

US Interest rates monitor

Treasury yields reflect the view that disinflation likely resumed in 2Q

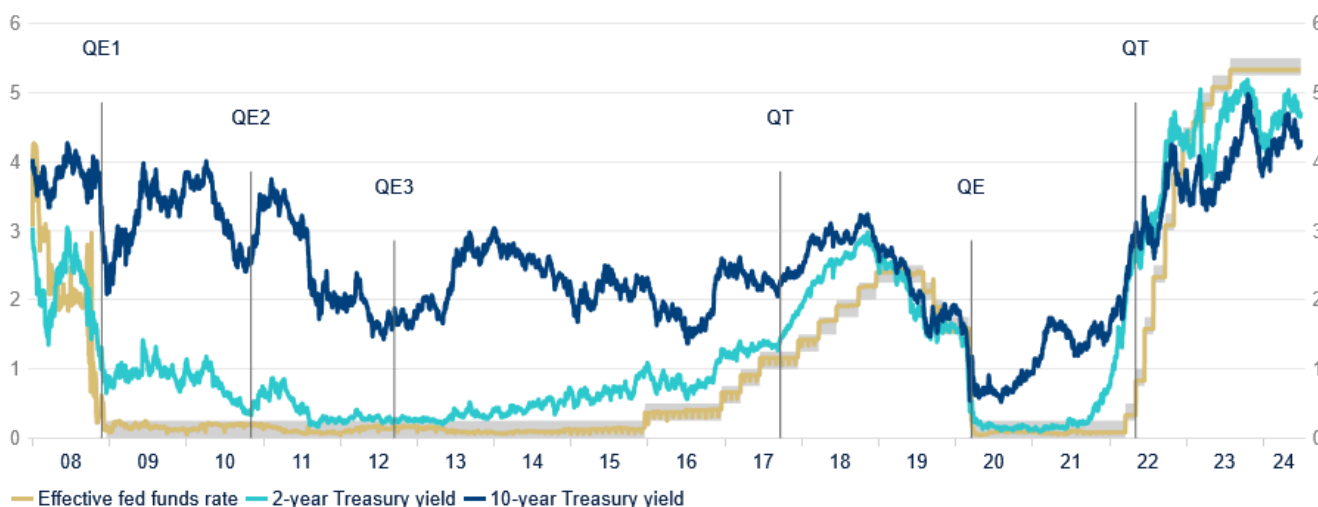
Javier Amador / Iván Fernández
June 27, 2024

Tomorrow’s PCE inflation data could open the door to a significant financial markets’ reassessment of the policy rate path

- “Conservative” inflation projections from this month’s SEP pointed to a slight improvement of confidence among FOMC participants, which partly explains why Treasury yields have kept declining ([Figures 6 and 7](#)).
- The modest deterioration of inflation expectations in 1Q reversed this month entirely, even as markets have come round to the view of a high-for-longer approach ([Figure 14](#)).
- More good inflation data could push the already well-anchored market-based inflation expectations even closer to 2%, opening the door to a significant reassessment of the policy rate path ([Figures 19 and 20](#)).
- This could lead the futures market to fully price in at least two rate cuts this year ([Figures 21 and 22](#)); even Powell acknowledged that the Fed’s median forecast of a single cut before year end was a “very close call.”
- Mortgage rates have recently been less sensitive to the evolution of long-term Treasury yields ([Figure 23](#)). Investment grade corporate bond spreads increased slightly, but they remain well below average ([Figure 24](#)).

Mid- and long-term Treasury yields eased further from their late-April’s highs on a less hawkish than expected Fed in this month’s meeting, and fresh signs that the inflation jump in 1Q will prove transitory

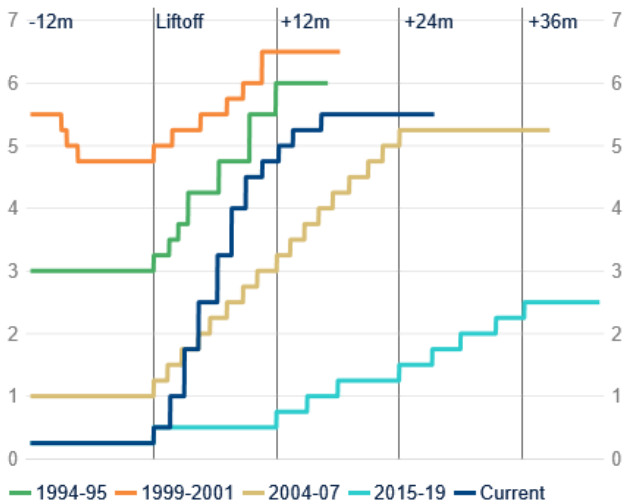
Figure 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

With economic activity still expanding at a solid pace and inflation above target, Fed members...

