

US Interest rates monitor

Treasury yields slide as fears of an inflation resurgence softened

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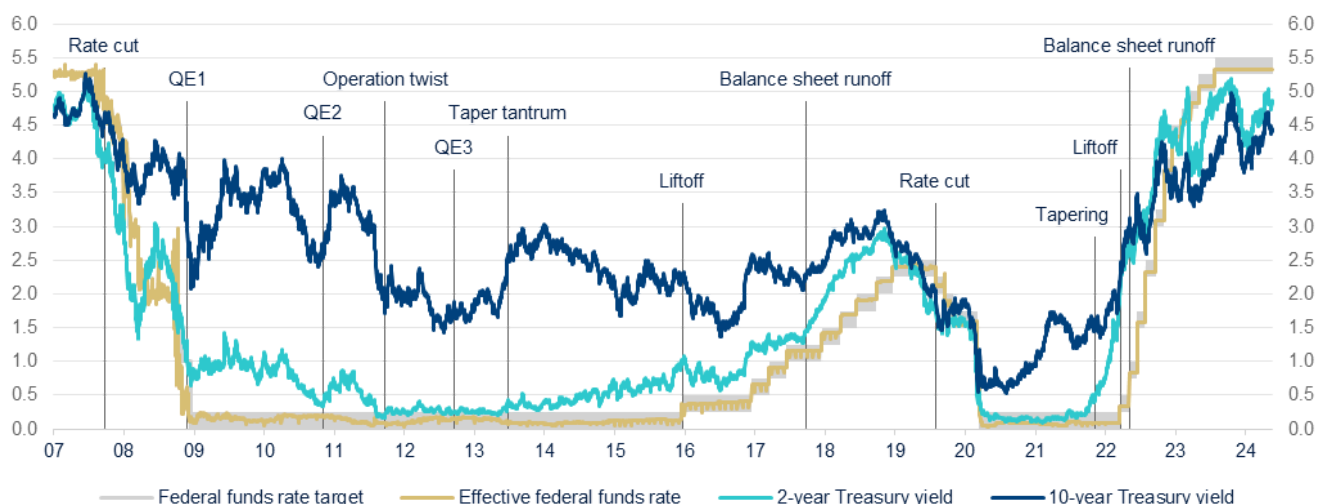
May 23, 2024

FOMC participants likely regained some confidence on the progress to 2% following the recent inflation and employment data

- The extent to which further data confirms that disinflation is still underway following a bump in the road in 1Q24 will partially determine the degree of market volatility in the coming months ([Figures 8](#) and [9](#)).
- The mid-to-long section of the yield curve is likely to flatten by year end, but it will take until mid-2025 for the whole Treasury yield curve to adopt a positively steepening shape ([Figures 11](#) and [12](#)).
- Half the jump of the 10-year yield from 2023-end through its late-April peak was attributable to higher real risk premiums, which have eased somewhat following this month's softer CPI and jobs reports ([Figures 13](#) and [14](#)).
- A further delay of rate cuts is likely to be present in next month's SEP when FOMC participants will likely formally catch up with the already market-implied high-for-longer outlook ([Figures 21](#) and [22](#)).
- The May-meeting minutes showed a discussion around the unequal effects of tight financial conditions among income levels, which appear to be favorable only for wealthier households ([Figures 25](#) to [28](#)).

Policy rate expectations and Treasury yields eased from their late-April's highs on softer employment and inflation data released recently. Hawkish tweaks from this month's meeting minutes showed the...

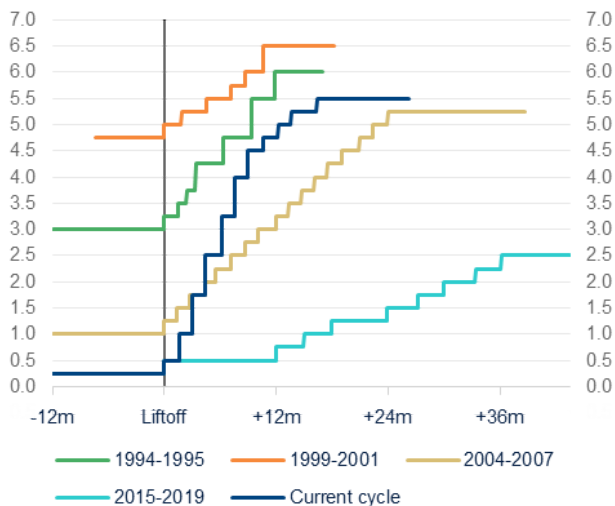
Figure 1. 2-YEAR, 10-YEAR TREASURY YIELDS AND FED FUNDS RATE (%)



Source: BBVA Research / Haver

... willingness of some officials to “tighten policy further should risks to inflation materialize”...

