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Bonds' Odd Behavior May Presage Weaker Second-Half Economy

By Randall W. Forsyth July 9, 2021 9:18 pm ET

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But after nearing the 1.75% mark at the end of the first quarter, the key benchmark yield has largely confounded those expectations by reversing course and moving lower. On Thursday, the 10-year yield skirted 1.25%, its lowest level since February. Even outside the bounds of the bond market, this raises a question: What's wrong with this picture?

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After all, the economy has been booming, accompanied by rising inflation—exactly the opposite of what would be conducive to lower yields and higher prices. Consensus estimates among economists had the U.S. gross domestic product zooming ahead at a 9.6% annual clip. The predictions have been accompanied by a parade of anecdotes about bubbles in house prices and tight supplies of used automobiles, as well as of workers. At the same time, the major stock market indexes were hitting or hovering near records.

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Yet the bond market didn't seem to get the message. A month ago, this column argued that the market instead seemed to be looking ahead. Yields rose sharply early in the year, before the current robust economic gains. But the bond market now is adjusting to the prospect of more moderate growth in the second half, with reduced fiscal largess and no $1,400 or $600 stimulus checks. And it's looking ahead to the eventual prospect of the Federal Reserve throttling back its securities purchases, which currently pump $120 billion a month into the financial system.