Research @ Citi Markets Edition: Should Markets Be Scared of U.S. Treasury Yields?

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Adam Pickett (00:03)

Welcome to Research @ Citi Markets Edition, where we break down global macro in 10 minutes or less.

I'm your host, Adam Pickett, Citi's Head of Global Macro Strategy here in London. And with me today is my colleague, Giammarco Miani. Welcome to the show, Giammarco.

Giammarco Miani (00:20)

Thanks, Adam. Pleasure to be here.

Adam Pickett (00:22)

We're recording this podcast at 9.30 a.m. Eastern time on Tuesday, September the 8th, 2026.

So, a lot going on in U.S. yields between Bessent and Warsh, but in particular on the back end, we don't think there's a UST problem. We don't see that as being much of a panic. It doesn't change our bullish views on equities and FX carry. And what we would flag is that compared to the buyer-strike concern in October 2023, the steepening of the curve has been much more benign, and the MOVE Index has barely budged. So, rates of all, hasn't picked up.

And other measures that we see around term premia — either the ACM or regressing the curve on the front end — also suggest that there's not much of a concern in the Treasury market.

Giammarco Miani (01:19)

Yeah. So Adam, many associate the global selloff with fiscal problems. How do you see it?

Adam Pickett (01:25)

One way we tried to look at that question was to decompose the 30-year move year-to-date into the real yield, the inflation swap and the asset swap. The vast majority of the move, especially recently, has been real yield, very little in the way of a big inflation-swap move or asset-swap move, which would suggest fiscal uncertainty.

Also, when we look at the 30-year move in the last six months or so, it's really correlated very well with BCOM Energy and a little bit with the S&P, which to us suggests you probably have, yes, an Iran problem. But also the economy is strong enough to handle higher yields because of the global manufacturing cycle, because of the AI cycle, and central banks are simply acknowledging that risk of higher r-star.

As an aside, when we've looked at higher-frequency proxies for productivity, we actually find higher-productivity environments tend to be synonymous with higher yields, not lower yields, which is interesting because we often hear the idea that higher productivity is more dovish from a disinflationary perspective. So purely on that fiscal question, we don't see too much evidence of anything concerning.

Giammarco Miani (02:37)

You know, the other reasons let's say associated with the selloff have been the global bond glut, the theme of the global bond which has been going on for a while, credit competition for capital coming particularly from the AI boom, and possibly the need of a credibility hike from the Fed. What do you think about those?

Adam Pickett (02:56)

Yeah, great questions. On the globality, a couple of things we would say. One is other curves are also experiencing predominantly real-yield-led moves when we do a similar decomposition. Mostly real yields driving the bus in Japan and the UK, with a bit more of an inflation flavor from their moves.

I mean, really it's only to some extent Germany and to a much bigger extent France that we see more fiscal risk, which makes sense with the election round the corner. On the global bond glut, when we do our global net-cash requirement, global safe-asset net-supply type of analysis, we don't find a massive dislocation between where our global supply to the price-sensitive sector overlay with term-premia framework suggests that term premia should be.

What we do find is that the unusual thing is that post-COVID, the frequency of term-premia spikes has increased to levels that are normally only seen around recessions. And so, it's not a one-way curve-steepening trade, but it maybe increases the vol in the back end and means that flatteners, if ever put on, need to be a bit more opportunistic, because there's always risk of a term-premia spike, or higher risk of term-premia spikes than in cycles before.

More broadly, though, on the competition for capital, we also don't find a great relationship between the frequency or the lumpiness of longer-dated IG issuance in the U.S. and the 5s30s curve. Which is to say, we would have thought that the months where you had lots and lots of hyperscaler issuance would have seen steeper curves, and there hasn't really been a clear-cut relationship.

If you squint at the 2s30s curve overlaid with the U.S. IG OAS spread, there's maybe a bit of a better relationship, but only in the last three months or so. So again, we think the jury's out there as well.

