

US Macroeconomics

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10-year Treasury Notes Signaling End of the Tightening Cycle

If yields on 10-year Treasury notes have peaked for this tightening cycle, we are close to the peak in fed funds. This is what history tells us.

Over the last four decades, the yield on the 10-year note has peaked before the peak in the fed funds rate in five out of six instances. The only time 10s did not top before the funds rate was in 2006 when both instruments peaked at the same time.

The six periods are shown in the table below. The average lead time is two months, and the longest lead time is four months in 2000. The cyclical high in 10s is 4.24% which occurred two months ago. They have rallied sharply since then.

If past 10-year note behavior is prologue, this December's rate hike could be the last one of this tightening cycle. This runs counter to both Fed and investor expectations.

The Fed is poised to raise rates 50 basis point (bps) and will add another 50 bps to its forecast of the terminal rate, bringing it to 5.125%. FOMC forecasts will show the funds rate on hold through 2023 with first rate cut not until 2024. The futures market forecasts the funds rate to peak at 5% by next March and then to gradually start cutting by November 2023. These expectations may miss the mark.

The far-right column in the table shows the slope of the yield curve at the time the funds rate peaked. There are two times when the curve was positive—1984 and 1995. They are also the only two soft economic landings. The other periods when the curve was inverted foreshadowed recession.

Essentially **when the curve is inverted at peak fed funds, monetary policy has overtightened, and recession is ahead.** Clearly that is what today's deeply inverted curve is telling us. The Fed is close to done tightening, with the potential for aggressive 2023 easing possible if our GDP and inflation projections come to fruition.

Peak Month		Lead Time	Yield Curve
10-year UST	Fed Funds	Months	2s/10s bps
May-84	Aug-84	3	25
Mar-89	May-89	2	-22
Nov-94	Feb-95	3	43
Jan-00	May-00	4	-40
Jun-06	Jun-06	0	-1
Oct-18	Dec-18	2	21
Oct-22	?	?	-22
Average >		2	

Source: Bloomberg, Haver, SMBC

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