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FEDOROVA/ EPA/ SHUTTERSTOCK Home Depot shoppers this week in New York. The retailer has benefited from cost-minded consumers seeking to take on smaller home-improvement projects.

Stocks, Bonds Slide in Brushoff To Bessent

Markets are on edge as retailers' latest results offer more consumer gloom

BY DAVID UBERTI AND PETER RUDEGEAIR

The stock market shuddered on Thursday after investors resumed a weekslong bond selloff that has defied the Treasury Department's attempts to curb borrowing costs.

Treasury Secretary Scott Bessent's move to ratchet up bond repurchases temporarily cooled yields on government debt, but yields rebounded Thursday near some of their highest levels in years. That pressured shares in Nvidia, SpaceX and other data-center hyperscalers that increasingly rely on debt to finance a globe-spanning artificial-intelligence build-out.

"This is a band-aid," said Lawrence Gillum, chief fixed income strategist for LPL Financial, referencing Treasury's expanded buyback program. "This doesn't really fix the problem."

Disappointing earnings by the U.S.'s largest retailer Thursday exacerbated the pressure on the market. Walmart reported its weakest sales growth in six years, extending a string of data suggesting that consumer spending—the key engine of U.S. economic growth—is softening somewhat. Walmart's shares slid 9.2%, helping drag down the Dow Jones Industrial Average 1.3%, or 704 points. The Nasdaq composite fell 1%, while the S&P 500 ticked 0.9% lower.

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Markets Brush Off Bessent

Although Bessent said on CNBC Thursday that coming buybacks could be more than $4 billion per operation—double or more their current levels— the yield on 10-year Treasury jumped to 4.697% on Thursday.

Describing Treasurys' action as a short-term response to spiraling U.S. debt, Mike Sanders, head of fixed income at Madison Investments, said, "My fear is that the market is going to try to fight them on it at a certain point."

Thursday's actions marked the latest subplot in an unusually dramatic mid-August week for Wall Street.

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The market's quants, or process-driven traders and funds guided by algorithms, endured one of their worst days in recent memory on Wednesday when bets against certain stocks backfired. That included Moderna, whose boffo cancer-therapy results launched its stock up 177% on Wednesday and scorched short sellers betting on its decline.

In a report to clients, Morgan Stanley called it a "MRNA squeeze," referring to Moderna's stock symbol. By 1 p.m.

on Wednesday, Goldman Sachs said it was the worst day in more than two years for "systematic long short managers," a category of quant funds. These funds lost 1.4% on the day at that point, though they remained up 1.7% for the month. The losses were "spread across" all regions, the bank said.

Market moves in biotechnology stocks were a "9/10 pain day for investors," Morgan Stanley's trading desk wrote to clients on Thursday. The bank said it was a record for short covering, or closing out short positions, across biotech, and a "genuine tail event" in positioning.

Thursday also brought new signs of economic pressure. Walmart boosted estimates for net sales and operating income this year in part because of gains led by upper-income households. But some customers spent more cautiously, particularly at the company's physical stores.

"It sort of states the obvious of seeing some incremental pressure on the consumer relative to the beginning of the year with higher fuel prices," Walmart finance chief John David Rainey said on an earnings call. Pointing to how Walmart has leaned in to lowering its own prices in response, he said, "We're really proud of that and how we're trying to be there for our customers and members during this period of time."

Walmart's report followed a series of mixed results from major retailers this week including Target and TJX. Home Depot reported higher quarterly sales despite a frozen housing market, citing homeowners who took on smaller maintenance projects.

For Lowe's, which reported sluggish growth, the middleincome homeowners to which the company caters "have a strong personal balance sheet. They got real disposable income growth," Chief Executive Marvin Ellison said on an earnings call. "Their house is getting older and they have increased equity. But the caveat to all of that is that this consumer is being cautious. And it's not just about fuel prices."

U.S. consumers have spent an estimated $88 billion more on gasoline and diesel in 2026 than they would have without the energy shock linked to the Iran War, according to Brown University's Climate Solutions Lab. While fuel prices typically dip as summer winds down, AAA records stretching back to 2000 show nominal gas prices have never been so high this late in the year.

