

US Interest rates monitor

# Do lower yields signal that the Fed might shift its focus back to growth risks?

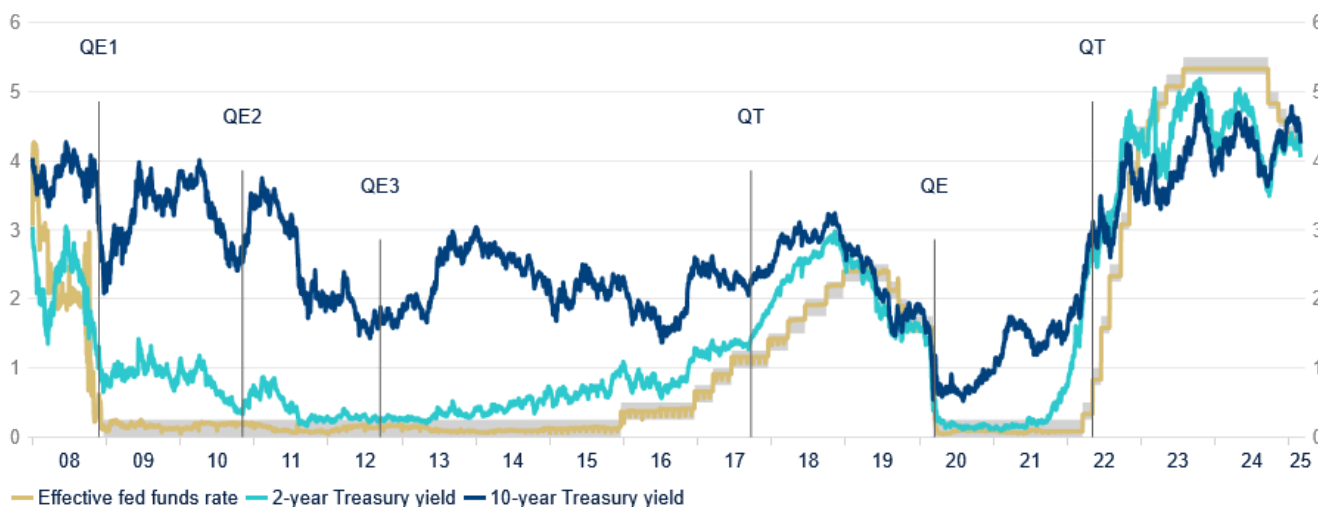
Javier Amador / Iván Fernández  
February 27, 2025

## Yields have come down in spite of high uncertainty. PCE inflation due out this Friday could either reverse or reinforce this trend

- The 10-year yield has fallen by c. 30 bps so far this month to 4.3% (Figures 6 and 7) as investors are less certain of a scenario in which the Fed keeps interest rates at their current level for the whole year.
- Bond market volatility measures (Figures 8 and 9) suggest that financial conditions have continued to allow investors to respond to incoming data without signs of panic despite the continued uncertainty.
- The downward shift in the mid- to long-end of the nominal Treasury yield curve (Figures 13 and 14) was driven by real yields, which were driven down by a declining term premium (see Figures 19 and 20).
- Market-implied 5-year inflation expectations are echoing recent survey-based evidence that has shown that US consumers are increasingly concerned about short-term inflation (Figure 15).
- Within this context of mixed signals, the futures market implied odds of no rate cuts this year dropped from 30% in early February to less than 10% in the last few days (Figures 21 and 22).

At 4.1%, the 2-year Treasury yield is down 10 bps for the week and 30 bps from the 4.4% high it reached a week before Trump’s inauguration. This likely suggests that, despite ongoing tariff-related inflation...

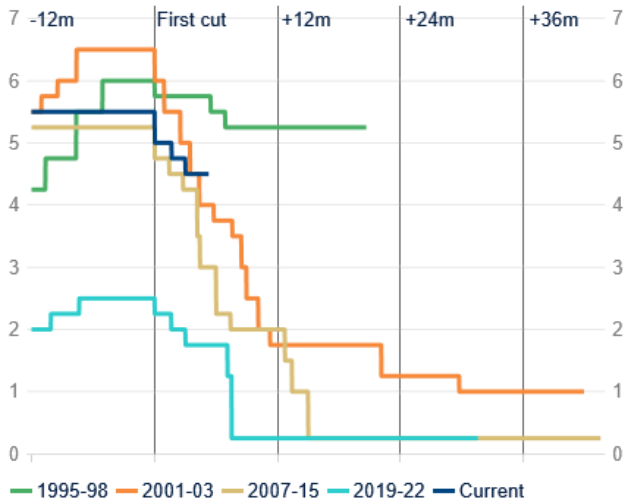
Figure 1. FED FUNDS RATE AND TREASURY YIELDS (%)



The gray area indicates the fed funds rate target range; QE and QT indicate quantitative easing and tightening announcements  
Source: BBVA Research / Fed / Treasury Dept.

... risks, market participants are less certain of a scenario in which the Fed keeps interest rates...

