

US Interest rates monitor

Markets have come round to the view that the Fed will not cut rates this year...

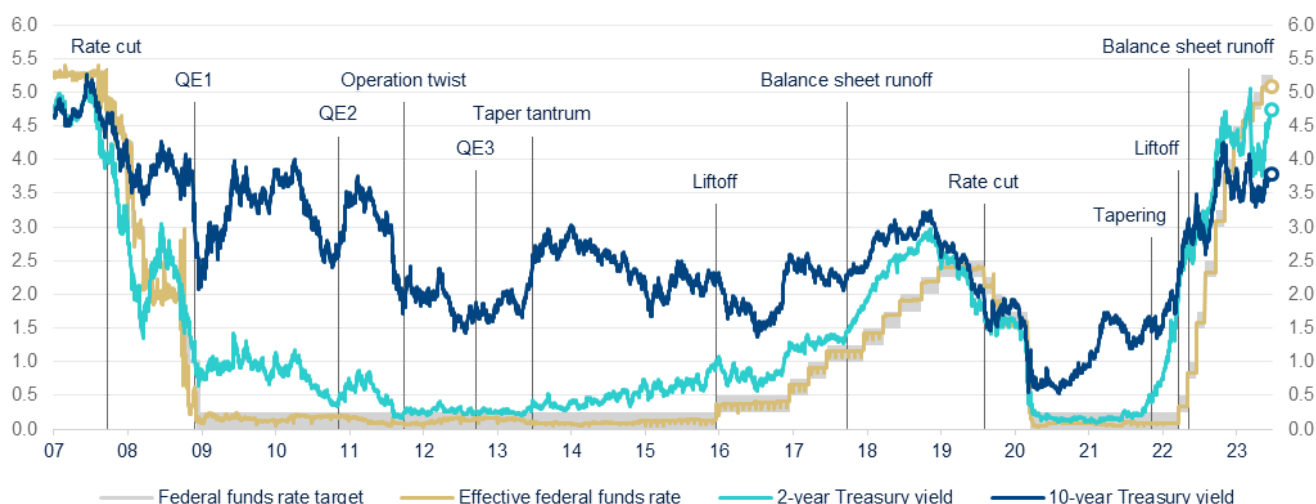
Javier Amador / Iván Fernández
June 28, 2023

... but continue to expect that lower inflation in 2024 will bring about lower rates

- Earlier this month, FOMC members voted unanimously for a skip rather than a longer pause with recent indicators suggesting that economic activity has continued to expand at a modest pace ([Figures 2](#) and [3](#)).
- Medium-term Treasury yields continued to rise amid renewed hike expectations, while short-term yields returned to normal after US lawmakers agreed earlier this month to lift the debt ceiling ([Figures 6](#) and [7](#)).
- The 10y-3m yield spread plunged to a fresh low of c. -200 bps after the odds of a hike in July jumped following the updated “dot plot” and Fed’s renewed hawkishness ([Figure 10](#)).
- Markets believe the Fed will only raise rates one more time in July; however, they also seem to have come round to the view that an easing cycle is unlikely to start this year ([Figures 20](#) and [21](#)).
- One more 25bp hike in July is now very likely; the FOMC will likely skip again in September, and November’s softer core inflation will likely convince them to end the hiking cycle ([Figures 28](#) and [29](#)).

Two weeks ago, FOMC members decided to keep the target range for the fed funds rate unchanged at 5.00-5.25%, but hinted they are set to hike in July and left the door open to another one before year-end

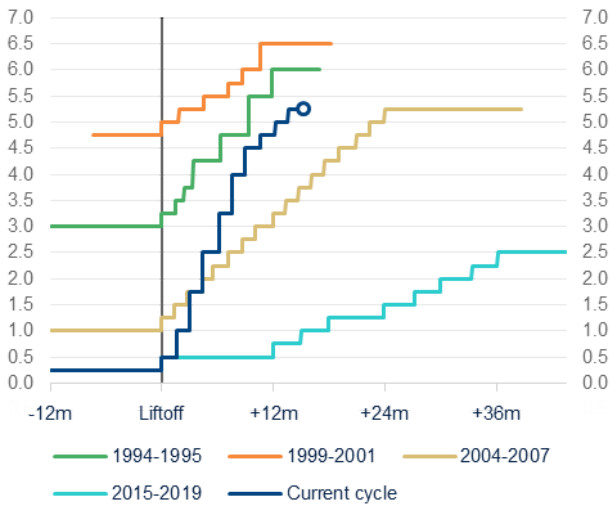
Figure 1. 2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE (%)



Source: BBVA Research based on data by Haver Analytics.

After hiking for ten meetings in a row since March 2022, the FOMC argued that this month's...

