

US Interest rates monitor

Markets price in an imminent end of the hiking cycle

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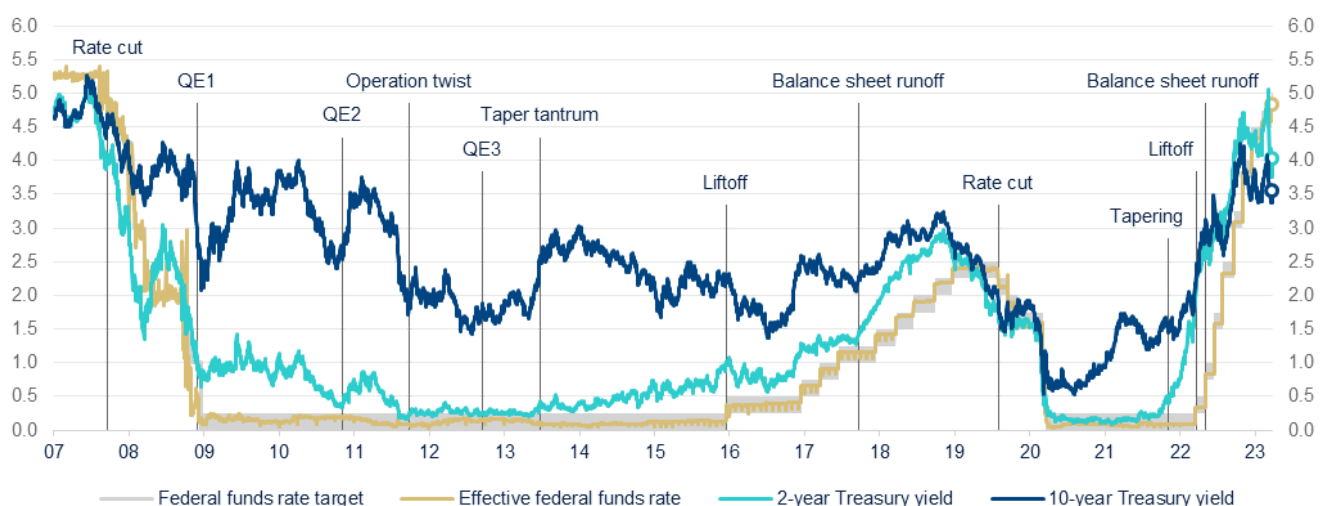
March 29, 2023

Bringing demand into better balance “doesn’t all have to come from rate hikes, it can come from tighter credit conditions”

- The yield curve is pricing in that the Fed is likely finished raising interest rates and that sooner rather than later will begin to cut rates as signs of economic weakness build ([Figure 7](#)).
- Market-based inflation expectations have remained relatively stable around low levels even though the progress on inflation has been slower than most anticipated ([Figure 16](#)).
- The 10y-3m Treasury yield spread continues to trend lower, but the 10y-2y spread edged up as markets bet the hiking cycle is likely done. Overall, spreads continue to signal that a recession will come soon ([Figure 10](#)).
- Markets are not only pricing in that the end of the hiking cycle is in sight, but also that the Fed will soon need to reverse course and begin to cut rates in the second half of this year ([Figures 20](#) and [21](#)).
- There are initial signs that banking turmoil achieved what Fed’s hawkish rhetoric couldn’t and broad financial conditions indexes will likely start to reflect tighter-than-average financial conditions ([Figures 24](#) to [27](#)).

The Fed stuck to a smaller-sized hike and took the fed funds rate to a 4.75-5.00% target range after signaling in early March a probable return to bigger hikes, while Powell acknowledged that tighter financial conditions ahead could be a “substitute for rate hikes”

