

Economic Alert iQ



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International

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U.S. Treasury Yield Curve Inverts for First Time Since 2007

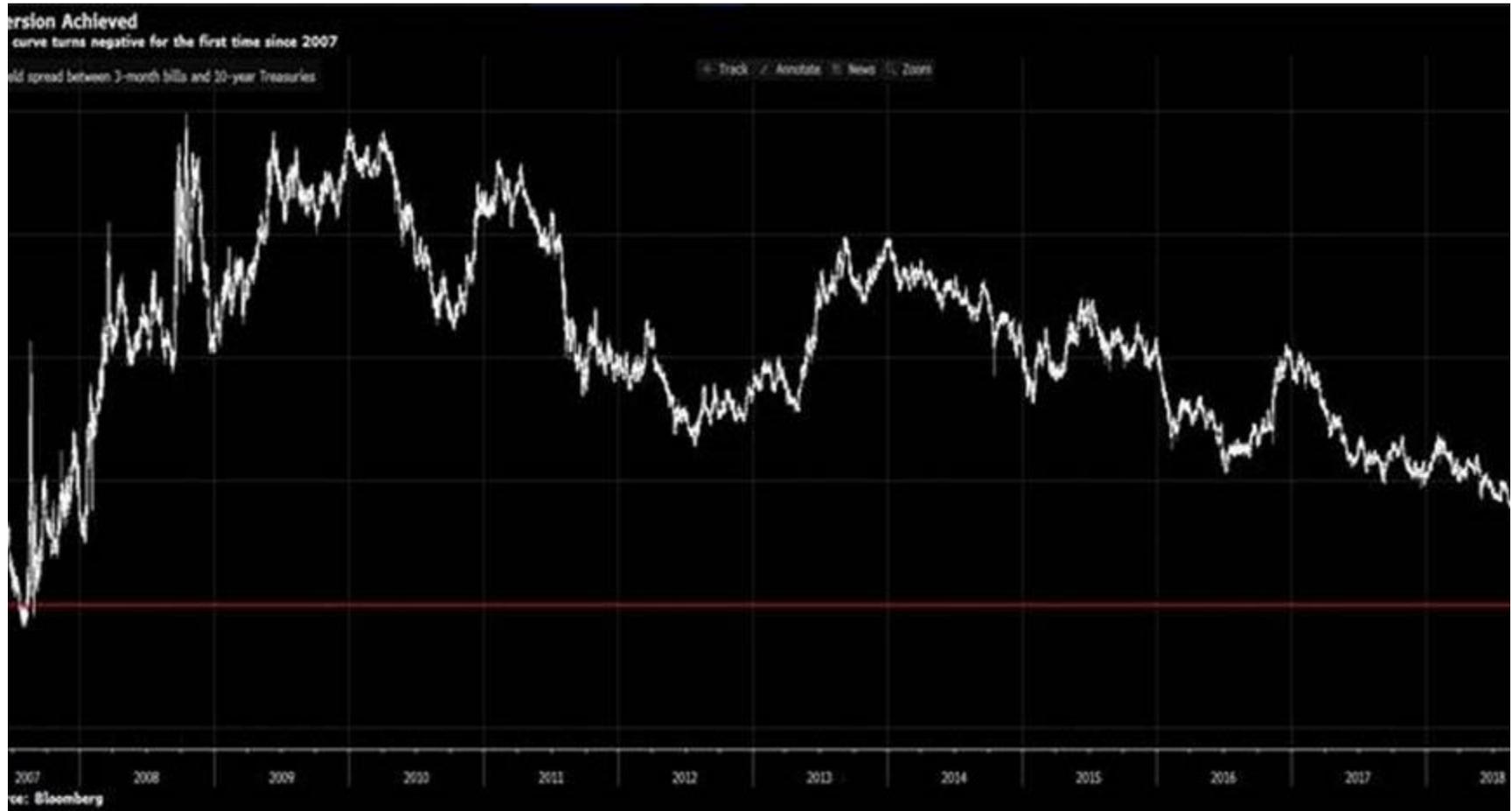
Inversion point

- The spread between the 3-month and 10-year Treasury notes fell below 10 basis points for the first time since 2007.
- An inverted yield curve, where short-term yields are higher than their longer-term counterparts, is considered a reliable recession signal.
- The Federal Reserve this week said the U.S. economy is still strong but is facing challenges from global weakness.
- Federal Reserve Chairman Jerome Powell's assertion this week that the U.S. economy remains strong, however, is facing a stern test from the bond market, which showed a classic recession sign.

Recession indicator

- U.S. central bank policy makers on Wednesday lowered both their growth projections and their interest rate outlook, with the majority of officials now predicting no hikes this year.
- Traders took that dovish shift as their cue to dig into positions for a Fed easing cycle, pricing in a cut by the end of 2020 and a one-in-two chance of a reduction as soon as this year.
- The 3-month to 10-year curve is widely favored as an indicator that the economy is within a couple of years of recession. But today's move is an extension of the inversion at the front end of the curve that happened in December.

Spread between 3-month bills and 10-year Treasuries turns negative.



