doge beforehand, what we did not anticipate was the intensity of its application. It remains unclear how realistic the doge spending cut goal is. But still, it can't be ignored as something that could help contain the fiscal deficit, and by extension Treasury issuance requirements.
- **Second**, we can't ignore Treasury Secretary Bessent's remarkable laser focus on the 10yr yield, and his suggestion that it's this rate that the Trump administration would like to get lower. While Bessent cannot control the 10yr yield per se, it's clear that he has an overt ambition to get it lower. All Treasury Secretaries would of course like to have as low a 10yr yield as possible, but few have been as vocal as Bessent on it. Leaving the funding profile front-end-heavy reflects the same.
- **Third**, potential adjustments to the supplementary liquidity ratio, in particular with reference to inclusion of Treasuries in the measure. During the pandemic the Fed implemented a temporary rule allowing banks to deduct Treasuries from their SLR calculation. Although since reversed, recently Chair Powell has voiced an openness to making such an adjustment again, but this time more permanent. This would free up balance sheet at banks, ultimately adding to liquidity in US Treasuries. And that in turn helps Treasury yields to trade lower than they would otherwise.

Treasuries have been re-rated versus the risk free rate



Source: Macrobond, ING estimates

Recent reversal lower in the 10yr swap spread symptomatic of an easing in excesses

We believe that these three factors have already been somewhat impactful already, as we see this on the spread from 10yr SOFR to the 10yr Treasury yield. At the end of 2024, this spread, had widening out to the 50bp area. That gap between the 10yr risk free rate and Treasuries was in part a reflection of supply pressure, and we were concerned that it could head out towards 75bp, mostly as there was no credible plan to solve the fiscal deficit issue.

US 10yr yield was becoming untethered, but less so now

That potential untethering of the 10yr yield was an important driver that could have pushed the 10yr yield towards 5.5%. Instead, the 10yr SOFR swap spread has re-tightened in the past few weeks, and is now at sub-40bp. Why is it tighter? For all of the reasons identified above – 1. Doge, 2. Bessent and 3. SLR adjustment talk. These act to reduce the negative credit perception towards Treasuries, while improving Treasury market liquidity, with some verbal suasion to boot.

An important additional point – the more successful doge is, the bigger are the impact risks posed to the wider macro economy. Getting government spending down is positive as it reduces the fiscal deficit, but lower government spending directly lowers GDP. Add to that a growing aggressiveness on tariffs. Tariffs pose near-term price rise risks (coming months and quarters), and in that sense are negative for US Treasuries, but the sting in the tail comes in the guise of risks to activity in the medium term (subsequent quarters and years).

That said, we're still structurally bearish on Treasuries. Now targetting the 5% area

That all being said, we remain structurally bearish on Treasuries for 2025. The US 10yr Treasury yield at around 4.5% is flat to our estimate of neutrality. It feels from here it's likely to trade in a 50bp range around that – effectively 4.25% to 4.75%. And breaks above or below these extremes would result in practically inevitable tests of either one of 4% or 5%. Structurally, and as a call for 2025, we maintain the view that a trek towards 5% is most likely.

> *The Trump administration has stimulus at its core*

The back story centres on US growth that remains lively, and the Trump administration has stimulus at its core at practically any cost. That, plus an already bloated US fiscal deficit, rationalises why the Fed will stop cutting at well above the 3% neutral area; we think some 75bp – 100bp above this. That should be echoed out the curve. Even if the 10yr yield is pulled lower initially, it will ultimately be prone to re-testing higher again. We think it will get back up to the 5% area.

This is not necessarily a call for the here and now. It's a call for the coming number of months, and in fact it could be something more for later in the year. By that time, US tariffs will begin to actually show up on CPI readings, and tax cuts will finally be through Congress (although it remains to be seen whether material additions are made beyond the extensions). It's always been a story of cumulative pressure that builds as we go through the year.

> *And don't forget the curve - it's far too flat, on spot and forwards*

And finally, don't forget that the curve is remarkably flat, still. If the Fed ultimately lands in the 4% area, which is where the market mindset is, then we should have the build of a yield curve on top of that. The logic is once the Fed has bottomed, the next move should be up. Whether rates subsequently get hiked or not, the market will build a steeper curve, from the back end. That alone can get us to the 5% area on the 10yr.

What's the risk to the view? That we gradually enter a recessionary tendency. And in fact, we do identify a growth recession risk for 2026. The thing is, between now and then (2025), we have a sticky inflation / elevated deficit combination front and centre that should remain as the dominant bully of the Treasury market.

And for all the reasons as laid out pre and post the US elections

This still fits with views we've been espousing since the middle of 2024. In May 2024 we laid out 4.5% as a neutral level for the 10yr, and that we should trade above neutrality. In July 2024 we doubled down on our call for 5% for 2025, and identified a 50bp delta for the US 10yr between a Harris outcome versus a Trump one. In August 2024 we homed in on a break above 5% as a point estimate for end 2025 on a Trump win. And in December 2024, we again went with 5%+ as a call the US 10yr yield. And we're still on that. We're just downsizing the extension to 5.5%.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com