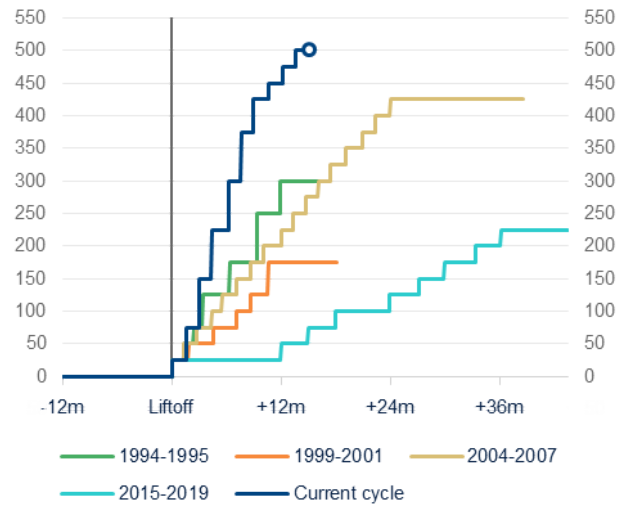
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



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.

... skip would allow them to “assess additional information and its implications for monetary...

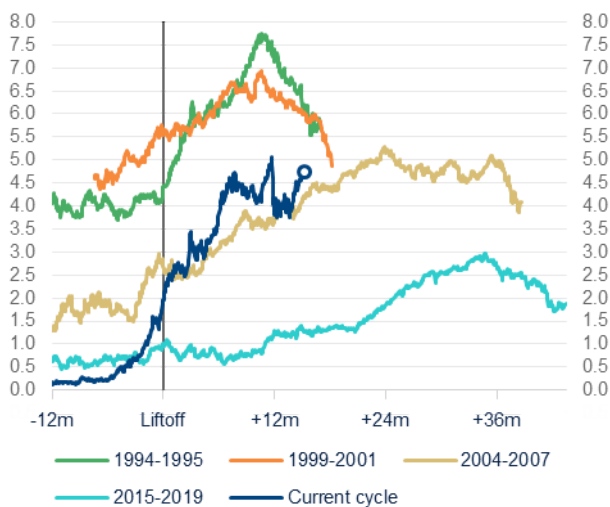
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE LEVEL AT LIFTOFF)**



Source: BBVA Research based on data by Haver Analytics.

... policy,” as progress in getting core inflation down is still slow and the labor market, though...

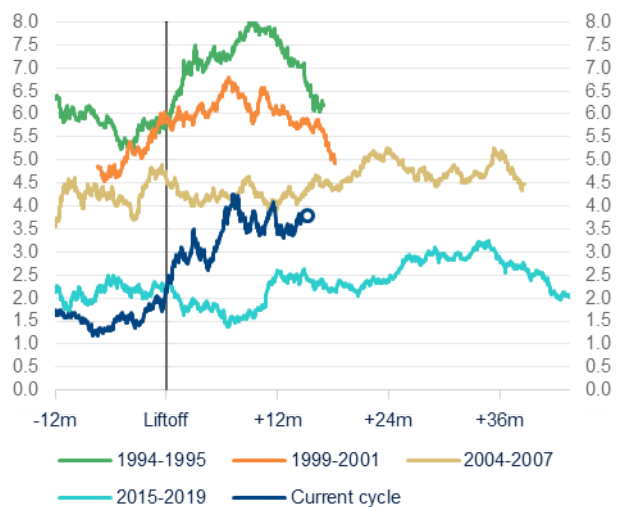
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

... gradually cooling, is still showing signs of strength

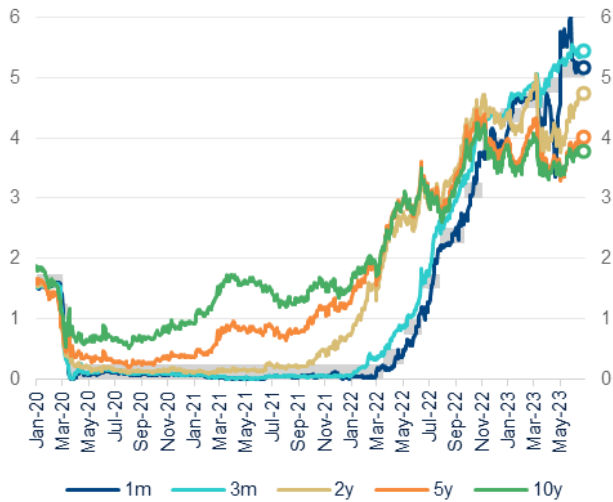
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

Medium-term Treasury yields continued to rise amid renewed hike expectations, as...

