

US Interest rates monitor

# Treasury yields rebound as hard-landing chances drop off the radar

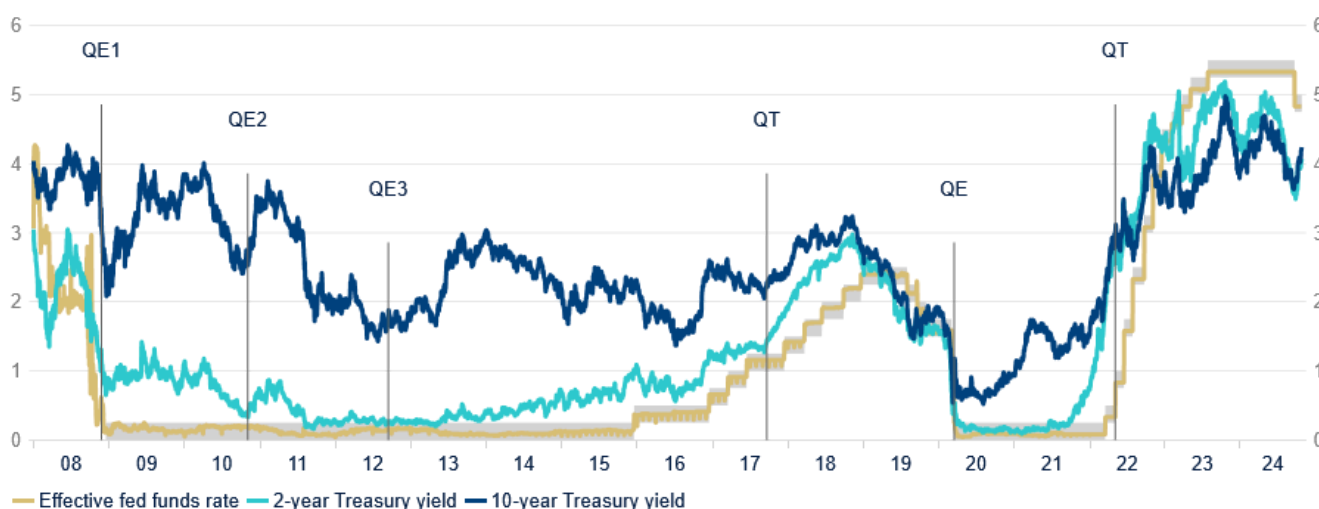
Javier Amador / Iván Fernández  
October 24, 2024

## Uncertainty over the outcome of next month’s presidential election also appears to explain part of the recent rise in long-term yields

- The Fed is set to proceed with more caution on the pace of rate cuts following its initial big 50bp cut, a sentiment echoed by markets, as evidenced by the surge in mid- and long-term yields (Figures 4 and 5).
- About ⅔ of the recent increase in nominal yields can be attributed to a parallel 30bp upward shift in the real yield curve (Figure 14). The remainder could be explained by increased inflation compensation (Figure 18).
- The term premium climbed above zero to a 2024-peak, suggesting that the uncertainty around the outcome of next month’s presidential election is also behind the recent rise in real long-term yields (Figures 19 and 20).
- The futures-implied path of the policy rate shows that financial markets now anticipate no more than six 25bp rate cuts (vs roughly eight last month) from this point forward until 2025-end (Figures 21 and 22).
- We would expect financial conditions to gradually ease as the Fed cuts rates (Figures 25 to 28). That said, we can’t ignore the possibility of market turbulence due to potential post-election economic policy changes.

