

Bonds, Treasury QE and the '3-3-3-30' Policy Framework

The Path to Faster Monetary Inflation

Bond markets are rarely the most exciting area of finance, yet they remain the most important for investors to understand. Government bonds are not simply another asset class. They underpin the global collateral system, determine funding conditions and establish the hurdle rate that all other investments must ultimately beat.

For that reason, the widespread belief that rising bond yields signal investor concerns about runaway fiscal deficits or a loss of confidence in US Treasuries must be refuted. Bond yields are undoubtedly rising, but this is a global phenomenon, with China the notable exception. **More importantly, the evidence suggests yields are rising for reasons very different from those commonly asserted in the financial press.**

If investors were genuinely becoming concerned about sovereign solvency, excessive debt burdens or the erosion of Treasury safe-asset status, **term premia** would be widening materially. They are not. The narrative of a Treasury market losing its reserve status is therefore not merely premature; it is increasingly inconsistent with the available evidence.

Subscribed

Behind Bond Yields

Bond yields can be decomposed into two largely independent components:

- The expected path of **policy interest rates** over the life of the bond, which can be estimated through the implied terminal policy rate.
- The **term premium**, which compensates investors for assuming duration risk and uncertainty over the maturity of the security.

The first component is predominantly driven by expectations for nominal GDP (NGDP) growth. The second reflects inflation uncertainty, bond market volatility and supply-demand imbalances across maturities.

This distinction allows investors to identify the true drivers of higher bond yields. If concerns over fiscal sustainability were dominant, term premia should be increasing sharply. If stronger economic growth were the primary force, then implied policy-rate expectations should explain most of the move.

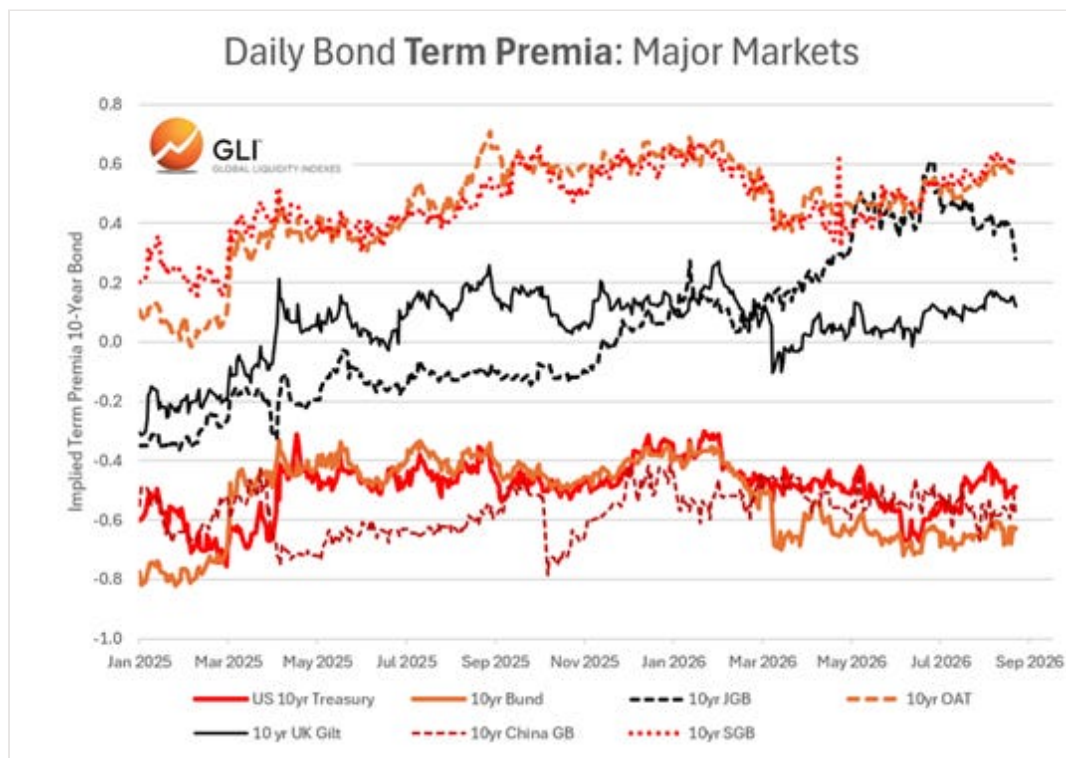
The evidence overwhelmingly favours the latter explanation.