Source: Bloomberg

U.S. Treasury Curve

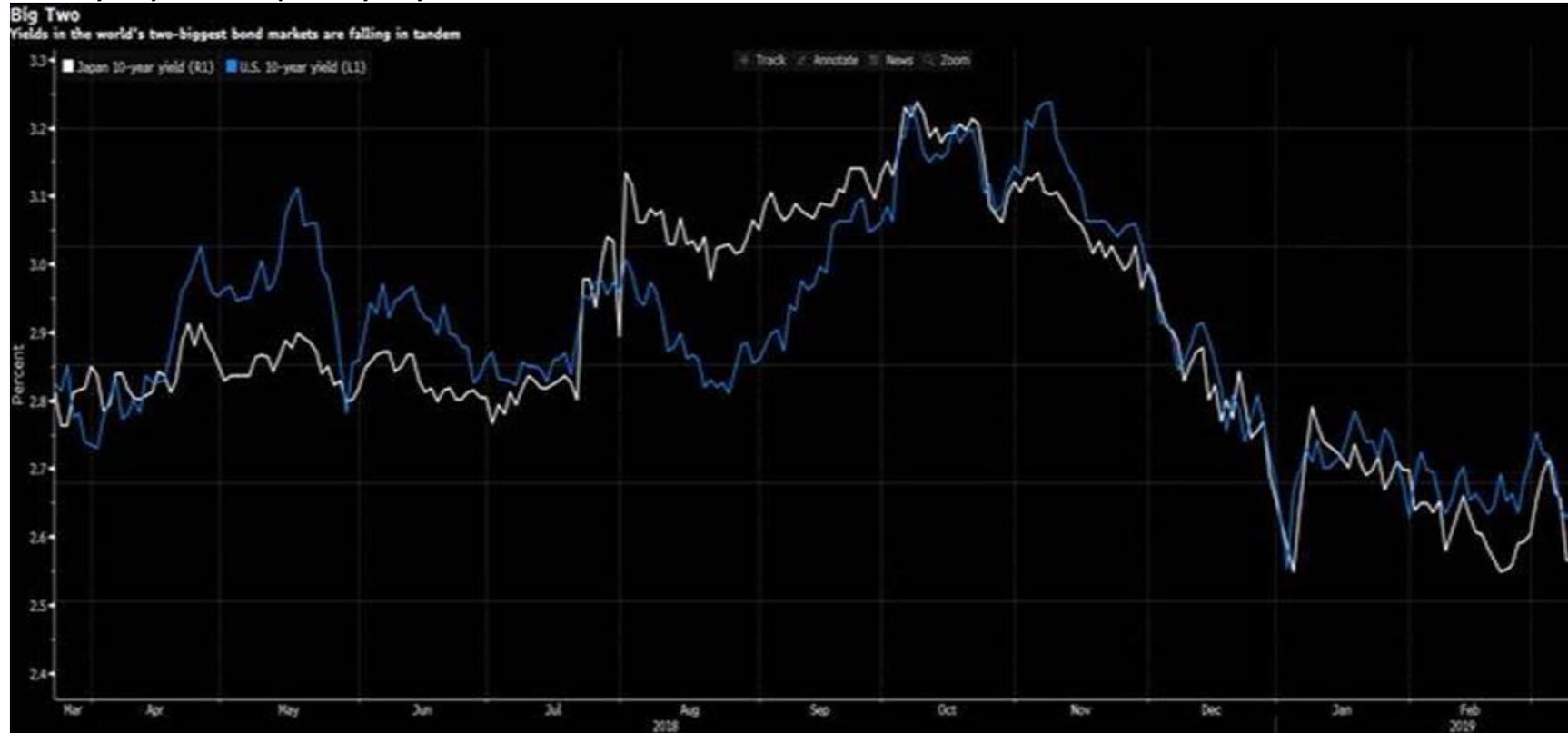


Source: Bloomberg

International yields impact

Japan's benchmark 10-year yield fell further into negative territory today, breaking below the level of minus 0.05% that had held three times this year. The yield on 10-year Treasuries dropped as much as 10 basis points to 2.44%, the least since January 2018.

U.S. 10-year yield and Japan 10-year yield



Source: Bloomberg

Germany 10-year yield slips below 0% again.



Source: Bloomberg

Germany is also experiencing a bond market rally, with benchmark 10-year yields dropping below zero on the back of disappointing manufacturing purchasing manager's indexes. Euro-area peers tracked the move, though those from the weaker economies including Italy failed to keep pace with the move in bunds.

Fed Stance

- The Federal Open Market Committee (FOMC) on Wednesday said that it won't be raising rates anytime soon — for at least the rest of the year — unless economic conditions change.
- Fed chairman, Jerome Powell, said the U.S. economy is “in a good place” though it is facing pressure from slowdowns in Europe and China.
- FOMC collectively lowered their expectations for GDP growth domestically, now seeing just a 2.1% gain in GDP for all of 2019 and 1.9% in 2020.
- A big part of the recent global bond rally is that the market anticipates the Fed's more cautious approach will eventually resolve itself into lower interest rates. Overnight-index swaps indicate traders are now pricing in two U.S. rate cuts by the end of 2020.



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