US Interest rates monitor

Treasury yields and interest rates will likely peak once the Fed is done tightening

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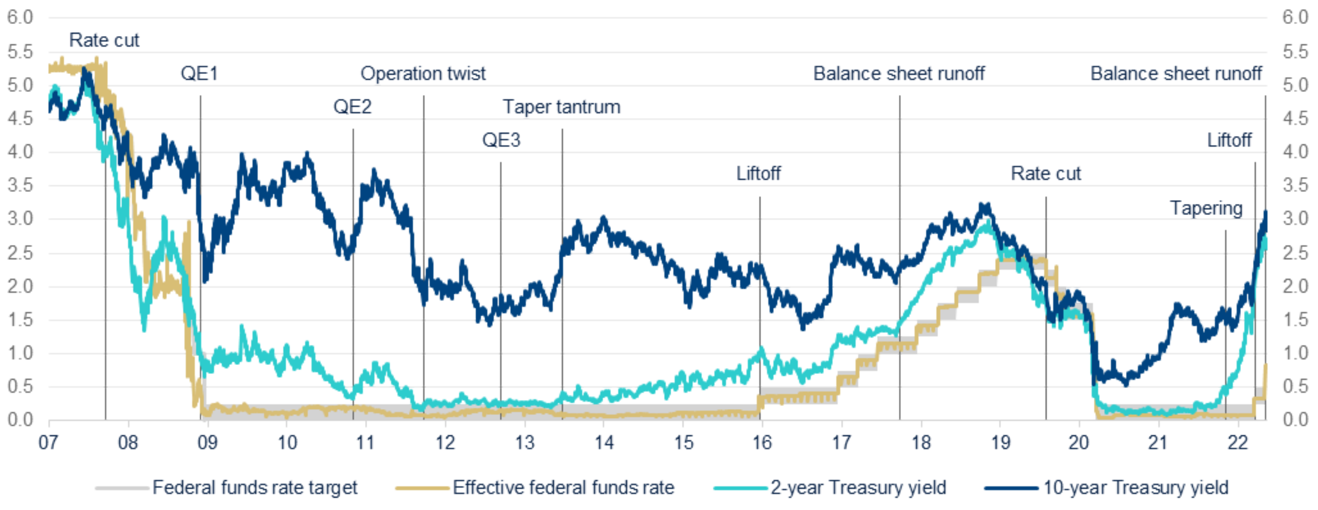
Bringing inflation back down to target will likely cause “some pain”; yet, markets are (still) pricing in a soft landing

- With the Fed set to hike rates by 50 bps in June and July, and potentially even in September, the tightening pace is set to be the fastest since the 1994-1995 hiking cycle (Figure 3).
- Long-term yields have risen recently, comparably more than shorter-term yields. As a result, and with expectations of a 75 bps hike off the table in the near future, the yield curve steepened somewhat (Figure 7).
- Overall, current Treasury yield spreads seem to be pricing in a soft landing. The 3m10y Treasury yield slope (at 190 bps as of May 13th) is not currently pointing to increased chances of an upcoming recession (Figure 10).
- The uncomfortable rising path of market based inflation expectations seems to have peaked at its April highs and has eased somewhat recently (Figure 16).
- Futures markets are now pricing that the fed funds rate will peak at 3% (vs 3.25-3.5% just a week ago), as markets begin to wonder about the probability of a soft landing, which nonetheless is still the scenario markets are pricing in (Figure 21).

Fed’s forward guidance since its late-2021 hawkish pivot has been tightening financial conditions well before liftoff. Rates across the yield curve have risen sharply as the hiking cycle unfolds

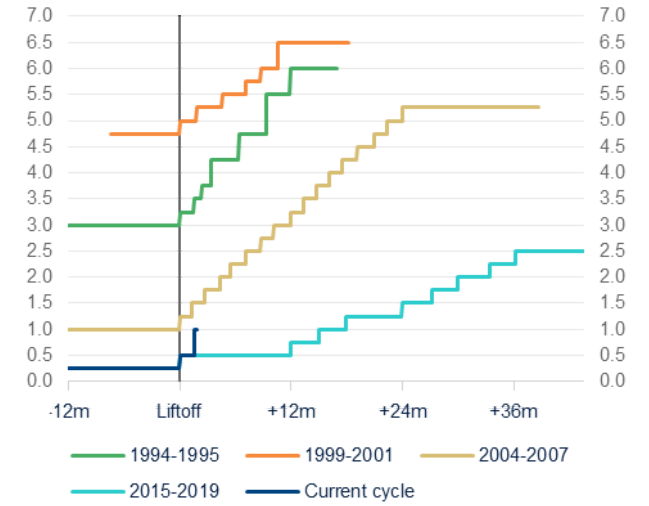
Figure 1. **2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

With the Fed set to hike rates by 50 bps in June and July, and potentially even in September, …

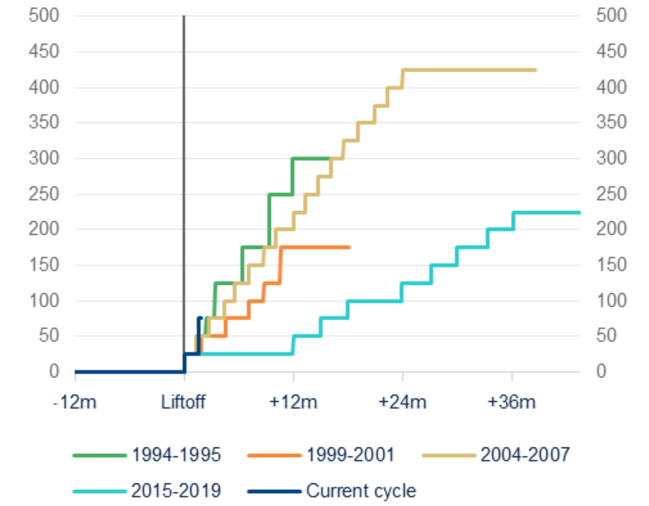
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES** (DAILY DATA, %)



Target rate for the 1994-1995, 1999-2001, and 2004-2007 cycles; upper limit of the target rate range for the 2015-2019 and current cycles.
Source: BBVA Research based on data by Haver Analytics.

