The Yield Also Rises

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After a seemingly non-stop, one-way trip south in the first eight months of the year, global bond yields have suddenly popped back up so far this month. In a broad risk-asset rally, yields posted their biggest weekly jump in years, with Treasuries rising 26-34 bps across the curve in a steepening fashion. German long-term yields, which appeared to have no limit on the far side of zero, became less negative this week by nearly 20 bps, even amid a meaty easing package from the ECB. Staying in character, Canadian yields posted a somewhat less aggressive back-up, but also were in step with the leaders, rising 15-23 bps on the week.

While the move is no doubt impressive, most yields are simply back to around early August levels, or at the time the latest trade war chapter opened. And, naturally, since it was the trade tiff that sent yields spinning lower again in August, it was a modest stand-down on that front that spurred rates to march back up this week. Both China and the U.S. extended some minor goodwill gestures on tariffs, ahead of low-level talks next week, and then more serious negotiations early next month. Moreover, rumours are swirling around the possibility of a limited deal to tide things over through 2020, before tougher topics are addressed. The rumour was officially denied by the U.S. (making it that much more credible), but such an arrangement could make some sense for both parties. Make no mistake, we remain highly sceptical that bilateral relations are headed in a good direction, but some easing of tensions could continue.

The less-negative tone around the trade war has helped dampen recession chatter, which reached full pitch in August. There are at least three other factors that have quieted the doom and gloom crowd a bit:

1. The **back-up in long-term yields** has somewhat renormalized the Treasury curve—that is, it's **no longer inverted** between 10s and 2s.
2. **Equity markets** are flirting with all-time highs, with the TSX reaching that mark on Friday. Stocks aren't always the best economic leading indicator, but they're rarely *that* wrong.
3. The **economic data** just aren't playing along with any recession script. While slowing, job gains remain healthy. The U.S. consumer is holding up very well, as shown by August retail sales—core sales were up 0.3% m/m and 5.3% y/y. And, consumer sentiment has snapped back after a spill last month, according to the University of Michigan.

Despite this sunnier backdrop, the Fed is still widely expected to trim rates again at next week's meeting by 25 bps to a range of 1.75%-to-2.00%. However, the market no longer views a third rate cut this year as a fait accompli. Beyond the factors listed above, there's the small matter that inflation is suddenly showing some flickers. Even as the Fed's measure of core inflation remains low at 1.6% y/y, the more timely core

CPI nudged up to a 2.4% y/y clip in August—its fastest annual pace in 11 years. We don't view this as a particularly worrisome development, but it chips away at the "inflation is too low" reasoning for further rate cuts.

But, of course, **the Fed also faces external pressure** to keep cutting. Not content to let policymakers deal with market expectations of meaty rate cuts, the President weighed in heavily with his own, unique views on monetary policy. Apparently envious of the ECB's negative rates, he called on the Fed to cut rates to zero or negative forthwith, allowing the U.S. to then *"refinance"* its debt. It's tough to know where to begin with this one, even looking past the gratuitous and far-from-civil *"boneheads"* shot. We'll simply note that the Fed can only directly control the very short end of the curve, and that longer-term rates are set by what lenders are willing to accept. In the extremely unlikely event that the Fed were to suddenly chop rates aggressively to pre-emptively spur an economy already at full employment, there is zero guarantee bond yields would fall in lockstep—and the very real possibility they could even rise.

Having said all that, there is a small kernel of an idea in the President's latest broadside on the 'refinancing' front. At least prior to this week's snap-back in yields, the massive rally in long-term bonds had left them below inflation almost everywhere, presenting debt managers with a **huge opportunity to lock-in borrowing costs for a very long time at very reasonable levels**. And, on cue, Treasury Secretary Mnuchin indicated that the possibility of **a 50-year** (and even century) **bond** was being studied. But, why complicate matters? Why not just tilt current borrowings a bit further out the curve? With 30-year yields now just above 2.3%, that already looks very inviting, unless one believes that nominal GDP growth will average less than 2.3% over a 30-year period. Treasury is normally highly reluctant to make tactical changes to its borrowing plan, but it could be argued that these **extreme low long-term yields** seem to be more of a **new fixture** rather than a quirk, so twisting borrowings would be more of a strategic measure, aimed at satisfying enormous demand for safe, positive-yielding, long-term paper.

Turning to Canada, the BoC of course is highly unlikely to face any political pressure to ease, even amid the federal election campaign that officially got under way this week. The much better tone in markets—notably including the record high for the TSX—as well as decent domestic economic data, on-target inflation, a stable loonie, and a revival in housing have almost taken BoC rate cuts out of the picture for now. Today's Q2 results showed another dip in the debt/income ratio for the third quarter in a row. But, a rebound in housing has perked up mortgage borrowing again; it has climbed to 3.8% y/y (from a low of 3.3% earlier this year). The comeback in Canadian housing markets make it that much tougher to justify BoC rate relief. Of course, the overall picture could change on a dime (or a tweet), since the Bank's next rate decision is still nearly seven weeks away (October 30, same day as the FOMC) and is nine days after the election (October 21).

Finally, one of the first economic proposals from the ruling party on Canada's campaign trail was a 1% annual speculation tax on vacant homes held by non-residents. We would simply note that after years of denial from almost all corners of Ottawa policymakers, there seems to be a grudging official recognition that this form of speculation was indeed a major factor behind the steep run-up in home prices (and thus household debt), especially in 2016/17.

Lucky 13: It's only appropriate that some equity markets reached their all-time high today, on Friday the 13th. I, for one, welcome the date. Why? Well, being one of the 3.29% of Earth's population who came into this world on the 13th day of a month (as did my wife), I find it rather preposterous that anyone should consider 13 to be unlucky in any way, shape, or form.

Speaking of birthdays, here's a fun factoid, totally unrelated to anything. Newly crowned U.S. Open champ Bianca Andreescu, who will almost certainly be this year's Canadian athlete of the year, was born precisely three days after Penny Oleksiak, the 2016 winner of the prize—both born in the GTA, within three days of each other in June 2000. Oh, and the latter young lady was born on the 13th.