

US Interest rates monitor

# Policy uncertainty and rising term premia are keeping Treasury yields elevated

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## Volatility highlights fragile business sentiment; higher risk premia reflect the difficulty of walking back attacks on Fed independence

- The initial flight to safety that led to a drop in the 10-year Treasury yield to 3.86% on April 3 was followed by a subsequent bond sell-off that caused yields to rebound sharply ([Figure 10](#)).
- The increased risk compensation demanded by investors has prevented long-term Treasury yields from declining in tandem with market-based inflation expectations ([Figures 15](#) and [16](#)) and rate projections.
- As long as there are no clear signs of a sharp slowdown in economic activity, the Fed will likely have room to maintain its current policy stance at the June meeting as well ([Figures 21](#) and [22](#)).
- Mortgage rates edged higher, driven by rising Treasury yields ([Figure 23](#)), and corporate bond spreads, though still near historical lows, widened amid a worsening business outlook ([Figure 24](#)).
- Some broad financial stress indicators have shown mild upticks, reflecting growing uncertainty and sensitivity to geopolitical and policy shocks ([Figures 25](#) to [28](#)).

Treasury yields have swung sharply amid heightened policy uncertainty, though volatility has eased slightly after a 90-day pause on reciprocal tariffs and Trump saying he has “no intention” of firing Powell

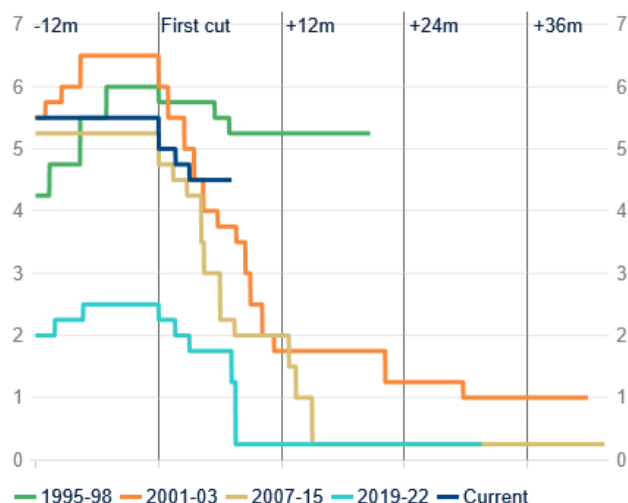
Figure 1. **FED FUNDS RATE AND TREASURY YIELDS (%)**



The gray area indicates the fed funds rate target range; QE and QT indicate quantitative easing and tightening announcements  
Source: BBVA Research / Fed / Treasury Dept.

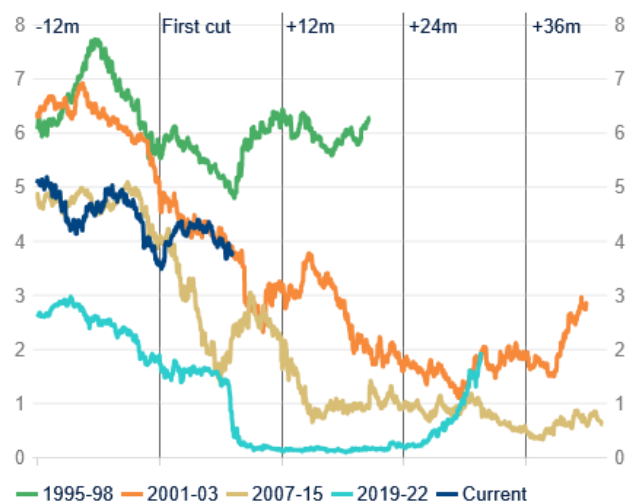
## Markets aren't shrugging off recession risks, but inflation concerns are in the mix too

Figure 2. **FED FUNDS RATE IN EASING CYCLES**  
(%)