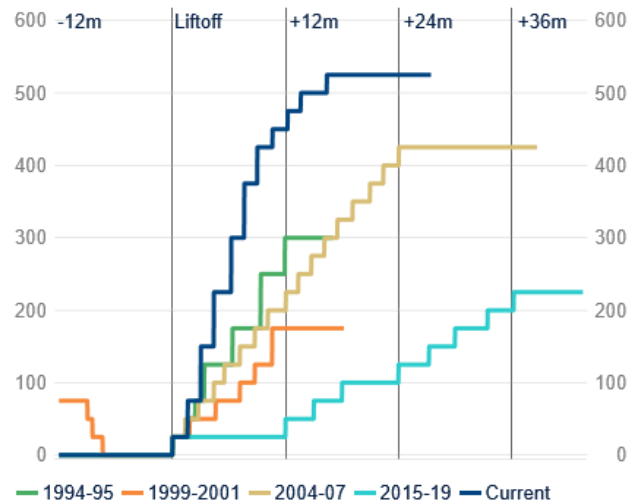
Figure 2. **FED FUNDS RATE IN TIGHTENING CYCLES (%)**



Target rate for the 1994-95, 1999-2001, and 2004-07 cycles; upper limit of the target rate range for the 2015-19 and current cycles
Source: BBVA Research / Fed

... voted earlier this month in favor of keeping rates unchanged for the 7th meeting in a row, ...

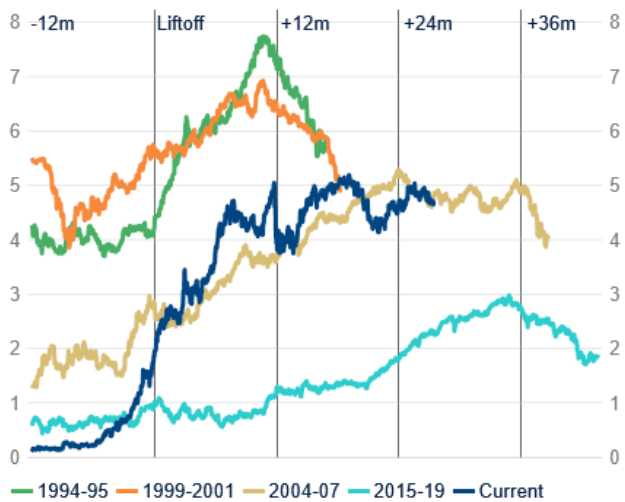
Figure 3. **FED FUNDS RATE IN TIGHTENING CYCLES (BPS VS RATE AT LIFTOFF)**



Source: BBVA Research / Fed

... pushed back the start of a rate cut cycle pointing to a single cut this year instead of 3, ...

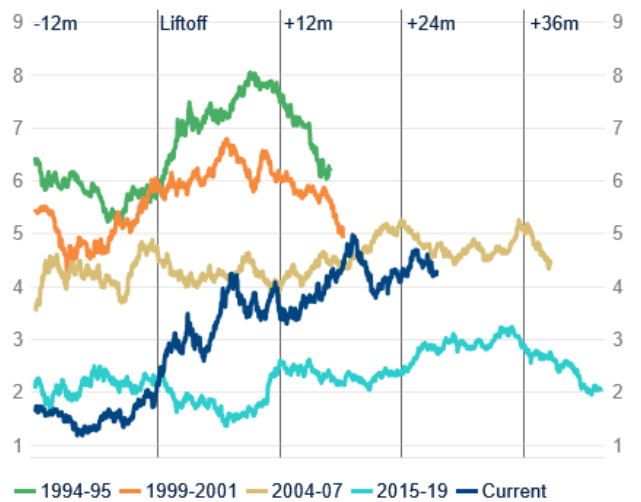
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Treasury