Crude-oil prices that help dictate those fuel costs are climbing again. Brent futures, the international benchmark, rose 2.4% Thursday to $93.78 a barrel.

For now, many economists believe prices at the pump haven't veered high enough to force a sharp consumer pullback from other items that the Federal Reserve watches more closely as it sets policy. There are also some signs that spending among middle- and lower-income people isn't only stable, but accelerating.

Discretionary spending growth by those groups jumped in July, according to a Bank of America Institute analysis of customer card data. At the same time, growth by the top 5% of earners dipped slightly after a long run-up, narrowing the gap between income cohorts.

Consumer spending that is not too hot, and not too cold, is keeping a lid on inflation, and that has been key to the stock market's resilience this year. Investors pared back bets in recent weeks that the central bank will increase interest rates in 2026, helping the stock market stay near records and propelling semiconductor and memory storage makers to soar.

"The economy is strong enough to avoid recession but not strong enough to drive inflation higher," said Luke Tilley, chief economist at Wilmington Trust. "It's really good for equity markets because it keeps the Fed on hold."

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'A safety premium' confers lower everyday borrowing costs.

image

Treasurys' Haven Status Fades

CAPITAL ACCOUNT

By Greg Ip

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This year's upward march in bond yields has many drivers, from sticky inflation to heavy AI-linked corporate borrowing.

Lurking in the background, though, is a more troubling possibility. Treasurys, long the world's preferred "safe" asset, are looking less safe. Relative to other securities, their yields are no longer quite so low, and in moments of stress, they don't behave like a haven. Note

The main reason for this is that since the pandemic, the U.S. has flooded the market with additional debt, reaching $40 trillion, including intragovernmental debt, this week. There is no sign that the flood will abate.

The U.S. Treasury's surprise announcement Wednesday that it would boost buybacks of less-liquid longerterm debt simply treats the symptoms rather than the underlying cause. The move, while reducing yields in the short run, might yet raise them in the long run by eroding the U.S.'s reputation for stability and predictability. Note

Treasury debt has long enjoyed a unique status globally. It is backed by the unparalleled economic and financial strength of the United States, denominated in the world's preferred reserve currency, and is overseen by strong and stable laws and institutions, in particular the Federal Reserve and the Treasury itself.

Treasurys don't just fund the U.S. government. They are where investors and governments like to park extra cash, for example, to defend their currencies. They are used to price, hedge and collateralize countless transactions in unrelated markets.

This status brought "a safety premium," conferring lower everyday borrowing costs for the U.S. and virtually unlimited financing capacity.

These benefits became especially apparent in the wake of the global financial crisis. U.S. borrowing soared, yet yields fell. The reason: Private borrowing collapsed, and securities once thought safe, such as triple-A rated mortgages, turned out not to be safe. The Fed and other central banks began buying their own governments' debt.

This led to what Ricardo Caballero, an economist at the Massachusetts Institute of Technology, dubbed the "safe-asset shortage": As investors' demand for supersafe assets collided with a finite supply, yields plummeted.

Those conditions ended with the pandemic when inflation and interest rates rose and deficits shot up. In a recent study, Caballero finds that instead of investors accepting lower yields because Treasurys are so desirable, they are demanding higher yields; the safety premium has become an absorption premium.

One way Caballero infers this is by comparing Treasury yields to swaps, derivatives used to manage interest exposure that serve as a sort of benchmark for corporate borrowing costs. Historically, Treasurys yielded less than swap rates. But recently, they have yielded more. He sees this as reflecting the greater strain dealers now bear to trade, warehouse and distribute debt. Another clue comes from the term premium, the extra return investors demand to hold long-term bonds instead of shorterterm Treasury bills. That term premium has steadily marched higher.

Combining these two, Caballero infers that the shift from a safety premium to an absorption premium explains about 0.75 percentage point of the roughly 2.5 percentage point rise in yields since 2015.

A separate study by Hanno Lustig at Stanford University comes to similar conclusions. Historically, Treasurys yielded less than AAA-corpo---rate bonds, even after adjusting for default risk, but since 2022, that advantage has disappeared. Treasury yields were also comparable to or lower than other sovereign bonds when hedged into dollars, but have been generally higher since the pandemic.