The upward revisions to GDI published late last month and the stronger-than-expected payrolls figure for September (+254k) wiped out most recession fears fueled by the weaker jobs reports from early 2H24

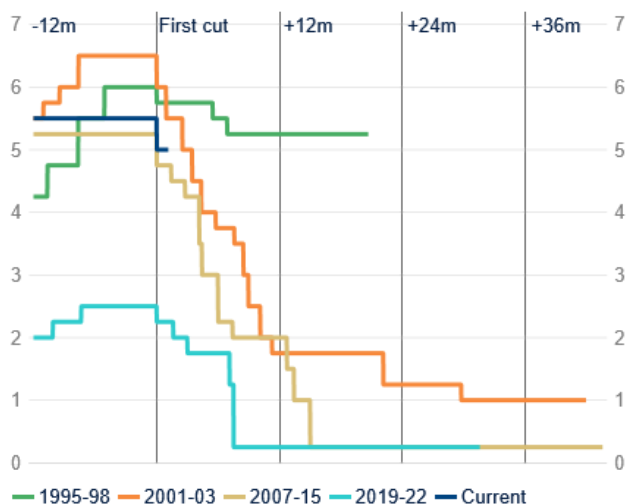
Figure 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

These updates, coupled with a somewhat hotter-than-expected CPI report, suggest the Fed is...

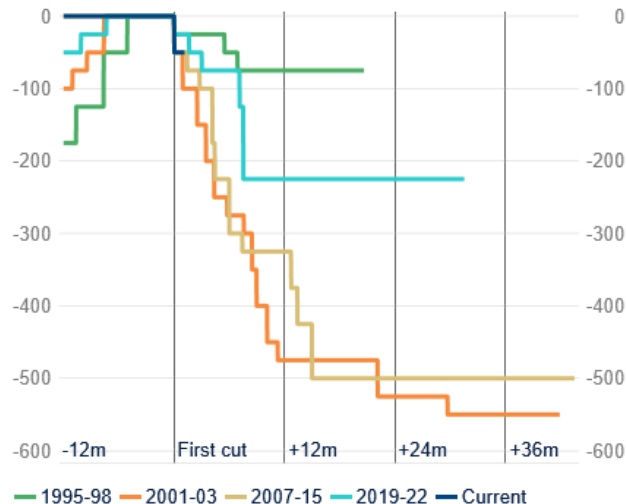
Figure 2. **FED FUNDS RATE IN EASING CYCLES (%)**



Target rate for the 1995-98, 2001-03, and 2007-15 (prior to 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

... set to proceed with more caution on the pace of rate cuts following its initial big 50bp cut, a...

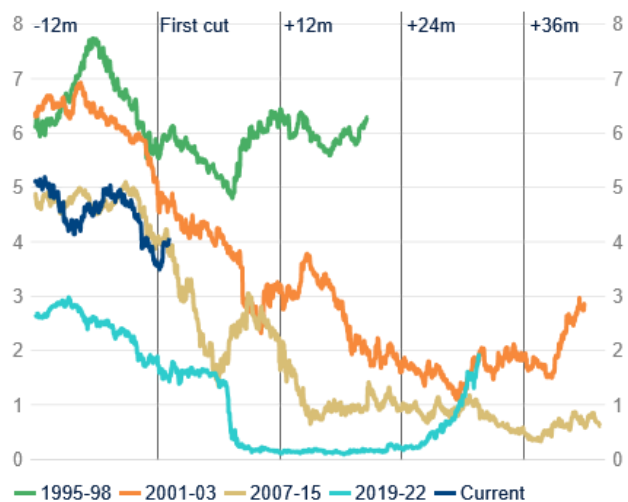
Figure 3. **FED FUNDS RATE IN EASING CYCLES (BPS VS RATE AT FIRST CUT)**



Source: BBVA Research / Fed

... sentiment echoed by markets, as evidenced by the surge in mid- and long-term Treasury yields