... but at the same time now anticipate a faster easing cycle next year with 4 cuts instead of 3

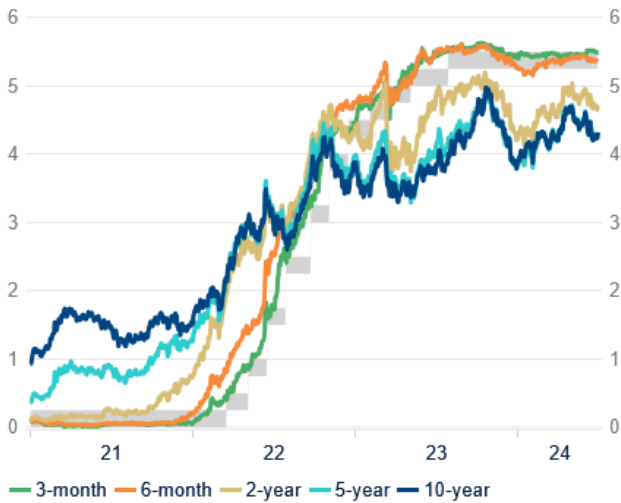
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Treasury

“Conservative” updated inflation projections pointed to a slight improvement of confidence...

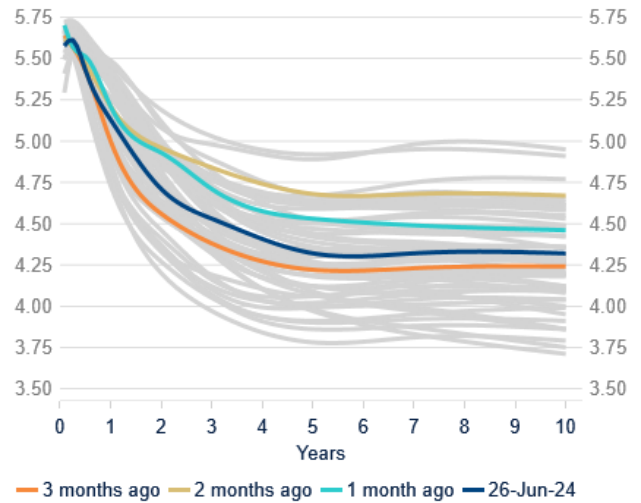
Figure 6. **TREASURY YIELDS**
(%)



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

... among FOMC participants, which partly explains why mid- and long-term Treasury...

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



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

... yields have continued to decline in recent weeks. Negative inflation surprises were the...

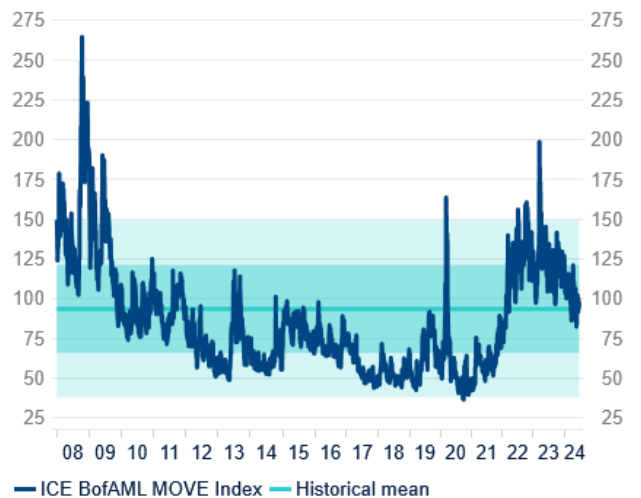
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

... main driver behind the bouts of volatility in 1Q, but there is still no evidence of significant stress

