

Long-term yields edge down on easing bets and risk repricing

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Low volatility & tight spreads contrast with fiscal and inflation risks as the Fed rebalances its two goals, leaning toward employment

Even with clearer guidance on further cuts, the current easing cycle is unfolding more gradually than past ones amid lingering uncertainty and resilient domestic demand ([Figures 5](#) and [6](#)).

Long-term yields have fallen more sharply in recent weeks amid expectations of a longer easing cycle, yet they remain well above levels from a year ago ([Figures 9](#) and [10](#)).

The 10y yield's drop this month reflects a 25bp fall in term premium offsetting last month's rise ([Figure 18](#)). The Q3 adjustment has been just ~10bps, driven by shifting policy expectations.

Markets are aligned with the two additional 25bp cuts signaled by the median FOMC participant for this year, but expect deeper easing next year ([Figures 21](#) and [22](#)).

Subdued financial volatility ([Figure 11](#)) and unusually tight corporate bond yield spreads ([Figure 24](#)) relate to Powell's remark this week that "stocks are fairly highly valued."

Last week, the Fed resumed its rate-cutting cycle with a 25bp reduction, its first move this year, citing a shift in the balance of risks amid weaker labor market data. It signaled more cuts ahead, with the median...

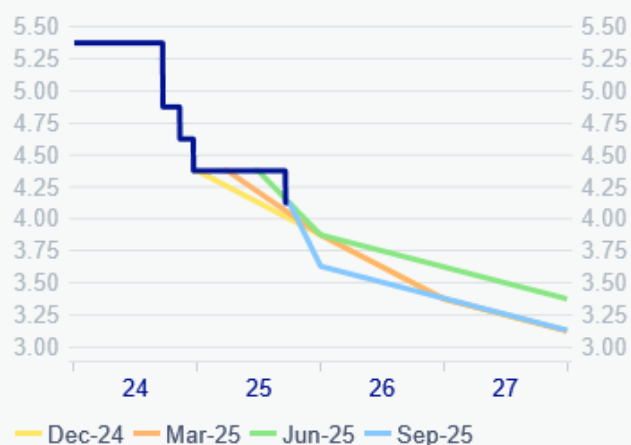
FIGURE 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

... year-end rate projection falling after three steady meetings. A split persists within the...

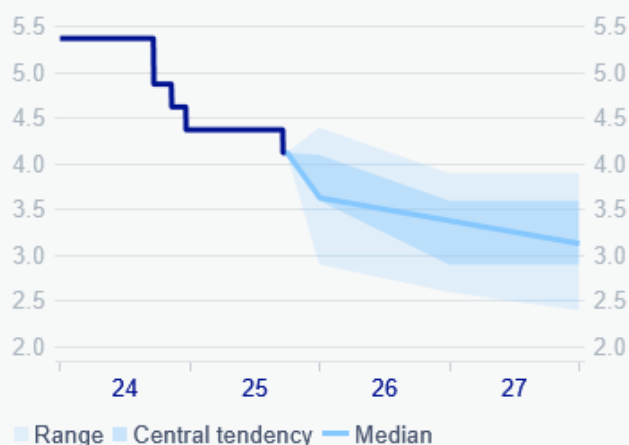
FIGURE 2. FOMC PROJECTED FED FUNDS RATE (%)



Source: BBVA Research / Fed

Fed, with some leaning toward faster easing while others foresee few cuts before 2027

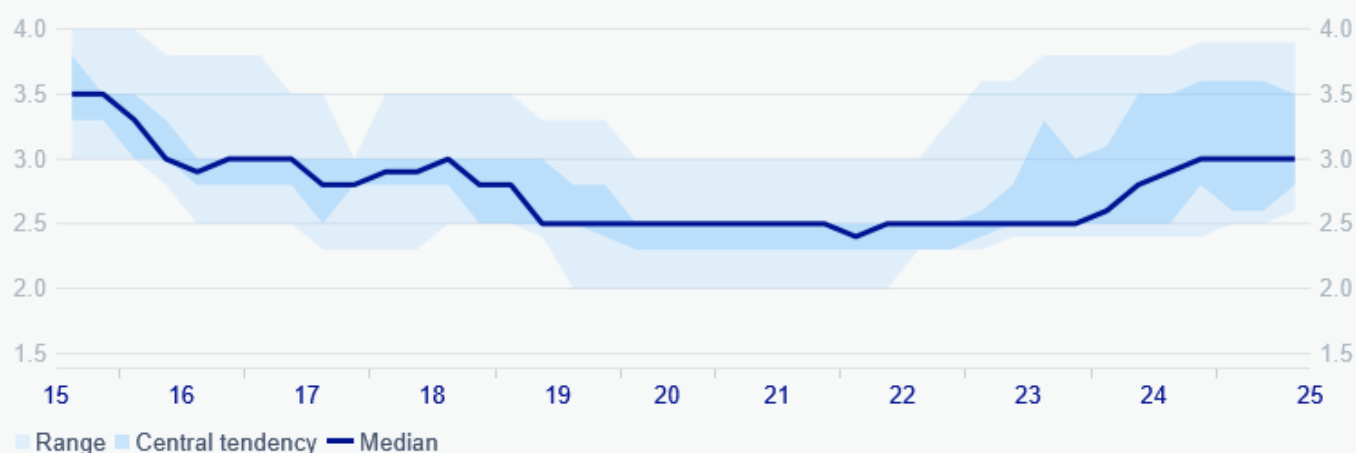
FIGURE 3. FOMC PROJECTED FED FUNDS RATE (%)