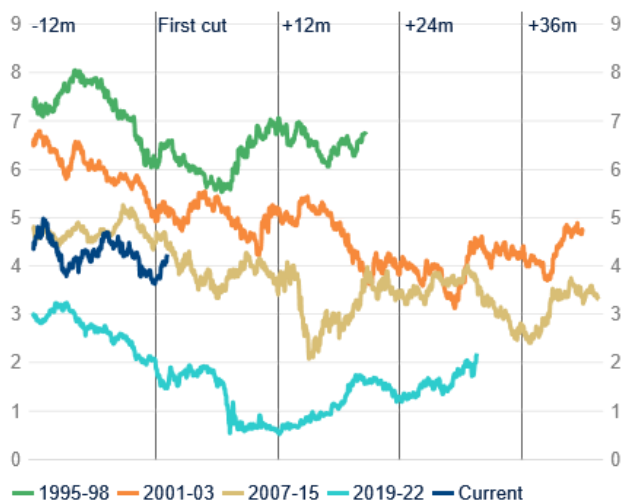
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Treasury

The roughly 50bp parallel upward shift in most of the yield curve isn't entirely unexpected, given...

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



Source: BBVA Research / Treasury

... the overly steep decline in Treasury yields that occurred in July and August, when some...

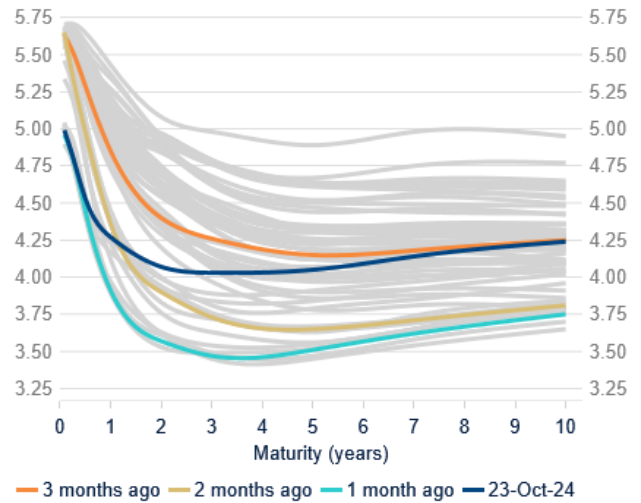
Figure 6. **TREASURY YIELDS**  
(%)



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

... market observers were even calling for an emergency FOMC meeting. This abrupt change...

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

... in market sentiment has resulted in a surge in volatility within the Treasury market, reaching...

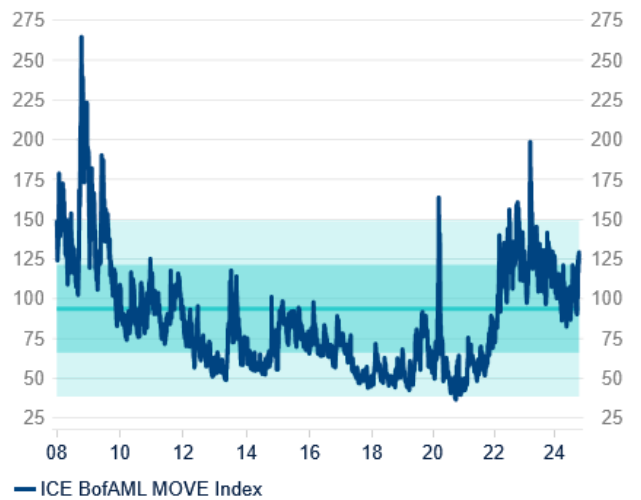
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**  
(% AND BPS)



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

... a 2024 high by certain metrics, although it remains below the levels seen in previous years

