Gold Screams 'Debasement Trade.' Bonds Say Otherwise.

If investors expect debasement, it is very odd that the bond market's best guess at long-run inflation is basically unchanged

By *James Mackintosh* Follow

Oct. 9, 2025 5:30 am ET

The price of gold is up about 51% in the past 12 months. PHOTO: HIBA KOLA/REUTERS

Debasement fears seem to be everywhere—except the one place they should be most obvious: bonds. Sure, there was a nudge up in global long-end yields this week, thanks to politics. Japan's ruling party picked a leader who likes big spending and low rates, and France lost yet another prime minister after failing to reconcile the need to save money with a parliament that disagrees.

Yet, the bond markets remain confident that U.S. inflation won't run out of control, even as investors point to soaring gold prices as a sign of fear that politicians and central banks will choose inflation as the easy way out of debt problems.

How come? Well, bond markets are split between worrying that a U.S. jobs slowdown portends weak growth and fear that politicians pouring fuel on the smoldering embers of inflation will eventually stoke another fire.

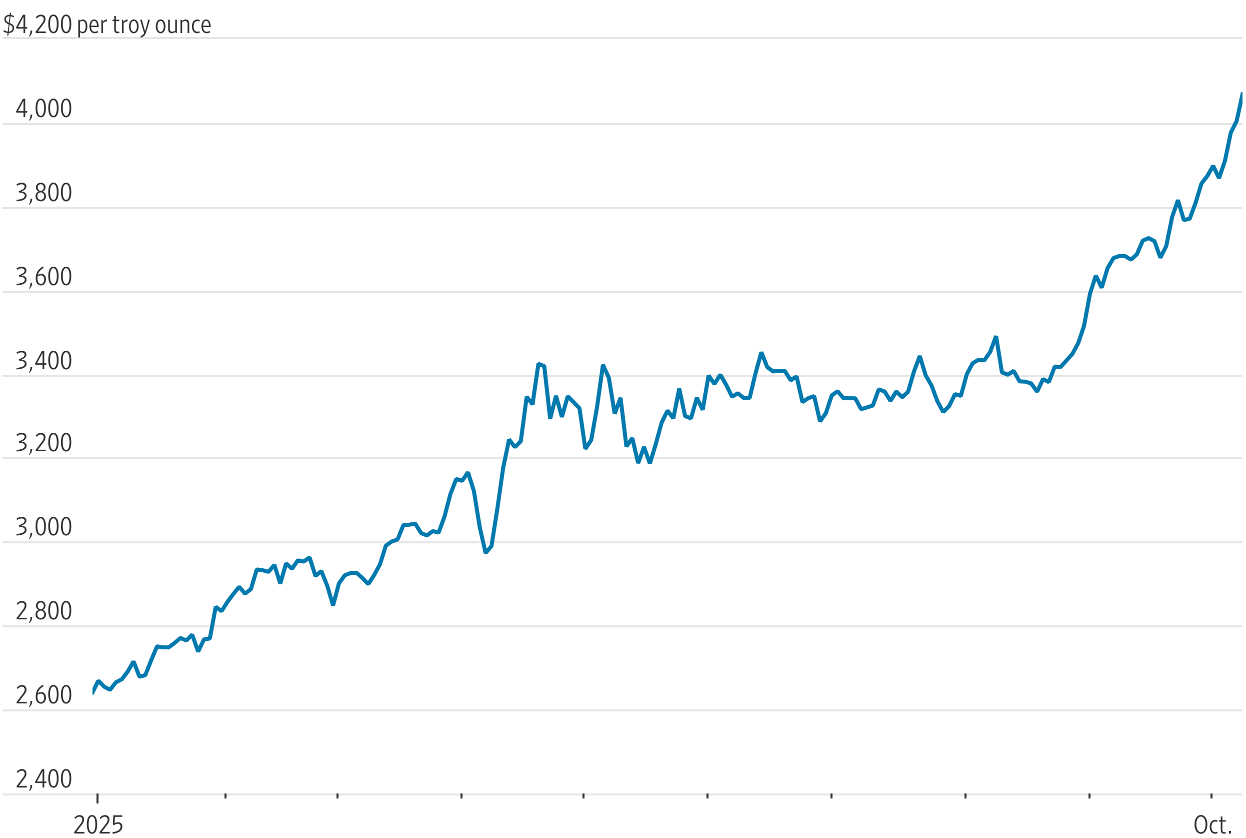
Just how effective inflation can be as a hidden tax is shown by Japan: Its net debt has dropped from a high of 162% of output in 2020 to an estimated 134% this year, according to the International Monetary Fund, even as it continued to spend more than it taxed. Just how ineffective it can be is shown by the U.S., where there was more inflation but the government spent all its gains so that net debt rose from 96% in 2020 to a forecast 98% this year.

