US Interest rates monitor

Long-term yields remain relatively low as financial conditions eased slightly

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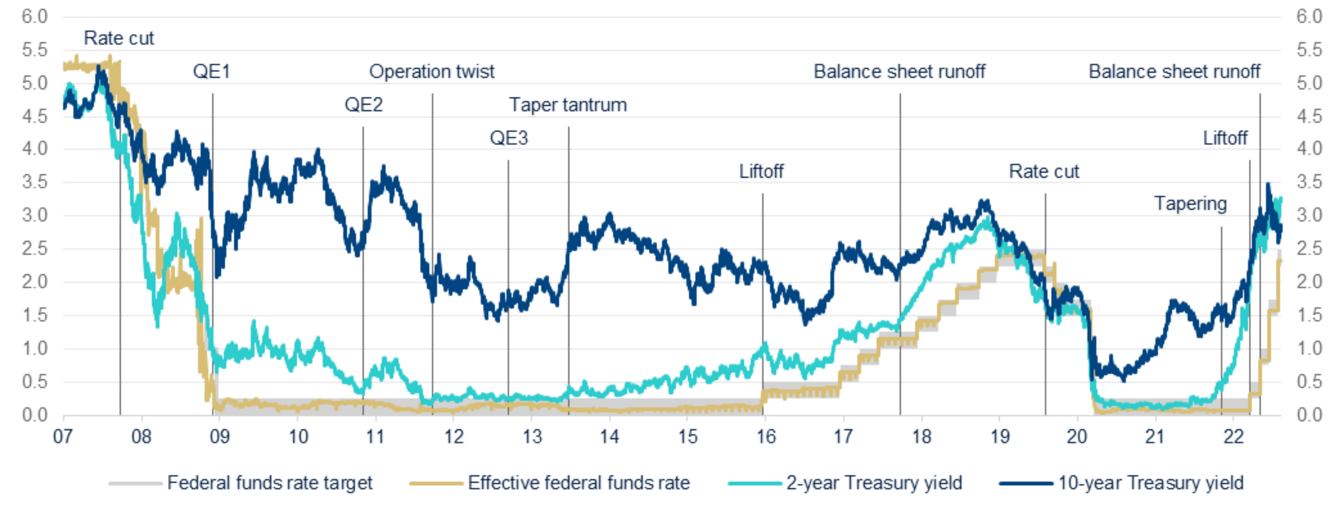
Signs that inflation is stabilizing and rising recession risks add to the market view that the policy stance could reverse sooner

- More hikes are coming, as the Fed is still looking to take rates to a moderately restrictive level to bring inflation back down; however, the tightening pace will likely slow going forward (Figures 2 and 3).
- The 2-year yield hovered around 3% as markets assess the end of the cycle (Figure 4), while longer-term yields dipped, likely driven by an expectation that the policy stance will reverse sooner (Figure 5). The entire yield curve will likely invert by year-end unless QT adds further support (Figure 7).
- The recent 75bp fed funds rate hikes drove the 3m10y yield spread to near zero at an unprecedented speed and will likely become negative in the following weeks. This will add fuel to the public debate on rising recession risks (Figure 10).
- More economic data due next month will help confirm whether the Fed is cooling demand, and will give more clarity about the next hike; today odds are roughly 1 to 1 between 50 or 75 bps (Figures 20 and 21).
- Overall, broad financial conditions and stress indices loosened slightly in the last weeks (Figure 24).

So far, the FOMC has raised the fed funds rate by 225 bps; the policy rate is now at the 2.25-2.50% target range, which is consistent with the median FOMC participant estimate of the long-run neutral rate

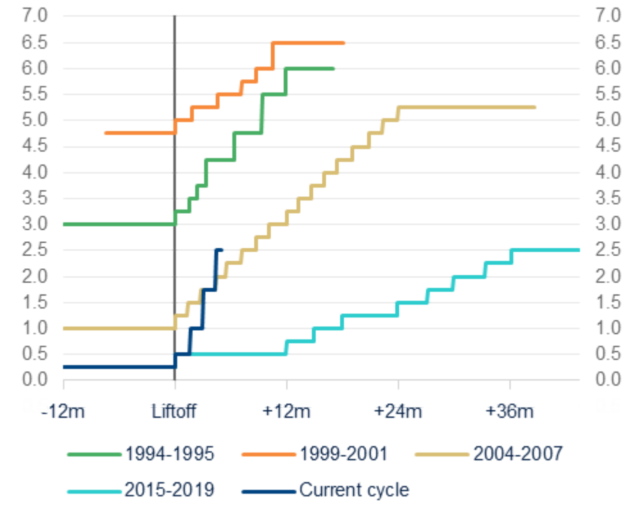
Figure 1. **2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

More hikes are coming, as the Fed is still looking to take rates to a moderately restrictive level…

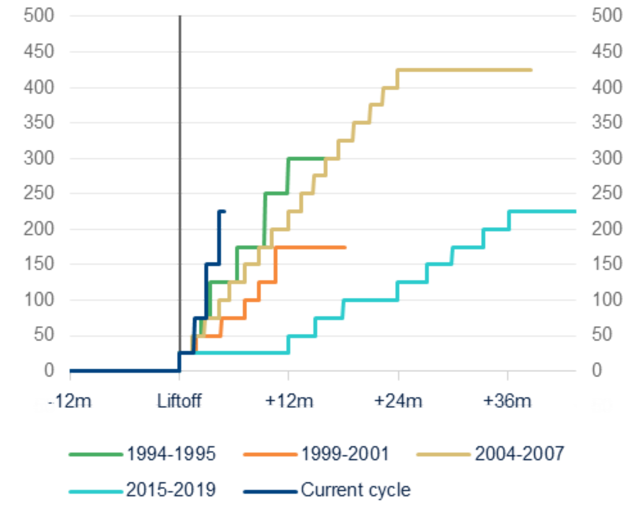
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES** (DAILY DATA, %)



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.

