



This is the third note in our series to explain the drivers of the global bond yields. Please see the links below for the previous versions ([Monitor 1 in April 2021](#); [Monitor 2 in October 2021](#); and [Global Financial Stability Note](#) detailing the methodologies)

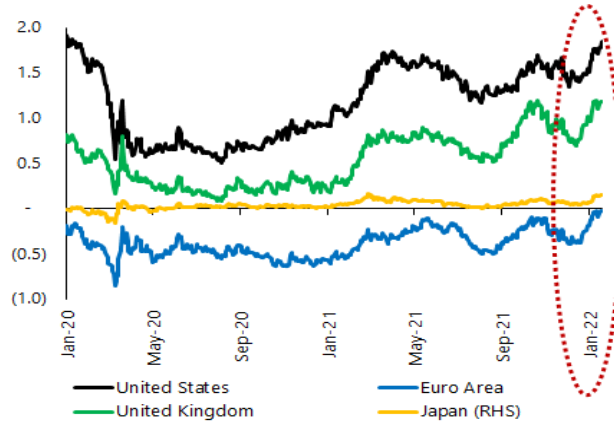
GLOBAL RATES HAVE RISEN SHARPLY IN 2022

- Global nominal bond yields have increased significantly this year, with US and EUR 10-year yields rising by ~30 basis points and ~15 basis points, respectively, since December 31, 2021. The current level of long-term yields is almost back to pre-pandemic levels. This upward move has been driven predominantly by a rise in real yields across most regions and tenors. However, despite this rebound, real yields remain deeply negative and are expected to remain so in most jurisdictions.
- The level of real rates reached over the last few days is now partially offsetting the decline over the latter half of last year. Nevertheless, the decomposition back to January 2020 shows that breakevens remain the main driver of nominal rates counteracting the lower real yields.
- The underlying drivers of recent yield dynamics described above have been (i) higher expected policy rates – as reflected by the risk-neutral yield – in conjunction with (ii) higher term premia, at both 5y and 5y5y tenors. Specifically, the US risk-neutral yield has risen sharply in the last few months, especially for the near-term, reflecting a repricing of market expectations of faster Fed rate hikes, with the first move fully priced in for March 2022. Increase in term premia, on the other hand, can essentially be seen as a consequence of asset purchase tapering and balance sheet run-off expectations. More broadly, market-implied policy curves across most regions have increased, but the longer-term path remains shallow, as medium-term expectations of policy rates have not changed meaningfully.
- While central banks are at a different stage in their monetary policy tightening cycle, global rates have moved in sync in advanced economies (AEs), highlighting greater cross-border spillovers amid global concern about inflation. Yield curves for major AEs have become highly correlated at both short as well as long tenors in the last few months – reflecting market pricing of faster rate hikes across countries (admittedly at varying pace, however).
- Prevalence of inflation pressures are also reflected in continued fund flows towards inflation protected securities – notwithstanding the recent stabilization. This is also visible in probability of ‘high’ inflation outcomes (derived from inflation caps and floors), which remains elevated by historical standards.

What has been driving the global bond yields

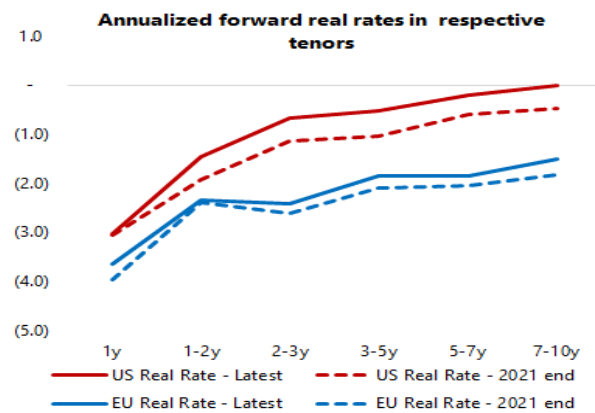
Global bond yields have risen sharply this year, reaching the pre-pandemic levels....