No wonder investors are talking about the "debasement trade" and I've had the Pixies' surreal 1989 single "Debaser" stuck in my head all week.

Some aspects of the markets fit the idea that debt will be inflated away (the modern version of debasing the value of gold coins with base metals). Gold just passed $4,000, up 51% in 12 months. The dollar is down more than 10% from January's high against a basket of major currencies. Stocks, which provide some protection from inflation as revenue rises with prices, are setting new highs.

Gold Has Soared...

Gold futures



Source: FactSet

But if investors expect debasement, it is very odd that the bond market's best guess at long-run inflation—the so-called break-even inflation rate for the five years starting in five years' time—is basically unchanged, and close to the Fed's 2% target.

Likewise, European five-year, five-year inflation swaps show investor faith in the European Central Bank keeping inflation under control. They aren't priced for an inflation-busting bailout of France. Even in the near-term, little inflation is priced, and there's been no rise in expectations since the latest run-up in gold began in August.

It's possible that different markets are attracting investors with starkly different views on inflation, unlike in the past. But I find it more plausible that stocks are being led up by bets on artificial intelligence and an economy producing strong growth with little inflation.

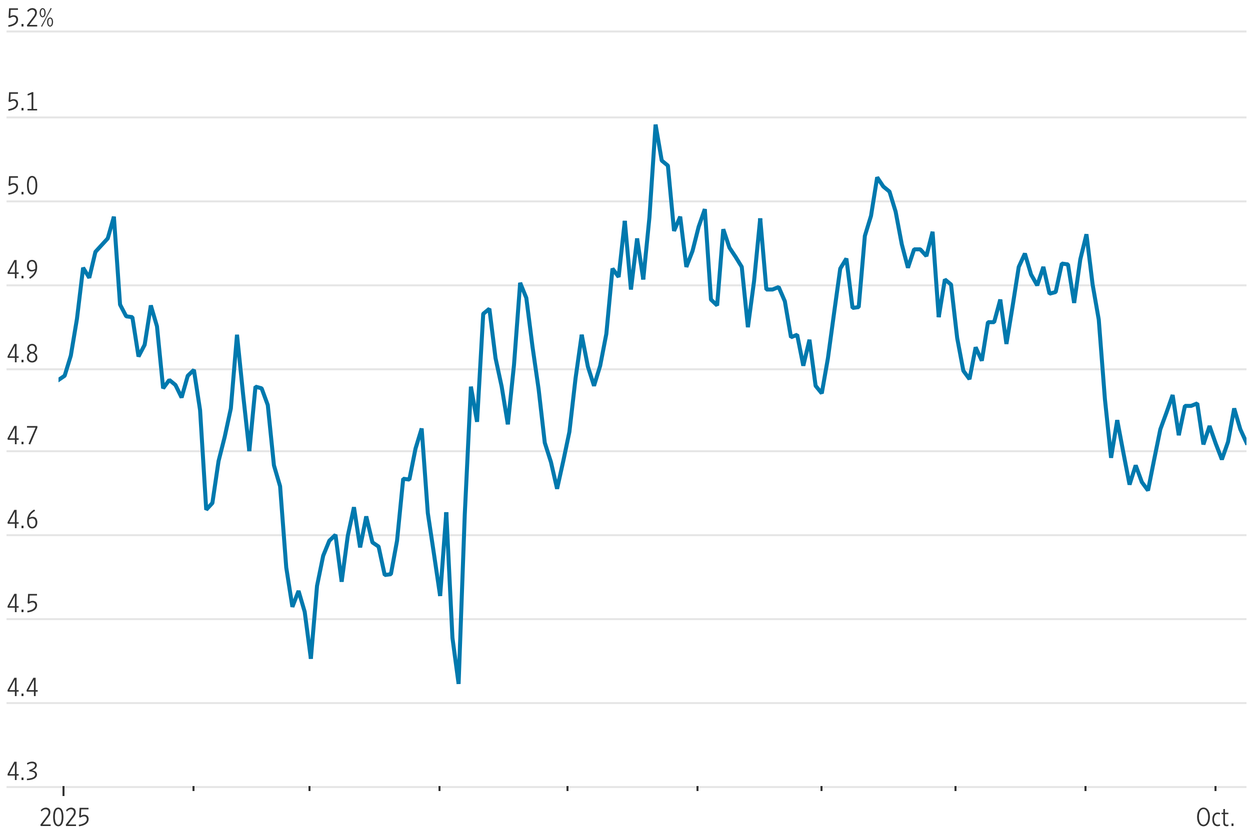
Gold is booming because central bank reserve managers worry about relying on an unpredictable U.S. in a crisis, plus its natural rise when rates fall, boosted by buyers trying to jump on to rising prices.

Aside from gold, the two obvious debasement trades are to bet on big, inappropriate rate cuts while selling the longest-dated Treasurys, and to bet on higher inflation breakevens, the gap between ordinary and inflation-linked Treasurys. Both should do well if the president seized control of the Federal Reserve and forced it to finance the government cheaply.

