

US Rates Watch

Spread seasonals: 10y widens 2nd half Jan

Jan has the biggest change in IG volumes

The corporate supply calendar falls off dramatically each December and picks up strongly in January (Exhibit 2). This creates some seasonal patterns of 10y and 30y swap spread tightening at the start of Jan. We find that the supply wave tends to tighten spreads in the first half of Jan, but then spreads widen out in the 2nd half, especially for the 10y maturity, which is the average maturity of the corporate index (Exhibit 1). The spread tightening is due to a combination of 1) unwinds of rate locks in swaps (receive fixed flow in swaps), 2) swapping new issuance from fixed to floating (receive fixed flow in swaps), and 3) overall duration supply in the cash markets (cheapens Treasury cash bonds).

10y widening in 2nd half Jan shows best stats

Because swaps have traded only since the early 90s, the depth of seasonal data is too limited to have strong statistical confidence around seasonal results. But the main result we find in the seasonals is that after the initial spread tightening flows of corporate supply in the 1st half of January, 10y spreads tend to widen back out in the 2nd half. The table below shows the frequency of tightening and widening in the 1st half and 2nd half of January, respectively, along with the average tightening and widening moves. 10y spreads since 2010 have widened back out in the 2nd half of January 79% of the time. With 10y spreads at their tightest levels since 2017, we would expect some tactical demand to buy 10y spreads to develop after this week.

Exhibit 1: Exhibit Spread seasonals show a high frequency of 10y spread widening in 2nd half of Jan

Data covers the month of January from 2010 through 2023

	1st half of Jan		2nd half of Jan	
term	tightening freq	avg tightening	widening freq	avg widening
30y	57%	-3.0	50%	3.5
10y	64%	-2.0	79%	2.4
5y	29%	-4.1	59%	3.1
2y	57%	-3.7	34%	2.6

Source: BofA Global Research, Bloomberg

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For 2024, there are some potential spread-positive factors such as increased bank buying of Treasuries, declining implied volatility, and a potentially weaker dollar if the Fed remains more dovish than other central banks. Regulatory developments also might turn positive for Treasuries vs swaps in 2024 if the focus turns to increasing bank liquidity requirements. Because Treasury clearing will not start until 2026, we expect it to have little impact on spreads this year. But the trajectory of federal deficits - combined with the Fed's ongoing QT program - creates an overall negative backdrop for Treasuries for the foreseeable future. The forward spread curve appears to incorporate this outlook, with for example 1y spreads at -60bp in 2029.

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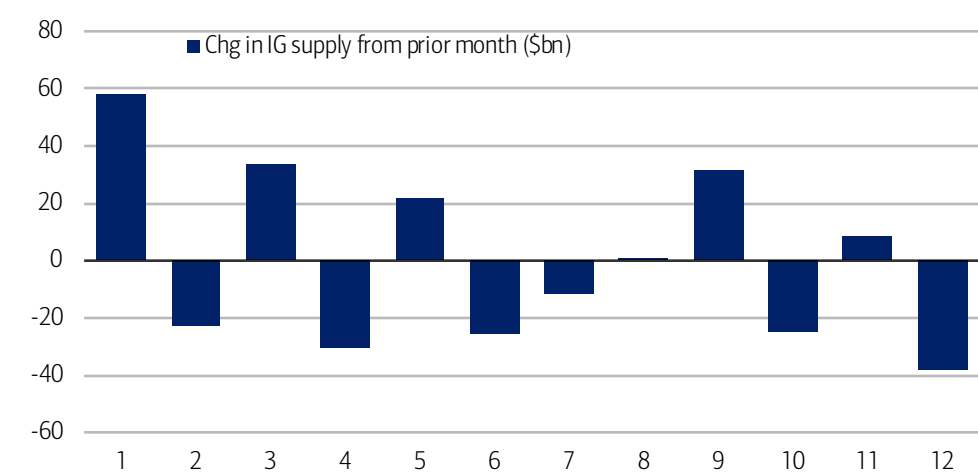
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Exhibit 2: Jan shows largest change in IG corporate supply from prior month
Average monthly supply since 1998, months are numbered 1-12



Source: BofA Global Research

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