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Investments - Flash

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REAL YIELDS ON TIPS WILL FALL

Price rises possible without change in inflationary expectations

Real TIPS yields are once again at record highs, a phenomenon that is unlikely to last. Ten-year nominal Treasury yields should theoretically take into account long-term trends in the economic cycle and inflation trends, but in practice, long rates are largely influenced by short-term prospects. This is particularly the case since the raising of the debt ceiling validated in June, which caused 10-year Treasury rates to rise from 3.25% to 4.3% in 5 months, while inflation fell from 5% to 3% at the same time. In parallel, the real yield on TIPS (10-year) approached 2% this week, recovering significantly from its low point of -1.1% reached in August 2021, to a level not seen since 2009. In many countries, the trend was similar, suggesting in the case of the USA that long-term expectations for CPI are now 2.35%, up slightly from the March low of 2.1%.

De facto, the estimated real yield of 2% represents the "risk-free" cost of financing the economy above inflation close to that desired by the Fed. The TIPS real yield (spread) had reached its peak of 3% in April 2022, three months before the annual CPI top (9%), before beginning a significant adjustment to 1.1% in March 2023. The recent rise above the November 2022 peak of 1.74% has put real rates back to the levels seen previously, when inflation also averaged 3% between 2003 and 2008. It should also be noted that TIPS are not systematically hedged against inflation, as demonstrated by the massive fall in their prices in 2022. Today, we believe that a fall in the real yield on TIPS will support their valuation, without the need for a rise in inflationary expectations.