

US Interest rates monitor

Higher long-term yields on strong growth...

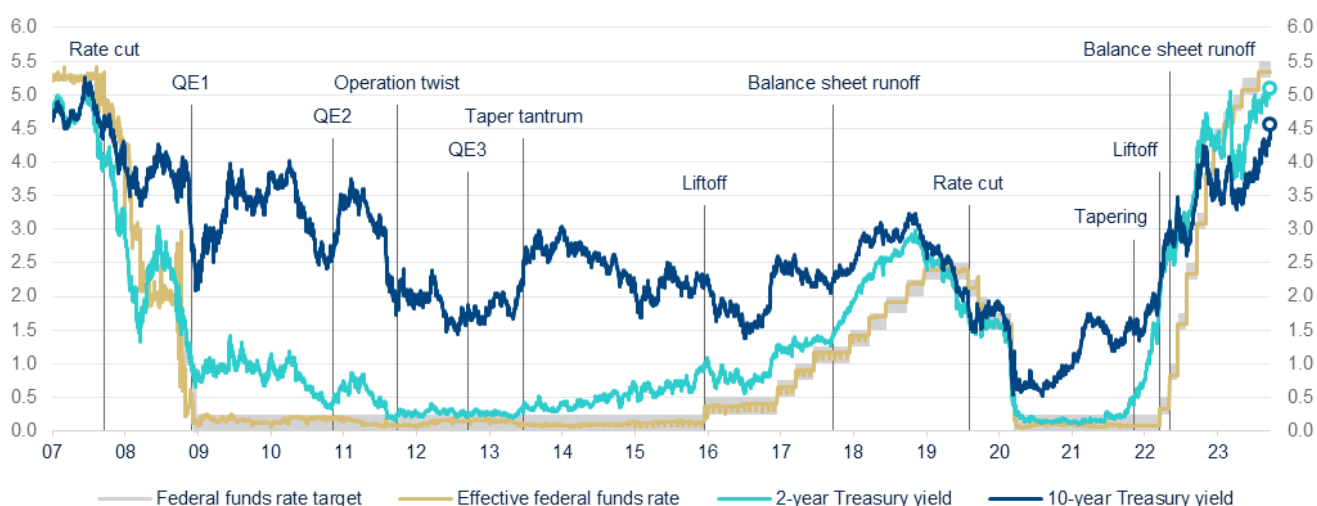
Javier Amador / Iván Fernández
September 26, 2023

... and the expectation of fewer rate cuts in 2024

- Monetary policy remains well positioned to “proceed cautiously”: an additional 25bp rate hike before the end of the year is not off the table; the decision will lie on the upcoming data (Figures 2 and 3).
- The yield curve has flattened as mid- and long-term yields have moved up sharply “not because of inflation”; it probably has “something to do with stronger growth” (Figures 6 and 7).
- The 10y-3m yield spread reverted half of its previous negative low, rebounding from c. -200 bps to c. -100 bps driven by the recent spike in long-term yields and the proximity of the end of the hiking cycle (Figure 10).
- Real interest rates are “well above mainstream estimates of the neutral policy rate”, a welcome development for the Fed as “meaningfully positive” real rates will help to get inflation down to target (Figure 13).
- Fed: continued evidence of stronger growth is the main reason for possibly “needing to do more” as “reducing inflation will require a period of below trend growth” (Figures 28 and 29).
- Although the median estimate of the neutral rate remained at 2.5%, the updated projections showed some FOMC participants raised their estimates (Figure 30).

The FOMC held the fed funds rate steady at a 22-year-high 5.25-5.50% target range; the accompanying Summary of Economic Projections (SEP), especially the dot plot, reinforced the higher for longer rhetoric

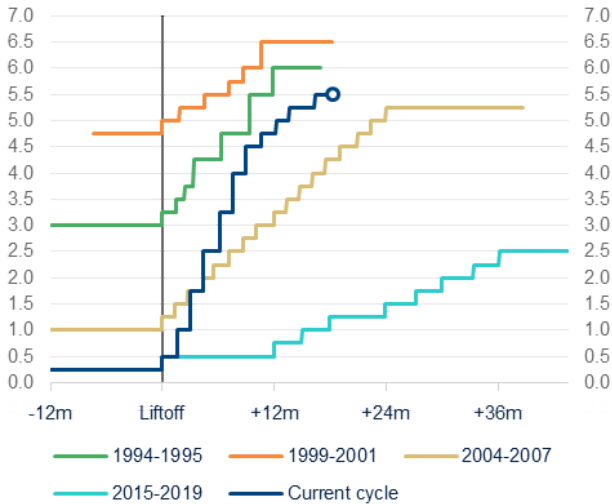
Figure 1. 2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE (%)



Source: BBVA Research based on data by Haver Analytics.