Source: BBVA Research / Fed

Some in the latter camp may also be among those who see the nominal neutral rate closer to 4% than to 3%, though the stable median projection suggests most still consider policy as modestly restrictive

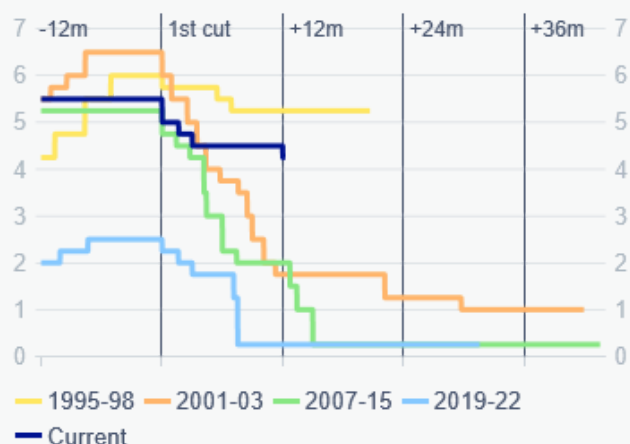
FIGURE 4. FOMC LONGER RUN FED FUNDS RATE ESTIMATION (%)



Source: BBVA Research / Fed

Even with clearer guidance on further cuts, the current easing cycle is unfolding...

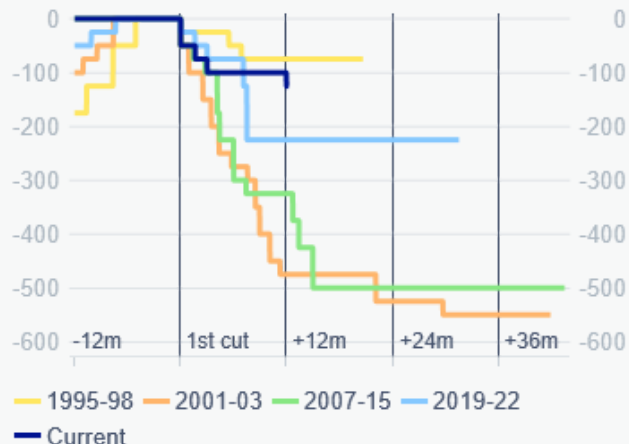
FIGURE 5. FED FUNDS RATE IN EASING CYCLES (%)



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

... more gradually than previous ones amid uncertainty over new U.S. policies...

FIGURE 6. FED FUNDS RATE IN EASING CYCLES (BPS VS RATE AT FIRST CUT)



Source: BBVA Research / Treasury Dept.

... and a surprisingly resilient economy, suggesting long-term rates are unlikely...

FIGURE 7. 2-YEAR TREASURY YIELD IN EASING CYCLES (%)



Source: BBVA Research / Treasury Dept.

... to fall back near the ultra-low levels seen before the pandemic

FIGURE 8. 10-YEAR TREASURY YIELD IN EASING CYCLES (%)



Source: BBVA Research / Treasury Dept.

Long-term yields have fallen more sharply in recent weeks as renewed easing expectations...

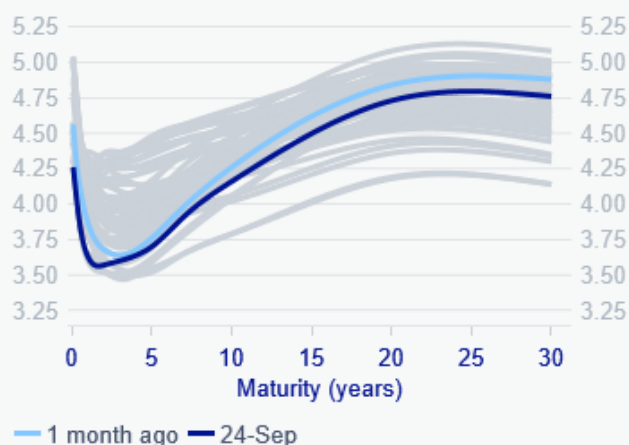
FIGURE 9. TREASURY YIELDS (%)



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

... outweighed fiscal and inflation risk repricing, yet they remain well above levels observed a...

