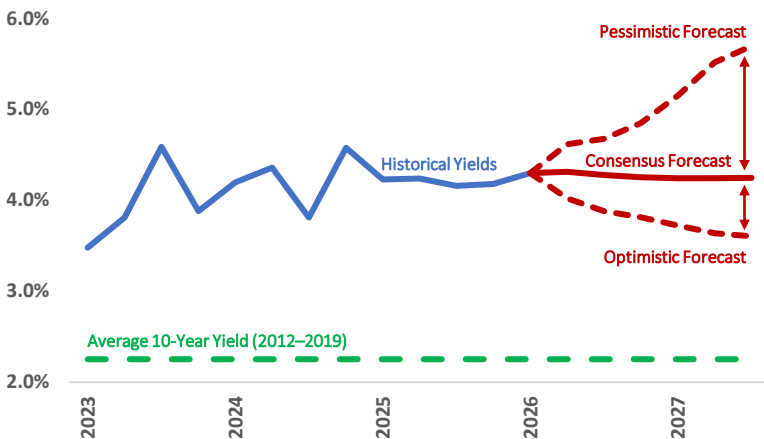


Briefing

- Prior to the 2008 financial crisis, the Federal Reserve’s assets (the total value of U.S. Treasuries and other securities held by the Fed) were equal to 6% of U.S. gross domestic product (GDP) versus 19% in 2019 and 21% today. To pump liquidity into financial markets in the wake of the 2008 crisis, the Fed purchased enough Treasuries to double its holdings. That was the first round of quantitative easing (QE). As the crisis passed, incoming Fed Chair Kevin Warsh argued for rolling back QE. Instead, the Fed doubled-down by initiating a second round of Treasury purchases. Warsh continues to call for price stability by unwinding QE. Returning to 2019 levels (19% of GDP) would require the Fed to shed almost \$750 billion in Treasuries (**Figure 1**).
- As the bulk of the Treasuries the Fed holds have 10-year or longer maturities, selling a significant quantity of Treasuries likely means selling a significant quantity of long-term Treasuries (**Figure 2**). That will put upward pressure on long-term interest rates.
- Higher interest rates have fiscal implications. More than half of the Treasuries currently outstanding come due within 5 years (**Figure 3**). As interest rates rise, the government will be forced to refinance those expiring Treasuries at higher rates, putting upward pressure on future deficits.

Chart of the Week

10-Year Treasury Yield (End of Quarter)



Commentary

Since 2023, the consensus among Blue Chip forecasters has been that the 10-year Treasury yield will remain “higher for longer.” But a new wrinkle has emerged in the past month. Warsh has restated (most recently in his Senate confirmation hearing) his desire to see the Fed roll back QE, forecasters have come to see a greater high side to future long-term rates and a lesser low side.

Examining the spread of forecasts reveals a range of agreement—a span encompassing 95% of forecasts. For two years or more, the range above the consensus forecast (the pessimistic forecast) has been as large as the range below (the optimistic forecast). For the first time this month, the pessimistic forecast is further above the consensus than the optimistic is below. This points to forecasters’ sense that there is a greater range of possibilities for higher long-term rates than for lower (**Chart of the Week**).

If a Warsh-led Fed does shrink the Fed’s balance sheet, and if it does so at the same pace as from 2023 through 2025, then it will likely take until late 2027 for the Fed’s balance sheet to return to the same level, relative to GDP, that it was prior to QE4 (see **Figure 1**).

Snapshots

Figure 1. Federal Reserve Assets (Trillions)

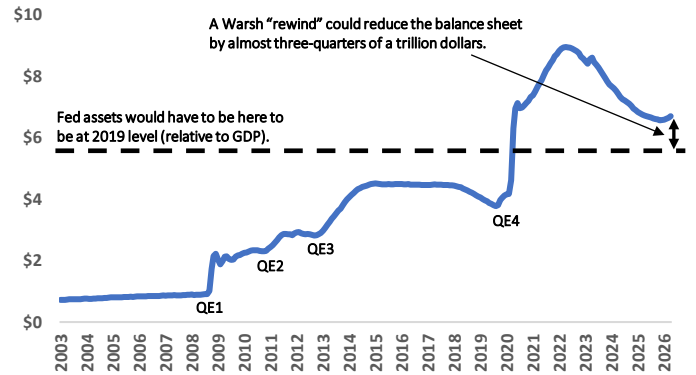


Figure 2. Fed Assets by Maturity (Trillions)

