

US Interest rates monitor

Treasury yields edge higher as disinflation hits another bump on the road

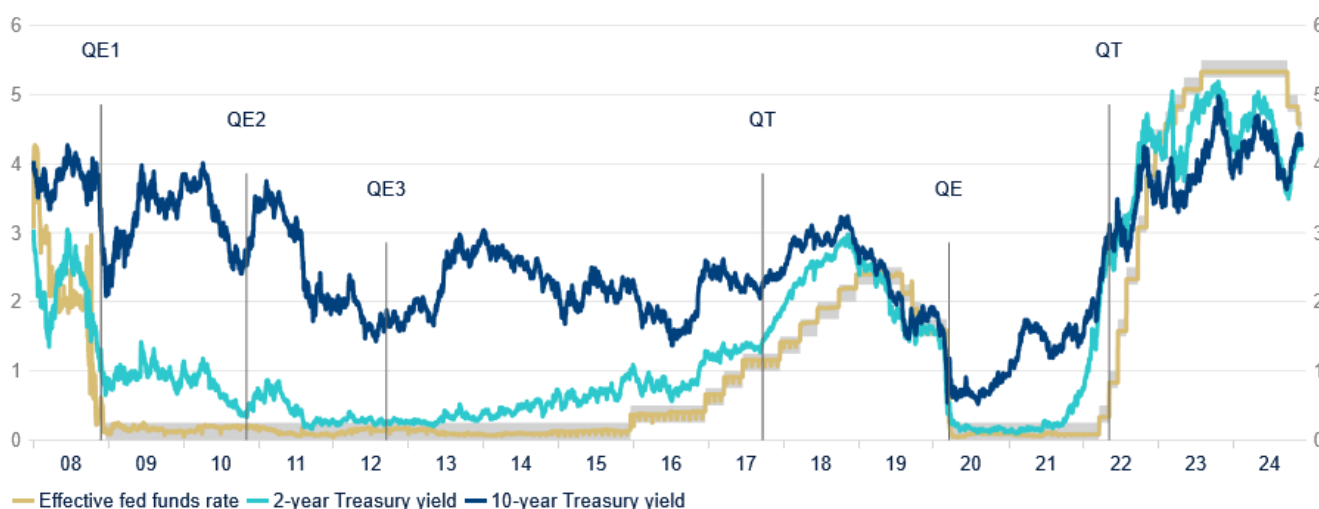
Javier Amador / Iván Fernández
November 28, 2024

Part of the rise in yields is also explained by increased risk premia on the higher global uncertainty around Trump’s potential policies

- Financial markets have priced in the risk that inflation could remain elevated for longer than previously expected, as shown by the roughly 80bp-shift of mid- and long-term Treasury yields (Figures 6 and 7).
- Real yields also stay at relatively high levels as the continued strength of economic activity keeps suggesting that the path to a soft landing is likely not as narrow as initially thought (Figures 13 and 14).
- Market-based inflation expectations have increased (Figures 15 and 16), but most Fed members are unlikely to be overly concerned: “many participants [...] highlighted the importance of focusing on underlying [...] trends.”
- Both stronger inflation data and greater uncertainty around the future of the US economy have driven the futures market to significantly reassess its expectations for the path of the policy rate next year (Figure 21).
- Mortgage rates mirrored the increase in long- term yields amid the housing sector’s supply-side issues (Figure 23), but the corporate bond market remains immune to the increased uncertainty (Figure 24).

The Fed continued to remove monetary policy restriction through a 25bp rate cut earlier this month, but Treasury yields continued to rise on stronger-than-expected inflation readings and Trump’s victory

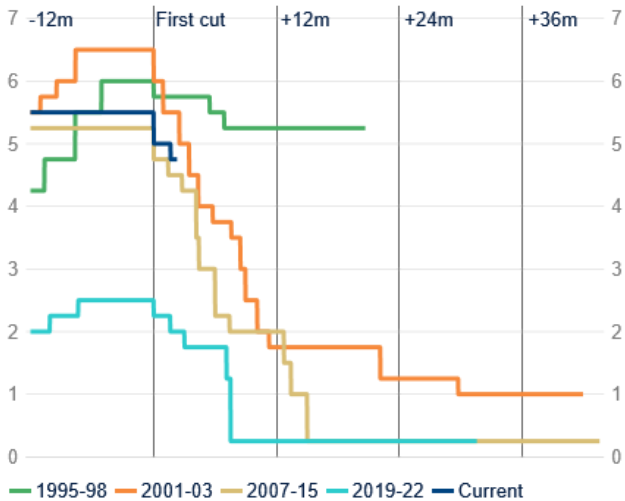
Figure 1. FED FUNDS RATE AND TREASURY YIELDS (%)



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

Both CPI and PCE core inflation increased at a 0.3% MoM pace in October, but chances are...

