Bond yields are changing. Should we expect a US recession—or the opposite?

By Jesper Rangvid

US President Trump wants lower yields. To his discomfort, the 10-year yield has remained stubbornly flat in recent years, despite significant rate cuts by the Fed. Yet if history is any guide, this may actually be a welcome development.

If we have learned one thing about President Trump, it is that he pays close attention to the US 10-year Treasury yield. We saw this clearly in April last year, when markets panicked over the tariff frenzy on "Ruination Day," as I call 2 April 2025. While Trump initially tried to play down the massive sell-off of U.S. assets—remarking that "people got a little yippie"—he ultimately backed off and reduced tariffs after the 10-year Treasury yield began to rise; I wrote about this in a previous post (link).

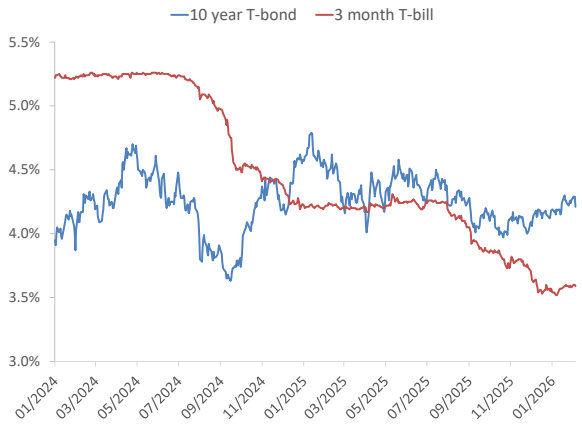
We now even have the well-known acronym TACO—Trump Always Chickens Out: Trump climbs down the tree when markets panic and the 10-year Treasury yield rises in response to yet another erratic decision by the president.

In short, Trump wants low rates, both short rates—as evidenced by his repeated attacks on Fed Chair Jerome Powell for not cutting the (short-term) federal funds rate as much as Trump would like (link)—and long rates as well.

From this perspective, recent movements in yields have probably not pleased Trump. Short yields have fallen, but long yields have barely moved.

Figure 1 shows the yield on the 3-month T-bill since early 2024, alongside the yield on the 10-year Treasury. As the figure illustrates, the 10-year yield today is more or less at the same level as in early 2024—around 4 percent. Two years have passed, with some ups and downs along the way, but overall, we are still at roughly that same 4 percent level.

Figure 1*. Yields on 3-month Treasury bills and 10-year Treasure bonds. Daily data. January 2024-February 2026.*
Source: FRED of St. Louis Fed and J.Rangvid.



In contrast, the yield on 3-month T-bills has fallen sharply. It stood above 5 percent in early 2024; today, it is around 3.5 percent. In other words, short rates have declined by almost two percentage points, while long rates have barely moved.

Figure 2 shows the difference between long and short yields.

While long yields were more than one percentage point below short yields two years ago, they are now about 0.5 percentage points higher.

***Figure 2**. Difference between yields on 10-year Treasure bonds and 3-month Treasury bills. Daily data. January 2024-February 2026.*
Source: FRED of St. Louis Fed and J.Rangvid.

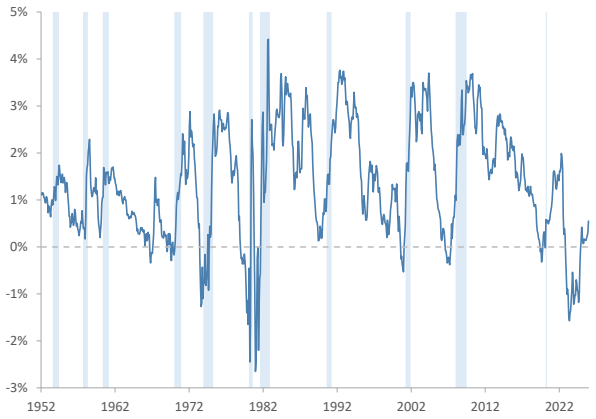
Why have long yields not fallen?