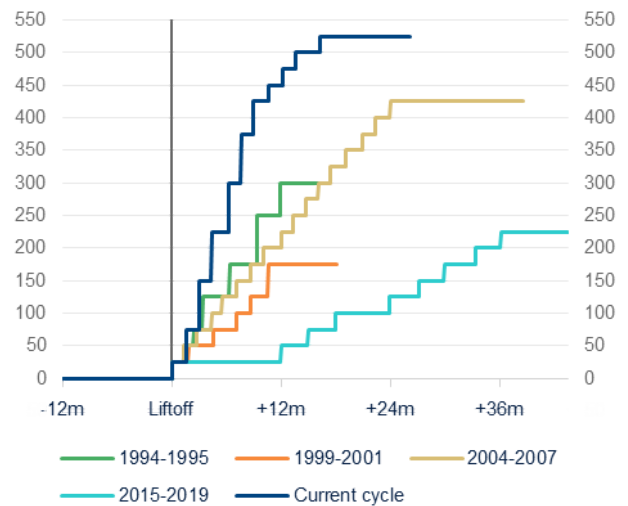
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



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

... amid the “uncertainty regarding the degree of restrictiveness of current financial conditions”

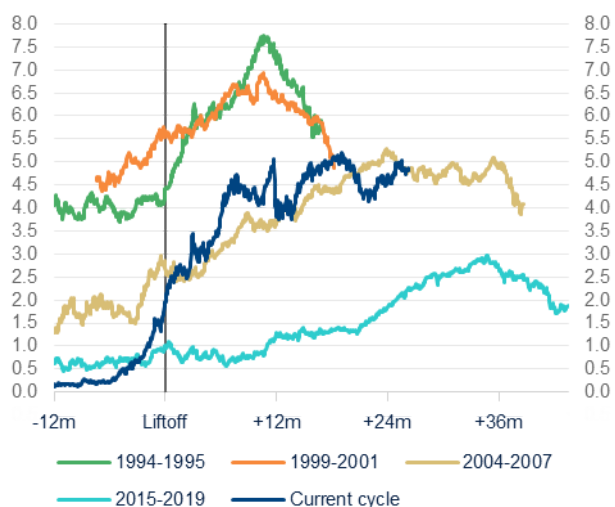
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE LEVEL AT LIFTOFF)**



Source: BBVA Research / Haver

However, participants continued to assess “that monetary policy remained well positioned to...”

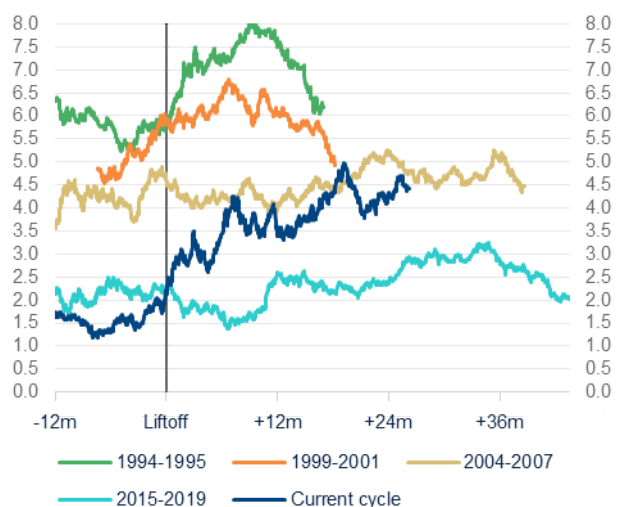
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Haver

... respond to evolving economic conditions and risks to the outlook.” FOMC members likely...

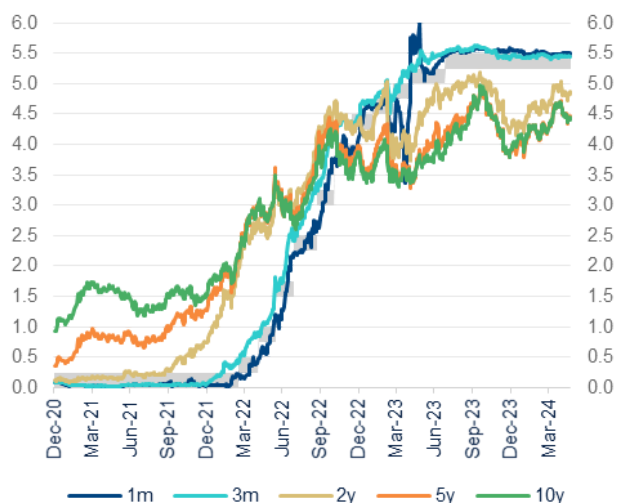
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Haver

... regained some confidence following the more recent post-meeting data, which seems to be...

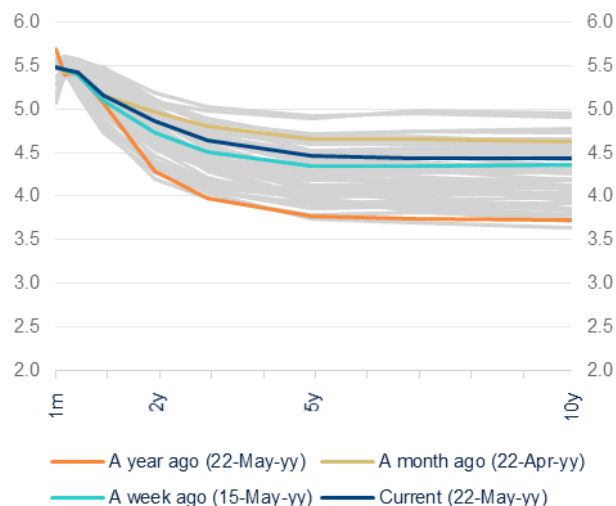
Figure 6. **TREASURY YIELDS**
(%)



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

... the case among market participants as shown by lower yields along the Treasury yield curve