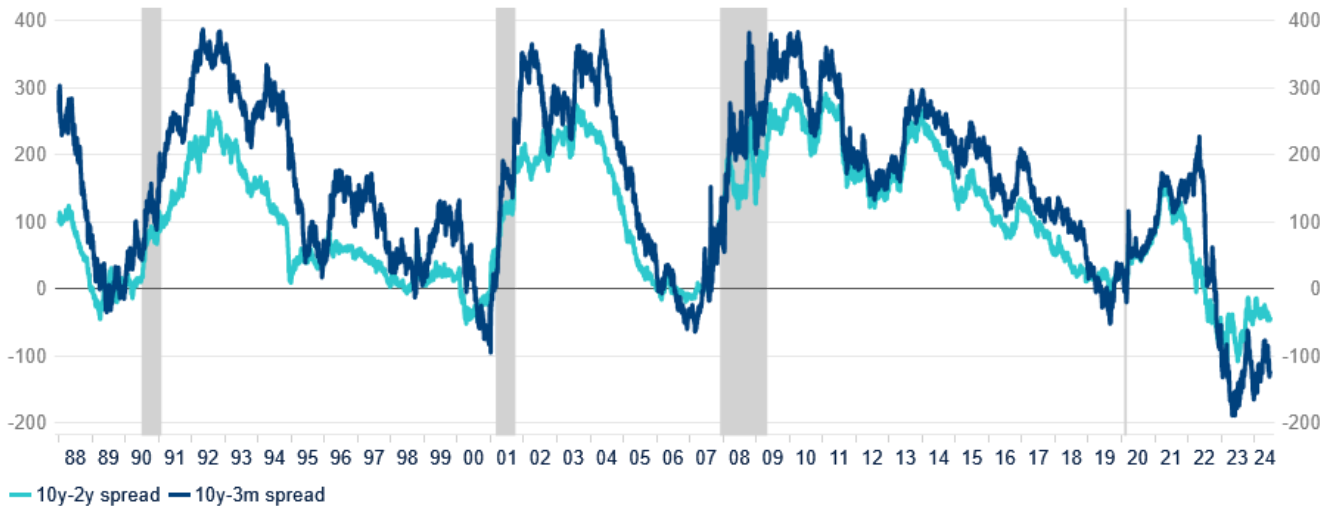
Figure 9. **ICE BOFAML MOVE INDEX**
(BPS)



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

The yield curve has been inverted since mid-Oct 22, when the policy rate was at 3-00-3.25%. It is unlikely to return to a normal upward slope until well into 2025. Both 2- and 10-year yields eased in sync this...

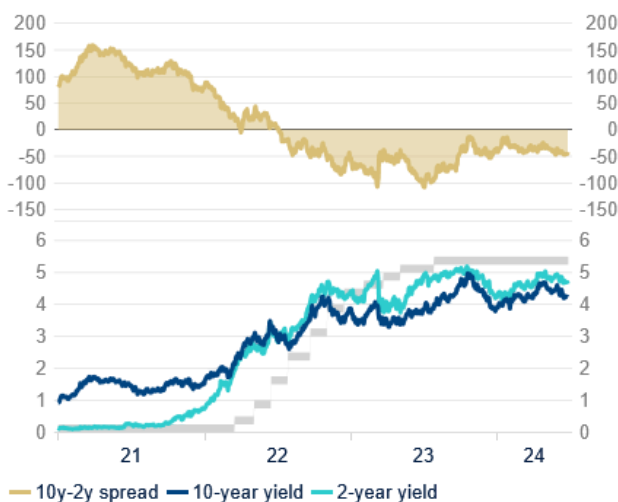
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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

... month, keeping the 10y-2y yield spread steady at around -45 bps. Stable short-term yields and...

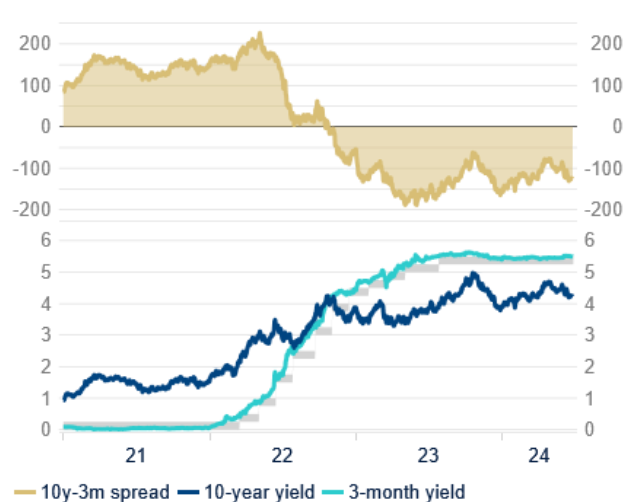
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (BPS AND %)**



