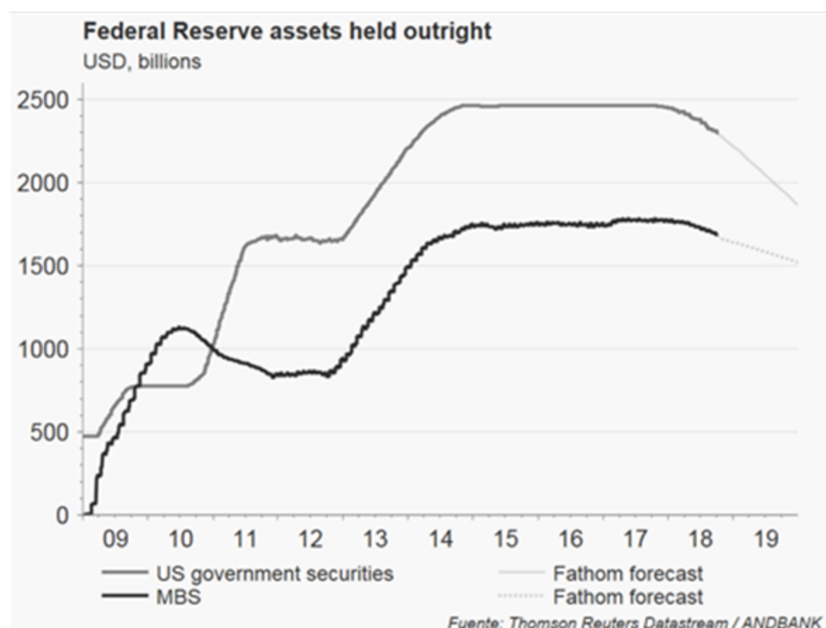
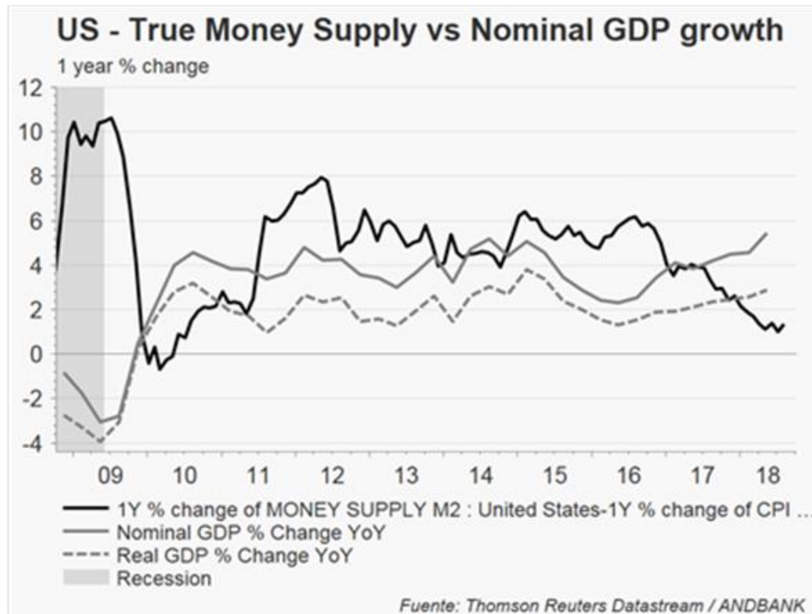
Flash Note 10/10/2018

Alex Fusté
@AlexFusteAlex
alex.fuste@andbank.com

Understanding the factors that lie behind the recent rise in yields. What's next

1. The Fed is shrinking its balance sheet, and has sold almost 200bn of US government securities (see chart one) just in a moment of rising deficit (and issuance of new bonds). More bonds have to be absorbed by the market.
2. At the same time, the Fed is offering much less money supply than the economy is demanding – approximated by the % change in nominal and real GDP) -see chart two-, meaning that companies and households are forced to sell their assets (mainly bonds) in the market to face their higher working capital requirements (which grow in line with nominal GDP)
3. The result is an inevitable rise in yields. The fortune of bond yields will depend on how aggressive the Fed is on both fronts.
4. There are factors that can offset these two drivers that push yields upwards, and could prevent us from additional increases:
    a. A drop in the price of crude oil, which would free up a lot of global liquidity that would probably be channeled into bond demand.
    b. A recovery in global trade, which would increase the volume of international reserves in foreign central banks, leading to an increase in the demand for Treasuries.
    c. A relaxation in the economic data in the USA that would reduce the need for working capital (and the need for selling bonds).





Best regards

Av. Brig. Faria Lima, 2179 | 9° andar
01452-000 | São Paulo | SP
Tel: +55 11 3095-7070
Fax: +55 11 3095-7071
www.andbank.com.br

Ouvidoria: 0800 600 16 77 | ouvidoria@andbank-lla.com.br