# Another Interpretation Of The Flattening Yield Curve

By Erika Morphy
Published: July 3, 2018


Morningstar's headquarters in Chicago

CHICAGO–Talk of a flattening yield curve and what it portends for a recession has been increasing. The most notable example came a week ago when *The New York Times* pointed out that the last time the gap between two-year and 10-year US Treasury notes was roughly 0.34 percentage points was in 2007 "when the United States economy wa heading into what was arguably the worst recession in almost 80 years."

**Morningstar** has weighed in as well in its newly-released Market Outlook for 3Q and its analysis of the situation is a bit more reassuring.

First, some background.

The yield curve, of course, is the difference between interest rates on short-term US government bonds, such as two-year Treasury notes, and long-term government bonds, su as the 10-year Treasury. The short-term rates tend to rise in response to the federal funds rate and, as the Federal Reserve has been raising this rate, short-term notes have bee duly affected. Long-term rates, though have been lagging these interest rate increases — despite the recent and brief increases over the 3% psychological barrier — thus prompting fears that the flattening yield curve will eventually invert, a near-sure sign of recession.

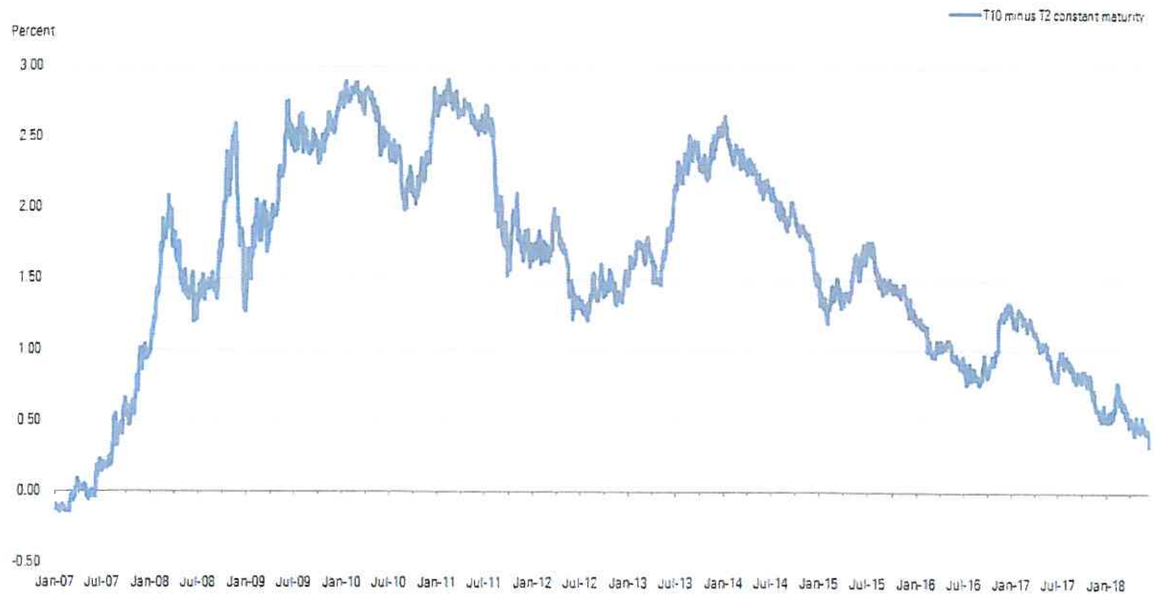
Morningstar, however, says that this time might be different. It says that this particular economic signal might not be foreshadowing a near-term recession risk "as it has been heavily influenced by global central bank actions and current economic activity hasn't shown any indications of slowing down."

Morningstar pointed out that the bid for longer-term US Treasuries "coincided with the increasing rhetoric surrounding global trade re-negotiations and the rising risk that ne tariffs will be imposed and the responding retaliatory tariffs will impede global economic growth."

It was at this point that the spread between the 2-year and the 10-year Treasury dropped to 35 basis points, it said.

Of course, what Morningstar doesn't explicitly state is that a trade war could usher in a recession, flat yield curve or not.

**Exhibit 4** 10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity




Source: Morningstar, Inc. Data as of June 25, 2018