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Impact of Rising Bond Yields Hits Other Key Rates

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Note

Renewed hostilities in the Middle East are driving a prolonged selloff in U.S. government bonds, sending yields close to their highest levels of the year and lifting borrowing costs for businesses and consumers.

The yield on the benchmark 10-year U.S. Treasury note—which helps set rates on mortgages and student loans—settled at 4.657% on Wednesday.

With rebounding oil prices fueling inflation concerns, rising yields are already pushing up mortgage rates and undercutting the stock rally. Major indexes have mostly treaded water in recent weeks and finished mixed again on Wednesday.

Treasury yields are largely determined by investors' expectations for short-term interest rates set by the Federal Reserve. When investors expect those rates to go up, the relative appeal of Treasurys diminishes—causing their prices to fall and their yields to rise to a competitive level again.

Note

The most immediate reason yields are rising is the resumption of fighting between the U.S. and Iran. The resulting rebound in oil prices has renewed worries about the inflation outlook and spurred a shift in interest-rate expectations, as investors bet that the Fed will need to raise rates to bring inflation down.

Still, yields have proved to be only loosely connected to oil prices in recent months. Before the breakdown in the U.S.-Iran ceasefire, oil prices had already retreated to February levels, before the U.S. and Israel attacked Iran. Yields, meanwhile, remained well above their prewar levels.

One reason for that disconnect: Before the U.S.-Iran war, many investors had expected the Fed to lower interest rates this year to ensure the economy didn't slip into a recession.

But as the war progressed, monthly jobs numbers were surprisingly encouraging. That seemed to take rate cuts off the table—even as oil prices subsided.

Factors other than the Iran conflict have also kept inflation hotter than expected, including surging demand for artificial-intelligence services. That has also supported the case for rate increases.

Treasury yields influence borrowing costs across the economy, from the rates on new bonds issued by companies to the cost of taking out a mortgage.

Yields on existing Treasurys indicate what rates investors will demand when the government issues new bonds. And for all of its challenges, the U.S. government is still the most creditworthy borrower around—making its own borrowing costs a benchmark for what everybody else has to pay.

Right now, rising borrowing costs appear to be an inconvenience to individual borrowers rather than a serious threat to economic growth. Even with the rise in yields, big tech companies have continued their historic borrowing spree to fund the construction of artificial- intellligence data centers. Consumers have kept on spending on everything from auto parts to electronics.

Note

Higher yields can also threaten stocks both by increasing borrowing costs for companies and giving investors an attractive alternative to riskier investments. Here, again, the fallout has been modest, with stock indexes remaining close to all-time highs. But stocks have still underwhelmed of late: The S&P 500 dropped 0.1% Wednesday and is roughly flat this month.

The Dow Jones Industrial Average ticked down less than 0.1% Wednesday, while the Nasdaq composite fell 0.6%.

Note

Treasury yields typically rise and fall in an orderly fashion. But yields that rise too fast or become unmoored from economic fundamentals can spell trouble, which is why investors are keeping a close eye on the bond market right now.

Some analysts warn that if the 10-year yield breaks through its recent high of 4.687%, its rise could accelerate while traders search for a new equilibrium.

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