Chart 1. Global Nominal Bond Yields



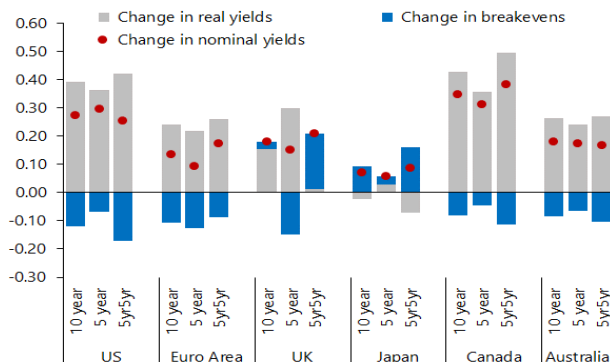
....mainly driven by a sharp move in real rates, even though real rates remain deeply negative.

Chart 2. Real Yields (percent)



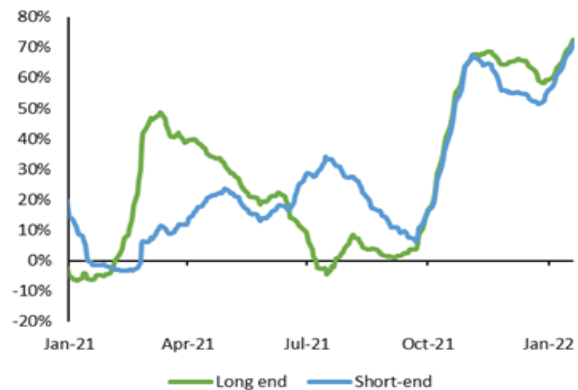
Rise in bond yields YTD are predominantly driven by a rise in the real yields across most regions and tenors

Chart 3. Decomposition of the change in global nominal bond yields – in 2022 (basis points)



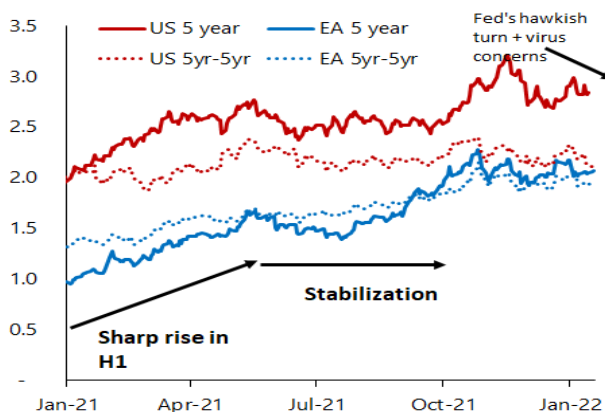
Advanced economy bond yields have become more correlated across both short and long end

Chart 4. Average pairwise Correlation between 2year and 10year bond yields (Percent; for G4 economies)



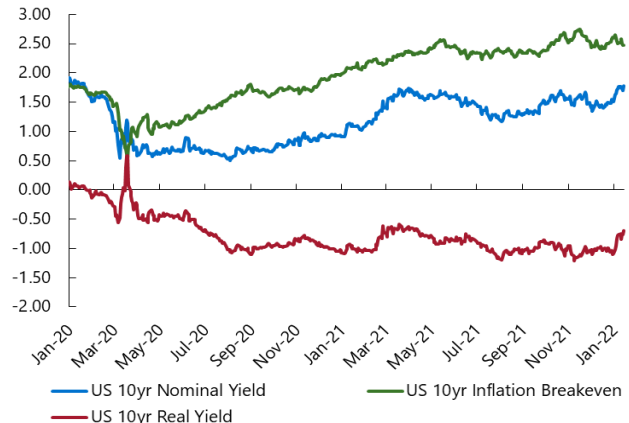
Near-term inflation expectations declined as a result of the central banks hawkish turn, and global growth concerns, but remain higher when compared to Sept-end levels

Chart 5. Inflation breakevens (percent)



The decomposition of the US 10-year yield shows that the inflation breakeven remains the main driver, particularly compared to the pre-pandemic level – offsetting the decline in real yields

Chart 6. Decomposition of the US 10 year nominal bond yield.