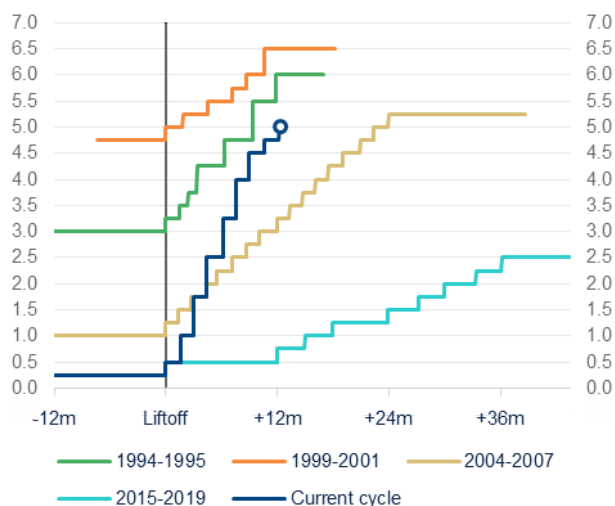
Figure 1. 2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE (%)



Source: BBVA Research based on data by Haver Analytics.

The Fed pressed ahead with a 25bp hike amid slow progress on inflation but paved the way...

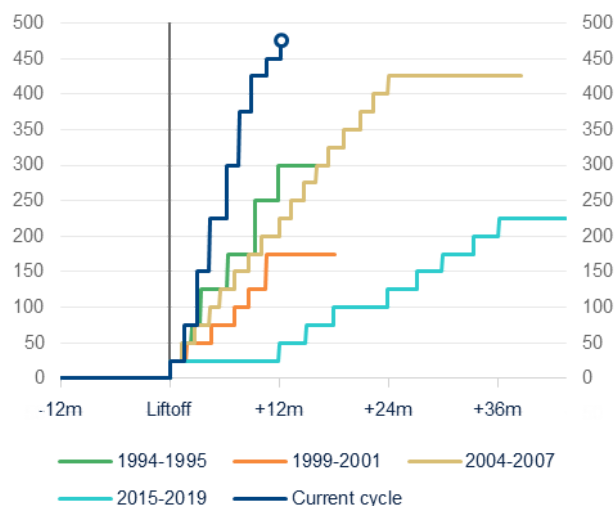
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



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 wrap up the hiking cycle soon as financial conditions are set to tighten significantly

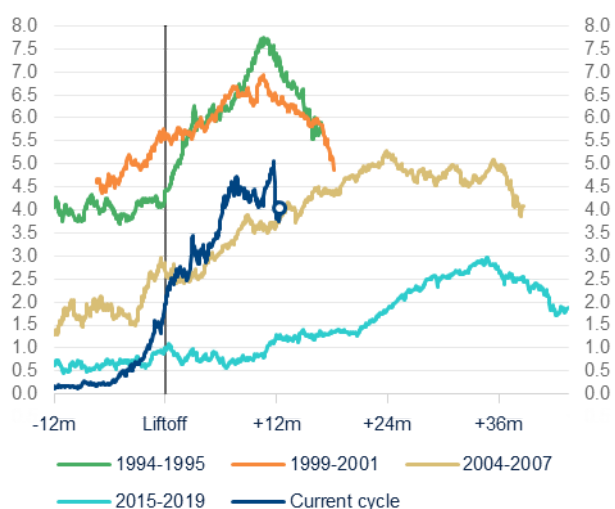
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE LEVEL AT LIFTOFF)**



Source: BBVA Research based on data by Haver Analytics.

The yield curve is pricing in that the Fed is likely finished raising interest rates and that sooner...

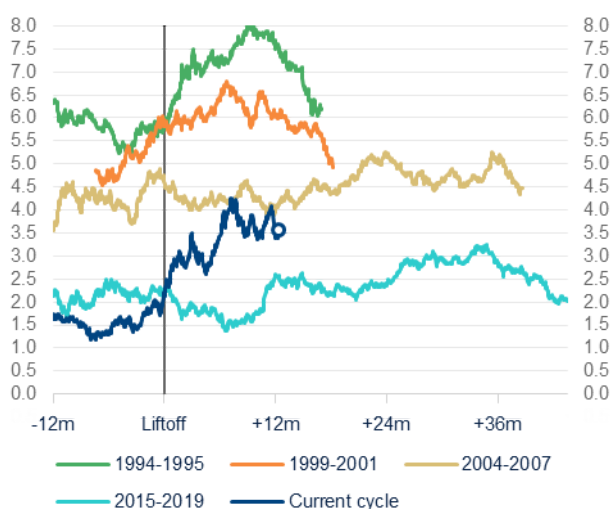
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