Policy remains well positioned to “proceed cautiously”: an additional 25bp rate hike...

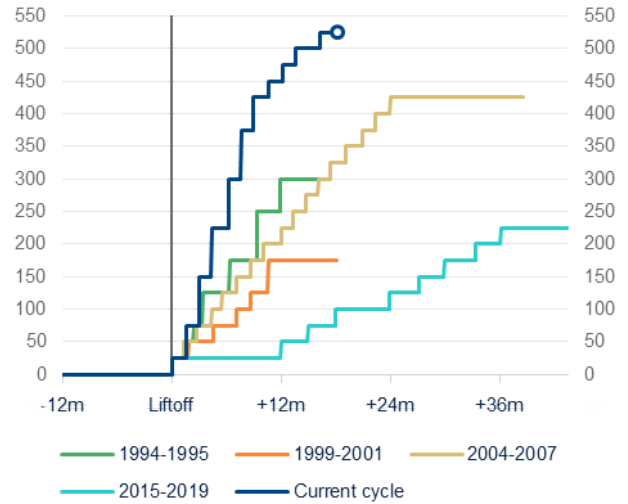
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



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.

... before the end of the year is not off the table; the decision will lie on the upcoming data

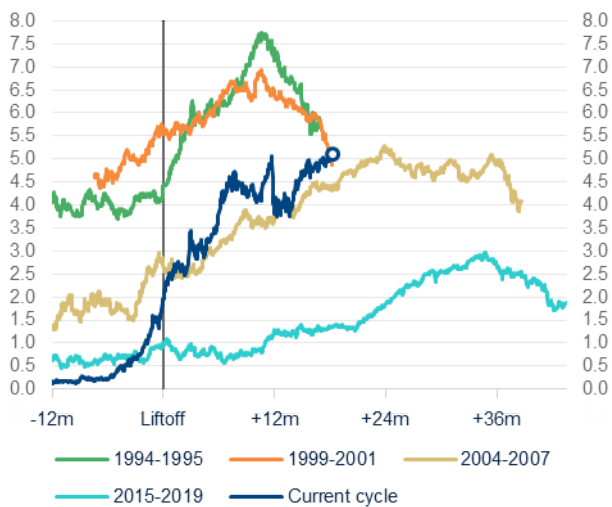
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE LEVEL AT LIFTOFF)**



Source: BBVA Research based on data by Haver Analytics.

Mid- and long-term yields have moved up sharply, but “it’s not because of inflation”...

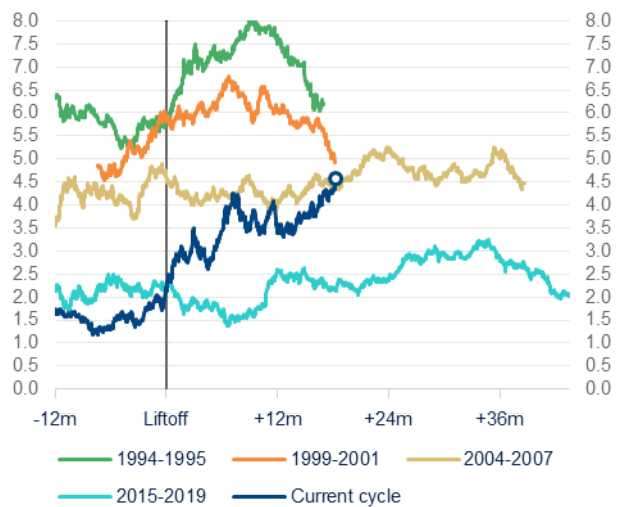
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

... it probably has “something to do with stronger growth”...

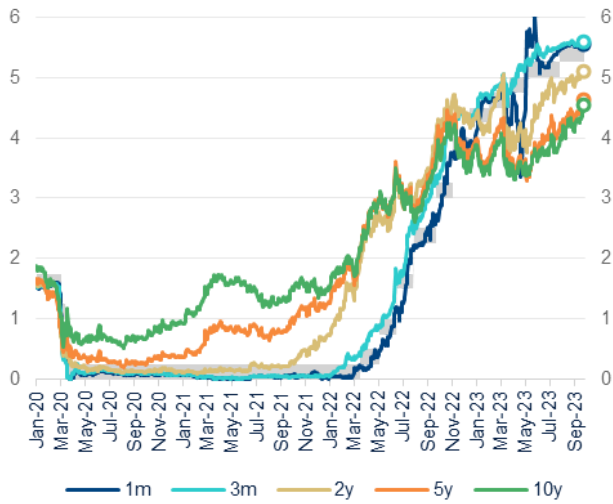
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research based on data by Haver Analytics.

