INSIGHTS

Markets: The Fed’s rate-cutting cycle has come to an end.

The higher-for-longer interest rate outlook is gaining traction.

August 2026

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Highlights

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The market has moved away from expectations of Fed rate cuts, **pricing in a higher-for-longer rate environment** amid persistent inflation risks and a more restrictive monetary policy stance.

Post-pandemic inflation has altered the Fed's reaction function, with inflation readings remaining persistently above the 2% target and exhibiting greater volatility than during the pre-pandemic period.

The Treasury yield curve and term premium underscore a structural shift in the interest rate landscape, reflecting increased compensation for duration exposure, fiscal risks, and diminished expectations of a return to a lower-rate environment.

Recent 10-year U.S. Treasury and TIPS auctions confirm a higher cost of nominal and real financing, with investors demanding yields significantly above those seen in the decade preceding the pandemic.

Latin America and emerging markets continue to deliver exceptional performance, experiencing one of their strongest periods in recent years. Sovereign spreads are at levels not seen in more than 15 years, currencies have posted a marked recovery against the U.S. dollar, and corporate credit upgrades to investment grade have reached their highest levels in nearly a decade.

The Fed's shift toward providing less forward guidance has prompted a strong market reaction, with investors making their views on Kevin Warsh increasingly clear.

Warsh's arrival as Fed Chair points to meaningful changes in the central bank's communication strategy, with a focus on **reducing reliance on *forward guidance***.

The discussion focused on several key themes, including a review of the current communications framework, debate over the optimal frequency of FOMC meetings, concerns about the reliability and representativeness of certain economic indicators, and a reaffirmation of the Federal Reserve's commitment to achieving and maintaining its 2% inflation target.

-Image made with Copilot
Source: Bloomberg – Economic Research Bladex

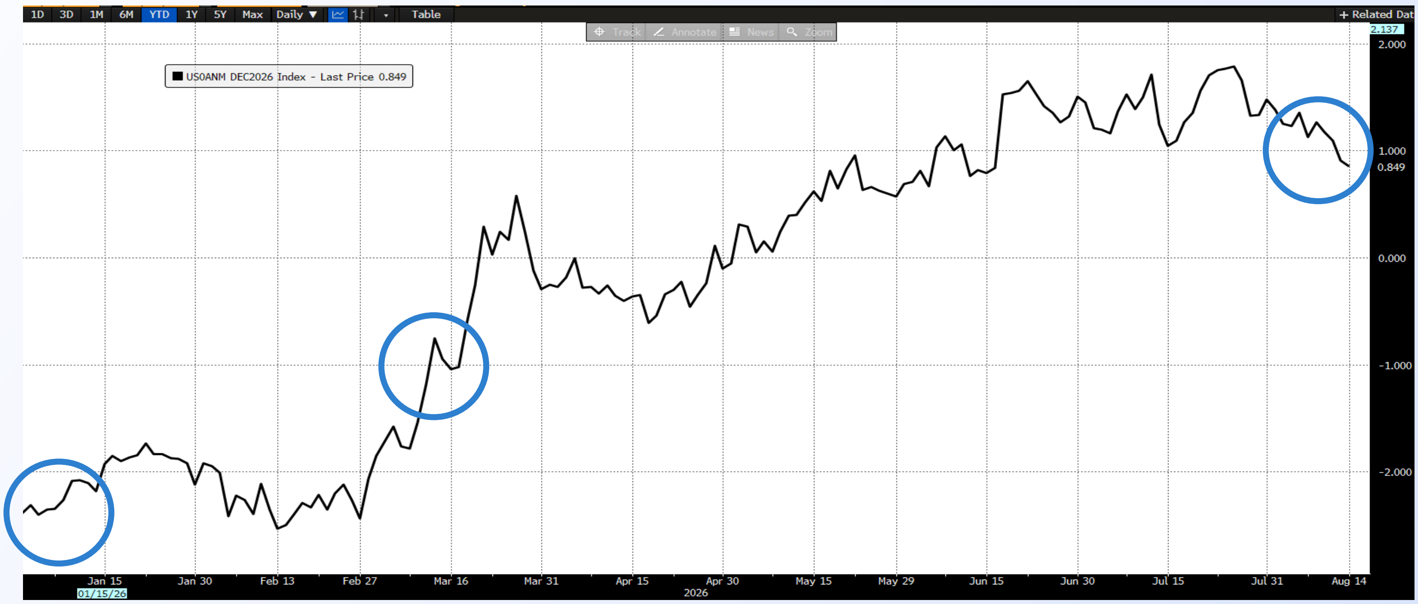
Inflation's persistence above the 2% target, extending beyond transitory factors, coupled with elevated inflation volatility since the pandemic, has increased the Fed's focus on inflation risks and reinforced a more cautious policy stance. This represents a clear break from the pre-pandemic era of persistently low inflation.