… the tightening pace is set to be the fastest one since 94-95. With a still easing policy stance, …

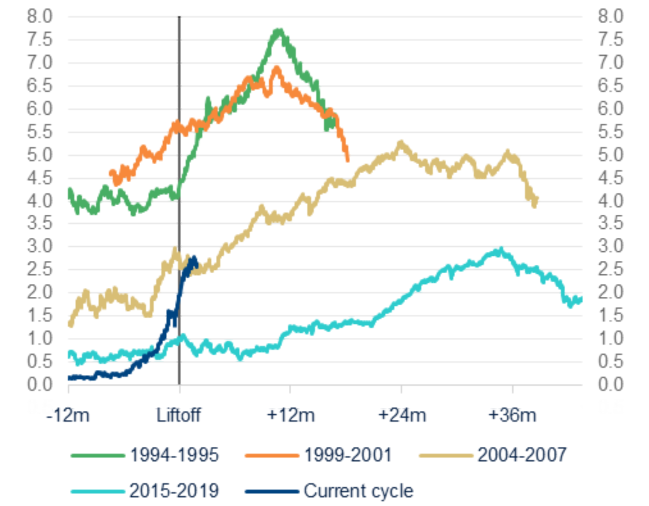
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES** (DAILY DATA, BPS VS RATE LEVEL AT LIFTOFF)



Target rate for the 1994-1995, 1999-2001, and 2004-2007 cycles; upper limit of the target rate range for the 2015-2019 and current cycles.
Source: BBVA Research based on data by Haver Analytics.

… Treasury yields remain relatively low despite recent sharp increases across the yield curve, …

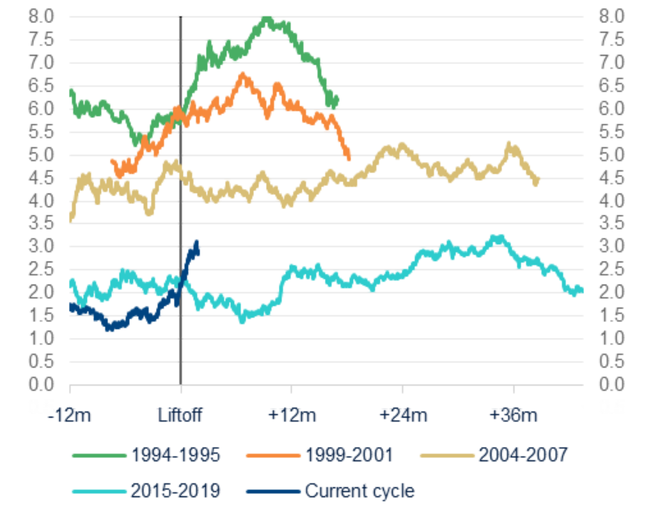
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

… and will most likely increase further. Yields will possibly peak once the Fed is done tightening

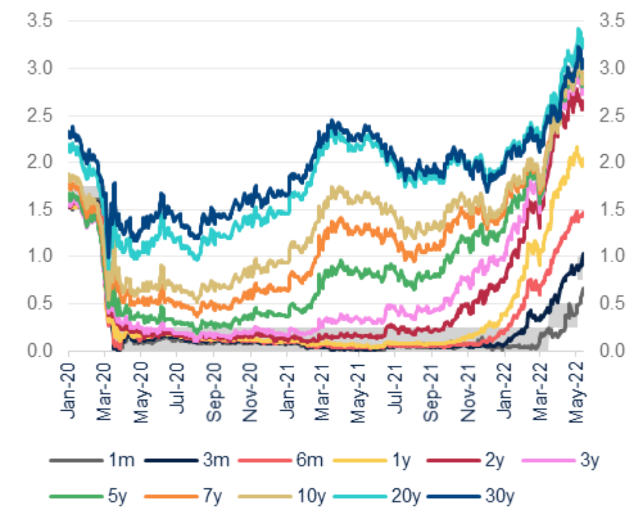
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

Long-term yields have risen recently, comparably more than shorter-term yields. As a result, …

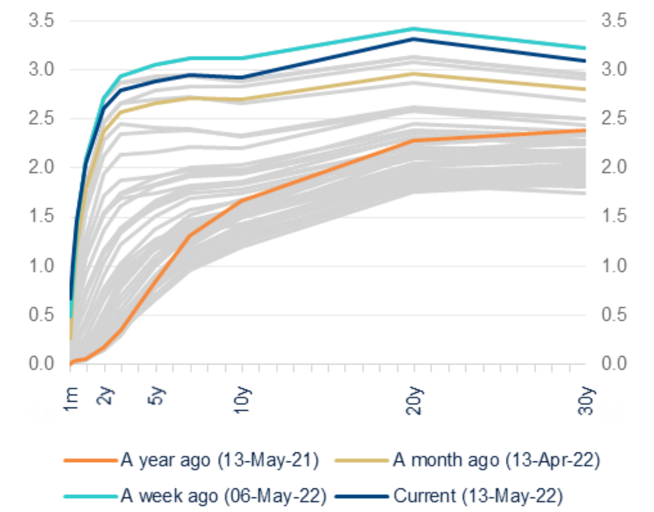
Figure 6. **TREASURY YIELDS (CONSTANT MAT., DAILY DATA, %)**



The gray area indicates the federal funds rate target range.
Source: BBVA Research based on data by Haver Analytics.

