Historically, the yield curve for U.S. Treasuries has been a signal for a potential recession. In particular, when the shape of the curve begins to flatten or invert, the odds for a recession increase. If shorter-term rates (e.g., maturities of two or five years) begin to rise relative to longer-term rates (e.g., maturities of 10 years), the yield curve compresses. Changes in the yield curve could signal turning points in the business cycle. The chart to the left plots the 10-year and 5-year Treasury yields for the year and illustrates how the gap between the two yields has narrowed.

- Given the recent inflation headlines, it is a bit surprising that longer-term Treasury rates have not risen closer to pre-pandemic levels of roughly 2.5%. The 10-year rate has hovered around the 1.5% range after rallying earlier in the year from historic lows. The short end of the curve has risen as the Federal Reserve is almost certain to raise rates in 2022.

- One possible explanation for the yield curve flattening is that the market is betting that the Federal Reserve will raise interest rates too quickly and throw a wet blanket on the economy, thus putting us in a recession. Likewise, the COVID pandemic is a cloud that continues to loom over the global financial markets.