Shifts in Treasury yields & market functioning

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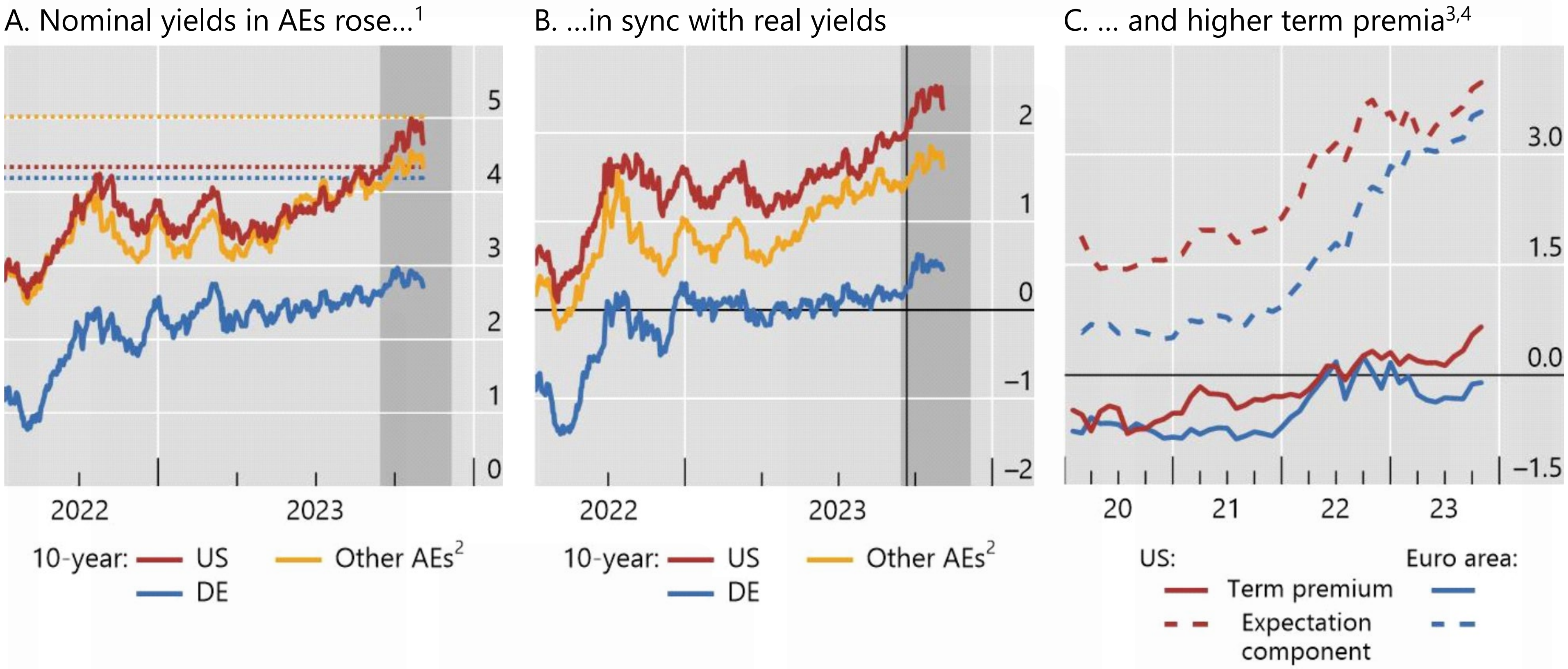
Big global upward shift in Treasury yields since July led by the US …



[1] The horizontal lines indicate January 2007–June 2008 average. [2] Simple average of AU, CA and GB. [3] Ten-year maturity. Monthly data up to end-October 2021. [4] Estimates based on the joint macroeconomic and term structure model of Hördahl and Tristani (2014).

Sources: P Hördahl and O Tristani, "Inflation risk premia in the euro Area and the United States", International Journal of Central Banking, vol 10, no 3, September 2014; S Joslin, K Singleton and H Zhu, "A new perspective on Gaussian dynamic term structure models", Review of Financial Studies, vol 24, no 3, 2011; Bloomberg; Datasream BIS calculations.