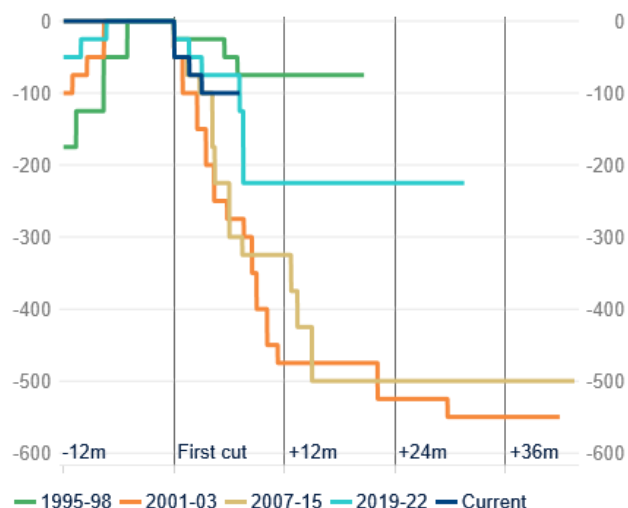
## 2-year yields have come down as markets expect at least 75bp worth of rate cuts this year

Figure 4. **2-YEAR TREASURY YIELD IN EASING CYCLES**  
(%)



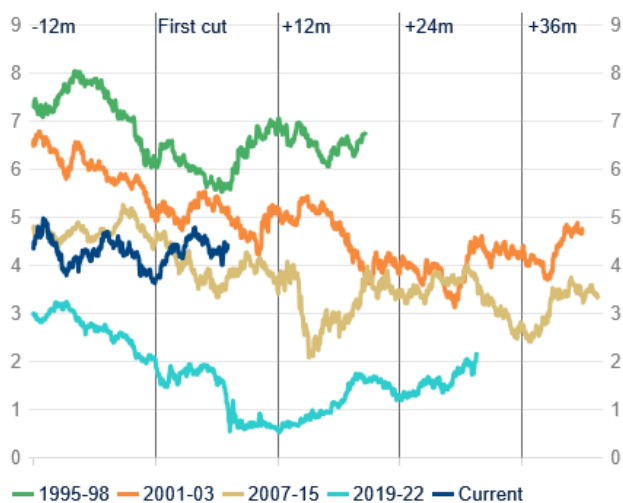
## As the May 7 FOMC meeting nears, Fed officials show little concern over a sudden slowdown

Figure 3. **FED FUNDS RATE IN EASING CYCLES**  
(BPS VS RATE AT FIRST CUT)



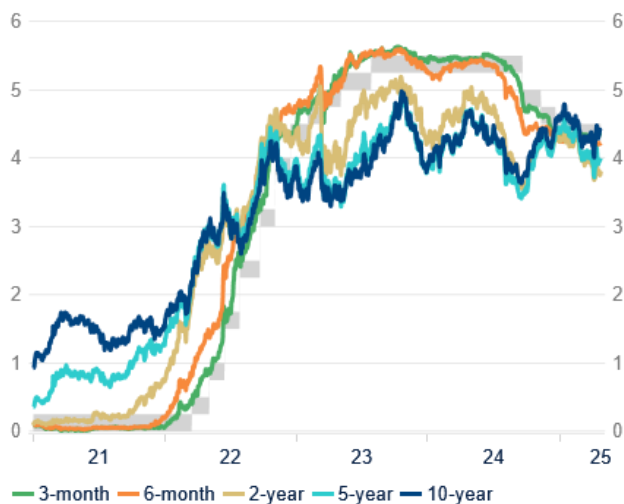
## A short-lived flight to safety pushed the 10-year Treasury yield down to 3.86% on April 3, but...

Figure 5. **10-YEAR TREASURY YIELD IN EASING CYCLES**  
(%)