… to bring inflation back down; however, the tightening pace will likely slow going forward

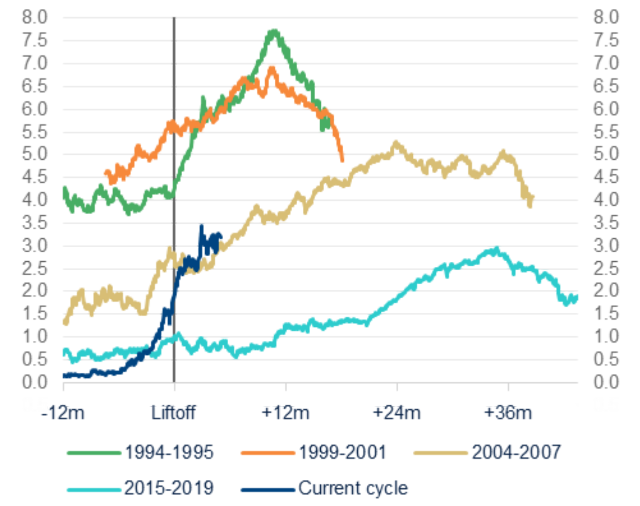
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES** (DAILY DATA, BPS VS RATE LEVEL AT LIFTOFF)



Source: BBVA Research based on data by Haver Analytics.

The 2-year yield hovered around 3% as markets assess the end of the cycle, while longer-term…

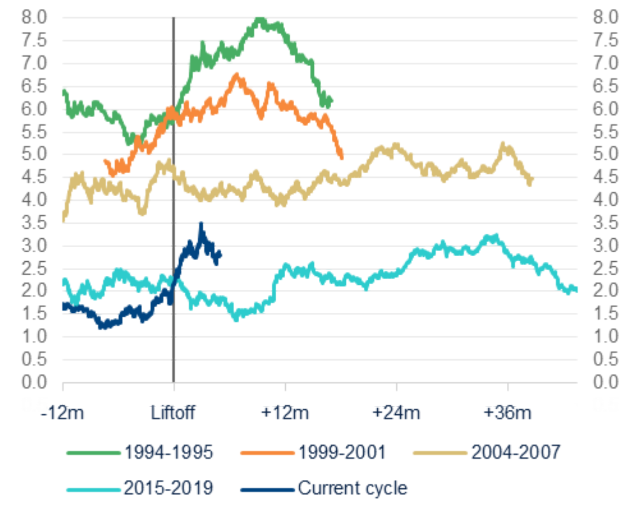
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

… yields dipped, likely driven by an expectation that the policy stance will reverse sooner

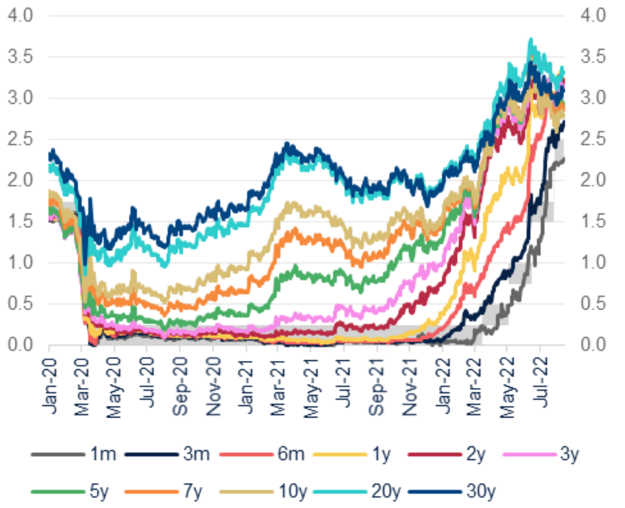
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

The long end of the Treasury yield curve eased slightly; if longer-term yields remain low, …

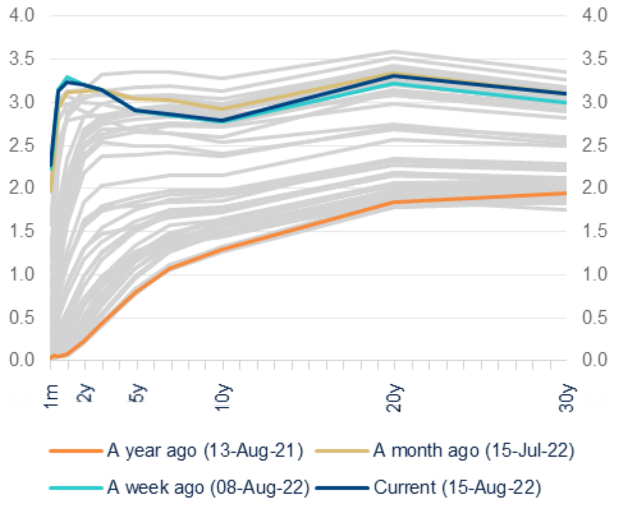
Figure 6. **TREASURY YIELDS (CONSTANT MAT., DAILY DATA, %)**



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

… the entire yield curve will likely invert by year-end unless QT adds further support

