

August 21, 2023 – Economic Commentary

There are many factors which can influence the yield curve and there actually is no unifying theory of the determinants of its shape. Three major concepts dominate: 1) the time value of money, which dictates that money lent for longer should command a higher interest rate 2) inflation expectations, where longer term bonds will have a higher interest rate if inflation is expected to rise (and vice-versa) and 3) market supply and demand for specific maturities, pushing rates up or down according to the volume of new issuance and selling or buying by various market participants, often for reason not directly related to the fixed income markets themselves. An example of this latter influence is the tendency, in times of stress, for hedge funds to dump shorter term credit instruments in order to raise cash, pushing prices down and raising fixed income yields. For those interested in a very well-done discussion of the beauties and puzzlements of the yield curve (revealing the passions of way-too-many economists with too much time on their hands), this [Wikipedia post](#) is highly recommended.

And the reason for this Economics Public Service Announcement? Last week, the yield curve was back in the news and it is likely to remain so. Rates rose to unexpectedly high levels, creating grief for equity markets, and the reasons behind the development will continue to be dissected this week. While it is unlikely that inflation expectations have changed, it seems that, once again, the market is in the process of re-thinking how much higher interest rates will go and how long they will remain higher. Furthermore, issuance of some US Government Treasury maturities has increased, testing the strength of demand. [The auction scheduled for mid-week is not particularly large, but will bear watching.](#) And investors seeking yield are salivating.

Data to Watch:

1. US Existing Home Sales for July, released Tuesday, August 22
2. S&P Global US Composite Purchasing Managers Index for August, released Wednesday, August 23
3. US Durable Goods Orders for July, released Thursday, August 24

Suggested Reading:

1. [What's Holding Back India's Economic Ambitions?](#)
2. [Why a Zara Store Bet Big on the Maxi Dress This Summer](#)
3. [Gauging the 'subscription economy' boon to companies](#)

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