... rather than later will begin to cut rates as economic weakness signs build

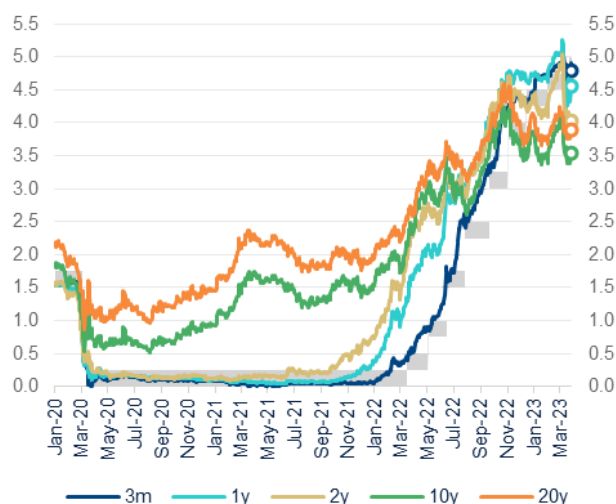
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

Rates along the yield curve remain well below the levels reached earlier this month after...

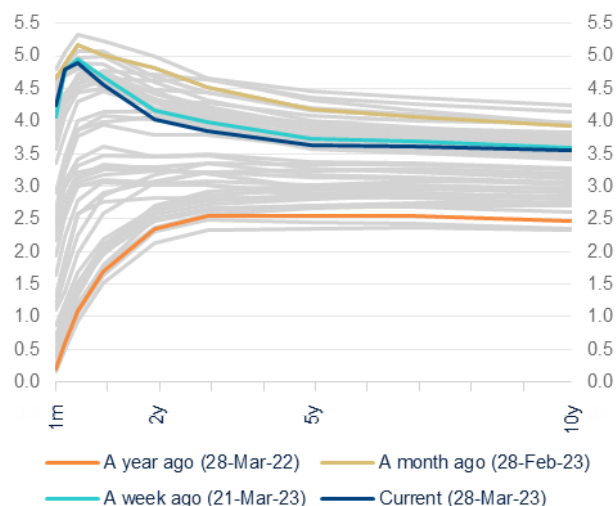
Figure 6. **TREASURY YIELDS**
(%)



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

... Powell said that the Fed was “prepared to increase the pace of rate hikes” if warranted

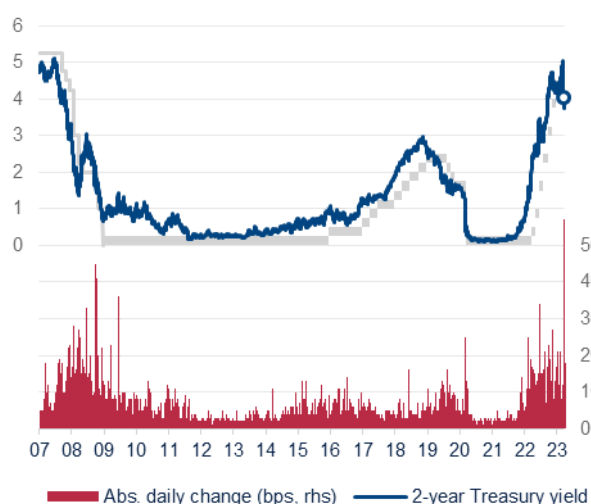
Figure 7. **TREASURY YIELD CURVE**
(%)



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

The 2-year Treasury yield bounced back to 4.0% but had reached 5.0% earlier this month

