

US Interest rates monitor

# Treasury yields soar amid a lack of further progress on inflation so far this year

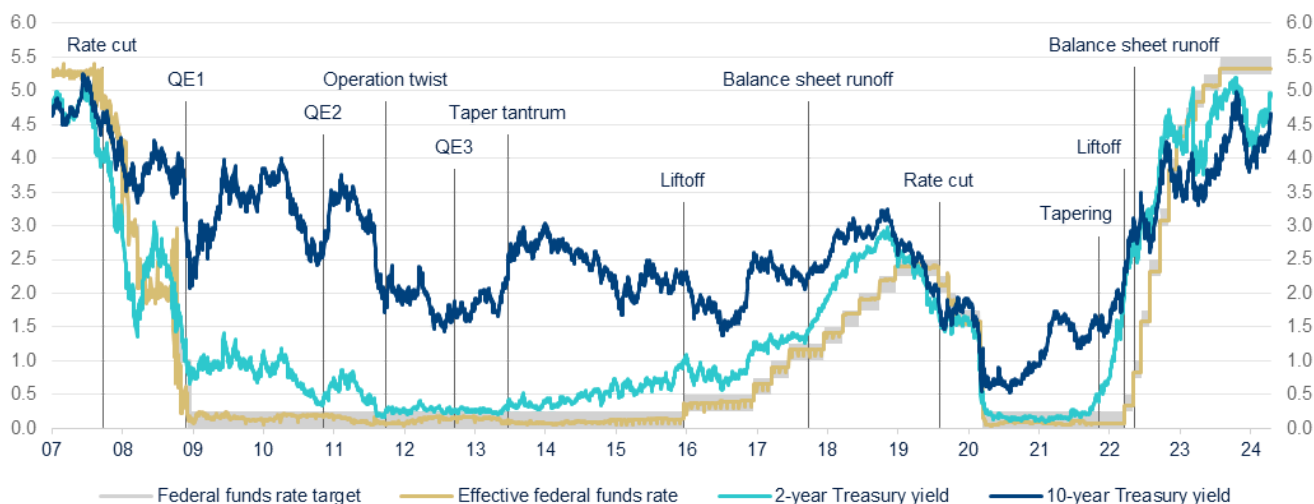
Javier Amador / Iván Fernández  
April 24, 2024

## The most recent data suggest a rate cut soon is off the table as odds for less than three rate cuts this year jumped

- 2- and 10-year Treasury yields are now 25 and 35 bps higher than last month's (Figures 4 and 5) after pricing in that the policy stance will likely need to remain restrictive for longer.
- The stability of 3- and 6-month Treasury yields below 5.5% reflects the relatively low risk priced in by financial markets that the Fed will need to hike rates at any of the upcoming meetings (Figures 6 and 7).
- The single-day 20bp jump in the 10-year Treasury yield following the latest CPI report was the largest since September 2022 (Figure 8), which was echoed by equity (VIX) and fixed income volatility indexes (Figure 9).
- The implied probability in the futures market of at least three rate cuts this year went from 77% a month ago to 23% after the most recent stronger-than-expected CPI inflation report (Figures 21 and 22).
- While the Fed expected "some unevenness" in monthly inflation readings as it returns to target (Figures 29 and 30), the most recent economic data suggest a rate cut in the upcoming meetings is likely off the table.

A third-in-a-row 0.4% MoM core CPI inflation reading for March following strong jobs reports added to a series of hot data that points to a lack of further progress so far this year to bring inflation back to target

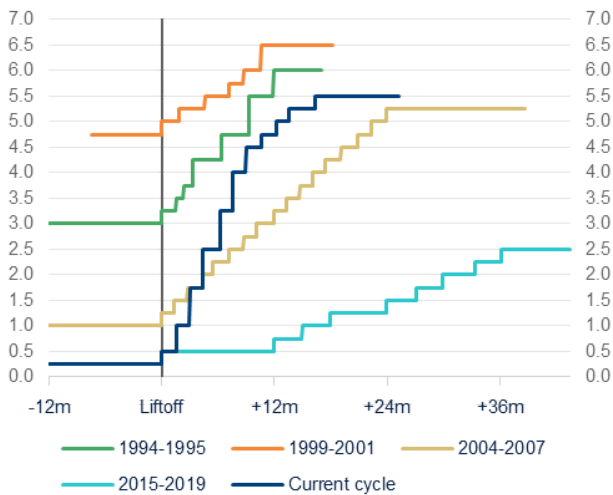
Figure 1. 2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE (%)



Source: BBVA Research / Haver

Powell noted last week that these developments suggest it will take “longer than expected” to...