The study, prepared for the Aspen Economic Strategy Group (of which I am a member), listed signs that investors no longer flee to the safety of Treasurys during stress periods as they once did. When stocks go down, yields now tend to go up—for example, following President Trump's "Liberation Day" tariffs last year. News of larger deficits tends to put upward pressure on yields, Lustig found. All of this, he argues, shows Treasurys are seen as less safe.

There could be other explanations for these developments, for example, related to market functioning or inflation.

These dynamics cannot be attributed solely to Trump, since they were under way before he took office. But he also hasn't reversed them. Early on, Treasury Secretary Scott Bessent said Trump's priority was lower bond yields, which influence mortgage rates. This, he said, would be achieved through increased energy production that reduces inflation, AIdriven productivity, and a lower budget deficit, which was $1.8 trillion in fiscal 2024.

Instead, the Iran war has driven up energy prices and inflation. Meanwhile, the Congressional Budget Office projects the deficit will reach $2.1 trillion this year. As a share of gross domestic product, that is double the 3% target Bessent once envisioned. At the same time, corporations will issue a record $1.9 trillion in investment- grade debt this year, much of it to finance the AI build-out, according to Barclays. All of this has pushed bond yields higher instead of lower.

So rather than address the fundamentals behind higher yields, Bessent has turned to fiddling with the bond market itself. Rather than expand bond auctions, he is financing the deficit with more Treasury bills and hinted that auctions of some bonds might actually shrink. He intervened to boost the Japanese yen to keep Japanese interest rates from rising (and spilling into the U.S.) while suggesting Japan borrow from the Fed to finance yen buying without selling Treasurys.

Since the 1970s, Democratic and Republican Treasury Departments alike have sought to make debt issuance "regular and predictable" rather than trying to time the market. Bond sales were detailed at quarterly refundings. Buybacks, launched in 2024 to improve liquidity in little-traded issues, were similarly scheduled at the same time.

Bessent has also endorsed "regular and predictable," yet departed from it in announcing the buyback Wednesday just two weeks after the last quarterly refunding.

The buyback caught investors offside and thus achieved its short-term goal: yields fell. But such progress might not be sustained.

If issuance and buybacks are no longer regular or predictable, bonds might become more volatile. Investors might demand a higher yield to "account for this extra unpredictability," said Blake Gwinn, head of U.S. rates strategy at RBC Capital Markets.

By shifting from bonds to bills, Treasury faces more rollover risk—the chance that interest rates will have risen when that debt must be refinanced.

That, however, might be a problem for a future Treasury secretary.

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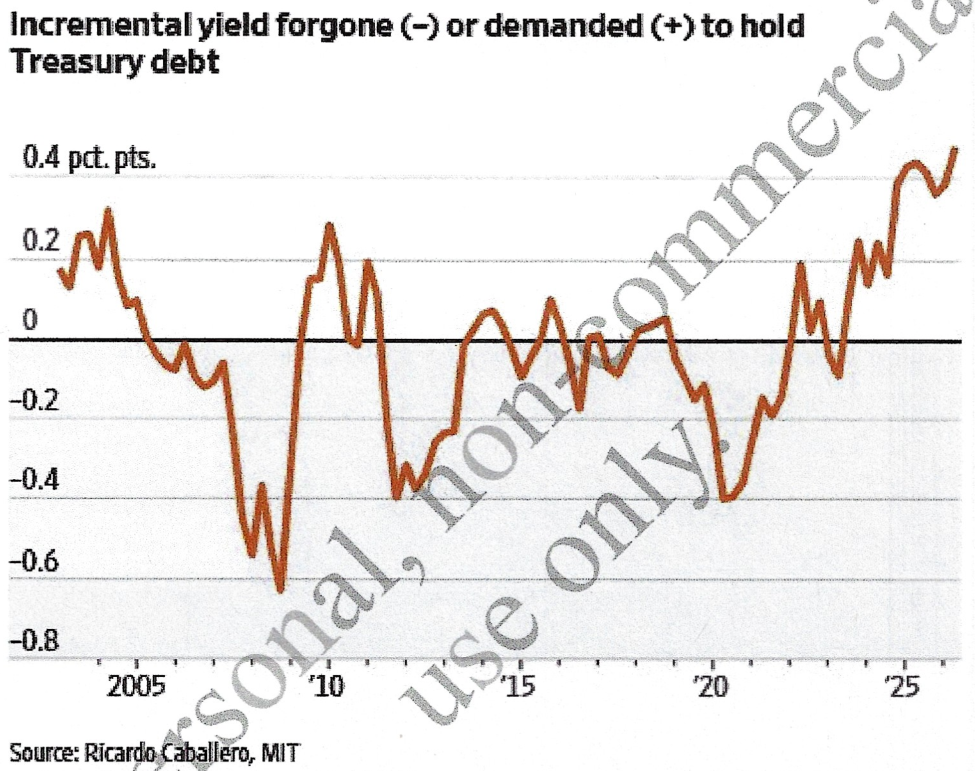

