Economics

DBS Flash

Tracking the universe of positive yielding bonds

Strategy/Rates

DBS Group Research

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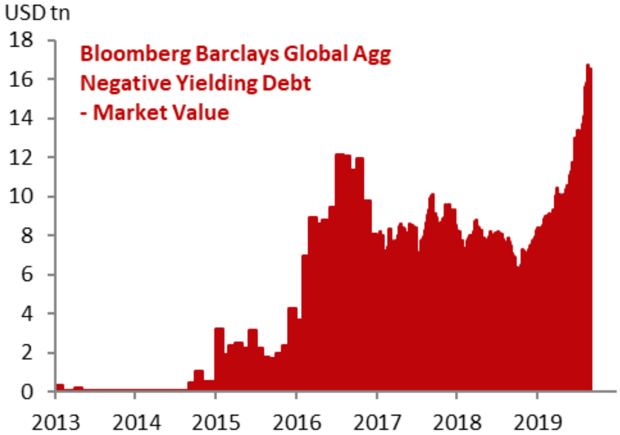
- *A striking rise in negative-yielding debt notwithstanding, there is no shortage of positive yielding hard currency debt globally.*
- *Of the total outstanding hard currency debt, more than 80% are yielding positive.*
- *61% of global hard currency debt are issued in USD; that's where most of the positive yielding securities reside.*
- *But at the same time, USD-hedging costs are prohibitively expensive.*
- *However, if the US Fed cuts rates more than global central banks (markets are pricing for it), USD-hedging costs will come down eventually.*
- ***Implications for investors** – Go to the US if you need positive yields.*

Stock of negative-yielding global bonds has almost doubled in 2019

This year, global bond yields have gone in one direction - down. Week after week, the yields on more and more bonds cross below zero. Referencing the Bloomberg Barclays Global Aggregate Bond Index, the stock of negative-yielding debt has risen from USD8.3tn at end-2018 to USD16.2tn today. This has important implications for global investor behaviour. In their attempt to lock in some level of acceptable positive yields, investors have kept taking on more risks by extending duration and moving down the credit curve. A question of interest then, where can we still find positive yields?

Global negative-yielding debt at a record high and still climbing.



Source: Bloomberg

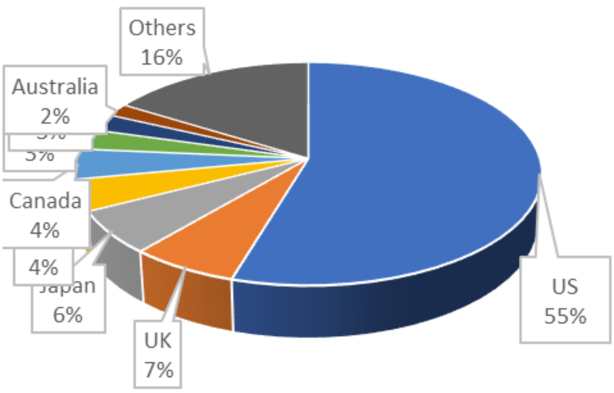
Finding positive yields

As per BIS's latest estimated, of the total outstanding hard currency debt in the world, more than 80% are yielding positive. 61% of global hard currency debt are issued in USD;

that's where most of the positive yielding securities reside.

Looking at the Bloomberg Barclays Global Aggregate Bond Index, we see that USD39.9tn of positive-yielding bonds are outstanding. The breakdown by country is probably not much of a surprise. In top place, USD21.8tn or 55% of positive-yielding bonds are in the US. UK comes far behind in 2nd place with USD2.6tn or 7% of positive-yielding bonds. In descending order, Japan, Italy, Canada, China, France and Australia take up 3rd to 8th place. Calculating average yields weighted by bond values, the US comes in 2nd with 2.12%, losing out only to China (3.10%).

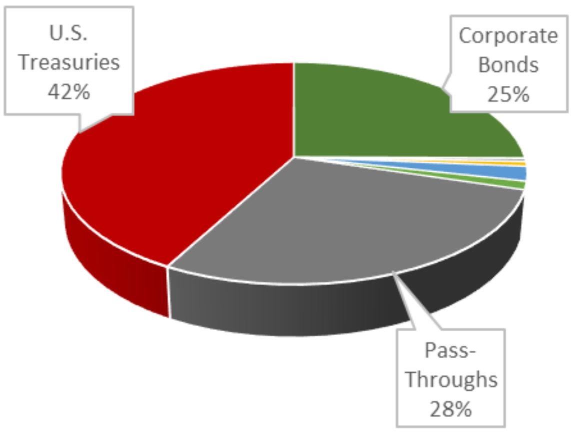
Positive-Yielding Global Bonds



Country	Average Yields
China	3.10
US	2.12
Others	2.03
Canada	2.00
Australia	1.29
UK	1.24
Italy	1.10
France	0.91
Japan	0.32

For US bonds offering a positive yield, US Treasuries and Corporate Bonds take up a combined 77%.