Upward pressure on yields – a confluence of factors at play …

- Changing **expectations of future monetary policy** (higher for longer)
  - Repricing of Fed expectations due to a more resilient economy
  - Rates may need to stay higher as their equilibrium level higher than previously thought

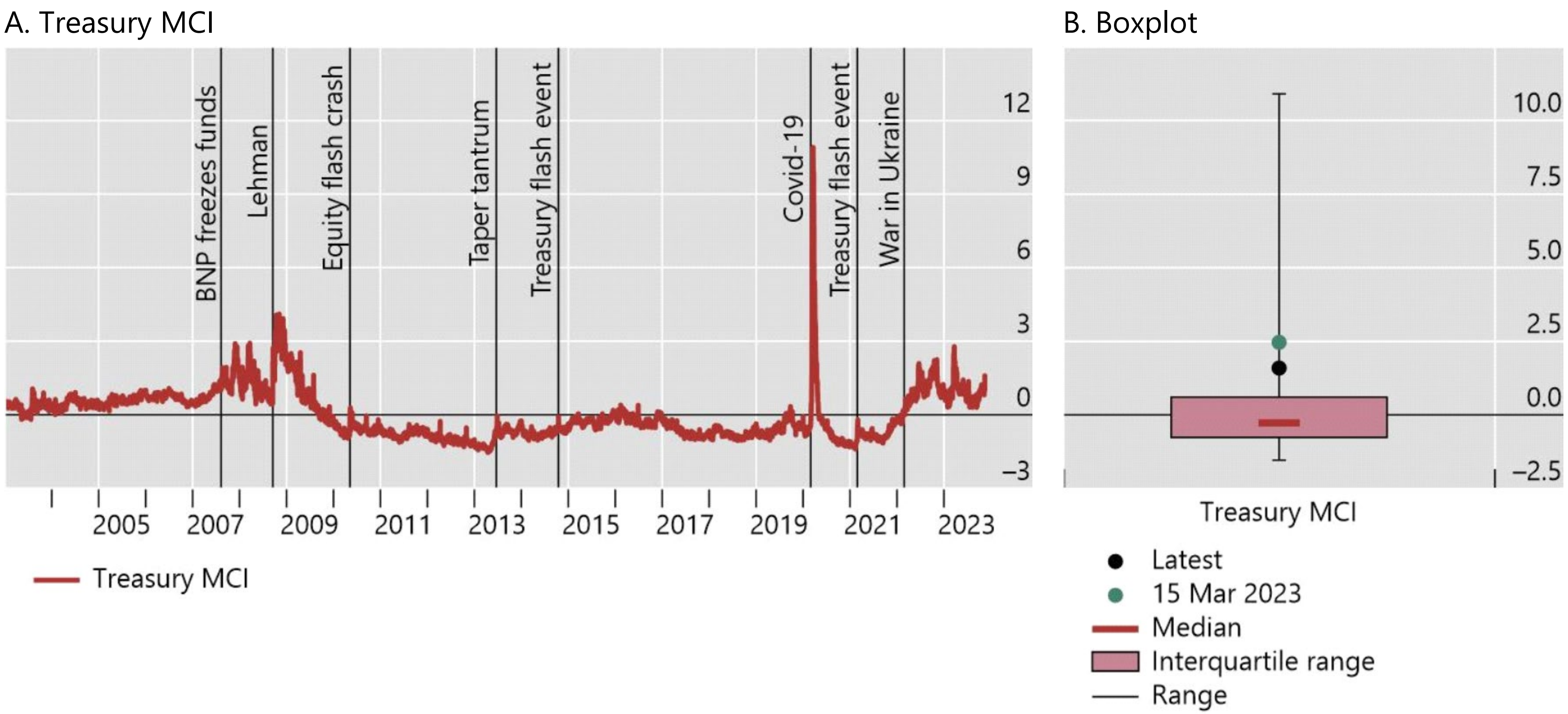
- Rebuilding a **term premium back into bond yields:**
  - Fiscal news: refunding announcement in August + the potential impact of wars on fiscal deficits
  - QT: shift in marginal buyers away from Fed requires change in price
    - Eren / Schrimpf / Xia (2023): around $600 bn reduction in the Fed balance sheet in 2023 -> approx. 28 bp rise in long-term bond yields
  - Stock-bond correlation flipping sign: Bonds less valuable as a hedge with more persistent inflation

- Important **spillovers** of shifts in US Treasury yields to markets around the globe

Treasury market stirred, but not shaken …

Market stress indicator: US Treasury market

In standard deviations



Sources: Aldasoro, Iñaki, Peter Hördahl, and Sonya Zhu. "Under pressure: market conditions and stress." (2022); BIS.