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

... a c. 30bp decline of the 10-year Treasury yield drove the 10y-3m yield spread below -100 bps

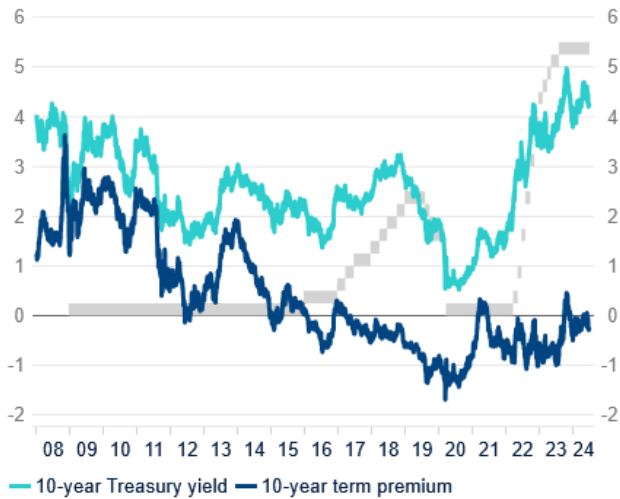
Figure 12. **10Y-3M TREASURY YIELD SPREAD (BPS AND %)**



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

The deterioration of inflation expectations in 1Q fully reversed this month, even as markets...

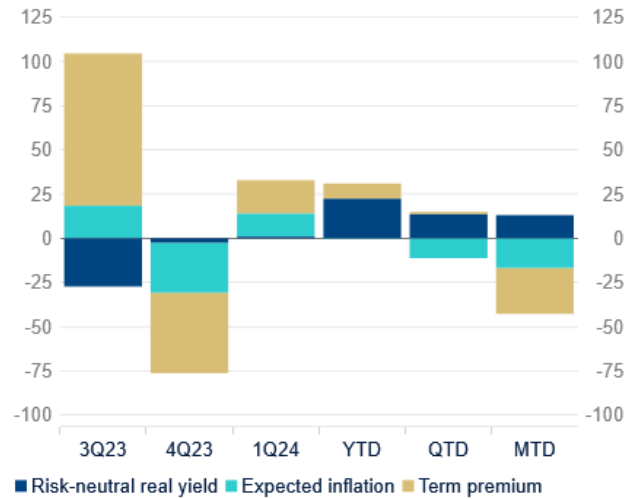
Figure 13. 10-YEAR TREASURY YIELD AND TERM PREMIUM (%)



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

... have come round to the view of a high-for-longer approach. Tomorrow's PCE inflation...

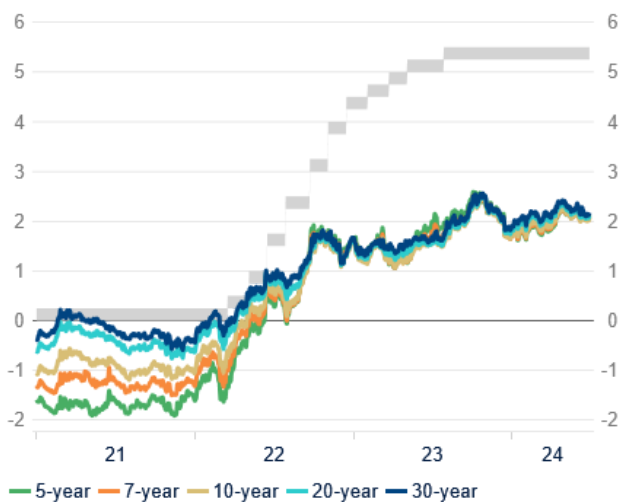
Figure 14. 10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)



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

... data is likely to reinforce the view that disinflation resumed in 2Q, which could be...

