MACRO STRATEGY

Cycle Peaks of 10-Year Yields

November 3, 2021

The conventional view of 10-year yields has been that they rise throughout the business cycle, and peak toward cycle end as inflation rises. This characterizes the patterns after the 1973 and 1980 recessions. However, since then, rates have generally peaked early in the business cycle.

Our forecast calls for rates to peak in 2022 and begin their descent in 2023. This stands in contrast to the consensus view which expects rates to continue to rise into 2023, which we feel is not supported by the recent behavior of the 10-year yield.[1]

Table 1 | 10-Year Rates, Summary Statistics

Recession onset	10Yr, cycle average	10Yr, cycle peak	Peak timing
1973	8.20	10.65	Nov 1979, close to cycle end (56 months from recession end)
1980	12.52	14.10	May 1981, close to cycle end (10 months)
1981	9.60	13.56	June 1984 (19 months, early/mid-cycle)
1990	6.36	8.28	June 1991, (3 months, early)
2001	4.45	5.28	March 2002 (4 months, early)
2007	2.45	3.85	April 2010 (10 months, early)
2020	NA	1.74	March 2021 (11 months)

Source: NBER, Board of Governors of the Federal Reserve System

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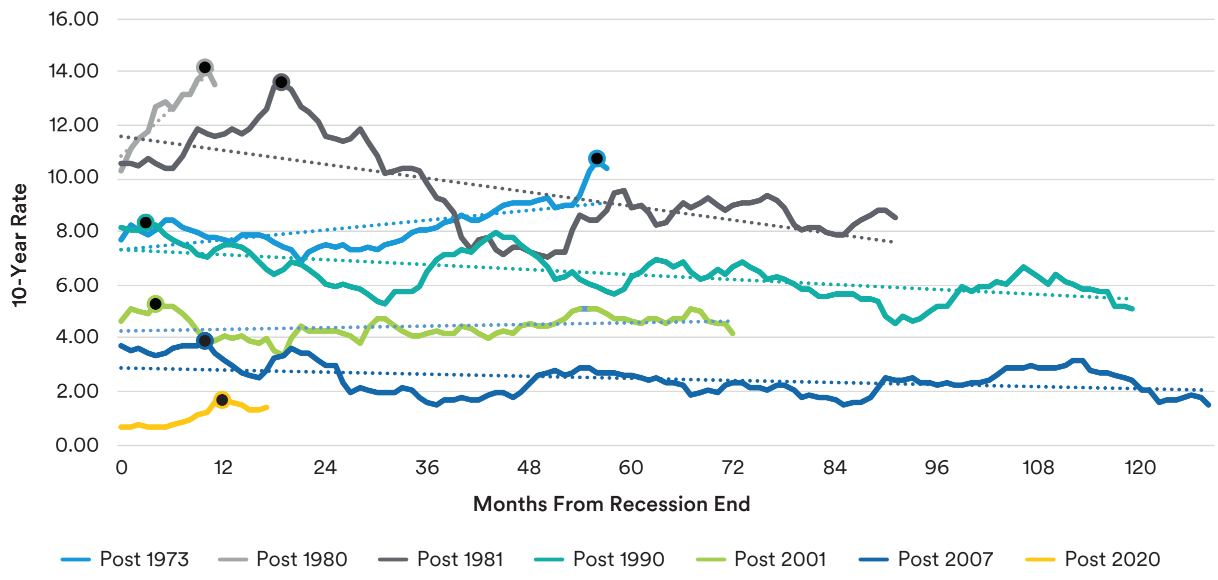
In recent business cycles, the 10-year rate might best be characterized as a series of largely separate cycles. Toward the end of each cycle, the Fed has cut rates, forming a new low, and the next cycle appears to never fully escape the new level setting. Moreover, within a cycle, rates tend to oscillate around rates that were achieved in the first several months of a recession, while never exceeding those early rate peaks. See chart below.

10-Year Rates After Recession End



Circles represent peak 10-year rate for the cycle
Source: NBER, Board of Governors of the Federal Reserve System

Economically, it makes sense for rates to be relatively high at the beginning of the cycle. High real rates, and a steep yield curve in particular, denote optimism about the future. Relatedly, the yield curve tends to steepen early in the recovery as yields generally rise ahead of Fed tightening. This is effectively the opposite of the yield curve inversion that takes place toward the end of the business cycle.

Earlier this year in March, the 10-year yield peaked at 1.74%. We believe this level will be surpassed in the coming year with the 10-year rising above 2.0% in 2022. There are a few reasons for this view. First, the Fed is deliberately permitting a higher inflation rate this cycle; letting inflation run hotter than usual may introduce a new dynamic that delays the cycle high. Second, rates are currently on an increasing path with the decline of the delta variant wave, and this may continue as virus optimism improves. Finally, the post-recession growth path has been particularly troubled, particularly by supply chain and labor market problems. The relief from these imbalances—which we expect to take place in the back half of 2022—could create a renewed optimism about the overall economic trajectory.

These are all compelling reasons for the 10-year to drift higher into 2022. However, there are also many compelling reasons why we believe the peak in rates will take place in 2022 and not in 2023 as consensus forecasts suggest. We believe it is wise to pay attention to the patterns of past business cycles that we outlined and note the cycle peak for rates.

Endnote

1 E.g. the Bloomberg Consensus view of the 10-year rate by economic forecasters. On October 13, 2021, of the 33 forecasters listed, only two had a declining forecast from 2022 to 2023.

Author

TANI FUKUI
Global Economic & Market Strategy

Tani Fukui is an Economist and Associate Director for the Market Strategy and Research Group. Her responsibilities include assessing and communicating economic conditions and overseeing coordination of the global economic view. Prior to joining MetLife in 2015, Tani was an economist at the U.S. International Trade Commission, an independent Federal agency. Tani holds a B.S. in Finance from the Wharton School at the University of Pennsylvania, an M.A. in International Affairs from Columbia University and a Ph.D. in International and Macroeconomics from UCLA.

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[2] As of June 30, 2021. At estimated fair value. Represents the value of all commercial mortgage loans and real estate equity managed by MIM, presented on the basis of gross market value (inclusive of encumbering debt). At estimated fair value. Includes MetLife general account and separate account assets and unaffiliated/third party assets.

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