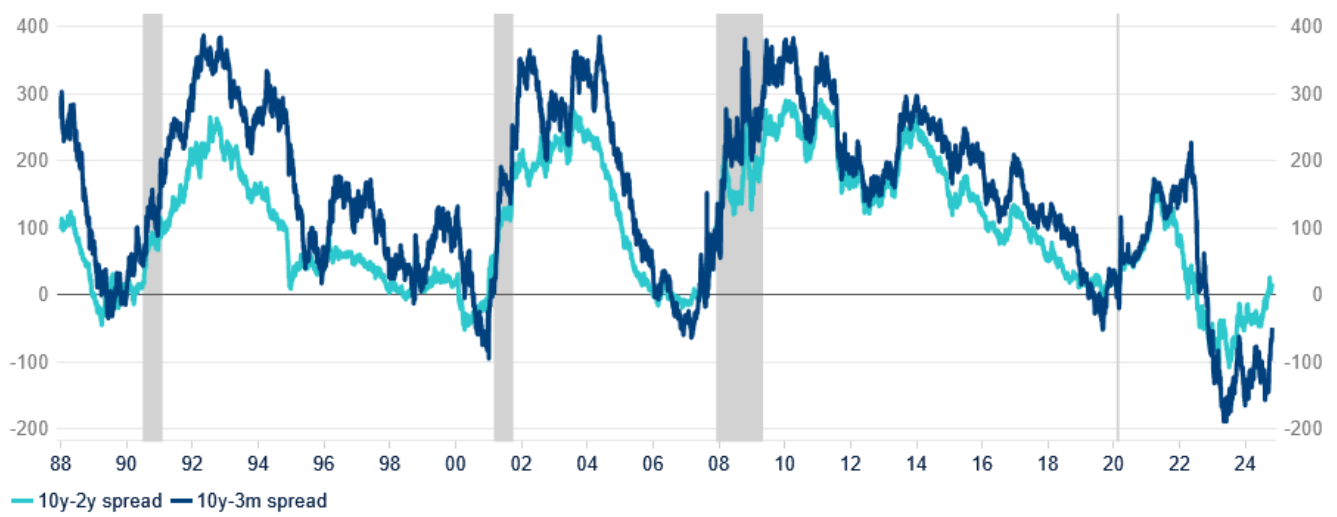
Figure 9. **ICE BOFAML MOVE INDEX**  
(BPS)



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

Even with the recent uptick in Treasury yields, the market is far from having ruled out the possibility of further rate cuts. This is reflected by the fact that the 10y-2y spread remains positive. Upcoming jobs...

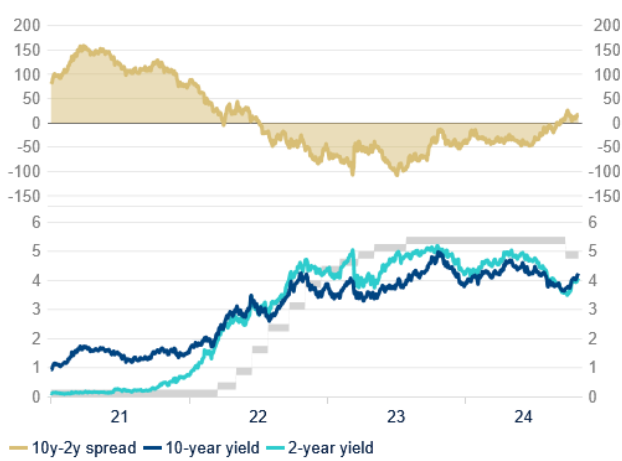
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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

... and inflation data are likely to favor the view that the economy is expanding at a healthy...

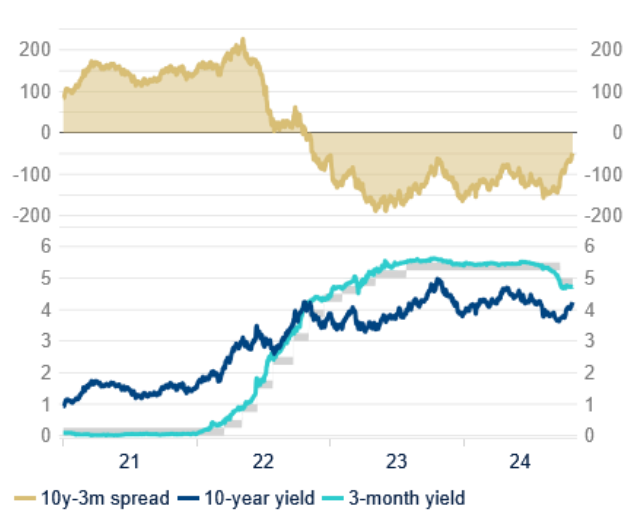
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (BPS AND %)**



