

Despite expected cuts, investors push Treasury spreads higher

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Increased risk compensation partly reflects mounting concerns that Fed's policy could be kept looser than warranted in the future

The 2-year Treasury yield has fallen by ~35 bps since late July, but the reaction in longer maturities was far more limited, as US debt term premia remain elevated ([Figures 6 and 7](#)).

Despite recent economic developments Treasury market volatility has remained contained. The MOVE index shows markets have navigated these episodes in relative calm ([Figure 8](#)).

Low volatility does not necessarily mean that markets have become less concerned about the risks to the central bank's independence ([Figures 9 to 11](#)).

A slow but steady rise in 5y-5y forward inflation expectations suggests growing concerns that political interference may undermine the Fed's ability to keep inflation anchored ([Figure 14](#)).

Markets are pricing in near certainty of a Sep rate cut, though still assign a ~13% chance that upcoming jobs and inflation data could shift the outlook and delay easing ([Figures 18 and 19](#)).

Three developments shaped the Treasury market over the past month: a weak jobs report, a dovish tone from Powell at Jackson Hole, and renewed political pressure from Trump's push to replace Gov. Cook

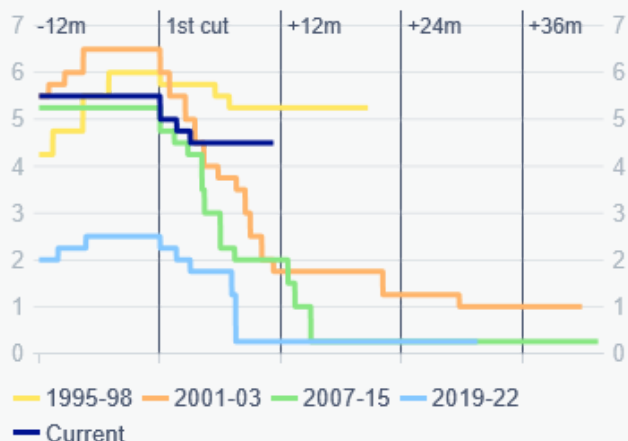
FIGURE 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

With tariff effects on prices still low and labor market risks mounting, the case for a rate cut...

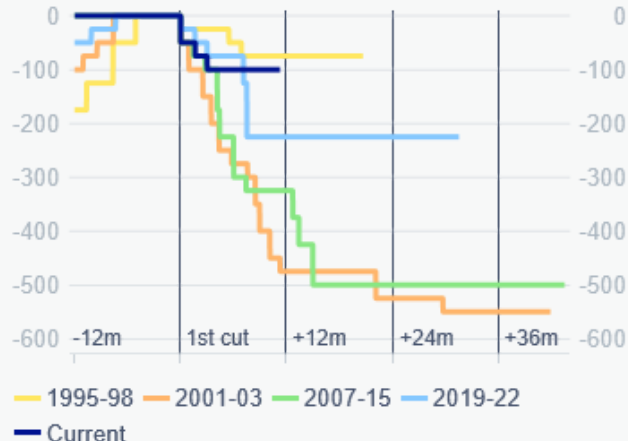
FIGURE 2. FED FUNDS RATE IN EASING CYCLES (%)



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

... has strengthened. Powell himself noted that "the shifting balance of risks may warrant" it

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



Source: BBVA Research / Treasury Dept.

The most pronounced market move was in the 2-year Treasury yield, which typically reflects...

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



Source: BBVA Research / Treasury Dept.

... shifts in policy expectations quickly. It has fallen by roughly 35 bps since late July

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



Source: BBVA Research / Treasury Dept.

Yet, more market-driven long-term rates have barely moved on increased risk premia that...

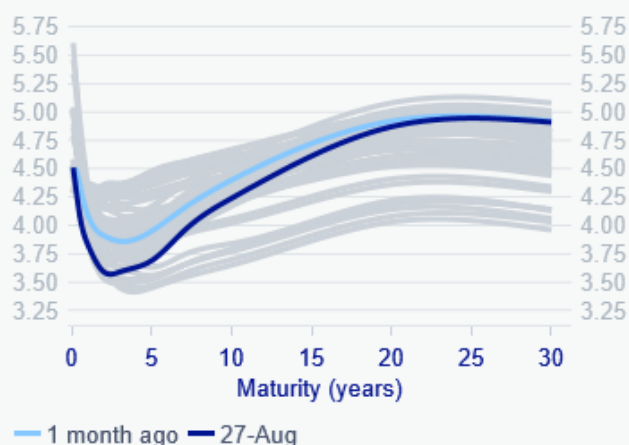
FIGURE 6. TREASURY YIELDS (%)



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

... partly reflect concerns that policy could be kept looser than warranted in the future

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.

Despite recent developments and shifts in policy expectations, Treasury market volatility has remained contained. The MOVE index shows markets have navigated these episodes in relative calm

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

Yet, the yield curve has continued to steepen, with shorter-term yields falling in the expectation of rate cuts, and longer-term yields remaining high amid lingering concerns about the Fed's independence

FIGURE 9. TREASURY YIELD SPREADS (BPS)



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

The 10y-2y spread has been widening steadily, while the 30y-10y spread has more than...