FIGURE 10. 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.

... year ago. Even after brief turbulence, volatility remains subdued. Powell's remark this week that "stocks are fairly highly valued" points to the risk that market calm may disguise emerging imbalances

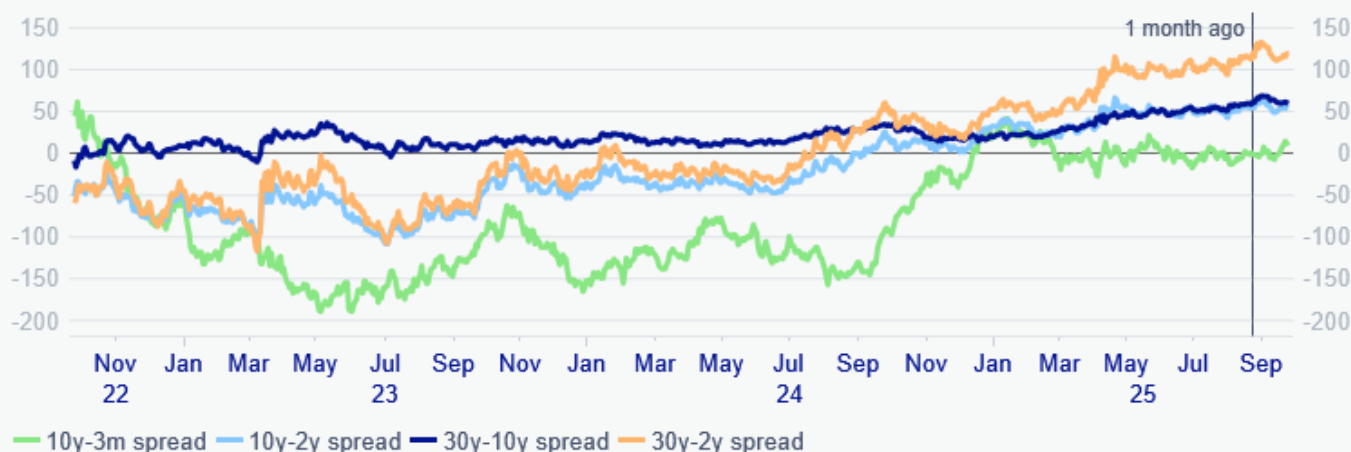
FIGURE 11. ICE BOFAML MOVE INDEX (INDEX POINTS)



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

The sharper drop in long-term yields in recent weeks has halted the steady widening of term spreads amid renewed expectations of monetary policy easing

FIGURE 12. TREASURY YIELD SPREADS (BPS)



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

Yet, still-elevated levels continue to reflect fiscal and institutional risk premia, suggesting...

FIGURE 13. 10Y-2Y TREASURY YIELD SPREAD (BPS AND %)



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

... that the underlying concerns have not receded but merely stopped intensifying

FIGURE 14. 30Y-10Y TREASURY YIELD SPREAD (BPS AND %)



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

The decline in nominal yields has been driven mainly by lower real rates, with the long end...

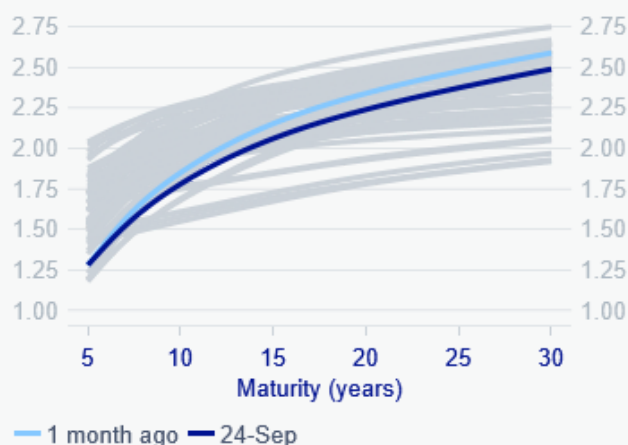
FIGURE 15. TREASURY REAL YIELDS (TIPS) (%)



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

... showing the sharpest adjustment after several months of stability at elevated levels

FIGURE 16. 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.

Target-consistent 5y-5y forward inflation expectations ease concerns on the Fed, ...