The chart below demonstrates that the recent rise in Treasury yields has been driven principally by higher policy-rate expectations rather than an expansion in term premia. While term premia have increased by 29

basis points since late June, implied policy-rate expectations have risen by 51 basis points. More significantly, term premia have been broadly unchanged over the past year.



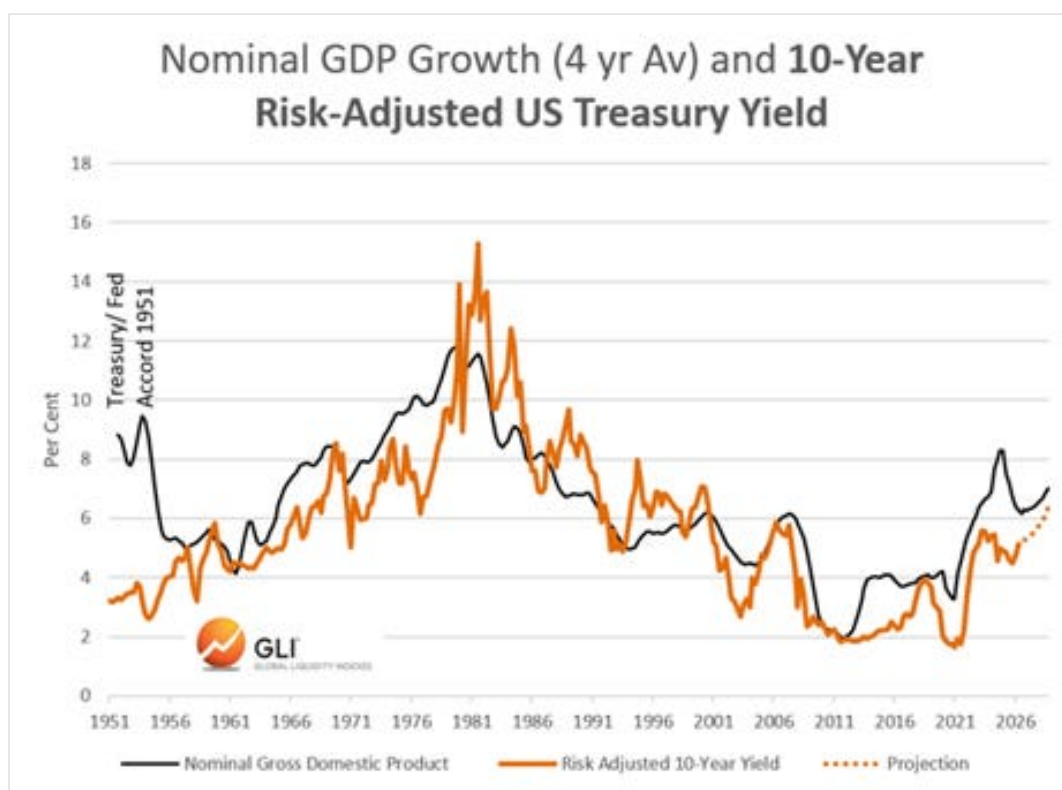
International comparisons tell a similar story. US Treasury term premia remain lower than those observed in many other developed bond markets. Measures such as the *convenience yield*, reflected in the spread between Treasuries and equivalent default-free securities, likewise suggest stability rather than deterioration in the safe-asset characteristics of US government debt.



Strong Economies Do Not Have Strong Financial Markets

The rise in policy-rate expectations is readily explained by the remarkable resilience of the US economy. The relationship between NGDP growth and risk-adjusted 10-year Treasury yields, excluding term premia, remains both close and compelling.

US nominal GDP growth is currently running at its fastest pace since the mid-1980s. If this historical relationship continues to hold, underlying Treasury yields may ultimately test the 6% level.



Yet the more important question for investors is not why yields are rising. It is how policymakers are responding.

The conventional view is that monetary policy operates primarily through changes in the Fed funds rate. Increasingly, however, policymakers appear focused on something different: the **management of funding conditions**.

The distinction is critical. Interest rates influence the price of money. Funding conditions determine its availability. The analogy is a modern expressway: interest rates represent the speed limit, while the flow of traffic equates to liquidity.