… and with a 75 bps hike off the table in the short term, the yield curve steepened somewhat

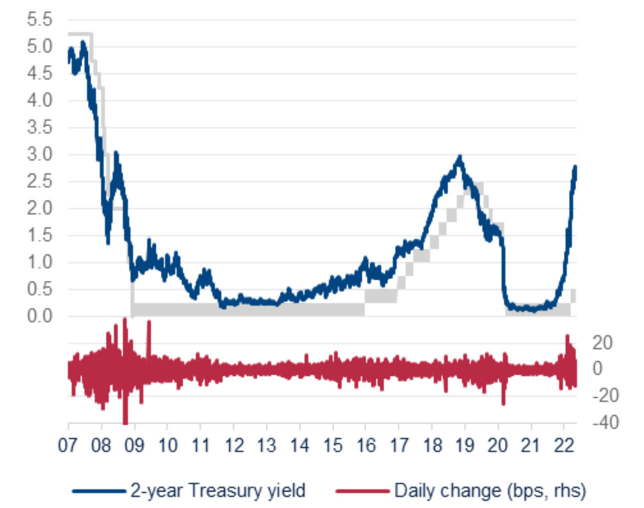
Figure 7. **TREASURY YIELD CURVE (CONSTANT MAT., DAILY DATA, %)**



The gray lines indicate weekly yield curves from a year ago.
Source: BBVA Research based on data by Haver Analytics.

There is room for 2y yields to keep rising if as we expect the fed funds rate reaches 3.5% by May-23

Figure 8. **2-YEAR TREASURY YIELD DAILY CHANGE (CONSTANT MAT., DAILY DATA, % AND BPS)**



The gray line and area indicate the federal funds rate target.
Source: BBVA Research based on data by Haver Analytics.

If a soft-landing is still priced in over the coming months, 10y yields would also rise further

Figure 9. **10-YEAR TREASURY YIELD DAILY CHANGE (CONSTANT MAT., DAILY DATA, % AND BPS)**

The gray line and area indicate the federal funds rate target.
Source: BBVA Research based on data by Haver Analytics.

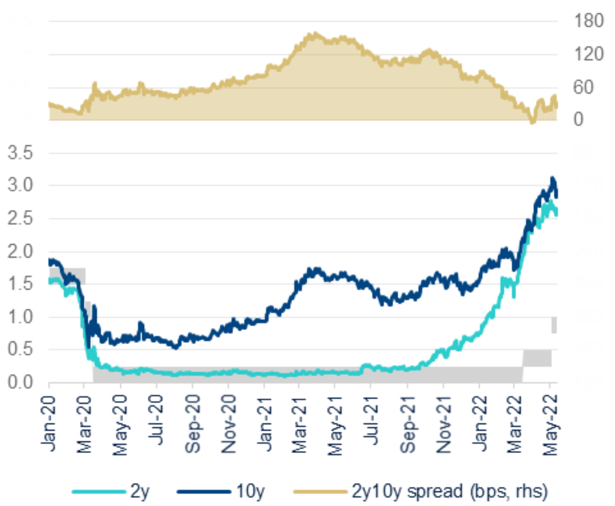
The 3m10y yield slope is not currently pointing to an upcoming recession. Yet, if inflation keeps surprising, that spread could rapidly shrink under an even more aggressive response by the Fed

Figure 10. **TREASURY YIELD SPREADS** (CONSTANT MAT., DAILY DATA, BPS)

Gray shaded areas indicate US recessions as defined by the National Bureau of Economic Research (NBER).
Source: BBVA Research based on data by Haver Analytics.

A shift back to 25 bps hikes in late-22 will likely cause the 2y10y slope to remain low but positive

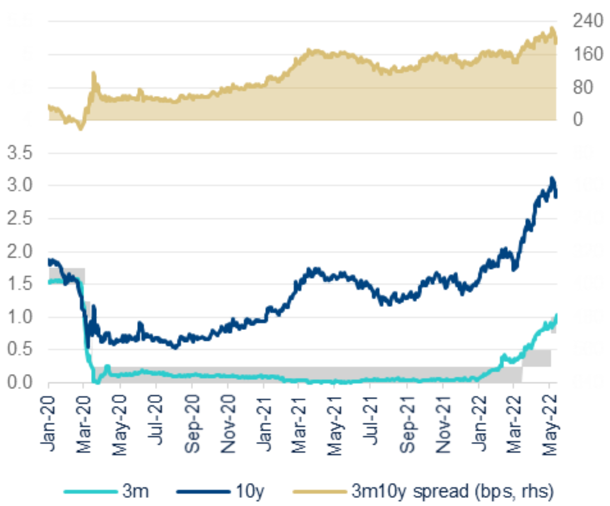
Figure 11. **2Y10Y TREASURY YIELD SPREAD** (CONSTANT MAT., DAILY DATA, % AND BPS)



The gray area indicates the federal funds rate target range.
Source: BBVA Research based on data by Haver Analytics.