Lastly, on the idea of a credibility hike, a couple of ways to think about this. One is 2s and 30s are historically very correlated, especially when you're in an environment of oil moving up. And secondly, if you look at Japan in the last couple of months, the 2s10s curve has flattened as the BOJ have become more hawkish, but the 10-year has continued to sell off. So, it's not obvious to us that a very hawkish Fed would put a lid on longer-term yields.

That being said, Giammarco, at Jackson Hole we did get a more hawkish-sounding Warsh potentially trying to re-inject some credibility. Now, how do you view the Fed debate at the moment, and what seems to be a bit of a Warsh vs. Waller camp?

Giammarco Miani (05:42)

Yeah, that's exactly right, Adam. The debate around the Fed and what will happen in the September meeting is really about the view — or at least a little bit more clarification into the input of the reaction function — that we got from Kevin Warsh at Jackson Hole, vs. let's call it a more patient, dovish view from Gov. Christopher Waller more recently.

So with respect to Fed Chair Kevin Warsh, what did we learn? Again, we didn't get obviously forward guidance, and I wouldn't say we really got his full reaction function, but we got a little bit of clarification of his inputs into his reaction function.

So what did we get? Fed Chair Warsh downplayed inflation expectations, wages and headline NFP and also stressed that the trend in core PCE is the target and one or two more benign data points are not enough.

So the read was obviously very hawkish given we did get a little bit of his reaction function. We put together these inputs into an indicator to understand how it’s screening vs. the recent past and also historically. And we call this the Warsh Shadow Rate.

So we took a lot of these inputs and took the median zed-score of all these indicators, and what we actually see is that it's not only extremely high since Kevin Warsh became Fed chair, but it's also from a historical point of view since the 90s, it's been very high.

So on the one hand, you have this very hawkish view that's pointing toward a near-term hike. On the other hand, we had Governor Christopher Waller, who talked about being a bit more patient, and also a view that is conditional. So ultimately, we think Gov. Waller has a reasonably high bar to hike in September, and certainly higher than Fed Chair Kevin Warsh.

Where does that leave us? Citi economists expect a Fed that remains on hold for the remaining of this year. That is conditional on their expectation, their forecast of CPI coming in shy of 0.2.

Adam Pickett (07:47)

That's great. And given that the market has already priced the full hike and there's obviously room for us to be wrong, we did look into how macro markets trade into the first Fed hike of a cycle. What were some of the key conclusions from that, Giammarco?

Giammarco Miani (08:02)

Yeah, so bonds obviously take the biggest hit. Historically, you see a selloff into the first hike and they remain weaker for longer. Then I would say U.S. equities also weaken historically after the first hike, but they recover essentially after the first two months post-hike. And then obviously the other impact we see is in FX, so hikes obviously tend to strengthen the dollar. Euro dollar for example weakens into the first hike, especially let's say part of the cycle gets priced in, and then it becomes more stable.

Adam Pickett (08:34)

OK, so relatively short-term implications from the first hike of a cycle, you would say.

Giammarco Miani (08:41)

Yeah, exactly.

Adam Pickett (08:43)

Sounds good.

So in sum, we're not concerned about the U.S. Treasury or indeed global back end with respect to our positive views on equities and on FX carry. We do believe that there's a bit more two-way risk around the September hike than perhaps the market gives credit for. And with respect to the risk that our house view on no hikes this year is wrong, and that there is a hike this year, some of our work around macro into the first hikes suggests some bond weakness and dollar strength into the first hike that stabilizes afterwards.

A little bit of U.S. equity weakness after the first hike that also recovers, but broadly no meaningful consistent trends in cross-asset volatility that would concern us in the medium term.

Thank you for joining us today. This episode was recorded on Sept. 8, 2026. For more details, Citi clients can check out our recent reports on the Citi Velocity portal. Next week's Research @ Citi Markets edition will be hosted by Beata Manthey, Citi's Head of Global Equity Strategy.

And be sure to watch for our other podcast series, Research @ Citi, which you can view on the same channel. The macro strategy team will be back in two weeks. Stay sharp!

Disclaimer (10:04)