FTfm US Treasury Bonds

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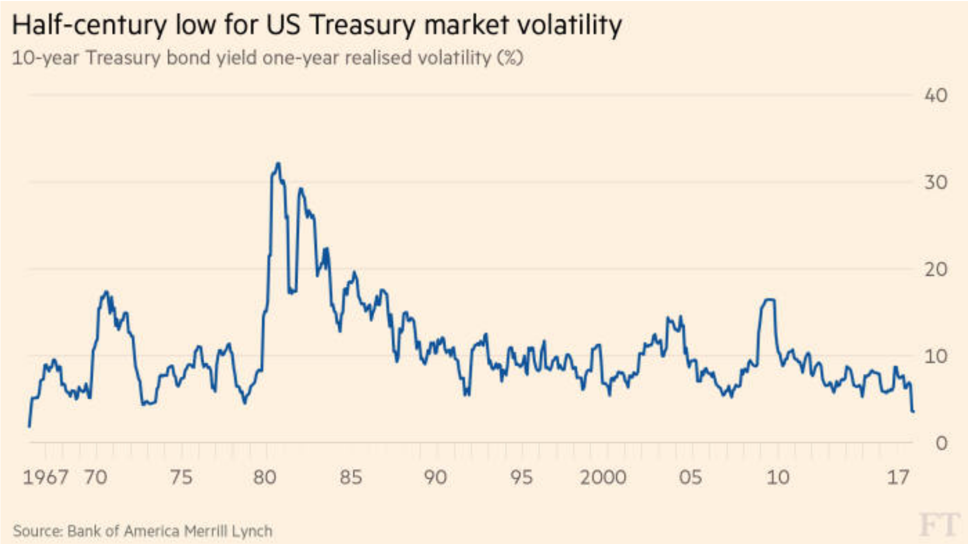
Warning signs emerge for US Treasury market

Bond yields are close to breaking what had been a steady downward trend



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7 HOURS AGO

US Treasury bond market volatility has declined to a remarkably subdued level, sinking to its lowest in more than half a century in spite of the Federal Reserve's clear signal that it expects to raise interest rates further in 2018.

The decline mirrors similar developments in the US equity market where volatility has also sunk to its lowest level since the 1960s.

It seems highly improbable, however, that such serene conditions will persist throughout this year.

The 10-year Treasury yield has trended down steadily since the early 1980s but the long bull run for US bonds is showing signs of nearing a turning point. Bond yields have moved up since President Donald Trump's plan to reduce taxes was passed by Congress last month and are close to breaking what had been a steady downward trend. This would be a profoundly important moment for asset markets because the 10-year Treasury yield plays a critical role in setting the notional "risk-free rate" in financial transactions globally.

Further increases in US interest rates and the gradual withdrawal of quantitative easing by the US central bank is likely to lead to more upwards pressure on government bond yields.

JPMorgan forecasts that the US 10-year bond yield will rise from its current level of 2.45 per cent to 2.7 per cent by the end of 2018.

It warns that US Treasuries are likely to deliver negative returns of 0.1 per cent this year with weaker performances expected from government bond markets in Germany (-2 per cent) and Japan (-4 per cent).

JPMorgan also forecasts that corporate bond markets in the US and Europe will deliver returns in 2018 that are lower than last year and also below their long-term average.

It expects US investment grade and high-yield bonds to deliver returns of 2 per cent and 5.5 per cent respectively.

Emerging-market bond markets denominated in local currencies are expected to hold up better with returns of about 7 per cent, down from 12 per cent in 2017.