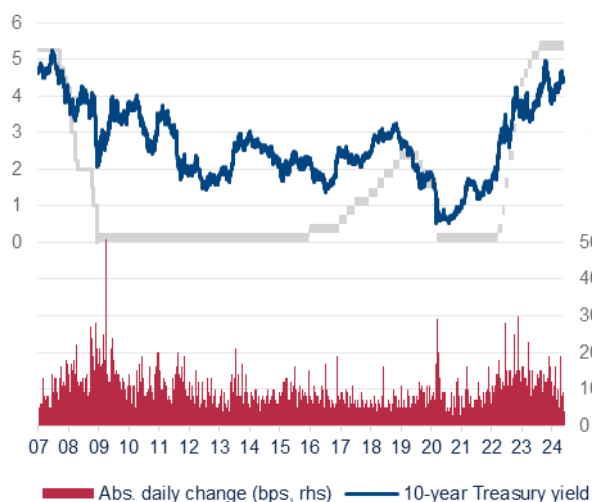
Figure 7. **TREASURY YIELD CURVE**
(%)



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

The extent to which further data confirms that disinflation is still underway following a bump...

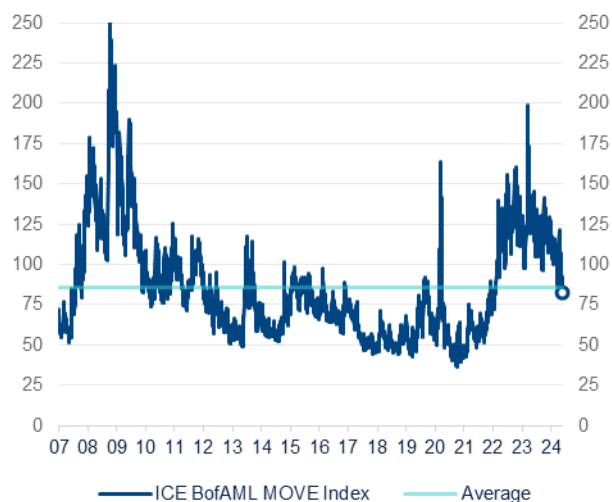
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

... in the road in 1Q24 will determine markets' calm against the high-for-longer environment

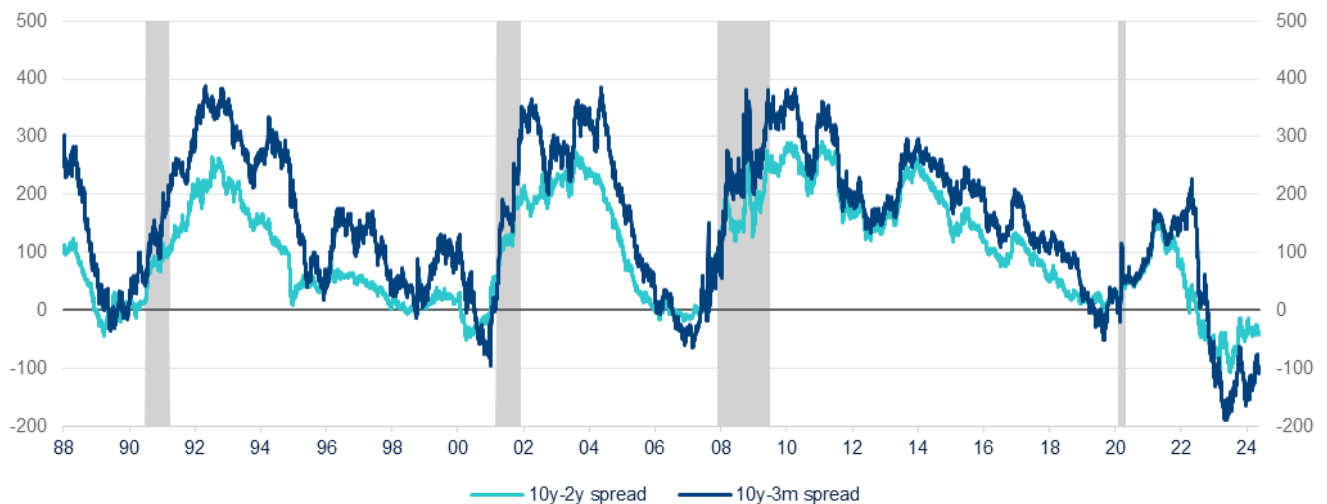
Figure 9. **ICE BOFAML US BOND MARKET OPTION VOLATILITY ESTIMATE INDEX (BPS)**



Source: BBVA Research / Haver

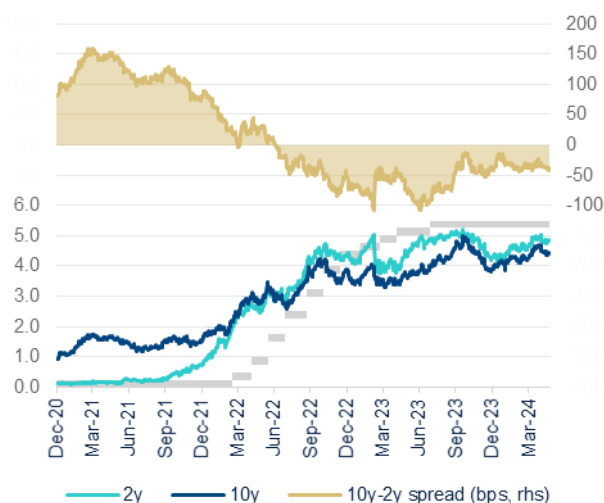
A likely resumption of the disinflationary trend in the coming months and the low probability of no rate cuts this year means that the 10y-2y Treasury yield is likely to continue to hover around a narrow range