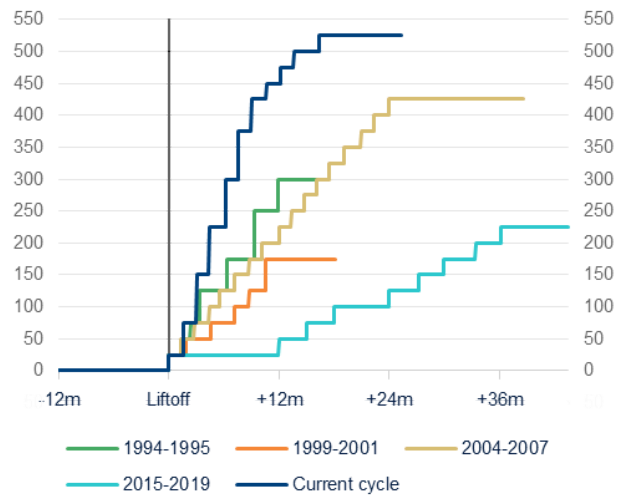
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



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 / Haver

... achieve the needed confidence on a sustained disinflation process, which means it will take...

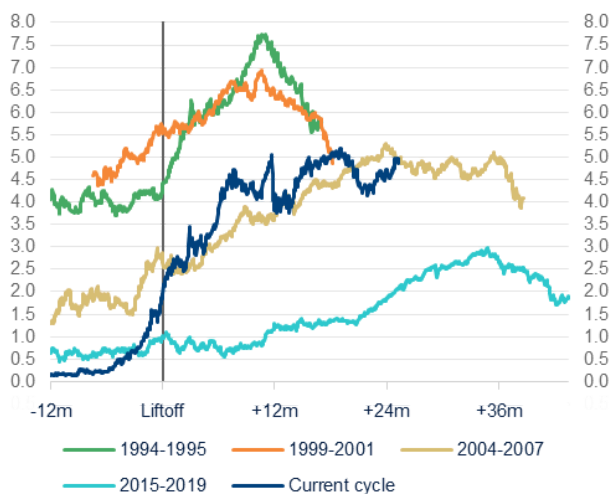
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE LEVEL AT LIFTOFF)**



Source: BBVA Research / Haver

... longer than expected to begin a rate cut cycle; 2- and 10-year Treasury yields are now 25 and...

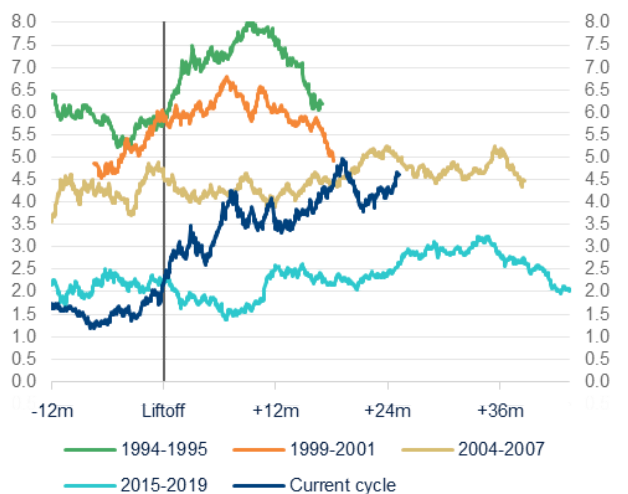
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Haver

... 35 bps higher than a month ago as markets priced in the need to remain restrictive for longer

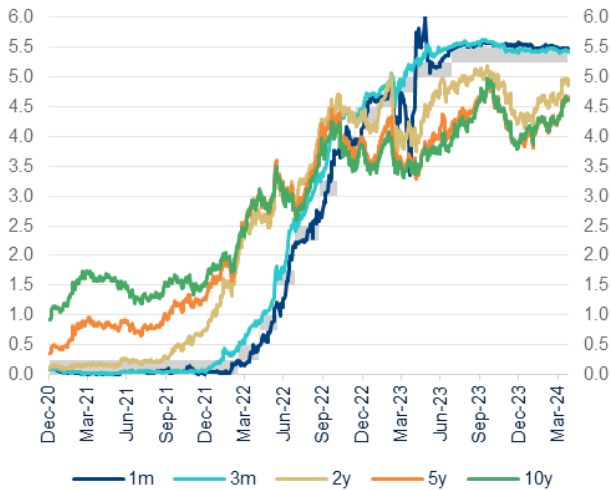
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Haver

**With policy deemed to be “well positioned to handle the risks [faced] if higher inflation does...**

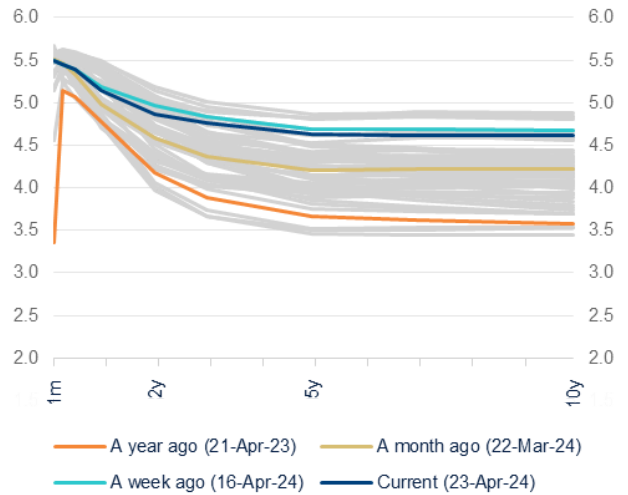
Figure 6. **TREASURY YIELDS**  
(%)



