Viewpoint | Citi Research

18 Sep 2026 18:03:07 ET | 35 pages

US Rates Weekly

Only hawks outside the window

Flagship

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With thanks to
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CITI'S TAKE

Chair Warsh was unquestionably hawkish in our view, but such action should limit downside tails for the long-end of the curve for now. Core long positions face two challenges ahead: 1) Avoiding a rate hike in October and 2) weathering the seasonally strong Jan and Feb core PCE prints. We are concerned on both fronts and close our long 20y bond position at a loss. For investors who can withstand this volatility, we do still see value especially into the November refunding. We update our rates forecasts and see 10y USTs at 5% by year-end even if the FOMC keeps rates on pause at the October meeting.

USTs — The latest flow of funds data reports hedge fund basis books have shrunk the most since COVID. We outline why this is not as large of a risk as the popular narrative suggests.

Short-end —SOFR has continued to fix below IORB this past week. We show how reserves have been a larger driver of repo rates compared to T-bill outstanding recently and we think this suggests we're in a lightly abundant reserves environment. We present a framework to estimate SOFR/FF for the rest of the year, and we find that current market pricing looks bearish compared to our estimates. Lastly, we discuss what Fed Vice Chair for Supervision Bowman's timeline for GSIB reform means for year-end liquidity conditions.

Inflation — We examine the downside risk for inflation expectations after the hawkish FOMC. We continue to like our short 2y breakevens position with the energy hedge as we see a lot of room for ex-gasoline inflation expectations to move lower from here.

Vol — Rates vol has been and should continue to be driven by the expected pace of the Fed's hiking cycle. The 2s5s rate curve could flatten meaningfully in an overly hawkish/policy error scenario, and we recommend buying SFRH7 put against 2y midcurve SFRH9 put as a cheap front-end bear flattener tail hedge.

Please join us for a 15-minute call on Monday September, 21, at 10am NY time/3pm London time when we will summarize key views for the week ahead: Global Rates & FX Weekly Call

Note: Clients subject to MIFID II unbundling should have a full-service research agreement in place to participate. If unsure about your agreement, please check with your in-house, sell-side research coordinator, or with the event organizer

Note: Futures trading involves substantial risk of loss.

See Appendix A-1 for Analyst Certification, Important Disclosures and Research Analyst Affiliations