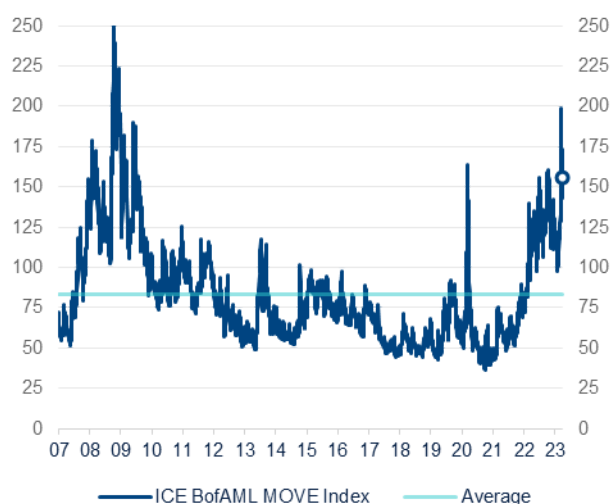
Figure 8. **2-YEAR TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

Bond market volatility edged down recently but remains hovering around multi-year highs

Figure 9. **ICE BOFAML US BOND MARKET OPTION VOLATILITY ESTIMATE INDEX (BPS)**



Source: BBVA Research based on data by Haver Analytics.

The 10y-3m Treasury yield spread continues to trend lower, but the 10y-2y spread edged up as markets bet the hiking cycle is likely done. Overall, spreads continue to signal that a recession will come soon

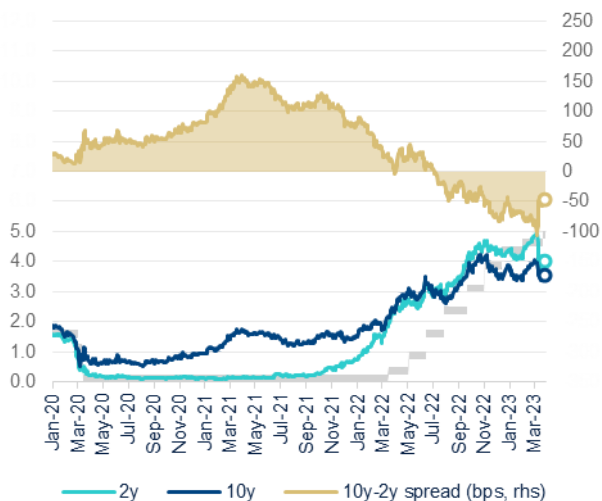
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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.

2-year yields fell more than 10-year yields and the 10y-2y negative spread was cut in half...

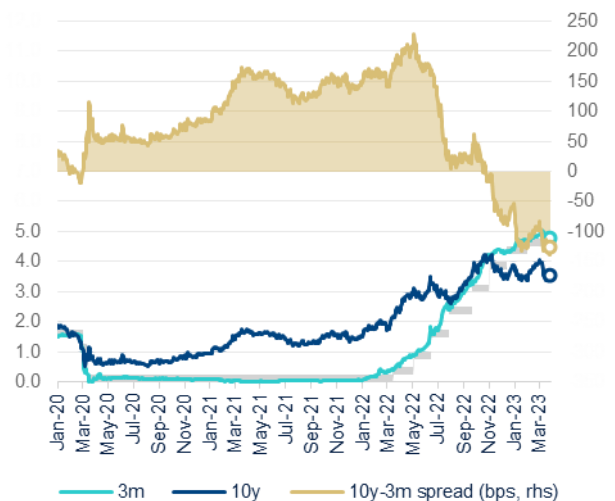
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (% AND BPS)**



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

... but with the Fed pushing ahead with hikes, the negative 10y-3m spread turned even lower