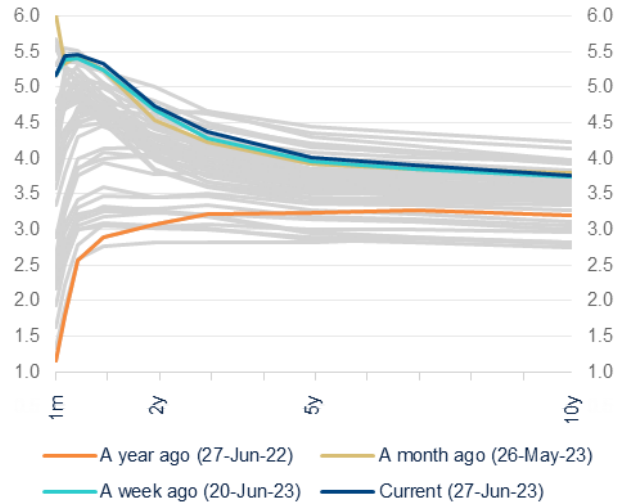
Figure 6. **TREASURY YIELDS**
(%)



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

... reflected by a slightly upward shift of the yield curve. Short-term yields returned to normal...

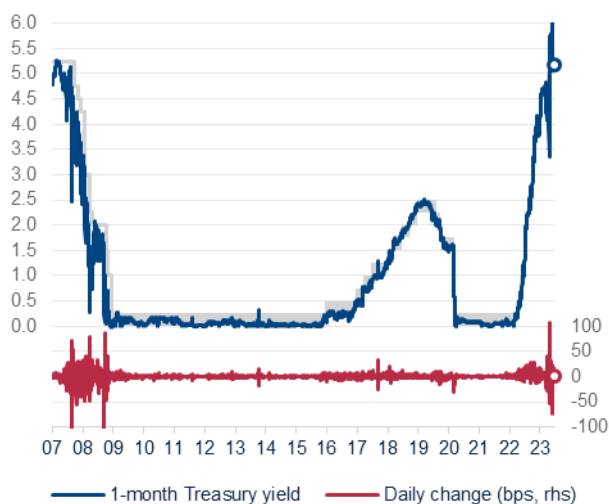
Figure 7. **TREASURY YIELD CURVE**
(%)



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

... after US lawmakers agreed earlier this month to lift the debt ceiling and put caps on...

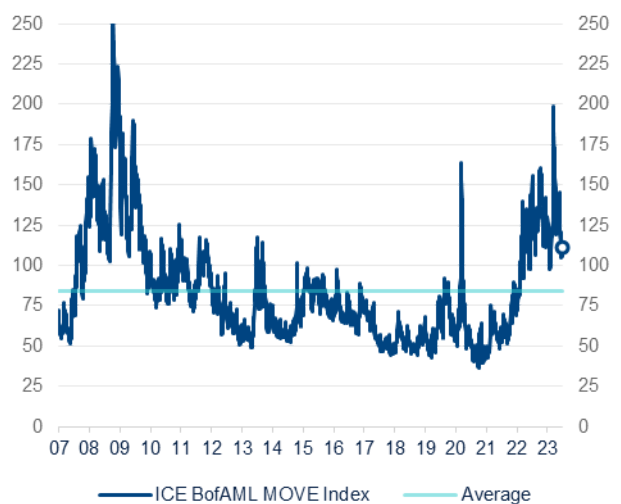
Figure 8. **1-MONTH TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

... federal spending for 2 years. This took some pressure off the still volatile gov. bond market

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



Source: BBVA Research based on data by Haver Analytics.

The 10y-3m yield spread plunged to a fresh low of c. -200 bps after the odds of a hike in July jumped following the updated “dot plot” and Fed’s renewed hawkishness. 2-year Treasury yields moved up ...

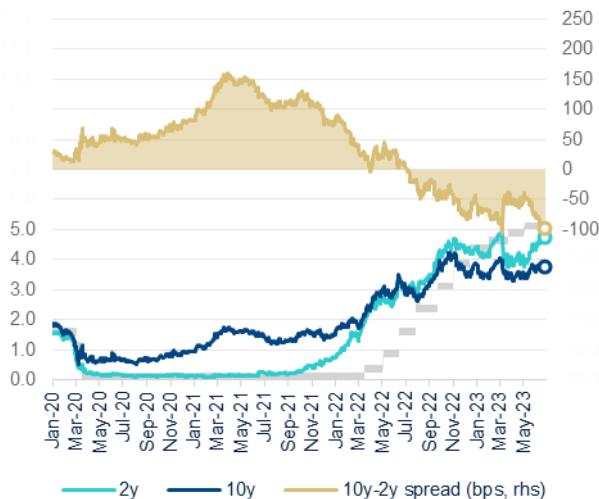
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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.