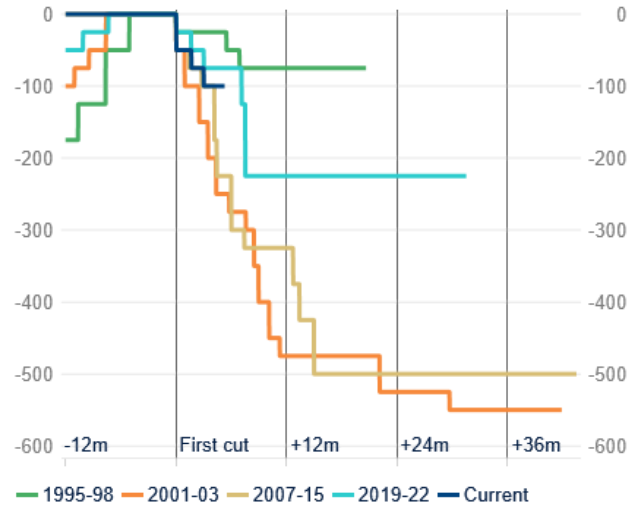
Figure 2. **FED FUNDS RATE IN EASING CYCLES (%)**



Target rate for the 1995-98, 2001-03, and 2007-15 (before 16-Dec-08) cycles; upper limit of the target rate range for the 2007-15 (after 16-Dec-08), 2019-22, and current cycles. Source: BBVA Research / Fed

... at their current level (4.25-4.50%) for the whole year amid a potential economic slowdown in...

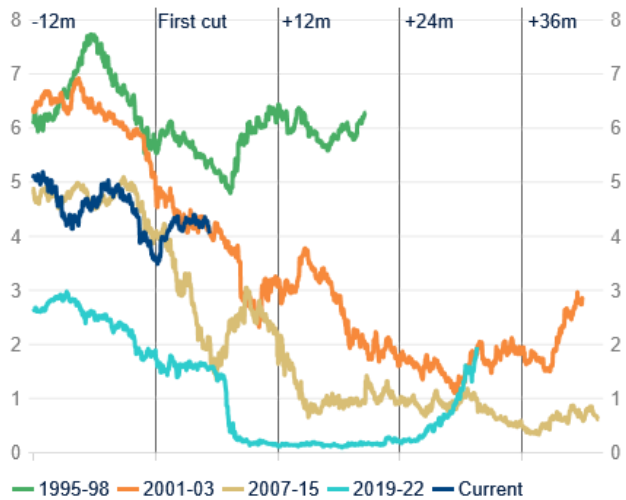
Figure 3. **FED FUNDS RATE IN EASING CYCLES (BPS VS RATE AT FIRST CUT)**



Source: BBVA Research / Fed

... the following quarters. A string of weak data—consumer confidence plummeted, existing...

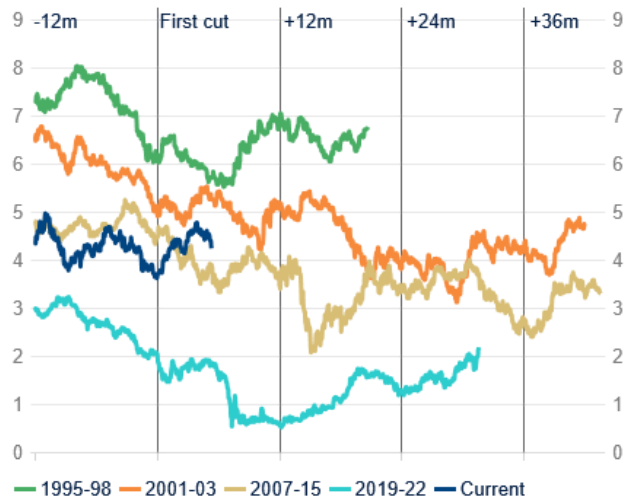
Figure 4. **2-YEAR TREASURY YIELD IN EASING CYCLES (%)**



Source: BBVA Research / Treasury Dept.

... home sales and housing starts fell 30% and 10% MoM—is likely behind this shift in market...

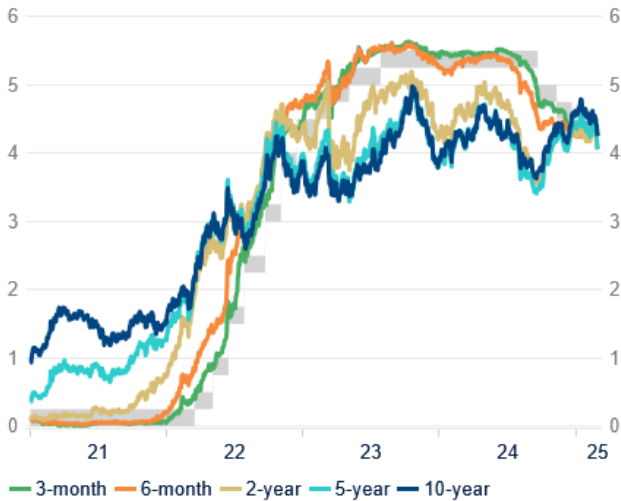
Figure 5. **10-YEAR TREASURY YIELD IN EASING CYCLES (%)**



Source: BBVA Research / Treasury Dept.

... expectations, which could either reverse or reinforce depending on the extent to which the...