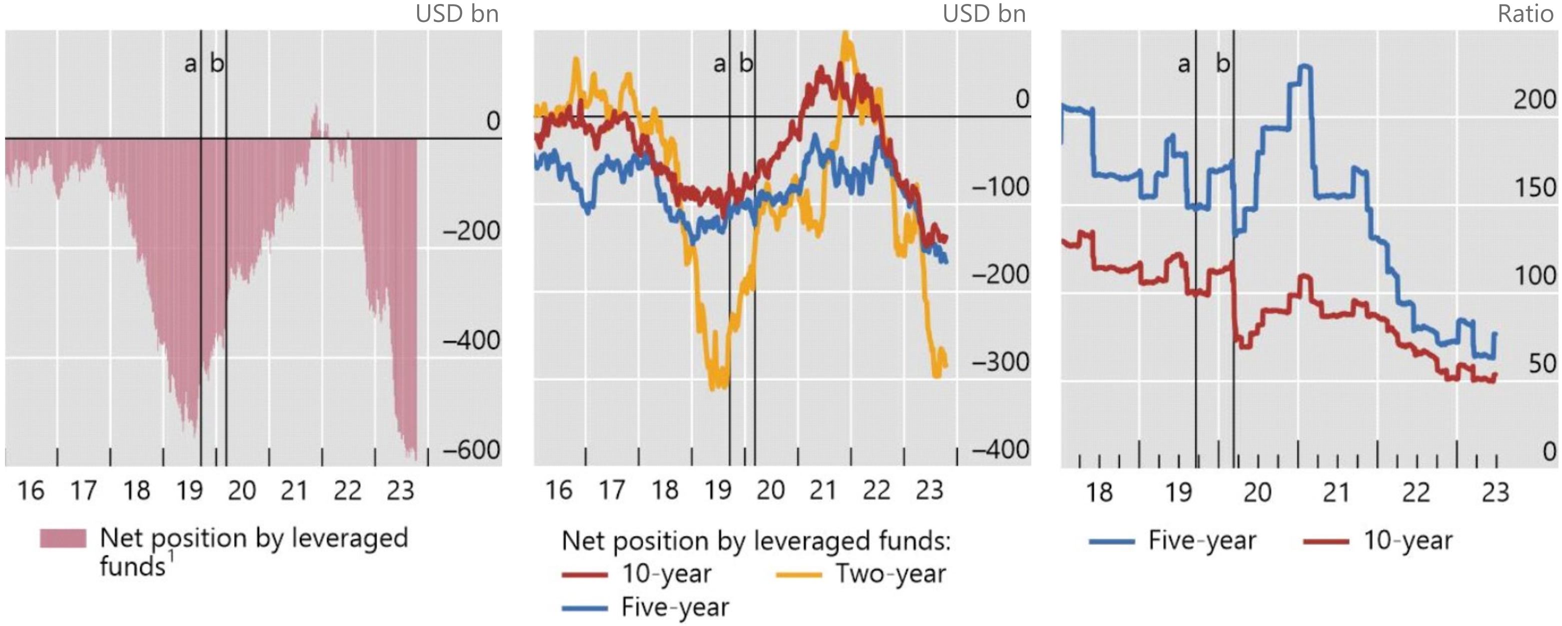
Hedge funds help smoothing the market absorption, but vulnerabilities remain

Speculative positions in US Treasury futures rose despite higher initial margins

A. Surge of leverage funds' net short positions in US Treasury futures…

B. …has been concentrated at the belly of the yield curve

C. Leverage declined sharply before distress in 2019 and 2020[2]



[a] Repo market stress (17 Sep 2019). [b] "Dash-for-cash" (9 Mar 2020).

[1] The sum of net positions in two-, five- and 10-year US Treasury futures. [2] Contract price over initial margin.

Sources: Commodity Futures Trading Commission; Bloomberg; Chicago Mercantile Exchange, BIS.