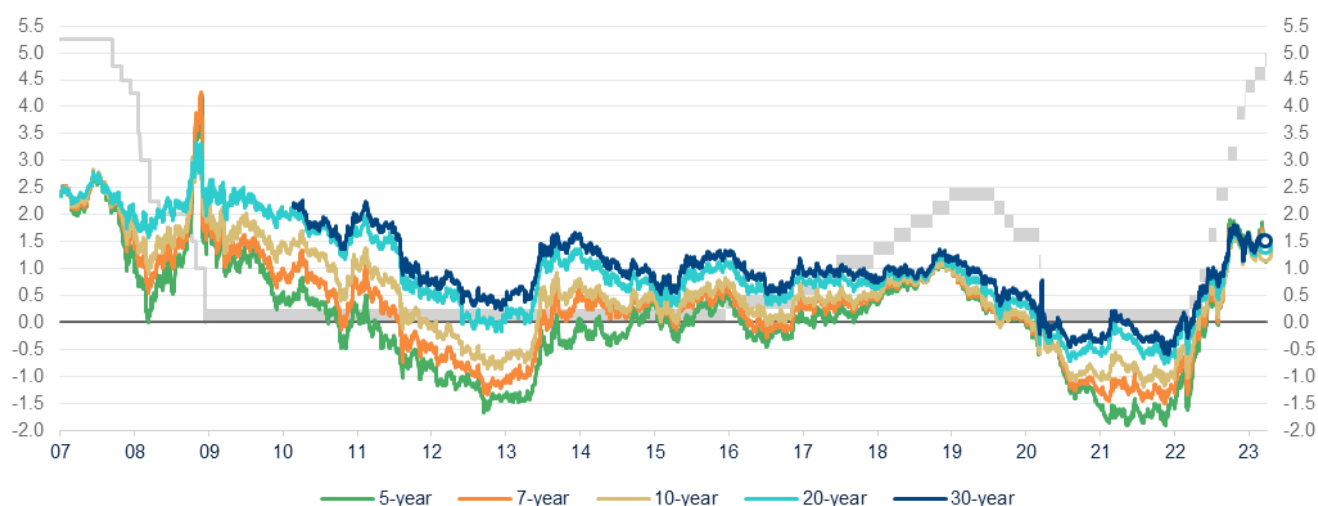
Figure 12. **10Y-3M TREASURY YIELD SPREAD (% AND BPS)**



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

Inflation-indexed Treasury (TIPS) yields pulled back somewhat as market-based inflation expectations are still relatively high—compared to the last two decades—and nominal rates dropped sharply...

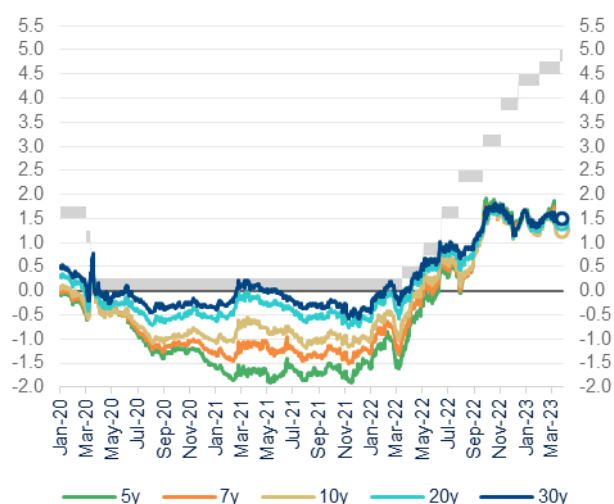
Figure 13. **INFLATION INDEXED TREASURY (TIPS) YIELDS (%)**



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

... yet, the real yield curve remains hovering around a narrow range...

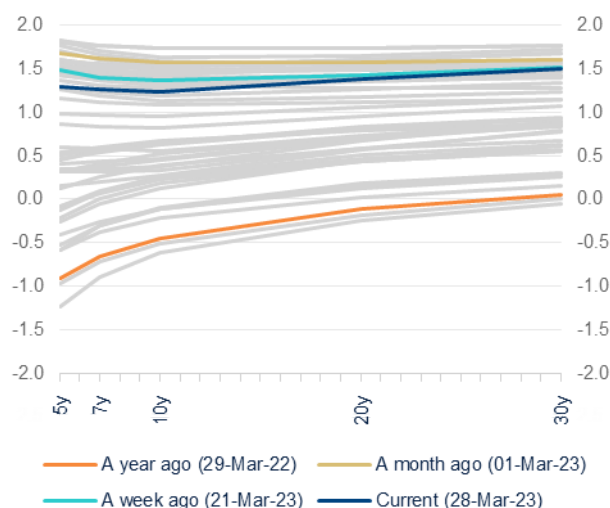
Figure 14. **INFLATION INDEXED (TIPS) YIELDS (%)**



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

... and continues to allow the Fed to have relatively high real yields along the whole curve