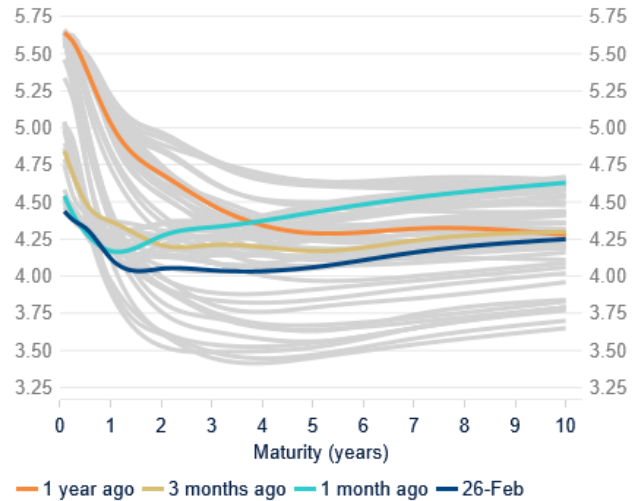
Figure 6. **TREASURY YIELDS**  
(%)



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... PCE inflation report due out this Friday surprises market expectations. The 10-year...

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



The gray lines indicate weekly curves over the past year; intermediate rates calculated with natural cubic spline interpolation  
Source: BBVA Research / Treasury Dept.

... Treasury yield has fallen by c. 30 bps so far this month to a 4.3% 10-week low. Bond...

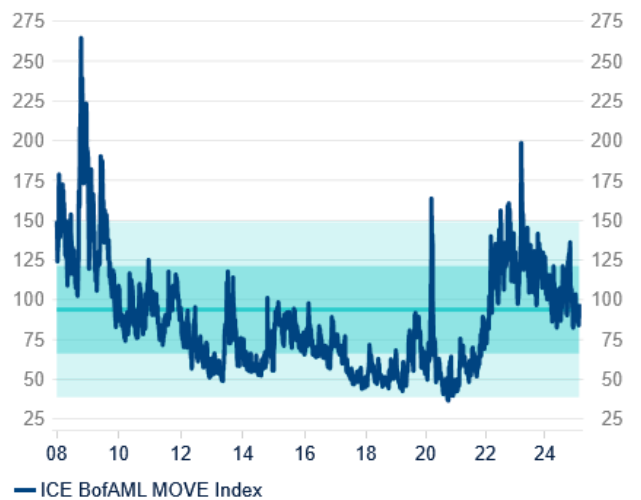
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**  
(% AND BPS)



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... market volatility measures suggest that financial conditions have continued to allow...

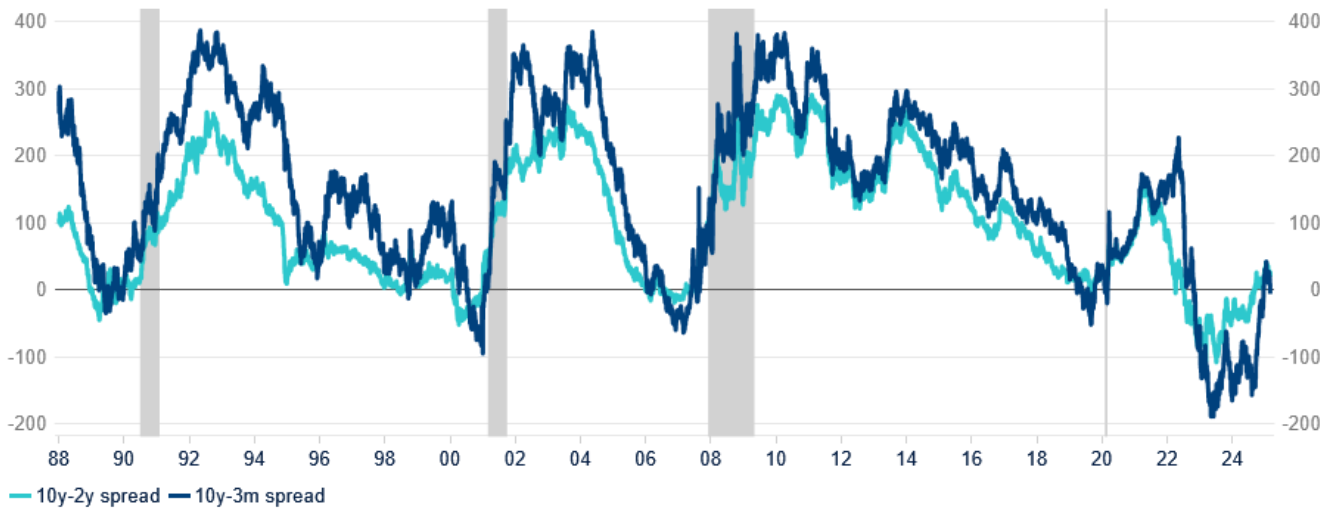
Figure 9. **ICE BOFAML MOVE INDEX**  
(BPS)



The shaded areas indicate the ranges within one and two standard deviations from the mean. Source: BBVA Research / ICE BofAML

... investors to respond to incoming data without signs of panic despite the continued uncertainty around the economic outlook. Both the above-described 10-year yield developments and a stable...