Under a soft-landing scenario, the 3m10y spread will orderly shrink as the hiking cycle evolves

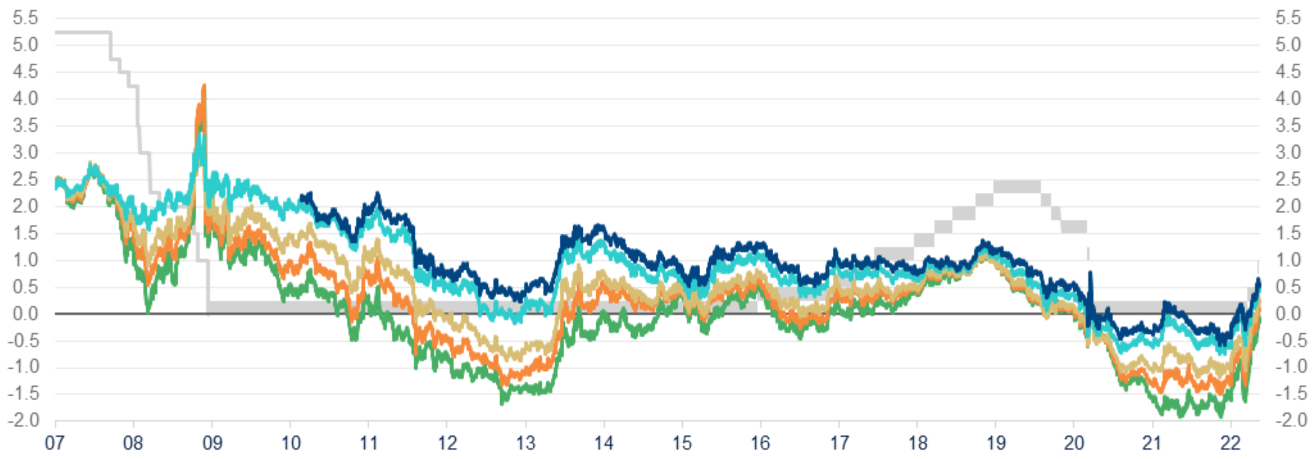
Figure 12. **3M10Y TREASURY YIELD SPREAD** (CONSTANT MAT., DAILY DATA, % AND BPS)



The gray area indicates the federal funds rate target range.
Source: BBVA Research based on data by Haver Analytics.

The policy normalization is pushing TIPS yields up from their historical lows. If inflation concerns were worsening, inflation-indexed yields would be expected to fall, or not to rise as much as they have done

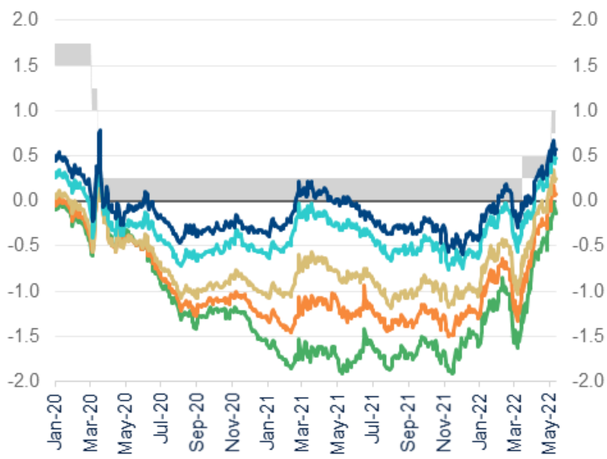
Figure 13. **INFLATION INDEXED TREASURY (TIPS) YIELDS** (CONSTANT MAT., DAILY DATA, %)



The gray line and area indicate the federal funds rate target.
Source: BBVA Research based on data by Haver Analytics.

Inflation-indexed yields resumed their upward path after the market turmoil of late February

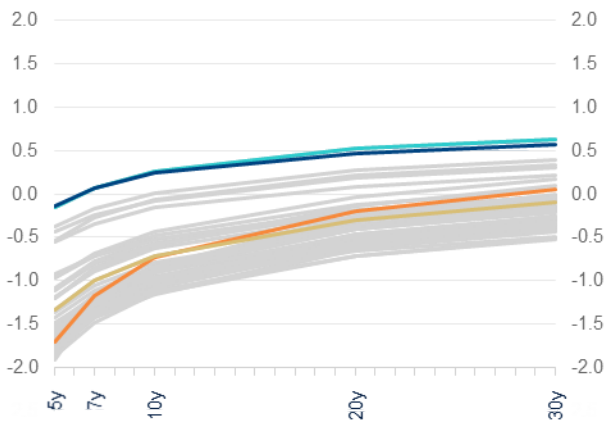
Figure 14. **INFLATION INDEXED (TIPS) YIELDS** (CONSTANT MAT., DAILY DATA, %)



The gray area indicates the federal funds rate target range.
Source: BBVA Research based on data by Haver Analytics.

With only the 5y yield still slightly negative, the TIPS yield curve has moved to positive grounds

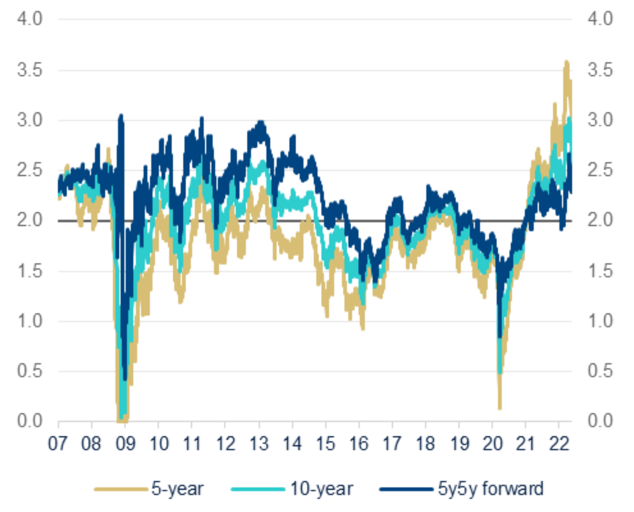
Figure 15. **INFLATION INDEXED (TIPS) YIELD CURVE** (CONSTANT MAT., DAILY DATA, %)



The gray lines indicate weekly yield curves from a year ago.
Source: BBVA Research based on data by Haver Analytics.