There's little sign of that happening yet. Sure, the 30-year Treasury yield has stuck mostly in a 4.5% to 5% range this year, higher than it's been in a long time. But it is lower than at the start of the year and, like inflation-linked Treasury yields, lower than before the latest gold run-up began six weeks or so ago. Investors don't expect persistent inflation to erode the value of Treasurys.

...But Not Long-Dated Yields

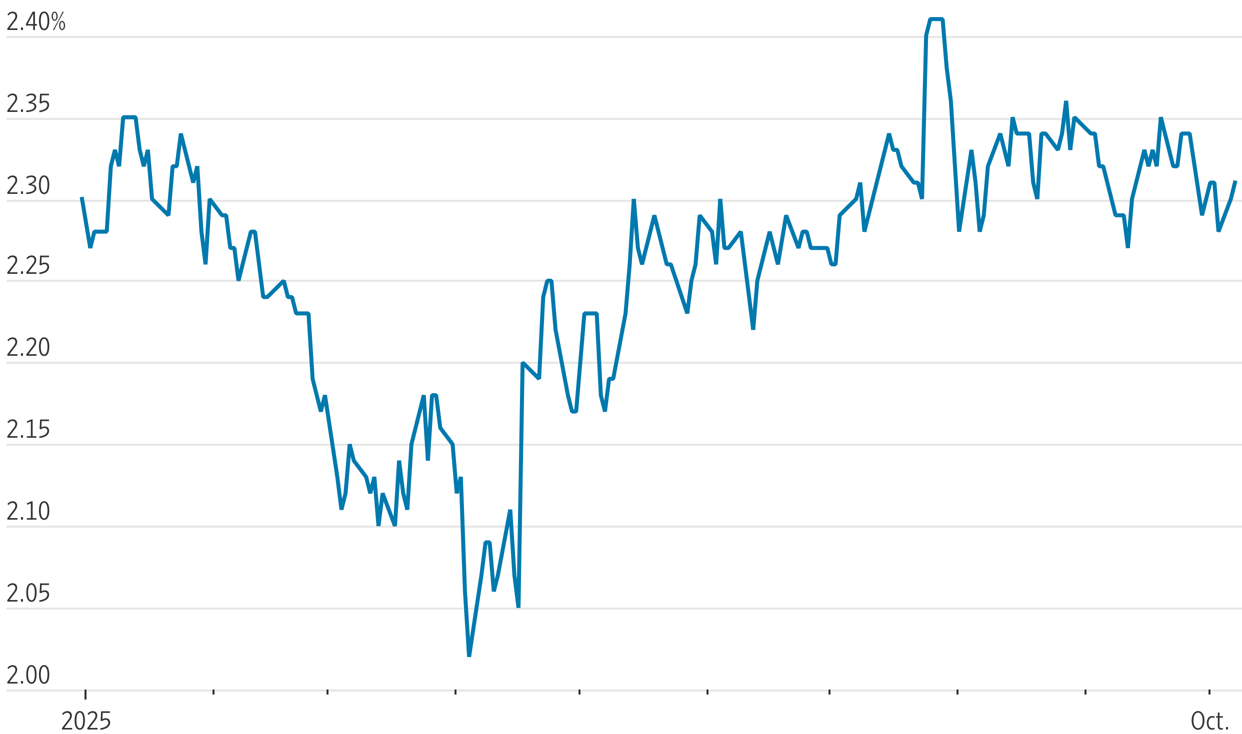
30-year U.S. Treasury yield



Source: Tullett Prebon

Bond Markets Think This Is Fine

Breakeven inflation rate for five years, starting in five years



Note: Constant maturity

Source: Federal Reserve Bank of St. Louis

My view is that investors are split, as they have been all year. The jobs market is weak, or at least it was the last time the government was functional enough to release numbers. Inflation has been picking up, and the economy has been strong, if over-reliant on AI investment. If you were concerned that weak jobs creation is a sign of trouble ahead, the Fed's precautionary rate cut made sense. If you were worried about incipient inflation, it makes things worse.

It's important to keep the long-term problem distinct from what happens right now. If the U.S. keeps spending too much, taxing too little and running up debt, eventually the U.S. will face a proper bond market showdown. That will force a choice of austerity or inflation, and I suspect politicians will take the easy route of higher inflation. But that could be many years away.

Right now, if the economy keeps on growing as fast as it has been and the jobs slowdown proves merely a blip, the Fed will have to abandon predicted rate cuts. It could even start raising them again. Stocks, bonds and gold would all suffer from the Fed hitting the brakes when they're positioned for acceleration. Only if the Fed chose, or was forced, to let the economy keep moving too fast would the debasement trade come into its own.

Write to James Mackintosh at james.mackintosh@wsj.com

Videos