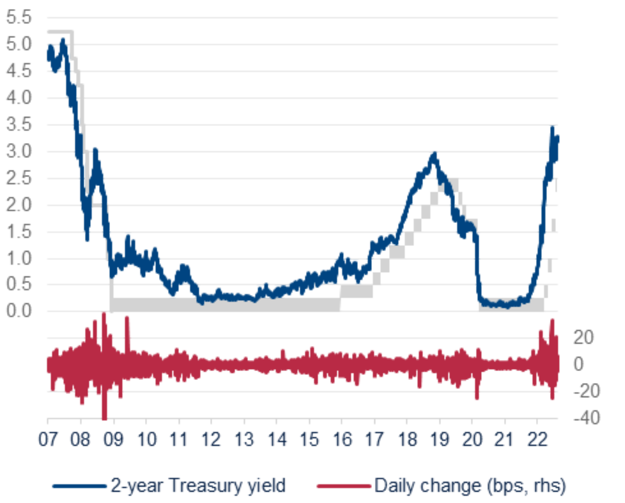
Figure 7. **TREASURY YIELD CURVE (CONSTANT MAT., DAILY DATA, %)**



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

Treasury yields remain volatile compared to historical standards, driven by fast-changing…

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.

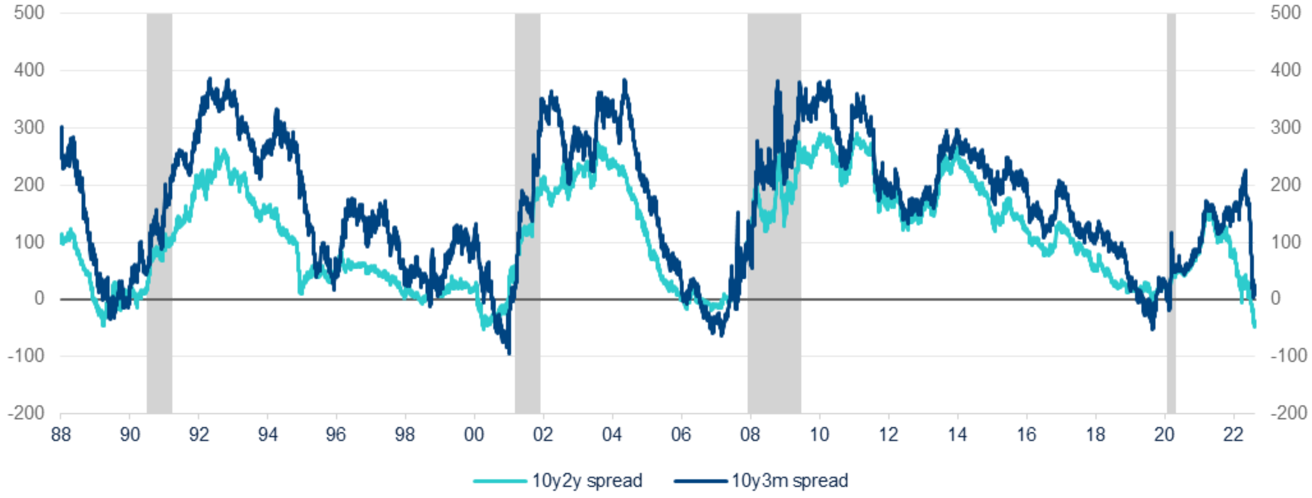
… and sometimes conflicting economic data, as well as the current super-sized Fed moves

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 recent 75bp fed funds rate hikes drove the 3m10y yield spread to near zero at an unprecedented speed and will likely become negative in the following weeks. This will add fuel to the public debate on…

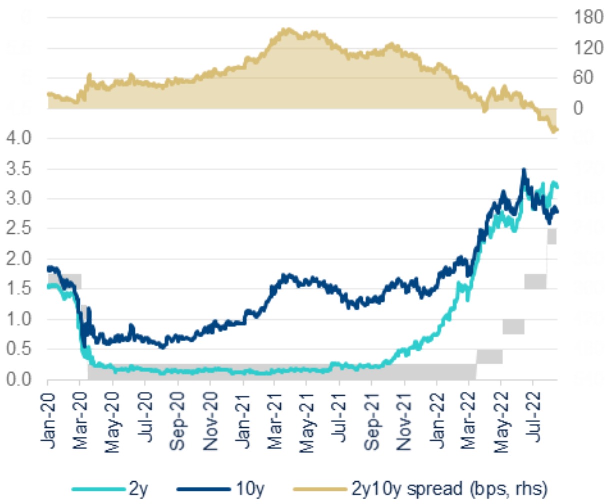
Figure 10. **TREASURY YIELD SPREADS** (CONSTANT MAT., DAILY DATA, BPS)



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.

… rising recession risk; Fed officials will likely continue to rule it out given that today's yield…

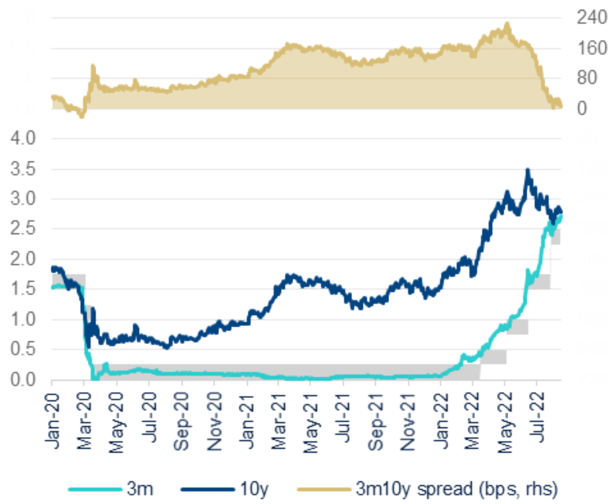
Figure 11. **2Y10Y TREASURY YIELD SPREAD** (CONSTANT MAT., DAILY DATA, % AND BPS)