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.

... tripled this year, approaching levels last seen during the pandemic and the post-GFC period

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.

The real Treasury yield curve steepened further, as consistently high longer-term...

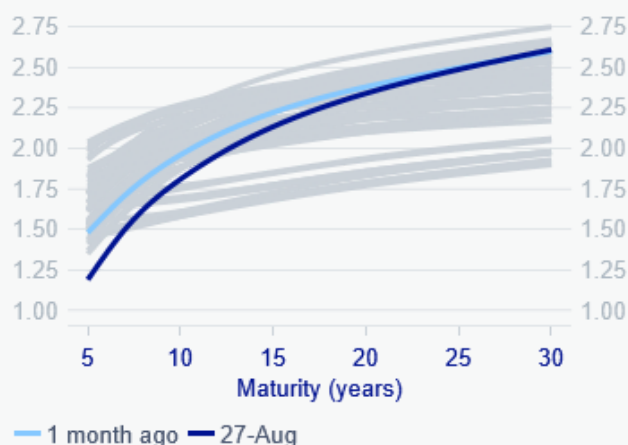
FIGURE 12. TREASURY REAL YIELDS (TIPS) (%)



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

... yields continue to reflect higher risk premia rather than an upgrade in 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.

A slow but steady rise in 5y-5y fwd. inflation expectations suggests growing concerns that...

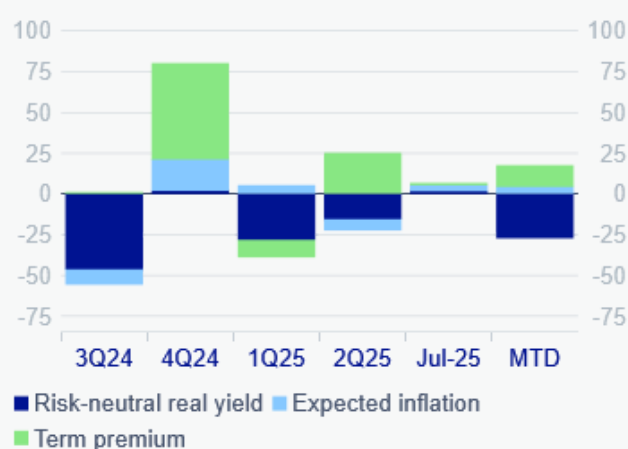
FIGURE 14. BREAK-EVEN INFLATION RATES (%)



Source: BBVA Research / Treasury Dept.

... political interference may undermine the Fed's ability to keep inflation anchored

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



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

Moves in the 10-year yield continue to be driven largely by term premia, reinforcing the...

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



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

... idea that risk is weighing heavily on long-term rates and the US dollar

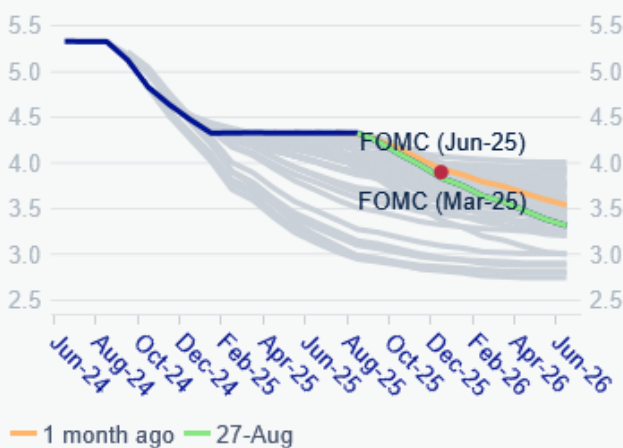
FIGURE 17. 10-YEAR TREASURY YIELD & DXY INDEX (% & INDEX POINTS)



Source: BBVA Research / ICE / Treasury Dept.

Markets are pricing in near certainty of a Sep rate cut, though futures still assign roughly a...

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



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

... 13% chance that upcoming jobs and inflation data could shift the outlook and delay easing

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



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

Mortgage rates have eased somewhat recently, in line with the slight decline in 10-year yields

FIGURE 20. MORTGAGE RATES (%)



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

Corporate spreads, meanwhile, showed little change

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...

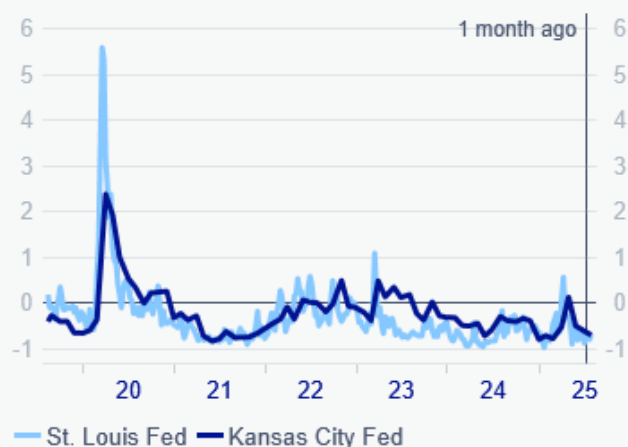
FIGURE 22. CHICAGO FED NATL. FIN. COND. INDEX (>0: TIGHTER THAN AVG.)



