When Will Martin Feldstein Be Right?

Macroeconomics is an eternally fruitful field for debate, as no one is ever wrong. There is always another calculus-strewn, opaque "serious" study to cite, or another country to praise or condemn, or an irrefutable theory to which to genuflect. When all else fails, there is resort to, "Just you wait. There will be consequences."

And so we have prominent macroeconomist Martin Feldstein this mid-November warning investors of a potential 38% plunge in equity values, when stock-market price-earnings ratio return to historic norms.

And that $9.5 trillion reduction in wealth will savage US spending, which will cut overall GDP growth by 2% —very close to snuffing out economic expansion.

But Why the P-E Plunge?

As Marketwatch put it, Feldstein explained the fearful financial outlook "is the result of the Fed's aggressive bond buying in the wake of the financial crisis. Speaking at the Cato Institute, he called on the Fed to tighten monetary policy swiftly, bringing the Fed funds rate up to 4% by the end of 2019 from just over 1% now."

Feldstein also declared the debt market is in dire straits, and that, "Bond prices are also out of line." The yield on 10-year US Treasuries should be near 4%, not the present 2.3% range, Feldstein posited.

With such a harrowing outlook, the Fed should push the Fed funds to 4% in the next year, Feldstein advocated. Otherwise eventually yields on 10-year Treasuries will rise and that "could have a substantial destabilizing effect."

Just you wait.

Conclusion

Martin Feldstein has a lengthy track record of predicting higher inflation and interest rates, extending back to at least April 19, 2009, with his missive "Inflation is Looming On America's Horizon".

Back then, Feldstein also warned that US Treasuries were, yes, overvalued. At the time of his prognosticating, 10-year U.S. Treasuries offered a 4.97% yield.

Of course, Feldstein has been wrong, and inflation is still below the Fed's 2% PCE target, and (as Kevin Erdmann points out) the CPI core sans shelter is rising at a 0.7% rate.

And 10-year Treasury yields have been cut in half, and then some, since Feldstein's long-faced warnings in 2009. Anybody buying US Treasuries using Feldstein as a negative indicator has made a lot of money.

So, is buying 10-year US Treasuries the right move now? Perhaps.

The Fed appears determined to raise short-term interest rates, even if in slow motion. The Fed also says they will sell off their balance sheet, and all this while they are still below their putative inflation target. A reasonable fear is that the Fed will trigger a recession, and then a flight to safety, and thus buying US Treasuries now is a good idea.

On the other hand, both Asia and Europe appear to growing again, which may forestall a Fed-induced economic contraction.

As usual, the large and fluid Treasuries market probably has matters pegged about right. It is difficult to out-forecast the market.

Feldstein's bravado in again declaring the bond market is wrong is…well, understandable. After all, in macroeconomics, no one is ever wrong,

Just you wait.