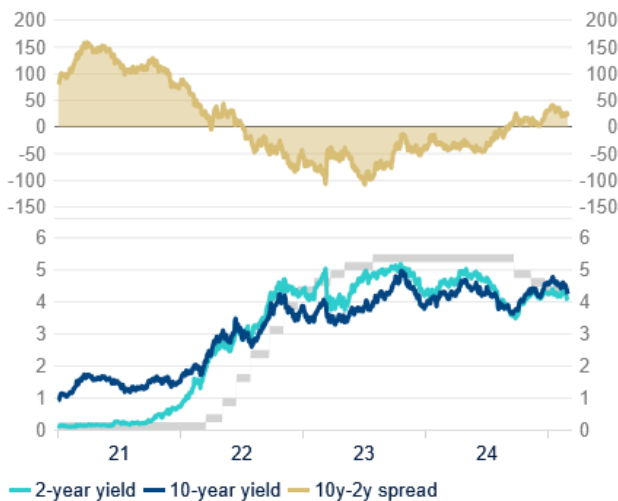
Figure 10. **TREASURY YIELD SPREADS (BPS)**



The gray shaded areas indicate US recessions as defined by NBER  
Source: BBVA Research / NBER / Treasury Dept.

... 3-month Treasury yield following last month's FOMC decision to hold rates at 4.25-4.50%...

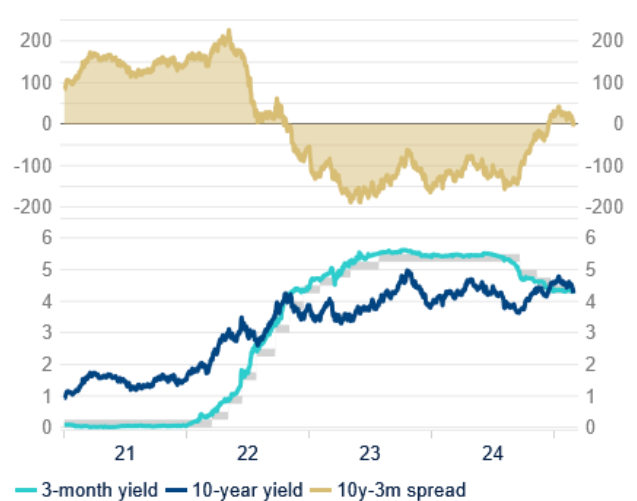
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (BPS AND %)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... drove the 10y-3m yield spread below zero for the first time since mid-December 2024

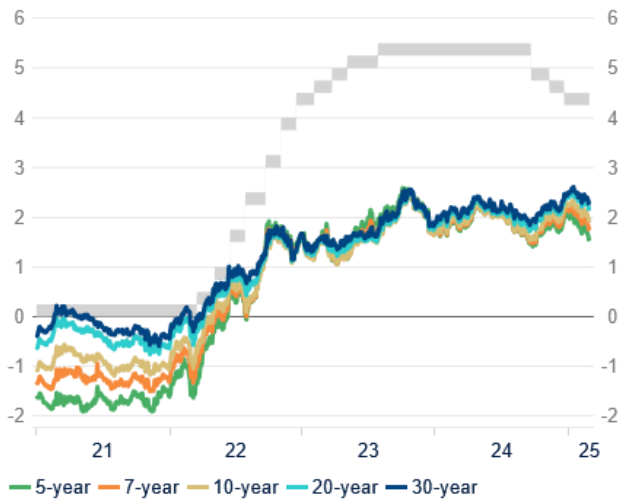
Figure 12. **10Y-3M TREASURY YIELD SPREAD (BPS AND %)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

The downward shift in the mid- to long-end of the nominal Treasury yield curve was driven by...

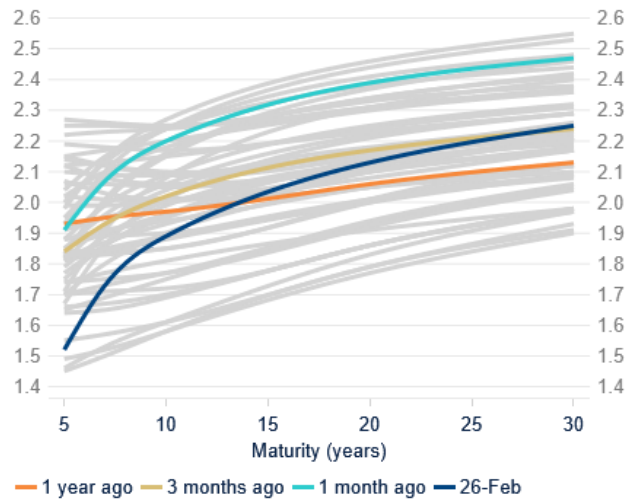
Figure 13. **TREASURY REAL YIELDS (TIPS)** (%)



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... real yields, which were driven down by a declining term premium (see Figures 19 and 20)

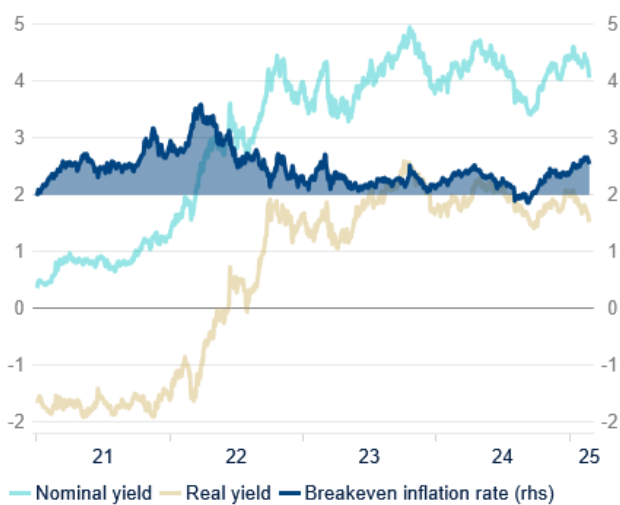
Figure 14. **TREASURY REAL YIELD CURVE (TIPS)** (%)



The gray lines indicate weekly curves over the past year; intermediate rates calculated with natural cubic spline interpolation  
Source: BBVA Research / Treasury Dept.