Inflation United States (%)

Source: BLS – Bloomberg – Economic Research Bladex

The outlook for Federal Reserve monetary policy has undergone a 180-degree shift over the past six months. Market expectations have moved from pricing in as many as two rate cuts in 2026 to adopting a more hawkish stance, reflecting growing concerns over inflation risks stemming from geopolitical tensions and the ongoing trade war.

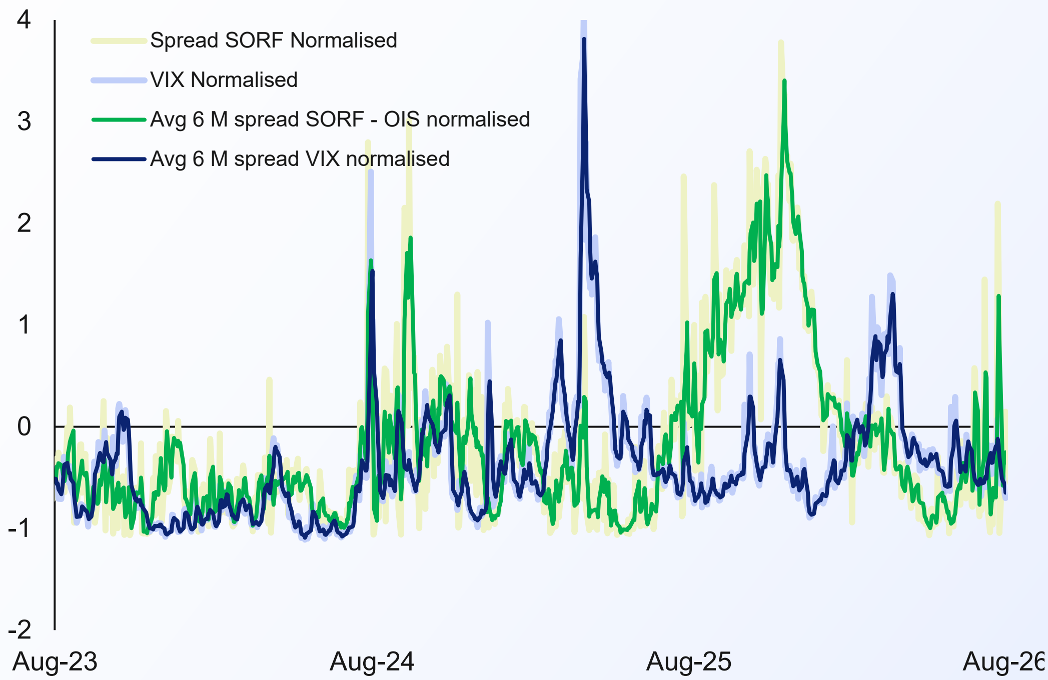
Expected FED rate movements according to futures
(# Number of times)