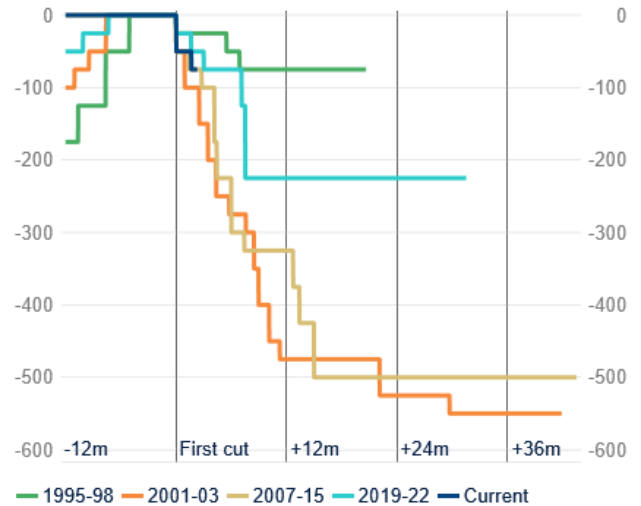
Figure 2. **FED FUNDS RATE IN EASING CYCLES (%)**



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

... that the Fed remains confident enough to keep cutting rates at a modest 25bp pace in December

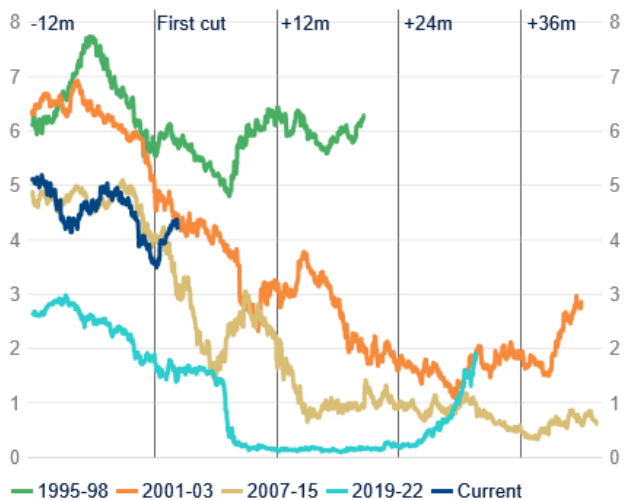
Figure 3. **FED FUNDS RATE IN EASING CYCLES (BPS VS RATE AT FIRST CUT)**



Source: BBVA Research / Fed

Powell noted recently that he expects “inflation to continue to come down, [...] albeit on a...

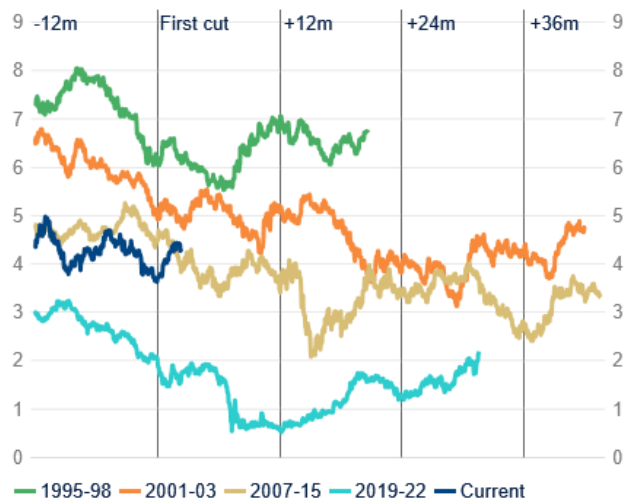
Figure 4. **2-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Treasury

... sometimes-bumpy path,” but financial markets have priced in the risk that inflation could...

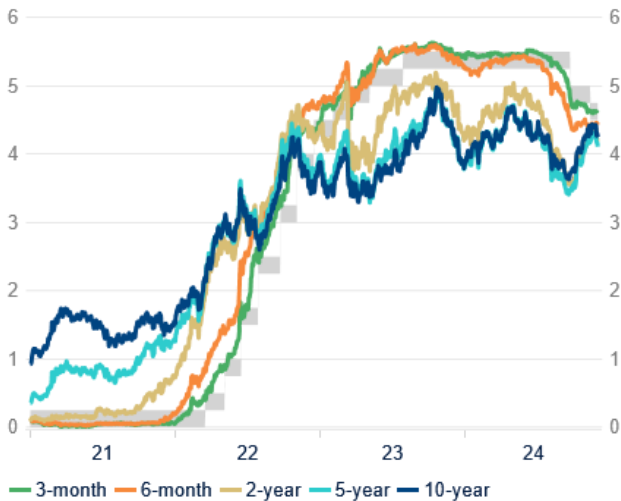
Figure 5. **10-YEAR TREASURY YIELD IN TIGHTENING CYCLES (%)**



Source: BBVA Research / Treasury

... remain elevated for longer than previously expected, as shown by the roughly 80bp-shift...