Despite still well anchored long-term inflation expectations, market-implied 5-year inflation...

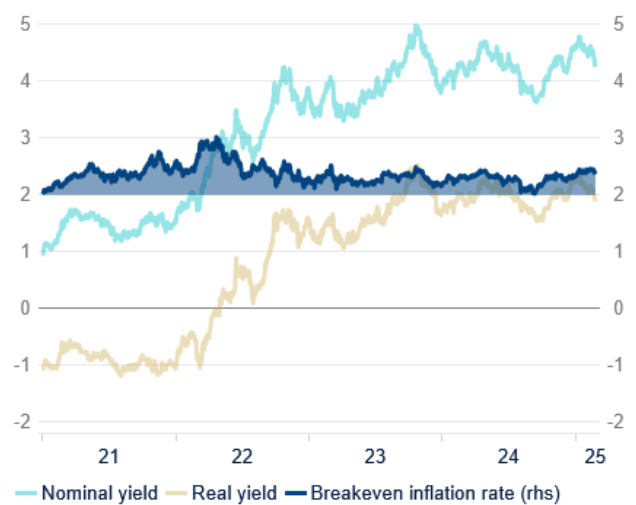
Figure 15. **5-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



The shaded area indicates the deviation from the 2% inflation target  
Source: BBVA Research / Treasury Dept.

... expectations are echoing recent survey-based evidence that has shown that US consumers...

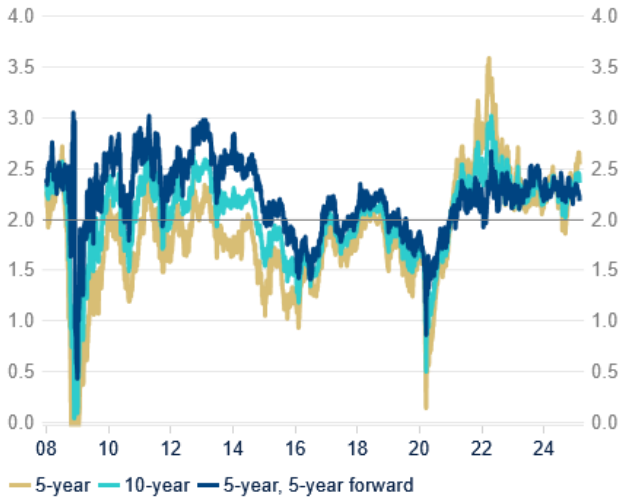
Figure 16. **10-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



The shaded area indicates the deviation from the 2% inflation target  
Source: BBVA Research / Treasury Dept.

... are increasingly concerned about short-term inflation. Markets do not anticipate this could...

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



Source: BBVA Research / Treasury Dept.

... push the Fed to hike rates, but rather continue to expect rate cuts by year end

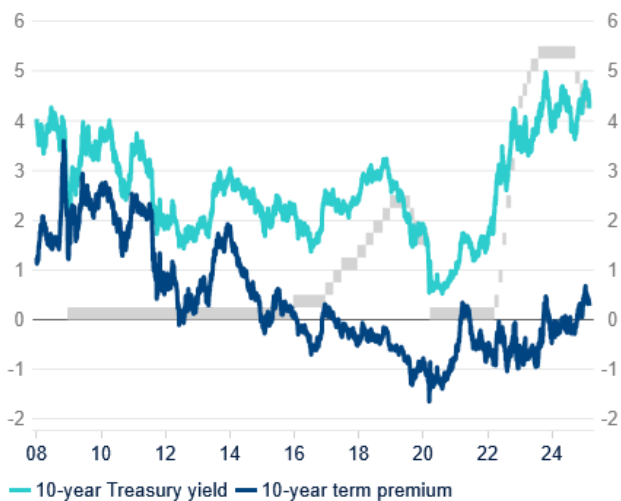
Figure 18. **BREAKEVEN INFLATION AND FUTURES-IMPLIED FED FUNDS RATE (%)**



Source: BBVA Research / CME / Treasury Dept.

Although uncertainty remains high, the postponement of tariffs along with a less...

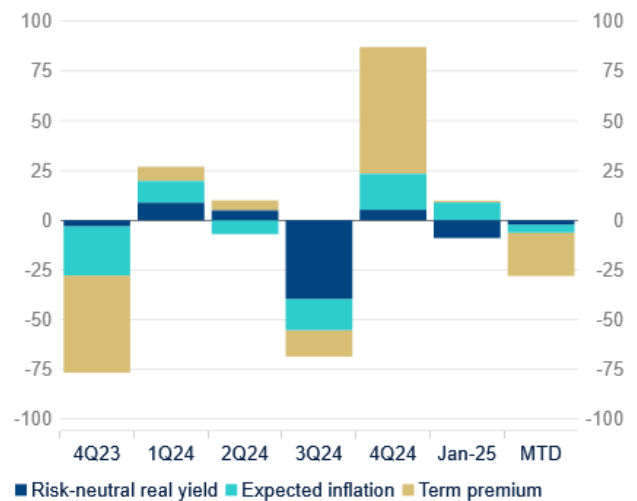
Figure 19. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



The gray area indicates the fed funds rate target range; the term premium is based on the NY Fed ACM model. Source: BBVA Research / Fed / Treasury Dept.