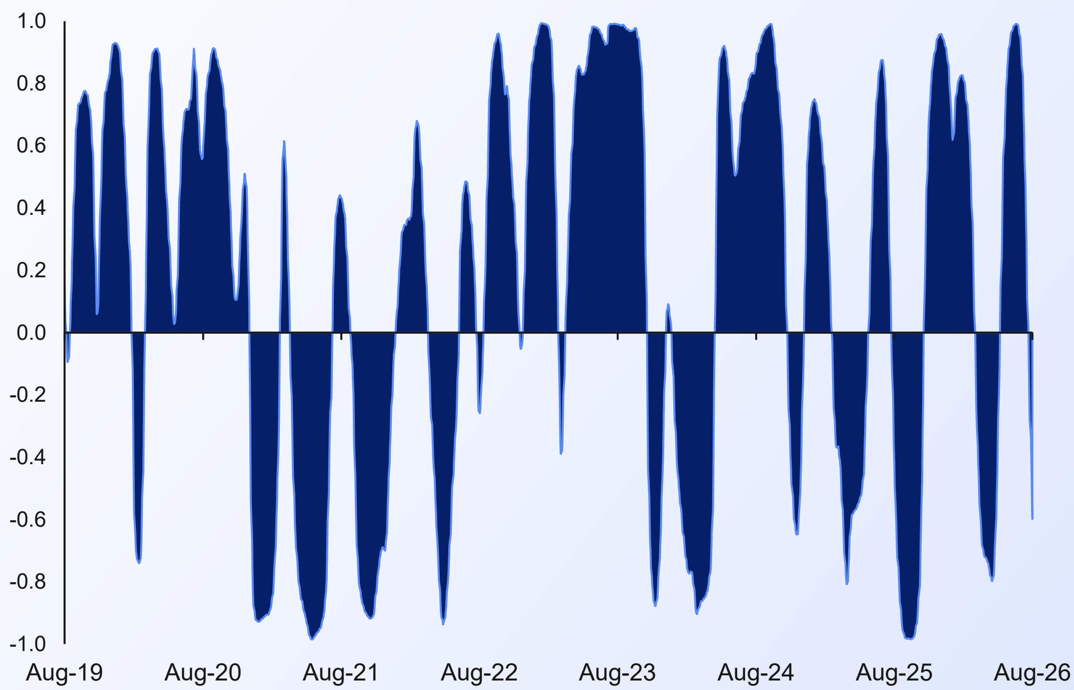
Source: Bloomberg – Economic Research Bladex

Liquidity markets have become the primary source of volatility. While movements in the VIX (a proxy for risk sentiment) remain relatively contained, the SOFR-OIS spread (a liquidity proxy) has shown more pronounced and frequent swings, reflecting increased sensitivity of funding conditions to changes in monetary policy and liquidity expectations.

Spread SOFR – OIS* vs. VIX** (Normalized Series, Standard Deviation)



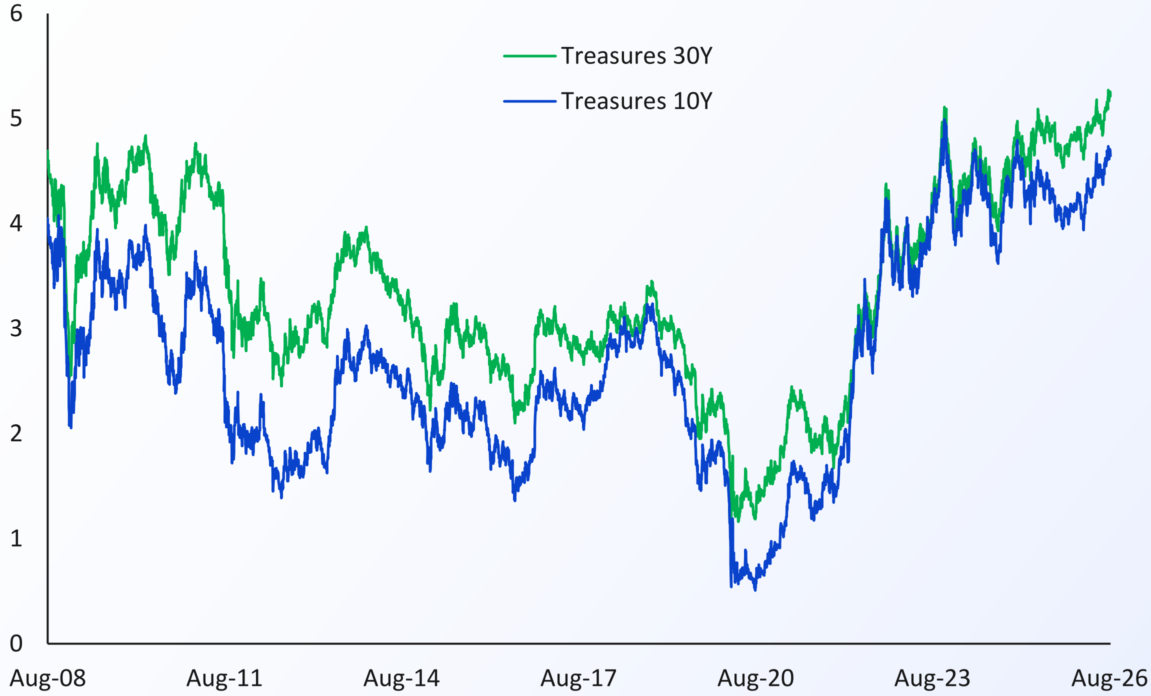
3 Month Moving Correlation Spread SOFR OIS – VIX (Units)



Source: Bloomberg – Economic Research Bladex.
*Spread SOFR-OIS: the spread between the SOFR rate and the OIS rate, used as an indicator of liquidity and stress conditions in short-term funding markets. **VIX: Expected Volatility Indicator of the U.S. Stock Market

Recent developments in the yield curve reinforce expectations of a structurally higher interest-rate environment (“higher for longer”). Persistent inflation risks and the deterioration of the U.S. fiscal position continue to exert upward pressure on yields across the curve.