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

... pace rather than overheating, potentially leading to a modest decline in long-term yields

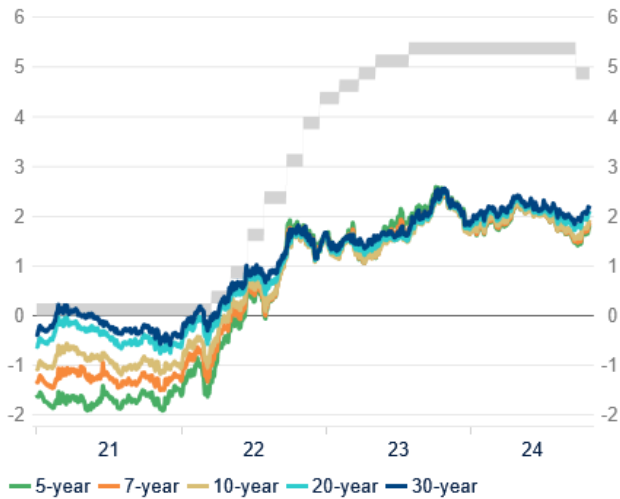
Figure 12. **10Y-3M TREASURY YIELD SPREAD (BPS AND %)**



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

About 2/3 of the recent increase in nominal yields can be attributed to a parallel 30bp upward...

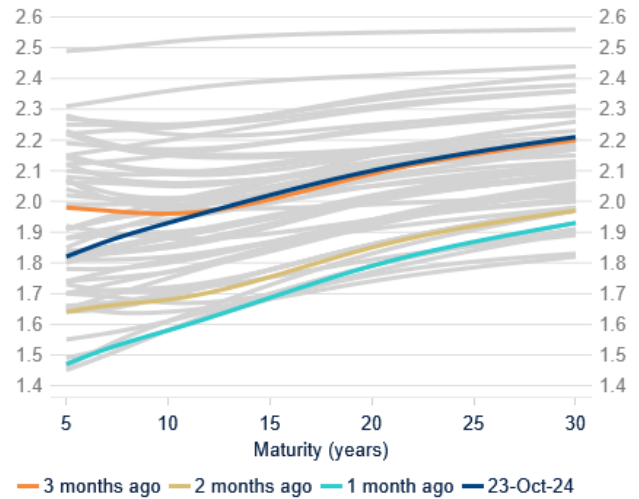
Figure 13. **TREASURY REAL YIELDS (TIPS)** (%)



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

... shift in the real yield curve, while the remainder could be explained by increased...

Figure 14. **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

... inflation premia. Well-anchored inflation expectations continue to support the Fed's...

Figure 15. **5-YEAR TREASURY BREAK-EVEN INFLATION RATE (%)**



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

... confidence that inflation is on track towards 2%. If a deterioration of inflationary risks can...

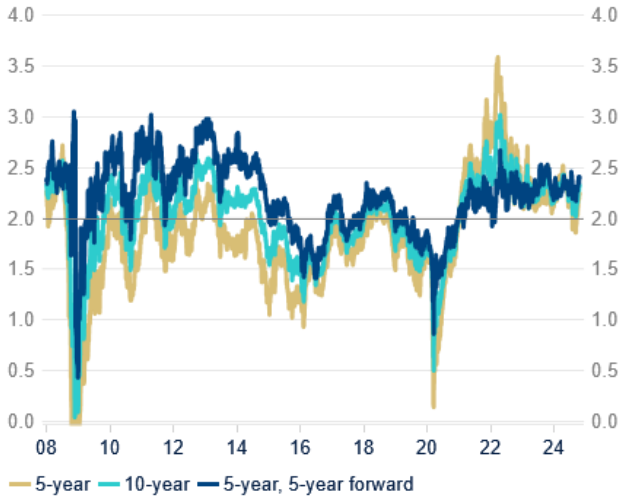
Figure 16. **10-YEAR TREASURY BREAK-EVEN INFLATION RATE (%)**



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

... once again be ruled out, as was the case after the disappointing 1Q data, inflation surprises...