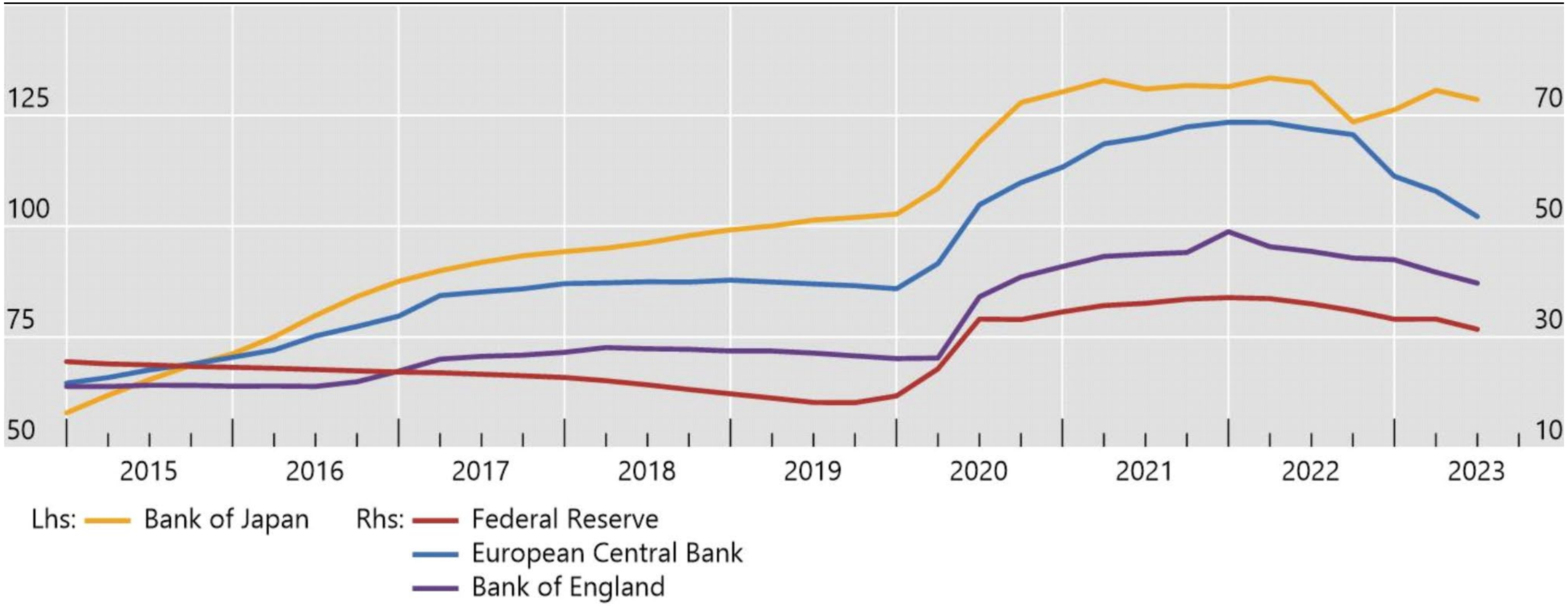
Avalos & Sushko (2023): Margin leverage and vulnerabilities in US Treasury futures, BIS Quarterly Review September 2023

