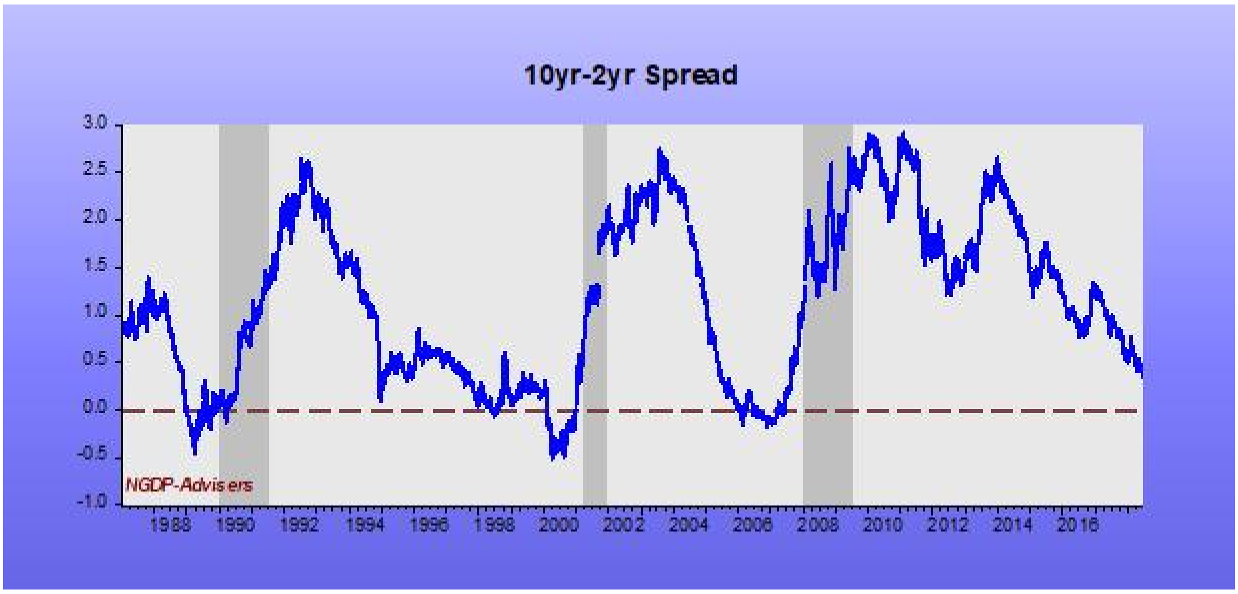
The Negative Yield Curve Haunts Global Economies

Market Monetarist and Mercatus Center scholar David Beckworth recently blogged that the “negative yield curve”—when short-term rates rise above long-term—is here already in some economies, and heading to the US.

For the uninitiated, a negative yield curve has been a reliable precursor to recessions. Beckworth charts 2-year Treasuries vs.10-year:



Ouch.

David Glasner, proprietor of the always-thoughtful *Easy Money* blog, also treated the inverted yield curve, and his concluding money quote is this:

> *Nominal GDP has been increasing at a very lackluster annual rate of about 4-4.5% for the past two years. Certainly, further increases in the Fed Funds target would not be warranted if the rate of growth in nominal GDP is any less than 4% or if the yield curve should flatten for some other reason like a decline in interest rates at the longer end of the yield curve. Caution, possible inversion ahead.*

Why Not Stand Still?

And then the sometimes irascible Brad DeLong weighed in, concluding that the orthodox macroeconomic take on the inflation-unemployment nexus seems frozen yet awry, and that the last few decades do not seen to credit the Phillips Curve. The Federal Reserve should wait and see if inflation actually arrives, suggests DeLong.

The Fed

Yet the Fed has been issuing studies that the US is "beyond full employment," that the NAIRU rate is 4.7% and even that the long-term real GDP growth path of the US economy is 1.8%.

Recent Fed posturing seems to indicate two more rate hikes in 2018, and then even more hikes in 2019. As of now, it appears the Fed wants to push short-term rates above 3% and possibly above longer-term rates—that is, the Fed appears to be targeting an inverted yield curve.

Conclusion

After 2008, it is hard to imagine that the Fed would repeat an over-tightening mistake. But then hubris and ossification are the hallmarks of independent (yet perhaps industry-captured) public agencies the world over.

The Fed does not have worry that its products or services are not good enough in the market, nor Fed staffers need worry they will be voted out of office. Even the Fed disaster of 2008 did not result in a house cleaning.

For investors, a tricky road ahead. Indeed, the S&P 500 is about flat for 2018, year-to-date.

Presidents Nixon and Reagan, of course, leaned heavily on Fed chairs to do their bidding. President Trump, who has a background in real estate (and also TV reality shows) may do the same.

Watch carefully.