Markets appear to be adjusting to this reality more rapidly than policymakers themselves. The implications extend well beyond fixed income markets. Stronger NGDP growth should support corporate earnings, but higher bond yields simultaneously place downward pressure on valuation multiples. Earnings may improve, yet the valuation component of equity returns becomes increasingly challenged.

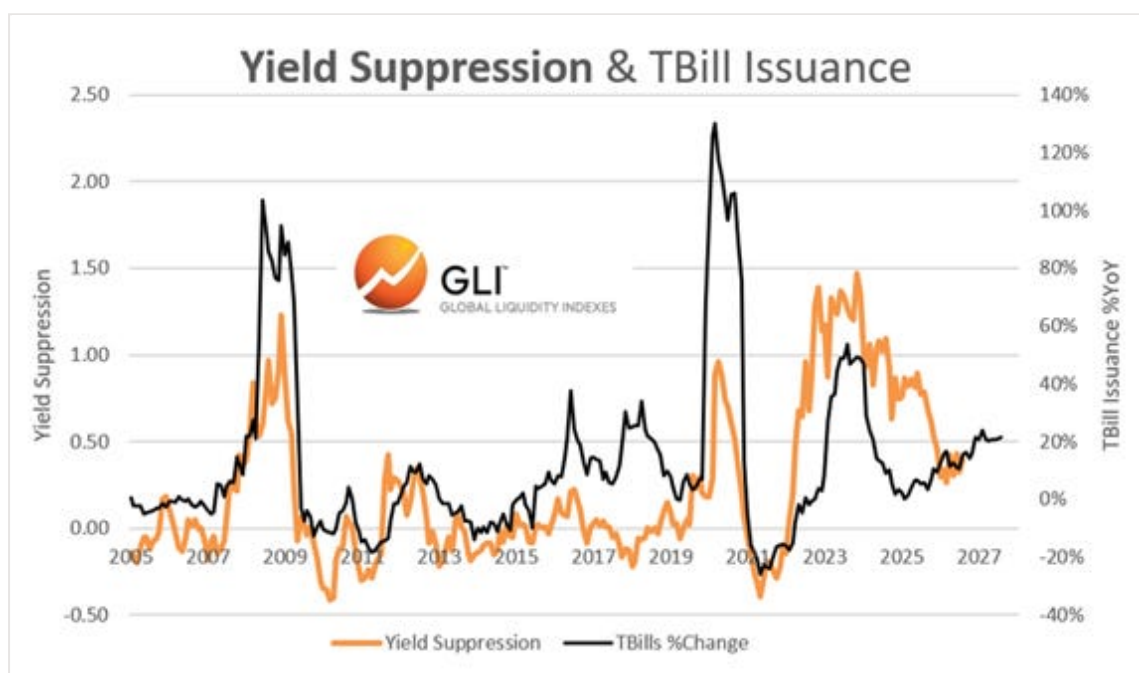
In such an environment, real assets, particularly **commodities**, may offer more attractive opportunities than conventional financial assets.

Kicking The Can Down The Road

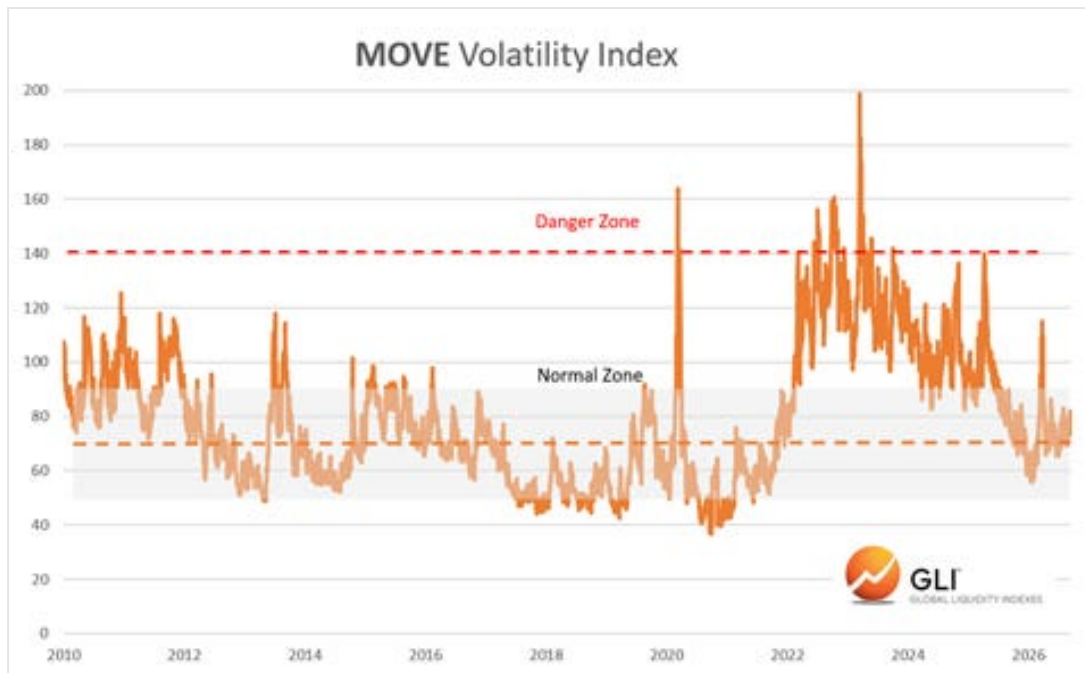
At the same time, US policymakers appear to be pursuing an orderly adjustment to higher bond yields through three related objectives:

1. Creating **scarcity at longer maturities** through greater Treasury bill issuance
1. Suppressing **bond market volatility**
1. Maintaining abundant **money-market liquidity**

Consider first the impact of Treasury bill issuance. The chart below shows the spread between US Treasuries and equivalent risk-free agency MBS securities. Fluctuations in this spread provide a useful measure of deliberate yield suppression and correlate closely with periods of elevated Treasury bill issuance.

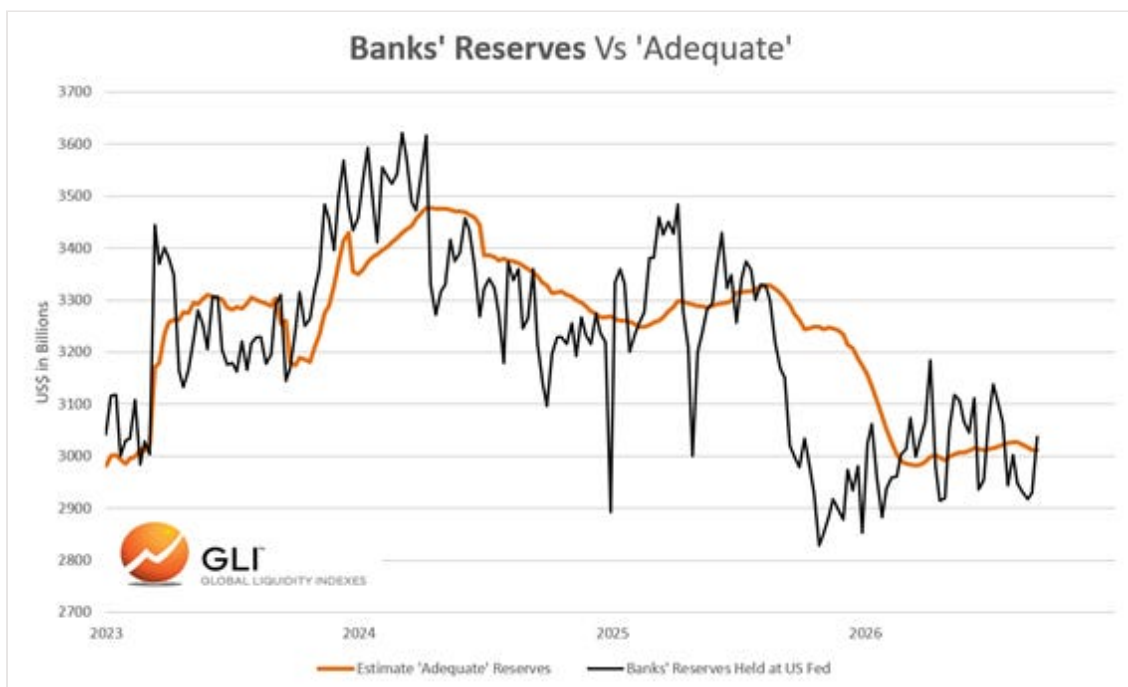


Similarly, the remarkable stability of the MOVE Index suggests that policies such as Treasury buybacks have been effective in suppressing bond market volatility and stabilising longer-dated yields.