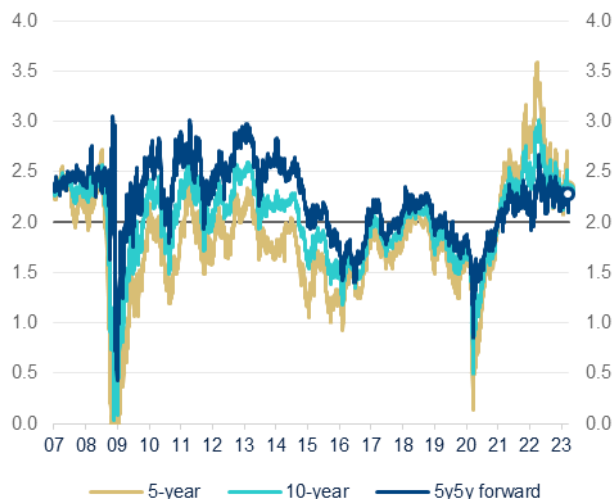
Figure 15. **INFLATION INDEXED (TIPS) YIELD CURVE (%)**



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

Market-based inflation expectations have remained relatively stable around low levels...

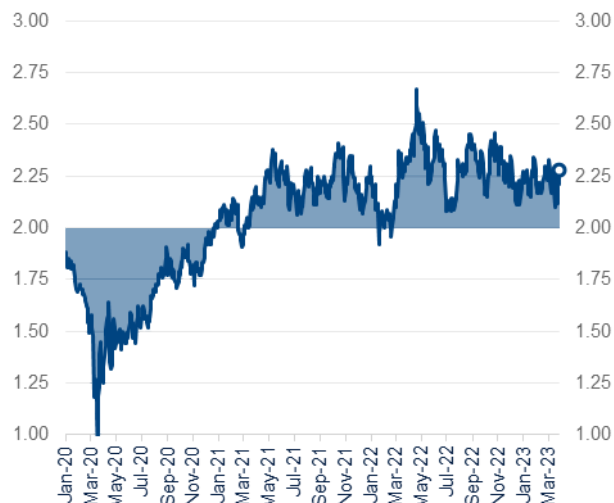
Figure 16. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research based on data by Haver Analytics.

... even though the progress on inflation has been slower than most anticipated...

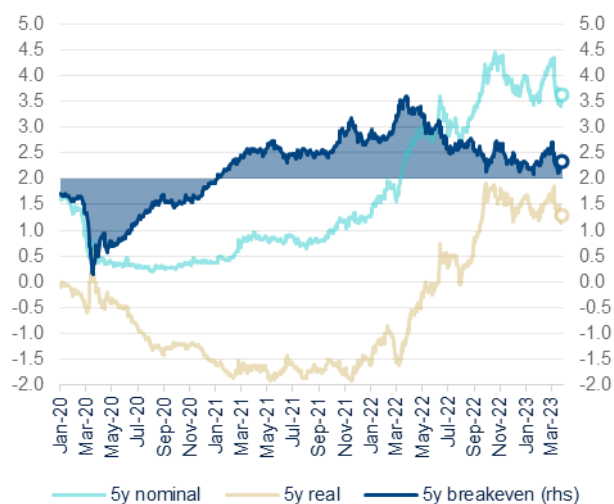
Figure 17. **5Y5Y FORWARD IMPLIED INFLATION RATE (%)**



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

... which shows there is continued confidence among market participants that the Fed...

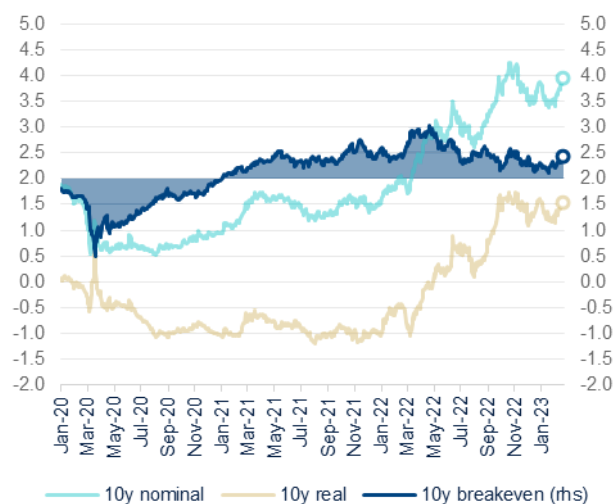
Figure 18. **5-YEAR BREAKEVEN INFLATION RATE (%)**