The uncomfortable rising path of market-based inflation expectations peaked at its April highs

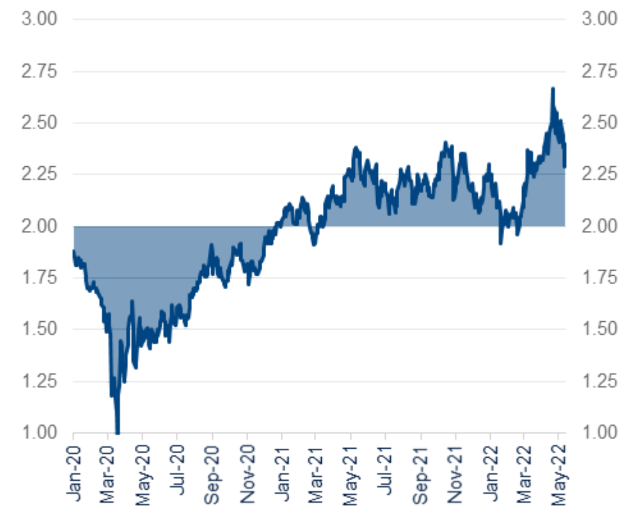
Figure 16. **BREAKEVEN INFLATION RATES (CONSTANT MAT., DAILY DATA, %)**



Source: BBVA Research based on data by Haver Analytics.

The implied inflation rate over the 5y period that begins 5y from today eased from its 2.67% peak

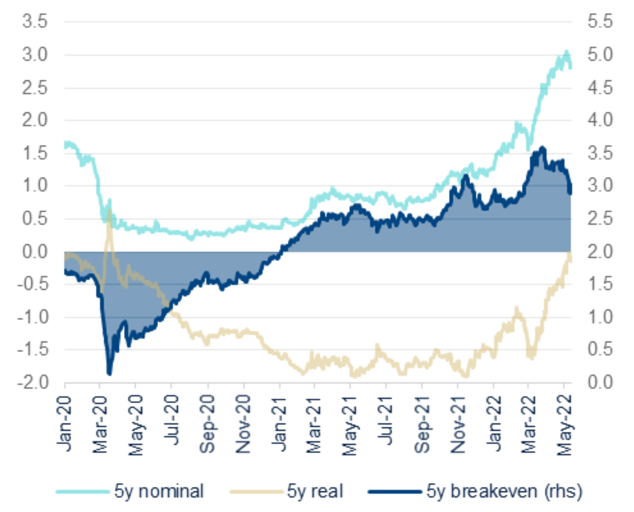
Figure 17. **5Y5Y FORWARD IMPLIED INFLATION RATE (CONSTANT MAT., DAILY DATA, %)**



The shaded area indicates deviations from the FOMC's inflation target.
Source: BBVA Research based on data by Haver Analytics.

Unless inflation panic kicks in, inflation-indexed yields should increase in line with nominal rates

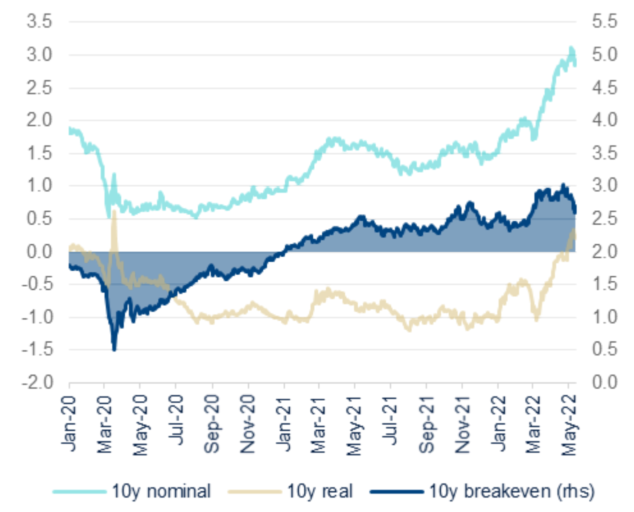
Figure 18. **5-YEAR BREAKEVEN INFLATION RATE (CONSTANT MAT., DAILY DATA, %)**



The shaded area indicates deviations from the FOMC's inflation target.
Source: BBVA Research based on data by Haver Analytics.

With the Fed now focused on inflation, we expect both nominal and real rates to keep rising further

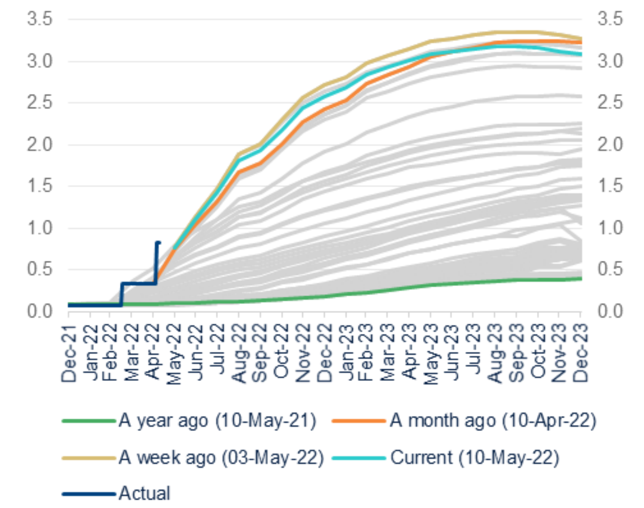
Figure 19. **10-YEAR BREAKEVEN INFLATION RATE (CONSTANT MAT., DAILY DATA, %)**



The shaded area indicates deviations from the FOMC's inflation target.
Source: BBVA Research based on data by Haver Analytics.