... a quick bond sell-off sent it surging to 4.5% by April 10

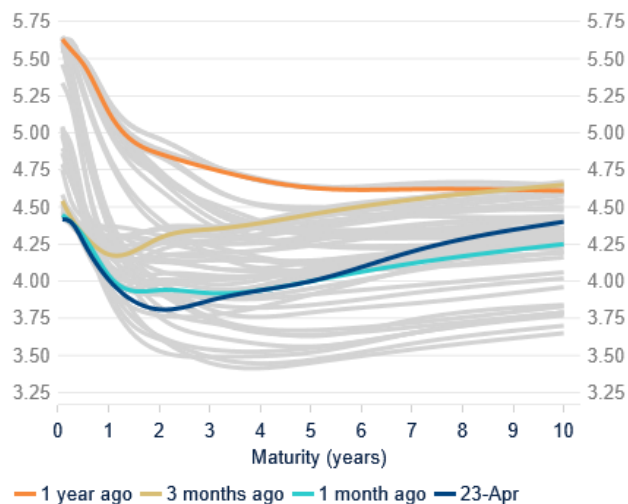
Figure 6. **TREASURY YIELDS (%)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

This volatility drove the Trump administration to announce a 90-day...

Figure 7. **TREASURY YIELD CURVE (%)**



The gray lines indicate weekly curves over the past year; intermediate rates calculated with natural cubic spline interpolation  
Source: BBVA Research / Treasury Dept.

... delay of global reciprocal tariffs. Since then, the 10-year yield has hovered near 4.3%, ...

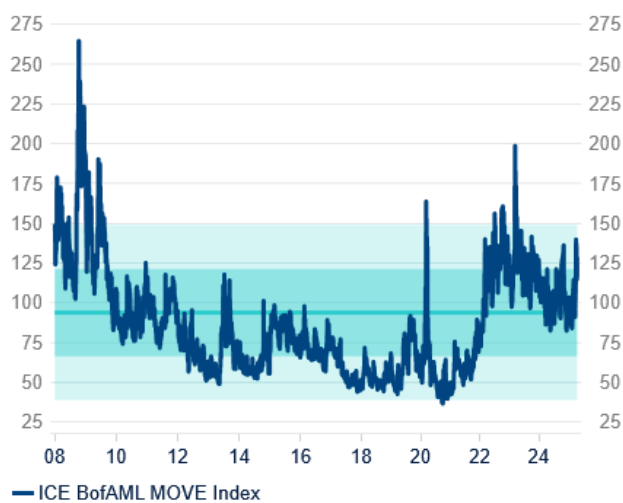
Figure 8. **10-YEAR TREASURY YIELD DAILY CHANGE (% AND BPS)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... but inflation risks and doubts over Fed independence could keep long-term yields high

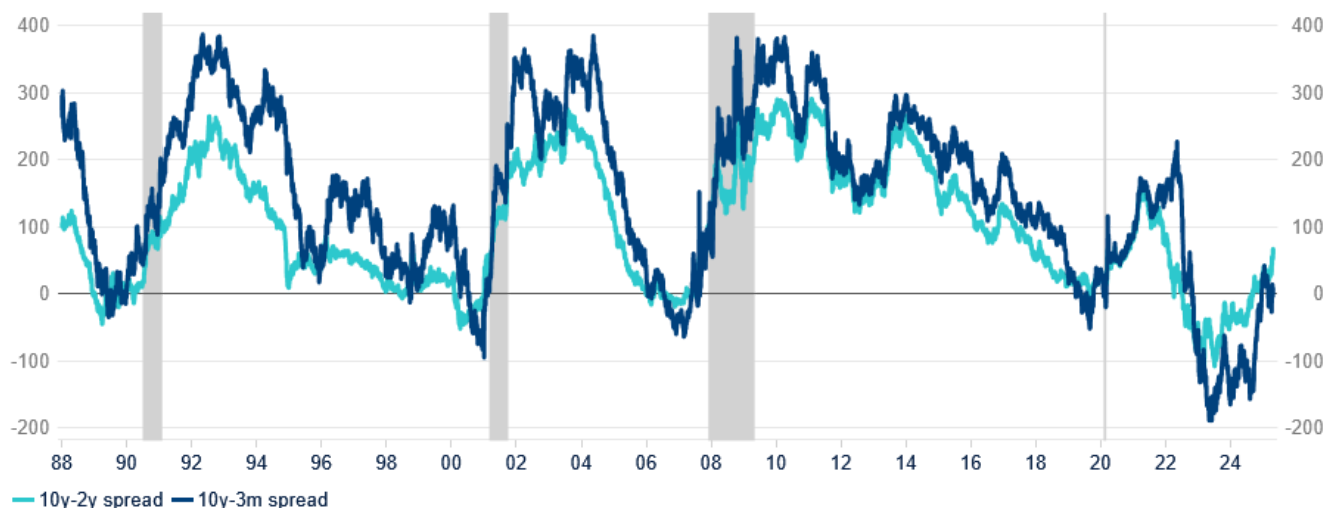
Figure 9. **ICE BOFAML MOVE INDEX (BPS)**