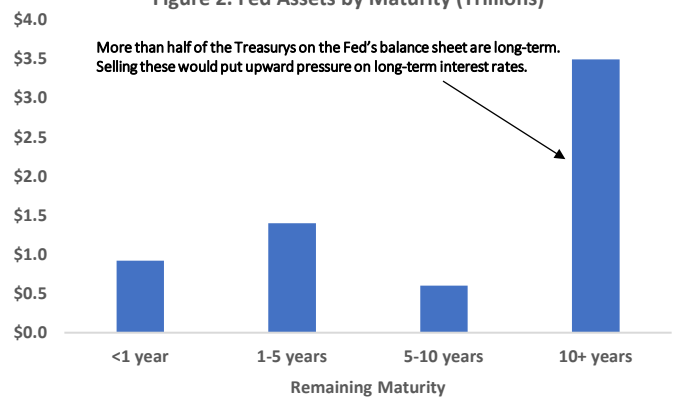
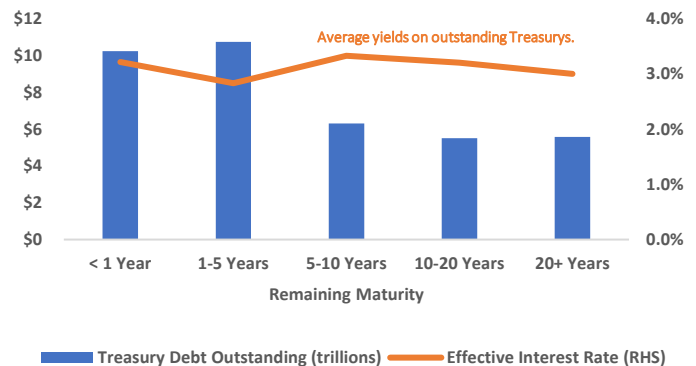


Figure 3. Interest Rates on Outstanding Treasuries



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Key Indicators

INTEREST RATES ¹	2026				2027	
	Current	Q2	Q3	Q4	Q1	Q2
Fed Funds Target ² (%)	3.75	3.75	3.75	3.75	3.75	3.75
SOFR (%)	3.60	3.60	3.50	3.40	3.30	3.30
2Y UST (%)	4.04	3.70	3.60	3.60	3.60	3.60
5Y UST (%)	4.22	3.90	3.80	3.80	3.80	3.80
10Y UST (%)	4.57	4.30	4.30	4.30	4.20	4.20
30Y UST (%)	5.11	4.90	4.90	4.80	4.80	4.80

ECONOMY	2026				2027	
	Current	Q2	Q3	Q4	Q1	Q2
PCE Inflation (YoY %)	3.5	4.6	2.4	2.5	2.5	2.3
CPI Inflation (YoY %)	3.8	5.6	2.3	2.3	2.4	2.3
Real GDP (QoQ %)	2.0	1.5	1.7	1.9	2.1	2.1
Unemployment (%)	4.3	4.4	4.5	4.5	4.5	4.4
Consumer Spending (QoQ %)	1.6	1.5	1.7	1.9	1.9	2.0
Industrial Production (YoY %)	1.4	1.1	1.2	1.4	1.6	1.7

Equities & Currency

	Current	Year ago	YoY Δ
DJIA	49,697	42,792	16.1%
Nasdaq	26,246	19,215	36.6%
S&P 500	7,427	5,940	24.5%
US Dollar Index	\$1,201.12	\$1,224.98	(2.6%)

Commodities

	Current	Year ago	YoY Δ
Crude Oil (Per Barrel)	\$104.50	\$62.14	70.0%
Natural Gas (Per MMBtu)	\$3.01	\$3.11	(3.4%)
Coal (Per Short Ton)	\$13.17	\$9.93	33.0%
Gold (Per Ounce)	\$4,565.00	\$3,222.20	41.8%
Corn (Per Bushel)	\$4.73	\$4.48	5.6%
Soybean (Per Bushel)	\$12.12	\$10.51	15.4%

Industry

	Current	Year ago	YoY Δ
Natural Gas Storage (Billion Cubic Feet)	2,290	2,239	2.3%
U.S. Daily Power Consumption (MWh)	9,703,376	9,782,942	(0.8%)
World Container Index (Per 40ft)	\$2,553	\$2,233	14.3%

¹ Unless otherwise indicated, forecasts are from the Blue Chip Professional Forecasters.
² Target rate forecast is based on futures market contracts.

Sources: © Oxford Economics, Blue Chip Financial Forecasts, Trading Economics, Moody's Analytics, Statista, Oxford Economics, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Energy Information Administration, U.S. Treasury Department, Federal Reserve Bank of Atlanta, Federal Reserve Bank of New York, Federal Reserve Bank of St. Louis, International Monetary Fund, World Bank, University of Michigan, The Conference Board.

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Forecasts