... worrisome fiscal bill than feared explain the ~20 bp term premium drop this month

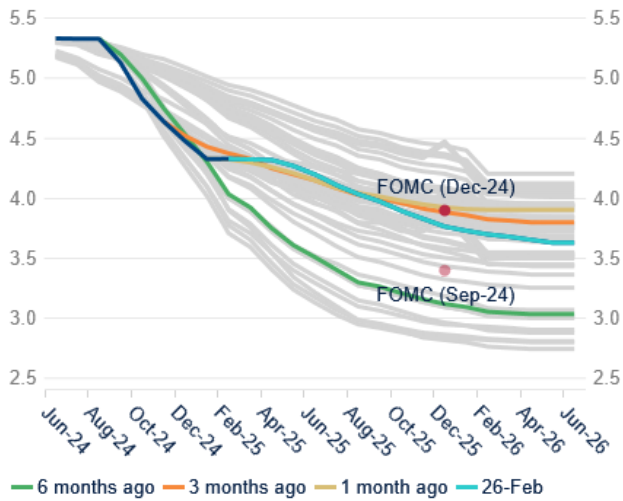
Figure 20. **10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)**



Based on the NY Fed ACM model  
Source: BBVA Research / Fed / Treasury Dept.

**Within this context of mixed signals, the futures market implied odds of no rate cuts this year ...**

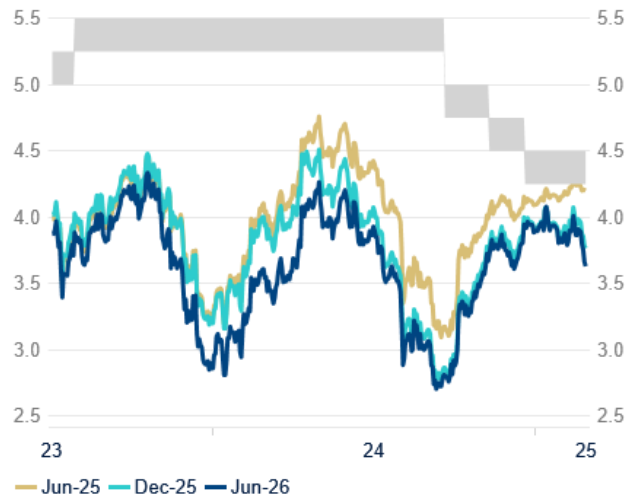
Figure 21. FUTURES-IMPLIED FED FUNDS RATE (%)



The gray lines indicate weekly implied rate paths over the past year  
Source: BBVA Research / CME / Fed

**... dropped from 30% in early February to less than 10% in the last few days**

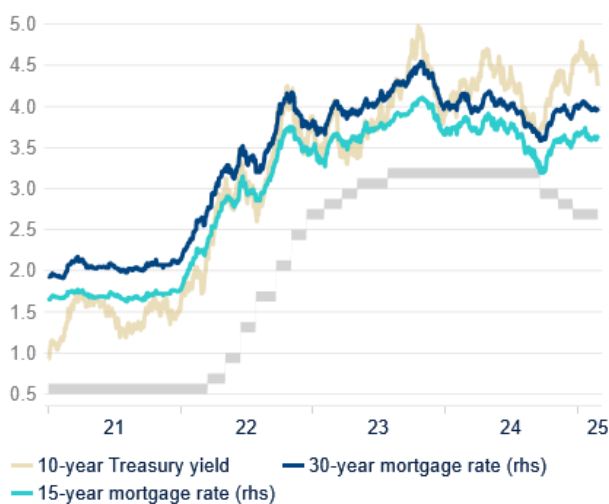
Figure 22. FUTURES-IMPLIED FED FUNDS RATE (%)



The gray area indicates the fed funds rate target range  
Source: BBVA Research / CME / Fed

**Elevated mortgage rates continue to suppress demand in the housing market**

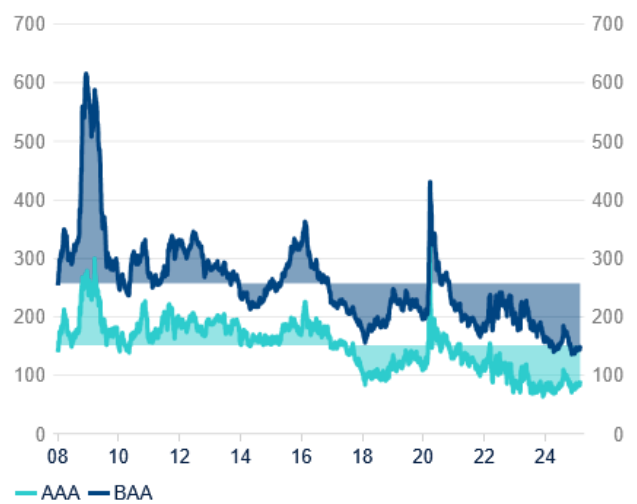
Figure 23. MORTGAGE RATES (%)



The gray area indicates the fed funds rate target range (rhs)  
Source: BBVA Research / Bankrate / Fed / Treasury Dept.