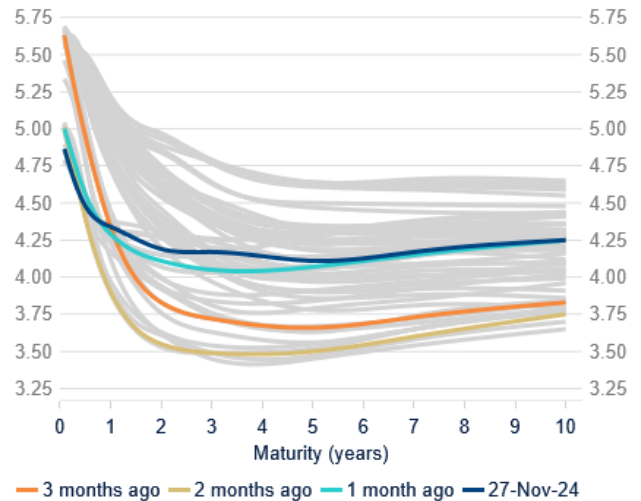
Figure 6. **TREASURY YIELDS**
(%)



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

... of mid- and long-term Treasury yields from their mid-Sep lows, when the Fed began its...

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

... easing cycle with a 50bp cut. This risk is not negligible, as reflected by the latest FOMC...

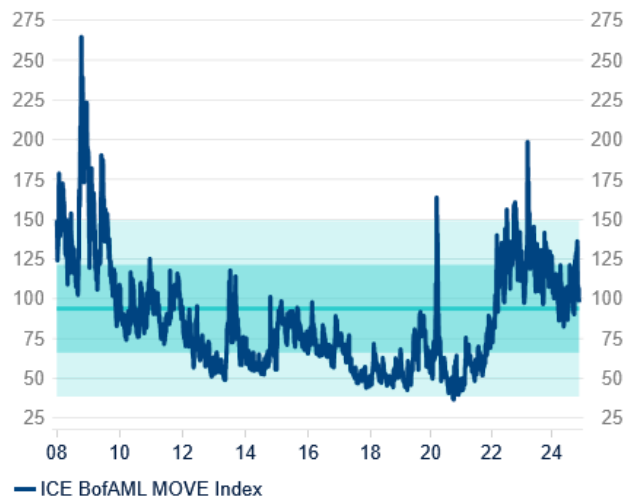
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE**
(% AND BPS)



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

... meeting minutes that showed that "a couple [of participants] noted the possibility that the..."

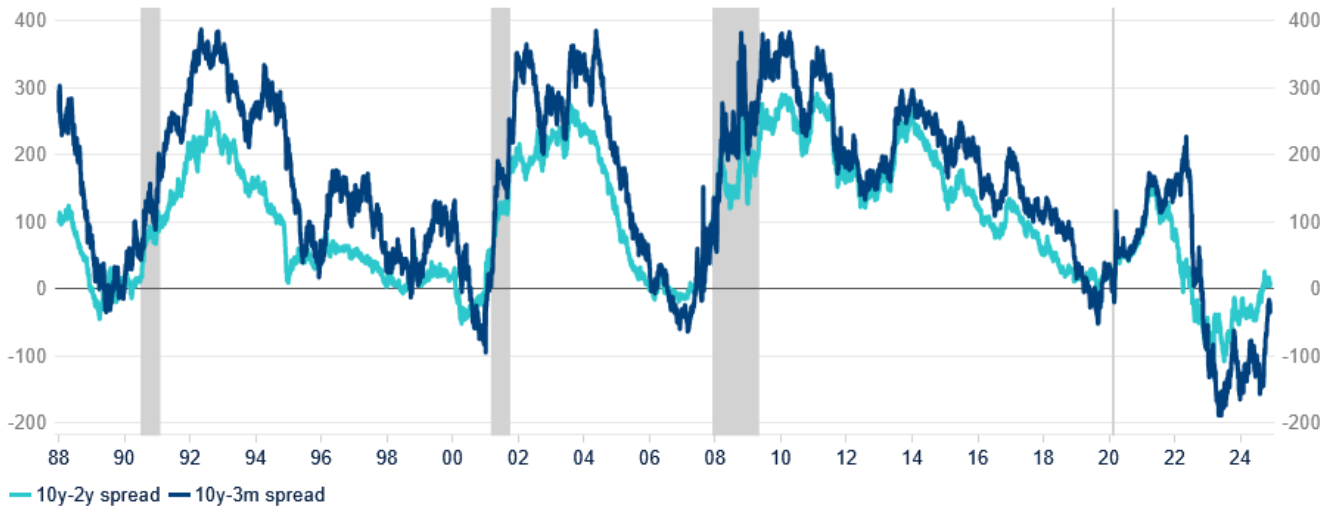
Figure 9. **ICE BOFAML MOVE INDEX**
(BPS)



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

... process [of disinflation] could take longer than previously expected,” but there were also “many” who “highlighted the importance of focusing on underlying economic trends,” probably referring to the fact...

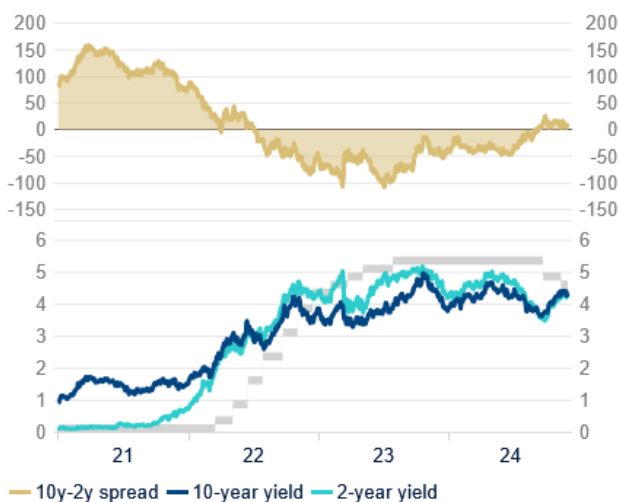
Figure 10. **TREASURY YIELD SPREADS (BPS)**



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

... that the resurgence of significant demand-driven inflationary pressure is unlikely in the...

