

Yield curve steepens further after Fed's 2025 rate cuts conclude

Javier Amador, Iván Fernández

Elevated term premia likely driven by fiscal and institutional risks keep long-end yields high despite stable inflation expectations

The risk of tariff-inflation persistence and the ongoing resilience of activity will likely justify the decision to keep rates around neutral but closer to restrictive levels in the next months ([Figure 4](#)).

The Fed's rate cut mechanically widened long-end yields relative to shorter maturities, but the persistence of long-end spreads continues to point to mixed factors ([Figure 12](#)).

The real yield curve rose in parallel by about 10 bps on average over the past month, despite stable—and even easing—market-implied inflation expectations ([Figures 16](#) and [17](#)).

The move reflected an increase in the term premium, which for the 10-year yield is again just below 80 bps after averaging closer to 60 bps since mid-September ([Figures 18](#) and [19](#)).

Markets currently see just a 20% chance of a fourth consecutive rate cut next month and roughly 50-50 odds to the fed funds rate ending 2026 above or below 3% ([Figure 21](#)).

Last week, the Fed delivered a third consecutive 25bp “risk-management” cut to 3.50-3.75%, but also signaled it will likely step to the sidelines in the following couple meetings. The policy...

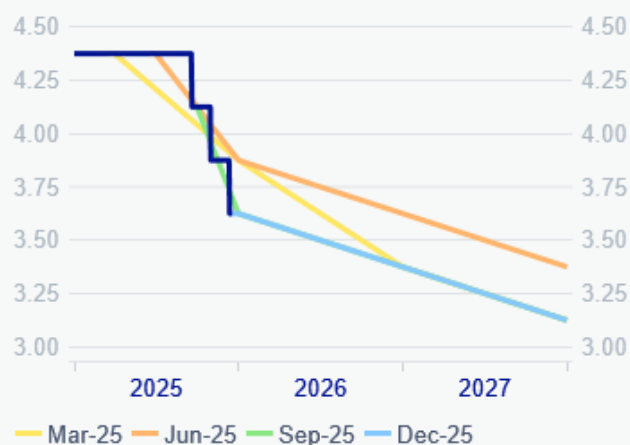
FIGURE 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

... rate is now within the neutral range, and while the median participant continues to see...

FIGURE 2. FOMC PROJECTED FED FUNDS RATE (% , MEDIAN PROJECTION)



Source: BBVA Research / Fed

... some more room to cut rates through 2027, there are 7 participants who see no need for ...

FIGURE 3. FOMC PROJECTED FED FUNDS RATE (% , MEDIAN PROJECTION)



Source: BBVA Research / Fed

... more cuts next year. The risk of tariff-inflation persistence and the ongoing resilience of activity will likely justify the decision to keep rates around neutral but closer to restrictive territory in the next months

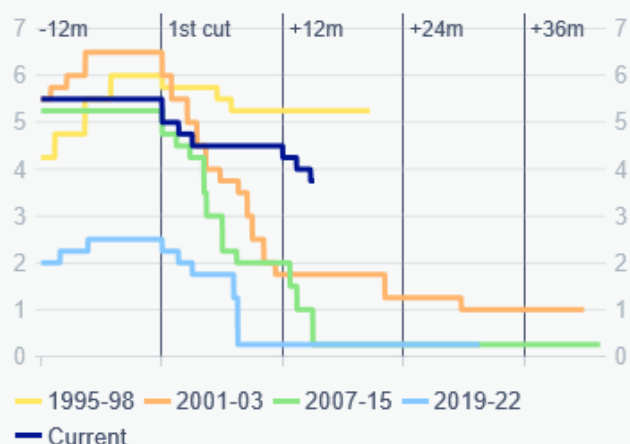
FIGURE 4. FOMC LONGER RUN FED FUNDS RATE ESTIMATION (%)



Source: BBVA Research / Fed

After 75 bps of easing this year and 175 bps since last year's first cut, the Fed feels "well..."

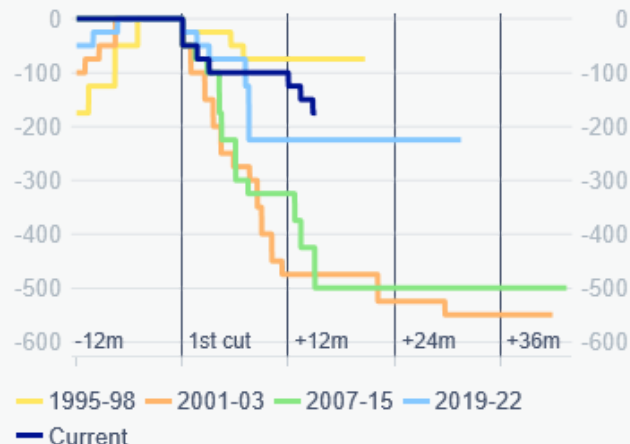
FIGURE 5. FED FUNDS RATE IN EASING CYCLES (%)



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

... positioned to wait to see how the economy evolves," amid mixed signals of downside risks...