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



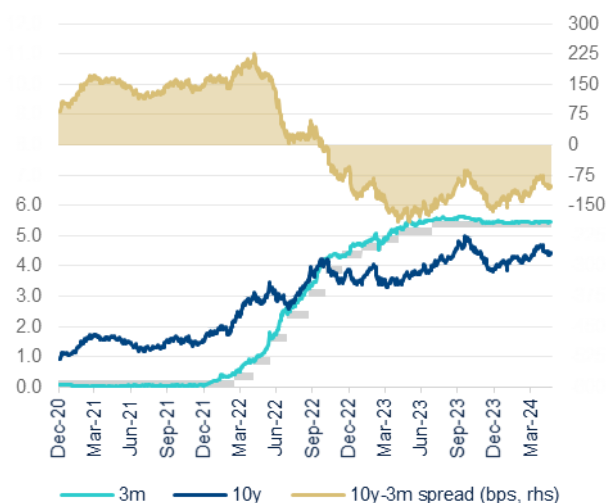
The mid-to-long section of the yield curve is likely to flatten by year end, but it will likely...

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



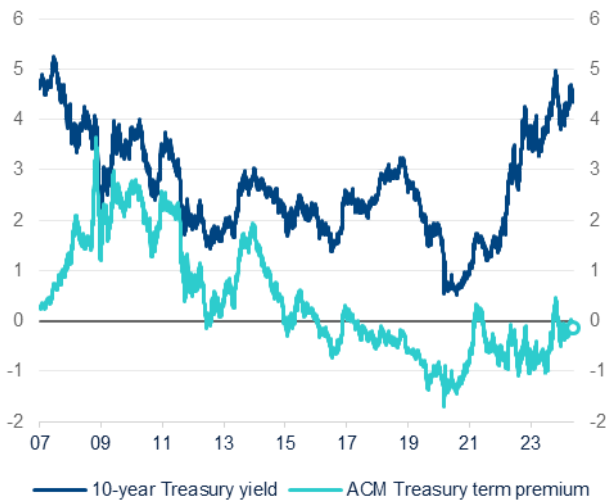
... take until mid-2025 for the whole Treasury yield curve to adopt a positively steepening shape

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



Half the jump of the 10-year yield through its late-April peak was attributable to higher real...

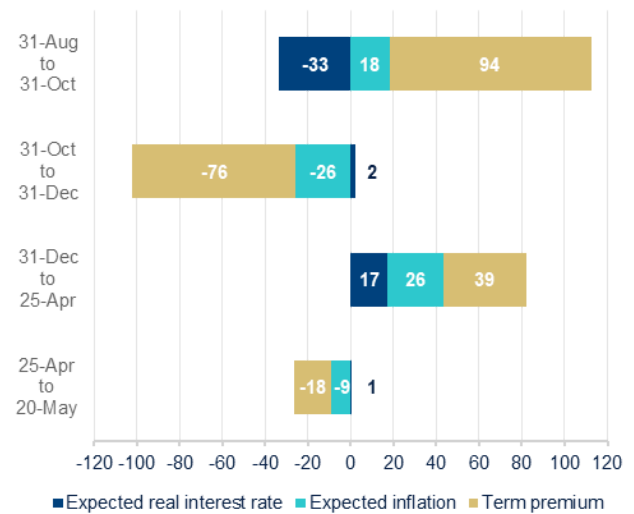
Figure 13. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



Source: BBVA Research / Haver

... risk premiums, which have eased somewhat following this month's softer CPI and jobs reports

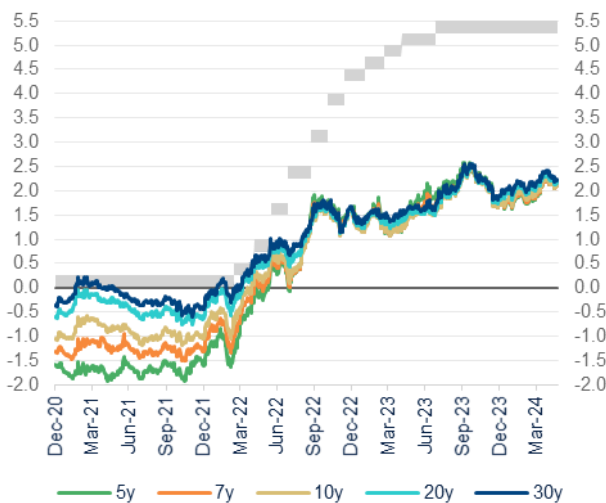
Figure 14. **CHANGE IN 10-YEAR TREASURY YIELD (BPS)**



Source: BBVA Research / Haver

The real yield curve shifted down accordingly, likely giving...