US Treasuries 10Y vs. 30Y(%)

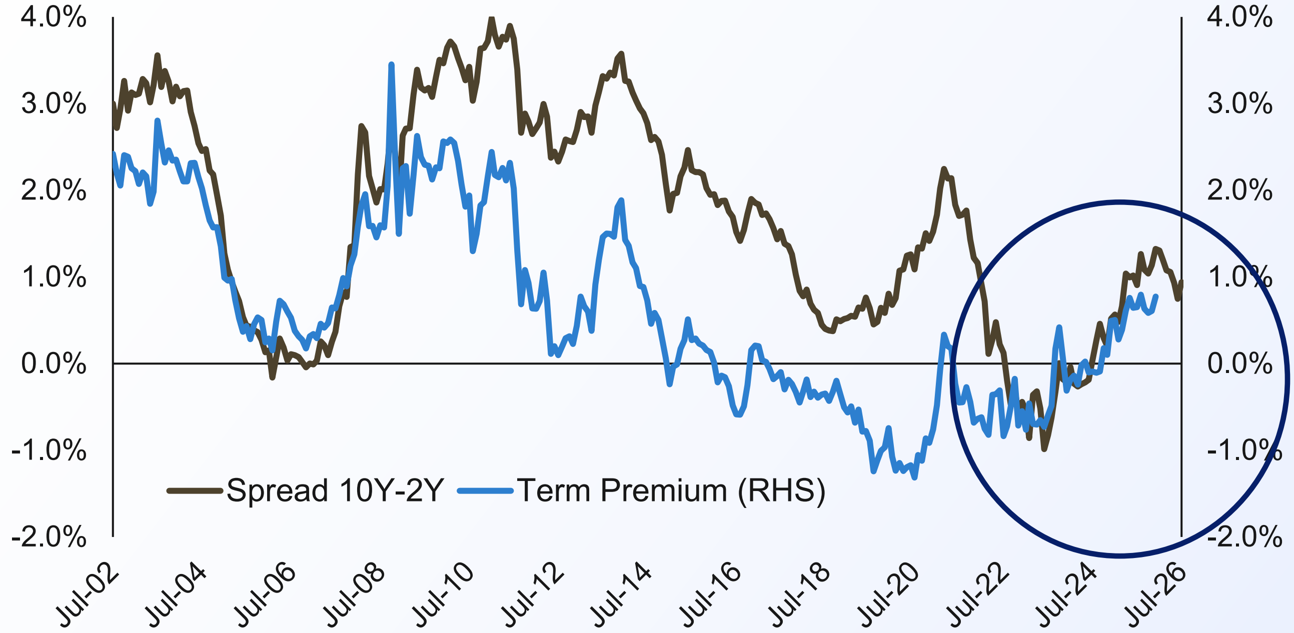


30Y-2Y U.S. Treasury Spread (pp) *

Source: Bloomberg – Economic Research Bladex.
∗Spread SOFR-OIS: the spread between the SOFR rate and the OIS rate, used as an indicator of liquidity and stress conditions in short-term funding markets. ∗∗VIX: Expected Volatility Indicator of the U.S. Stock Market

Markets are once again demanding greater compensation for duration risk. The combination of a steeper yield curve and a positive term premium suggests investors are pricing in a higher-for-longer rate regime, driven by persistent inflation risks and mounting fiscal pressures in the United States.

Treasury Yield Curve Slope vs. Term Premium (%) *



Source: Bloomberg – Economic Research Bladex

*Term premium: additional return required for assuming the risk of holding bonds at longer maturities.

Recent 10-year U.S. Treasury auctions indicate that investors continue to demand yields significantly higher than those prevailing during the decade preceding the pandemic. The combination of more volatile inflation and increased fiscal financing needs has established a new equilibrium of elevated nominal interest rates.