... and more recently with a more hawkish Fed, which flattened the yield curve...

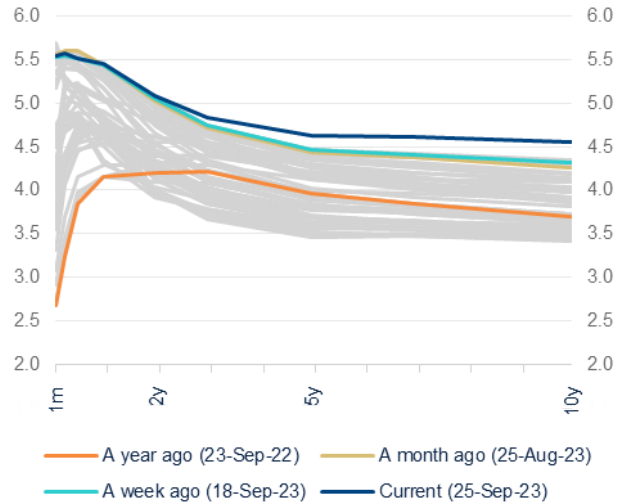
Figure 6. **TREASURY YIELDS**
(%)



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

... i.e., steady short-term yields and higher mid- and, particularly, long-term yields

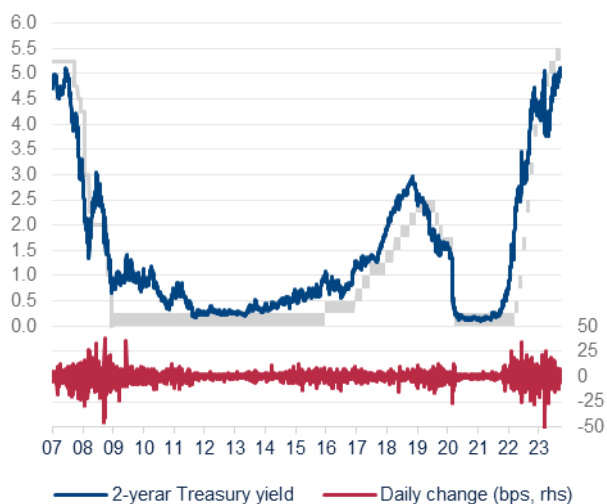
Figure 7. **TREASURY YIELD CURVE**
(%)



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

Volatility in the Treasury market remains relatively contained...

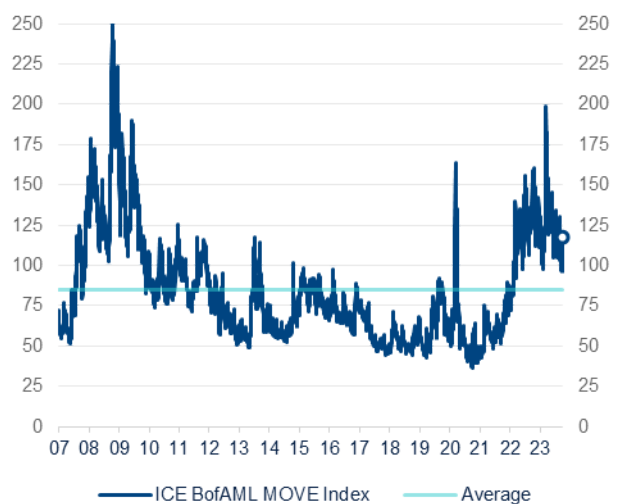
Figure 8. **2-YEAR TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

... even after markets were surprised by a more hawkish Fed

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 reverted half of its previous negative low, rebounding from c. -200 bps to c. -100 bps driven by the recent spike in long-term yields and the proximity of the end of the hiking cycle

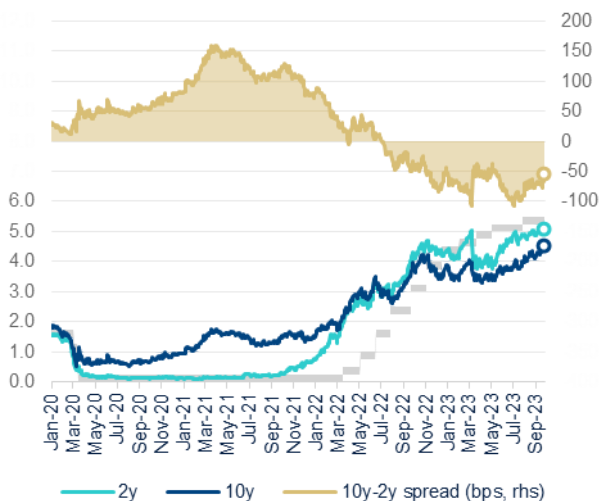
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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.