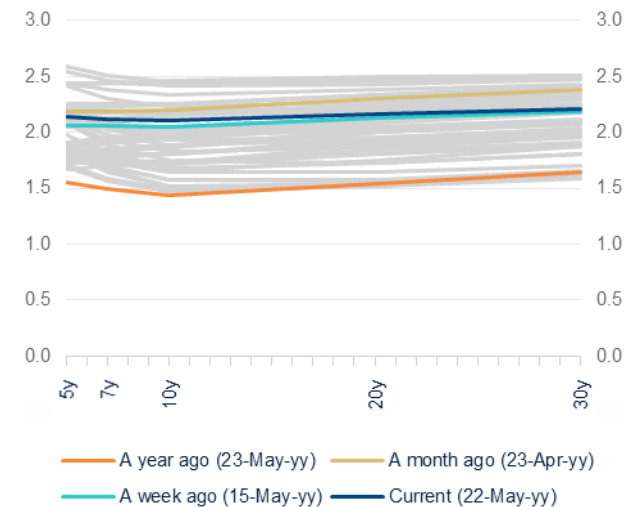
Figure 15. **INFLATION INDEXED (TIPS) YIELDS (%)**



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

... some confidence to Fed members around the positive degree of restrictiveness applied

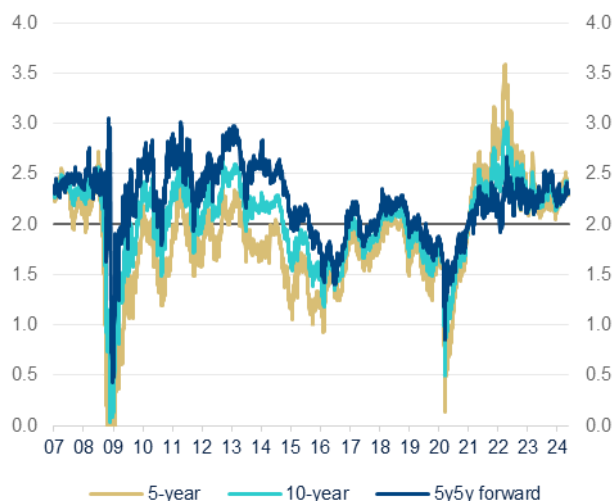
Figure 16. **INFLATION INDEXED (TIPS) YIELD CURVE (%)**



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

Some survey-based measures of short-term inflation expectations moved up on the...

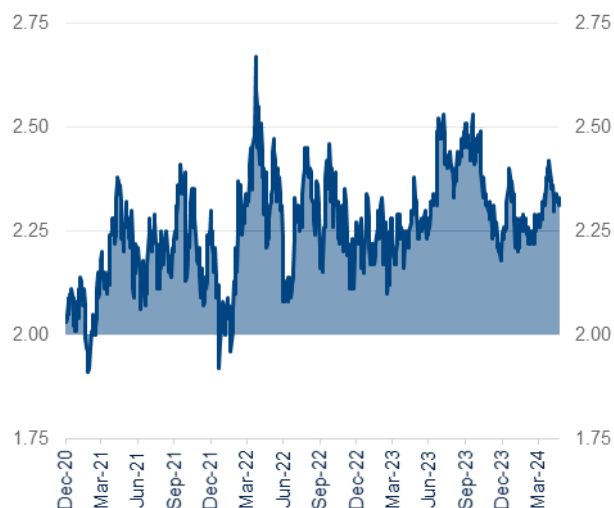
Figure 17. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research / Haver

... broad-based increase in 1Q24 inflation, but market-implied long-term inflation expectations...

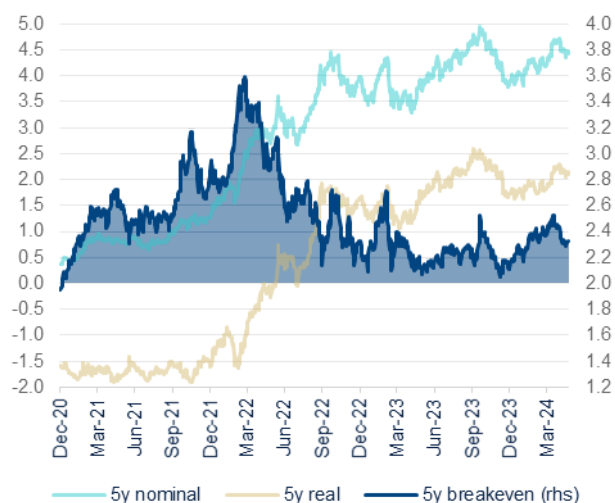
Figure 18. **5Y5Y FORWARD IMPLIED INFLATION RATE (%)**



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

... have been little changed and stand at levels consistent with those that prevailed before the...

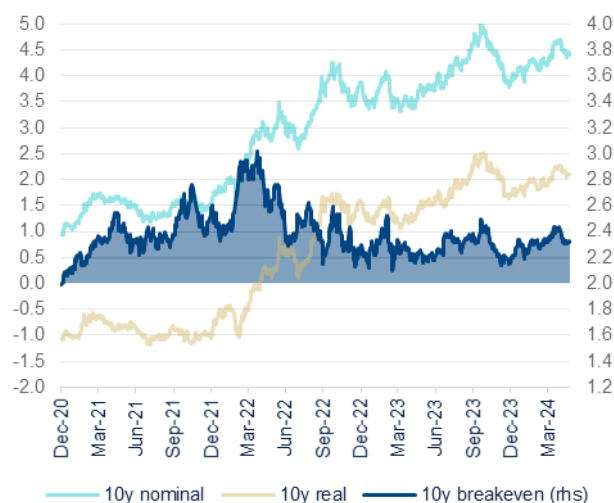
Figure 19. **5-YEAR BREAKEVEN INFLATION RATE (%)**



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

... pandemic, which is "crucial for meeting the [Fed's] inflation goal on a sustained basis"

