Economic News

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EURO ZONE

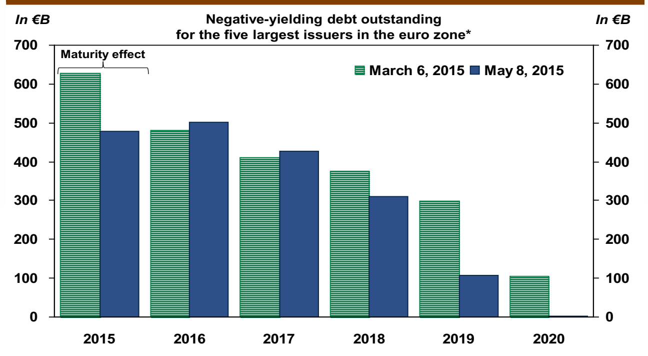
Negative yields and bond market selloff: Parallel worlds

The rapid rise in bond yields in recent weeks is reminiscent of the summer 2013 taper tantrum episode. However, to date, the global scope of the selloff is arguably one of the distinctive elements the current experience. In 2013, the phenomenon was mainly concentrated in the United States (where a reduction in asset purchases was anticipated), United Kingdom, Canada and Australia, countries that exhibited the best growth prospects back then. In 2015, we observe that Europe core bond markets dictate the tone, with most other developed countries following the lead.

This being said, in Europe, bonds at shorter maturities seem to live in a parallel world. Two-year bond yields in France, Germany, Switzerland and Denmark remain negative and have not significantly distanced themselves from their levels of two months ago. In general, compared to the beginning of March, the amount of negative-yielding bonds outstanding has declined only moderately. For example, for the five largest issuers with negative-yielding debt in the euro zone, the outstanding amount of these bonds has gone from €2,300B to €1,837B. The decline in negative-yielding debt outstanding that is strictly related to rising bond yields is observed mainly in the more distant maturity buckets of 2019 and 2020.

Hence, despite a remarkable selloff in the long ends of sovereign curves, this is not yet the end of the negative-yield era for shorter maturities. Currently, yields for these maturities are mainly influenced by deposit rates set by central banks. Central banks maintain these rates slightly negative, either because some of them, like the European Central Bank and the Swedish Riksbank, are pulling out all stops to defend inflation targets that have recently been undermined by falling energy prices and a chronically anemic growth, or because other central banks (i.e. in Switzerland and Denmark) are fighting capital inflows and their undesirable effects on foreign exchange levels.

The amount of debt with a negative yield to maturity remains high in the euro zone



* Five largest issuers of currently negative-yielding debt (Germany, France, Netherlands, Austria, Belgium).
Sources: Bloomberg and Desjardins, Economic Studies

Implications: Central banks maintaining the arsenal of aggressive policies recently deployed in Europe (negative rates and bond purchases) strongly limits the ability of short-term sovereign yields to extricate themselves from sub-zero levels. However, there are also limits to the ability of rates to venture too deeply into negative territory. For instance, arbitrage opportunities favouring the holding of cash in physical form would become increasingly attractive. Furthermore, while it can be rational to invest in securities with a negative nominal rate in an environment characterized by fears of deflation, as was the case earlier this year, the strengthening of Euro area inflation expectations rather tends to limit the attractiveness of short-term bonds at present. Ultimately, barring any unintended consequence of current policies, we expect short-term yields to remain relatively stable at slightly negative levels in the Euro area, until the day central banks begin signalling the end of unorthodox measures.

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