Seed Global

The ongoing rise in the US 10-year bond yield, now trading at around 4.6%, has raised questions about its potential impact on global financial markets. Despite the significant increase in global interest rates, markets have shown surprising resilience thus far. However, the crucial question remains: will this trajectory lead to a soft landing or a harsh global recession, only time will reveal.

In this article Ian De Lange, Seed Chief Investment Officer asks the question Soft or Hard?

Follow Ian on X

Soft or Hard?

A key indicator that we watch on an ongoing basis is the yield, or interest rate, on the US 10-year bond. Just a few years ago, during the depths of the pandemic, this key rate plummeted to a low of around 0.5%. Ever since then it has been on an upward trajectory, and this week traded through the 4.6% level.

While this move up in global interest rates has been significant, there has been surprisingly little "damage", so to speak, to global financial markets. However, if interest rates keep moving up, or even stay steady at elevated levels, the only question that remains is: will it be a soft landing or a hard global recession?

Only time will tell.

Chart of the US 10 Year Yield

In May this year, I discussed the issue of the world awash in debt – at that stage the US government debt ceiling had to be raised from $31.4 trillion, but this month US government debt levels exceeded $33 trillion for the first time, and there is another possibility of a US government shutdown.

Naturally, there are many economists who are concerned about the state of the US and global economies, especially given the debt levels. In simple terms, how we arrived at this point, can be summarised as follows:

- In response to the Covid-19 crisis, governments and central banks worldwide escalated spending, provided financial support and increased debt levels. This excess money supply ultimately created inflationary pressures but failed to generate sustained economic growth.
- Now these same monetary authorities are working to reduce the money supply to dampen down the persistent high inflation. However, there is a risk of being excessively restrictive in this process.

Inevitably, rising interest rates impact both individuals and companies burdened with high debt levels, especially where growth is slowing, and lower-cost debt must be refinanced at higher rates.

The higher interest expense for governments and individuals translates to reduced disposable income.

Higher interest rates also exert a downward pressure on asset prices, which is painful for all owners of real assets.

Nonetheless, it's worth noting that higher rates also provide an income stream for less indebted investors. Additionally, should central banks err on the side of being overly restrictive, they will eventually be compelled to adopt more accommodative measures, which in turn will be beneficial for owners of assets.

Ian De Lange CA(SA)
Chief Investment Officer

If you have any questions, please do not hesitate to reach out to Ian and our team directly on global@seedinvestments.co.za.

Follow Ian De Lange on Social Media