- Appendix -

QT is on track …

Central bank assets

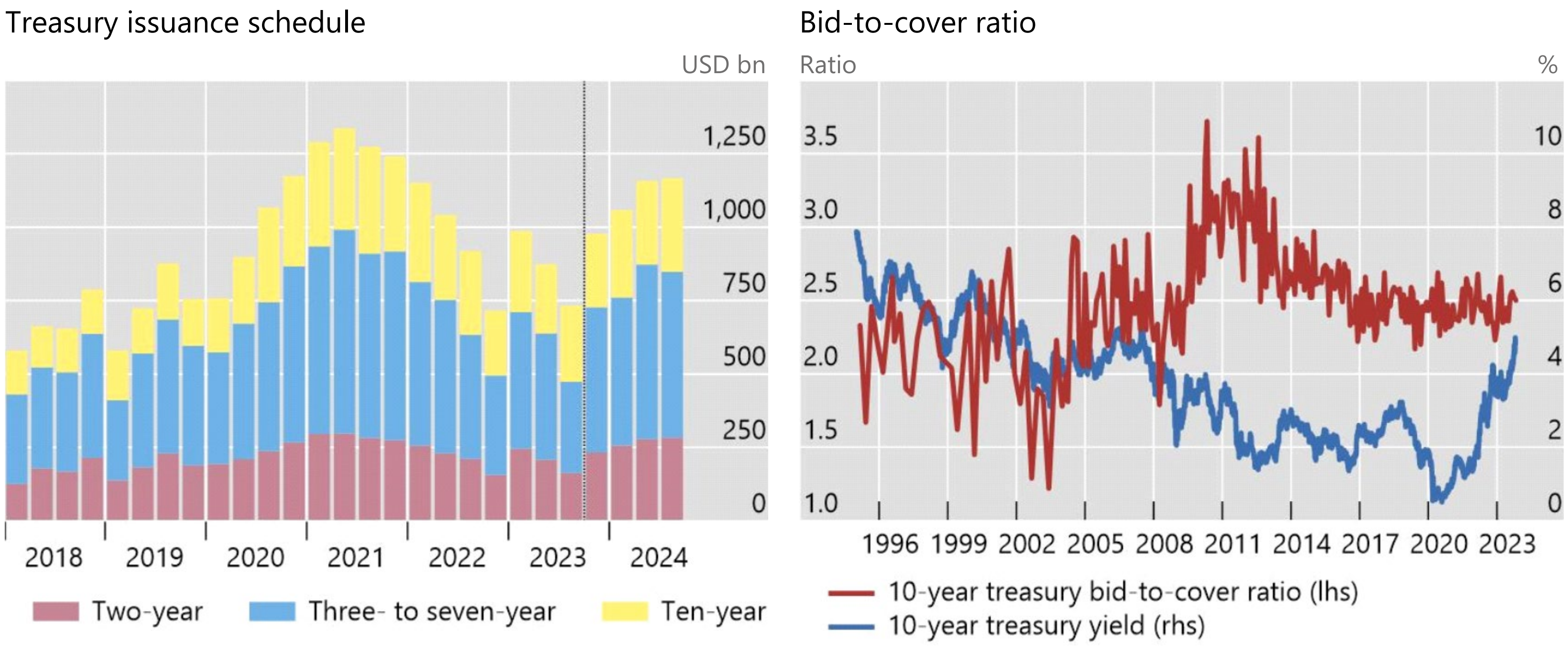
In per cent of GDP



Sources: national data; BIS.

Treasury issuance and bid-to-cover

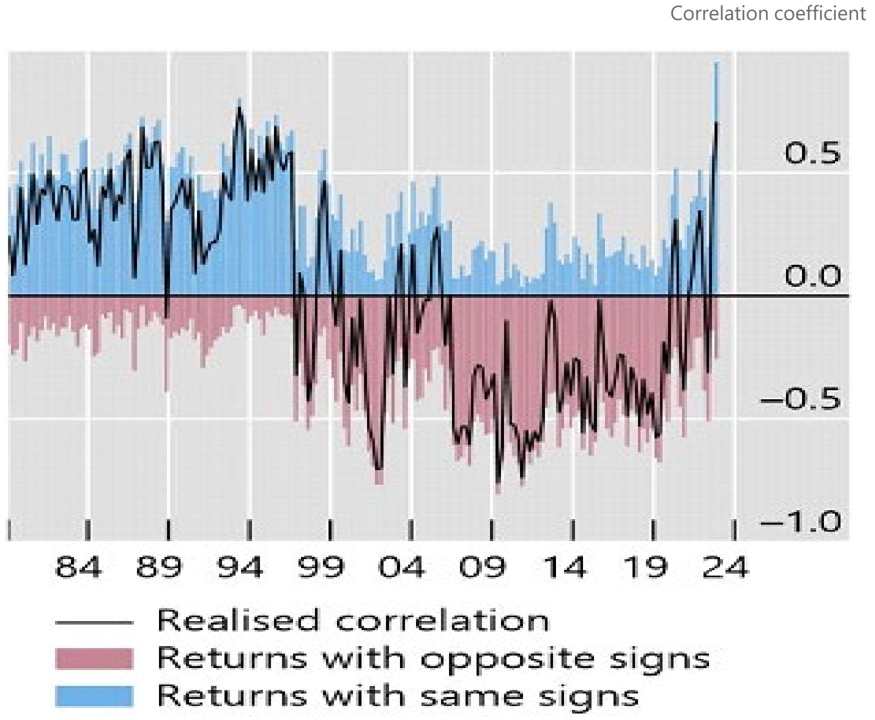
Treasury issuance and auction outcomes



Sources: Bloomberg; BIS.