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

…curve inversions face a stronger labor market compared to previous cycles

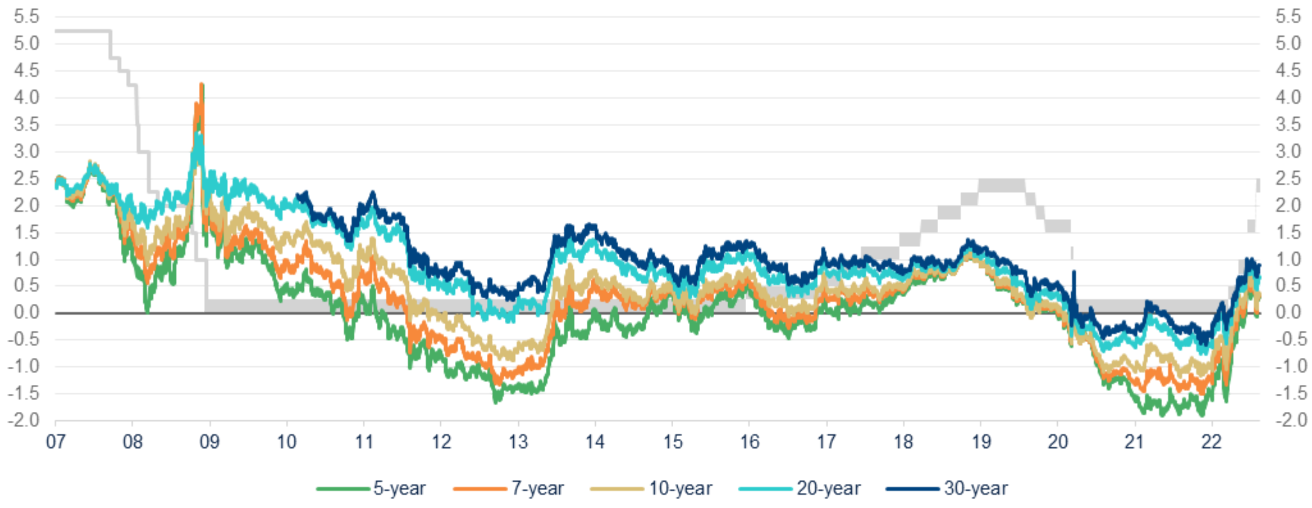
Figure 12. **10Y3M TREASURY YIELD SPREAD** (CONSTANT MAT., DAILY DATA, % AND BPS)



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

Shorter inflation-indexed yields faced a short-lived decline towards zero after the July's FOMC decision

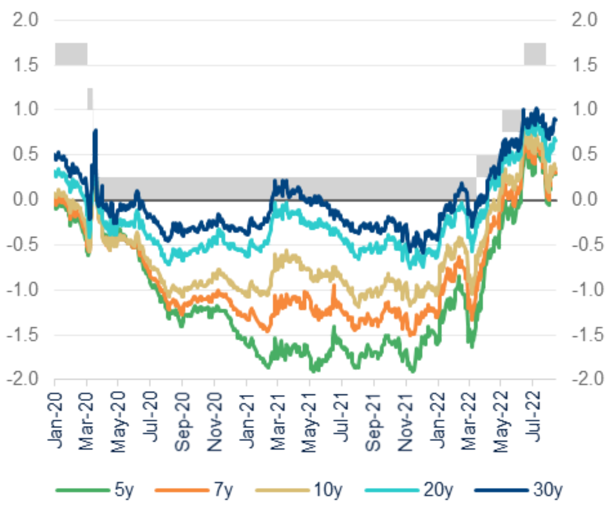
Figure 13. **INFLATION INDEXED TREASURY (TIPS) YIELDS** (CONSTANT MAT., DAILY DATA, %)



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

They will continue to help tighten financial conditions as long as they remain positive, and…

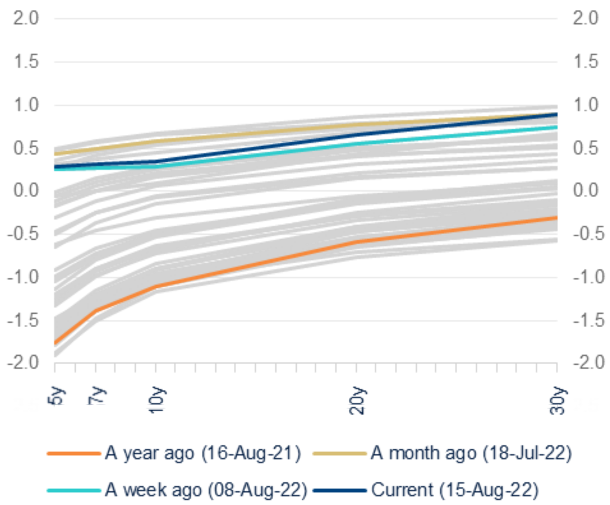
Figure 14. **INFLATION INDEXED (TIPS) YIELDS** (CONSTANT MAT., DAILY DATA, %)