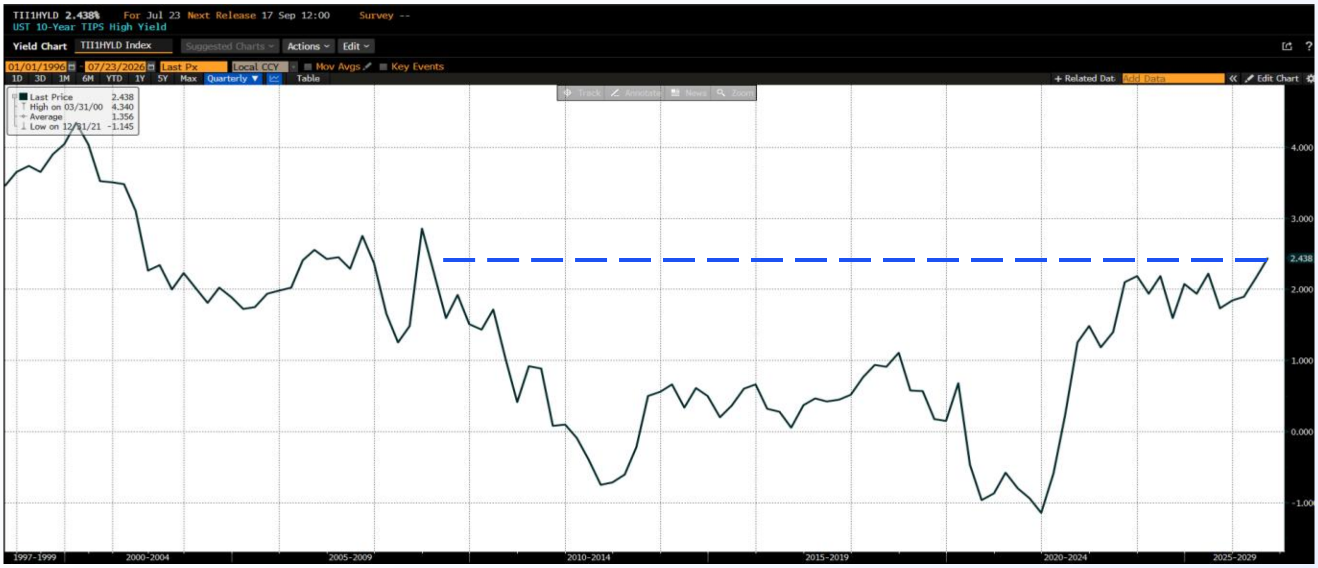
Cut-off Yield in Weekly 10-Year U.S. Treasury Auctions* (%)

Source: Bloomberg – Economic Research Bladex

* Cut-off yield: the yield at which 10-year U.S. Treasury securities are allocated in auction, serving as a gauge of funding costs and market appetite for U.S. government debt.

Recent TIPS auctions suggest that markets have embraced a new regime of structurally higher real interest rates. With real yields near 2.4%, well above the average of the past decade, the implications include: pressure on risk-asset valuations, reduced relative attractiveness of emerging markets, tighter financial conditions, and greater market sensitivity to persistent inflation.

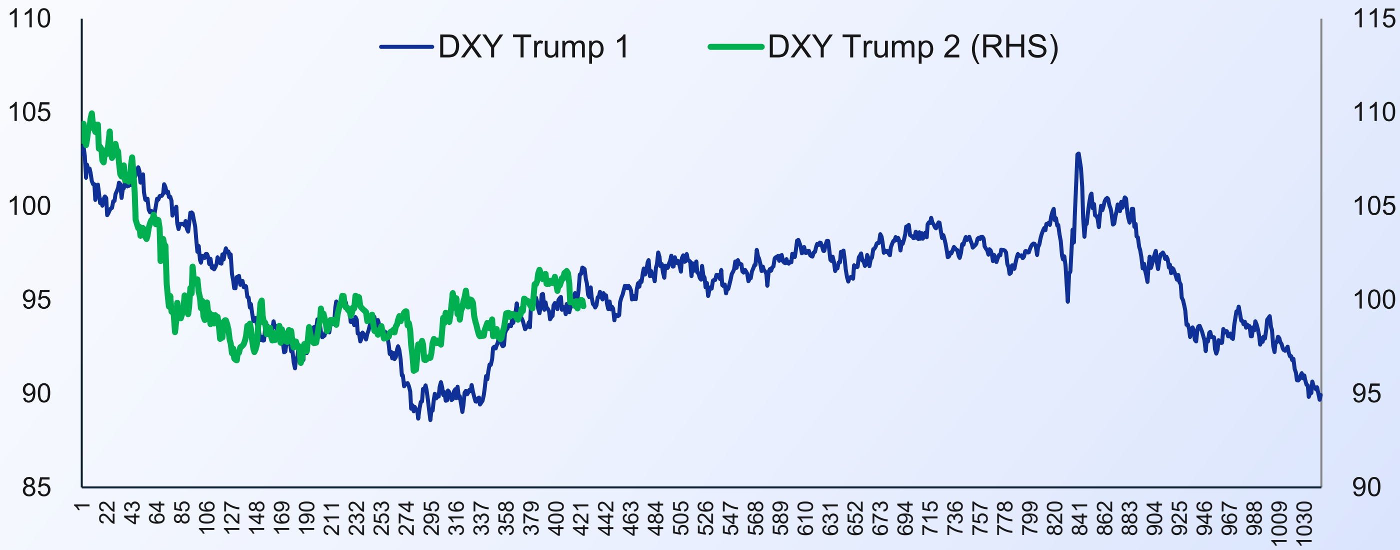
UST 10-Year TIPS High Yield* (%)



