The Investment Institute
by UniCredit

Coffee Break

Coffee Break is our daily publication, offering topical insights as an intellectual ingot to start the day.

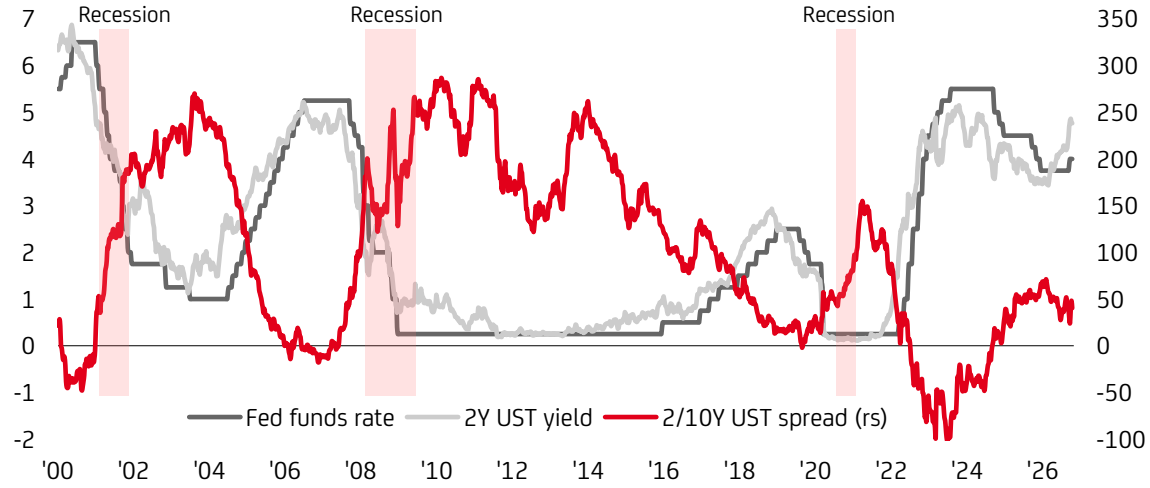
What the shape of the UST curve tells us

16 October 2026

USTs have recovered ground this week in light of the risk-off mood. While rate expectations remain aggressive, the 2/10Y UST spread has remained firmly positive, as several factors are keeping long-dated yields to higher levels than in the past.

THE RELATIONSHIP BETWEEN CURVE INVERSIONS AND RECESSIONS HAS WEAKENED RECENTLY

FED FUNDS RATE (LS), 2Y UST YIELD (LS), 2/10Y UST SPREAD (RS) ALONG WITH RECESSIONS SINCE 2000



Source: Bloomberg, NBER, The Investment Institute by UniCredit

THE CONTEXT

Are UST curve inversions able to predict economic recessions in the US? No – or rather, no longer. While this was the case for the two recessions that took place at the beginning of the century (2001 and 2008-09), which were preceded by an inversion of the 2/10Y UST spread, this did not hold true for the economic downturn in 2020, which was caused by an exogenous factor (the outbreak of the pandemic), when the curve had not inverted. In addition, the substantial inversion of the 2/10Y spread in 2022-23, which fell below -100bp, its lowest level since the 1980s, was not followed by an economic slowdown. While recent history has challenged a vast literature on the connection between curve inversions and recessions, the UST curve still has some important messages to convey, especially following the latest moves in UST yields.



THE DATA

USTs have been on a roller-coaster ride this week. Slightly higher-than-expected CPI data for September led to only a temporary increase in UST yields, which have since fallen following the tech sell-off and investor concerns about AI. Investor expectations regarding the fed funds rate have edged lower, although OIS forward rates continue to indicate roughly 75bp of rate hikes in the next 12 months. The 10Y UST yield has fallen back to the 5% area, 30bp below its recent peak.

The 2/10Y UST spread has flattened by 10bp this week. Unlike in the second half of September, this has been a bull-flattening rather than a bear-flattening. At 35bp, the 2/10Y spread is 15bp higher than its low in September and unlikely to invert, in our view. First, despite the aggressive repricing of rate hike expectations in September, the peak priced in by OIS forward rates remains lower than the peak reached in most tightening cycles, including the most recent. Although inflation is well above the Fed's target, long-term inflation expectations remain well-anchored, which reduces pressure on the Fed to act. We expect the Fed to remain on hold at its next meeting at the end of the month, buying time ahead of the midterm elections. Second, long-dated UST yields have risen substantially in the past few months, driven by solid economic data, hawkish central bank rhetoric and increased competition for capital due to abundant supply from both public and private issuers. The UST term premium has risen, reflecting higher economic uncertainty. On the other hand, risks arising from loose US fiscal policy have mattered less given that several indicators, such as the UST-OIS spread, have remained under control.



OUR VIEW

USTs are likely to remain volatile in the near term, due to ongoing geopolitical tensions keeping energy prices elevated, quite solid economic data and the political uncertainty brought about by the midterms. A normalisation of energy prices, which we forecast in our baseline scenario, should lead to a decline in yields worldwide.