A third pillar appears to be active management of reserve balances within the banking system. The chart below compares our estimate of adequate reserve levels with actual reserve balances.

With the notable exception of late 2025, when quantitative tightening contributed to stress in repo markets and necessitated the *Reserve Management Purchases* (RMP) programme, reserve balances have generally been maintained close to desired levels. More recently, reserve management appears to have become increasingly precise.



Treasury QE

This growing emphasis on funding conditions rather than policy rates likely reflects both the structure of the post-GFC financial system and the Treasury's evolving funding requirements.

Before the Global Financial Crisis, one could broadly characterise the private sector as lending to the Federal Reserve. Today, the reverse is closer to reality. The Federal Reserve increasingly supplies liquidity into a highly leveraged financial system whose stability depends upon predictable funding conditions.

At the same time, Treasury bill issuance has become an attractive funding mechanism for the State. Domestic banks are natural buyers because short-dated government securities align more closely with the maturity structure of their liabilities. As a consequence, investors should expect the average maturity of US government debt to continue declining as Treasury bills move toward what may prove a critical threshold of, say, 30% of outstanding debt, compared with roughly 23% today.

This observation leads to what we describe as the **3-3-3-30 Framework**.

Treasury Secretary Bessent has already signalled ambitions for:

- 3% real economic growth.
- A 3% fiscal deficit.
- An additional 3 million barrels per day of US oil production.

However, a fourth element may ultimately prove the most important: Treasury bills rising toward 30% of total outstanding government debt.

That threshold matters because of its implications for **debt monetisation**.

Many observers wrongly describe this process as *financial repression*. We believe that characterisation understates the significance of what is occurring. Financial repression suppresses returns on savings. *Monetary inflation* erodes the purchasing power of those savings altogether. **One reduces income; the other diminishes accumulated wealth.**

The distinction matters.

We have argued previously that greater Treasury bill issuance effectively shifts a rising share of government financing onto the banking system because banks and other credit intermediaries are the natural buyers of short-dated government debt. The chart below estimates the proportion of US money-supply growth attributable to banks absorbing Treasury issuance.

More than one-fifth of recent monetary growth now appears directly linked to public-sector financing activity.

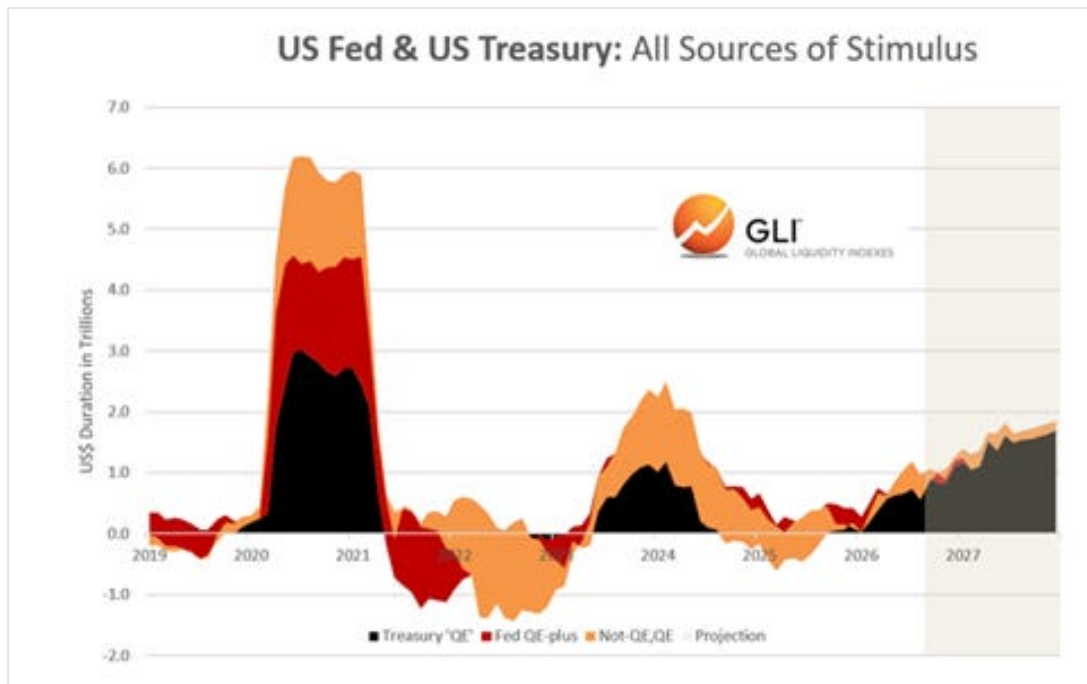


Put differently, commercial banks are increasingly performing a role historically associated with central-bank quantitative easing.