...more than 10-year yields. Thus, the 10y-2y spread moved decisively down. Although a

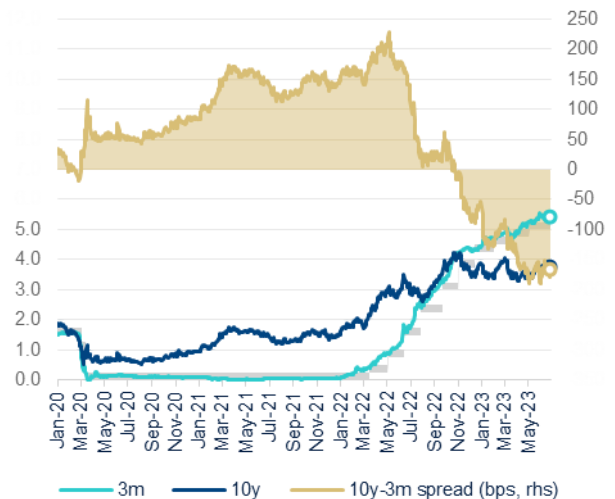
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (% AND BPS)**



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

... 25bp rate hike in July is mostly priced in, it would bring the 10y-3m spread below -200 bps

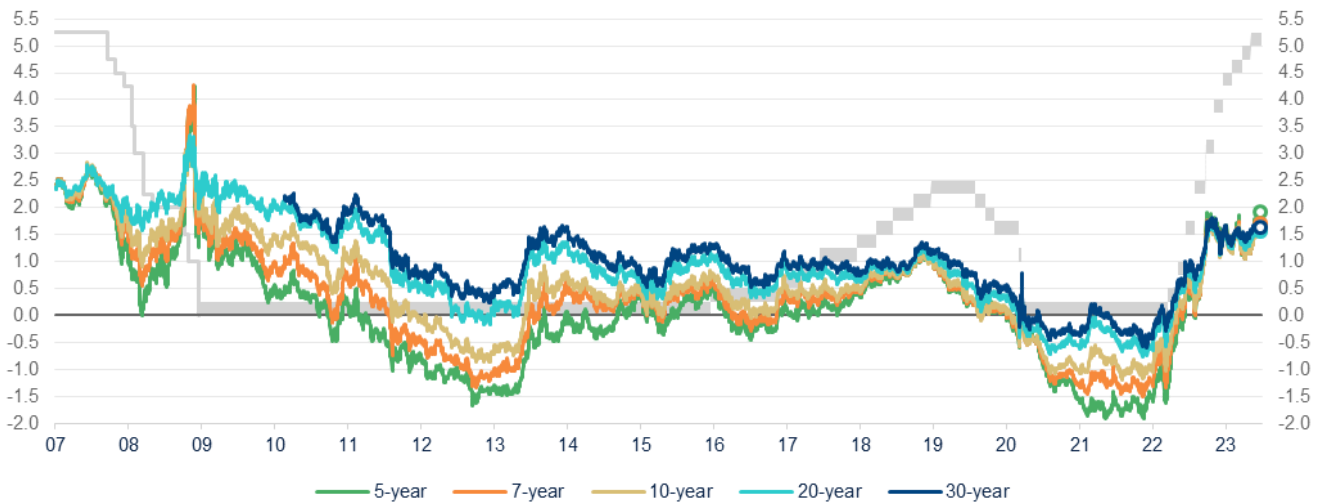
Figure 12. **10Y-3M TREASURY YIELD SPREAD (% AND BPS)**



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

Most inflation-indexed Treasury (TIPS) yields have moved closer to their recent highs with somewhat higher nominal rates

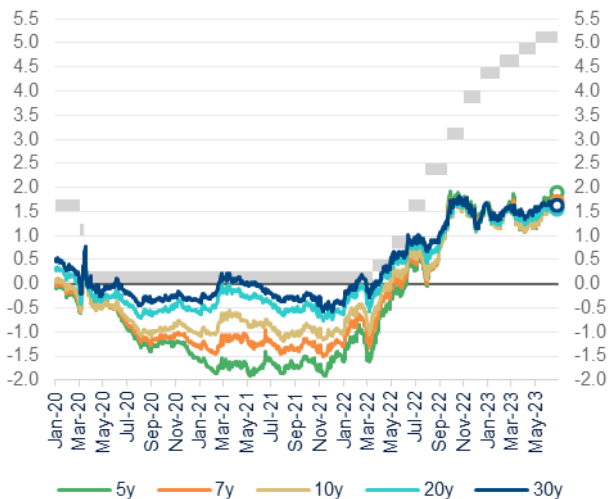
Figure 13. INFLATION INDEXED TREASURY (TIPS) YIELDS (%)



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

With the exception of longer-term real yields, most have reached fresh highs...