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The Fed is becoming less willing to subsidize spendthrift lawmakers. This is a good turn.

POLITICAL ECONOMICS

The Bond 'Chaos' Is a Sign Kevin Warsh's Plan Is Working

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"What an exciting week for bond markets" isn't generally a phrase one wants to hear, but here we are. Yields on U.S. Treasurys surged on Monday and Tuesday, especially at the longer end, with the 30year briefly hitting a level last seen in 2007. Yields fell back down again on Wednesday after Treasury Secretary Scott Bessent announced an intervention: Starting next month, Treasury will accelerate its buyback of longer-dated bonds and issue shorter-term debt instead.

One of the sillier interpretations of these events is that somehow Federal Reserve Chairman Kevin Warsh is failing at his new job. In this telling, an excess of dovishness is causing long yields to rise in expectation of future inflation. Meanwhile, Mr. Bessent's intervention supposedly is a repudiation of Mr. Warsh's determination to keep government hands off the bond market.

Something much more interesting is afoot.

Note

The most convincing explanation for the surge in yields is an uptick in expectations for future economic growth. This is manifested by the willingness of tech companies to bid up interest rates as they borrow to invest in artificial intelligence.

Note

It's the latest sign that "financial repression" is unwinding, and not a moment too soon. The term refers to a suite of economic policies (the details vary at different times and places) designed to allow the government to borrow at below-market rates, at the expense of savers and with woeful distortions throughout the economy. This has been the dominant policy mode across the West since the 2008 financial panic.

Note

Financial repression in the U.S. is enforced primarily by the Federal Reserve, via the expansion of its balance sheet under quantitative easing. The central bank bought Treasurys and mortgage-backed securities, which it then held as assets on its balance sheet. In exchange, it created large new liabilities in the form of commercial banks' reserve deposits at the central bank. Banks were encouraged to hoard these reserves both by blackletter liquidity regulations and by strenuous winking and nodding by their supervisors at the Fed. The central bank also released a constant stream of forward guidance hinting at low rates in the future to deter markets from bidding up yields.

The effect of this on the government's consolidated balance sheet was to exchange more expensive debt (Treasurys held by the public) for much cheaper debt (reserve balances on which the Fed paid lower interest). The net reduction in effective borrowing costs was achieved by the central bank's remittances to the Treasury of its profits from this arrangement, which can be understood as a rebate of some of the interest Treasury paid to the Fed on the bonds the Fed now owned.

It was a great deal for spendthrifts in Congress, facilitating a runup in federal debt at interest rates that hardly seem to represent the true risks of this situation. And it may be ending now. Despite the obvious ways this arrangement entangled the central bank with the Treasury, the Fed retained enough independence to raise policy rates after inflation took hold in 2021 and 2022. By late 2022, the interest rate paid on reserves started to exceed the yield on the Fed's holdings of Treasury debt, a necessary if not sufficient condition for ending this form of financial repression.

Now, perhaps, we're entering a new phase. Mr. Warsh is adamant about shrinking the Fed's balance sheet. This would disable the primary mechanism by which the Fed-Treasury complex has suppressed government borrowing costs. And under his no-forward-guidance rubric, he isn't delivering the central bank's usual vague reassurances that rates probably will fall in the future. This has kicked out another crutch on which Treasury once could lean.