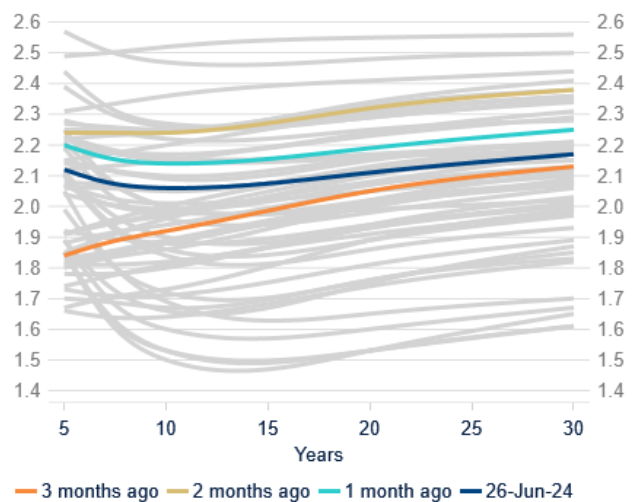
Figure 15. TREASURY REAL YIELDS (TIPS) (%)



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

... reflected in an additional decrease in both the term premium and real and nominal yield curves

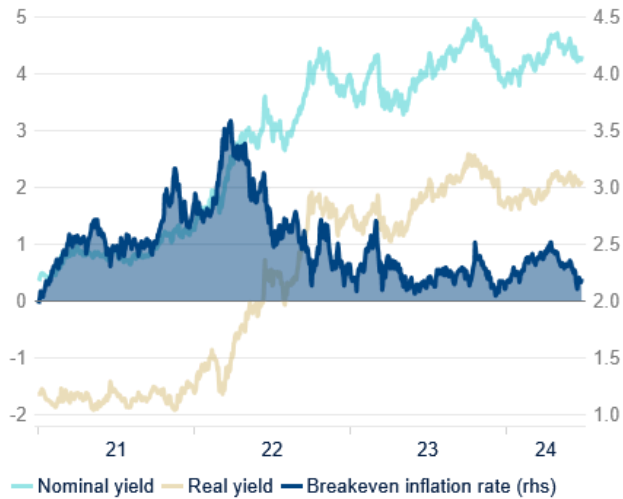
Figure 16. TREASURY REAL YIELD CURVE (TIPS) (%)



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

While mid- and long-term inflation expectations remained well anchored even amid...

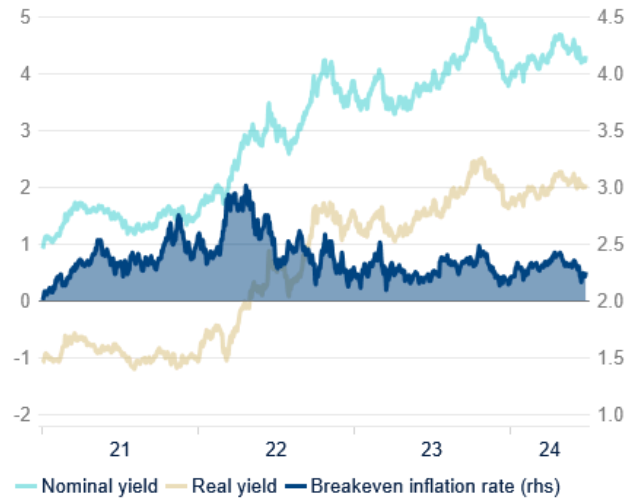
Figure 17. **5-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



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

... last quarter's disappointing inflation figures, more good data in the coming months could...

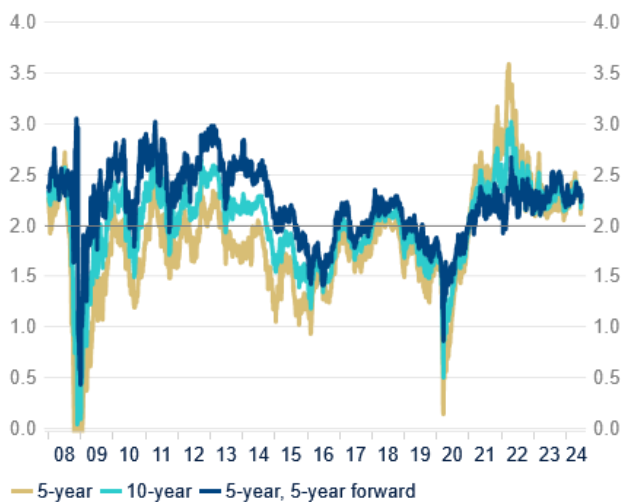
Figure 18. **10-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



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

... push them even closer to 2%, which in turn would open the door to a significant financial...