One possible explanation is that investors have increased the risk premium they demand for holding long-dated US Treasuries, reflecting heightened political risk in the United States. Under this interpretation, the Fed has lowered the policy rate, pulling down short-term yields, while long-term yields have failed to follow because investors have grown more cautious about holding long US Treasuries. This is certainly a possibility. I am not convinced, however, that we can conclude this based on these yield-curve developments.

Instead, I believe what we are seeing is simply a return to normal. Markets had priced in a recession following the interest rate hikes of 2022, and we are now gradually moving away from that expectation. Such a pattern has played out many times in the past, as illustrated in Figure 3.

The figure shows the difference between long and short Treasury yields—just as in Figure 2—but now extending back to the early 1950s, that is, to the period after the Treasury–Federal Reserve Accord of 1951, when the Fed began setting rates independently. Months in which the US economy was in recession are shaded in Figure 3.

***Figure 3**. Difference between yields on 10-year Treasure bonds and 3-month Treasury bills. NBER recession months indicated by shades. Monthly data. January 1952 – December 2025.*
Source: FRED of St. Louis Fed and J.Rangvid.



As Figure 3 shows, the yield spread has historically been a robust predictor of recessions. The difference between long and short yields has typically narrowed ahead of recessions—that is, short yields have tended to rise relative to long yields before economic downturns. Such developments have repeatedly and reliably signalled recessions in the United States.

When a recession arrives, the yield curve steepens: short rates are cut, widening the gap between long and short yields.

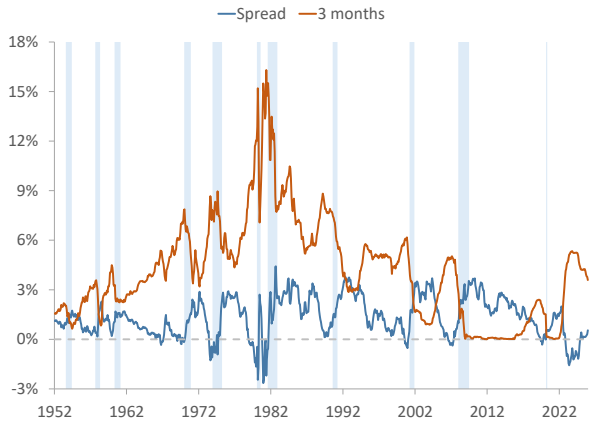
At some point after the recession, the Fed begins raising rates again, leading to a flattening of the yield curve as short rates rise relative to long rates—and the cycle starts over.

As a concrete example, consider the period leading up to the 2008 financial crisis. In the

mid-2000s, the Fed began raising rates, and the yield curve flattened. The recession then hit in 2008. The Fed subsequently cut rates, causing the yield curve to steepen. It peaked toward the end of the recession in June 2009, after which the yield curve began flattening again.

I have written this as if changes in short yields are the main driver of fluctuations in the term spread. Does the long yield not move? Of course it does. But movements around recessions are primarily driven by changes in the Fed's policy rate, which then spill over to other short-term yields. This is illustrated in Figure 4, which shows both the difference between long and short yields and the 3-month Treasury yield.

Figure 4*. Difference (spread) between yields on 10-year Treasure bonds and 3-month Treasury bills together with the 3-month T-bill yield. NBER recession months indicated by shades. Monthly data. January 1952 – December 2025.*
Source: FRED of St. Louis Fed and J.Rangvid.