The gray area indicates the federal funds rate target range  
Source: BBVA Research / Haver

**... persist,” concerns on the possibility of further rate hikes seem overdone**

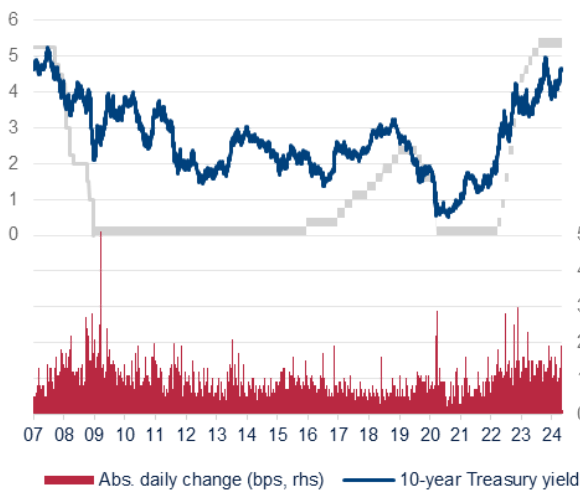
Figure 7. **TREASURY YIELD CURVE**  
(%)



The gray lines indicate weekly yield curves from a year ago  
Source: BBVA Research / Haver

**The single-day 20bp jump in the 10-year Treasury yield following the latest CPI report was the...**

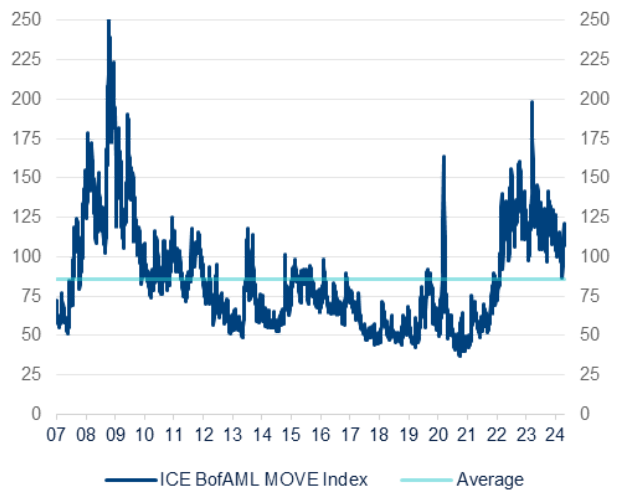
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**  
(% AND BPS)



The gray line and area indicate the federal funds rate target range  
Source: BBVA Research / Haver

**... largest since Sep 2022, which was echoed by equity (VIX) and fixed income volatility indexes**

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



Source: BBVA Research / Haver

The stability of 3- and 6-month Treasury yields below 5.5% reflects the relatively low risk priced in by financial markets that the Fed will need to hike rates again, i.e., today's uncertainty revolves around...

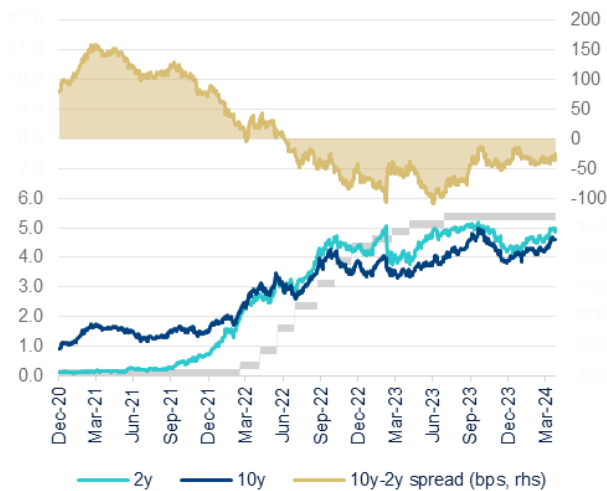
Figure 10. **TREASURY YIELD SPREADS (BPS)**



Gray shaded areas indicate US recessions as defined by the National Bureau of Economic Research (NBER)  
Source: BBVA Research / Haver

... how much longer should the fed funds rate remain at its current level, and not about how...

