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Why US government bond yields are artificially low

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From Mr Alan Rohrbach.

Sir, Tony Jackson aptly notes that non-financial companies are exhibiting understandably defensive behaviour by solidifying balance sheets (**"Companies take comfort in equities in these hard times"**, April 14.) Projected weaker earnings is indeed good reason to be well capitalised.

Even for the most highly rated borrowers there is another factor he touches on that savvy treasurers probably appreciate. Companies with the highest credit ratings do enjoy yields close to those on government securities, and the "rise in spreads has been almost wholly offset by the fall in Treasury yields".

However, those US government bond yields have been artificially suppressed by a "haven" effect, attracting large flows due to pervasive recent suspicion over the fungibility of debt from low-rated issuers. They may remain low while equity markets suffer, yet are not likely to do so once the crisis is over.

As a point of perspective, the last time the US bond market experienced a rally (and drop in yields) such as the one since last July was autumn 1985-spring 1986. What was very different then was the fundamental force behind it: a crude oil price freefall back below $25 per barrel on its way to $10. Along with the price of food and other commodities, no such benign environment appears likely soon.

The ultimate reinforcement for the degree to which government bond yields are artificially low comes from a bit of truth in advertising by the Fed. As the source was the previously dovish governor Frederic Mishkin, his recent statement is even more telling: "...it is headline inflation that we want to focus on." As a long-time critic of the specious central bank focus on "core" inflation at a time when energy and food price escalation extends well beyond temporary bulges, I also know that anyone looking for the next bubble need only look at government bond pricing relative to headline inflation. "Real yield"? Do the mathematics.

Evidently corporate treasurers at solid non-financial companies have done so. In spite of the fact that the yield on "govvies" may fall further in the near term, they do not seem very impressed by the current availability of cheap credit. It is likely they are clever enough to anticipate what repricing that debt might cost once the financial crisis is over.

Alan Rohrbach,
President,
Rohr International,
Chicago, IL 60606, US