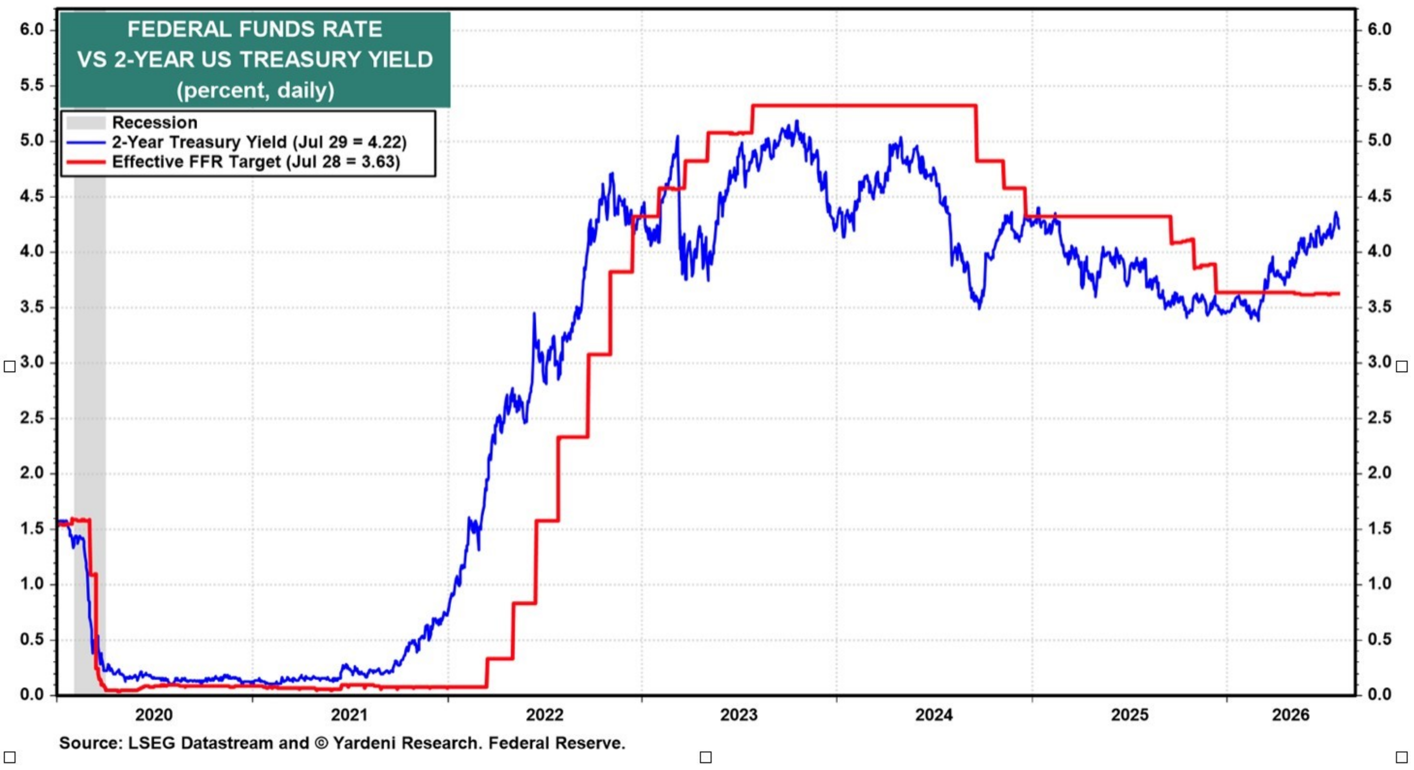
Chart of the Month

July 2026



The Federal Open Market Committee (FOMC) met on Wednesday and voted 9-3 to leave the federal funds rate (FFR) unchanged at 3.50%-3.75%. The three dissenters preferred to raise the FFR 25 basis points (0.25%).

As shown above, the current yield on the two-year Treasury (blue line) is nearly 0.60% above the midpoint of the FFR (red line), suggesting the Fed is behind the curve in raising rates. The last time the two-year was higher than the FFR was in 2021-2022 when the Fed was in the process of hiking rates 11 times to north of 5.00%. The Fed eventually lowered the FFR in 2024 and 2025 to its current level but has been slow to respond to the recent rise in Treasury yields.

The two-year bottomed earlier this year and has climbed approximately 75 basis points to its current level of 4.23%. The bond market is effectively telling the Fed that it needs to bump up rates accordingly with the goal of reducing the inflation rate (which has stubbornly remained at 3%+) toward its target of 2%. Of note, the fed funds futures market believes the Fed will hike rates to 3.75%-4.00% at the next FOMC meeting in September.

Meanwhile, as shown below, the yields on the 10-year and 30-year Treasury have increased to 4.66% and 5.21%, respectively. The latter is the highest it has been in close to two decades. The yields on these longer bonds tracked each other until the middle of last year when the 30-year pulled away from the 10-year. Mortgage rates are generally set at roughly 2.00% above the 10-year, placing them well beyond 6% for the better part of the past few years.

While counter intuitive on the surface, a higher fed funds rate may actually *lower* the yields on longer-dated maturities because it would likely signal to the market that the Fed is serious about reducing the inflation rate, which would be “music to the ears” for bond investors.

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