

Concerns over Fed independence keep weighing on term premia

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The fiscal bill, set to push debt higher over the next decade, had puzzlingly only a muted impact on term premia and the U.S. dollar

June CPI pointed to still limited tariff-related effects on prices, but renewed tariff delays added uncertainty on when the Fed might resume easing, likely pushing cuts further out ([Figures 2](#) and [3](#)).

Long-term yields briefly spiked last week, following media rumors that Trump intended to remove Powell, but Trump's quick rejection brought yields back near last month's levels ([Figures 6](#) and [7](#)).

The widening of the 30y-10y yield spread ([Figure 11](#)) suggests that those reactions, though short-lived, are likely contributing to a gradual buildup of deeper concerns among market participants.

Although far from de-anchoring, the recent rise of market-based long-term inflation expectations will likely contribute to the Fed's continued caution ([Figure 14](#)).

In early July, the futures market priced in up to a 60% chance of at least three rate cuts this year. They have since declined to ~20%, roughly where they stood a month ago ([Figures 18](#) and [19](#)).

Treasury yields showed little movement despite the approval of the fiscal bill and renewed tariff threats, suggesting market complacency and a belief the government will not follow through on those threats

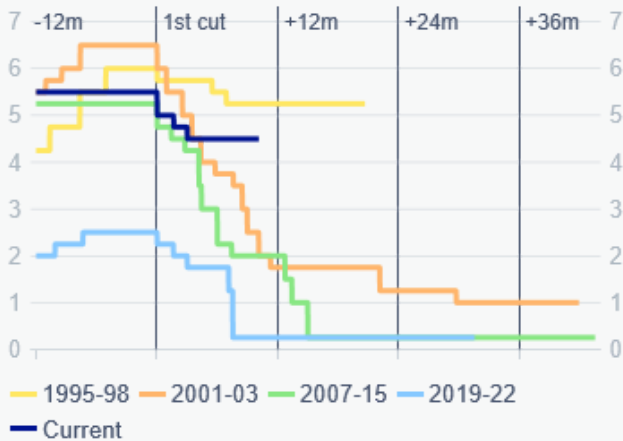
FIGURE 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

June CPI pointed to still limited tariff-related effects on prices, but renewed tariff delays...

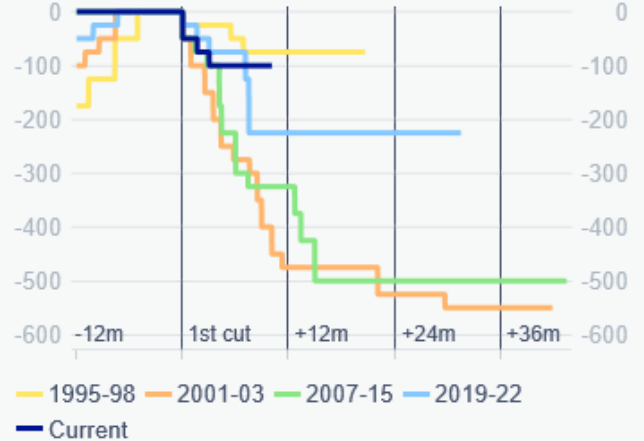
FIGURE 2. FED FUNDS RATE IN EASING CYCLES (%)



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

... added uncertainty on when the Fed might resume easing, likely pushing cuts further out

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



Source: BBVA Research / Treasury Dept.

A couple of FOMC members (Bowman, Waller) signaled support for a cut next week, but the...

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



Source: BBVA Research / Treasury Dept.

... June minutes showed a vast majority will likely stick to a wait-and-see approach

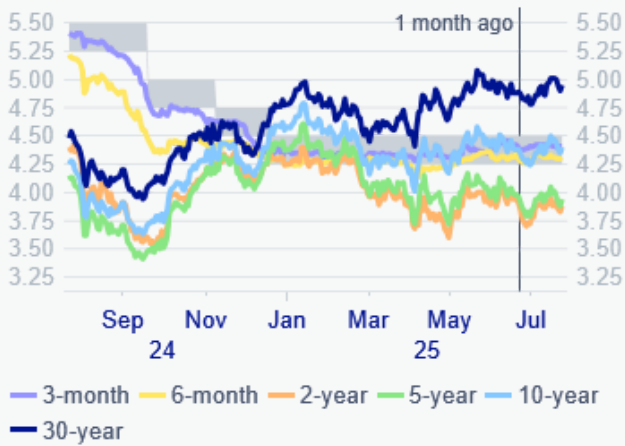
FIGURE 5. 10-YEAR TREASURY YIELD IN EASING CYCLES (%)



Source: BBVA Research / Treasury Dept.

Nominal long-term yields briefly spiked last week (the 30-year hit 5%), following media...