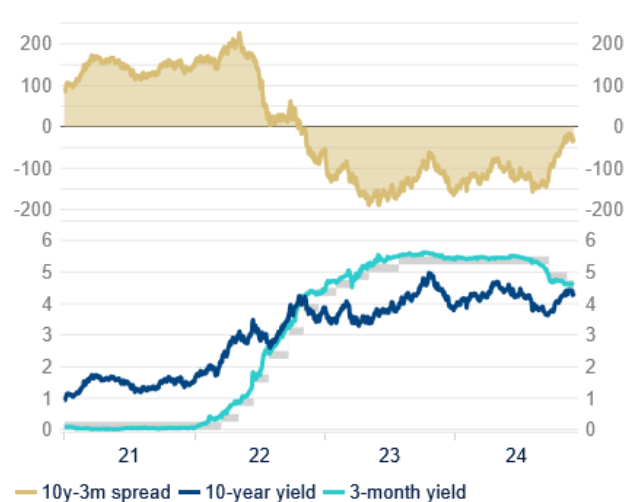
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (BPS AND %)**



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

... near future given the evident rebalancing of the labor market, which has cooled down notably

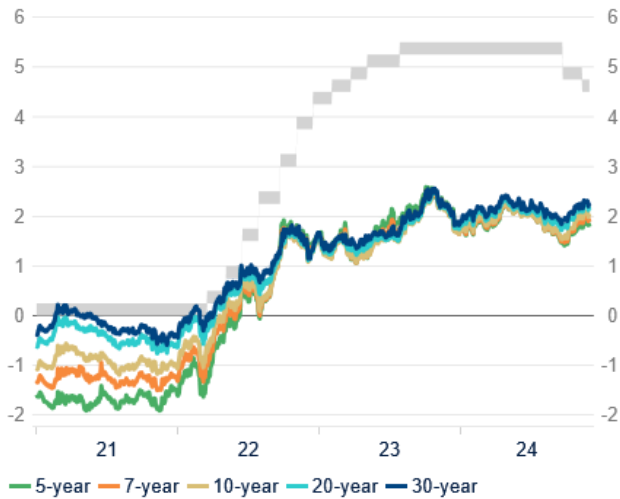
Figure 12. **10Y-3M TREASURY YIELD SPREAD (BPS AND %)**



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

Real Treasury yields stay at relatively high levels as the continued strength of the economy...

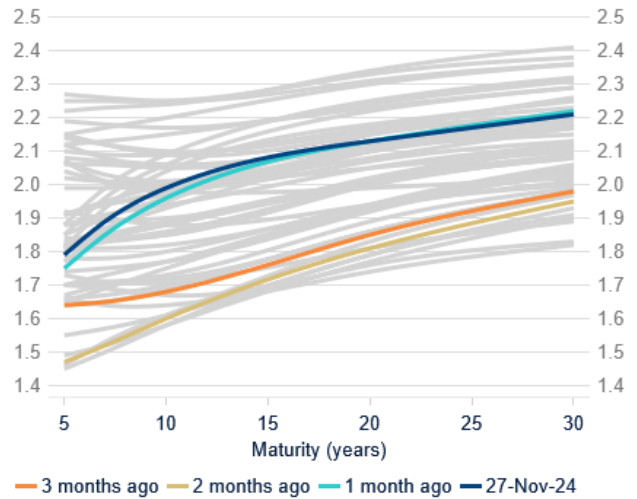
Figure 13. **TREASURY REAL YIELDS (TIPS)**
(%)



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

... keeps suggesting that the path to a soft landing is likely not as narrow as initially thought

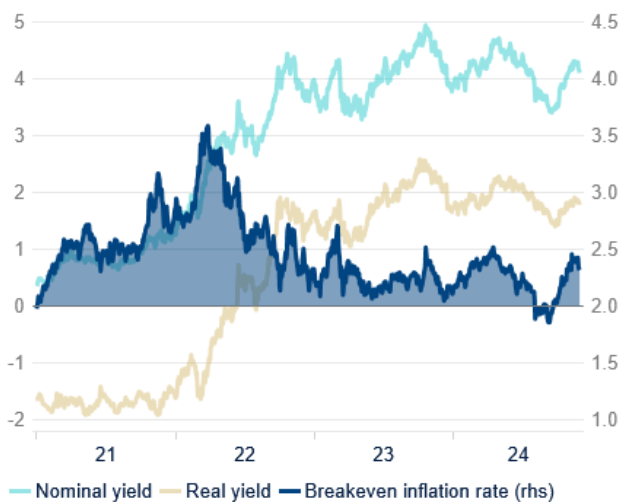
Figure 14. **TREASURY REAL YIELD CURVE (TIPS)**
(%)



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

And while market-based inflation expectations have increased in recent months, the Fed is...