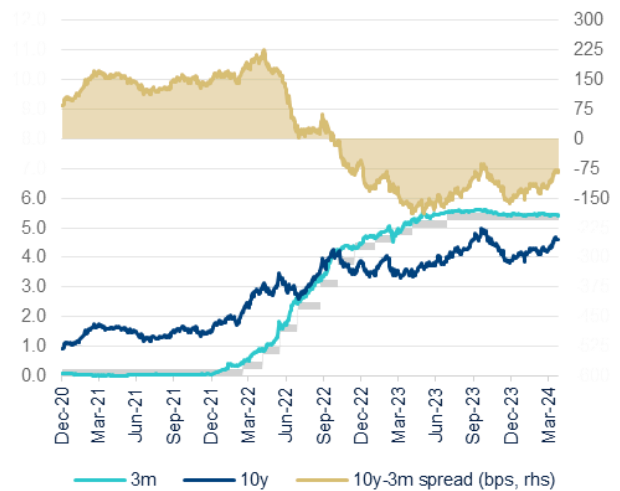
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (% AND BPS)**



The gray area indicates the federal funds rate target range  
Source: BBVA Research / Haver

... higher should it go (as it was the case during 3Q23). This makes it less likely that the 10-year...

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



The gray area indicates the federal funds rate target range  
Source: BBVA Research / Haver

... Treasury yield will reach the 5% level hit last October. The term premium is close to positive...

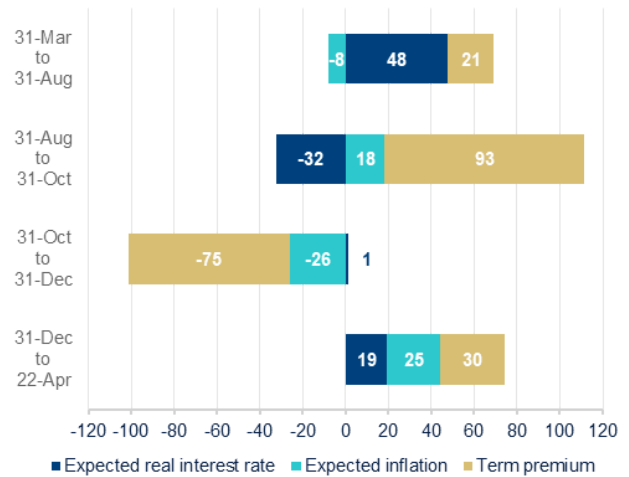
Figure 13. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



Source: BBVA Research / Haver

... territory despite these nuances regarding the nature of the current uncertainty

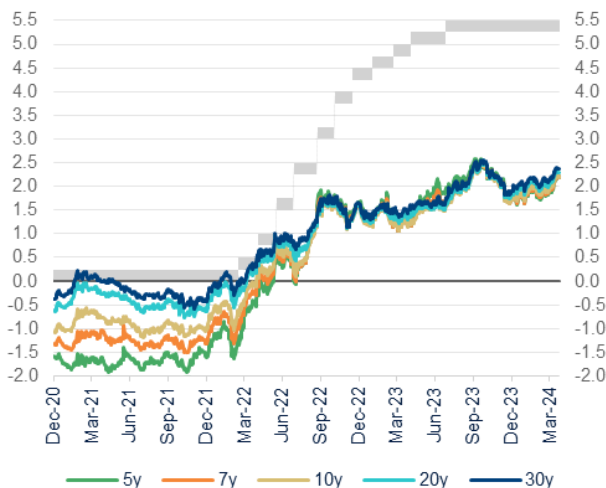
Figure 14. **CHANGE IN 10-YEAR TREASURY YIELD (BPS)**



Source: BBVA Research / Haver

Strong labor market readings and better-than-expected economic activity data despite last...

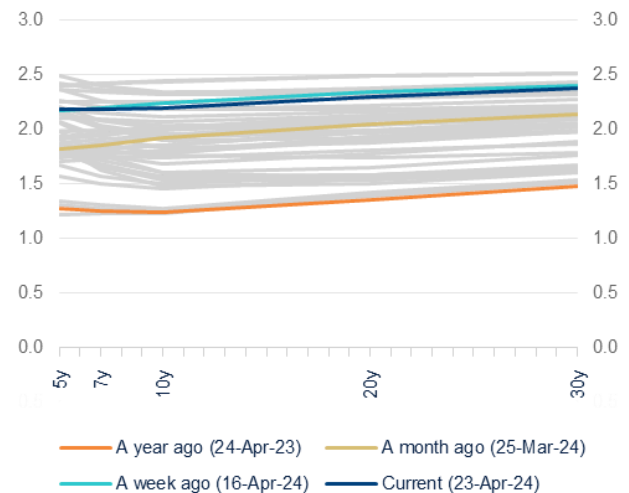
Figure 15. **INFLATION INDEXED (TIPS) YIELDS (%)**



The gray area indicates the federal funds rate target range  
Source: BBVA Research / Haver

... year's progress on inflation is reflected in higher rates across the real yield curve. Greater...