While significantly low by historical standards, Treasury yield spreads are gradually pointing...

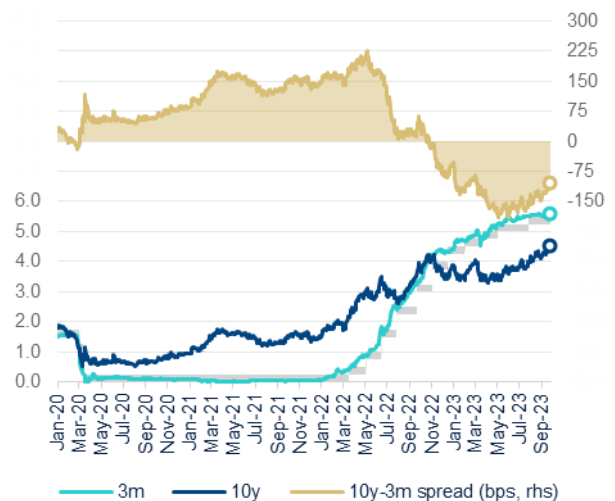
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (% AND BPS)**



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

... to lower odds of an economic recession

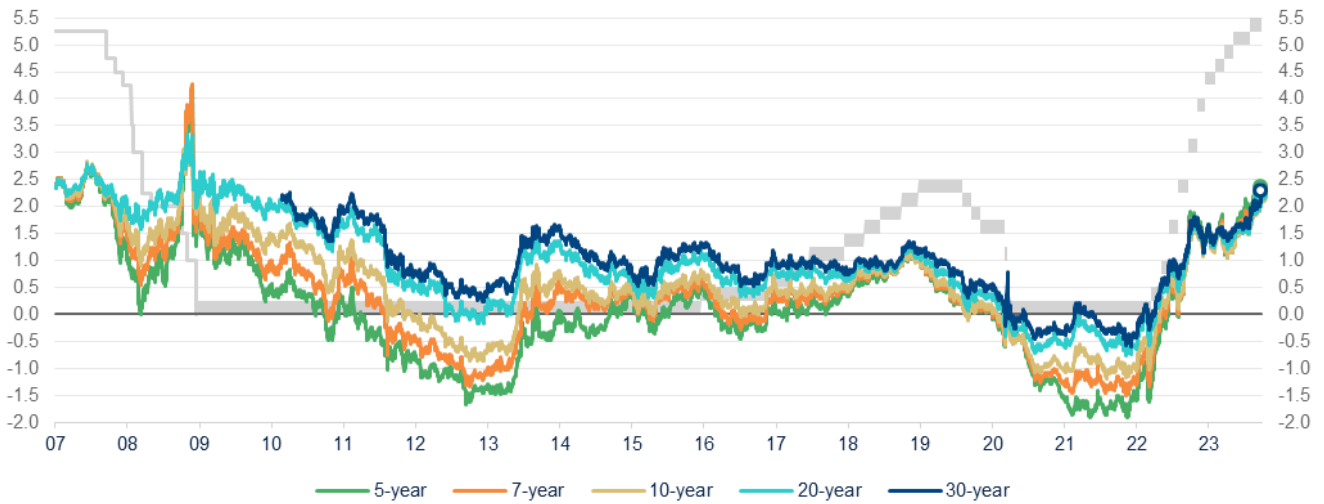
Figure 12. **10Y-3M TREASURY YIELD SPREAD (% AND BPS)**



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

Real interest rates are now “well above mainstream estimates of the neutral policy rate”

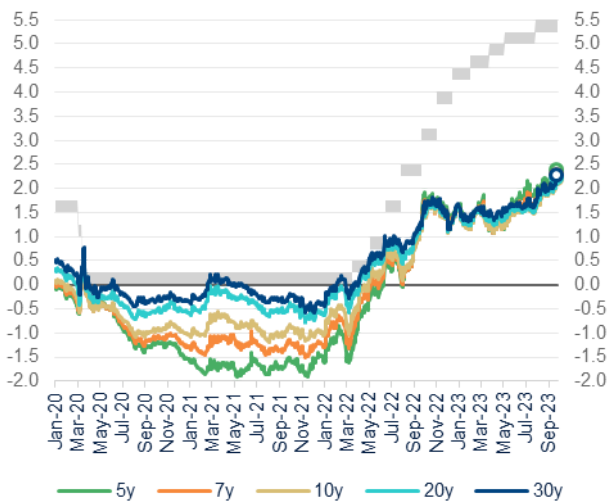
Figure 13. **INFLATION INDEXED TREASURY (TIPS) YIELDS (%)**



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

This is a welcome development for the Fed as “meaningfully positive” real rates...

