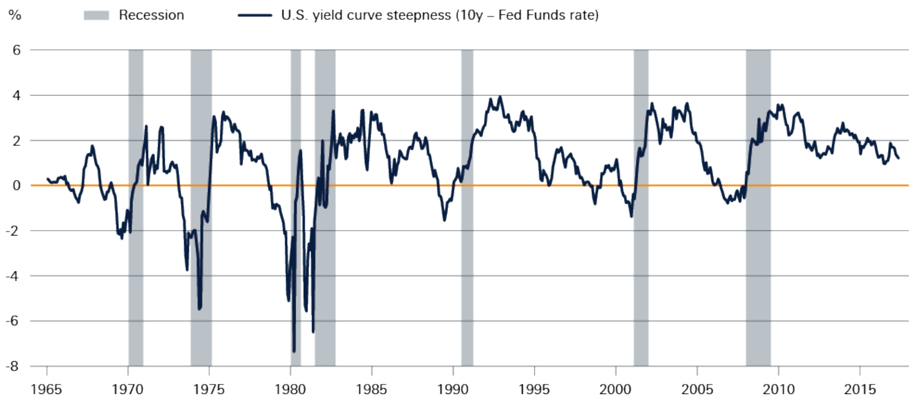
Chart of the week

Does the U.S. bond market hint at a recession ahead? We don't think so.

In June, the U.S. central bank (Fed) delivered another rate hike, the fourth such hike in this cycle. Despite higher short-term rates, yields for longer-dated bonds declined: the yield on 10-year Treasury securities dropped to a low point of 2.10%. Ironically, this low point was hit just on the day of the Fed rate hike. 10-year yields have come down from 2.60% in mid-March. Technically, this constitutes a "flattening" of the yield curve, which could suggest a downgrade of future growth expectations for the U.S. economy. Some analysts are even arguing that the bond market sees a recession on the horizon. We don't subscribe to that view.

Looking at the experience of the past 50 years, the U.S. economy has never dropped into recession unless the yield curve inverted before, as our "Chart of the week" demonstrates. In the current context, an inversion would mean that 10-year bond yields trade below the federal funds rate. Although the yield curve has become flatter, we are still some 90 basis points away from inversion. This is one of the reasons we see a very low probability of a U.S. recession in the next 12 months.



Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH, as of 6/21/17

Glossary

Federal funds rate

The federal funds rate is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

U.S. Federal Reserve (Fed)

The U.S. Federal Reserve, often referred to as "the Fed", is the central bank of the United States.

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