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

… as the nominal yield curve, the TIPS yield curve will keep flattening

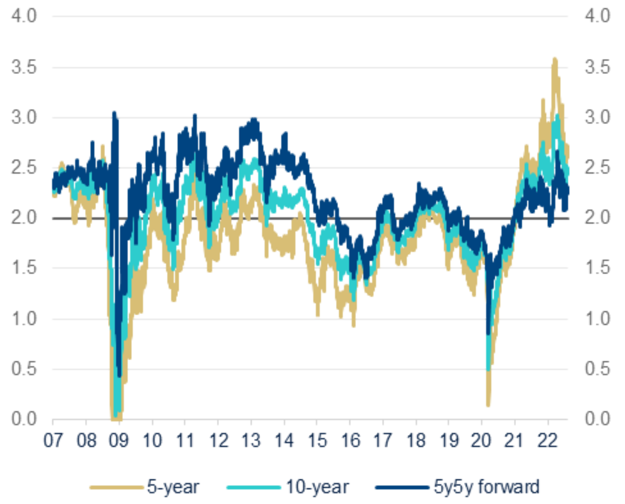
Figure 15. **INFLATION INDEXED (TIPS) YIELD CURVE** (CONSTANT MAT., DAILY DATA, %)



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

Market-based inflation expectations remain consistent with a scenario in which inflation…

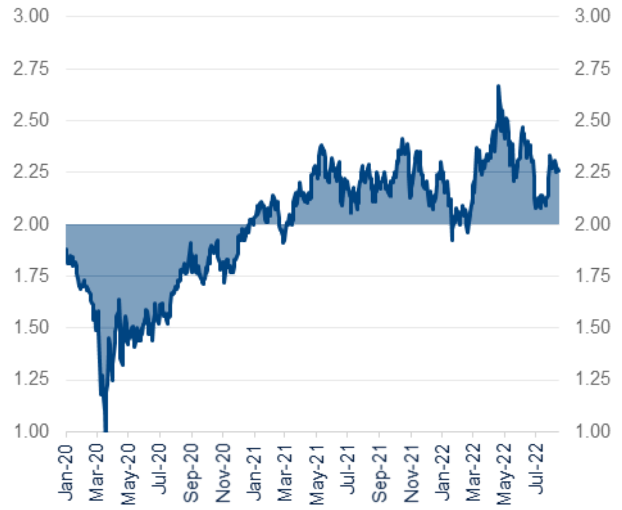
Figure 16. **BREAKEVEN INFLATION RATES** (CONSTANT MAT., DAILY DATA, %)



Source: BBVA Research based on data by Haver Analytics.

… is a problem that will be solved sooner rather than later

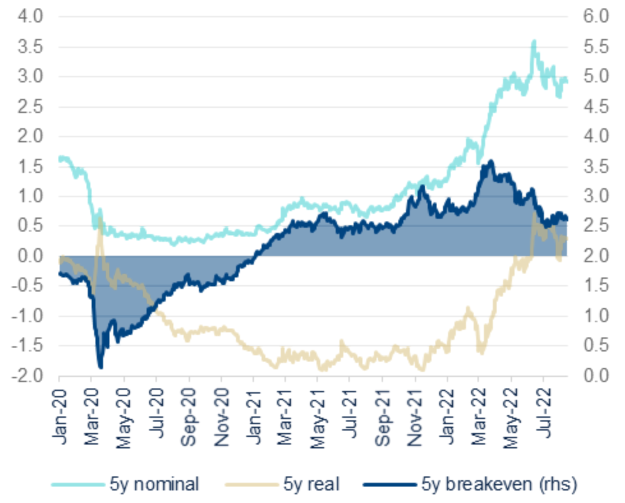
Figure 17. **5Y5Y FORWARD IMPLIED INFLATION RATE** (CONSTANT MAT., DAILY DATA, %)



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

Markets are still confident that the Fed will be able to bring inflation down over the long term…

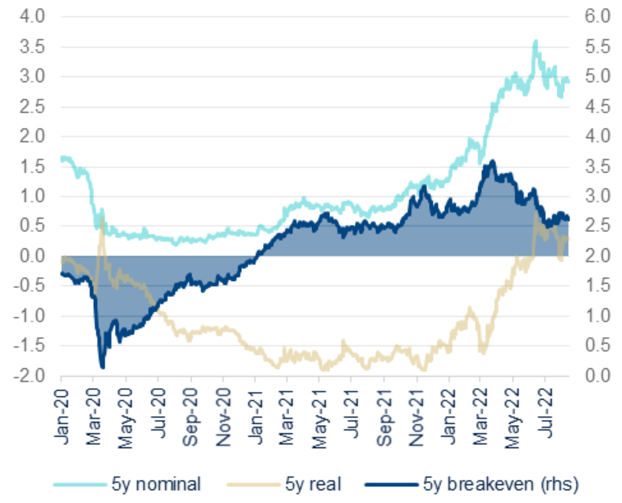
Figure 18. **5-YEAR BREAKEVEN INFLATION RATE** (CONSTANT MAT., DAILY DATA, %)



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

… and that an inflation easing environment will not accompany an eventual recession

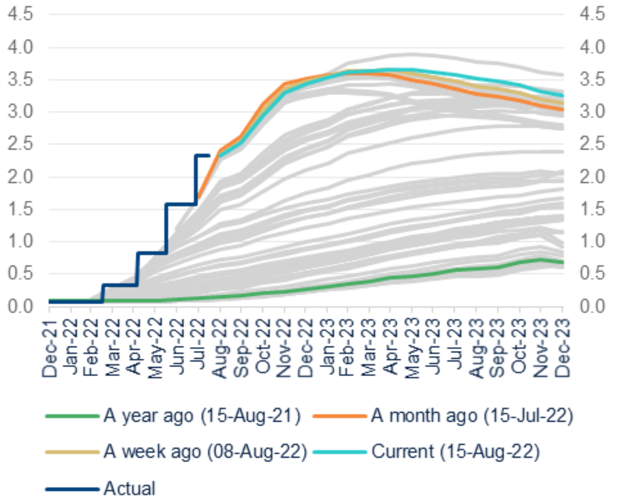
Figure 19. **10-YEAR BREAKEVEN INFLATION RATE** (CONSTANT MAT., DAILY DATA, %)