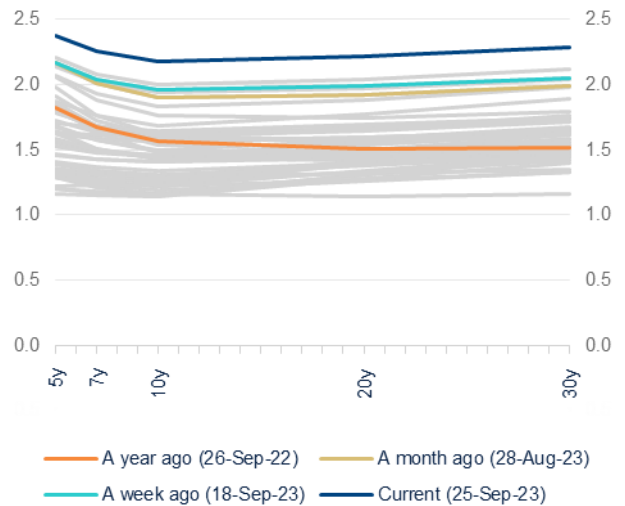
Figure 14. **INFLATION INDEXED (TIPS) YIELDS (%)**



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

... will help to get inflation down to target

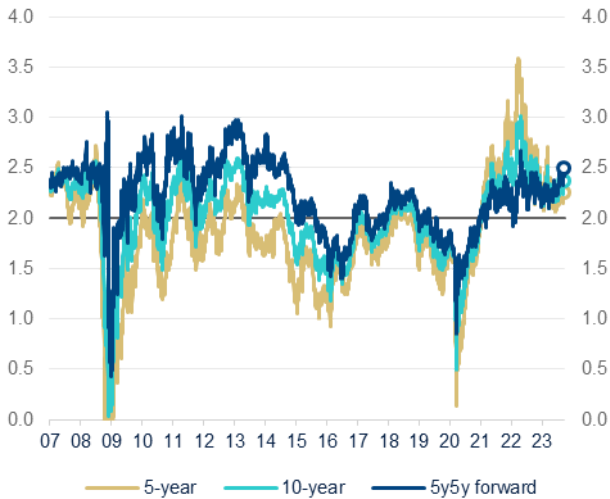
Figure 15. **INFLATION INDEXED (TIPS) YIELD CURVE (%)**



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 ticked up, but recent movements are not concerning...

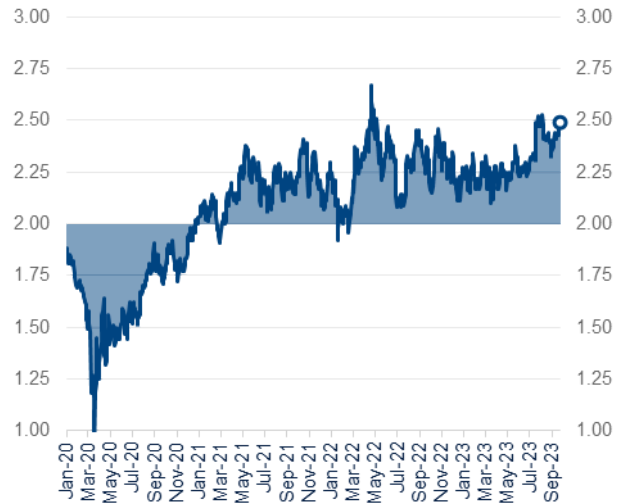
Figure 16. **BREAKEVEN INFLATION RATES** (%)



Source: BBVA Research based on data by Haver Analytics.

... in the backdrop of improving survey-based inflation expectations (e.g., UoM Survey)

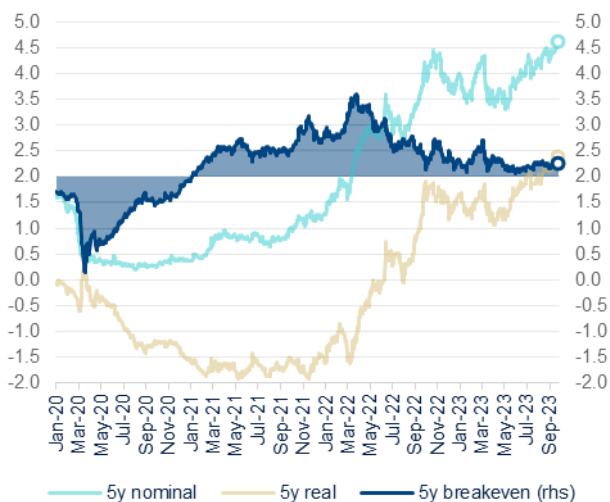
Figure 17. **5Y5Y FORWARD IMPLIED INFLATION RATE** (%)



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

Mid- and long-term market inflation expectations remain well anchored...