Sharp repricing of market rates expectations

The US risk-neutral yield has risen sharply in the last few months, especially in the near-term, reflecting market expectations of faster rate hikes. The latest sell-off is also driven by a rise in term premia at both 5y and 5y5y tenors.

Chart 7. Cumulative change in drivers of US 5 year nominal yields (ppts)

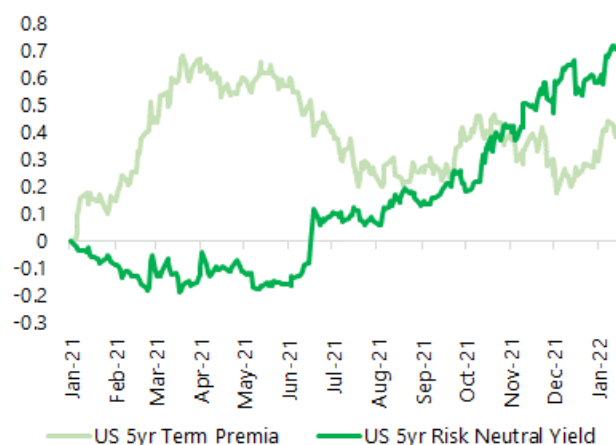
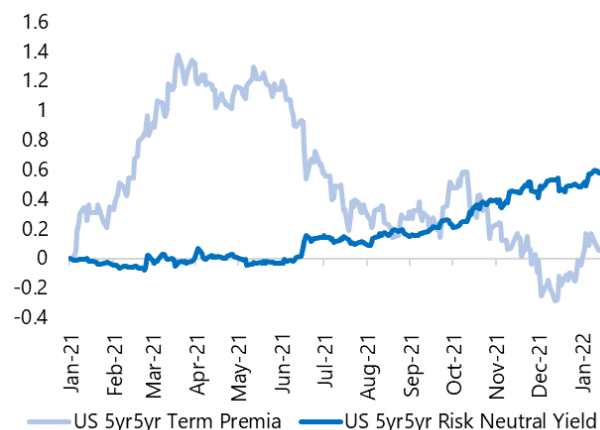
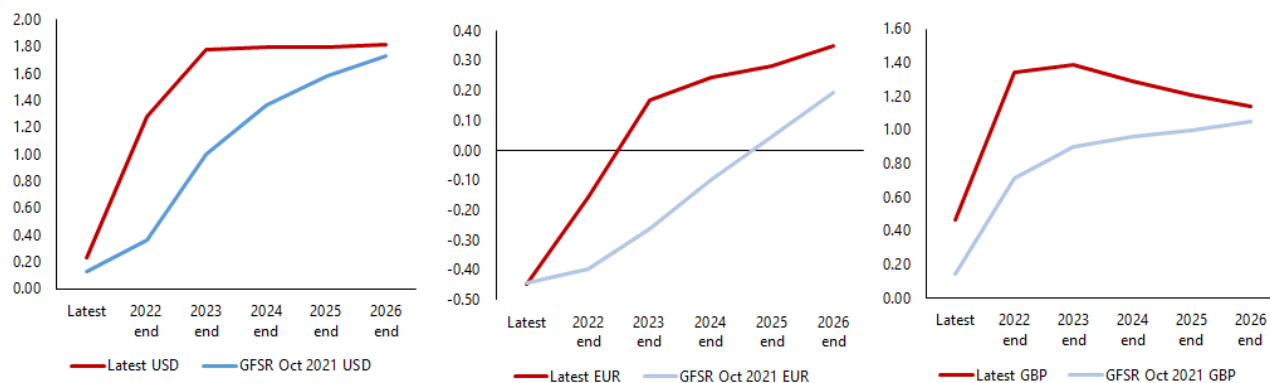


Chart 8. Cumulative change in drivers of US 5y5y year nominal yields (ppts)



While market expectations of rate hikes have substantially risen across regions, the long-term path remains shallow given medium-term expectations of policy rates have remained broadly unchanged.

