Capital Markets Strategy

Essential inCights for the C-Suite

Chart of the Day

Over the last week, 10 year UST yields have jumped closer to 4% after trading in a largely range-bound area of 3.40% to 3.70% for much of the 1H 2023. "Real rates" provide an inflation adjusted measure of interest rates compared to the "expected" rate of US inflation over the same tenor. **Since the Fed began its accelerated "double tightening" just over 15 months ago (raising rates, reducing balance sheet), and as the economy has shown resilience with inflation declining, US "real" rates have moved more firmly positive.**

This divergence between rates and inflation expectations, in turn, reflect a general confidence in the Fed's ability and willingness to combat inflation. Higher "real rates" also create headwinds for risk assets and the sustainability of government debt burdens over time.

According to a recent study by the IMF, the increases in real interest rates across advanced economies over the last year are likely to be temporary. With inflation expected to continue its decline in the months ahead, the IMF expects central banks to ease monetary policy in 2024 and bring real rates back closer to pre-pandemic levels.

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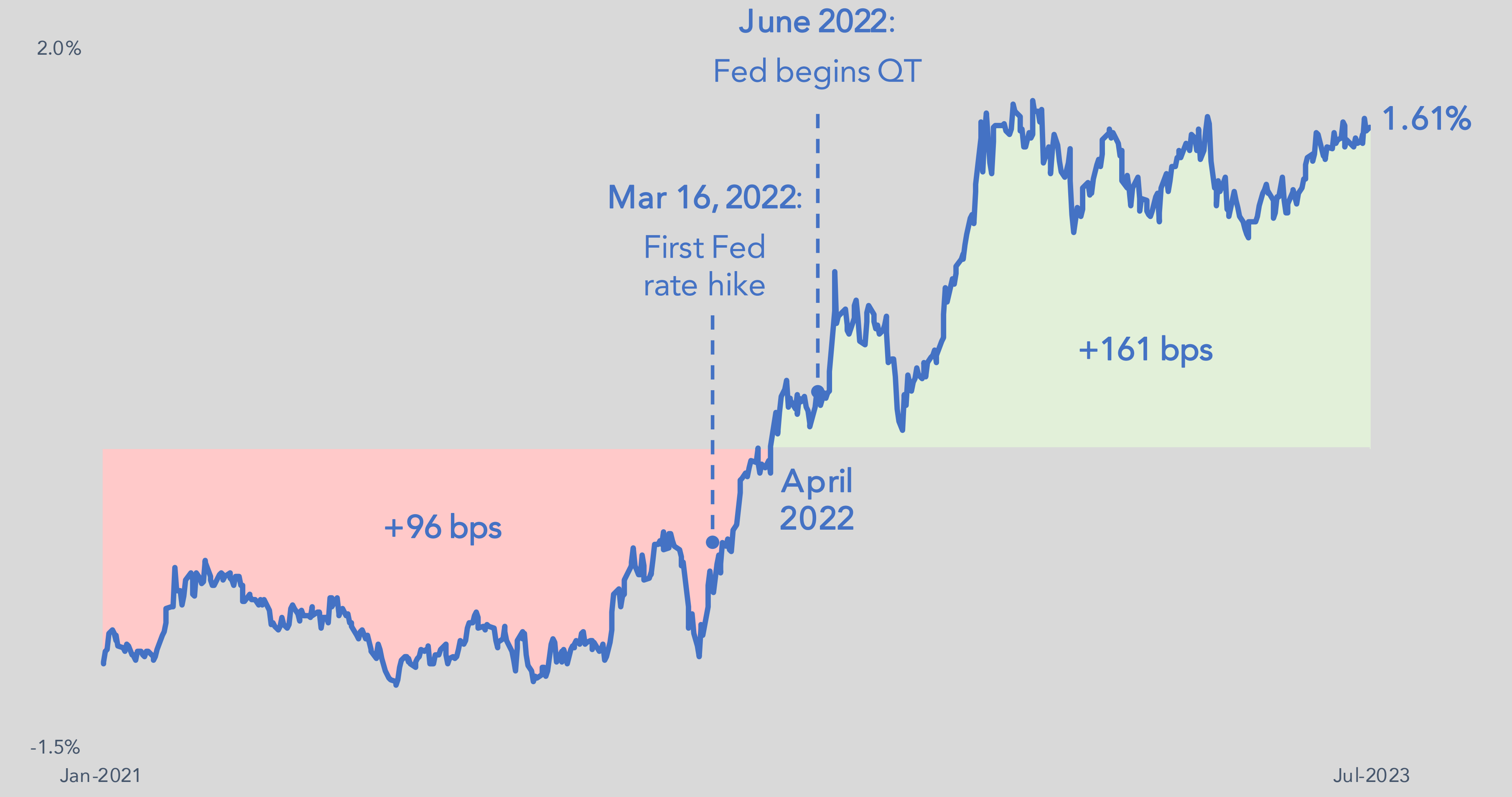
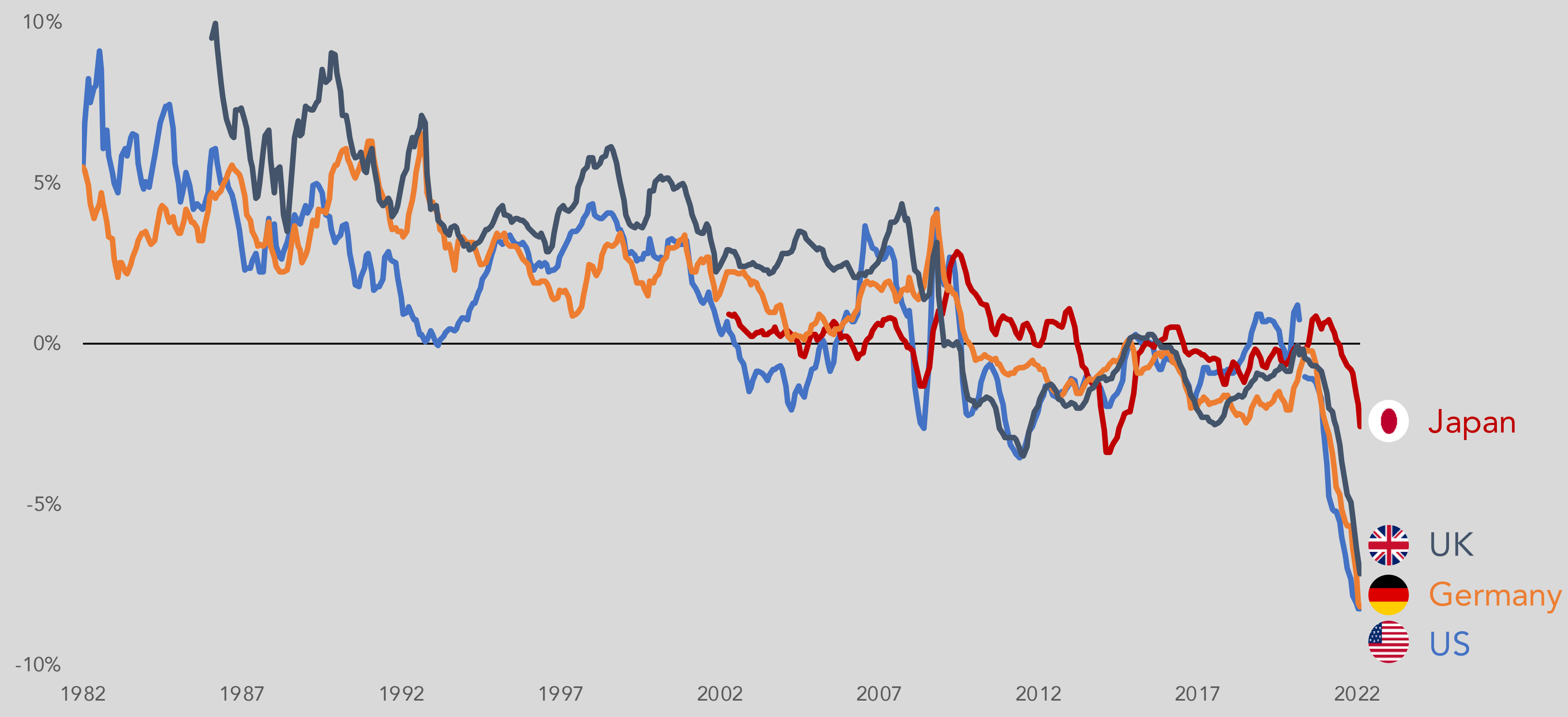
10 year UST real yields



Since the 1980s, "real" (inflation-adjusted) rates across most maturities for most advanced economies have been steadily declining. In the two year period from COVID's inception in March 2020 to the start of the Fed's tightening cycle in March 2022, real rates dropped at a much more rapid rate than their multi-decade trend.

Real 3 month interest rates



Source: (1-2) Bloomberg. Data as of July 5, 2023. Federal Reserve. IMF Calculations. The real interest rates are the difference between the three-month interbank rates and the average of the realized inflation measured by the consumption price index in the next three months for each country. Japan's 3 month interbank rates are spliced with CDs from 1979 – 2002.

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"Macro stability isn't everything, but without it, you have nothing."