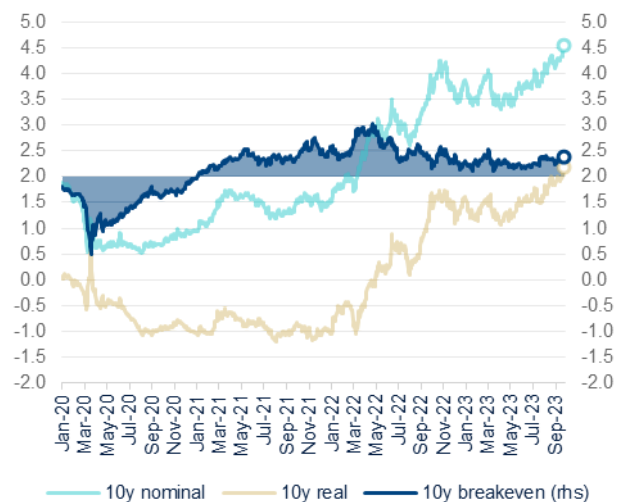
Figure 18. **5-YEAR BREAKEVEN INFLATION RATE** (%)



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

... on continued core inflation easing

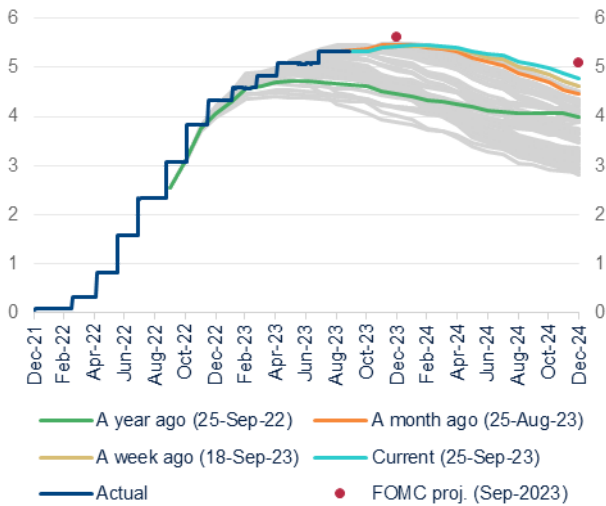
Figure 19. **10-YEAR BREAKEVEN INFLATION RATE** (%)



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

Markets have been coming round to the view that the Fed will need to hold a restrictive stance...

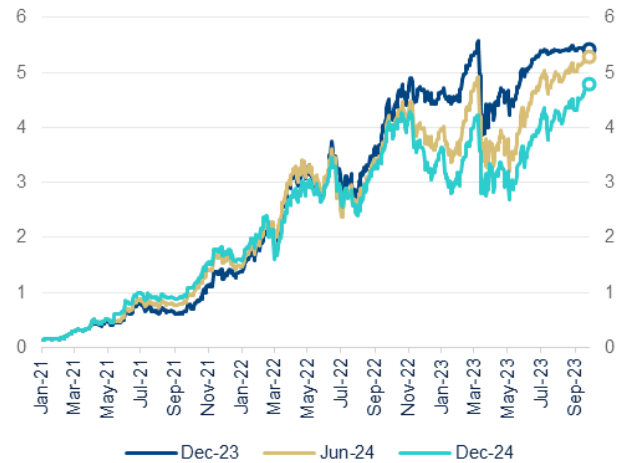
Figure 20. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



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

... for longer to bring inflation down to target at a sustained pace

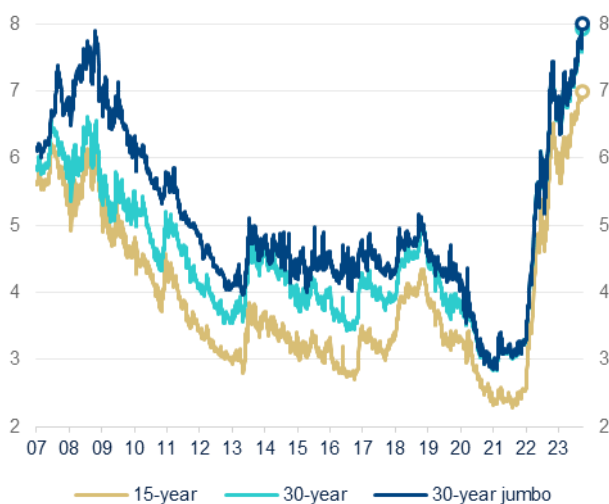
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



Source: BBVA Research based on data by Bloomberg.