Source: Bloomberg – Economic Research Bladex.
*Real yield awarded at 10-year TIPS auctions, used as a benchmark for long-term real interest rates in the United States.

The recent trajectory of the DXY bears similarities to the early phase of Trump's first term. In both cases, the U.S. dollar experienced a significant depreciation following the start of the administration. The experience of Trump 1.0 suggests that a subsequent recovery is possible. However, risks related to the fiscal outlook, trade policy, and expectations surrounding the Federal Reserve continue to constrain any rebound.

DXY: Trump 1.0 vs Trump 2.0 (Levels)



Source: Bloomberg – Economic Research Bladex

Latin America continues to demonstrate resilience from a sovereign risk perspective, with the regional EMBI still near multi-year lows. This strength is also evident in credit rating dynamics, where the balance between upgrades and downgrades stands at levels not seen in more than a decade.

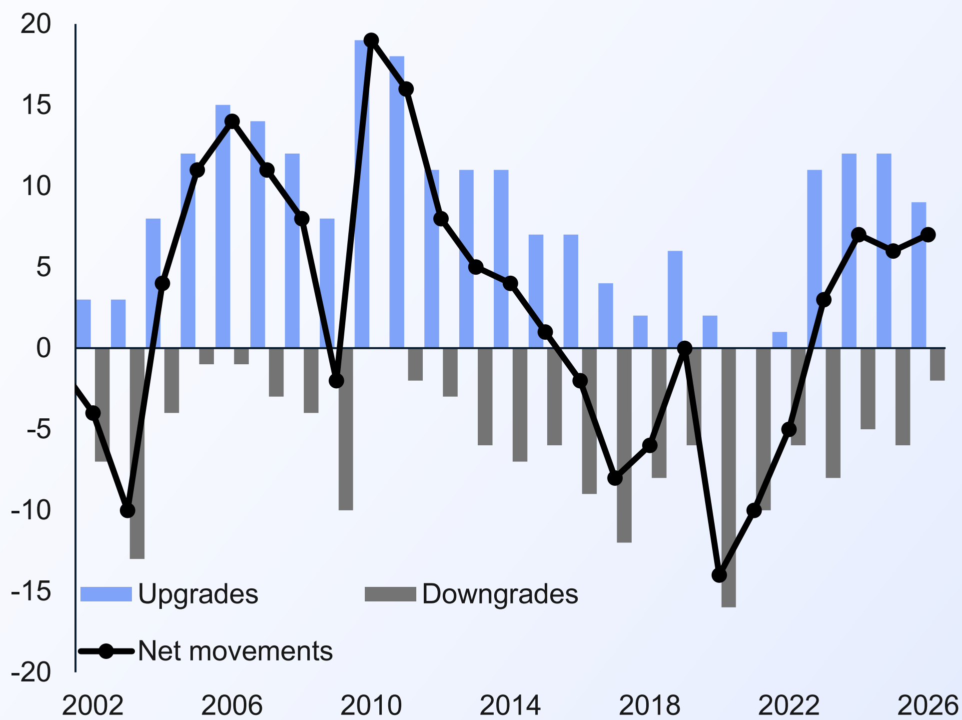
EMBI by Country in Latin America (pp)

