NOTOS NEWS | GLOBAL ECONOMY

Recently, the US treasury yield curve partly inverted, raising concerns about future economic growth in the United States. However, the US economy is still in a good shape, even though signs of weakening rise. We are convinced that the Fed is on standby and ready even for interest rate cuts, if need be.

PARTLY INVERTED US TREASURY YIELD CURVE

Worries about a global economic slowdown and Brexit have led financial market participants to fly into the safe haven of high-quality government bonds.

End of March, and for the first time since 2007, the yield curve for US government bonds inverted for maturities from three months up to one year. As shown by the graph below, on 22 March 2019 the yield on the 3M Treasury bill was 2.46 percent while the yield on the 10Y Treasury note stood at 2.44 percent.

Below graph also reveals that the US Treasury yield curve has flattened considerably during the past five months. While the spread between the 10Y Treasury note and the 3M Treasury bill amounted to 86 basis points as of 22 October last year, it dropped continuously over the following months and fell to minus two basis points on 22 March 2019.

Further, it can be seen that this decrease in spreads was particularly felt in December last year after the US Fed had raised the range for the Fed Funds Rate by 25 basis points. Hence, the orange-colored yield curves dating back to before the interest rate hike are much steeper than the blue-colored yield curves following such move.

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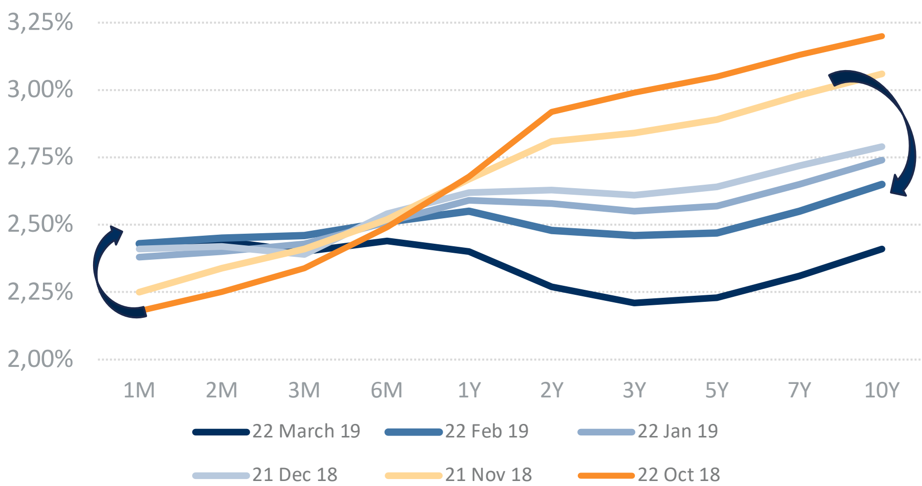
FLATTENING OF THE US TREASURY YIELD CURVE



Source: U.S. Department of the Treasury, Notos 04/2019

AN INDICATOR FOR RECESSION?

Such shifting of the US yield curve is usually connected with changing expectations about the future development of the economy. An upward bended yield curve means that investors assume a sound economy. By contrast, the yield curve slopes downwards when market participants believe economic growth to fall. In the past, an inverted yield curve has proven a quite reliable indicator for recession.

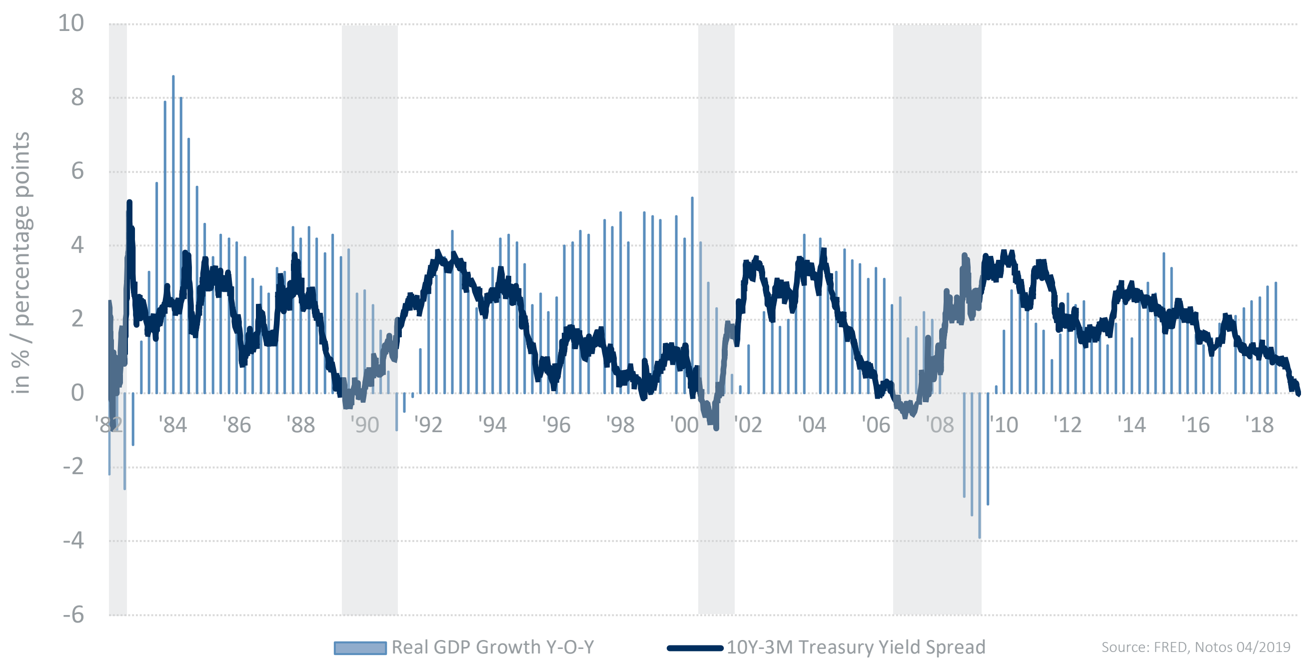
The below graph seems to confirm this view. When the spread between 10Y and 3M Treasuries was negative - this was the case in 1982, 1989, 2001 and 2006 - real GDP growth turned negative as well within a period of four to six quarters.

US ECONOMY STILL ROBUST BUT STARTING TO WEAKEN

The US economy is still in a good shape, especially when compared to the Euro area. Latest US economic indicators reveal that sentiment in the manufacturing industry has improved; construction spending increased as well; and the situation on the labor market is more than satisfactory. GDP growth rates for Q4/2018 indicate that economic growth is continuing, however, at a lower speed. This is confirmed by the Fed's latest downwards revision of US growth rates in March. Accordingly, real GDP growth is projected to reach 2.1 percent this year (December forecast: 2.3 percent) and 1.9 percent in 2020. This is considerably lower than the 2.9 percent growth achieved for the full year 2018.

This news was not well received by the financial markets at first. However, markets have recovered quickly since then, trusting the Fed will step in and cut interest rates, if need be. At least, Fed Chair Jerome Powell has pushed open the door for this possibility.

INVERTED YIELD CURVE AN INDICATOR FOR RECESSION?



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