The Daily Dish

The Long and Short of It

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Treasury watchers are probably aware of the fact that the department said it would increase "by at least double" (to $4 billion) the size of buybacks of longer-dated securities. Secretary Bessent attributed the move to liquidity issues — the need to ensure orderly trading in a "thin" summer market. They are probably also aware of the drama that ensued, in which Bessent mentor and veteran investor Stanley Druckenmiller took to the pages of *The Wall Street Journal* to sharply criticize the move:

> *The long-term Treasury yield is the most important price in the world. It is also the only fiscal disciplinarian the U.S. has left. Neither party will run on entitlement reform. Both have spent the past decade expanding commitments while ignoring arithmetic. Democracies don't repair their finances because a budget office publishes a table. They repair them only when the cost of inaction becomes visible and immediate, when mortgage rates bite, when auctions tail, when the political price of a rising long bond finally exceeds the political price of touching spending.*
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> *Every basis point of artificial yield suppression is a subsidy to procrastination. Suppressed long rates sugarcoat the interest-cost projections, shrink the apparent urgency, and let incumbents assure voters the debt is someone else's problem.*

Mr. Bessent fired back: "Stan's a great investor. He changes his mind a lot, and he doesn't like losing money. I think he lost money the day he sent in the editorial."

But readers may not be aware of the competing explanations for the links between short-term interest rates and the yield on longer-term Treasury securities. The Treasury policy is often described as buying up long-dated securities to lower their yields, while financing this with short-dated securities, which would require raising the interest rate they offer. Can you do this?

Fortunately, AAF's Oren Swagel has a succinct summary of the various views of the connection between short-term and long-term interest rates in "The Long and the Short of It: The Term Structure of Interest Rates." As he lays out, at one end of the spectrum is the notion that the interest rate on 2-year bonds is the average of the two 1-year expected interest rates. And the yield on the 3-year bond is the average of the expected interest rates on the three 1-year bonds over the same period. In this view of the world, long rates are the same as the average of short rates — the two are closely related.

At the other end of the spectrum, the two maturities are not linked at all, and there are views in between. It is worth a read to get a feel for this suddenly central issue.