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DAILY ECONOMIC COMMENTARY

Whither Treasury Yields After Operation Twist?

April 11, 2012

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The Fed's monetary policy accommodation in the form of two rounds of quantitative easing (QE) and the current Operation Twist (OT) that is underway have provided support for economic activity and helped to stabilize the financial system. Operation Twist will be completed as of June 2012. QE1 and QE2 led to higher Treasury note yields followed by a reduction in yields as the two programs were completed (see Chart 1). Operation Twist has succeeded in establishing a firm floor for rates, but on the expiration of the program as of June 2012, the future is uncertain. If history is a guide, yields would trend down upon the expiration of Operation Twist, assuming soft economic conditions. However, if economic conditions are such that a self-sustained momentum supported by bank credit emerges, then higher yields would prevail. Headwinds from Europe present a challenge to the performance of the U.S. economy. Of the stronger economies in Europe for which factory production data are available, the numbers are disappointing. Factory production fell in Germany (-0.1%), France (-1.2%), Sweden (-5.6%), Norway (-0.7%) and United Kingdom (-1.1%) during February. Although the latter three have not adopted the euro, the extent of the weakness of each of these economies warrants close tracking.

Chart 1