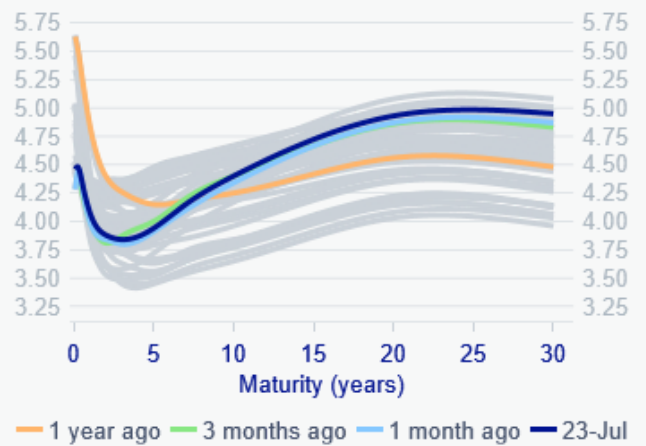
FIGURE 6. TREASURY YIELDS (%)



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

... rumors that Trump seriously intended to remove Powell. Trump's immediate rejection...

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.

... of those claims as "highly unlikely" quickly eased concerns and brought yields back near last month's levels. The recent short-lived nature of such reactions has so far not triggered major volatility bouts or...

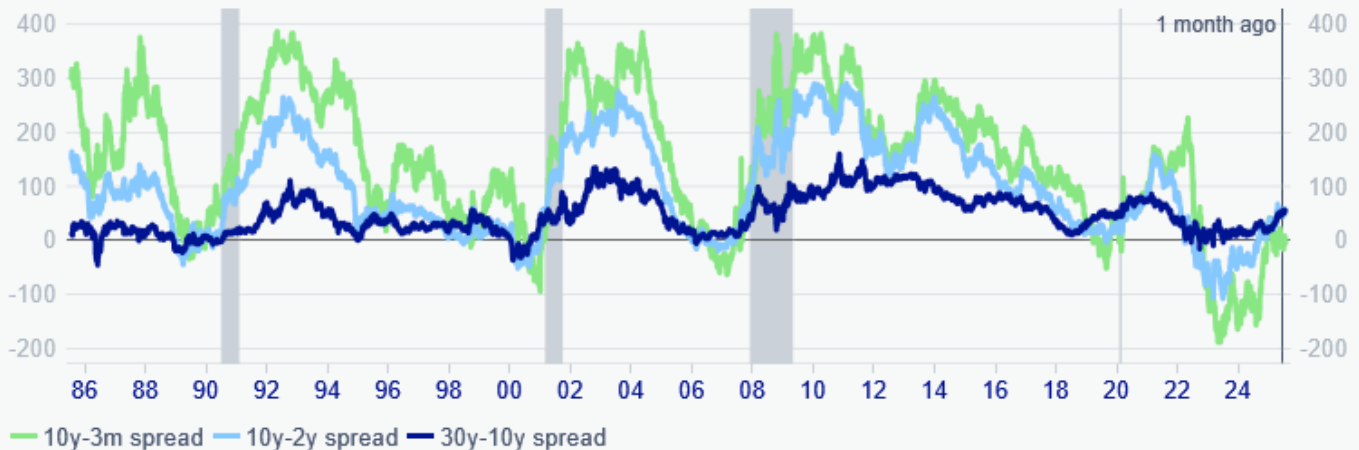
FIGURE 8. ICE BOFAML MOVE INDEX (INDEX POINTS)



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

... liquidity strains. However, it seems that they're likely contributing to a gradual buildup of deeper concerns among market participants about the long-term credibility of U.S. policy and the...

FIGURE 9. TREASURY YIELD SPREADS (BPS)



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

... dollar's global standing. One possible sign of this is the widening of the 30y-10y Treasury...

FIGURE 10. 10Y-2Y TREASURY YIELD SPREAD (BPS AND %)



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

... yield spread, which recently reached its highest level since October 2021

FIGURE 11. 30Y-10Y TREASURY YIELD SPREAD (BPS AND %)



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

In this context, the persistently elevated levels of longer-term yields—i.e., 20- and 30-year—...

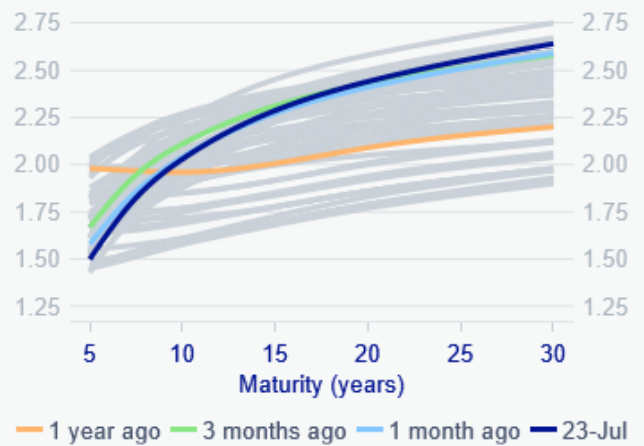
FIGURE 12. TREASURY REAL YIELDS (TIPS) (%)



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

... reflects higher risk premia rather than a fundamental reassessment of potential growth

FIGURE 13. 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.