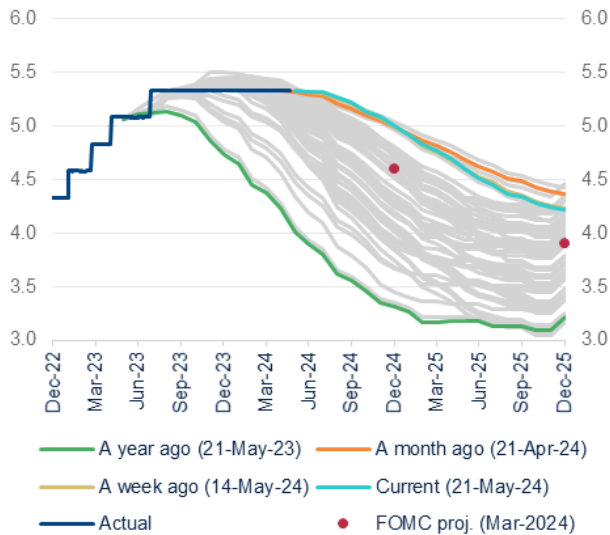
Figure 20. **10-YEAR BREAKEVEN INFLATION RATE (%)**



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

A further delay of rate cuts is likely to be present in next month's SEP, when FOMC participants...

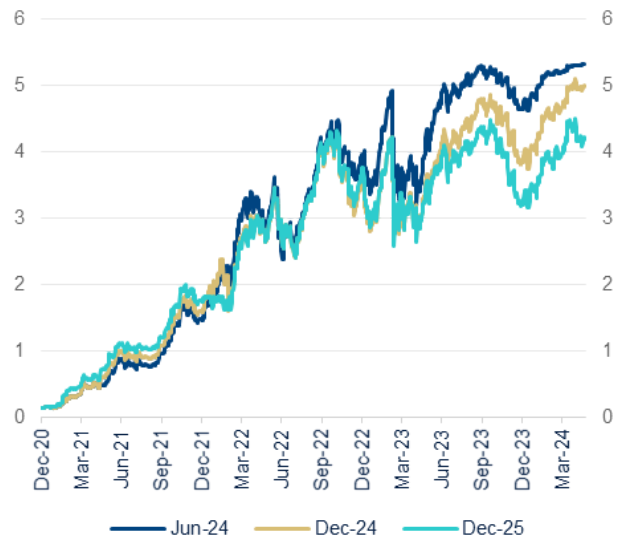
Figure 21. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



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

... will likely formally catch up with the already market-implied high-for-longer outlook

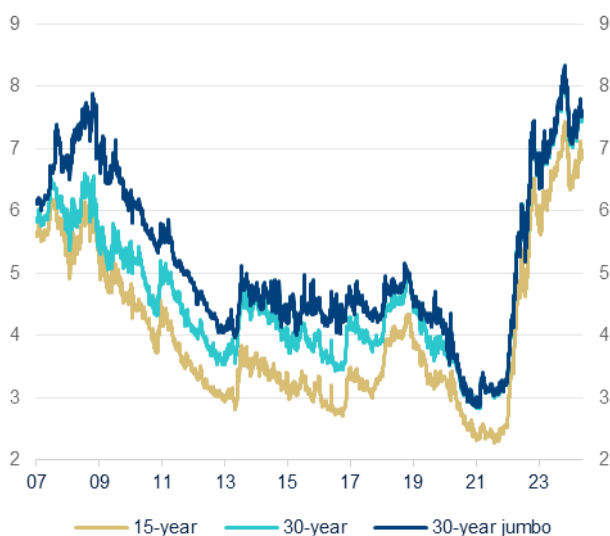
Figure 22. **IMPLIED RATE IN 30-DAY FED FUNDS FUTURES (%)**



Source: BBVA Research / Bloomberg

At 7.5%, rates on residential 30-year mortgages remain near recent high levels, while the credit...

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



Source: BBVA Research based / Haver

... quality of investment-grade firms borrowing in the corporate bond market remain stable overall

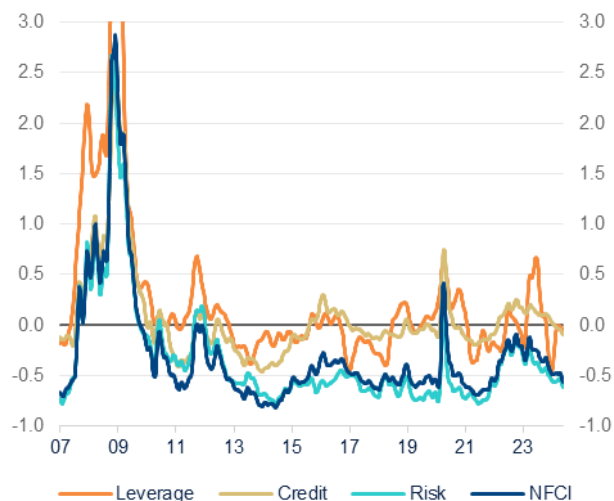
Figure 24. **CORPORATE BOND SPREADS**
(MOODY'S SEASONED YIELDS, DAILY DATA, BPS)



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

While, many FOMC participants noted that low- and moderate-income households are coming...