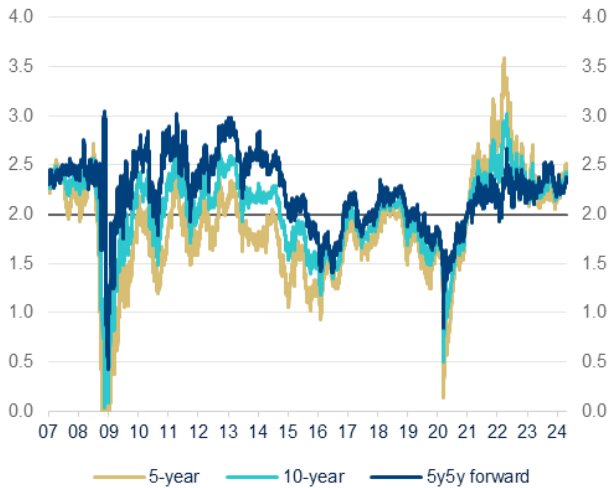
Figure 16. **INFLATION INDEXED (TIPS) YIELD CURVE (%)**



The gray lines indicate weekly yield curves from a year ago  
Source: BBVA Research / Haver

... potential output could be behind it. Likewise, although inflation data have disappointed so...

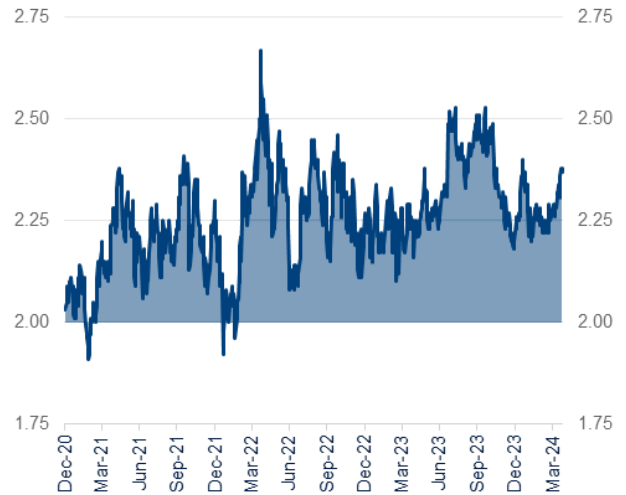
Figure 17. **BREAKEVEN INFLATION RATES** (%)



Source: BBVA Research / Haver

... far this year following 2023's notable progress, Treasury-market implied inflation expectations...

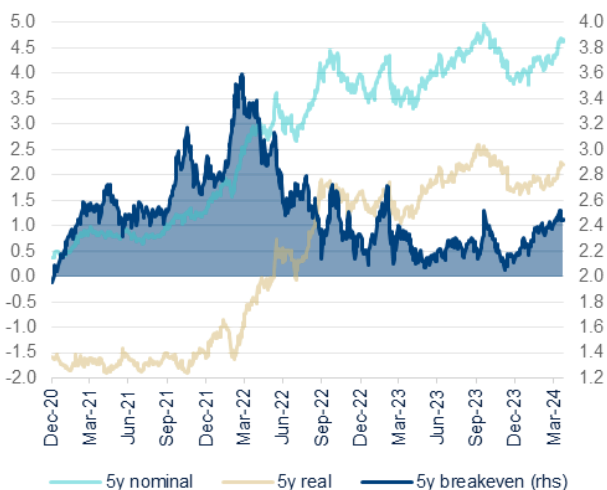
Figure 18. **5Y5Y FORWARD IMPLIED INFLATION RATE** (%)



The shaded area indicates deviations from the Fed's inflation target  
Source: BBVA Research / Haver

... moved up somewhat but remain well anchored as mid- and long-term expectations...

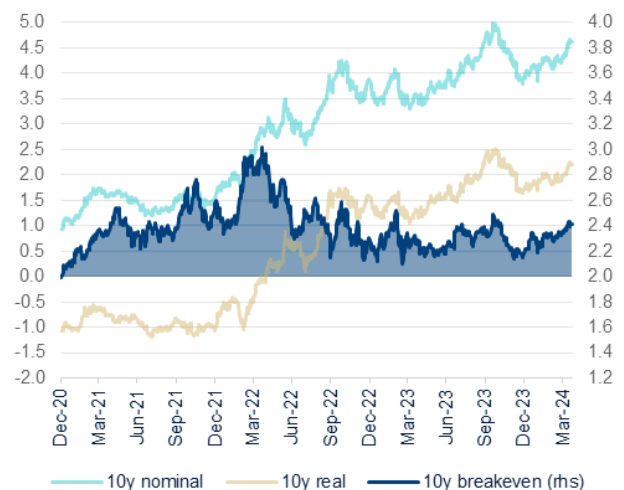
Figure 19. **5-YEAR BREAKEVEN INFLATION RATE** (%)



The shaded area indicates deviations from the Fed's inflation target  
Source: BBVA Research / Haver