Although far from de-anchoring, the recent rise of market long-term inflation expectations...

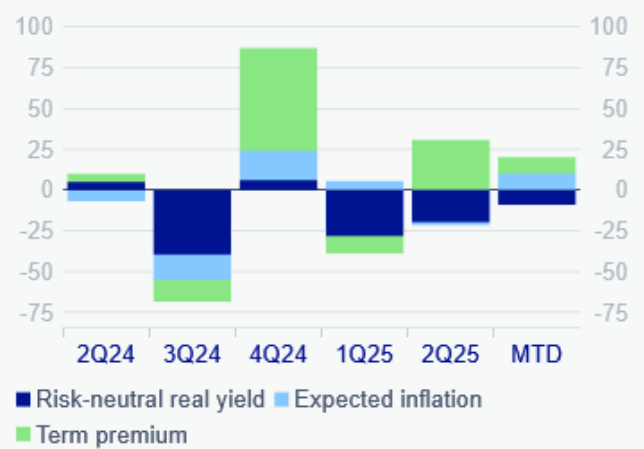
FIGURE 14. BREAK-EVEN INFLATION RATES (%)



Source: BBVA Research / Treasury Dept.

... will likely contribute to the Fed's continued caution, with term premia weighing heavily...

FIGURE 15. 10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)



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

... on yield movements. Puzzlingly, the fiscal bill approval—set to push debt higher over the...

FIGURE 16. 10-YEAR TREASURY YIELD BREAKDOWN (%)



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

... next decade—had only a muted impact on both the term premium and the U.S. dollar

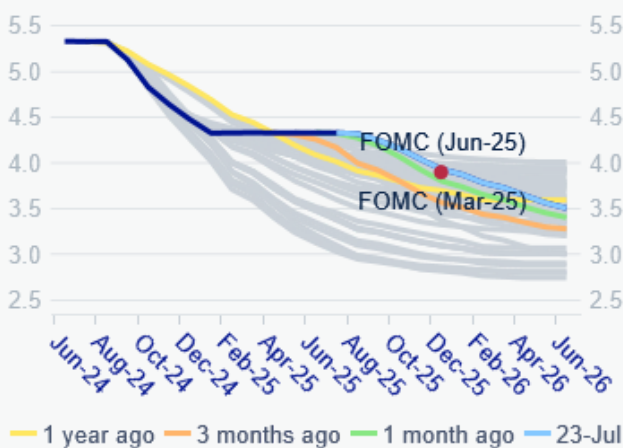
FIGURE 17. 10-YEAR TREASURY YIELD & DXY INDEX (% & INDEX POINTS)



Source: BBVA Research / ICE / Treasury Dept.

In early July, the futures market priced in up to a 60% chance of at least three rate cuts this...

FIGURE 18. FUTURES-IMPLIED FED FUNDS RATE (%)



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

... year. They have since declined to around 20%—roughly where they stood a month ago

FIGURE 19. FUTURES-IMPLIED FED FUNDS RATE (%)



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

Mortgage rates fluctuated over the period but remain elevated within a narrow range

FIGURE 20. MORTGAGE RATES (%)



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

Investment-grade corporate spreads continue to show little market concern on credit risks

FIGURE 21. CORPORATE BOND YIELD SPREADS (%)



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.

Broad indicators still signal overall financial stability and limited market stress, despite...

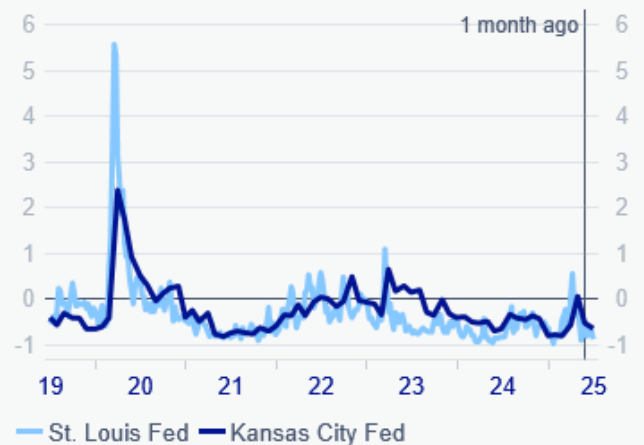
FIGURE 22. CHICAGO FED NATL. FIN. COND. INDEX (>0: TIGHTER THAN AVG.)



Source: BBVA Research / Fed

... the depth of recent U.S. economic policy shifts and the uncertainty surrounding them

FIGURE 23. FED FINANCIAL STRESS INDEXES (>0: ABOVE AVG. FIN. STRESS)



Source: BBVA Research / Fed

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