## US Macroeconomics

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# With the Fed Done, Yields Can Fall Substantially More

The Treasury market has rallied massively over the last eight weeks with the yield on the 10-year note falling from around 5% to under 4%. According to our calculations, this is the largest decline in long-term rates in such a short period since October to December 2008, which was the height of the Great Financial Crisis. But if history is a guide, yields can still fall substantially more in the months ahead.

The catalysts for the recent interest rate decline were softer current quarter real GDP forecasts, further moderation in inflation and most importantly, a pivot in monetary policy that was signaled at the December FOMC meeting. Past periods show that **when the Fed is done hiking, large declines in long-term interest rates are commonplace**.

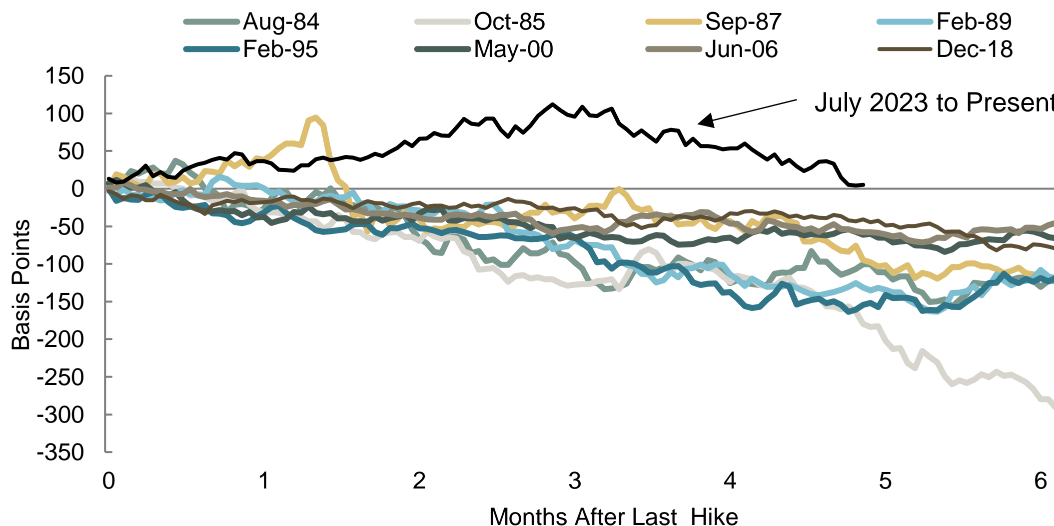
As illustrated in the chart below, **10-year Treasury notes have always rallied sharply in the months immediately after the Fed's last rate hike**. The one exception has been the current episode. On average, yields fall 41 basis points (bps) within the first two months of the Fed being done, and generally drift lower over the next four months, declining a cumulative 116 bps. But there is substantial variation among the cycles.

For example, in the two months following the completion of the 2018 tightening cycle, 10-year notes fell only 20 bps Meanwhile during the 1985 period, interest rates plunged 64 bps in two months and were substantially lower six months out, down a massive 290 bps in total.

In this business cycle, the Fed's last hike was July 2023, but unlike the eight episodes shown below, yields moved sharply higher this past summer and early fall. Why? **The unexpected increase in yields around mid-year 2023 was partially due to the Fed's signaling that another rate hike was possible by yearend**. In turn, this kept yields from falling. But there was another factor, too.

Unexpected US dollar strength led to foreign-related selling of Treasuries out of Asia. This also led to higher long-term interest rates in excess of our fundamental fair value model. But with the Fed done tightening and the dollar weakening, this is no longer a concern.

In conclusion, even though the bond market has rallied significantly over the last two months, **long-term interest rates are only back to where they were in July**. And now that investors are rightly convinced the Fed is done tightening, history tells us the yield on 10-year notes can fall appreciably further.




Sources: FRB, Bloomberg, SMBC Nikko

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