Futures markets are now pricing that the fed funds will peak at 3% (vs 3.25-3.5% a week ago)...

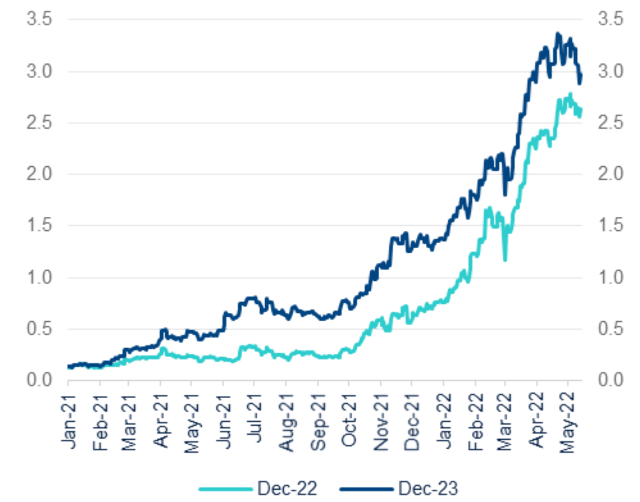
Figure 20. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES** (DAILY DATA, %)



The gray lines indicate weekly implied rate paths from a year ago.
Source: BBVA Research based on data by Bloomberg.

… as markets begin to wonder about the probability of a soft landing

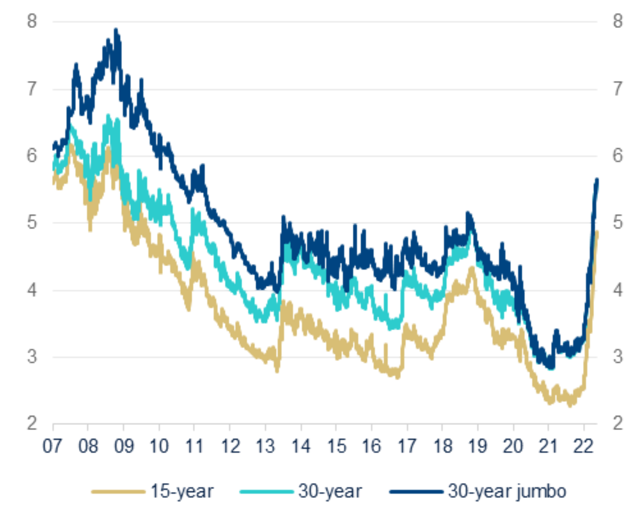
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES** (DAILY DATA, %)



Source: BBVA Research based on data by Bloomberg.

Financial conditions keep tightening as signaled by surging mortgage rates, now at 2010 levels

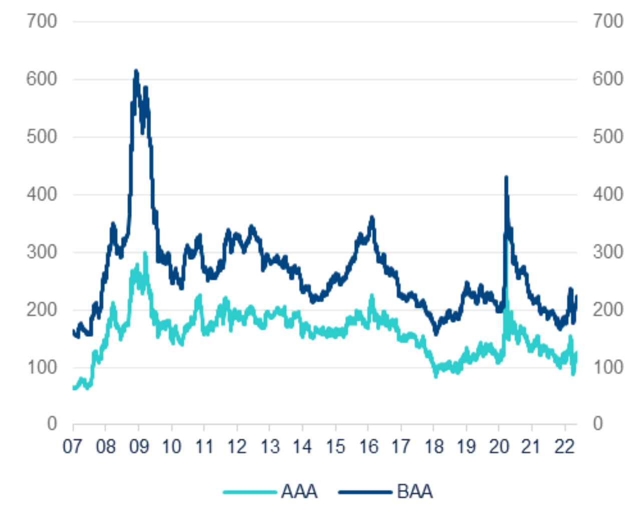
Figure 22. **MORTGAGE RATES** (WSJ CONSUMER FIXED RATES, DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

As risk appetite declines, corporate spreads are expected to rise from their current low levels

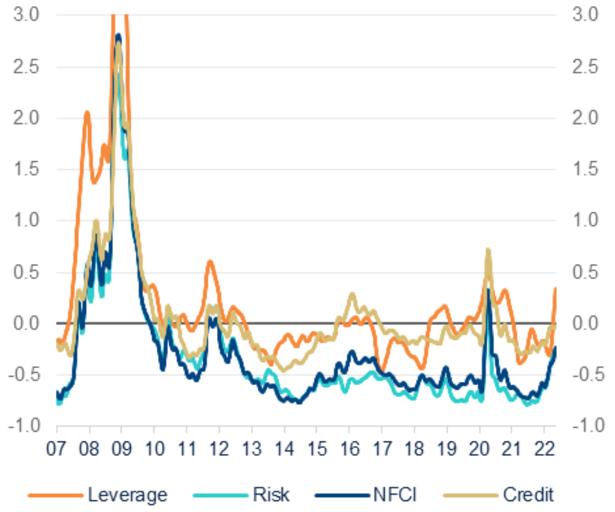
Figure 23. **CORPORATE BOND SPREADS** (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)



Spreads over the 10-year Treasury yield.
Source: BBVA Research based on data by the Federal Reserve Bank of St. Louis and Haver Analytics.