Higher mortgage rates are likely to reverse the recent rebound in the housing sector

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

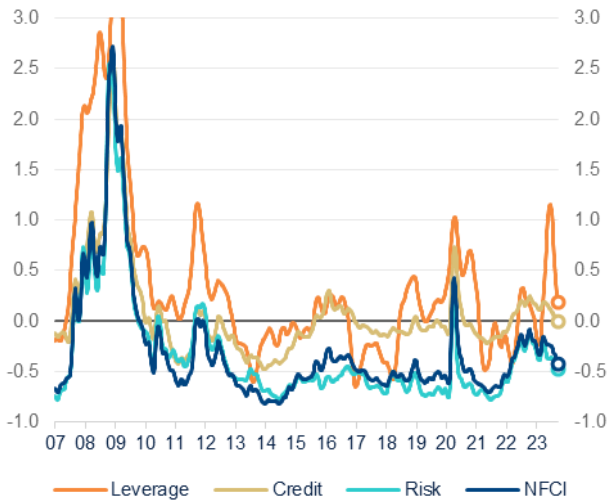
Figure 23. **CORPORATE BOND SPREADS (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)**



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

The NFCI leverage component has come down as regional banks' concerns have been fading

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



Source: BBVA Research based on data by Haver Analytics.

Most financial conditions indexes do not reflect a concerning tight financial environment

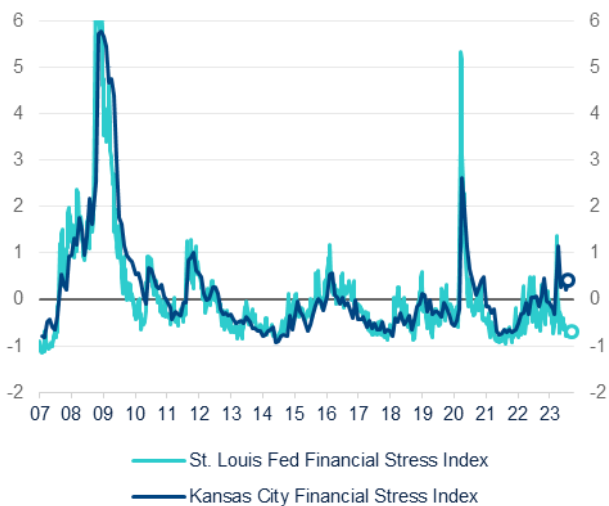
Figure 25. **BLOOMBERG FINANCIAL CONDITIONS INDEX (<0: TIGHTER THAN PRE-GFC AVG)**



Source: BBVA Research based on data by Bloomberg.

Conditions have eased somewhat recently and...

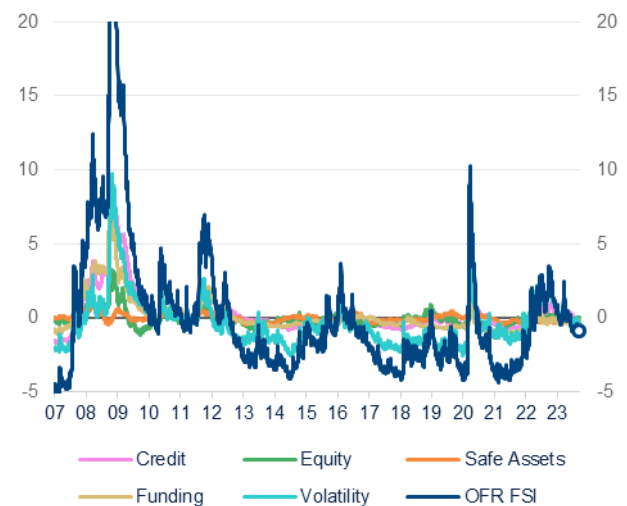
Figure 26. **FED FINANCIAL STRESS INDICES (>0: ABOVE AVG FINANCIAL STRESS)**



Source: BBVA Research based on data by Haver Analytics.

