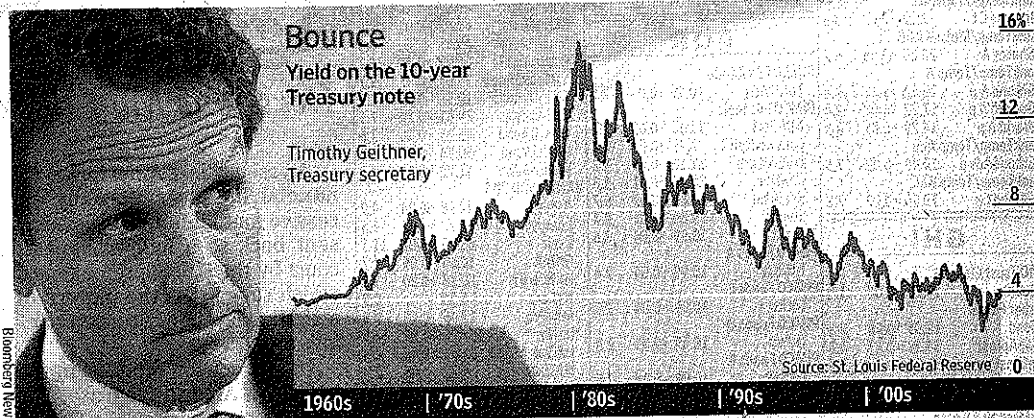

Timing Treasurys, or Not

The bond vigilantes have piled on too early. But that doesn't mean they won't be right in the end.

Of course, there is no end of good explanations for the yield on the 10-year Treasury note edging above 4% Monday. No one in their right mind would bet on inflation remaining substantially below 4% for the next 10 years. Indeed, the rise in the 10-year yield may be a sign that investors have started to price in the possibility that the Federal Reserve actually is fallible and will raise rates too late to stop an inflation breakout. Meanwhile, the credit quality of Treasury debt is deteriorating as government finances worsen. Anyone bullish on Treasurys has to believe that true fiscal conservatism will have a revival in Washington, where it always has struggled to find adherents.

As bad as it seems, though, don't expect 10-year yields to suddenly hit 5% in the next year or so. The reason? The almost complete lack of early warning signals right now of inflation. A Treasury bear plausibly might argue that a near-term inflation flare-up is likely. But that looks unlikely.

Northern Trust economist Paul Kasriel said inflation growth typically lags behind money-supply growth by about three years. So how fast is money supply increasing right now? It is up a pathetic 1% over the past 12 months, using a measure called M2. That is because, in today's deleveraging environment, banks are reluctant to lend and borrowers don't have a big appetite for credit.

The Fed and Treasury almost will certainly mistime their policies, which will do further damage to Treasury prices. But for now, the economic weakness they helped cause is working in their favor.

—*Peter Eavis*