Broad indices show that financial conditions are still loose but, as expected, tightening, …

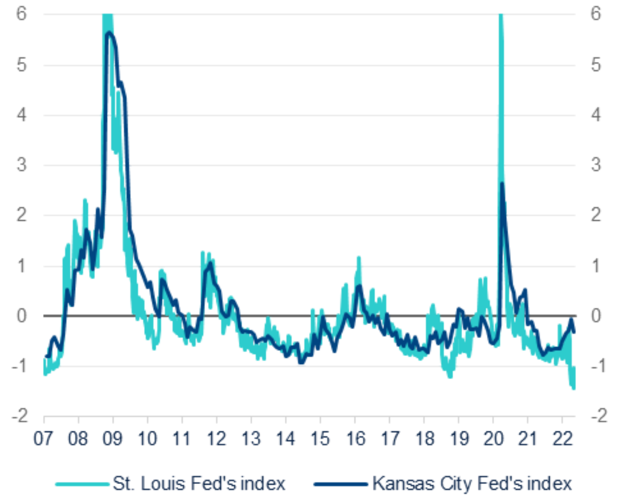
Figure 24. **CHICAGO FED'S NATIONAL FINANCIAL CONDITIONS INDEX** (>0 = TIGHTER THAN AVG)



Source: BBVA Research based on data by Haver Analytics.

… while financial stress indices do not suggest major concerns

Figure 25. **FED'S FINANCIAL STRESS INDICES** (>0 = ABOVE AVG FINANCIAL STRESS)



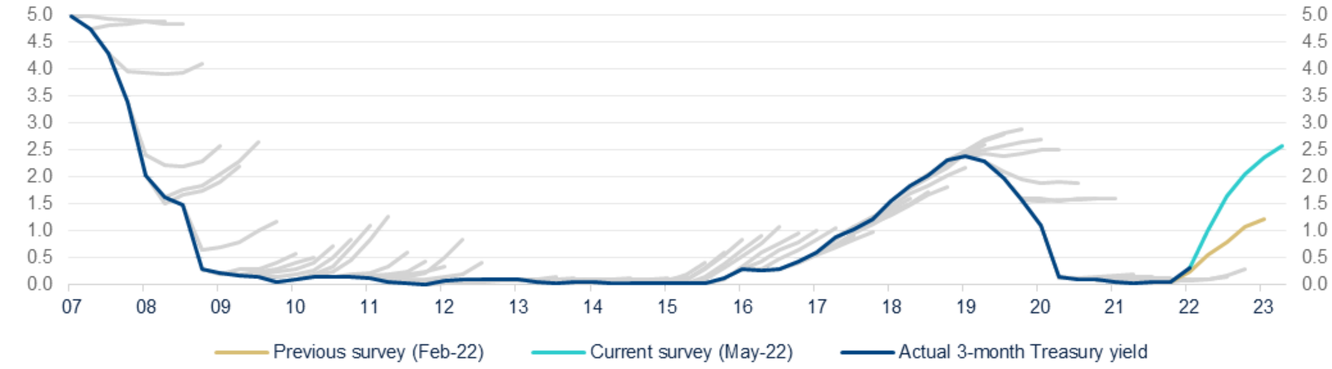
Source: BBVA Research based on data by Haver Analytics.

Professional forecasters revised up their interest rate projections

- Last Friday, the Federal Reserve Bank of Philadelphia released the Second Quarter 2022 Survey of Professional Forecasters, showing significant revisions to the projected path of interest rates.
- As the long end of the yield curve rose sharply in recent months, 75% of respondents now expect the 10-year Treasury yield to peak at a level of up to 4% by 2024 (Figure 28).
- While corporate yields are expected to rise significantly in line with Treasury yields, professional forecasters expect credit spreads to remain at low levels (Figure 31).

Professional forecasters revised up significantly their Treasury yields projections. The median forecaster now expects the 3m Treasury yield to reach 2.58% by the second quarter of 2023, …

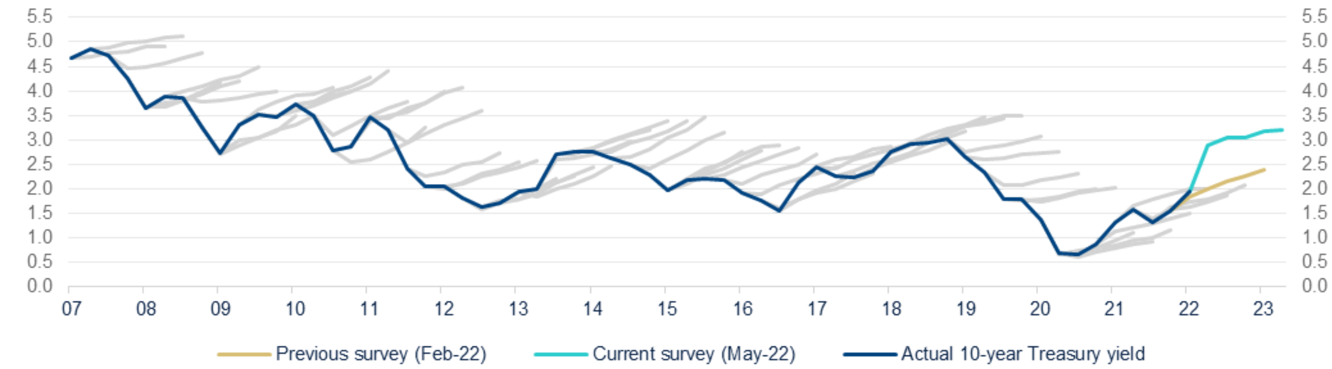
Figure 26. **PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS** (QUARTERLY DATA, %)



Median values. The gray lines indicate historic Professional Forecasters' expectations.
Source: BBVA Research based on data by Haver Analytics.

