The first mistake that I see bond markets making is buying into the idea that chronic inflation requires an FOMC response. Markets are not looking through an energy price spike and with Warsh doing the same, it is understandable.

More importantly, to play devils advocate, assume inflation does require a response. Bond markets are not pricing in one or two short lived rate hikes. Rather, they are pricing in a 400 bps fed funds rate 5-10 years out. But neutral is likely close to 300.

There are some reasons to think neutral is higher than 300 – AI driven productivity growth or fiscal concerns. But I have a harder time believing either has pushed neutral anywhere near 400.

Finally, my view remains that growth, not inflation, is the big risk. We see signs of this in the most recent cpi and jobs reports. Yields will come down when markets, and the fed realize this.

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