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

... will succeed in bringing inflation down

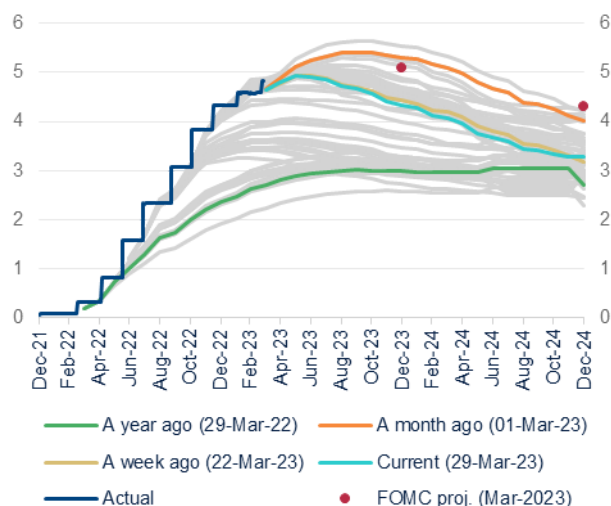
Figure 19. **10-YEAR BREAKEVEN INFLATION RATE (%)**



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

Markets are not only pricing in that the end of the hiking cycle is in sight, but also that the Fed...

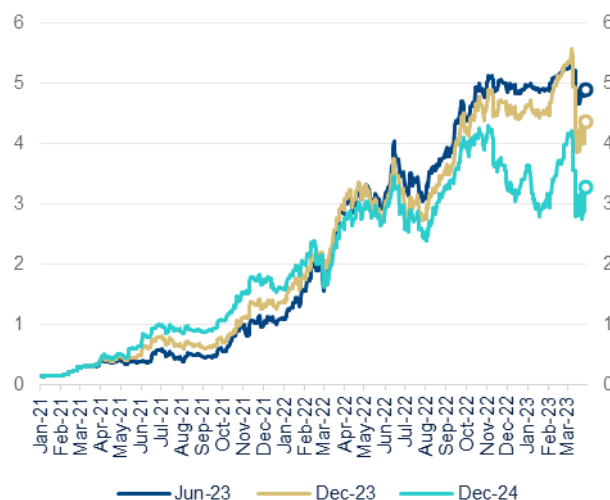
Figure 20. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



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

... will soon need to reverse course and begin to cut rates in the second half of this year

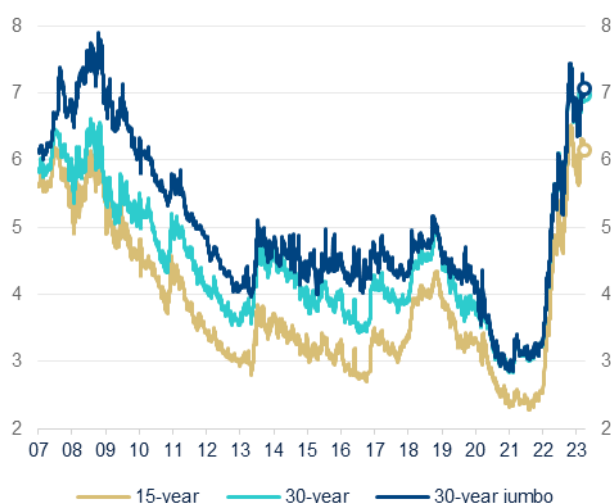
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



Source: BBVA Research based on data by Bloomberg.

After weeks pulling up higher, mortgage rates are off their recent highs and set to decline further

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



Source: BBVA Research based on data by Haver Analytics.

