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MARKETS

Negative Bond Yields Recede in Europe

Behind the rise in yields is a bet that the European Central Bank will have to raise interest rates sooner than it wants



The European Central Bank is unlikely to raise interest rates next year, according to its president, Christine Lagarde.

PHOTO: RONALD WITTEK/SHUTTERSTOCK

By *Patricia Kowsmann*

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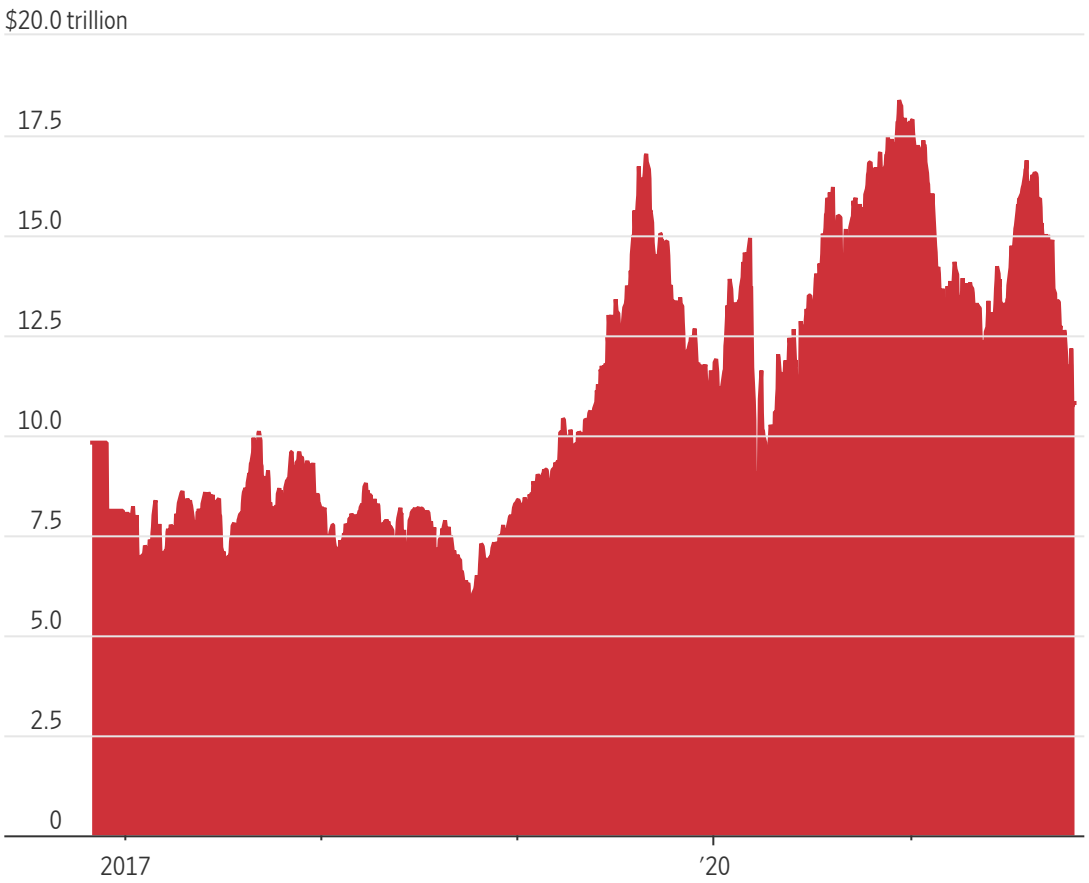
Negative bond yields are getting harder to find in Europe, shrinking the pool of debt that pays back less to investors than they put in.

French, Irish, Dutch and Swiss yields have all either turned positive or flirted with the line in recent weeks and months. German 10-year bond yields, the region's benchmark, are still negative, but rose as high as negative 0.07% this week, the closest they have come to turning positive since April 2019.

The moves have helped shrink the total stock of negative-yielding debt to $10.7 trillion this week, down from a peak of $18 trillion last December, according to a Bloomberg Barclays index. In addition to the eurozone, Switzerland and Japan are other economies with negative rates.

Total amount of negative-yielding debt globally



Source: Bloomberg Barclays index via FactSet

Behind the rise in yields is a bet that the European Central Bank will have to raise interest rates sooner than it wants. Inflation across Europe has hit multiyear highs during the coronavirus pandemic, driven by booming demand and supply-chain bottlenecks as economies reopen.

"Investors are clearly factoring in expectations of a rate hike sooner than expected," said Jens Peter Sorensen, chief analyst at Denmark's Danske Bank.

Other countries in Europe, including Norway and Poland, have already raised rates. In the U.S., the U.K. and Canada, where inflation is also rising, central banks signaled interest-rate increases are likely in 2022. In the U.K. it could come as early as Thursday.

In the eurozone, ECB President Christine Lagarde last week dismissed making a move next year, betting prices will fall again once the effects of the pandemic subside. Interest rates have been negative in the eurozone since 2014.

Investors seem to be ignoring her warning, selling off government bonds and pushing yields higher.

A market-based measure known as eurozone overnight index swaps shows investors expect the ECB to raise rates at least once in the next 12 months from the current level of minus 0.5%.

To be sure, bond yields in the past couple of days have reversed some of their march higher, dragged down by fears over the economy. Dutch 10-year yields, for instance, flipped from positive back to negative on Tuesday.

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Do you think Europe's experiment with negative rates is coming to an end? If so, what will be the impact? Join the conversation below.

Even if the ECB doesn't raise rates, bond yields could still continue to rise because of other measures it is likely to take, said David Zahn, head of European fixed income at Franklin Templeton. Like the Federal Reserve, Ms. Lagarde said, the ECB will soon end its emergency bond-buying program, although it is expected to ramp up other bond purchases. Fewer purchases by the central banks will put pressure on yields.

"The Fed tapering combined with the ECB tapering actually means that we have a huge amount of bond purchases removed from the bond market by say June of next year," Mr. Zahn said. "You are going to see an upward rise in yields, not a lot, but some," he added.

One big beneficiary of the rise in borrowing costs is banks. They rake in more profits from lending at a higher rate while deposit rates remain ultra low.

That has helped power a surge in share prices of European banks. France's Société Générale SA, for instance, is up 141% from a year ago, with half of that percentage gain coming this year, a performance on par with stock market phenomenon Tesla Inc.

Deutsche Bank AG Chief Financial Officer James von Moltke said last week that as markets assume lending-rate rises, the bank estimates $150 million more in revenue next year than what it estimated a year ago.

That said, he is closely watching inflation impacts on costs, in particular related to salaries. "We need to work to offset," he said on a conference call.

A labor union representing workers at public-sector banks in Germany has already been calling for salary increases to counter inflation, which surged 4.6% in October, well above a target of 2%.

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