May 15, 2014

PREDICTING WHEN INTEREST RATES WILL INCREASE . . . again!

Jim, I wrote this while thinking about your investment portfolio. For you, it is particularly important to predict when interest rates will begin to rise again. -Dick

The Prize Winning Question?

What is keeping interest rates, as measured by the 10 year Treasury Bond, falling? When will the 10 year Treasury Bond interest rate begin to increase?

There are many variables that come together to determine the 10 yr US Treasury bond rate. It seems that those variables also come together in determining the money supply number M-2**. It also appears that there may be a 1-2 month lead time projecting future rate changes - up and down.

The hypothesis: As Money Supply (M-2) increases, interest rates fall. As Money Supply (M-2) decreases, interest rates rise.

From before the first of the year, 2012, M-2 was growing at rates as high as over 10%, YOY (year over year), and consistently over 7% for the entire year 2012, probably averaging over 8.0% for the year.

- During the first 6 months of 2013, that rate of increase was about 7% YOY.
- For the second half of the year, the growth rate ranged between 5.5% and 6.7% and averaged about 6% YOY. The rate at the end of 2013 was 5.6%.
- Throughout the first Quarter, 2014, M-2 has grown at a rate greater than 6% YOY

Following the numbers analysis above, one would project higher interest rates in 2013, as the M-2 rate of growth slows, versus the previous year. The fact - that the M-2 rate is increasing during the first quarter of 2014 - would forecast lower interest rates during this period.

Certainly, nothing could be this simple, but ..... it does seem to work.

It is probably worthwhile to explore money flows in order to enhance our understanding of our analysis.

- The Federal Reserve continues to purchase US Treasuries and Mortgage Backed Securities
- The US Treasury continues to issue new Debt.

Total public debt *** has been increasing throughout 2012 and thru April, 2013; then, that debt level held relatively stable thru the middle of October, 2013.

- Total public debt then began to increase rather rapidly toward the end of 2013 and continues to expand rather rapidly today.

- Since October, 2013, until today, that total outstanding debt has steadily increased - a total increase in public debt of 4.2% during a period of about 6 months.

From this review, the data seems to verify our analysis. Interest rates rose throughout 2013, and have been falling continuously during 2014.

****The *Total Public Debt Outstanding*: *Represents the total par (principal amount) of marketable and non-marketable securities currently outstanding. Marketable securities include Treasury bills, notes and Treasury Inflation-Protected Securities (TIPS), all of which can be bought and sold in the secondary market at prevailing market prices.*

***M-2: A measure of money supply that includes cash and checking deposits (M1) as well as near money. "Near money" in M2 includes savings deposits, money market mutual funds and other time deposits, which are less liquid and not as suitable as exchange mediums but can be quickly converted into cash or checking deposits.*