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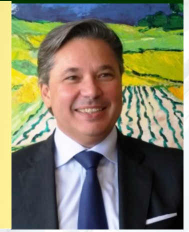
WEEKLY ANALYSIS



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PROSPECTS AND STRATEGIES
INTERNATIONAL BONDS

Long-term interest rates will gradually rise across the board. Renewed attractiveness of dollar bonds. Investment strategy focused on USD, CAD, and AUD markets

Key points

- Long-term interest rates will gradually rise across the board
- Renewed attractiveness of dollar bonds
- New upward trend in interest rates temporarily curbed by ECB action
- Trend reversal in interest rate markets
- Japanese long-term rates are following the general trend without conviction
- Chinese bonds still attractive

Long-term interest rates will gradually rise across the board

At the beginning of the year, we noted that the risks of an unexpected and uncontrolled rise in long-term yields seemed growing and increasingly likely. Q1 fully confirmed our predictions with the rise in long-term dollar yields leading this new trend. Even the downward adjustment of the economic outlook for Q1 in the euro zone countries due to further lockdowns did not prevent European bond markets from participating in the shift in investor expectations. The correlation among bond markets thus proved once again to be high, with practically all markets experiencing the same trend, albeit with varying degrees of amplitude.

The prospect of a strong global economic recovery in 2021 has thus been the main factor influencing bond markets in recent months and will certainly remain one of the determining factors going forward. The competition among governments to attract the capital needed to finance their growing budget deficits will require adjustments and the reconstitution of risk premia that disappeared during the down cycle. It was already clear in March 2020 that the additional financing needs resulting from global budget deficits incurred to meet the direct and indirect costs of managing the Covid-19 crisis should logically have an impact on market interest rates. However, in 2020, central bank interventions had made it possible to postpone this impact. However, with the economic recovery expected in the coming quarters, central banks will no longer face the same problem. It was indeed easier for them to keep long-term rates low through their various asset purchase programmes in a context of recession or health crisis than in a phase of general economic recovery. They will therefore probably no longer be able to contain the new yield requirements of investors, who may also be increasingly worried about rising inflation affecting the real returns on their bonds. This factor will certainly be one of the key elements in the changing outlook for bond markets in H2. While inflation remains below central bank targets everywhere, expected inflation is already above 3% for the year, especially in the US. We had already mentioned these likely developments for 2021 a few months ago, stressing that these risks seemed to us to be largely underestimated. We mentioned the fact that these elements would undoubtedly trigger an upward trend in rates in 2021. Today we reiterate our negative outlook for the bond markets.

Renewed attractiveness of dollar bonds

As we have been saying for several months, we felt that a rise in long-term rates in 2021 was inevitable in the context of a very clear improvement in the US economic outlook. The 50-basis-point rise in 10-year Treasury rates in H2 2020 merely heralded a trend reversal that was expected to strengthen and become more pronounced in 2021. Indeed, Q4 saw long-term rates rise a little further and approach the 2% threshold. The rise in Treasury yields from 0.9% on 31 December 2020 to almost 1.75% is significant and constitutes an important changing outlook factor in terms of financial risk assessment. It is also important to