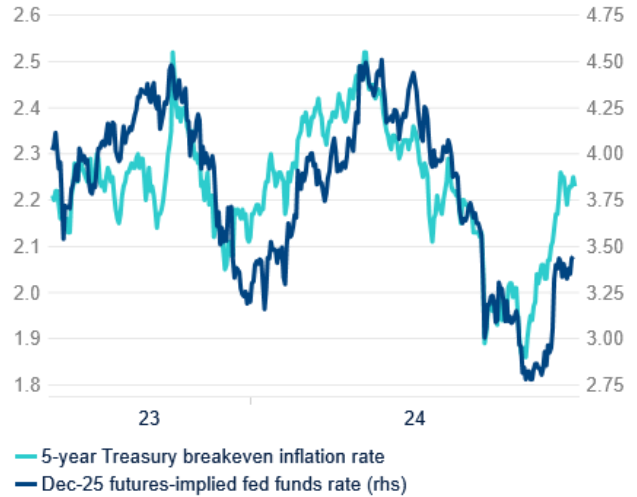
Figure 17. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research / Treasury

... could have a smaller impact on market expectations going forward. The term premium...

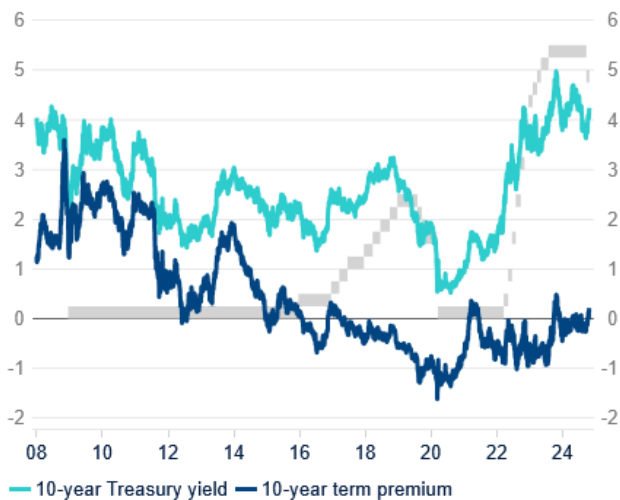
Figure 18. **BREAKEVEN INFLATION AND FUTURES-IMPLIED FED FUNDS RATE (%)**



Source: BBVA Research / Treasury / CME

... climbed above zero to a 2024-peak, suggesting that the uncertainty around the outcome of...

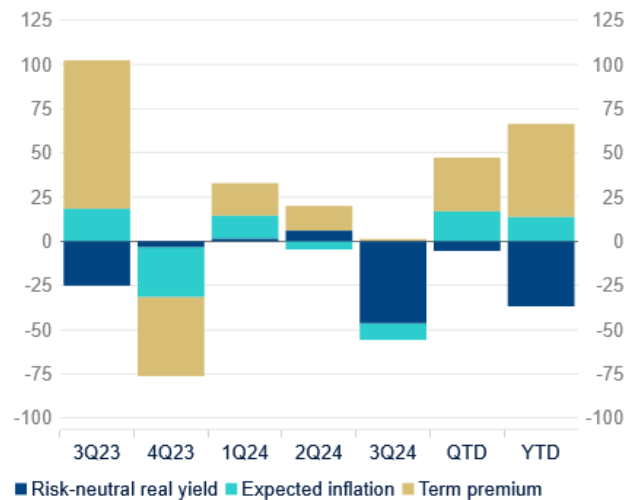
Figure 19. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