**Corporate-debt risk premia remain near the bottom of their historical distributions**

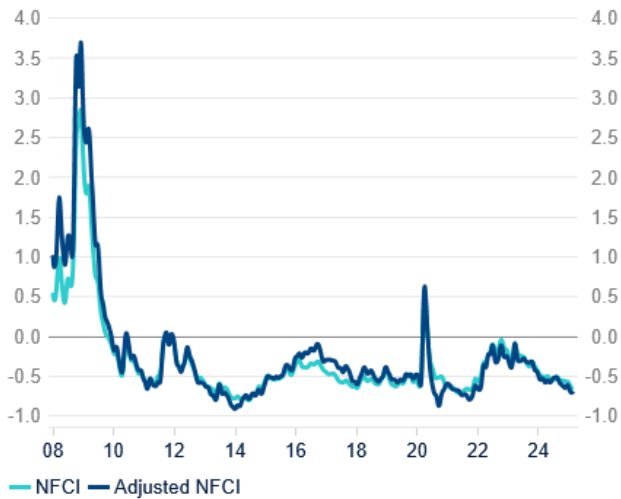
Figure 24. CORPORATE BOND YIELD SPREADS (BPS)



Spreads over the 10-year Treasury yield; the shaded area indicates the deviation from the historical average since 2008  
Source: BBVA Research / Fed / Treasury Dept.

The remarkable calm depicted by most broad financial conditions indices continues to...

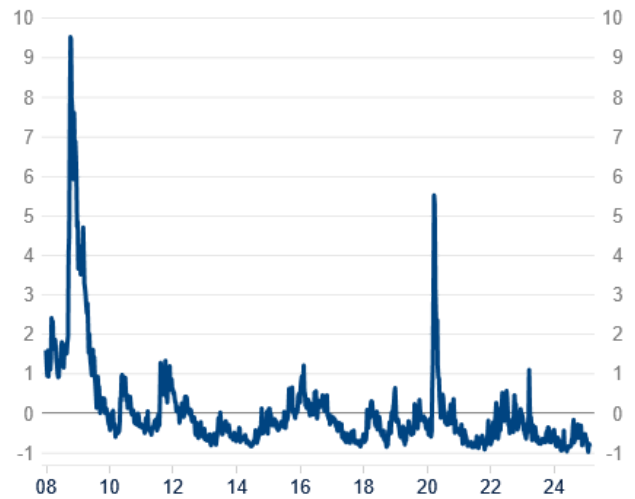
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0: TIGHTER THAN AVG.)**



Source: BBVA Research / Fed

... draw the attention of some Fed members. Gov. Bowman said recently that, given the current...

Figure 26. **ST. LOUIS FED FINANCIAL STRESS INDEX (>0: ABOVE AVG. FINANCIAL STRESS)**



Source: BBVA Research / Fed

... stance of monetary policy, she continues “to be concerned that easier financial conditions...

Figure 27. **KANSAS CITY FED FINANCIAL STRESS INDEX (>0: ABOVE AVG. FINANCIAL STRESS)**



Source: BBVA Research / Fed

... over the past year may have contributed to the lack of further progress on slowing inflation”

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



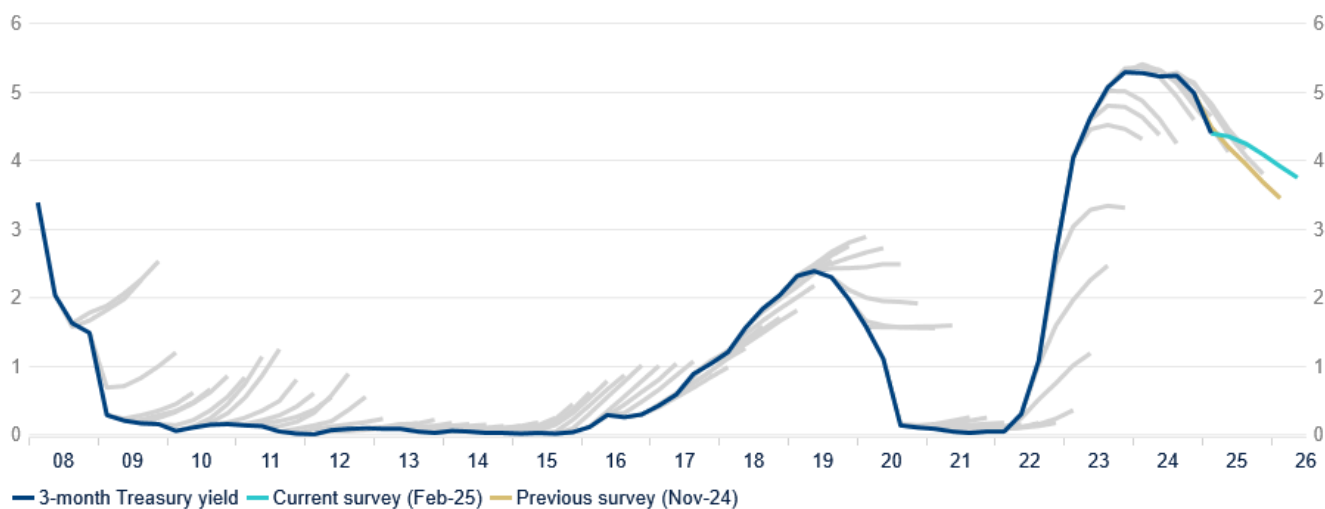
\* OFR: Office of Financial Research  
Source: BBVA Research / Treasury Dept.



