TREASURIES

The Fed Faces a Credibility Crisis—and the Stock Market Will Pay the Price

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Bond markets generally have the last word in any major dispute with the Federal Reserve—or for that matter a spendthrift government—over how to interpret messaging on interest rates, deficits, and the broader safety of long-term cash.

What they're saying on Thursday is worrying.

Benchmark 30-year Treasury bond yields, the market's best representation of long-term inflation risks and expanding government deficits, are trading at the highest levels since 2007 following a wild Fed meeting that could test the credibility of new Chairman Kevin Warsh.

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“Once again, the Bond Vigilantes are pushing bond yields higher,” said Ed Yardeni, founder and head of Yardeni Research and the first person to coin the term in the early 1980s to describe fixed income investors who sniff out inflation risks long before other financial assets and respond in kind.

“In effect, they are saying that if the Fed won’t be vigilant about inflation, then they will have to maintain law and order in the economy,” he added. “Talking hawkish but not acting so reduces the Fed’s credibility.”