Interest Rates Focus

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US rates: breakeven/real yield; reaction to tariff headlines; Treasury refunding

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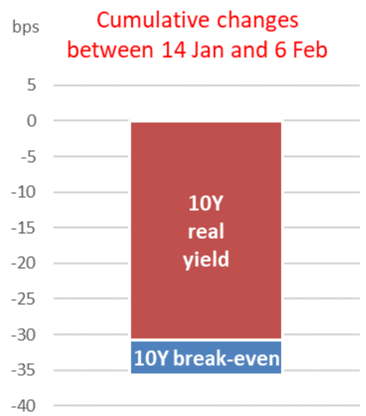
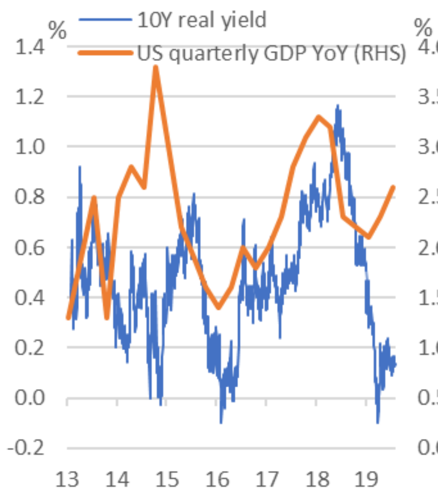
- **10Y UST yield**. UST yields rebounded upon the latest payroll and other labour market statistics; uptick in 10Y nominal yield was mainly driven by higher real yield while 10Y breakeven was relatively stable. Our view has been that real yield is likely the main driver for long end yield movements. Indeed, the downward move in 10Y UST yield from its recent peak attained in mid-January as of 6 February (before payroll) was primarily due to lower real yield (accounting for around 85% of the move in nominal yield). 10Y UST yield broke below the 4.52% resistance level (for the bond) that we had eyed, touching a low of 4.40% before rebounding to the latest 4.49%, versus our end-Q1 expectation of 4.40%. From current levels, **upside to 10Y yield remains likely driven by real yield, but downside will probably need both components to adjust**.

- 10Y breakeven has moved to a higher range of 2.38-2.46% and with the Fed's 2% inflation target, the bar does not appear low for long-end breakeven to break above this new range. 10Y real yield has moved back above the 2% level. Real yields fluctuated a lot over past years, and the relation with GDP growth has been unstable. During the 2013-2019 period, GDP YoY growth was decent in most of the quarters and 10Y real yield peaked at below 1.2%; however, 10Y real yield was mostly above 2% before 2008. The term premium is at play as well, which may feed into real yield or breakeven, or both. The 10Y term premium, as estimated by NY Fed's ACM model had retraced by a cumulative 36bps (as of 6 February) from the 14 January peak, suggesting easing concerns over the near-term fiscal outlook may be mostly in the price for now. Further downward move in the term premium looks limited in the near term as the medium-term fiscal outlook remains as a risk factor, although we see the supply outlook as neutral in the months ahead. Immediate support (for 10Y UST) is at 4.52% followed by 4.60%; resistance sits at 4.40%.

- **US Treasury Quarterly Refunding**. US Treasury kept the anticipation that it would **maintain nominal coupon and FRN auction sizes "for at least the next several quarters"**, despite TBAC recommendation to remove or modify this forward guidance. Net marketable borrowing in Q12025 is estimated at USD815bn, USD9bn lower than earlier estimates; net marketable borrowing in Q22025 is estimated at USD123bn; Q2 borrowing has usually been on the low side upon tax payments. End-march and