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)

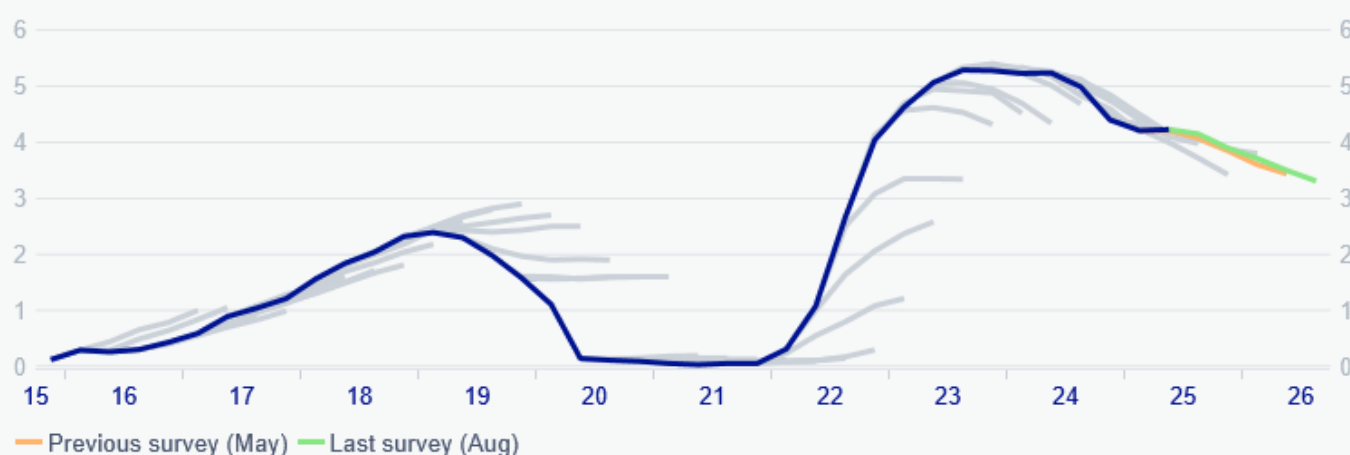


Source: BBVA Research / Fed

The August survey of professional forecasters showed little change in median Treasury yield forecasts compared to May

At first glance, it seems counterintuitive that short-term rate expectations rose in the latest survey, even though it covered the release of the latest payrolls report. However, the previous survey took place in...

FIGURE 24. PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS (%)



... May, when policy rate expectations were at year-to-date lows. The new median forecast of 3.90% for 3-month yields in 4Q25 remains consistent with market pricing of 2-3 cuts this year. Expectations for...

FIGURE 25. PROFESSIONAL FORECASTERS 10-YEAR TREASURY YIELD EXPECTATIONS (%)



... the 10-year yield have remained broadly unchanged across the last three surveys, with...

FIGURE 26. PROF. FORECASTERS TREASURY YIELDS EXPECTATIONS (%)



Shaded areas indicate interquartile ranges
Source: BBVA Research / Fed

... professional forecasters anticipating that the benchmark will struggle to break below 4%

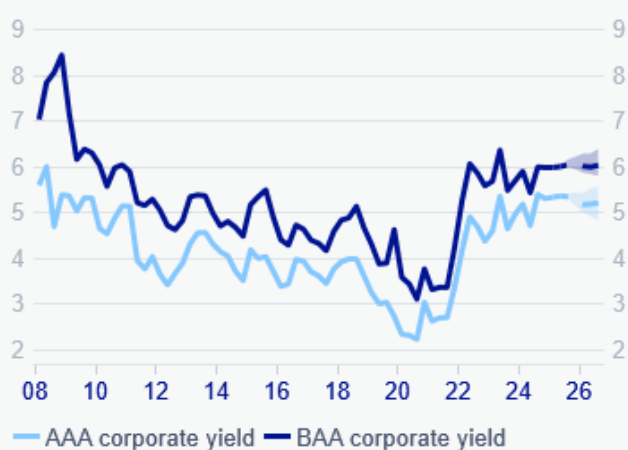
FIGURE 27. PROF. F'CASTERS IMPLIED YIELD SPREAD EXPECTATIONS (BPS)



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

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

FIGURE 28. PROF. FORECASTERS CORPORATE YIELDS EXPECTATIONS (%)



Shaded areas indicate interquartile ranges
Source: BBVA Research / Fed

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

FIGURE 29. PROF. F'CASTERS IMPLIED CORP. SPREADS EXPECTATIONS (%)



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

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