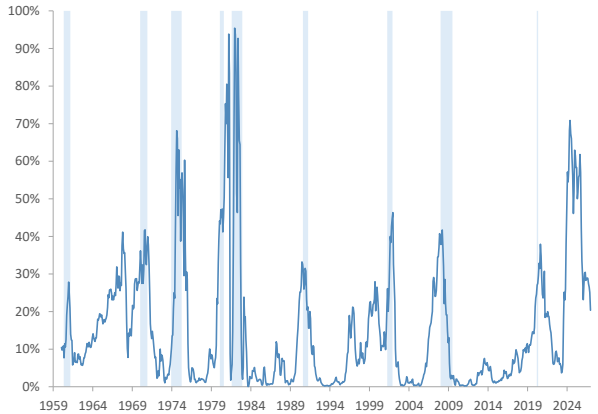


As Figure 4 shows, changes in the yield spread are primarily driven by abrupt movements in short-term yields—typically triggered by shifts in monetary policy. When short yields rise, the difference between long and short yields narrows; when short yields fall, the spread widens.

In fact, because of the historically strong relationship between a flattening yield curve and subsequent recessions, the yield spread is widely regarded as one of the best predictors of economic downturns. A few years ago, I wrote an analysis on the link between yield spreads and future recessions (link). In that piece, I also investigated whether yield spreads in Europe predict recessions in Europe. I found that they do. I also argued that we were unlikely to see a US recession in 2022—a call that, in hindsight, turned out to be correct 😊.

Given this strong historical predictive power, the New York Fed maintains a model that estimates the probability of entering a recession within one year based on the yield spread. These estimated probabilities are shown in Figure 5.

Figure 5*. Probabilities of recession based on the yield spread. NBER recession months indicated by shades. Monthly data. January 1952 – December 2025.*
Source: New York Fed and J.Rangvid.



At present, the yield spread implies a roughly 20 percent probability that the U.S. economy will be in recession one year from now—that is, by the end of 2026. This is down sharply from the roughly 70 percent probability implied by the yield curve in mid-2024.

The big miss

So, the most likely explanation for why long yields have not moved much, even as short yields have fallen in recent years, is simply that we are moving away from the very high recession probabilities implied by the yield curve a couple of years ago.

But—and this is an important point—we did not experience a recession in 2023–2024. Many observers had predicted one, and so had the yield curve.

In that sense, the yield curve clearly made a big miss this time. The sharp rate hikes following the post-pandemic inflation surge led the yield curve—and many forecasters—to signal an impending recession. It never materialized.

Why did the yield curve fail so spectacularly in this episode, in contrast to most others in history? I wrote an analysis on this question (link). My conclusion was that the main reason economic activity held up so well, despite significant rate hikes by the Fed, was that households entered this tightening cycle with large savings accumulated during the pandemic. In other words, the pandemic triggered both the inflation surge and the subsequent interest rate hikes, but it also left the economy unusually resilient. There were other contributing factors—such as the prevalence of fixed-rate mortgages—but household savings were, in my view, the dominant reason.

Conclusion

Short-term yields have fallen over the past couple of years, while long-term yields have not. Does this signal that investors are losing confidence in US Treasuries? I am not convinced that it does. (To be clear, there may well be other indicators pointing to reduced appetite among international investors for US Treasuries; I just do not think recent yield-curve movements alone justify that conclusion.)

Instead, what we are seeing appears to be a familiar pattern. At some point during an economic expansion, the Fed raises rates to cool the economy. Short-term yields rise, while long-term yields rise less—or not at all—and the yield curve flattens.

When the recession arrives, the Fed cuts rates and the yield curve steepens. As the economy recovers, the Fed eventually begins tightening again, and the cycle repeats.

This time, the pattern began with rate hikes following the inflation surge of 2022, which flattened the yield curve. More recently, the Fed has been lowering rates, and the yield curve has steepened—entirely in line with historical experience.

The key difference in this episode is that no recession occurred in 2023–2024, despite the yield curve—and many forecasters—predicting one.

That may leave readers with an uneasy feeling. The Fed is now cutting rates, which, according to traditional yield-curve logic, suggests that a recession is further away. But the last time the yield curve made a call, it was a notable miss. Has the yield curve lost its usually robust predictive power?

That is a good question—but one best left for another day.