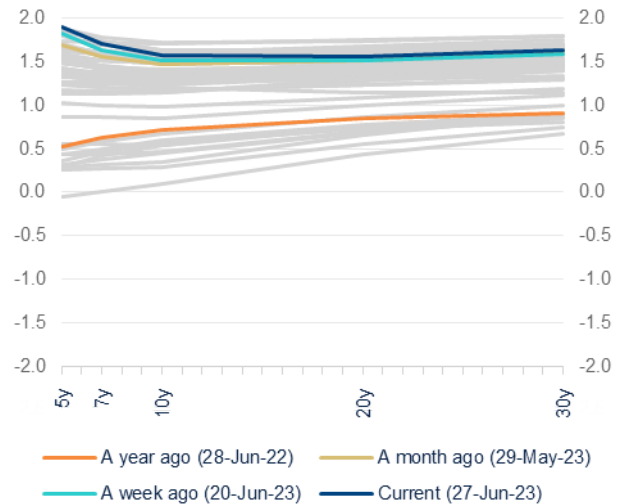
Figure 14. INFLATION INDEXED (TIPS) YIELDS (%)



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

... which was reflected in an upward shift of the real yield along the 5 to 10-year section

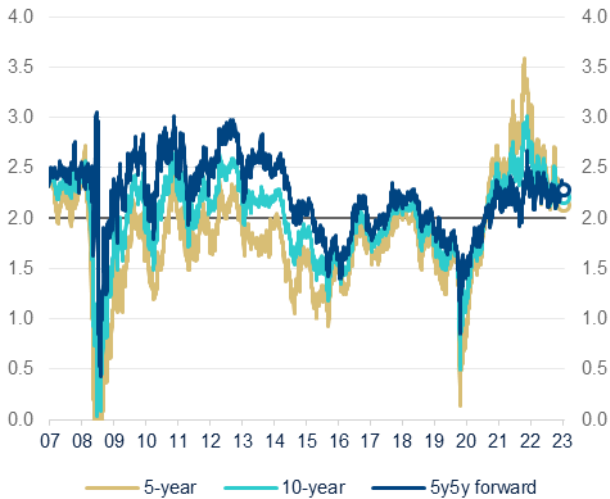
Figure 15. INFLATION INDEXED (TIPS) YIELD CURVE (%)



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

Market-based inflation expectations continue to hover around a narrow range at low levels...

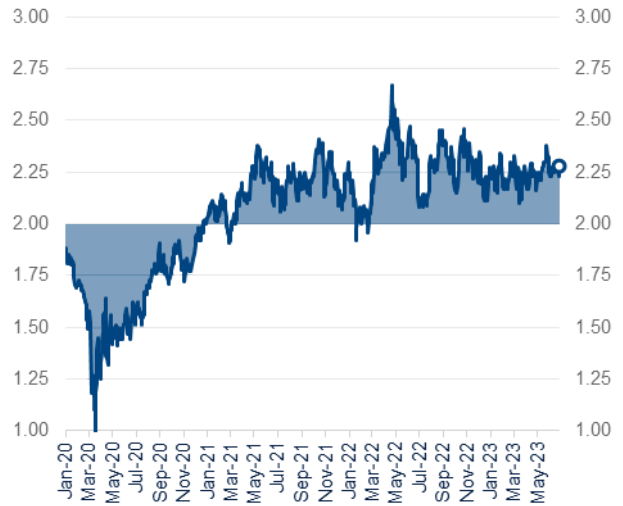
Figure 16. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research based on data by Haver Analytics.

... even though the pace at which inflation has come down has been slower than anticipated

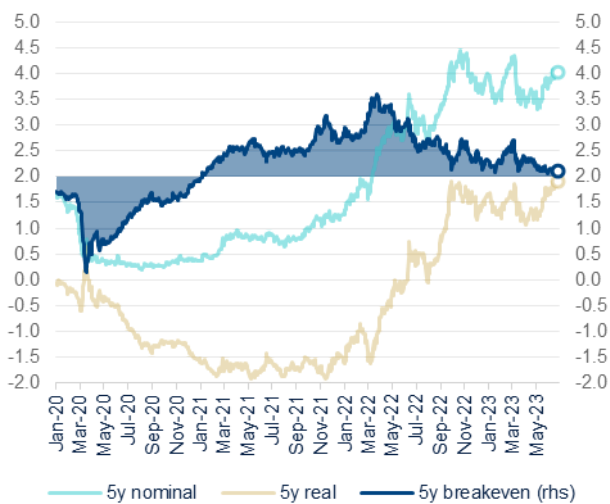
Figure 17. **5Y5Y FORWARD IMPLIED INFLATION RATE (%)**



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 will...