From a longer-term perspective, the jury is out as to whether 5% should be seen as a cap or a floor for the 10Y UST yield. The answer will depend on whether the neutral rate or R* has increased in the US in the past few years. Indications from Fed officials are quite notable in this respect, as the long-run dot plot has edged higher in the past few quarters (to 3.25% in the latest dot plot) amid greater dispersion in FOMC members' projections. This indication was confirmed by Fed Chair Kevin Warsh, who described financial conditions as not restrictive, even after the recent hike, although he refused to say that the key rate is currently above neutrality.

Looking at what happened in 2022-23, the magnitude of that inversion was probably due to both the slow reaction of long-dated yields to widespread economic resilience and more technical factors such as the substantial amount of Treasuries held by the Fed and foreign investor demand for USD-denominated paper, in a world where the greenback was, and continues to be, regarded as the safe-haven currency.

The 2022-23 episode highlights another interesting fact. Unlike in other tightening cycles, the Fed managed to slow down inflation without pushing the US economy into a recession. This could reflect the central bank's ability to use a more comprehensive toolkit than in the past, including forward guidance and programmes to prevent potential market disruptions. This has helped shape investor expectations and overall economic conditions in the US. By contrast, the 2022-23 tightening is viewed differently by those who argue that the neutral rate has been rising since the pandemic and that monetary policy was not sufficiently restrictive, even with the fed funds rate reaching 5.5%. The fact that yoy CPI inflation has not fallen below the 2% threshold in the past few years is used as an indication of this thesis.

This debate will probably remain open, especially as macroeconomic conditions have already changed significantly since 2022-23.

Author
Francesco Maria Di Bella, FI Strategist (UniCredit, Milan), francescomaria.dibella@unicredit.eu

Editor
Edoardo Campanella, Director and Editor-in-Chief of The Investment Institute (UniCredit, Milan)
edoardo.campanella@unicredit.eu

UniCredit S.p.A
The Investment Institute by UniCredit, Piazza Gae Aulenti, 4, I-20154 Milan
www.the-investment-institute.unicredit.eu

Legal Notices

Glossary

Terms used in the report are available on our website: Our glossary

Marketing Communication

This publication/video constitutes a marketing communication of UniCredit S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCredit Bank GmbH (hereinafter jointly referred to as the "UniCredit Group") is addressed to the general public and is provided free of charge for information only. It does not constitute investment recommendation or consultancy activity by the UniCredit Group or, even less, an offer to the public of any kind nor an invitation to buy or sell securities. The information contained herein does not constitute an investment research or financial analysis since, in addition to the lack of content, it has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

UniCredit Group, including all its group companies may have a specific interest in relation to the issuers, financial instruments or transactions detailed herein. Relevant disclosures of interests and positions held by UniCredit Group are available at: Conflicts of interest Any estimates and/or assessments contained in this publication represent the independent opinion of the UniCredit Group and, like all the information contained therein, are given in good faith on the basis of the data available at the date of publication, taken from reliable sources, but having a purely indicative value and subject to change at any time after publication, on the completeness, correctness and truthfulness of which the UniCredit Group makes no guarantees and assumes no responsibility. Interested parties must therefore carry out their own investment assessments in a completely autonomous and independent manner, relying exclusively on their own considerations of the market conditions and the information available overall, also in line with their risk profile and economic situation. Investment involves risk. Before any transaction in financial instruments please refer to the relevant offering documents. It should also be noted that:

1. Information relating to the past performance of a financial instrument, index or investment service is not indicative of future results.
2. If the investment is denominated in a currency other than the investor's currency, the value of the investment can fluctuate strongly according to changes in exchange rates and have an undesirable effect on the profitability of the investment.
3. Investments that offer high returns can undergo significant price fluctuations following any downgrading of creditworthiness. In the event of bankruptcy of the issuer, the investor may lose the entire capital.
4. High volatility investments can be subject to sudden and significant decreases in value, being able to generate significant losses at the time of sale up to the entire capital invested.
5. In the presence of extraordinary events, it may be difficult for the investor to sell or liquidate certain investments or obtain reliable information on their value.
6. If the information refers to a specific tax treatment, it should be noted that the tax treatment depends on the individual situation of the customer and may be subject to change in the future.
7. If the information refers to future results, it should be noted that they do not constitute a reliable indicator of these results.
8. Diversification does not guarantee a profit or protect against a loss.

The UniCredit Group cannot in any way be held responsible for facts and/or damages that may arise to anyone from the use of this document, including, but not limited to, damages due to losses, lost earnings or unrealised savings. The contents of the publication – including data, news, information, images, graphics, drawings, brands, and domain names – are owned by the UniCredit Group unless otherwise indicated, covered by copyright and by the industrial property law. No license or right of use is granted and therefore it is not allowed to reproduce its contents, in whole or in part, on any medium, copy them, publish them and use them for commercial purposes without prior written authorisation from UniCredit Group unless if purposes of personal use only. E 25/1