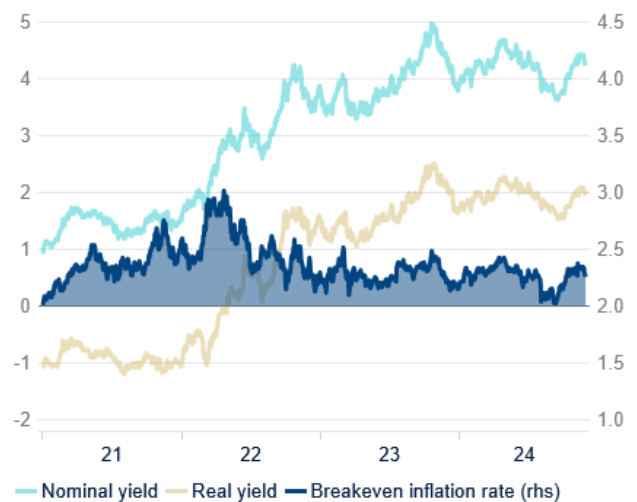
Figure 15. **5-YEAR TREASURY BREAK-EVEN INFLATION RATE (%)**



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

... unlikely to be concerned by them as noted in the last meeting minutes: "these measures..."

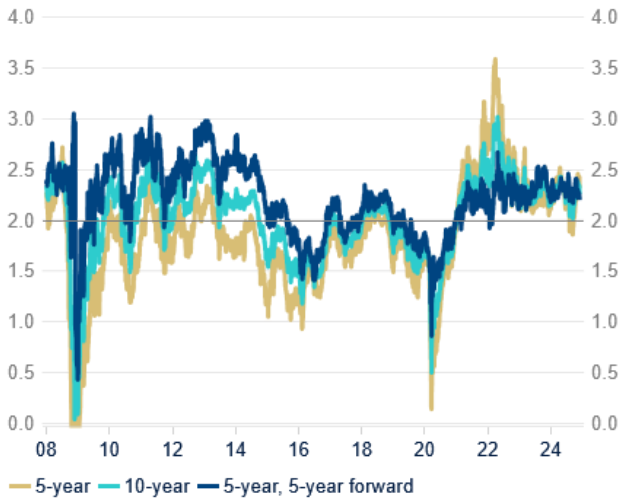
Figure 16. **10-YEAR TREASURY BREAK-EVEN INFLATION RATE (%)**



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

... continued to suggest an expectation that inflation would return over time” to 2%. Part of...

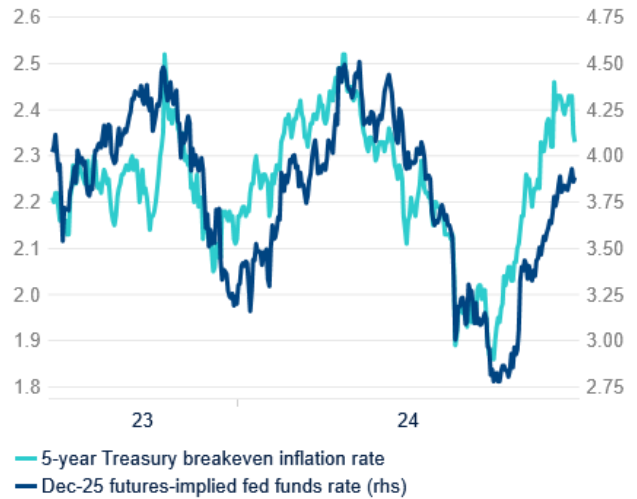
Figure 17. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research / Treasury

... the rise in Treasury yields is also explained by a higher term premium, which has likely...

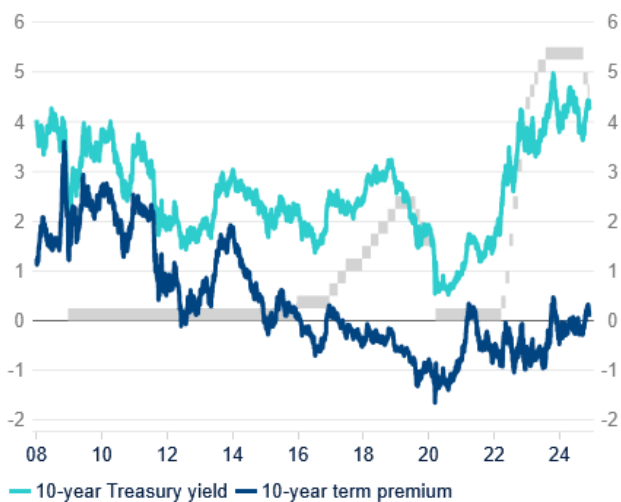
Figure 18. **BREAKEVEN INFLATION AND FUTURES-IMPLIED FED FUNDS RATE (%)**



Source: BBVA Research / Treasury / CME

... been driven by greater uncertainty around the US inflation and fiscal outlook in the following...

