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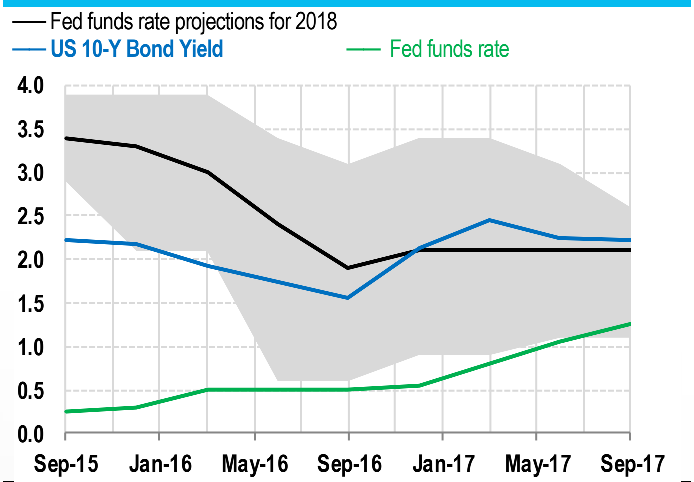
# US treasuries disregard the dots for 2018

■ The median projection of FOMC members for the federal funds rate at the end 2018 has been remarkably stable in recent quarters ■ US 10-year treasury yields, both spot and one year forward, are only slightly higher than this median projection ■ Different explanations are available with diverging implications for markets and the economy

In her speech last Tuesday on "Inflation, uncertainty and monetary policy", Janet Yellen did not lack clarity in emphasising that the FOMC should be *"wary of moving too gradually"*. The statement is reminiscent of the projections ("dots") of the FOMC members released last week when 12 out of 16 considered a rate hike in December appropriate. Such a move has thus become very likely. With 2018 getting nearer, one would expect markets to focus increasingly on the 'dots' for next year. The median projection for the federal funds rate at the end 2018 has been remarkably stable in recent quarters at 2.1%. Moreover, disagreement amongst the members has declined. At 2.32% the US 10-year treasury yield is only slightly higher than this median projection and the fluctuation range over the past year has actually been quite narrow. So it seems that although 2018 is getting closer, the 2018 dots have not been able to push up bond yields. Until November 2016, yields were even below the 2018 dots. This doesn't come as a surprise: when the central bank tells you that its policy is data-dependent, projections for the distant future are heavily discounted because it's the near term that matters. Today, 2018 is rapidly becoming "near term" yet the difference between the projected fed funds rate (2.1%) and the current 10-year yield is tiny. The same applies for the 10-year yield one year forward (2.52%). Different interpretations are possible. One, the market thinks that the doves in the FOMC will gain the upper hand. This would imply that the dots become largely irrelevant as a communication tool. Two, the market expects a big downward revision in the 2018 dots. This would suppose a sudden deterioration in the macro environment and nothing is pointing in that direction. Three, investors believe that the Fed funds rate will converge (to a considerable degree) towards the 2018 dots in the course of next year but are happy with a low yield pick-up. Such a flat curve would imply an expectation that by then the cyclical peak in Fed funds will have been reached. Four, the market is in a myopic mode and takes its cue from the actions of the FOMC. If the latter is following the dots, yields would have to move up. Whichever interpretation one goes for, it is a matter of attention.

FED FUNDS RATE PROJECTIONS (MEDIAN AND RANGE) AND INTEREST RATES




Source : Federal Reserve, BNP Paribas

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