... continue to hover around the levels seen in the decade before the pandemic

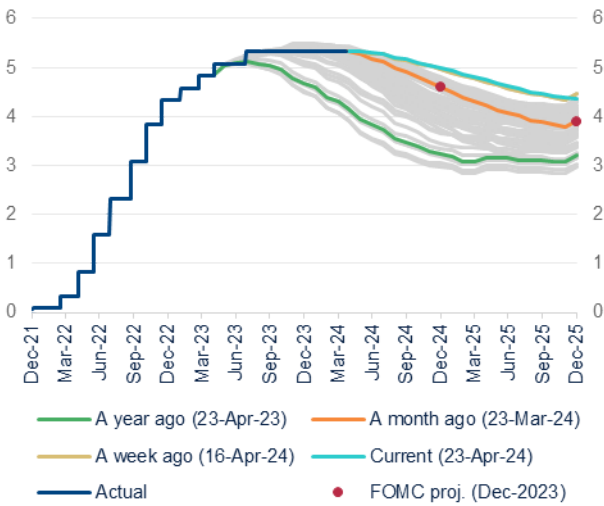
Figure 20. **10-YEAR BREAKEVEN INFLATION RATE** (%)



The shaded area indicates deviations from the Fed's inflation target  
Source: BBVA Research / Haver

The implied probability in the futures market of at least three rate cuts this year went from 77%...

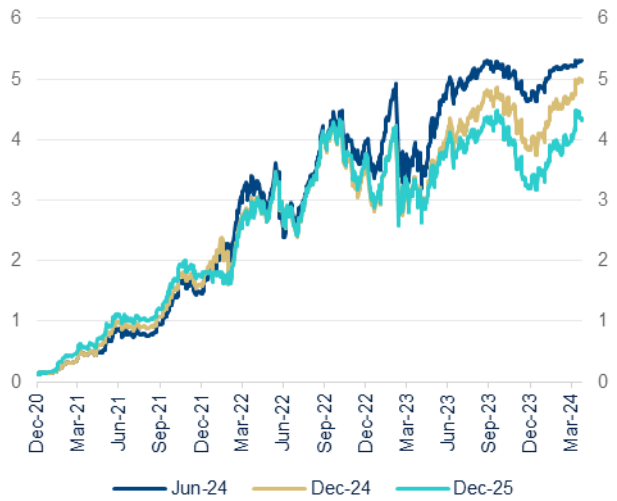
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



The gray lines indicate weekly implied rate paths from a year ago  
Source: BBVA Research / Bloomberg

... a month ago to 23% after the most recent stronger-than-expected CPI inflation report

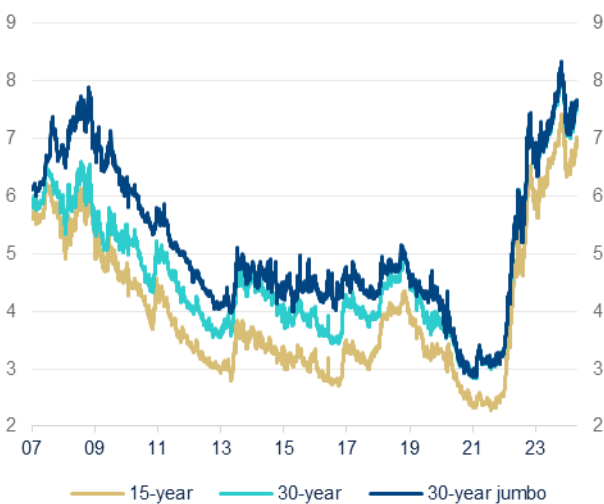
Figure 22. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



Source: BBVA Research / Bloomberg

The housing market continues to be the most sensitive to the high interest rate environment, ...

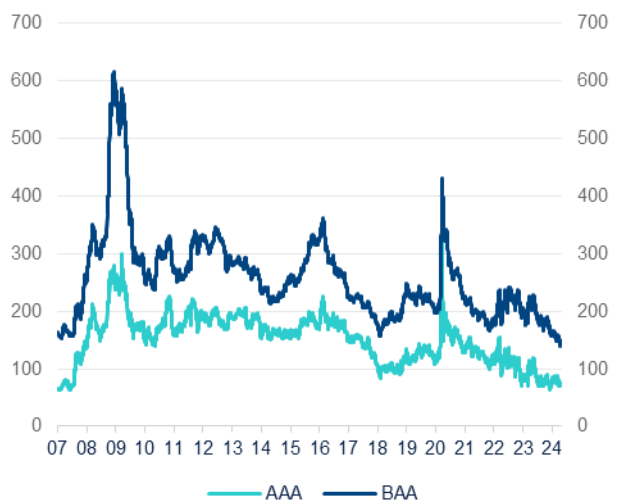
Figure 23. **MORTGAGE RATES (WSJ CONSUMER FIXED RATES, %)**



Source: BBVA Research based / Haver

... while the IG bond market appears to remain immune to the steepest hiking cycle in decades