... continue to point to below-average financial stress

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

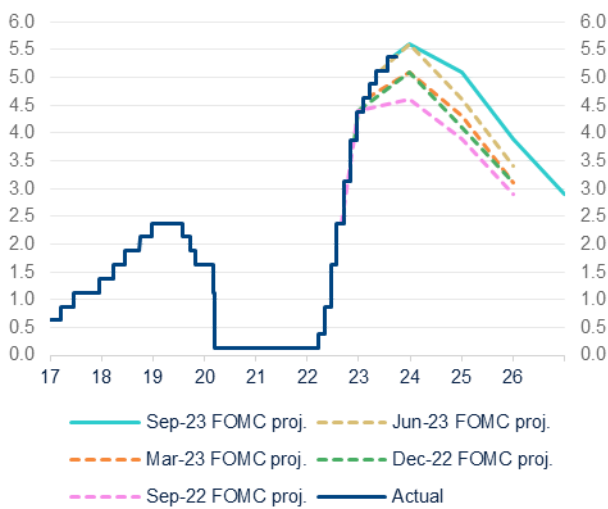


OFR: Office of Financial Research, US Department of the Treasury.
Source: BBVA Research based on data by Haver Analytics.

September's updated SEP showed the median FOMC participant now projects fewer rate cuts in 2024 (-50 bps vs -100 bps in June)

Continued evidence of stronger growth is the main reason for possibly "needing to do more"...

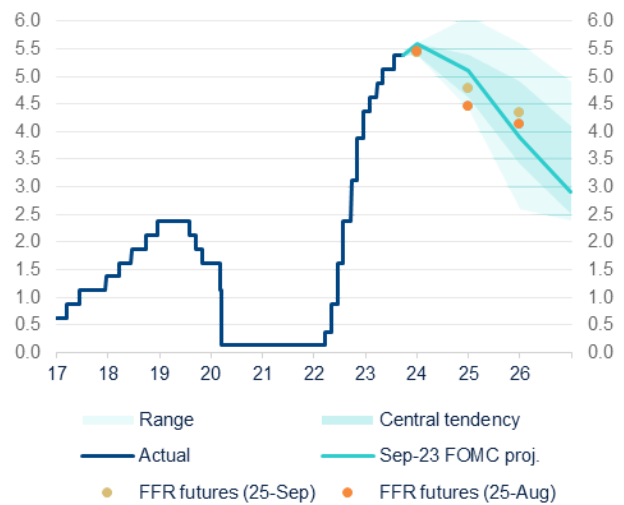
Figure 28. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



Source: BBVA Research based on data by Haver Analytics.

... as "reducing inflation will require a period of below trend growth"

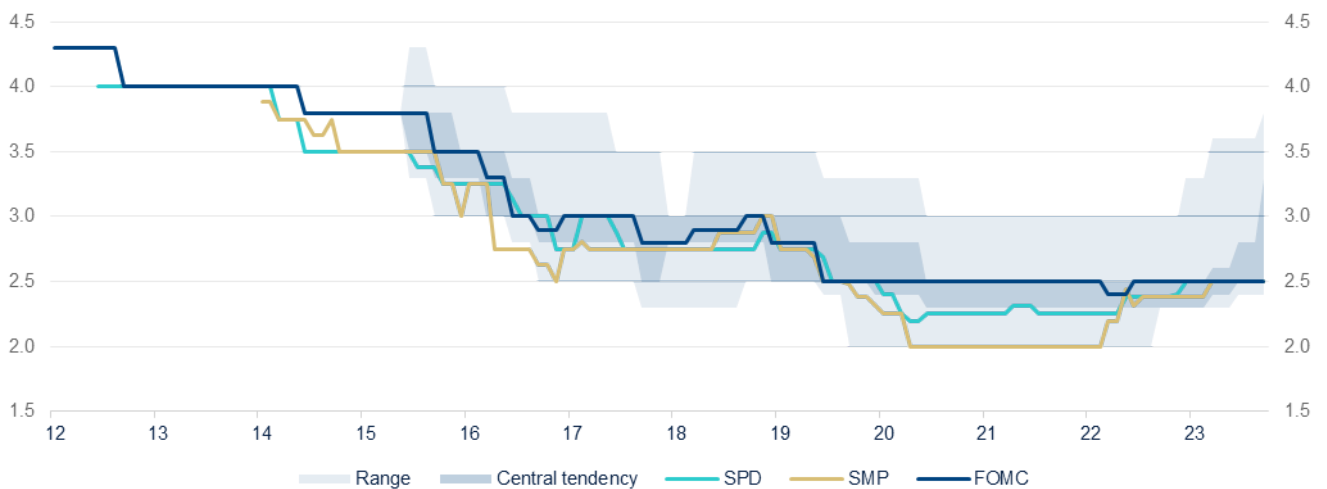
Figure 29. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



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

Although the median estimate of the neutral rate remained at 2.5%, the updated projections showed some FOMC participants raised their estimates

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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