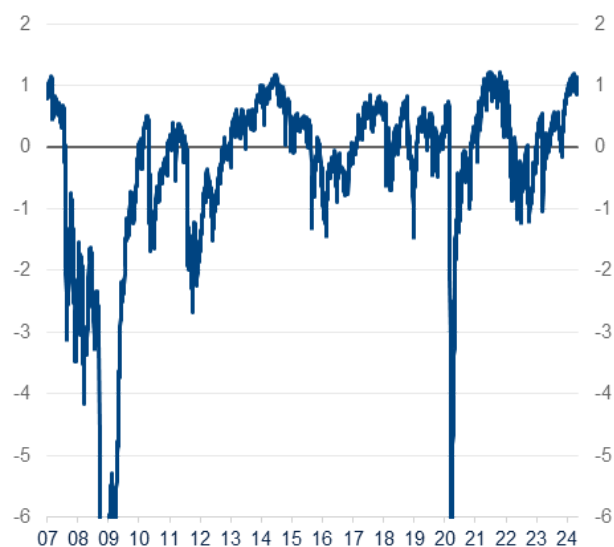
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0: TIGHTER THAN AVG)**



Source: BBVA Research / Haver

... into pressure from high rates, "a couple of participants noted that financial conditions...

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



Source: BBVA Research / Bloomberg

...appeared favorable for wealthier households, which account for a large portion of aggregate...

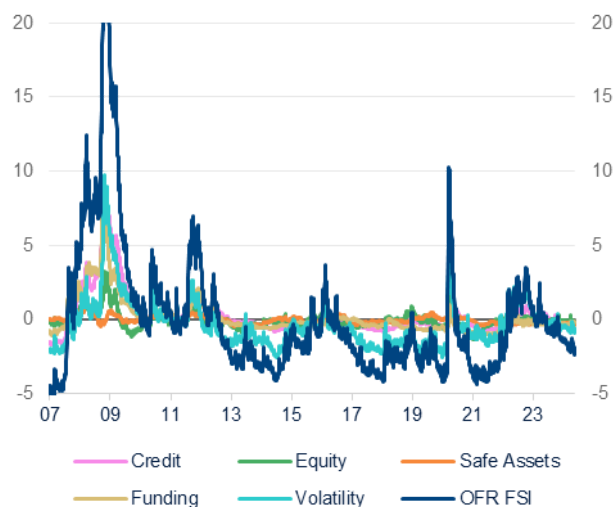
Figure 27. **FED FINANCIAL STRESS INDICES (>0: ABOVE AVG FINANCIAL STRESS)**



Source: BBVA Research / Haver

... consumption, with hefty wealth gains resulting from recent equity and house price increases"

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



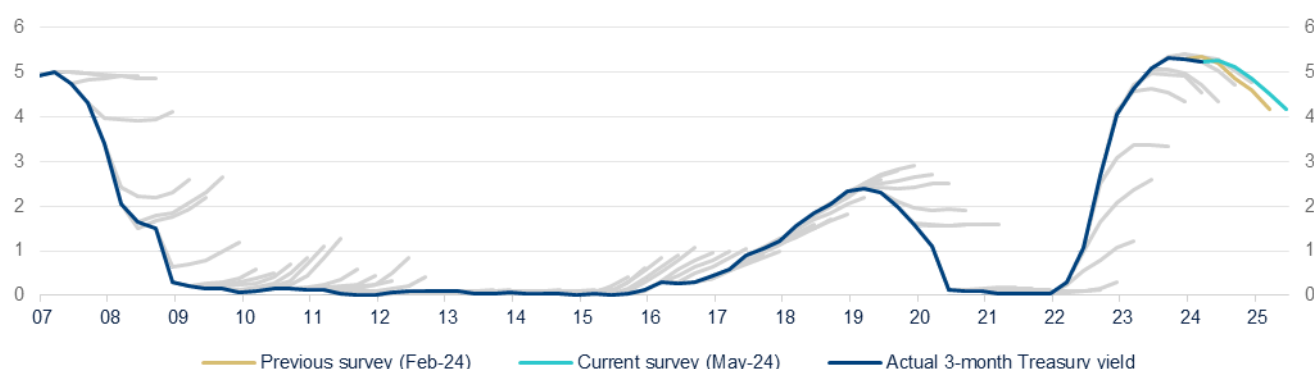
OFR: Office of Financial Research, US Department of the Treasury
Source: BBVA Research / Haver

Professional forecasters revised up their 10-year Treasury yield projections following a bump in the road in 1Q24

- Professional forecasters surveyed this month by the Philadelphia Fed expect a 4.9% 3-month Treasury yield by 4Q24, which is roughly equivalent to an expectation of two policy rate cuts ([Figure 29](#)).
- The median forecaster revised up its projection for the 10-year Treasury yield, which is now expected to remain above 4% until mid-2025 ([Figure 30](#)).
- Investment-grade corporate bond spreads are projected to gradually rise in the following months, but only to levels that are well below their pre-pandemic average levels ([Figures 33](#) and [34](#)).