Figure 19. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research / Treasury

... markets' reassessment of the policy rate path. This could lead the futures market to fully price...

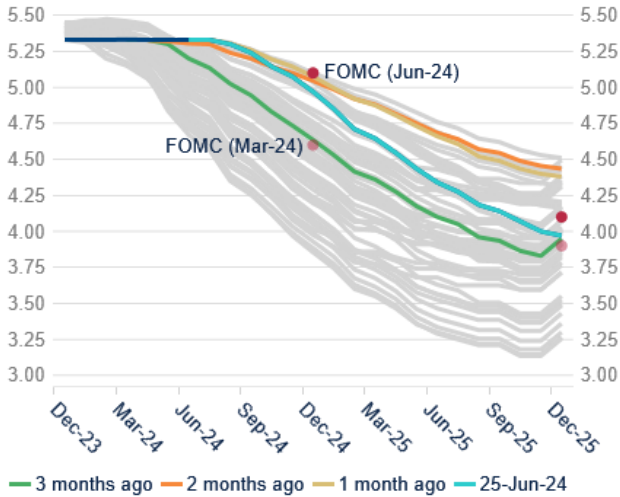
Figure 20. **BREAKEVEN INFLATION AND FUTURES-IMPLIED FED FUNDS RATE (%)**



Source: BBVA Research / Treasury / CME

... in at least two rate cuts this year (chances of this outcome stand at around 60% now); even...

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



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

... Powell acknowledged that the Fed's median forecast of a single cut was a "very close call"

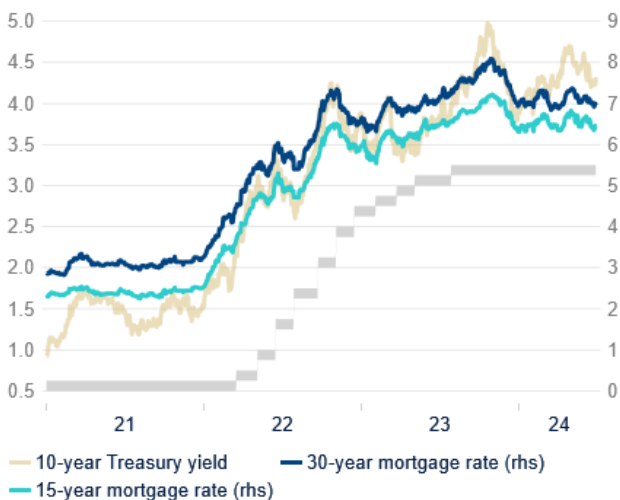
Figure 22. FUTURES-IMPLIED FED FUNDS RATE (%)



Source: BBVA Research / CME

Mortgage rates have recently been less sensitive to the evolution of long-term Treasury yields

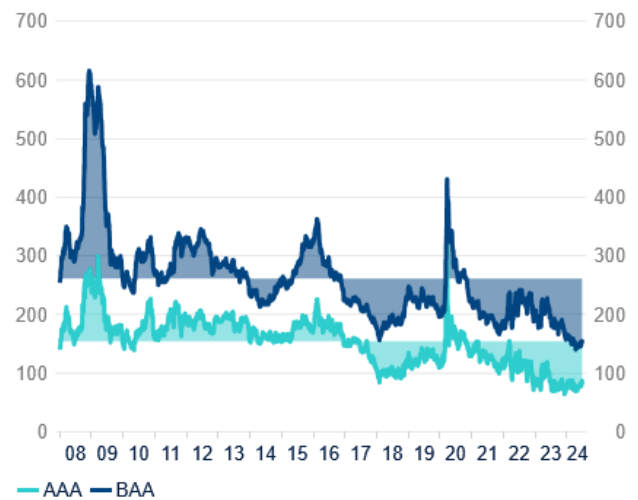
Figure 23. MORTGAGE RATES (%)



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

IG corporate bond spreads ticked up slightly in recent weeks, but they remain well below average