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

More economic data due next month will help confirm whether the Fed is cooling demand…

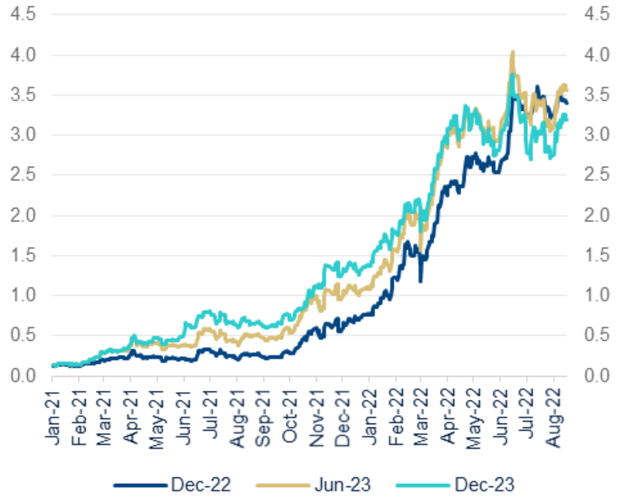
Figure 20. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES** (DAILY DATA, %)



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

… and will give more clarity about the next hike; today odds are 1 to 1 between 50 or 75 bps

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



Source: BBVA Research based on data by Bloomberg.

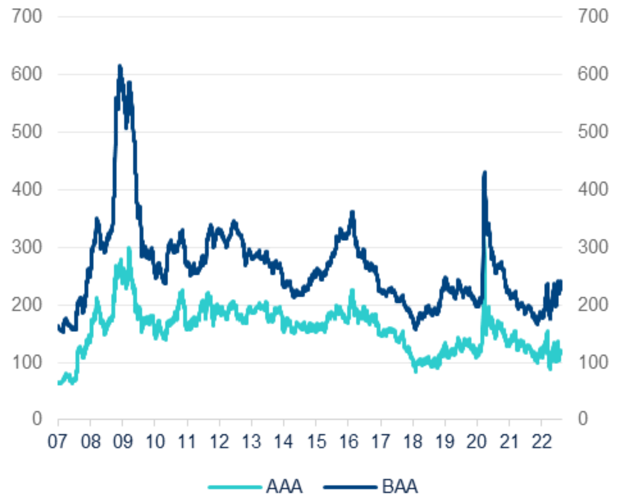
Mortgage rates eased further from their June max figures, though they remain at one-decade highs

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

Source: BBVA Research based on data by Haver Analytics.

No signals of credit strains are evident in investment-grade corporate bond spreads

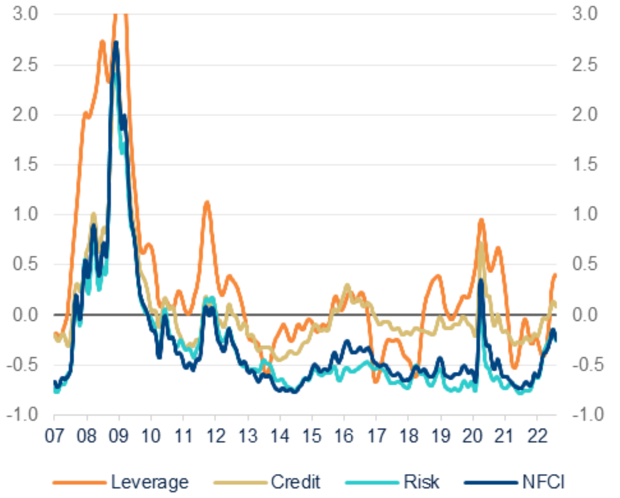
Figure 23. **CORPORATE BOND SPREADS** (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)



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

Overall, broad financial conditions and stress indices loosened slightly in the last weeks

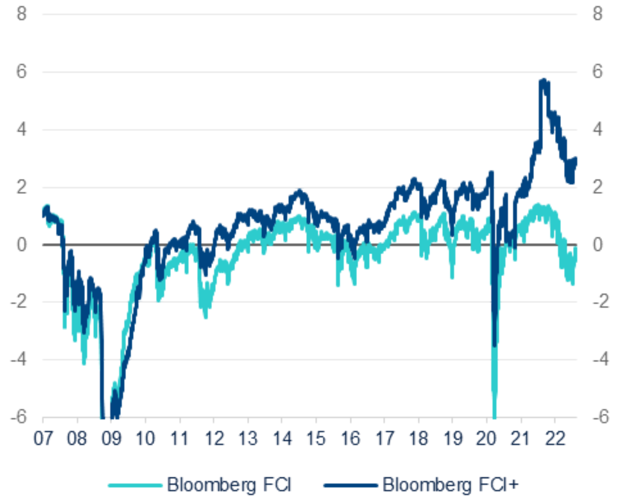
Figure 24. **CHICAGO FED'S NATIONAL FINANCIAL CONDITIONS INDEX** (>0 = TIGHTER THAN AVG)



Source: BBVA Research based on data by Haver Analytics.

Signs that inflation is stabilizing may be adding to slightly looser conditions, but markets may…

Figure 25. **BLOOMBERG FINANCIAL CONDITIONS INDICES** (<0 = TIGHTER THAN PRE-GFC AVG)



Source: BBVA Research based on data by Bloomberg.