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



Source: BBVA Research / Treasury Dept.

... to employment, but no evidence of an impending collapse. This explains why...

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



Source: BBVA Research / Treasury Dept.

... the current cycle has been the slowest this century to reach a neutral stance. This is...

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



Source: BBVA Research / Treasury Dept.

... reflected in still relatively elevated Treasury yields that are close to forming a fully...

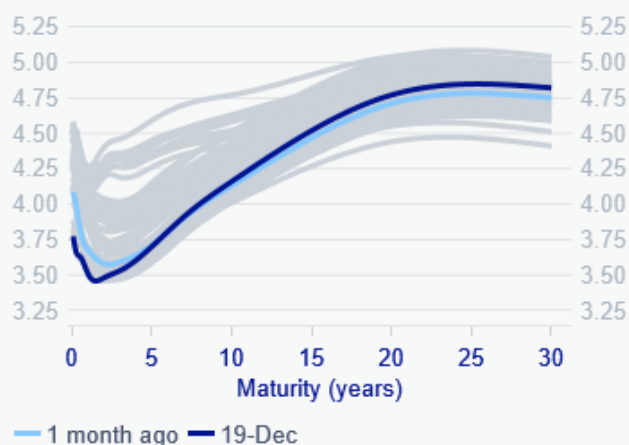
FIGURE 9. TREASURY YIELDS (%)



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

... steepened curve. This time, though, longer-term yields also embed a risk premium linked...

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.

... to institutional risks following this year's shift in U.S. economic policy. Outside isolated episodes of turbulence, markets have reflected favorable conditions over the year and throughout the easing cycle

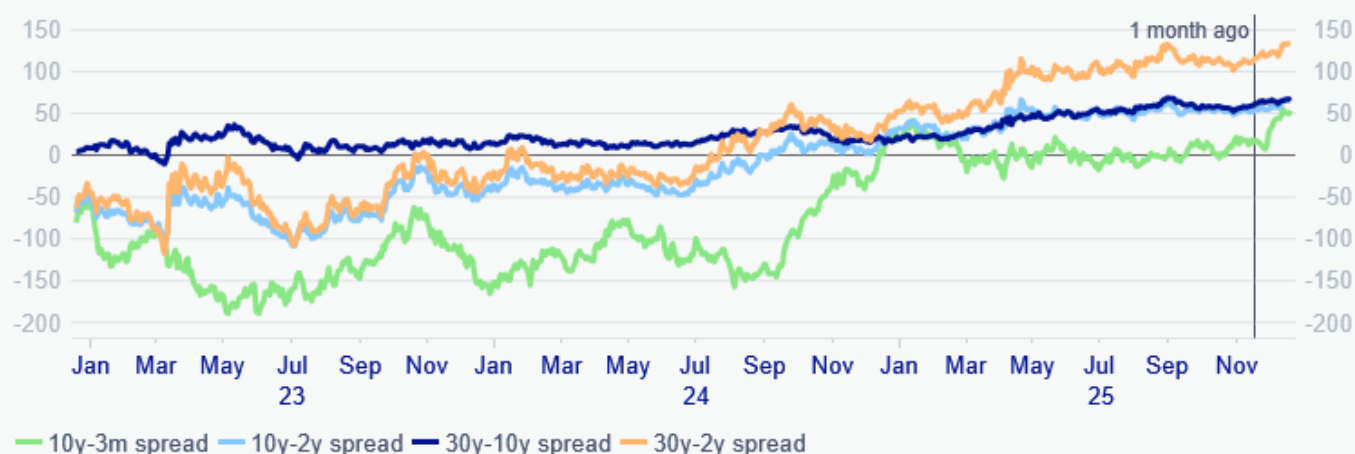
FIGURE 11. ICE BOFAML MOVE INDEX (INDEX POINTS)



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

The Fed's rate cut mechanically widened long-end yields relative to shorter maturities, but the persistence of long-end spreads continues to point to mixed factors. In Powell's words, "there's nothing happening..."