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

... next month's presidential election is also behind the recent rise in real long-term yields

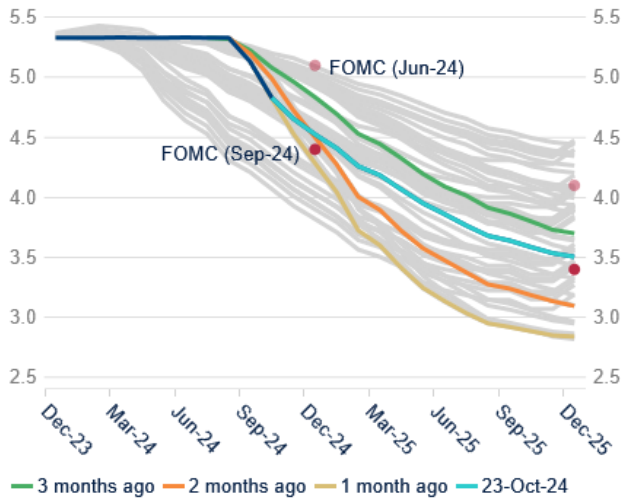
Figure 20. **10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)**



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

**The futures-implied path of the policy rate shows that financial markets now anticipate no more...**

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



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

**... than six 25bp rate cuts (vs roughly eight last month) from this point forward until 2025-end**

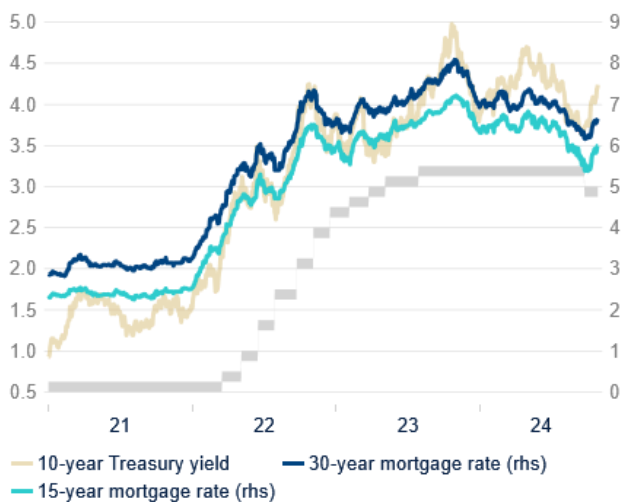
Figure 22. **FUTURES-IMPLIED FED FUNDS RATE (%)**