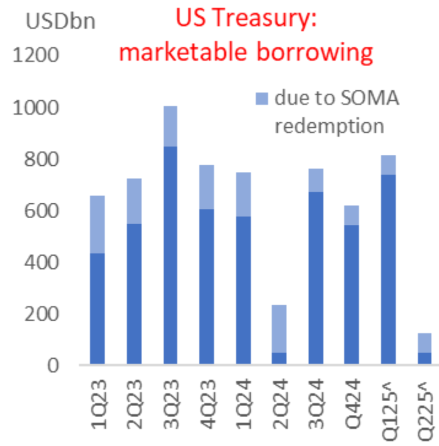


Source: Bloomberg, OCBC Research



Source: Bloomberg, OCBC Research

end-June cash balance is estimated at USD850bn, assuming enactment of a debt limit suspension or increase. Estimated cash balance is mildly on the high side, which can provide a buffer to unexpected increases in financing needs. In terms of the breakdown between bills and coupon bonds, net coupon issuance is planned at USD451bn in Q12025 and at USD505bn in Q22025, alongside planned bills paydown of as much as USD382bn in Q22025. The higher net coupon bond issuance in Q22025 compared to Q12025 will be mainly via higher net TIPS supply leaving net nominal bond supply similar to estimated Q12025 level. Overall, the supply outlook is somewhat neutral in the months ahead.



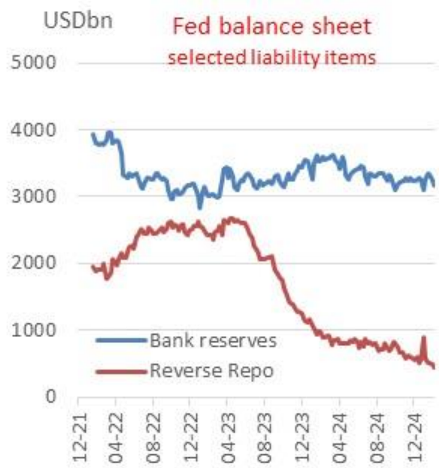
Source: US Treasury, OCBC Research
^US Treasury estimates

- T-bills share above 20% is not too much of a concern at this point of time. First, T-bills share has largely been fluctuating in response to prevailing demand over the years. Second, the strategy remains one that maintains predictable auction sizes of coupon bonds via adjustments in T-bill issuances, which may still be seen as a more desirable approach for the market. Third, average maturity of US Treasury's marketable debt outstanding was last at 70.6 months which was relatively high in the context of 1980-2024 history (average was 61.2 months). Granted, the medium-term fiscal outlook remains as a risk factor.

Implied bill funding based on recent borrowing esimates

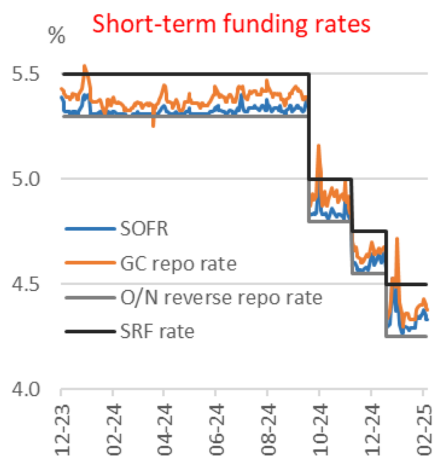
January – March 2025		April – June 2025	
Treasury Announced Net Marketable Borrowing	813	Treasury Announced Net Marketable Borrowing	123
Net Coupon Issuance	451	Net Coupon Issuance	505
Implied Change in Bills	364	Implied Change in Bills	(382)

Source: US Treasury
*Assuming constant coupon issuance sizes



Source: Bloomberg, OCBC Research

- **Bank reserves and (end of) QT timeline**. Impact of SOMA redemption on borrowing estimates is at USD75bn per quarter. We earlier flagged that we saw a potential end to QT as soon as at end-Q1, but we are pushing this expectation to end-Q2. Reduction in reverse repos have been absorbing the majority of the liquidity tightening from QT thus far, leaving bank reserves relatively more stable. The Fed's balance sheet has shrunk by a cumulative USD2.16trn since the peak in April 2022; meanwhile, reverse repos fell by USD1.62trn and bank reserves fell by USD647bn. It would then be natural to see lower bank reserves when usage of reverse repos falls to and stays stable at a low level. As bank reserves move from abundant to ample, front-end rates may become more sensitive to changes in bank reserves. For now, NY Fed's conclusion from their estimates of Reserve Demand Elasticity (RDE) is still that "the elasticity of the federal funds rate to reserve changes is very small and statistically indistinguishable from zero" and this "suggests that reserves remain abundant". Bank reserves stood at USD3.18trn and reverse repos (all tenors) at USD455bn,