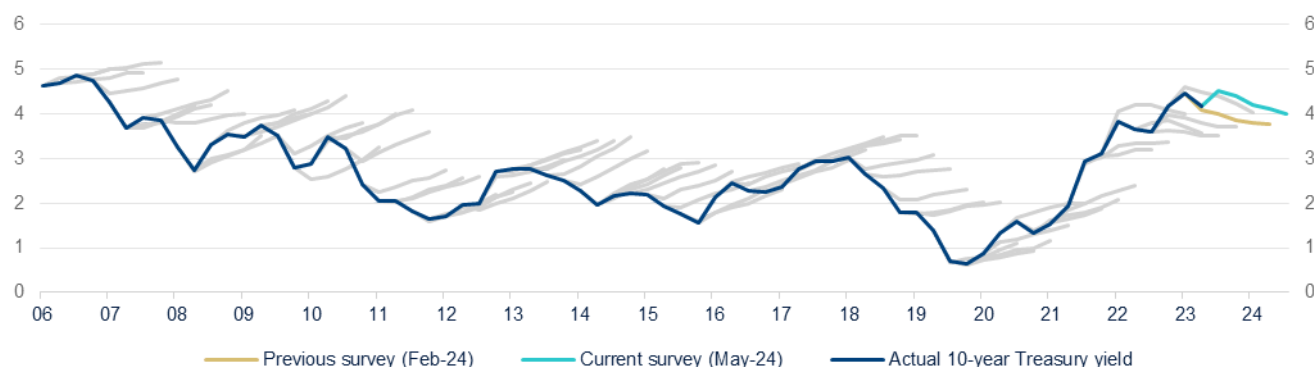
Professional forecasters' projections for short-term Treasury yields are consistent with market-implied expectations of a slower rate-cut cycle than the one signaled by FOMC participants in their latest SEP

Figure 29. **PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS (%)**



They also revised up their long-term rate forecasts as 1Q24 data releases pointed to inflation being more persistent than previously expected and to a generally resilient economy

Figure 30. **PROFESSIONAL FORECASTERS 10-YEAR TREASURY YIELD EXPECTATIONS (%)**



The implied expectation that the upcoming easing cycle will extend through 2027...

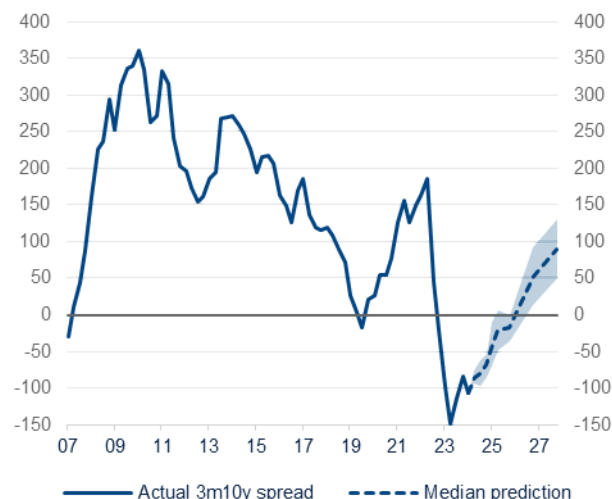
Figure 31. **PROF. FORECASTERS TREASURY YIELDS EXPECTATIONS (%)**



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

... means that the yield curve is expected to remain inverted for an extended period of time

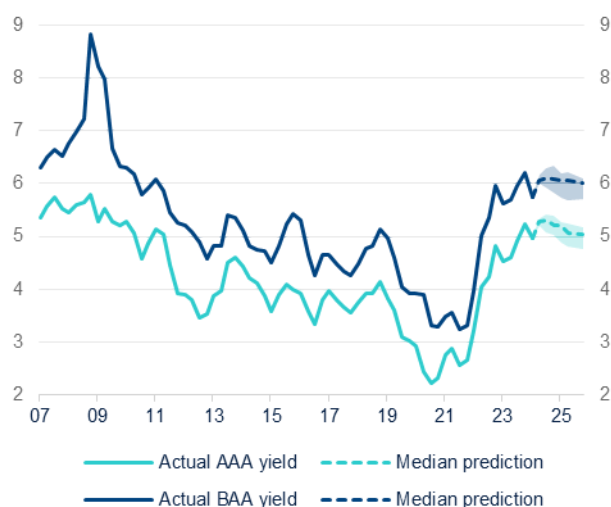
Figure 32. **PROF. FORECASTERS IMPLIED 10Y-3MY SPREAD EXPECTATIONS (BPS)**



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

Companies' credit risk profile appears to remain immune to high interest rates as investment...

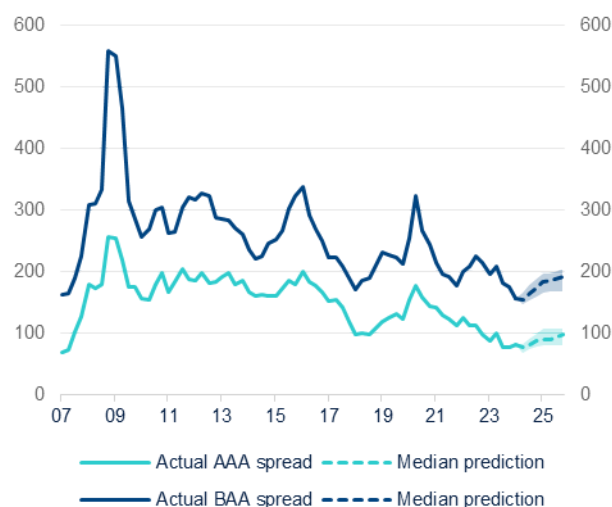
Figure 33. **PROF. FORECASTERS CORPORATE YIELDS EXPECTATIONS (%)**



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.

... grade bond spreads are projected to inch up but to remain below pre-pandemic average levels

Figure 34. **PROF. FORECASTERS IMPLIED CORPORATE SPREADS EXPECTATIONS (%)**



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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