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

**Both 15- and 30-year mortgage rates mirrored the rise in Treasury yields over the past month, as...**

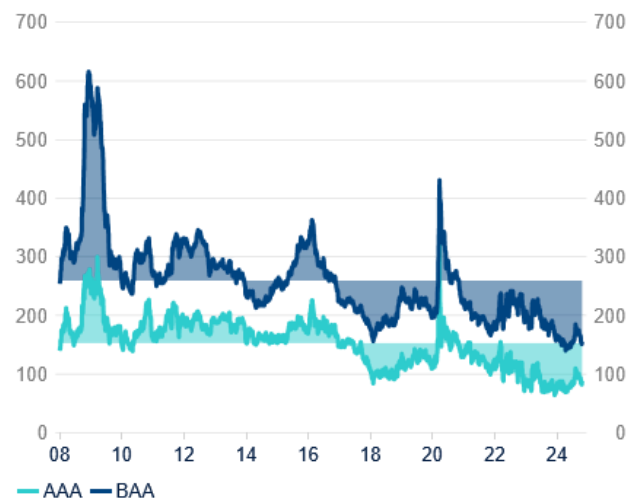
Figure 23. **MORTGAGE RATES (%)**



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

**... did the yields on investment-grade corporate bonds; credit risk premia remain subdued though**

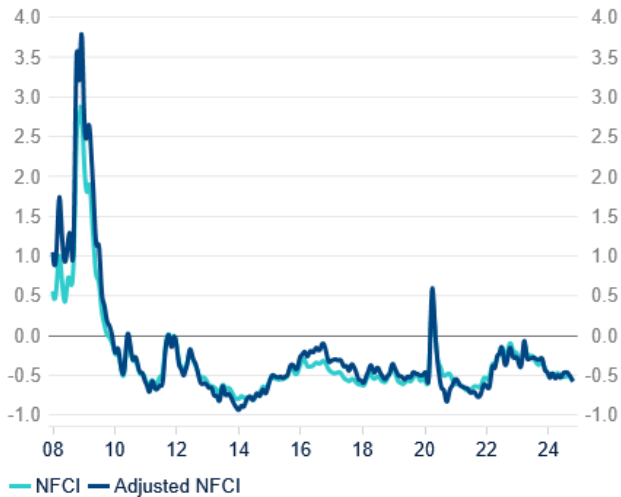
Figure 24. **CORPORATE BOND YIELD SPREADS (BPS)**



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

While the Treasury debt market has recently experienced increased volatility, this hasn't led...

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



Source: BBVA Research / Fed

... to a worsening of overall financial conditions or stress. In fact, we would expect financial...

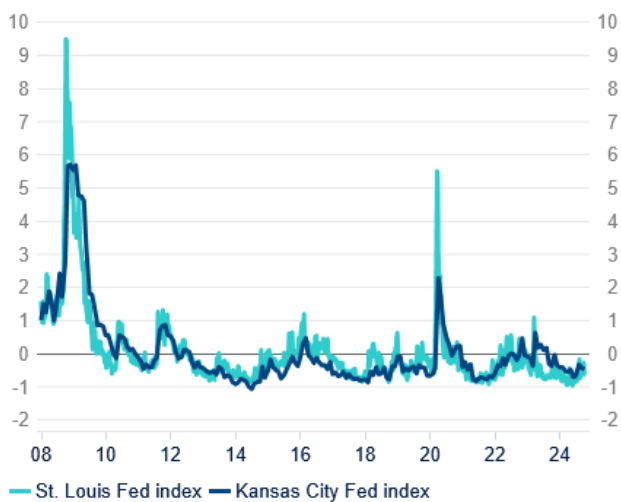
Figure 26. **BLOOMBERG US FINANCIAL CONDITIONS INDEX (<0: TIGHTER THAN PRE-GFC AVG.)**



Source: BBVA Research / Bloomberg

... conditions to gradually ease as the Fed cuts rates. That said, we can't ignore the possibility...

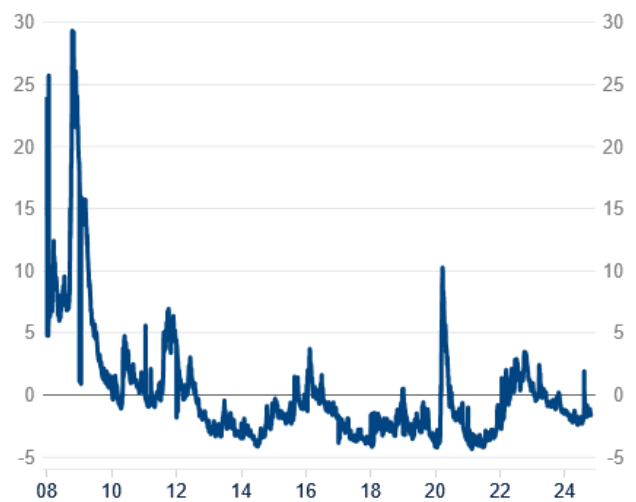
Figure 27. **FED FINANCIAL STRESS INDEXES (>0: ABOVE AVG. FINANCIAL STRESS)**



Source: BBVA Research / Fed

... of market turbulence due to potential post-election economic policy changes

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



OFR: Office of Financial Research  
Source: BBVA Research / Treasury



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