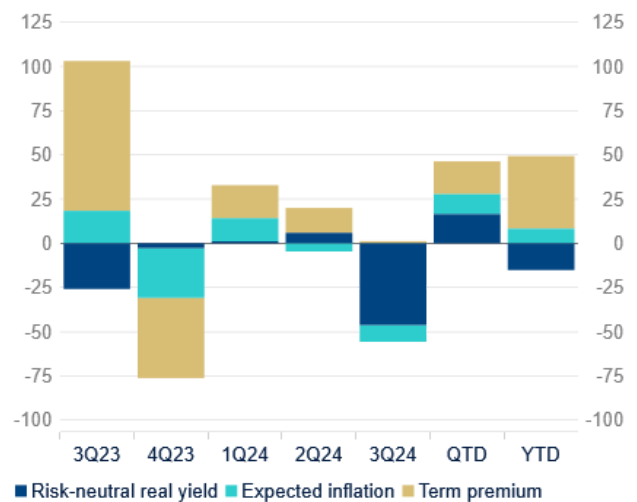
Figure 19. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



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

... years amid Trump’s potential trade, tax and migration policies. Both stronger data and...

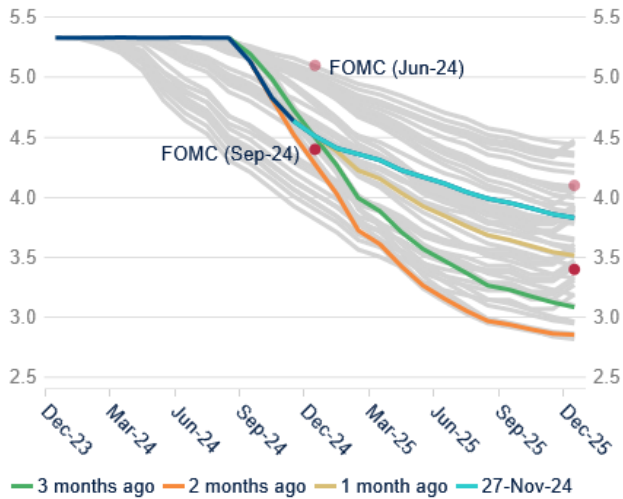
Figure 20. **10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)**



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

... greater uncertainty around the future of the US economy have driven the futures market to...

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



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

... significantly reassess its expectations for the path of the policy rate next year

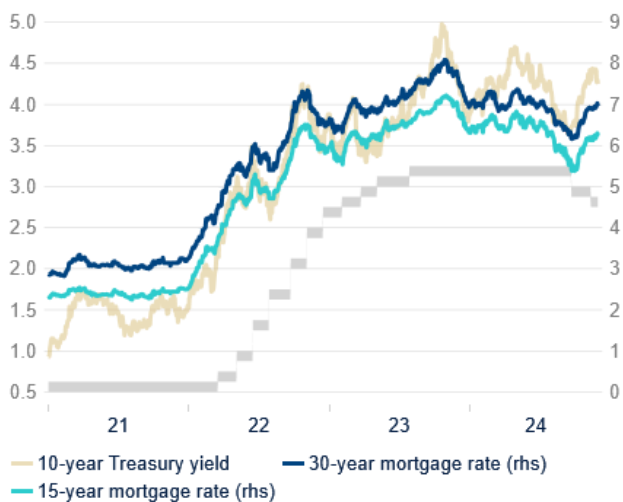
Figure 22. **FUTURES-IMPLIED FED FUNDS RATE (%)**



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

Mortgage rates mirrored the increase in long-term yields amid the housing sector's supply-...

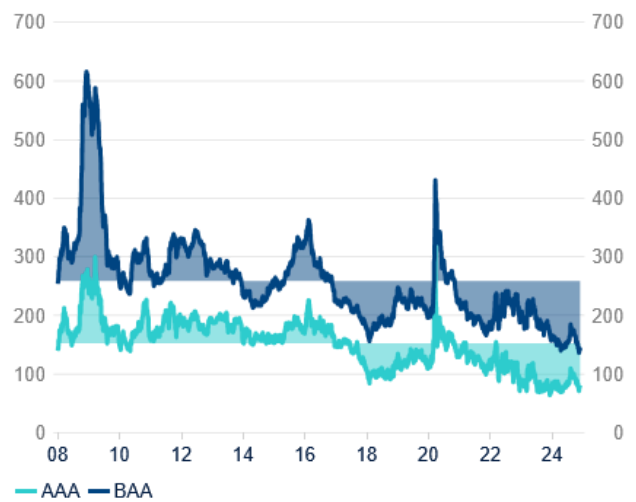
Figure 23. **MORTGAGE RATES (%)**



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

... side issues, but the corporate bond market remains immune to the increased uncertainty

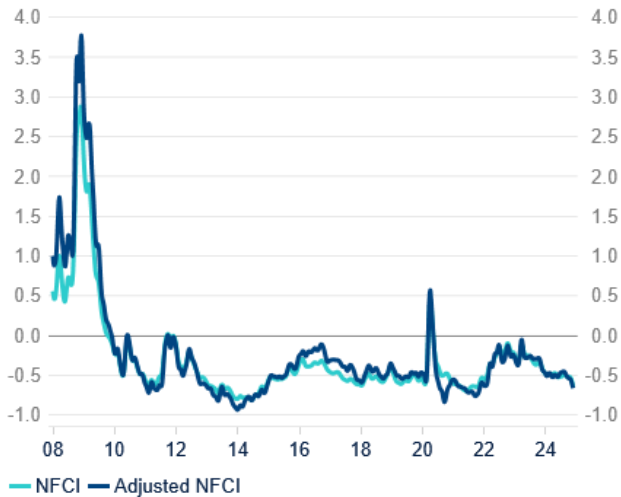
Figure 24. **CORPORATE BOND YIELD SPREADS (BPS)**



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 financial system has not had any major setbacks since the collapse of several regional...

