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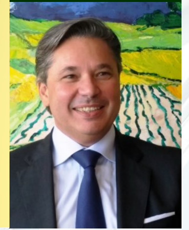
WEEKLY ANALYSIS



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LONG-TERM RATES RETURN TO THEIR 2016/2018 LEVELS

General increase in long term rates. Very high correlation. US 10-year rates break through the 2% mark. These movements are already significant. Caution is still the most appropriate approach.

Key points

- New bullish trends for long term rates
- Strong correlation in the normalization phase
- US bonds regain attractivity at 2%
- Pressures on GBP bonds have resurfaced
- European yields are touching their 2018 levels
- Relative calm on the yield curve in Japan
- The investment policy remains cautious in 2022

New bullish trends for long term rates

Investors' perceptions on the risks in the fixed income markets are evolving rapidly and have been gaining momentum for several weeks now. The introduction of the Federal Reserve's tapering, the end of its asset purchases has been moved up to March 2022, which coincides with the end of the ECB's emergency package as well as the Bank of England's first interest rate hike. This shows that central banks are determined to normalise their monetary policies at the beginning of the year. The more long-lasting and rising inflation figures have largely contradicted their previously over-optimistic forecasts. The end of the year was not without its milestones in terms of monetary policy developments.

These forthcoming liquidity cuts have finally started to affect yield curve levels in the US as well as in many other countries. The new macroeconomic environment with solid global GDP growth of around +5% in 2022 will be accompanied by likely persistent inflation and a new monetary policy paradigm. These conditions will not be favourable for bond markets in 2022. In Q4, we indeed saw an upward shift in most yield curves, though this was more evident on the 2-5-year end of the curve than on the long end.

In the US, 5-year Treasury yields almost tripled in 2021, rising from 0.35% at the beginning of the year to 1.26% at the end of December. During the same period, 10-year yields rose from 0.91% to 1.51%. Overall, yields have started to adjust in most economies with solid GDP growth prospects in 2022, including the Eurozone, the UK and even Switzerland.

The first few weeks of the year have witnessed a continuation of this trend with widespread yield increases around 30-40 additional basis points which have plunged the capital markets into global price consolidations of around –2.05%, with the UK (-4.0%), Australia (-4.17%) and Canada (-3.29%) recording the most significant declines.

Strong correlation during the period of rate normalisation

The year has therefore begun with a transition in the interest rate outlook. While most central banks will still hold back on thightening their policy rates for some time, we believe that long rates are already in the process of rapidly returning to a normalised level of yields.

The return of growth and historically high inflation must now be taken into account when determining nominal interest rates. Further yield curve pressures are increasingly likely in this context. Prior to the pandemic, the 10-year US Treasury yields were at +2% in December 2019 for an inflation level of +2.2% and a GDP growth of around +2% as well. Since the beginning of the year, they have finally risen from 1.3% to 2.05% in a few weeks only as inflation has exceed +7.4% year-on-year while the GDP growth was +6.9% in the last quarter.

In the current context, nominal rates are expected to continue their ongoing adjustments and return to pre-pandemic levels.