The shaded areas indicate the ranges within one and two standard deviations from the mean. Source: BBVA Research / ICE BofAML

**Yield curve dynamics remain tricky to interpret given the distorting effects of political announcements and shifting rate expectations: the rising 10y-2y yield spread alongside a flat 10y-3m spread is likely...**

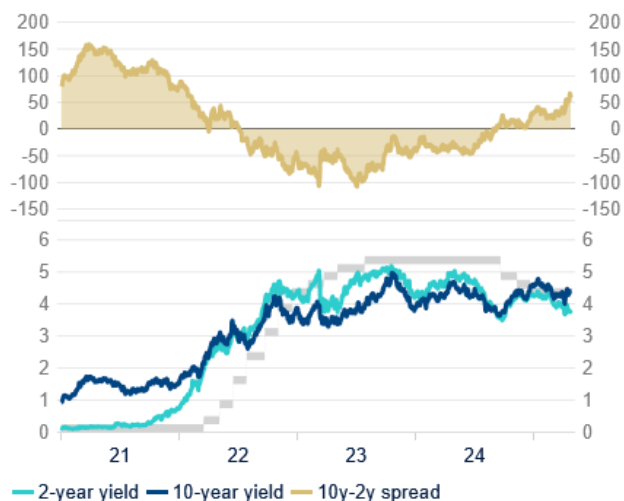
Figure 10. **TREASURY YIELD SPREADS (BPS)**



The gray shaded areas indicate US recessions as defined by NBER  
Source: BBVA Research / NBER / Treasury Dept.

**... reflecting that market policy rate expectations are out of sync with the Fed, at a time when...**

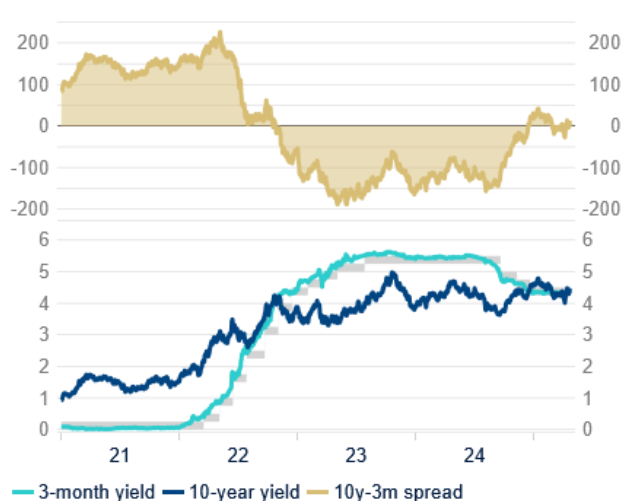
Figure 11. **10Y-2Y TREASURY YIELD SPREAD (BPS AND %)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

**... investors are also demanding greater compensation for long-term risk. This is...**

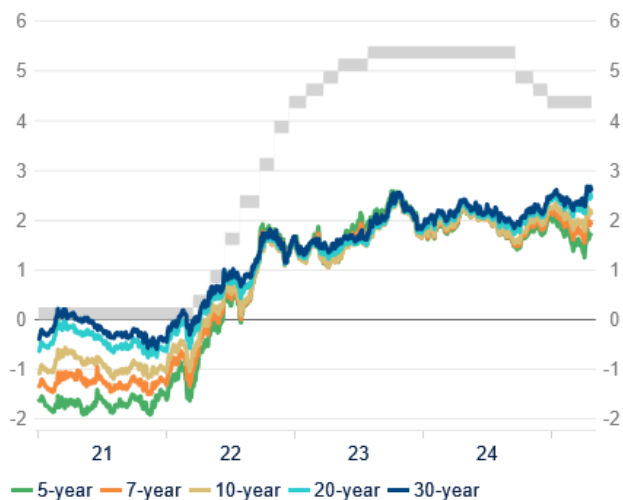
Figure 12. **10Y-3M TREASURY YIELD SPREAD (BPS AND %)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

...evident in the upward shift of the real curve, which reflects increased term premia...