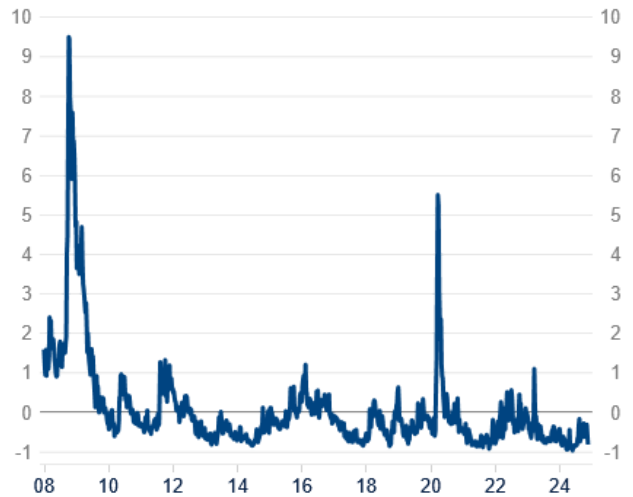
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX (>0: TIGHTER THAN AVG.)**



Source: BBVA Research / Fed

... banks in the spring of 2023, preventing a degradation in broad financial conditions indexes

Figure 26. **ST. LOUIS FED FINANCIAL STRESS INDEX (>0: ABOVE AVG. FINANCIAL STRESS)**



Source: BBVA Research / Fed

But the Fed’s staff has “continued to characterize the system’s financial vulnerabilities as notable...

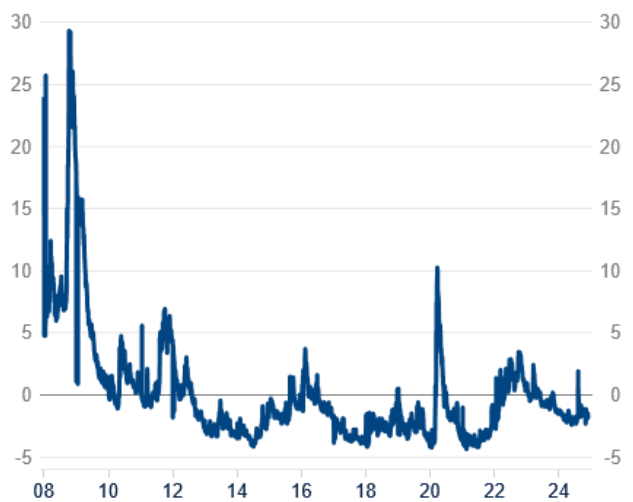
Figure 27. **KANSAS CITY FED FINANCIAL STRESS INDEX (>0: ABOVE AVG. FINANCIAL STRESS)**



Source: BBVA Research / Fed

... [...] with estimates of risk premiums across key markets low by historical standards”

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



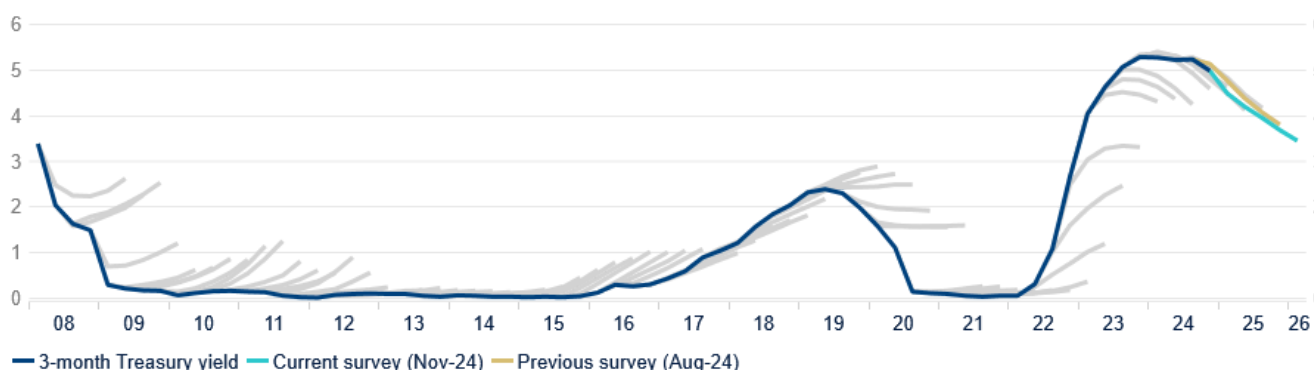
* OFR: Office of Financial Research
Source: BBVA Research / Treasury

Trump’s victory had less of an impact on professional forecasters’ interest rate predictions than on market-implied expectations

- Professional forecasters surveyed this month by the Philadelphia Fed revised down its 3-month Treasury yield for 4Q24 to 4.48% (from 4.75%) following the Fed’s initial big 50bp rate cut (Figure 29).
- The rest of their forecasts for the path of short-term rates did not change as significantly as did market-implied expectations.
- The median forecaster thinks that the recent rise of the 10-year Treasury yield will be short-lived: it will trend down next year towards 3.8% in 2025 and to a likely 3.7% steady-state level in 2026-27 (Figure 30).