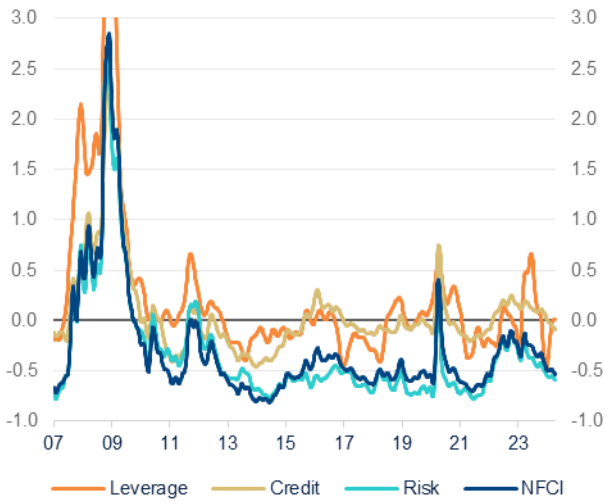
Figure 24. **CORPORATE BOND SPREADS (MOODY'S SEASONED YIELDS, DAILY DATA, BPS)**



Spreads over the 10-year Treasury yield  
Source: BBVA Research / FRED / Haver

**Broad indexes continue to point to easier financial conditions compared to past standards**

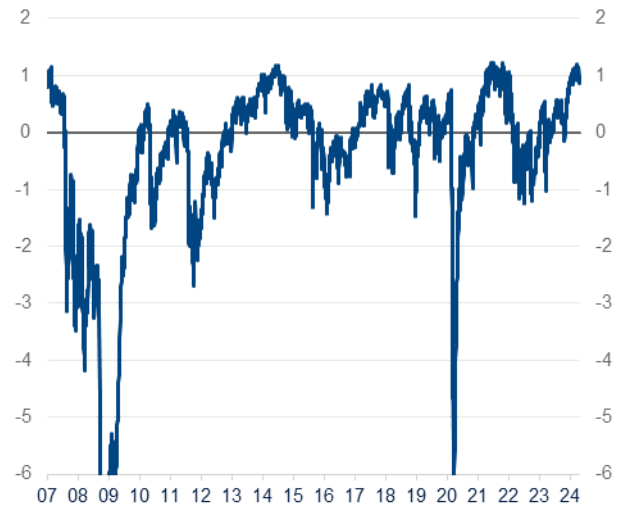
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0: TIGHTER THAN AVG)**



Source: BBVA Research / Haver

**A likely explanation is that both households and businesses have not been severely affected...**

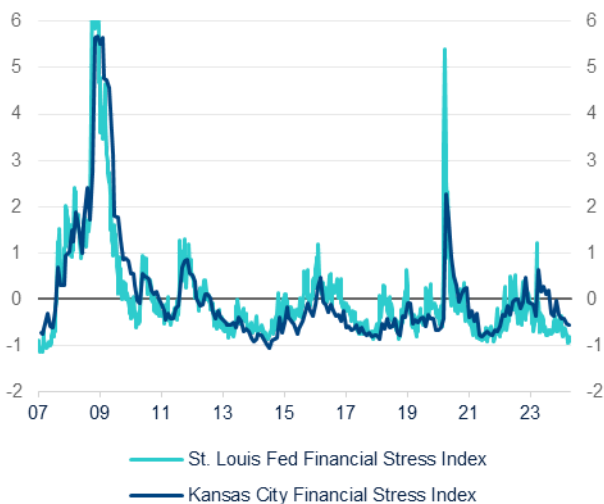
Figure 26. **BLOOMBERG FINANCIAL CONDITIONS INDEX (<0: TIGHTER THAN PRE-GFC AVG)**



Source: BBVA Research / Bloomberg

**... by the increase in financing costs because they managed to shield their liabilities during...**

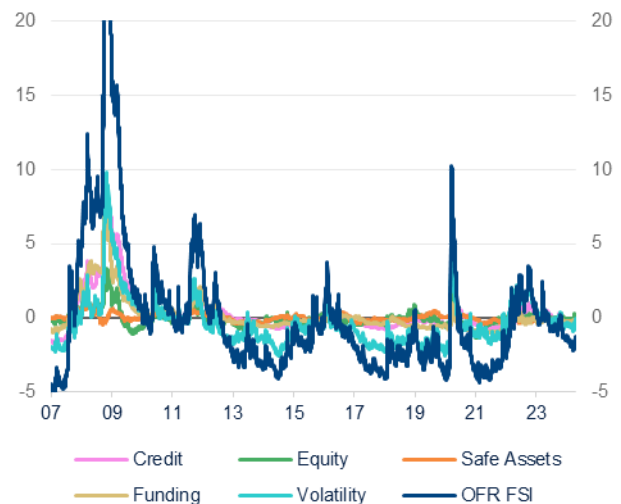
Figure 27. **FED FINANCIAL STRESS INDICES (>0: ABOVE AVG FINANCIAL STRESS)**