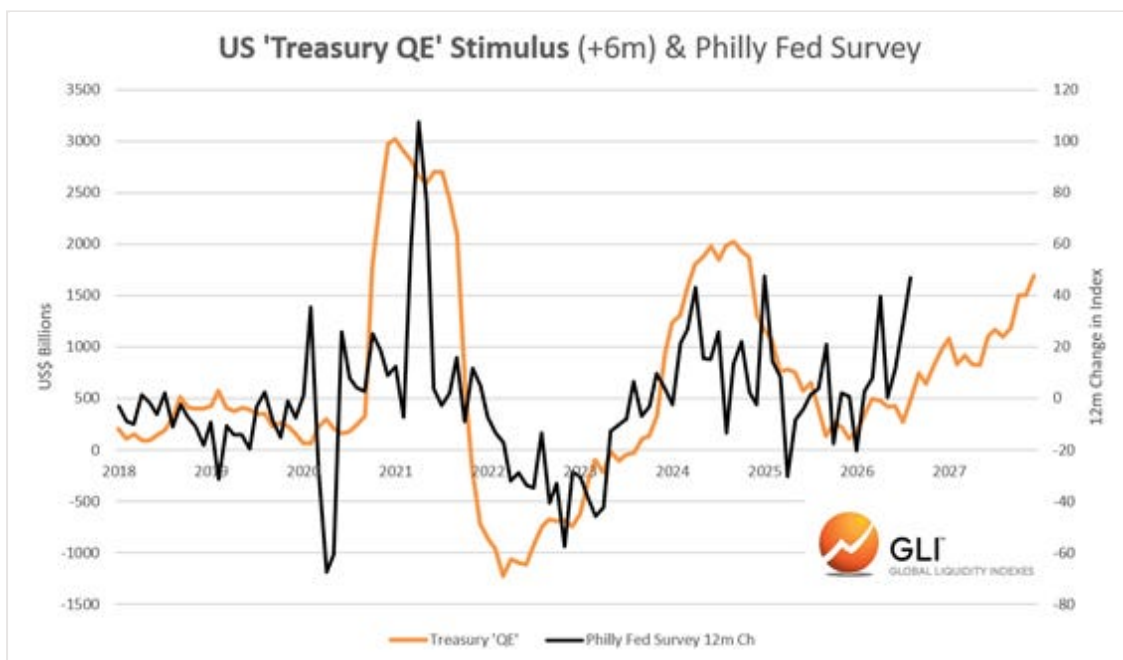
Under traditional QE, the Federal Reserve purchases government securities and creates reserves. Under what we term **Treasury QE**, commercial banks perform much the same economic function. By absorbing increasing quantities of Treasury bills they finance government spending while simultaneously expanding deposit money. The mechanics differ, but the monetary consequences are remarkably similar.

Rather than the Fed purchasing government debt outright, the banking system effectively performs the monetary expansion.

Treasury QE is now becoming one of the dominant forms of US policy stimulus. The evolution can be observed in the chart below, using our estimate that system liquidity is broadly equal to net financial assets divided by their average duration.



Not surprisingly, rising government spending and expanding liquidity are supporting economic activity and contributing to accelerating NGDP growth. The following chart illustrates the relationship between Treasury QE and the Philadelphia Fed's manufacturing activity index.



The effects are not confined to the United States. Similar policies are increasingly being replicated across developed economies. Partly as a consequence, the global economy is now expanding in nominal terms at its fastest pace since the early 1990s.

From Fiscal Dominance to Keynesian Dominance

Investors typically worry about fiscal dominance: the risk that monetary policy becomes subordinate to government financing requirements.

Today's environment may be more profound.

We are entering an era of **Keynesian dominance**.

Fiscal dominance describes a funding problem. Keynesian dominance describes a governing philosophy.

