

US Rates Watch

Curve dynamic in delayed landing scenarios

Delayed landing and repricing of Fed near term...

The pricing of delayed landing scenarios allows for a further pricing out of cuts over '24. We assume that the market may price out cuts to only 2 cuts over '24 as it prices delayed landing scenarios fully. We apply this perturbation on the policy trajectory by pushing out the timing of cuts by 1 quarter, which effectively leaves only c.50bp of cuts for '24.

... vs the policy trough

As the market prices out cuts near term, it is likely that it changes the view on the policy trough. Our guiding principle for potential scenarios for the policy trough is that under delayed landing scenarios the policy trough is still a gauge for the market consensus around neutral rate expectations. We therefore assume two cases for the policy trough:

1. Unchanged policy trough, which is only shifted by 1 quarter (see Exhibit 1).
2. Keep only 85bp of cuts for '25 & eliminate all cuts from '26 to bring the policy trough to 4% (see Exhibit 3). We think a repricing to 4% may happen in delayed landing scenarios, but beyond those levels we enter the no-landing realm.

Implications for the curve dynamic

The first scenario implies a bear flattening dynamic for the curve (up to c.16bp of flattening for 2s10s in an instantaneous repricing of scenario 1 – see Exhibit 2), but the second scenario implied a bear steepening dynamic for the curve (up to c.24bp of steepening for 2s10s in an instantaneous repricing of scenario 2 – see Exhibit 4).

Bear steepening breakeven level: 3y1y OIS > c.3.7%

These perturbations suggest calculating the breakeven level for the policy trough that splits the scenarios for the curve between bear flattening & bear steepening. We estimate that breakeven correspond to a selloff in 3y1y OIS levels to c.3.7% (not seen since late November).

Bottom line: In delayed landing scenarios where the market continues to fade cuts in '24 to only 2 cuts (but where 3y1y OIS continues to be a proxy for the neutral), the market may need to build conviction that neutral rate can be > 3.7% (i.e., 3y1y OIS can reprice to c.3.7% or above) to see a bear-steepening dynamic for the 2s10s curve dominate. We have not seen these levels since late Nov.

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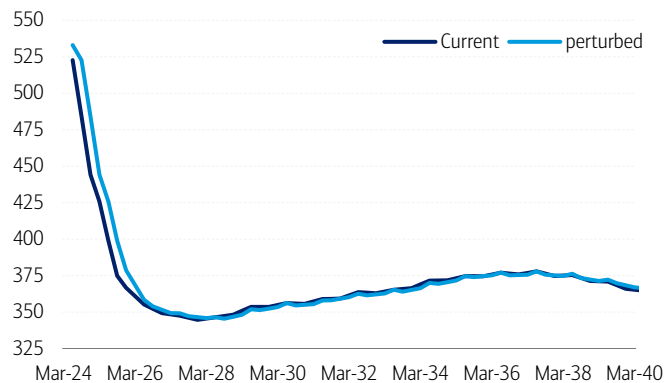
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Exhibit 1: Perturbation of Fed policy trajectory – Fed policy trajectory pushed forward by 1 quarter

Policy trough pushed forward 1 quarter by level unchanged

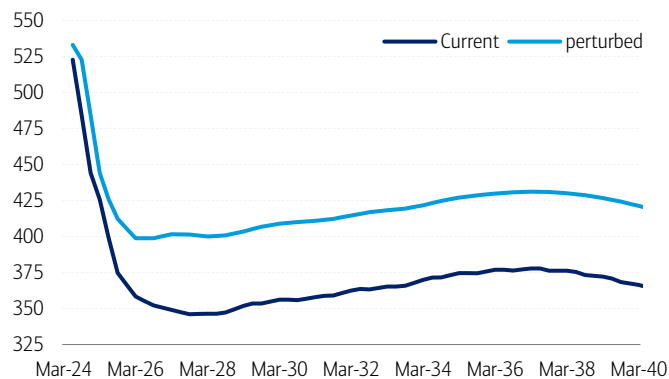


Source: BofA Global Research

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Exhibit 3: Perturbation of Fed policy trajectory – Fed policy trajectory pushed forward by 1 quarter and policy trough repriced higher to 4%

Policy through repriced to 4%



Source: BofA Global Research

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Exhibit 2: Perturbation of Fed policy trajectory – trajectory pushed forward by 1 quarter

Bear flattening dynamic on the curve

	1Y	2Y	5Y	10Y	30Y	2s10s	5s30s
Spot	19.2	20.5	9.5	4.8	2.9	(15.7)	(6.6)
3M	27.1	22.3	9.8	5.0	3.0	(17.3)	(6.8)
6M	31.4	21.5	9.2	4.6	2.9	(16.9)	(6.3)
1Y	21.7	12.9	5.2	2.4	1.9	(10.5)	(3.3)

Source: BofA Global Research

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Exhibit 4: Perturbation of Fed policy trajectory – trajectory pushed forward by 1 quarter and policy trough repriced higher to 4%

Bear steepening dynamic on the curve

	1Y	2Y	5Y	10Y	30Y	2s10s	5s30s
Spot	19.2	23.4	40.7	47.2	53.7	23.8	13.1
3M	27.1	30.2	43.8	48.9	54.6	18.8	10.8
6M	31.4	34.4	46.1	50.1	55.2	15.7	9.0
1Y	27.7	37.4	47.9	51.0	55.5	13.5	7.7

Source: BofA Global Research

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