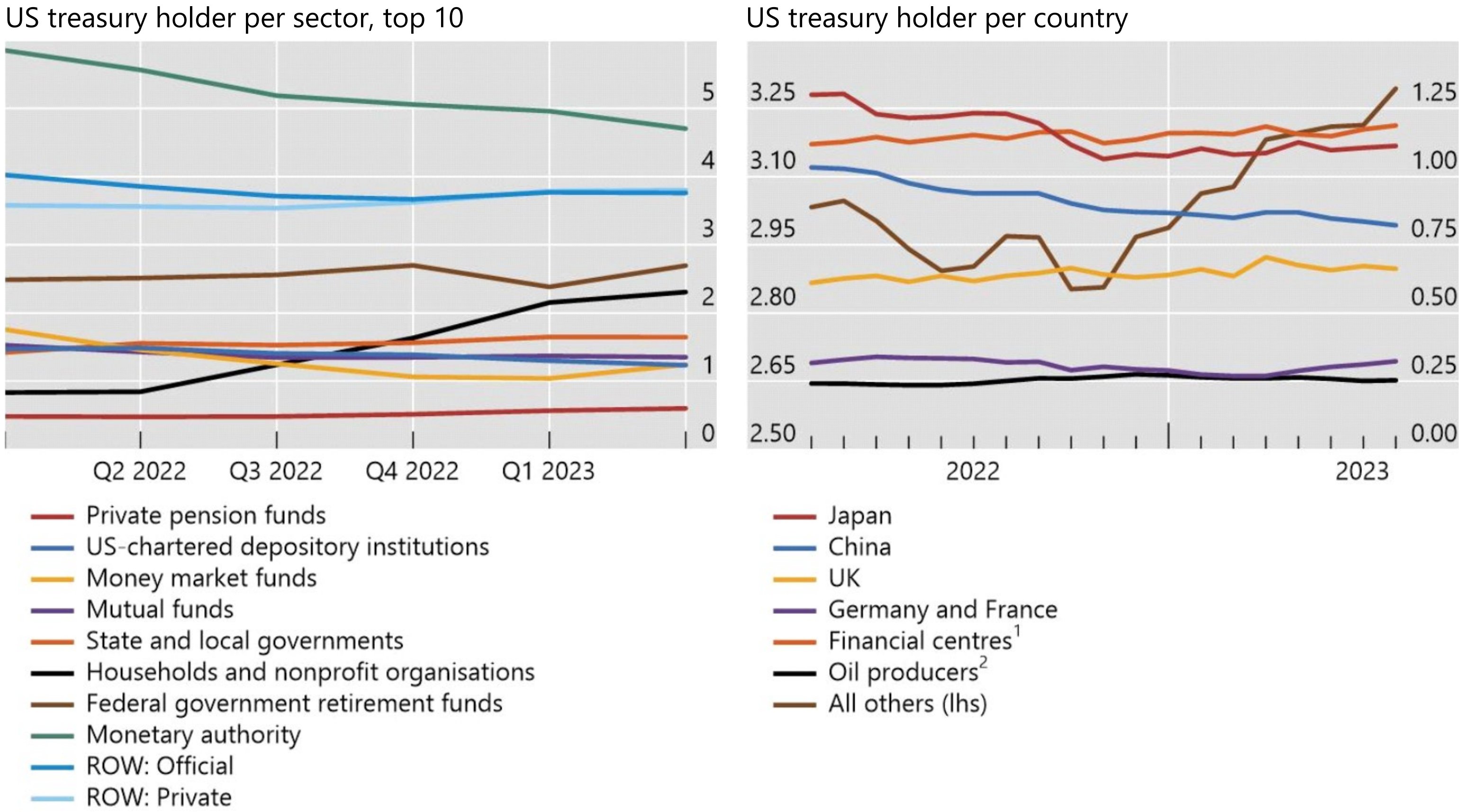
The stock-bond correlation has flipped sign …

- The stock-bond correlation has mostly been negative since the late 1990s but flipped sign
- Macro-environment and shift in inflation regime plays a key role
- Bonds no longer playing a hedging function
- Justifies a higher term premium



Holdings of US Treasuries by sector and by country

In USD trillions



Financial centres = BE, CH IR and KY. Oil producers = AE, DZ, GA, IQ, IR, KW, LY, NG, SA and VE.

Sources: Bloomberg; FRED; BIS.