… while the 10y Treasury yield is expected to reach a level of 3.2% over the same horizon. As the long end of the yield curve rose sharply in recent months…

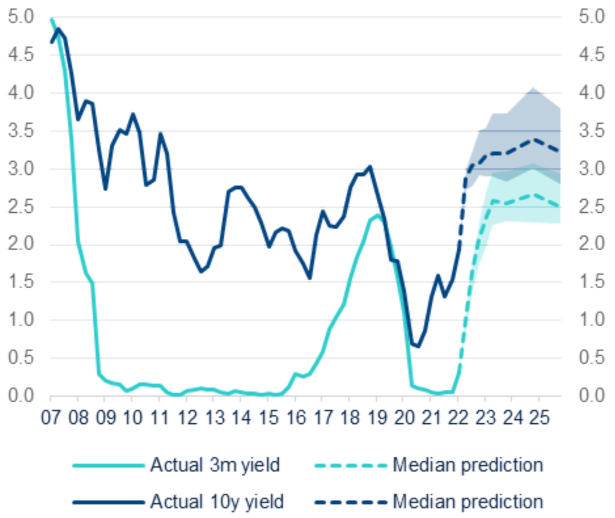
Figure 27. **PROFESSIONAL FORECASTERS 10-YEAR TREASURY YIELD EXPECTATIONS** (QUARTERLY DATA, %)



Median values. The gray lines indicate historic Professional Forecasters' expectations.
Source: BBVA Research based on data by Haver Analytics.

… 75% of respondents now expect the 10y yield to peak at a level of up to 4% by 2024, …

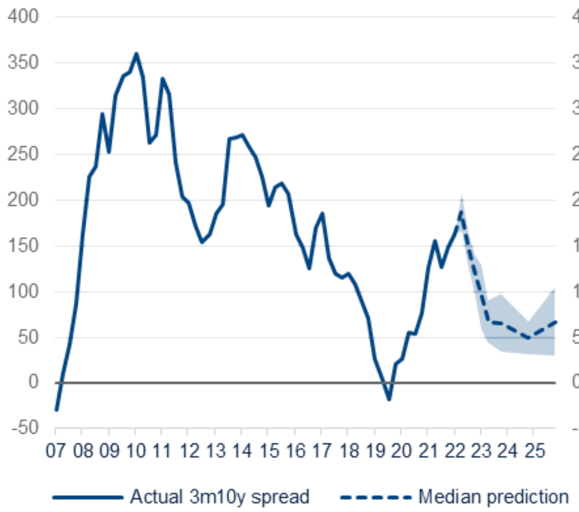
Figure 28. **PROF. FORECASTERS TREASURY YIELDS EXPECTATIONS** (QUARTERLY DATA, %)



Shaded areas indicate interquartile ranges.
Source: BBVA Research based on data by the Federal Reserve Bank of Philadelphia and Haver Analytics.

… and do not expect an inversion of the 3m10y slope in the foreseeable future

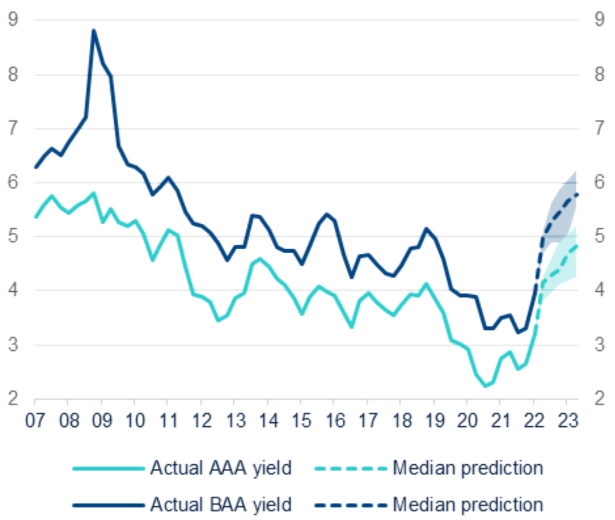
Figure 29. **PROF. FORECASTERS IMPLIED 3M10Y SPREAD EXPECTATIONS** (QUARTERLY DATA, BPS)



The shaded area indicates the interquartile range.
Source: BBVA Research based on data by the Federal Reserve Bank of Philadelphia and Haver Analytics.

While corporate yields are expected to rise significantly in line with Treasury yields, …

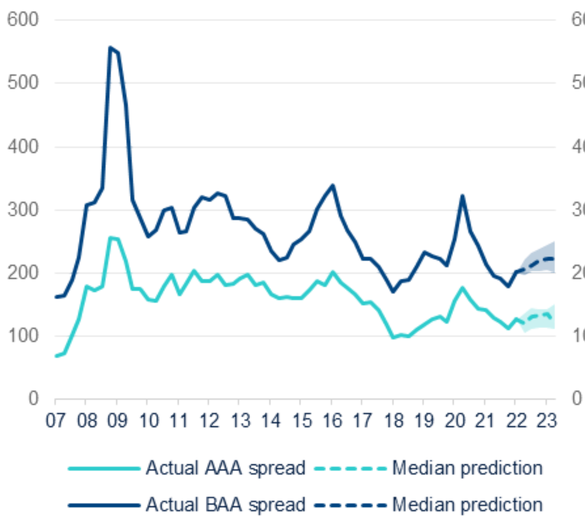
Figure 30. **PROF. FORECASTERS CORPORATE YIELDS EXPECTATIONS** (QUARTERLY DATA, %)



Shaded areas indicate interquartile ranges..
Source: BBVA Research based on data by the Federal Reserve Bank of St. Louis, the Federal Reserve Bank of Philadelphia, and Haver Analytics.

… professional forecasters expect credit spreads to remain at low levels

Figure 31. **PROF. FORECASTERS IMPLIED CORPORATE SPREADS EXPECTATIONS** (QUARTERLY DATA, %)



Spreads over 10y Treasury. Shaded areas indicate interquartile ranges.
Source: BBVA Research based on data by the Federal Reserve Bank of St. Louis, the Federal Reserve Bank of Philadelphia, and Haver Analytics.

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