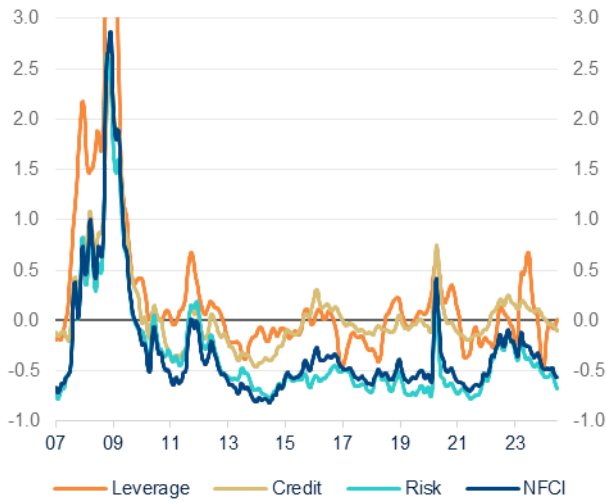
Figure 24. CORPORATE BOND YIELD SPREADS (BPS)



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

The fiercest period of monetary policy tightening in decades was not enough to bring the usual...

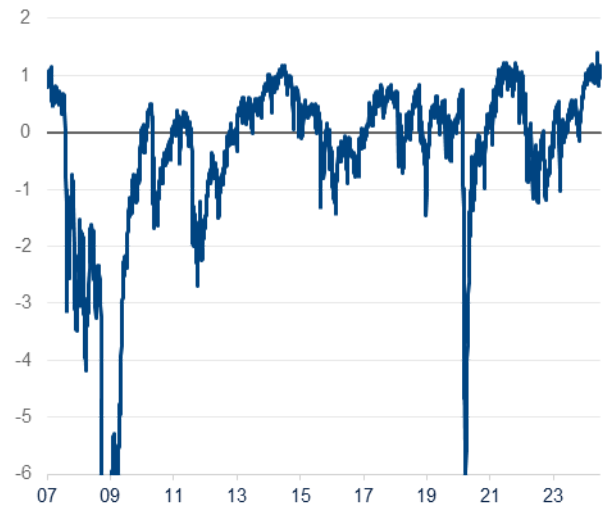
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0: TIGHTER THAN AVG)**



Source: BBVA Research / Haver

... financial conditions indexes anywhere near halfway to the deterioration they had in...

Figure 26. **BLOOMBERG FINANCIAL CONDITIONS INDEX (<0: TIGHTER THAN PRE-GFC AVG)**



Source: BBVA Research / Bloomberg

... previous episodes of stress. Powell said that going forward, when the Fed starts "to loosen..."

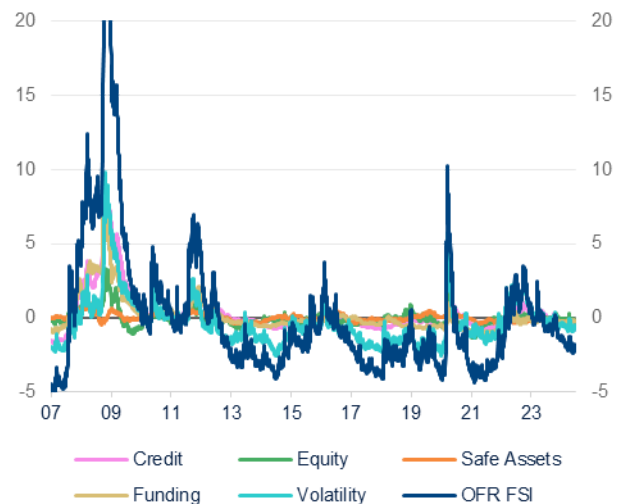
Figure 27. **FED FINANCIAL STRESS INDICES (>0: ABOVE AVG FINANCIAL STRESS)**



Source: BBVA Research / Haver

... policy, that will show up in a significant loosening in financial market conditions"

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



OFR: Office of Financial Research, US Department of the Treasury
Source: BBVA Research / Haver

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.

ENQUIRIES TO:

BBVA Research: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.

Tel.: +52 55 5621 3434

www.bbvaresearch.com