The distinction is important because today's policy regime combines expanding fiscal needs with a broader political consensus in favour of greater State involvement in economic outcomes. Ageing populations, geopolitical competition, re-industrialisation, defence spending and the intensification of what we have previously described as "Capital Wars" all point in the same direction: a structurally larger State sector and permanently higher funding requirements.

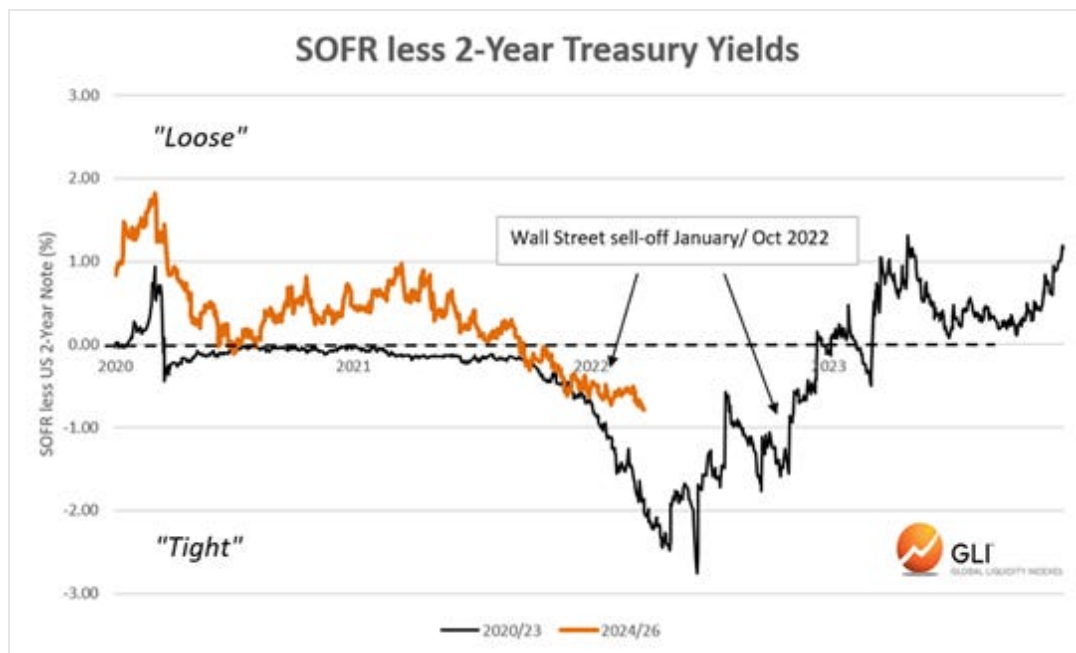
Austerity may be the most direct route to reducing public debt burdens, but it is increasingly unattractive politically and economically. The path of least resistance is monetary accommodation.

It is noteworthy that Keynes himself observed in the 1936 German preface to *The General Theory* that his framework was more easily adapted to economies characterised by substantial State involvement than to systems based exclusively on laissez-faire principles. Whether one agrees with that observation or not, it captures the essence of the current policy environment.

Under such conditions, monetary inflation becomes less a policy error than a policy instrument.

Bond markets appear to understand this changing regime better than policymakers. Higher yields are not necessarily signalling fiscal distress. Rather, they reflect an economy growing faster than official policy settings can comfortably accommodate and a policy framework increasingly dependent upon maintaining abundant liquidity.

We have lately argued that the Fed is foot-dragging over the need to tighten in order to keep funding flowing. Evidence again the following chart which shows the 2021-22 monetary tightening compared to the current cycle. The time to get worried is when the orange line, measuring the spread between SOFR rates in the repo markets with 2-year Treasury note yields, dips sharply lower.



Investors should therefore focus less on the precise path of Fed funds and more on the evolution of funding conditions. The key policy question is no longer whether monetary expansion continues, but how it is delivered.

Increasingly, the answer appears to be **Treasury QE**.

Viewed through that lens, the **3-3-3-30 Framework** is more than a debt-management strategy. It is a roadmap toward faster monetary inflation, stronger nominal growth and structurally higher equilibrium bond yields. The challenge for policymakers is not preventing yields from rising. It is preventing the adjustment from becoming disorderly. For investors, that distinction may prove decisive. In short: the can is being kicked down the road!

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