



GLOBAL MARKETS UPDATE

Raising our forecasts for the 10-year Treasury yield

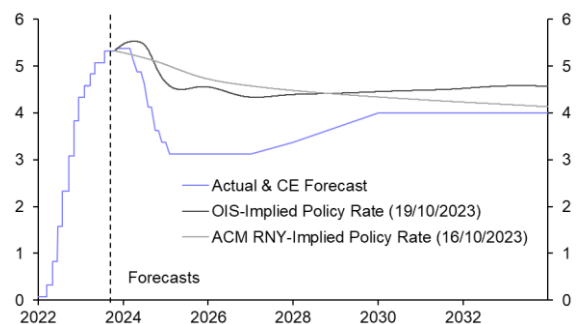
- We still expect the 10-year Treasury yield to fall in the coming quarters. But we’ve revised up our projections for that yield from now to end of 2025, and now think it will reach its cyclical low in 2024.
- There are two key reasons why we have pushed up our 10-year Treasury yield forecasts. First, we recently revised up our forecast for the federal funds rate at the end of 2025 (by 50bp, to 3.0-3.25%) and beyond. That shift mainly reflects the fact that we’ve raised our estimates of current and future levels of the equilibrium real interest rate (aka R*) in the US. Accordingly, we project that the federal funds rate will typically be higher in the future than we had previously envisaged, assuming that on average, over the economic cycle, it will be set around its equilibrium level. Our estimates for the *nominal* policy rate in 2030 are now significantly higher than our previous ones and close to market-implied levels, at least judging by ACM estimates. (See Chart 1.) (For the complete analysis and our new estimates for equilibrium real rates in major advanced economies, see our *in-depth research series* published earlier this week.)
- That increase in our federal funds rate forecasts translates into higher projections for the risk-neutral yield of 10-year Treasuries, which captures expectations for short-term interest rates during the following decade.
- Second, we think the 10-year Treasury term premium will stay at higher levels than their average following the Global Financial Crisis (GFC). We have argued for a while that Treasury term premia, which capture the net effect on Treasury yields of all factors other than expectations for short-term interest rates, were likely to rise. Indeed, over the past three months, the 10-year Treasury term premium according to ACM estimates has risen by over 120bp, accounting for the vast majority of the rise in the 10-year yield since then. However, despite that sharp increase, that term premium still looks quite low compared to its pre-GFC levels. Therefore, it seems likely to us that it will stay near its current level over the coming years or even rise further – especially since, in our view, upside risks have risen in light of the fiscal outlook.
- But, taking a step back, we still expect the 10-year Treasury yield to fall in the coming quarters. Despite sharing investors’ view that the policy rate will settle at a higher level in the longer run, in the *near term* we’re anticipating a much more aggressive loosening of policy than what is implied by the ACM risk-neutral estimate or the overnight index swap (OIS) market. (See Chart 2.) As investors come round to our view over the next year or so, we suspect this will more than outweigh any further rise in the 10-year Treasury term premium in the meantime.
- So, we now anticipate the 10-year Treasury yield to reach a trough in late 2024 and to pick up again a bit by the end of 2025. The upshot is that we now project that yield to be 4.50%, 3.75% and 4.00% by end-2023, end-2024 and end-2025, respectively. Those are higher than our previous forecasts of 3.75%, 3.25% and 3.00%, but below the current 10-year yield of ~5.00%.

Chart 1: Estimates Of The Long-Run US Real Interest Rate (%)



*CE historical data taken from our annual *Long Run Outlooks*.

Chart 2: Federal Funds Rate (%)



Sources: ACM, Refinitiv, CE





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