The investment-grade corporate credit market is (still?) not showing any signs of stress

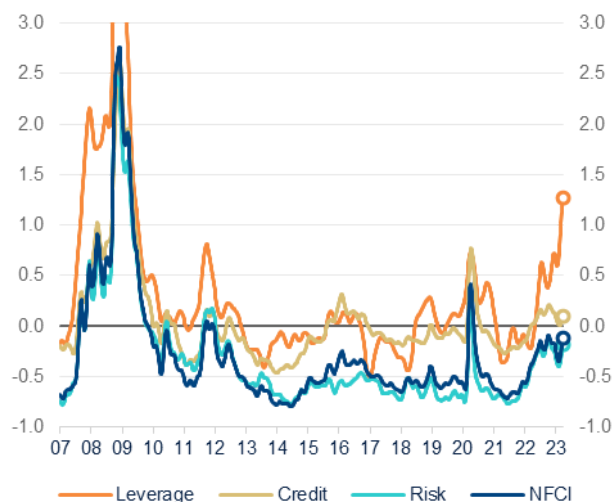
Figure 23. **CORPORATE BOND SPREADS (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)**



Spreads over the 10-year Treasury yield.
Source: BBVA Research based on data by the Fed of St. Louis (FRED) and Haver Analytics.

There are initial signs that banking turmoil achieved what Fed's hawkish rhetoric couldn't...

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



Source: BBVA Research based on data by Haver Analytics.

... and broad indexes will likely start to reflect tighter-than-average financial conditions

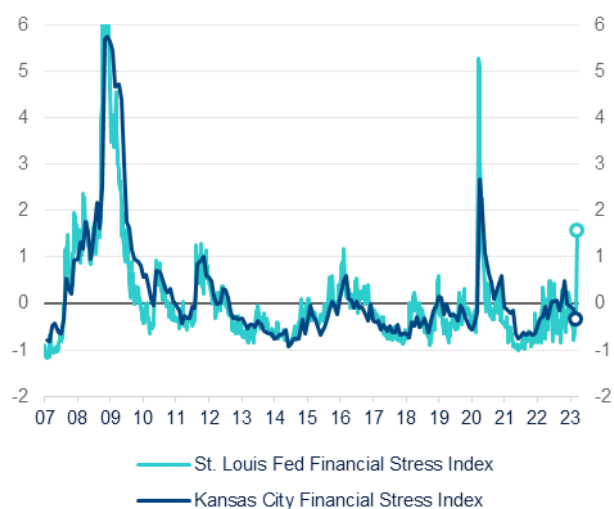
Figure 25. **BLOOMBERG FINANCIAL CONDITIONS INDEX** (<0 = TIGHTER THAN PRE-GFC AVG)



Source: BBVA Research based on data by Bloomberg.

Thus, there is less need for additional hikes as the banking crisis is "effectively doing the same thing that rate hikes do" for the economy...

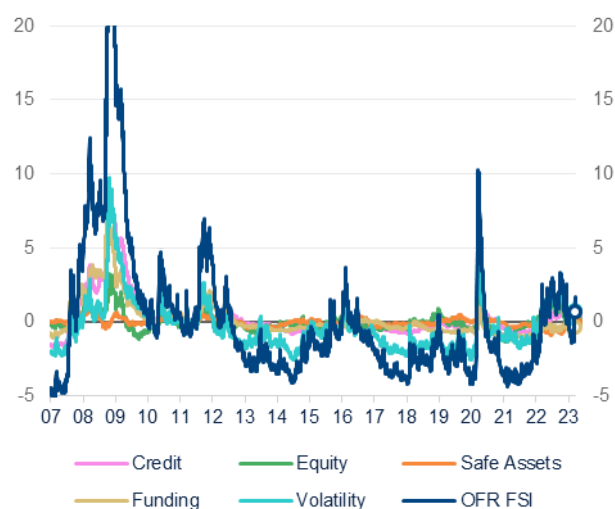
Figure 26. **FED FINANCIAL STRESS INDICES** (>0 = ABOVE AVG FINANCIAL STRESS)



Source: BBVA Research based on data by Haver Analytics.

... and as Powell also said, "it doesn't all have to come from rate hikes, it can come from tighter credit conditions"

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.

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