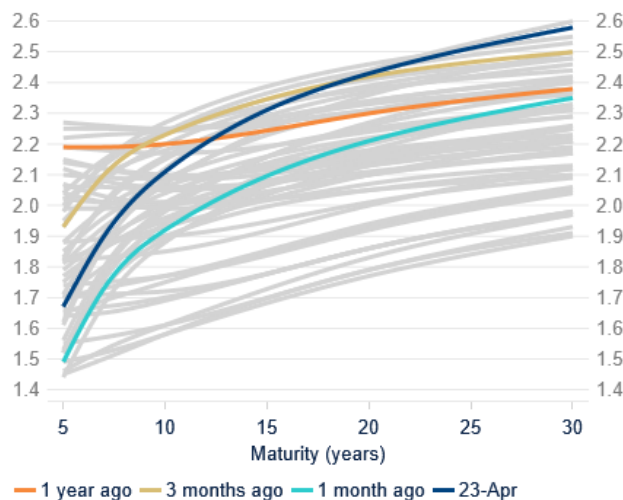
Figure 13. **TREASURY REAL YIELDS (TIPS)** (%)



The gray area indicates the fed funds rate target range  
Source: BBVA Research / Fed / Treasury Dept.

... rather than stronger growth expectations. Indeed, nominal Treasury yields have not...

Figure 14. **TREASURY REAL YIELD CURVE (TIPS)** (%)



The gray lines indicate weekly curves over the past year; intermediate rates calculated with natural cubic spline interpolation  
Source: BBVA Research / Treasury Dept.

... declined in tandem with market-based inflation expectations, which have decreased in recent...

Figure 15. **5-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



The shaded area indicates the deviation from the 2% inflation target  
Source: BBVA Research / Treasury Dept.

... weeks. This is a key element that will likely support the Fed's "no hurry" stance at the...

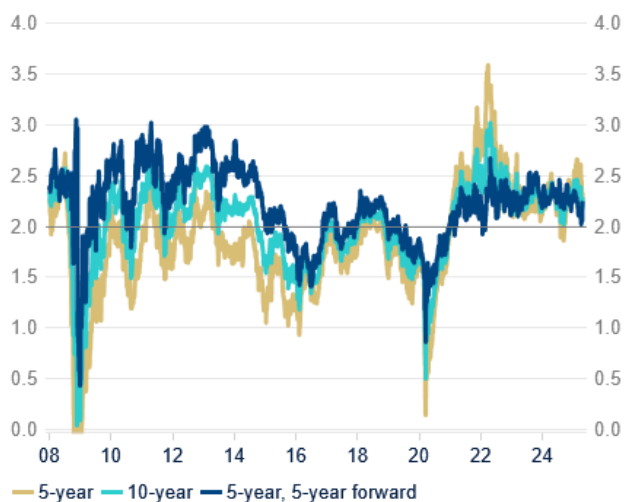
Figure 16. **10-YEAR TREASURY BREAKEVEN INFLATION RATE (%)**



The shaded area indicates the deviation from the 2% inflation target  
Source: BBVA Research / Treasury Dept.

... upcoming meeting despite rate cuts being aggressively priced in by financial markets.

