



The Daily Dish

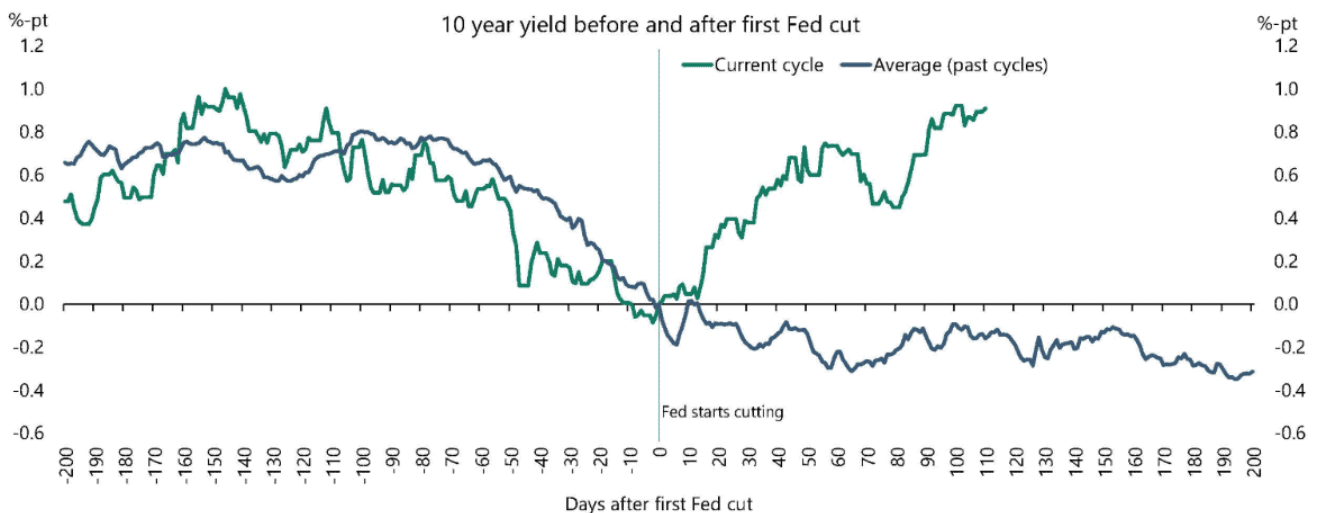
Bad News From the Bond Market

DOUGLAS HOLTZ-EAKIN | JANUARY 8, 2025

The chart (below) is courtesy of Torsten Slok, the Apollo chief economist, who [notes](#): “The Fed has cut interest rates 100 basis points since September, and over the same period, 10-year interest rates are up 100 basis points.”

APOLLO

Very unusual behavior in long rates after the Fed started cutting in September 2024



Source: Bloomberg, Apollo Chief Economist

What is going on?

There are few possibilities. One view of the link between short-term rates and long-term rates is that long rates are driven by expected future short rates. The logic is, for example, that you could buy a 2-year bond or you could buy a 1-year bond in each of two years. Rates on the 2-year bond will adjust so that you get the same return on the 2-year bond as you

expect to get with two 1-year investments. That is, the return on the “long” (2-year) bond is simply the average of the expected returns on the two “short” (1-year) bonds.

In this view, the market is telling us that future rates are going to be higher than previously expected. That could be because expected inflation is higher (leading to higher nominal interest rates). Or, it could be because the market is expecting the Fed to raise future short rates to fight inflation. Finally, it might be that the bond market vigilantes are finally rousing themselves about the flood of federal red ink coming in the next decade.

Regardless of which you believe, it is bad news.

Another view of the interest rates is that there are different clienteles for short-term bonds and long-term bonds. This is consistent with the notion that, faced with the tsunami of federal debt, market participants are demanding higher rates to absorb the borrowing. It is also consistent with the notion that global investors are becoming more skeptical of the United States and shifting their investments elsewhere.

Again, this is bad news.

The recent move in long rates is a warning to the incoming Trump Administration. It needs to have a view of how its plans for tax legislation, deficit reduction (or not), and cross-border economic policy will affect this recent development.