The result is a world where companies and investors are newly able to price risk in line with expected economic growth. For now, that means interest rates returning to their level before financial repression began in earnest in 2008.

Note

The big losers are lawmakers, who must pay market rates for debt. Interest payments are on track to be either the second- or third-largest federal expenditure in this fiscal year, behind Social Security and maybe Medicare. Expect that cost to grow as investors internalize the notion that the Fed may not always allow itself to become a backstop.

Whether or when this might become a financial crisis is a matter of debate. But it will become a political crisis soon, once Congress starts confronting some awkward realities about what constitutes "affordable" fiscal policy if the Fed no longer is subsidizing lawmakers' bad decisions.

Seen in this light, Mr. Bessent's bond intervention isn't a challenge to Mr. Warsh's hands-off approach to the government debt market, but rather a sign that Mr. Warsh's approach is starting to work. Mr. Bessent's move is the first—clumsy and likely ineffective—attempt by a politician to grapple with the implications of interest rates that are allowed to rise in line with economic growth. There will have to be more adjustments. Brace yourselves.

By Joseph C. Sternberg

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The problem isn't tax cuts. Spending is way above historical norms.

How the U.S. Went $40 Trillion in Debt

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After cheerleading for President Biden's spending binge, the liberal intelligentsia is now ringing alarms about the U.S. government's mounting debt, which surpassed $40 trillion on Tuesday. Naturally, the left is blaming the GOP's tax cuts, but this argument is like scarfing double cheeseburgers and then blaming weight gain on the lettuce and tomato.

The $40 trillion milestone marks "a very dark day for America's finances," Bloomberg News reported, with debt having "accelerated faster than predicted in part due to massive tax cuts under last summer's Republican tax and spending bill." Debt accumulation has accelerated, but the problem is spending by both political parties, including the Covid blowout and entitlement programs that keep growing on autopilot.

Gross national debt has increased $17 trillion since 2019. That's about as much debt as the U.S. added during the entire first 225 years of its history. While the liberal press blames the GOP's 2017 tax cuts, and their extension in last year's One Big Beautiful Bill, revenue has increased 68% since 2018. That's twice the rate of inflation.

Since 2018, revenue has averaged about 17% of GDP, roughly the historical norm. Yet spending has averaged slightly over 24% of GDP, versus a pre-pandemic historical average of 20%.

Congress's initial Covid relief bill in March 2020 might have been warranted to help mitigate the lockdown's economic damage, but many provisions, such as extra Medicaid and food-stamp allotments, didn't lapse until 2023. A bipartisan Congress piled on more spending that December.

Then after Democrats took over Congress, they fired off another round in March 2021, even though the economy had mostly recovered. Then came the bipartisan infrastructure bonanza, followed by a pork-laden bill to subsidize computer chips and, to top it off, a climate extravaganza that Democrats hilariously named the Inflation Reduction Act. This largess has cost more than the Congressional Budget Office originally estimated. Even so, the biggest contributors to soaring deficits fall under the category of "mandatory spending," including Medicaid, Medicare, Social Security, veteran benefits, and ObamaCare subsidies.

All of this is finally getting noticed now that the government has to pay higher interest rates. U.S. debt service payments totaled $963 billion during the first 10 months of this fiscal year. That's $200 billion more than spending on defense, and it's even slightly more than Medicare.

Republicans in last year's tax bill made modest reforms to Medicaid, food stamps and student loans, and they also rolled back some green-energy subsidies. Alas, these changes don't go far enough, and the GOP has shrunk from making bigger reforms.

The press is playing up the $40 trillion milestone and rising interest rates to scare Republicans off further tax cuts to give the economy a supply-side boost. And to justify tax increases when Democrats next control Congress.

President Trump's advisers are reportedly noodling the good idea of adjusting capital gains for inflation. But the policy answer on the debt is spending restraint, and one reason yields on long-term Treasurys might be going up is that investors have concluded that neither party intends to quit the double cheeseburgers.

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