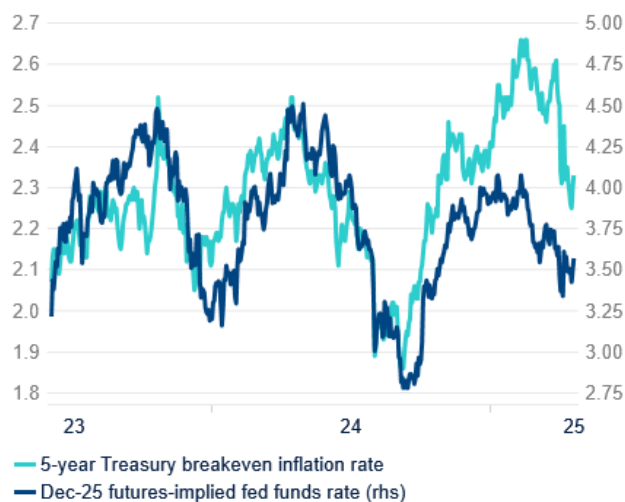
Figure 17. **BREAKEVEN INFLATION RATES (%)**



Source: BBVA Research / Treasury Dept.

Trump recently suggested he would not try to remove Powell from his position following...

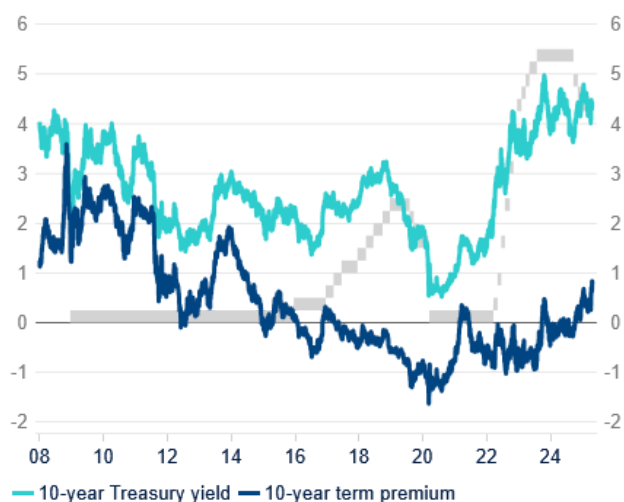
Figure 18. **BREAKEVEN INFLATION AND FUTURES-IMPLIED FED FUNDS RATE (%)**



Source: BBVA Research / CME / Treasury Dept.

... last week's attacks on the Fed, the institution underpinning the US's "exorbitant privilege"

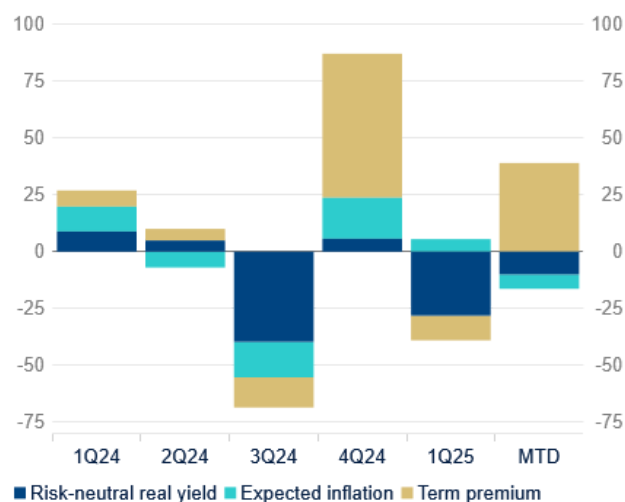
Figure 19. **10-YEAR TREASURY YIELD AND TERM PREMIUM (%)**



The gray area indicates the fed funds rate target range; the term premium is based on the NY Fed ACM model. Source: BBVA Research / Fed / Treasury Dept.

These threats pose a serious risk to the most liquid global market and the financial system

