Economic Analysis

Long-term yields edge up yet fundamentals remain unchanged

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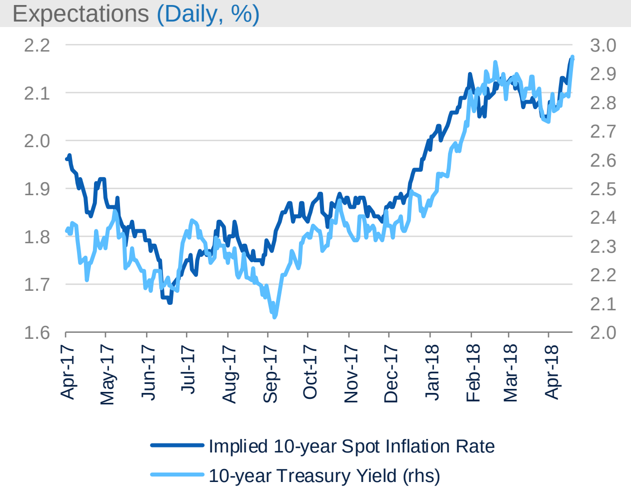
Long-term yields have moved up as the 10-year Treasury yield is expected to cross the 3.0% threshold – a level not seen since January 2014. The climb in long-term yields is backed by an increase in inflation expectations. The marked boost of inflation expectations reflects upward movement in commodity prices. The dynamics in 2014 was different with markets facing declining crude oil prices, gradual tapering of Federal Reserve's Large Scale Asset Purchases, and the Zero-Lower-Bound in the Fed funds rate. The current soft upwards movement in long-term yields, backed by inflation expectations, is expected to support and not hinder economic growth, particularly as underlying macro fundamentals remain strong and wage pressure remains muted. Moreover, it eases the flattening of the yield curve since short-term rates remain under upward pressure, in line with the Federal Reserve's steady policy rate tightening trajectory. The spread between the 10-year and 2-year Treasury yields has fluctuated between 41 and 53 basis points in April.

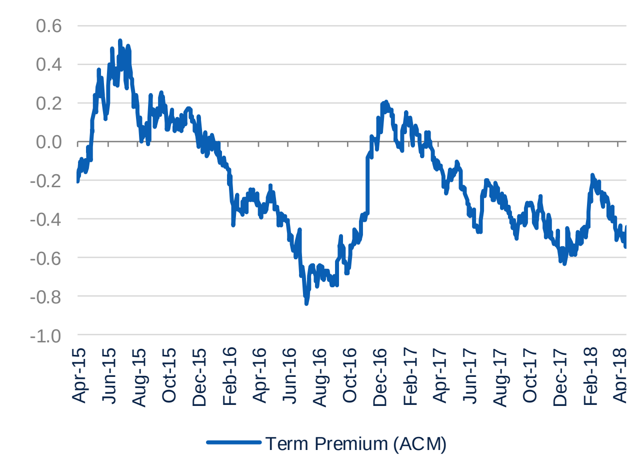
At the same time, the term premium on 10-year Treasury has remained largely unchanged and negative. The long-term term premium continues to reflect geopolitical risks, as the environment of supply and demand imbalance in long-term Treasuries and the amplified role of duration risk as a global shock absorber remain unchanged.

Figure 1. U.S. 10-year Treasury Note and Inflation Expectations (Daily, %)



Source: FRB, Treasury & BBVA Research

Figure 2. 10-year Treasury Note Term Premium (Daily, %)



Source: FRBNY & BBVA Research

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