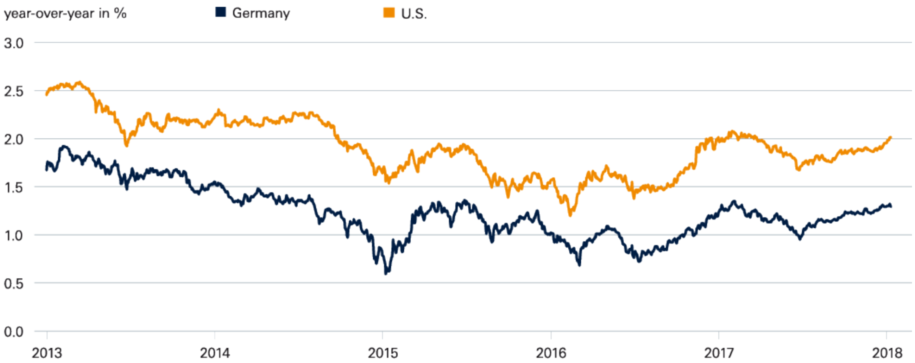
Chart of the week

What is behind recent bond market agitation? One thing worth keeping an eye on: inflation expectations.

In recent days, there has been plenty of market chatter that the long bull market in government bonds might, finally, end. For more than 35 years, sovereign bonds, such as U.S. Treasuries or German Bunds have delivered outstanding returns. Thanks to declining inflation rates, bond yields steadily fell. And when yields fall, bond prices go up, especially for long maturities. At least for a decade, pessimists feared that the good times could not last. Eventually, yields would rise. And there are good reasons to think we might be near the inflection point. Following recent U.S. tax cuts, much attention has focused on rising bond issuance and signs of diminishing interest by Chinese authorities. Then, there are lingering concerns about shrinking support from unconventional monetary policies. However, there is a third factor that has been receiving less attention. For almost two years, break even inflation rates, as derived from inflation linked securities, have been rising in both Germany and the U.S. The increases have been moderate, but fairly steady, as our Chart of the Week shows.

Break even inflation rates, as derived from inflation linked securities.



Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH as of 1/5/18

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