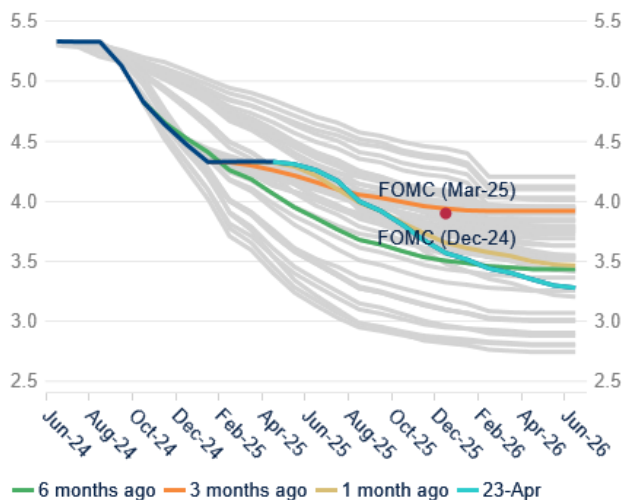
Figure 20. **10-YEAR TREASURY YIELD CHANGE BREAKDOWN (BPS)**



Based on the NY Fed ACM model  
Source: BBVA Research / Fed / Treasury Dept.

**As long as there are no clear signs of a sharp economic slowdown, the Fed will...**

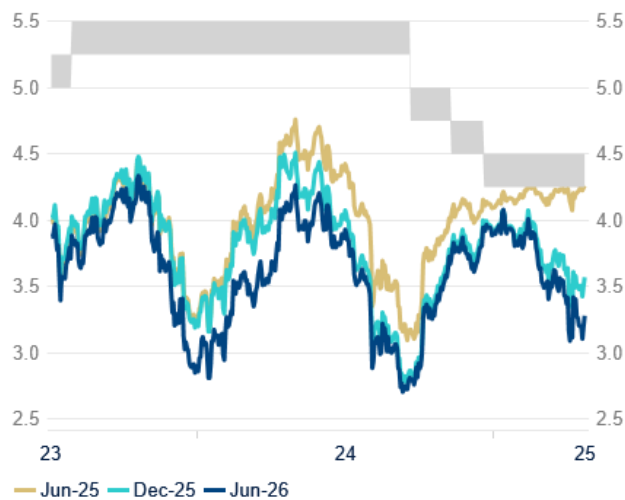
Figure 21. **FUTURES-IMPLIED FED FUNDS RATE (%)**



The gray lines indicate weekly implied rate paths over the past year  
Source: BBVA Research / CME / Fed

**... likely stick to its current wait-and-see stance at the June meeting as well**

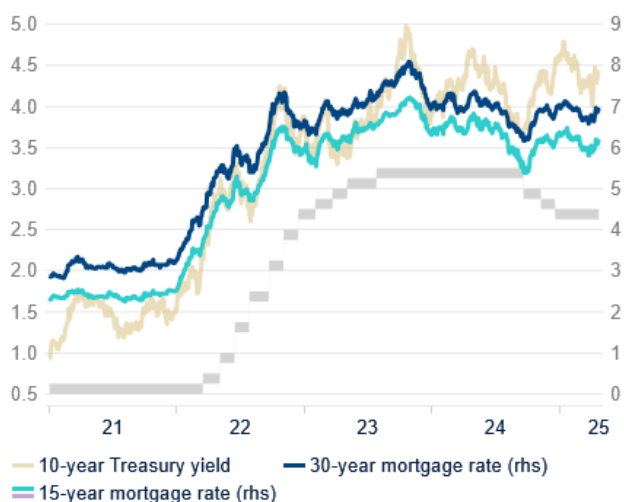
Figure 22. **FUTURES-IMPLIED FED FUNDS RATE (%)**



The gray area indicates the fed funds rate target range  
Source: BBVA Research / CME / Fed

**Mortgage rates edged higher, driven by rising Treasury yields. Corporate bond spreads, ...**

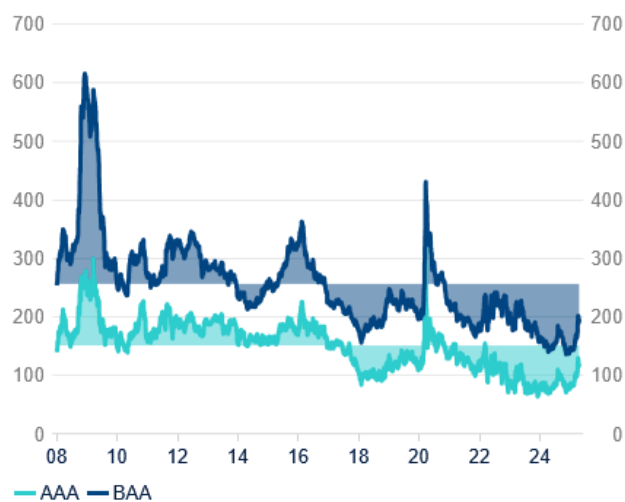
Figure 23. **MORTGAGE RATES (%)**



The gray area indicates the fed funds rate target range (rhs)  
Source: BBVA Research / Bankrate / Fed / Treasury Dept.