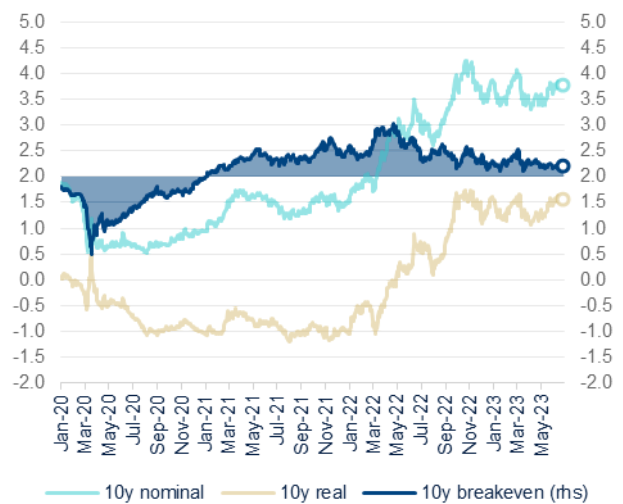
Figure 18. **5-YEAR BREAKEVEN INFLATION RATE (%)**



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

... succeed in bringing inflation down, and the economy will return to a low inflation setting

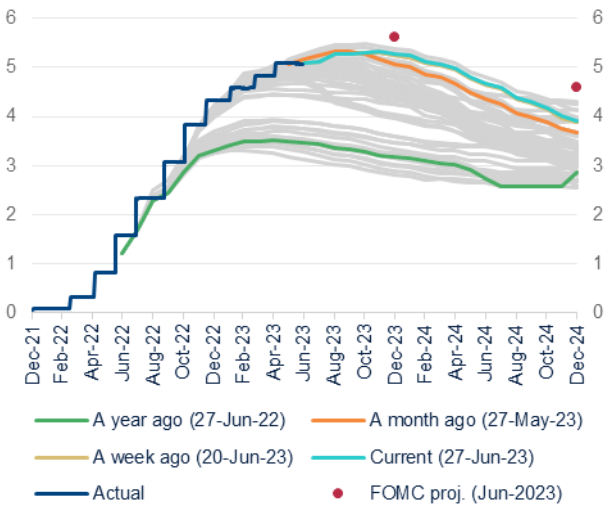
Figure 19. **10-YEAR BREAKEVEN INFLATION RATE (%)**



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

Markets believe the Fed will only raise rates one more time in July; however, they also seem to...

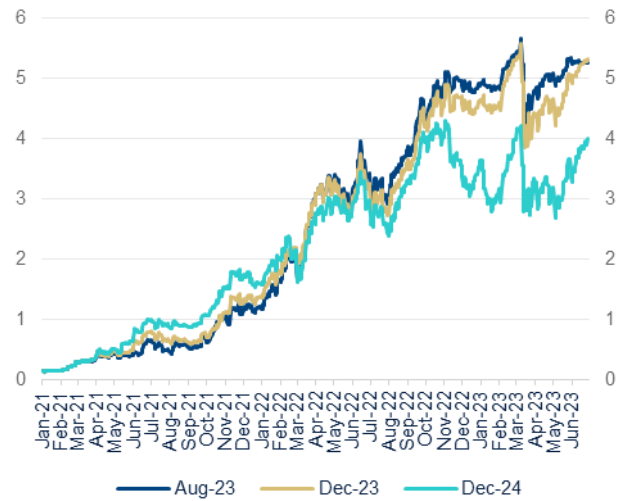
Figure 20. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



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

... have come round to the view that an easing cycle is unlikely to start this year

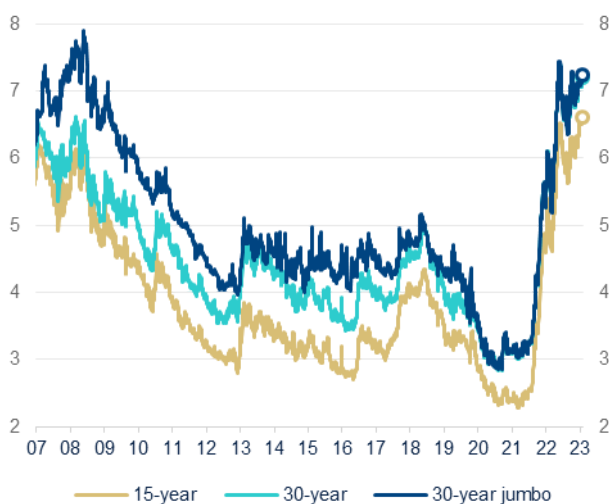
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



Source: BBVA Research based on data by Bloomberg.

Mortgage rates have continued to climb: 15-yr's have hit fresh highs, 30-yr's close to recent highs

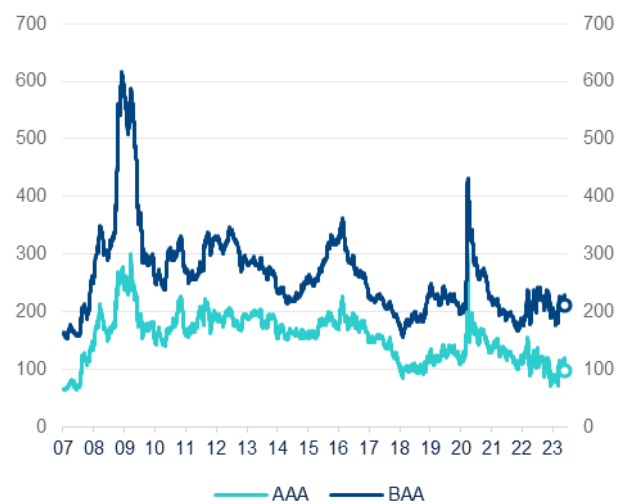
Figure 22. **MORTGAGE RATES (WSJ CONSUMER FIXED RATES, %)**



Source: BBVA Research based on data by Haver Analytics.