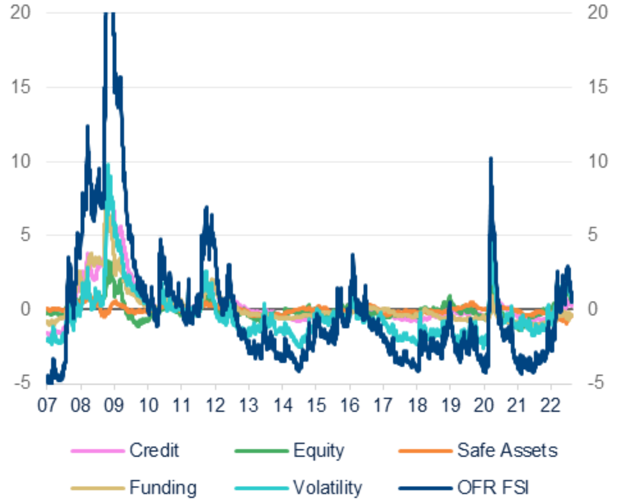
… be losing sight of the fact that inflation, though stable, will likely still remain high for some time

Figure 26. **FED'S FINANCIAL STRESS INDICES** (>0 = ABOVE AVG FINANCIAL STRESS)

Source: BBVA Research based on data by Haver Analytics.

The Fed will prefer to see tighter financial conditions for inflation to fall steadily

Figure 27. **OFR FINANCIAL STRESS INDEX** (>0 = ABOVE AVG FINANCIAL STRESS)



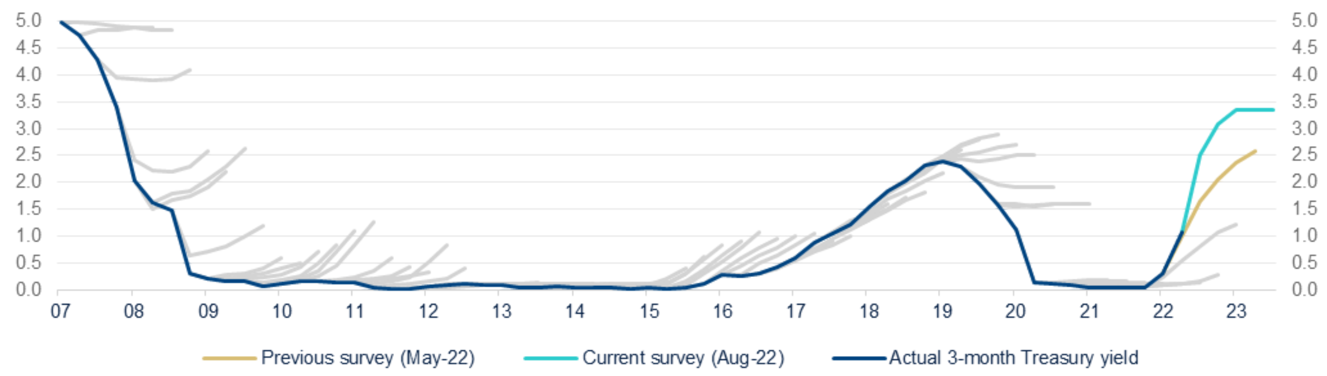
OFR: Office of Financial Research, US Department of the Treasury
Source: BBVA Research based on data by Haver Analytics.

Professional forecasters revised up their interest rate projections

- Last Friday, the Federal Reserve Bank of Philadelphia released the Third Quarter 2022 Survey of Professional Forecasters, showing significant revisions to the projected path of short-term interest rates (Figure 28).
- With no significant revisions to the 10-year Treasury yield forecasts, the 3m10y Treasury yield spread is now expected to remain near zero from today and throughout 2023; some anticipate a negative spread (Figure 31).
- Professional forecasters still expect credit spreads to remain at relatively low levels (Figure 33).

Professional forecasters revised up significantly their short-term Treasury yield projections. The median forecaster now expects the 3m Treasury yield to reach 3.35% by the second quarter of 2023

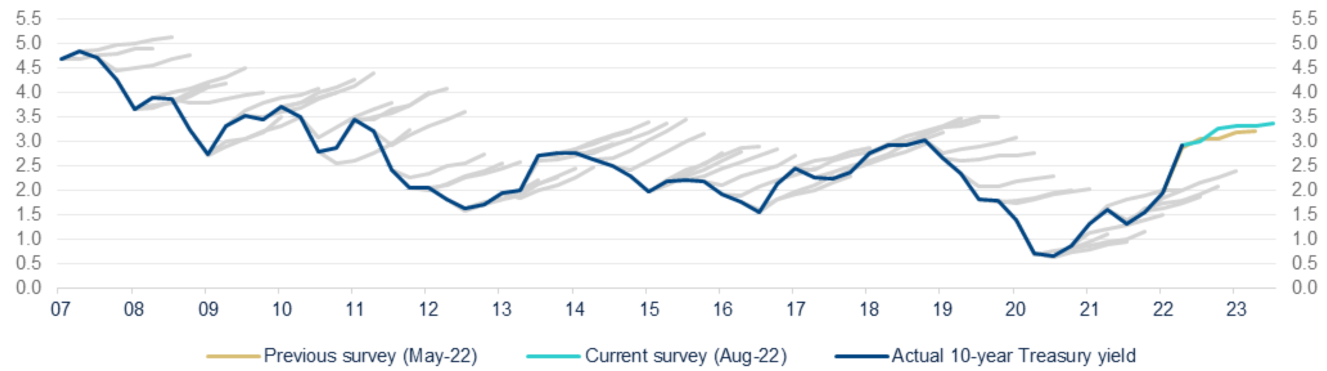
Figure 28. **PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS** (QUARTERLY DATA, %)