Positive-Yielding US Bonds

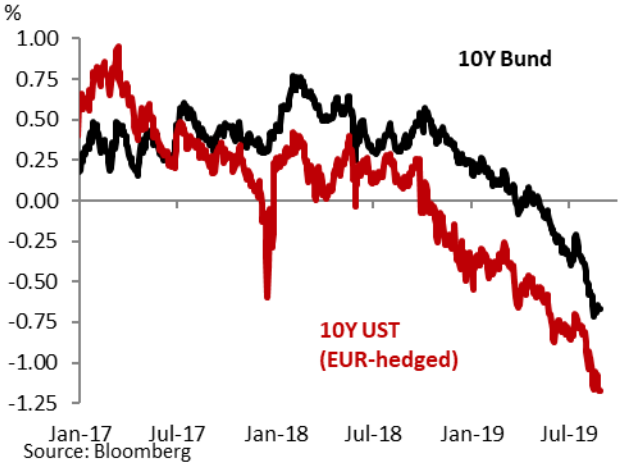


Positive yields are concentrated in the US

Much of the world's attractive yields are concentrated in the US. This may not be much of a worry considering that US growth is holding up much better relative to rest of the world and US consumer and corporate credit fundamentals are decent. A bigger problem for fixed income investors with global portfolios is probably a currency one. With much of the world's attractive yields denominated in USD, it may be difficult to achieve meaningful diversification of currency exposures.

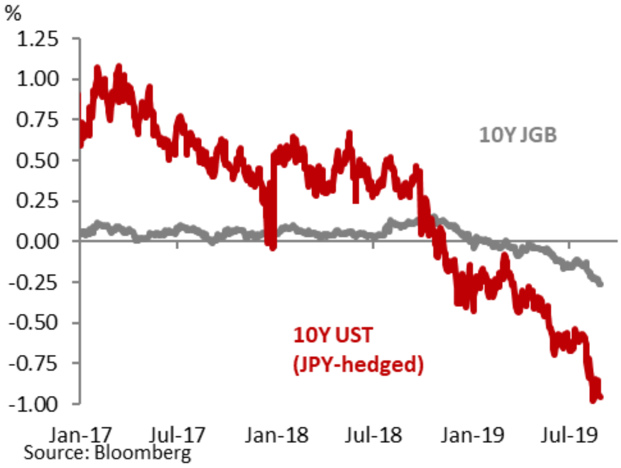
Perhaps then, foreigners should buy a lot of US fixed income and swap back to their base currencies to avoid currency risks? That's however challenging economically. The US Fed's 225bps of rate hike between 2015 and 2018 have driven up short-term US rates, making USD-hedging costs prohibitively expensive. At present, 10Y US Treasury swapped back to EUR offers 51bps less in yields vs 10Y German Bunds. Similarly, 10Y US Treasury swapped back to JPY offers 70bps less in yields vs 10Y Japan Government Bonds.

For European investors, FX-hedging of US Treasury purchases is prohibitively expensive…



Source: Bloomberg

…same for Japanese investors.

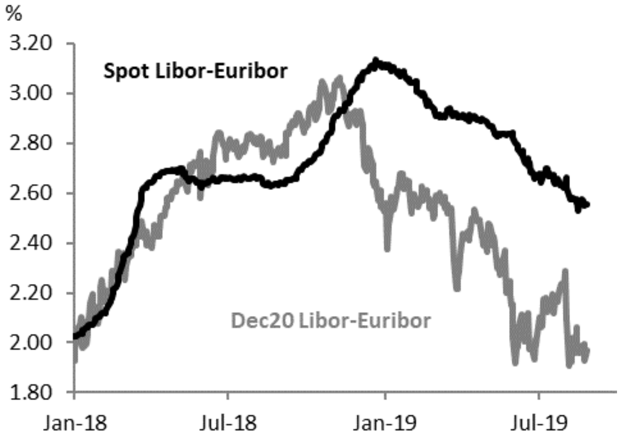


Source: Bloomberg

These realities have likely forced foreigners to reduce currency-hedge ratios on their purchases of US fixed income (i.e. more exposed to translation losses if USD weakens).

Things could however improve in the quarters ahead. If the US Fed cuts rates more than global central banks (markets are pricing for it), USD-hedging costs will come down eventually.

Markets are pricing Libor-Euribor spread to compress 60bps between today and end-2020.



Source: Bloomberg

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).