**... though still near historical lows, widened amid a worsening business outlook**

Figure 24. **CORPORATE BOND YIELD SPREADS (BPS)**

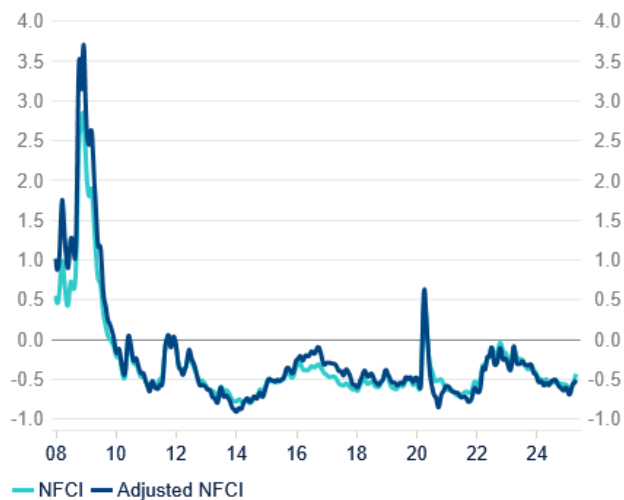


Spreads over the 10-year Treasury yield; the shaded area indicates the deviation from the historical average since 2008  
Source: BBVA Research / Fed / Treasury Dept.



**Most broad financial conditions indices remain accommodative, and markets have continued...**

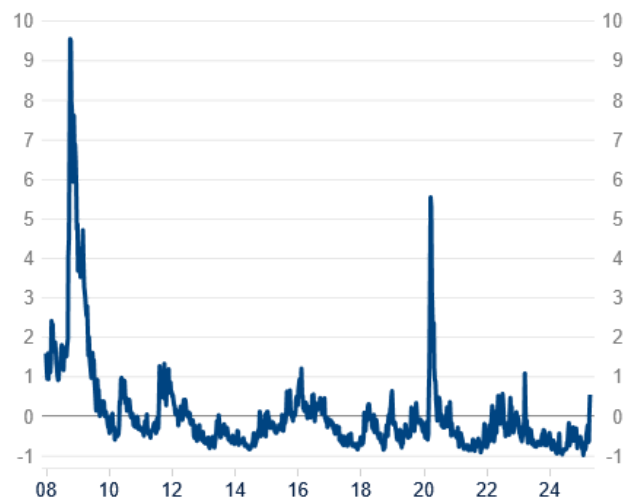
Figure 25. **CHICAGO FED NATIONAL FINANCIAL CONDITIONS INDEX** (>0: TIGHTER THAN AVG.)



Source: BBVA Research / Fed

**... to function smoothly—evidenced by the fact that the Fed has not had to deploy any special...**

Figure 26. **ST. LOUIS FED FINANCIAL STRESS INDEX** (>0: ABOVE AVG. FINANCIAL STRESS)



Source: BBVA Research / Fed

**... liquidity programs since the onset of the trade war. Still, select stress indicators have shown...**

Figure 27. **KANSAS CITY FED FINANCIAL STRESS INDEX** (>0: ABOVE AVG. FINANCIAL STRESS)



Source: BBVA Research / Fed

**... mild upticks, reflecting growing uncertainty and sensitivity to geopolitical and policy shocks**

Figure 28. **OFR\* FINANCIAL STRESS INDEX** (>0: ABOVE AVG. FINANCIAL STRESS)



\* OFR: Office of Financial Research  
Source: BBVA Research / Treasury Dept.



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