The investment-grade corporate credit market is not showing any signs of stress

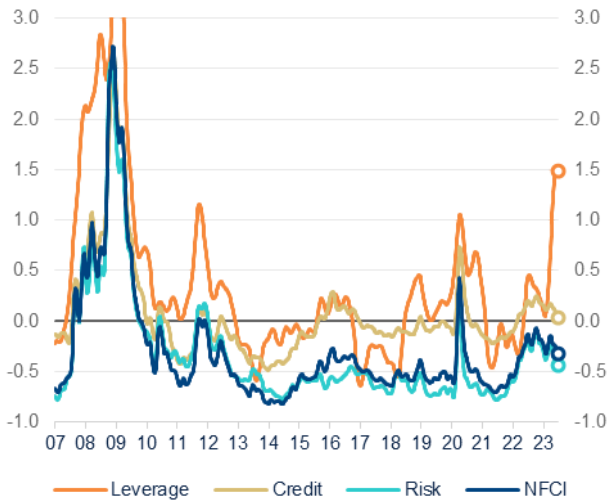
Figure 23. **CORPORATE BOND SPREADS (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)**



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

The leverage component of the NFCI, which takes into account borrowing costs and debt levels, ...

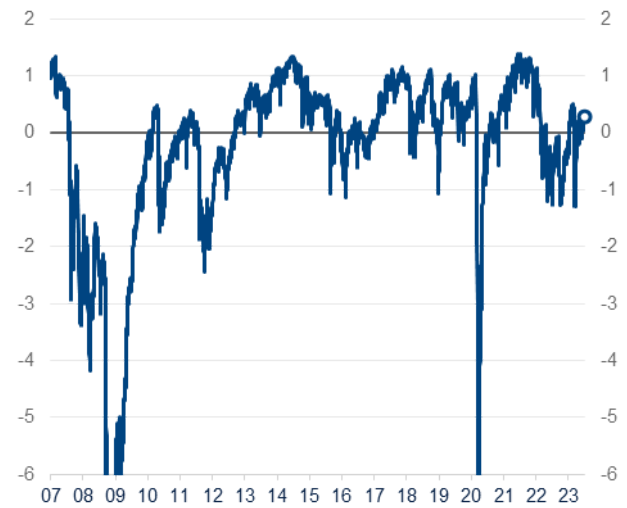
Figure 24. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0 = TIGHTER THAN AVG)**



Source: BBVA Research based on data by Haver Analytics.

... has risen further with rates trending higher again, but most financial conditions indices...

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



Source: BBVA Research based on data by Bloomberg.

... show that conditions have eased somewhat recently...

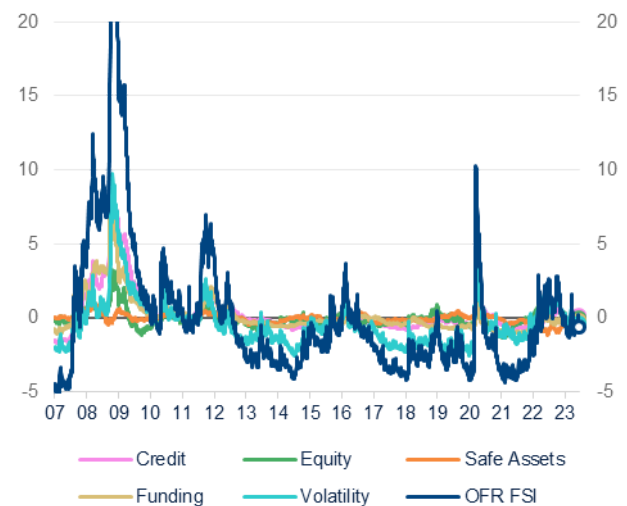
Figure 26. **FED FINANCIAL STRESS INDICES (>0 = ABOVE AVG FINANCIAL STRESS)**



Source: BBVA Research based on data by Haver Analytics.