FIGURE 12. TREASURY YIELD SPREADS (BPS)



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

... with rates going up out there that suggests concern about inflation in the long term or...

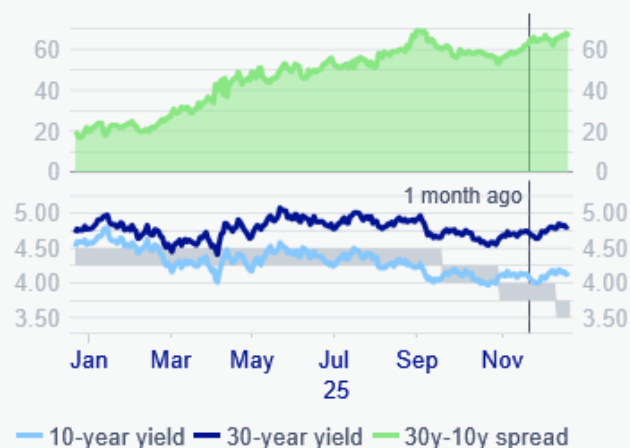
FIGURE 13. 10Y-2Y TREASURY YIELD SPREAD (BPS AND %)



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

... anything like that. [...] So why are rates going up? It has to be something else." In fact, the...

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.

... real yield curve rose in parallel by about 10 bps on average over the past month, despite...

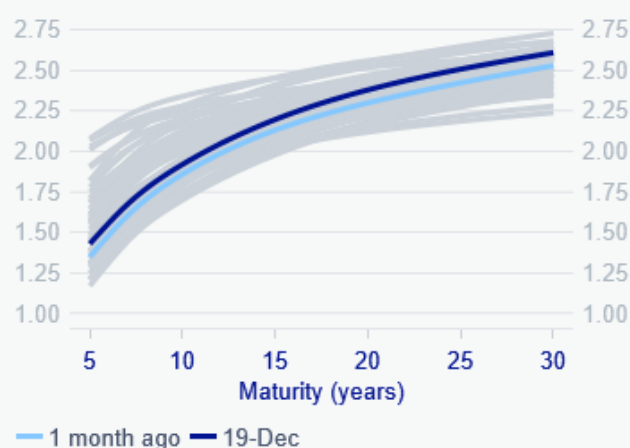
FIGURE 15. TREASURY REAL YIELDS (TIPS) (%)



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

... stable—and even easing—market-implied inflation expectations. Instead, the move...

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.

... reflected an increase in the term premium, which for the 10-year Treasury note is again...

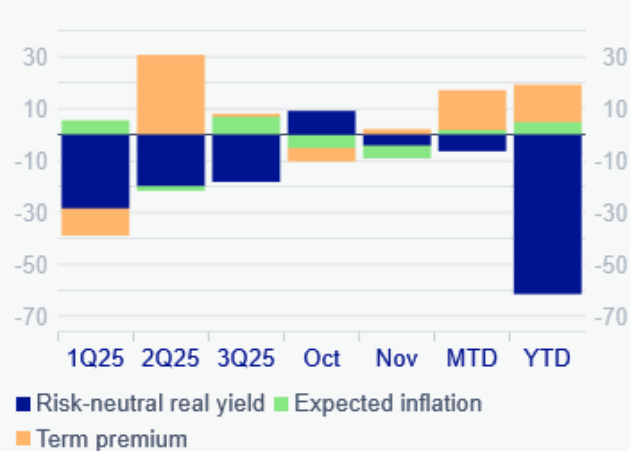
FIGURE 17. BREAK-EVEN INFLATION RATES (%)



Source: BBVA Research / Treasury Dept.

... just below 80 bps after averaging closer to 60 bps since mid-September

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



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

This is likely driven, in part, by lingering uncertainty about the risks to the Fed's...

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



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

... independence as the announcement of Powell's successor early next year approaches

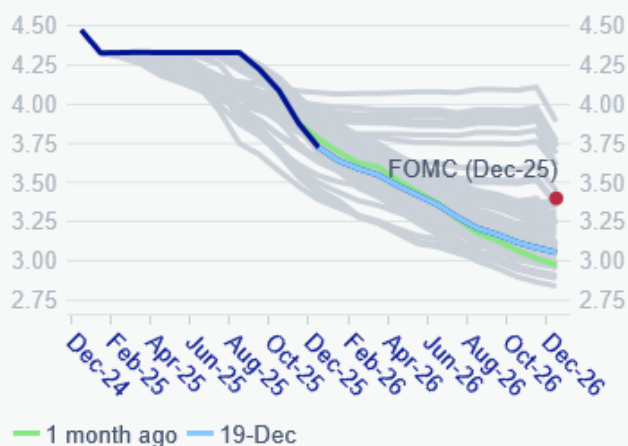
FIGURE 20. 10-YEAR TREASURY YIELD & DXY INDEX (% & INDEX POINTS)



Source: BBVA Research / ICE / Treasury Dept.