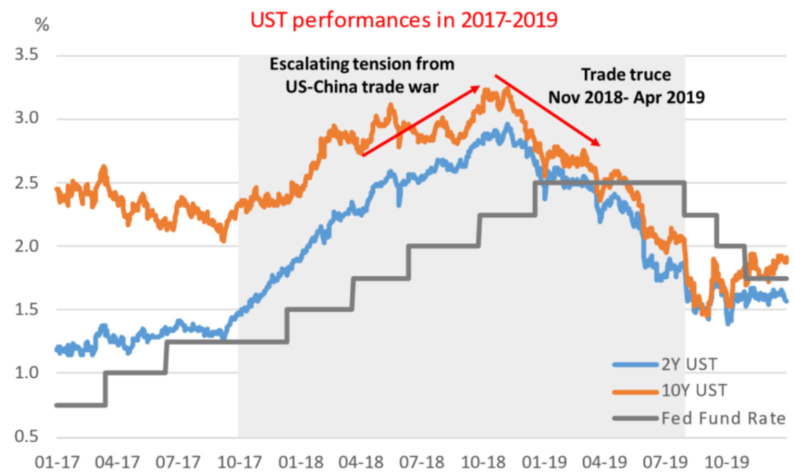


Source: Bloomberg, OCBC Research

as of 5 February; these may allow QT to run for a few more months.

- **Impact of tariff headlines.** Near-term reaction in USTs to negative tariff headlines may remain relatively muted compared to that in some other asset classes, as there are counteracting factors – namely, growth concerns and safe-haven flows – to inflation worries. Inflation worries may be more reflected at the short end while growth concerns more at the long end, likely leading to a flattening of the curve as a reaction to negative tariff headlines. In the absence of negative tariff headlines, we do not see much room for flattening, as front-end pricing is not dovish while near-term downside to the term premium appears limited.

- In an earlier report, we revisited what happened to US yields in the last episode of heightened trade tensions. **Trump 1.0 may not be a good reference for potential bond market reaction, not least because the Fed was in a different monetary policy cycle**. Granted, potential inflation impact of tariffs may in turn be factored into the FOMC's decision-making process.



Source: Bloomberg, OCBC Research
Shaded: First QT

- *Fed cycles*. The Fed started the rate hiking cycle by delivering a 25bp hike in December 2015; after an extended pause and after the 2016 elections, the Fed followed through by a slew of interest rate hikes from December 2016 through to December 2018 with cumulative 225bps of hikes including the December 2015 one. After range-trading for most of 2016, 2Y UST yield embarked on an uptrend starting November 2016 ahead of the slew of rate hikes; the upward move in yields across tenors gained momentum from September 2017 onwards, while tariffs/trade war intensified only in 2018. Note FOMC announced intention to carry out QT (quantitative tightening) in June 2017 and started QT in October 2017, which likely helped explain the pick-up in the upward momentum in yields. Yields continued to move higher through most of 2018, amid a confluence of factors including continued rate hikes, QT, and trade tensions. On balance, a significant part of the upward move in yields might have been attributable to the monetary policy cycle – rate hikes and QT, in our view. In comparison, the Fed has delivered a total of 100bps of cuts in this cycle thus far and we believe they remain in an easing cycle, while QT has been underway for quite some time now and the next to look for is a pause in QT as bank reserves move gradually from abundant to ample.

- *Breakeven movements*. Breakevens are highly relevant here as the popular notion is tariffs are inflationary and hence may push up yields. In 2017, 2Y breakeven moved up from the low of 1.15% in July to the high of 1.63% in November; further to a high of 2.06% in March 2018. Thereafter, 2Y breakeven fell amid heightened trade tensions. The timing between breakeven movements and tariffs did not appear to match entirely. Regardless, the recent increases in short end breakevens and the inverted breakeven curve suggest that the expected inflation impact may be partially in the price.

Source: Bloomberg, OCBC Research
Shaded: Heightened trade tensions

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