## Professional forecasters predict fewer rate cuts and higher long-term rates, signaling that neutral rates are far off

Professional forecasters still anticipate two rate cuts before the year is out (vs. 4 rate cuts previously), ...

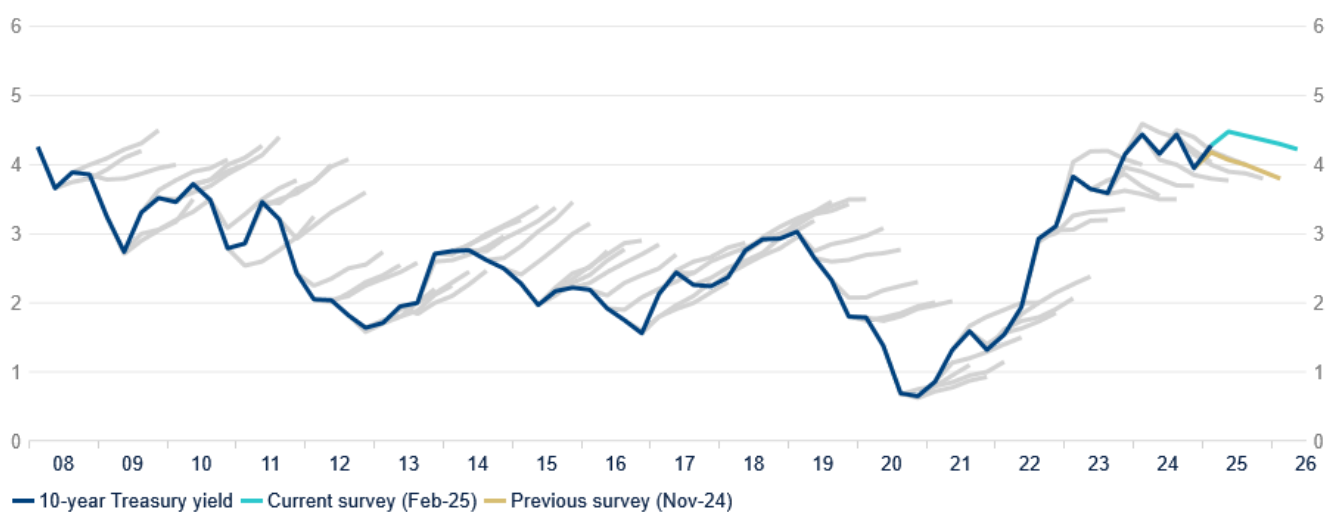
Figure 29. PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS (%)



Median forecasts. The gray lines indicate historical expectations  
Source: BBVA Research / Fed

... and expect long-term rates to remain higher for longer

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



Median forecasts. The gray lines indicate historical expectations  
Source: BBVA Research / Fed

**A median 3% 3-month Treasury yield until 2028 is signaling forecasters' belief that the Fed will...**

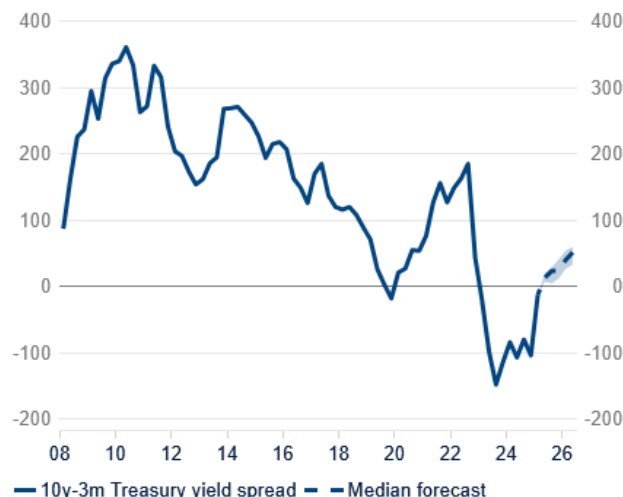
Figure 31. **PROFESSIONAL FORECASTERS TREASURY YIELDS EXPECTATIONS (%)**



Shaded areas indicate interquartile ranges  
Source: BBVA Research / Fed

**... need more than three years to bring interest rates to their neutral point; yet, ...**

Figure 32. **PROFESSIONAL FORECASTERS IMPLIED 10Y-3M YIELD SPREAD EXPECTATIONS (BPS)**



The shaded area indicates the interquartile range  
Source: BBVA Research / Fed

**... they do not anticipate that an extended period of monetary tightening will trigger any...**

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



Shaded areas indicate interquartile ranges  
Source: BBVA Research / Fed

**... significant disruptions in the corporate debt market**

Figure 34. **PROFESSIONAL FORECASTERS IMPLIED CORPORATE YIELD SPREADS EXPECTATIONS (BPS)**



Spreads over the 10-year Treasury yield. Shaded areas indicate interquartile ranges. Source: BBVA Research / Fed / Treasury

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