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

The 10y Treasury yield projections were only slightly changed; it is expected to reach a level of 3.33% over the same horizon. With no significant revisions to the 10-year Treasury yield forecasts, the 3m10y…

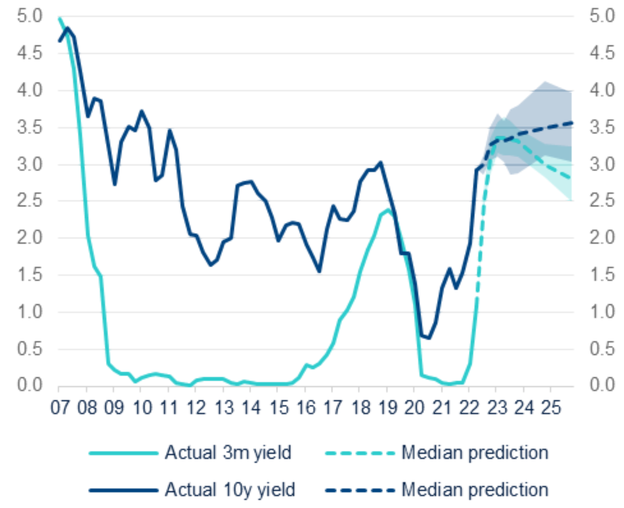
Figure 29. **PROFESSIONAL FORECASTERS 10-YEAR TREASURY YIELD EXPECTATIONS** (QUARTERLY DATA, %)



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

… Treasury yield spread is now expected to remain near 0 from today and throughout 2023…

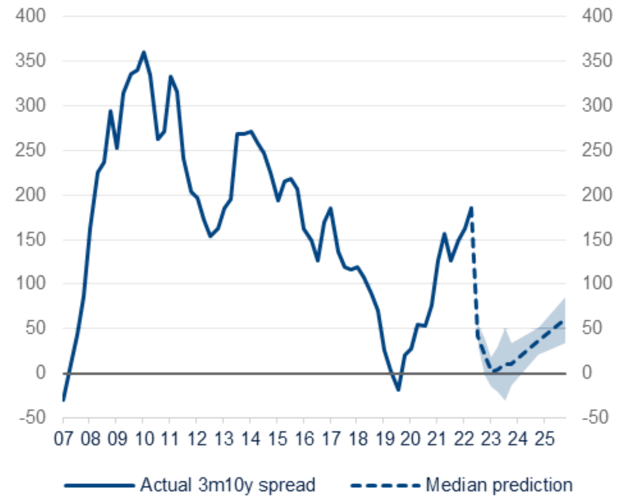
Figure 30. **PROF. FORECASTERS TREASURY YIELDS EXPECTATIONS** (QUARTERLY DATA, %)



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

Some professional forecasters anticipate a negative 3m10y yield spread

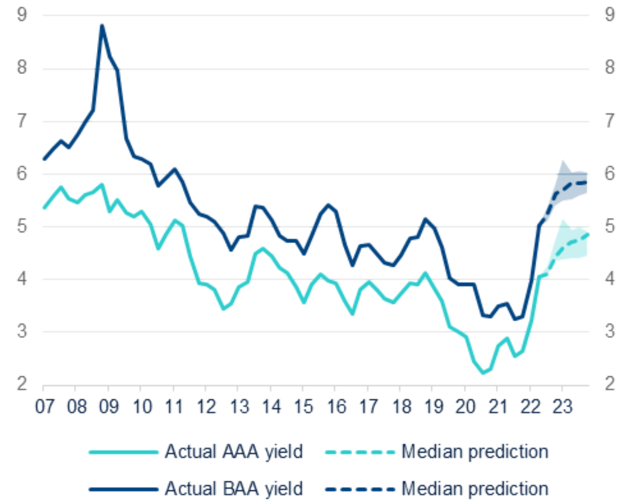
Figure 31. **PROF. FORECASTERS IMPLIED 3M10Y SPREAD EXPECTATIONS** (QUARTERLY DATA, BPS)



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

Professional forecasters still expect investment-grade bond yields to rise in an orderly fashion…

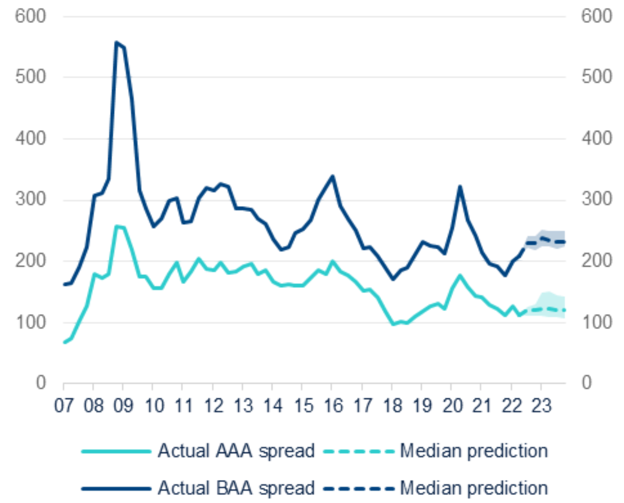
Figure 32. **PROF. FORECASTERS CORPORATE YIELDS EXPECTATIONS** (QUARTERLY DATA, %)



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.

… and credit spreads to remain at relatively low and flat levels

Figure 33. **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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