Professional forecasters’ projections for short-term Treasury yields continue to be broadly in line with the one signaled by FOMC participants in their latest SEP (September) for the fed funds rate

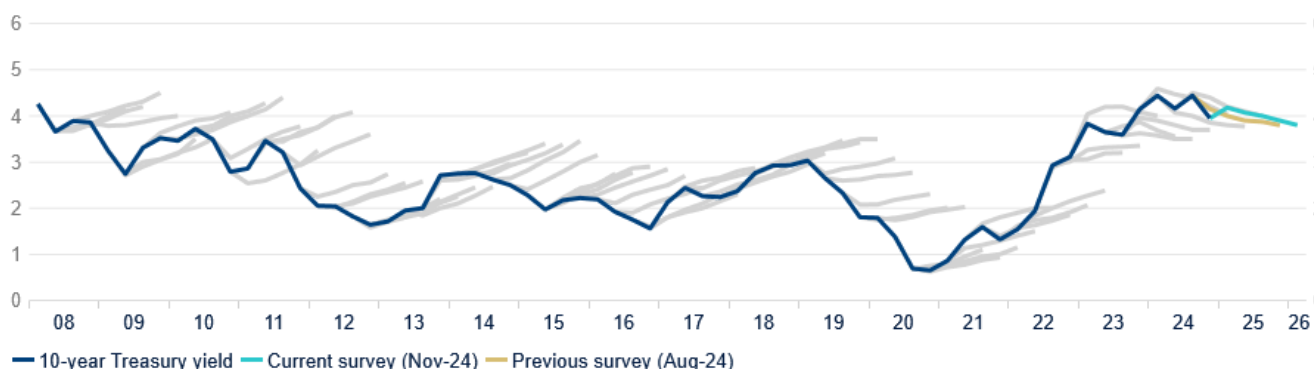
Figure 29. **PROFESSIONAL FORECASTERS 3-MONTH TREASURY YIELD EXPECTATIONS (%)**



Median values. The gray lines indicate historic Professional Forecasters' expectations
Source: BBVA Research / Fed

A higher starting point appears to be the main reason behind the slight revision to their 10-year Treasury yield forecasts. Forecasters do not seem to be assigning a significant risk premium to their predictions

Figure 30. **PROFESSIONAL FORECASTERS 10-YEAR TREASURY YIELD EXPECTATIONS (%)**



Median values. The gray lines indicate historic Professional Forecasters' expectations
Source: BBVA Research / Fed

Their expectation is still that the easing cycle will extend through 2027: the 3-month yield is still...

Figure 31. **PROFESSIONAL FORECASTERS TREASURY YIELDS EXPECTATIONS (%)**



Shaded areas indicate interquartile ranges
Source: BBVA Research / Fed

... expected to land at 2.8%, which would be consistent with a 2.75-3.00% Fed's target range

Figure 32. **PROFESSIONAL FORECASTERS IMPLIED 10Y-3MY SPREAD EXPECTATIONS (BPS)**



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

Companies' credit risk profile appears to remain immune to high interest rates as investment...

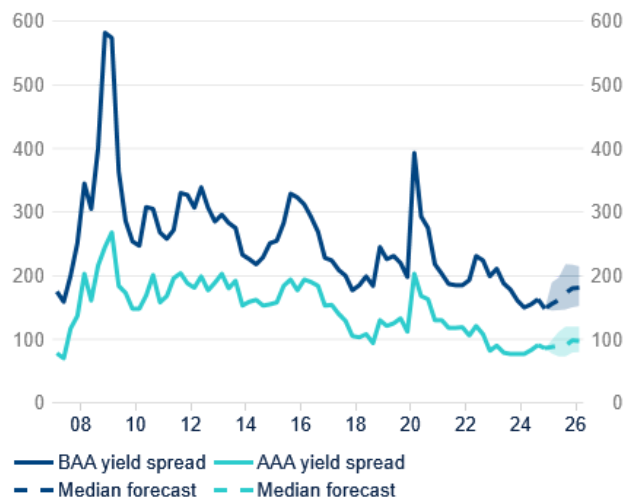
Figure 33. **PROFESSIONAL FORECASTERS CORPORATE YIELDS EXPECTATIONS (%)**



Shaded areas indicate interquartile ranges
Source: BBVA Research / Fed

... grade bond spreads are projected to inch up but to remain below pre-pandemic average levels

Figure 34. **PROFESSIONAL FORECASTERS IMPLIED CORPORATE YIELD SPREADS EXPECTATIONS (BPS)**



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

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