... and now point to below-average financial stress

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

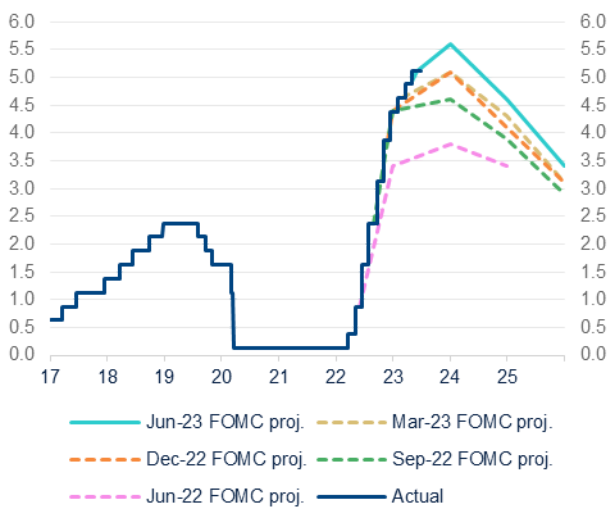


OFR: Office of Financial Research, US Department of the Treasury.
Source: BBVA Research based on data by Haver Analytics.

June's updated SEP showed that the median FOMC participant now projects the fed funds rate to rise to 5.6% by year end

One more 25bp hike in July is now very likely amid signs of a resilient economy; FOMC will...

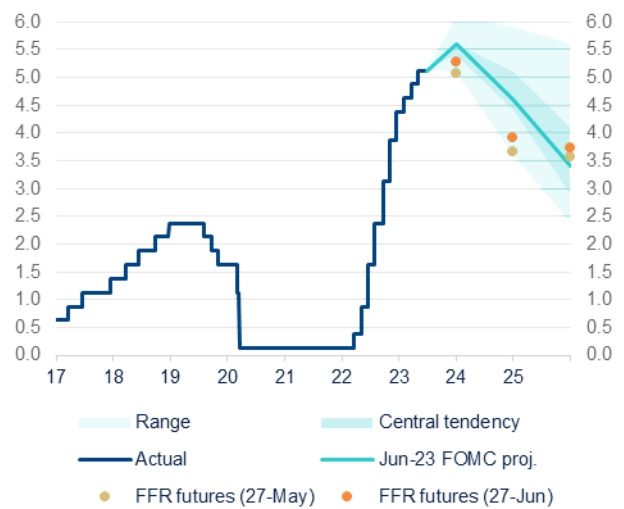
Figure 28. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



Source: BBVA Research based on data by Haver Analytics.

... likely skip again in Sep, and Nov's softer core inflation will likely convince them to pause

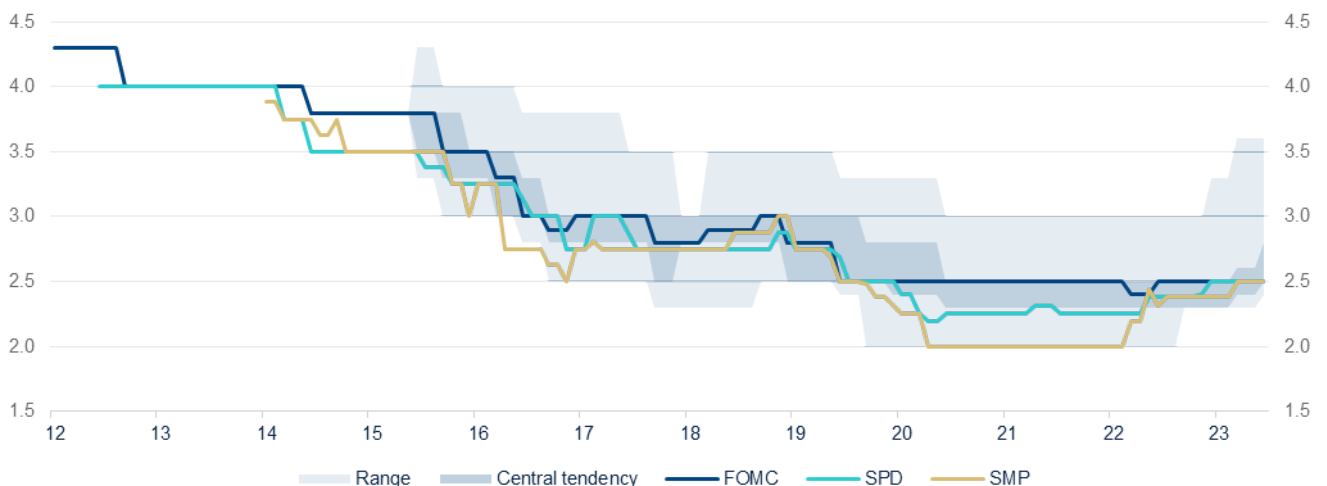
Figure 29. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



Source: BBVA Research based on data by Haver Analytics and Bloomberg.

The estimated steady-state fed funds rate remains unchanged, still implying the Fed believes that the structural factors that have driven it to that level will remain in place

Figure 30. PROJECTED LONGER RUN FEDERAL FUNDS RATE (MEDIAN ESTIMATE, %)



SPD: Survey of Primary Dealers; SMP: Survey of Market Participants. Source: BBVA Research based on data by Haver Analytics.

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