Country	5Y	3Y	2Y	1Y	YTD	1M	1W	20-Aug-26
Uruguay	1.39	0.96	0.84	0.71	0.68	0.60	0.66	0.68
Chile	1.41	1.34	1.30	1.02	0.89	0.84	0.89	0.90
Paraguay	2.36	2.07	1.68	1.35	1.01	1.00	1.06	1.09
Perú	1.85	1.73	1.65	1.28	1.35	1.04	1.07	1.11
Guatemala	2.64	2.07	2.06	1.67	1.41	1.14	1.09	1.18
Panamá	1.83	2.15	2.63	1.91	1.55	1.10	1.22	1.18
Costa Rica	4.84	2.41	2.30	1.80	1.41	1.26	1.25	1.31
Rep.Dominicana	3.67	3.06	2.14	1.80	1.69	1.65	1.62	1.57
Honduras	3.27	3.70	4.06	3.08	2.34	1.61	1.61	1.58
Brasil	2.97	2.17	2.20	1.96	1.96	1.70	1.78	1.81
Colombia	2.86	3.31	3.15	2.90	2.75	1.82	1.91	1.88
México	3.69	3.82	3.22	2.49	2.22	1.97	1.90	2.00
El Salvador	8.33	9.32	6.98	3.96	3.26	2.98	2.76	2.75
Bolivia	4.93	11.39	22.68	11.71	6.73	4.16	4.07	4.22
Ecuador	8.21	17.50	12.86	7.72	4.92	4.08	4.32	4.31
Argentina	15.98	21.11	14.88	7.47	5.61	4.18	4.70	5.35
Venezuela	283.16	405.89	195.32	170.86	127.41	68.18	66.62	67.70
LATAM EMBI*	**4.45**	**4.91**	**4.09**	**2.80**	**2.41**	**1.98**	**2.05**	**2.15**

Lower relative to peers

High relative to peers

Rating Moves(Number)



