Market View

Economics and Strategy

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Getting real at the long end

By Ethan Currie & Taylor Schleich

Despite the rally, yesterday's 30-year Treasury auction saw the highest clearing yield since 2001—with 10s setting a similar precedent earlier in the week. It's not runaway inflation expectations that are driving nominal rates higher. Rather, recent increases have been all about real yields—which are trading at levels last sustained in the early 2000s. There are several factors driving this: Heightened geopolitical uncertainty, fiscal deterioration, greater capital competition with the private sector, a shifting savings / investment balance, de-globalization, and the related reversal of a goods deflation regime. These factors have durability, which should keep real yields elevated relative to *post*-GFC norms. With breakevens well contained, we don't see much relief coming via lower expected inflation. Taken together, there's limited downside for nominal 30Y yields.

The Fed Chair has taken note of these *real* dynamics. In his first meeting, Warsh's zero tolerance stance on inflation led to hike expectations being ratcheted up, pushing real yields higher. Then, in July, he seemed to imply these intermeeting moves took pressure off the Fed to tighten:

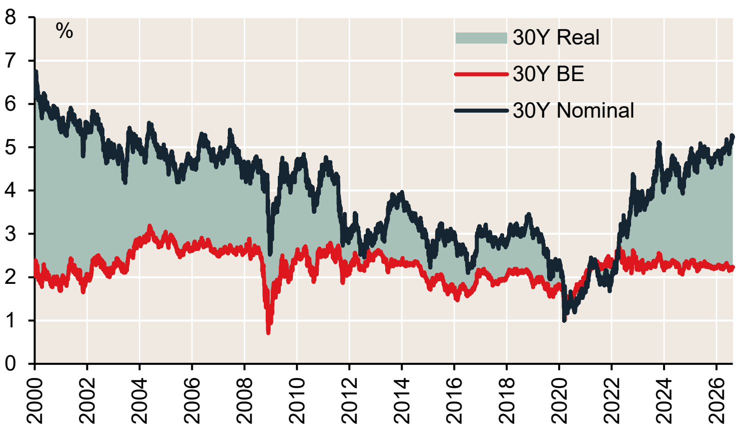
> "*We've seen a material tightening, not just in nominal rates, but in real rates too, and we're observing it… Even while at some level we haven't done much in 42 days, the markets have done quite a bit.*"

Cue the steepener that took hold on Fed day. As of today, real yields at most points on the curve are decisively lower. By Warsh's logic, markets have *un*done quite a bit since July. Does this pose a problem for the Fed, requiring them to tighten policy to make up for what the market unwound? Not in our view. While the Chair's relatively dovish press conference contributed to the real yield decline, so too did softer-than-expected economic and inflation data over recent sessions. In other words, traders are playing the ball instead of the referee (at least that's how Warsh would put it). Importantly, the long-end has been an exception. Real 30Y yields crept higher and have stayed higher since July 29th. This hasn't been a headwind for red-hot equity markets, but it is continuing to taper an already cool housing market. That may help Warsh justify holding steady again next month, in what could be a difficult communications exercise.

We use this *Market View* to re-affirm our call for the Fed to remained sidelined through this year—a call that is becoming less controversial, evidenced by markets stripping out a fully-priced 2026 hike earlier yesterday. And as outlined in our most recent *Fixed Income Monitor* (**here**), we still view the risks to term premia and long-end Treasury yields as tilted higher.

Chart 1: Longer-end inflation breakevens remain contained

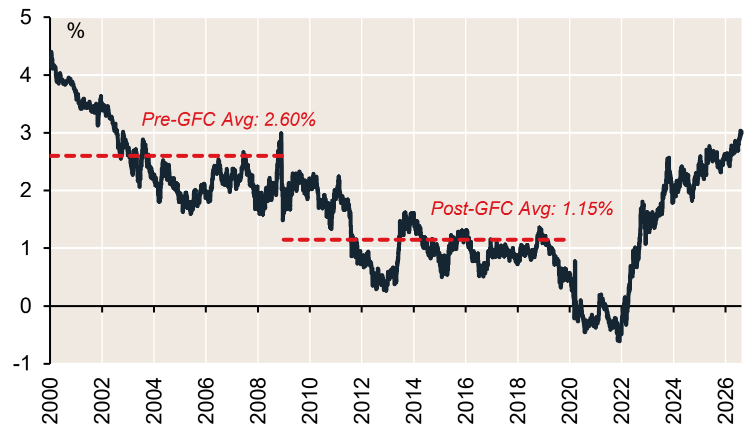
UST 30-year yield, decomposed into real yield and inflation breakeven component



Source: NBC, Bloomberg

Chart 2: Real yields are higher, but not unprecedented

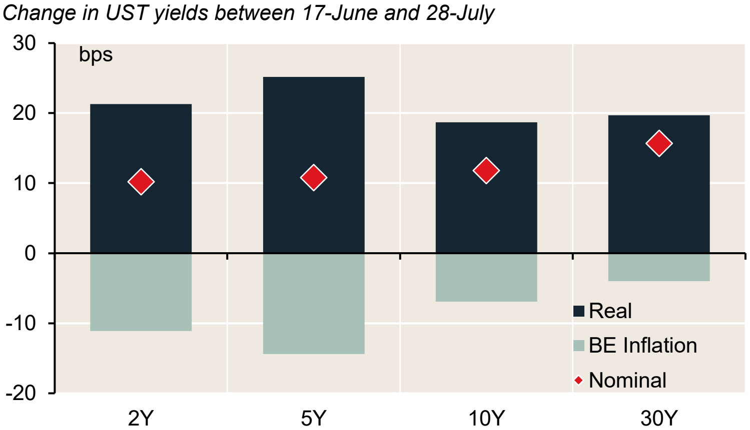
UST 30-year real yield with historical averages



Source: NBC, Bloomberg

Chart 3: In June, Warsh talked tough on inflation…

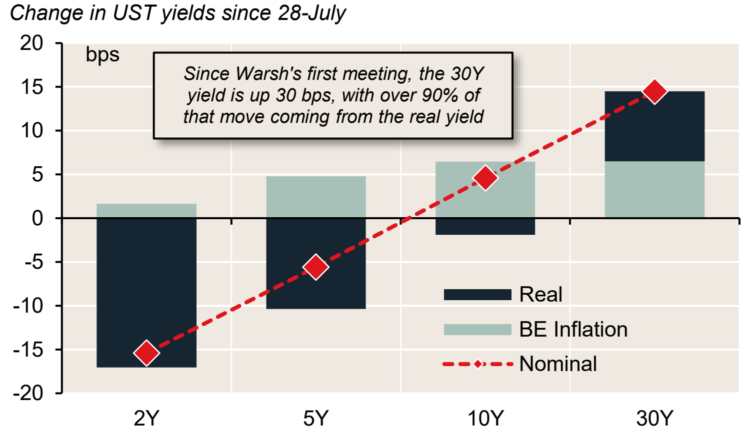
Change in UST yields between 17-June and 28-July



Source: NBC, Bloomberg

Chart 4: …but sent the curve steeper since July's meeting

Change in UST yields since 28-July



Source: NBC, Bloomberg

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