Source: BBVA Research / Haver

**... the ultra-low rates period. Risks remain as debts mature and are refinanced at higher rates**

Figure 28. **OFR FINANCIAL STRESS INDEX (>0: ABOVE AVG FINANCIAL STRESS)**



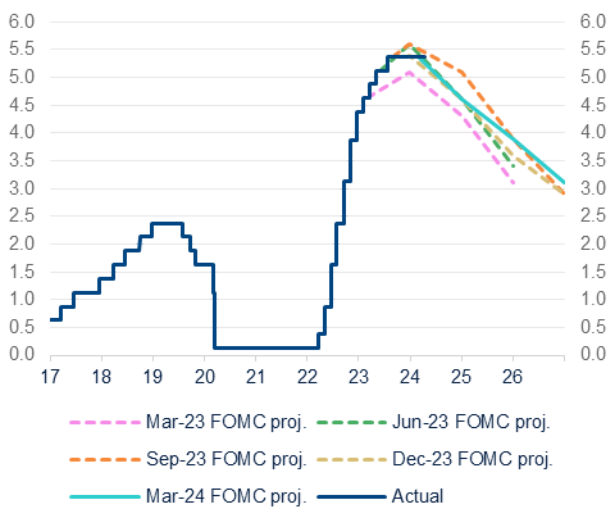
OFR: Office of Financial Research, US Department of the Treasury  
Source: BBVA Research / Haver



## Odds for less than three rate cuts this year have increased as some participants discard the “residual seasonality” explanation

While the Fed expected some unevenness in monthly inflation readings as it returned to...

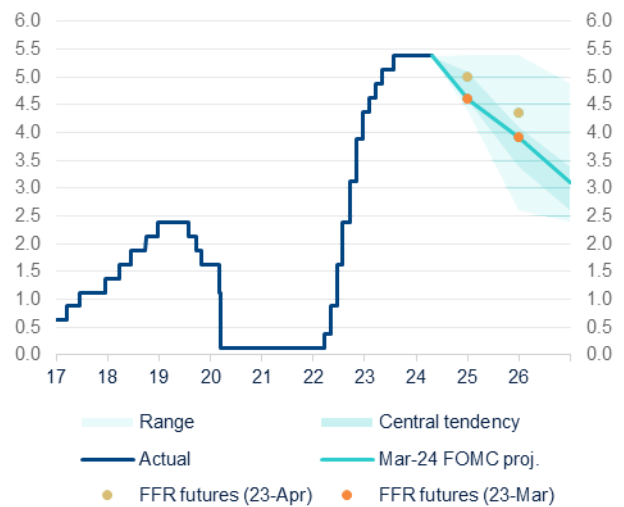
Figure 29. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



Source: BBVA Research based on data by Haver Analytics.

... target, and while there was a broad consensus among FOMC officials on beginning to dial...

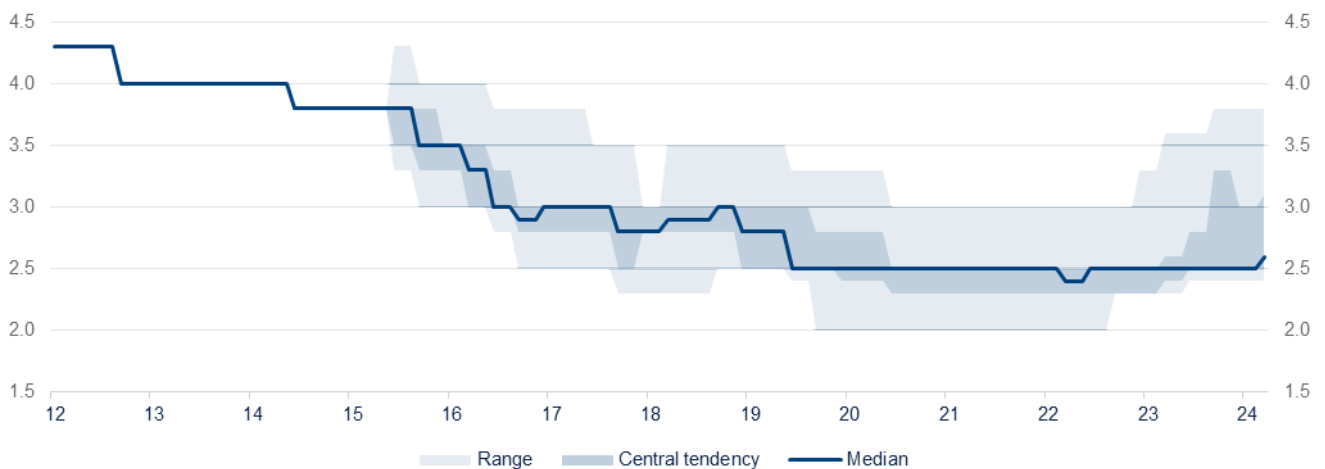
Figure 30. FOMC PARTICIPANTS PROJECTED FED FUNDS RATE (MEDIAN PROJECTION, %)



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

... back the policy restriction at some point this year, the most recent economic data suggest a rate cut soon is off the table. The median estimate for the neutral interest rate rose slightly to 2.6% from 2.5%

Figure 31. PROJECTED LONGER RUN FEDERAL FUNDS RATE (%)



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

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