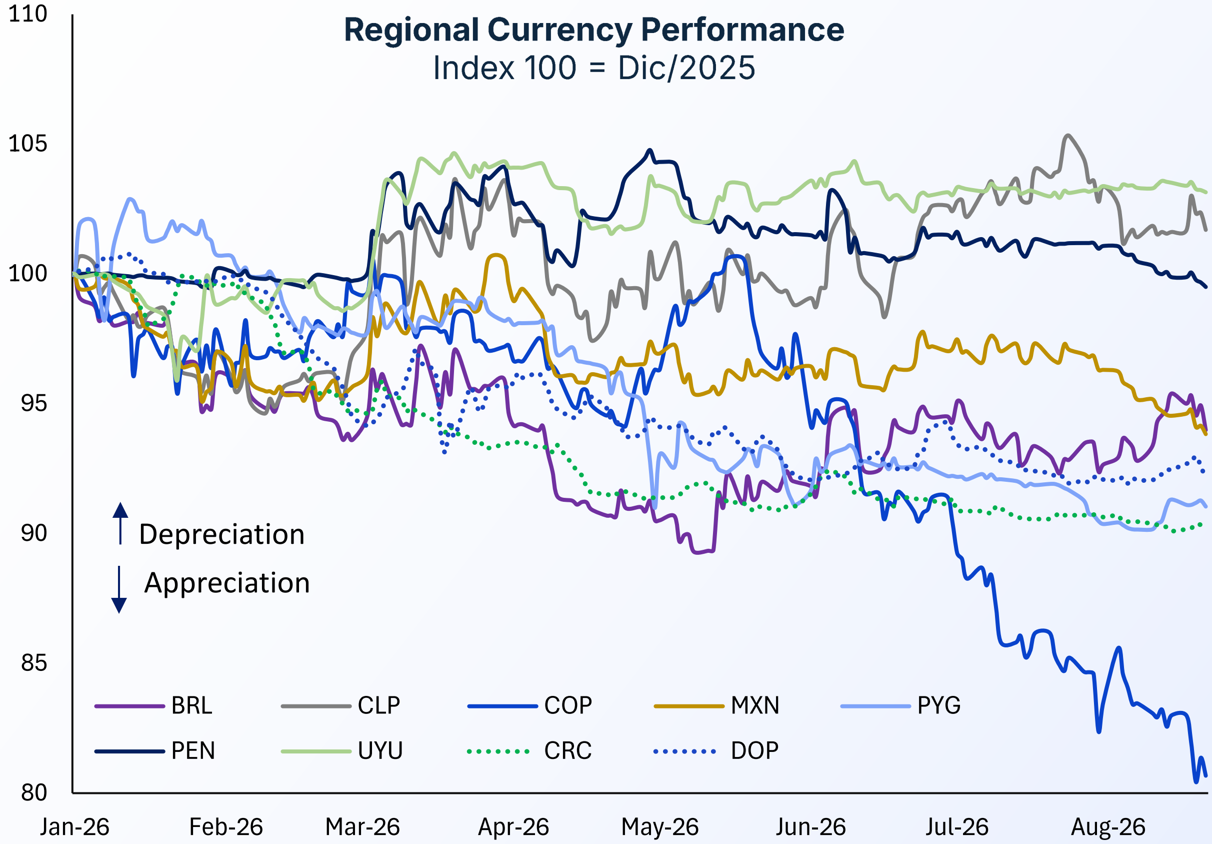
Rating Moves in 2026

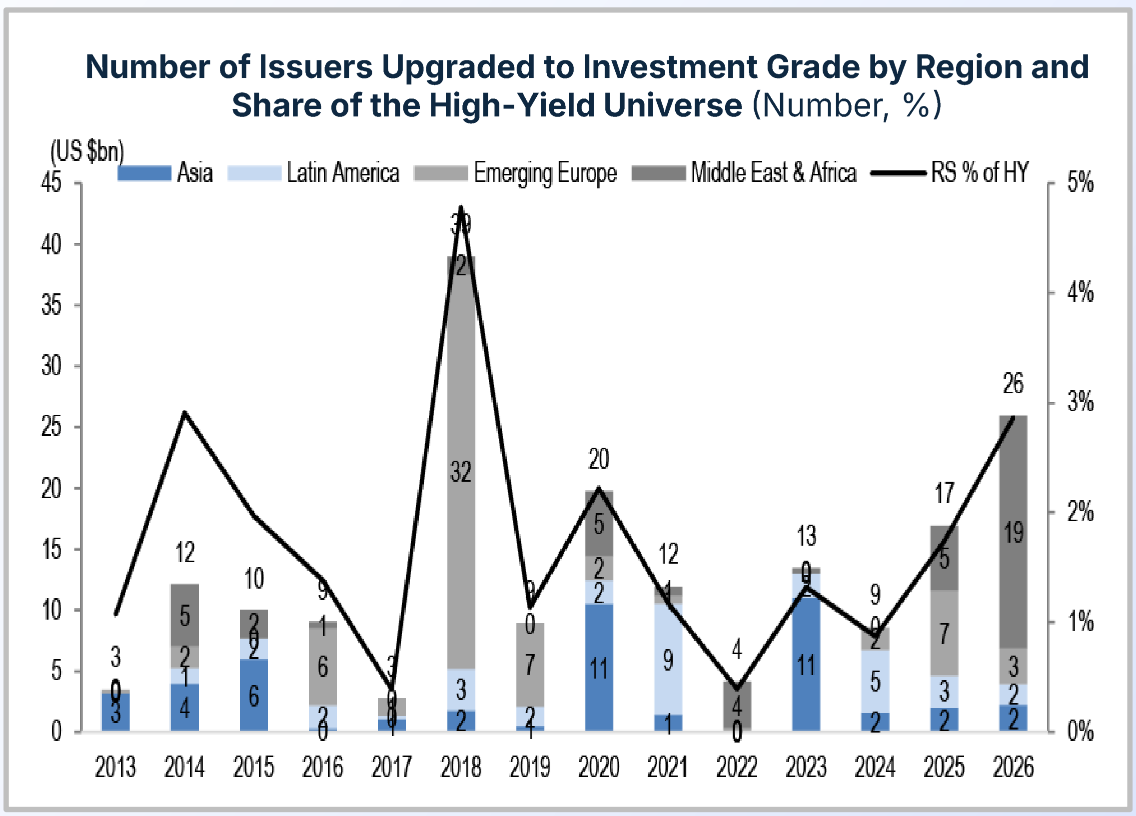
9 Upgrade

2 Downgrades

Source: Bloomberg – Moody's – S&P – Fitch – Economic Research Bladex

Risk appetite toward emerging markets remains strong: currencies continue to outperform, while corporate rating upgrades have reached historically elevated levels.





Source: Bloomberg – JP Morgan – Estudios Económicos Bladex

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