Markets currently see only a 20% chance of a fourth consecutive rate cut next month and...

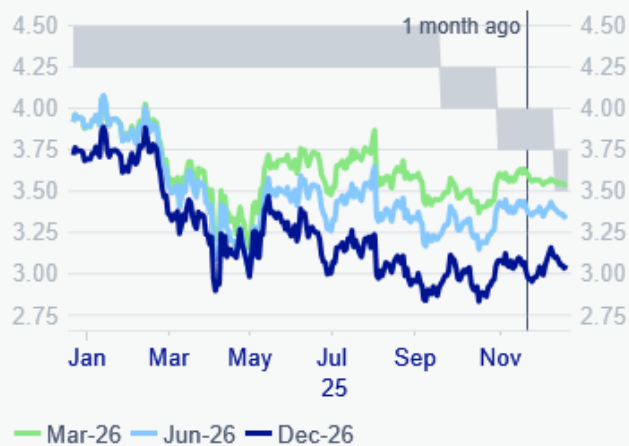
FIGURE 21. FUTURES-IMPLIED FED FUNDS RATE (%)



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

... roughly 50-50 odds to the fed funds rate ending 2026 above or below 3.00%

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



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

High mortgage rates keep weighing on housing affordability, while narrow credit spreads...

FIGURE 23. MORTGAGE RATES (%)



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

... highlight corporate strength—fueling the debate over the uneven impact of Fed’s policy

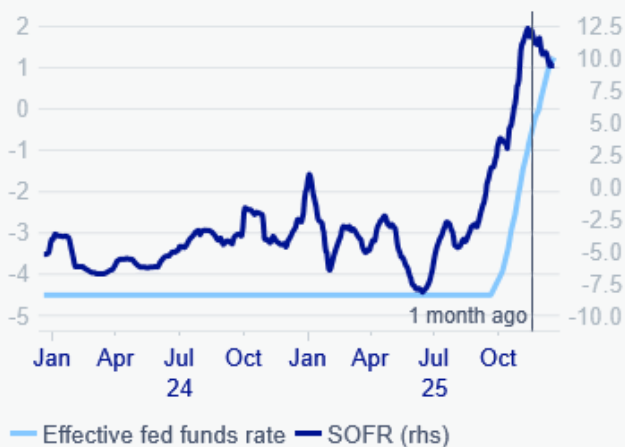
FIGURE 24. CORPORATE BOND YIELD SPREADS (%)



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.

With still elevated spreads in money markets, the Fed began to purchase Treasury bills...

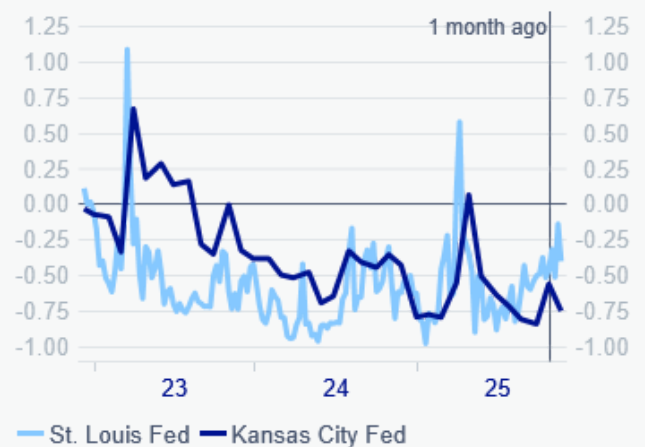
FIGURE 25. MONEY MARKET RATE SPREADS (BPS)



Spreads over the midpoint target fed funds rate
Source: BBVA Research / Fed

... “solely for the purpose of maintaining an ample supply of reserves over time”

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



Source: BBVA Research / Fed

DISCLAIMER

The present document does not constitute an “Investment Recommendation”, as defined in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (“MAR”). In particular, this document does not constitute “Investment Research” nor “Marketing Material”, for the purposes of article 36 of the Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MIFID II).

Readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data or opinions regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvaresearch.com.