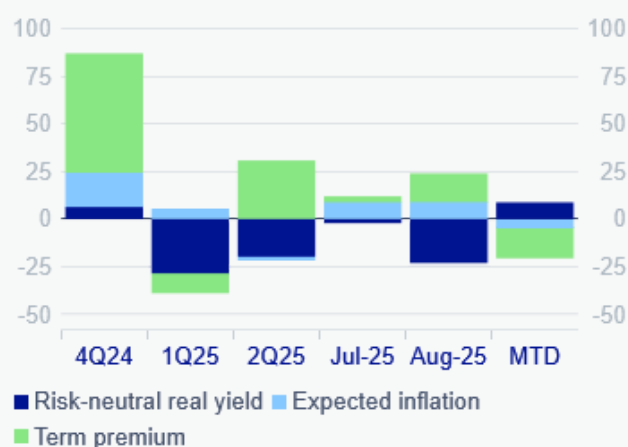
FIGURE 17. BREAK-EVEN INFLATION RATES (%)



Source: BBVA Research / Treasury Dept.

... allowing it to better balance its focus between the two goals. The 10y yield drop...

FIGURE 18. 10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)



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

... this month reflects a 25bp fall in term premium, offsetting last month's rise. So far, ...

FIGURE 19. 10-YEAR TREASURY YIELD BREAKDOWN (%)



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

... the Q3 adjustment has been just ~10 bps, explained by shifting policy expectations

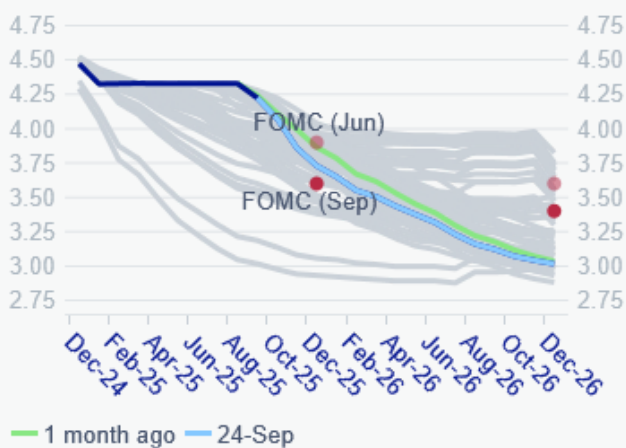
FIGURE 20. 10-YEAR TREASURY YIELD & DXY INDEX (% & INDEX POINTS)



Source: BBVA Research / ICE / Treasury Dept.

Markets are aligned with the two additional 25bp cuts signaled by the median FOMC...

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



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

... participant for this year, but expect deeper easing next year

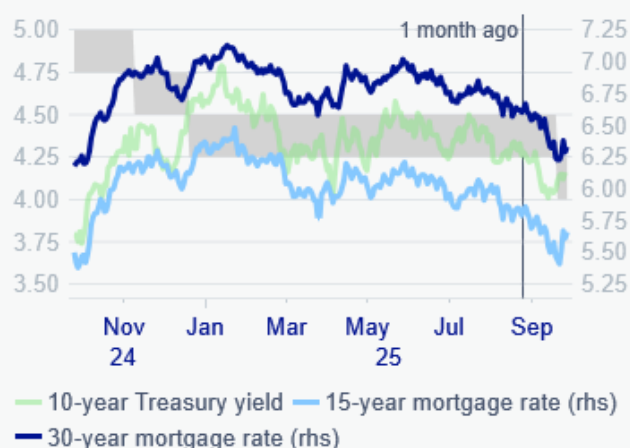
FIGURE 22. FUTURES-IMPLIED FED FUNDS RATE (%)



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

Mortgage rates have fallen as the Fed's shift pushed 10-year yields down

FIGURE 23. MORTGAGE RATES (%)



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

Investment-grade corporate spreads remain unusually tight, well below historical levels

FIGURE 24. 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...

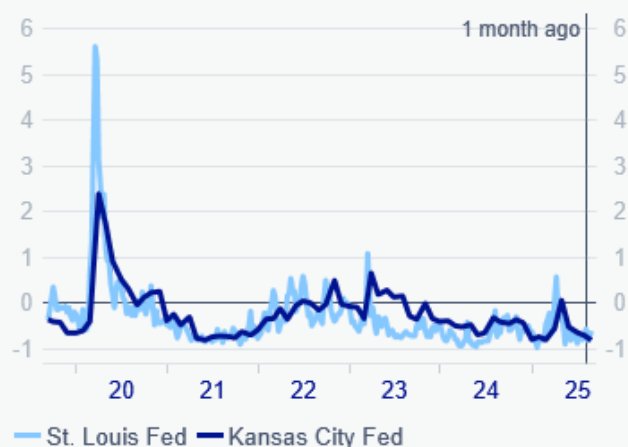
FIGURE 25. CHICAGO FED NATL. FIN. COND. INDEX (>0: TIGHTER THAN AVG.)



Source: BBVA Research / Fed

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

FIGURE 26. FED FINANCIAL STRESS INDEXES (>0: ABOVE AVG. FIN. STRESS)



Source: BBVA Research / Fed

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