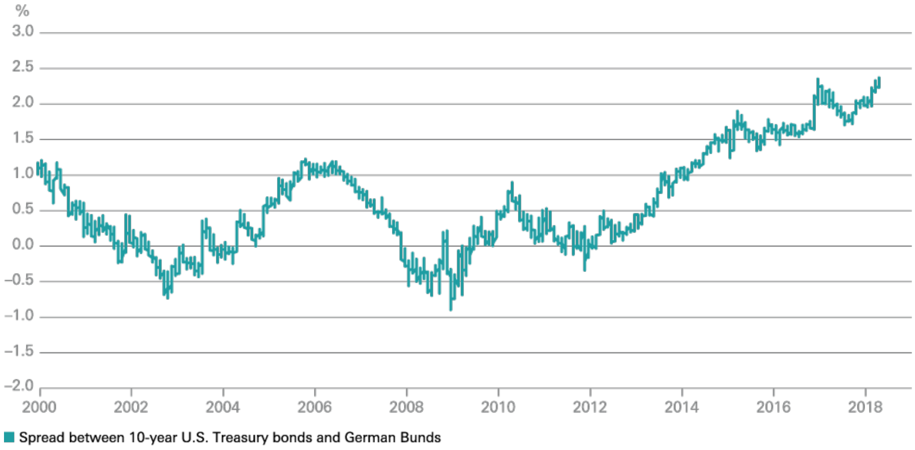
Chart of the week

The gap in yields on 10-year U.S. Treasury bonds and German Bunds has widened to almost 2.4 percentage points, the highest it has been since 1989.

In late April, U.S. yields rose, and the bond market has reached several interesting marks. For one thing, 10-year U.S. Treasury bond yields finally traded above 3%. Pundits were quick to point out that except for a couple of trading days around New Year's Eve of 2013, this hasn’t been the case since July 2011. Another "we haven’t traded at that level since" indicator concerned the steepness (or shall we say flatness) of the yield curve: The difference between 2-year and 10-year Treasury yields declined to 43 basis points, which is the flattest reading since September 2007. An even more remarkable reading could be observed in the spread between 10-year U.S. and German sovereign bond yields: At a level of almost 2.4 percentage points, one has to go back to 1989 to find a similar yield difference, as outlined in our "Chart of the Week".

According to Torsten Strohrmann, head of global rates EMEA at DWS, this reflects a variety of reasons. 1. A different stage in the monetary policy cycle. 2. Moreover, fiscal policy is on a diverging path: While European governments, not least due to the bad experience during the Euro crisis, have cut their deficits, the shortfall in U.S. public sector finances keeps rising. Over the medium term, higher public financing is likely to drive Treasury yields further upwards. 3. Finally, economists have become more optimistic on the prospects for economic growth in the U.S., and a little more cautious in Europe.

In itself, the transatlantic rate differential is nothing new. The gap between U.S. Treasury bonds and German Bunds has been widening for almost 10 years. Over the past year, this has done little to boost the dollar in foreign exchange markets. But for the last 10 days or so, the dollar has been making up lost ground against the euro. It is now trading at the highest level since mid-January. We believe that the greenback has gotten over its prolonged weakness, and would not be surprised if it continues to strengthen. Strategically, we expect the dollar to trade at 1.15 against the euro on a 12-month time horizon.



Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH as of 4/26/18

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Glossary

Fiscal policy

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

Greenback

Greenback is a commonly used expression for the U.S. dollar.

Monetary policy

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Sovereign bonds

Sovereign bonds are bonds issued by governments.

Spread

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Yield curve

A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

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