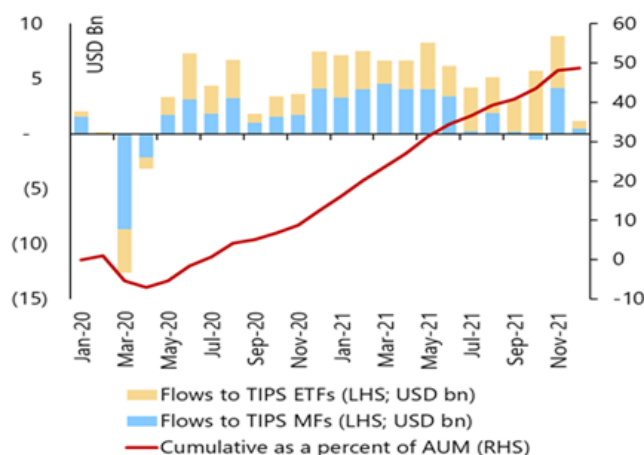
Chart 9. Market implied policy rates (from OIS curves) – Percent (US, Euro Area and UK)



Alternate ways of looking at market-implied measures of inflation pressures

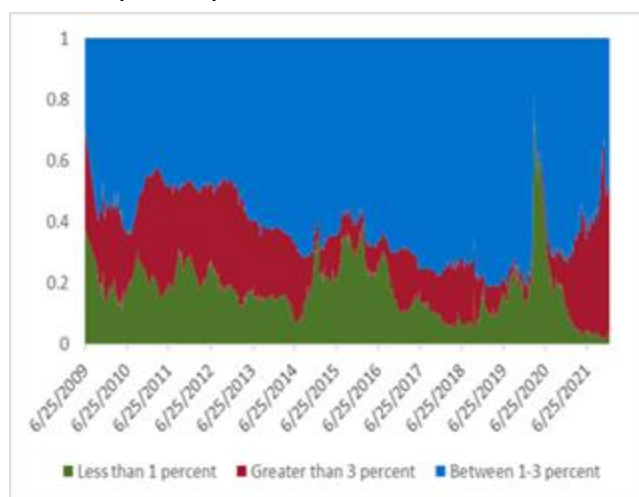
Flows to TIPS funds declined in December, but have remained positive for every single month since the pandemic

Chart 10. Monthly fund flows to TIPS (USD bn)



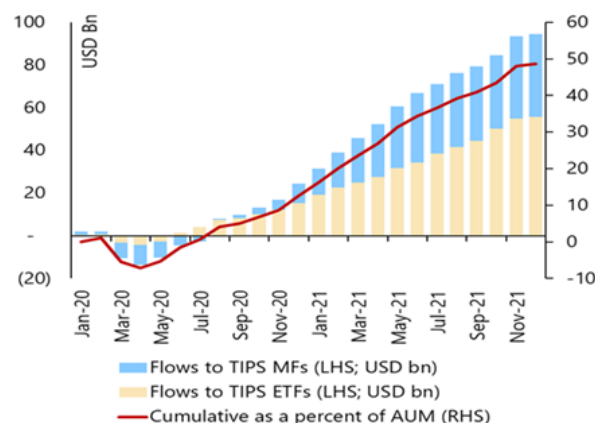
Risks to the inflation remain skewed to the upside in the US despite the recent decline, as the probability of high inflation remains elevated by historical standards

Chart 12. Probability of Inflation being in various regimes for the US (Percent)



Cumulative fund flows have reached towards \$100bn, which is equivalent to almost 50 percent of the total pre-pandemic AUMs for these funds

Chart 11. Cumulative fund flows to TIPS, since Jan 2020 (USD bn)



Notwithstanding the recent decline, upside risks to inflation have risen across major AEs in the last 3 months, with the move particularly pronounced for the EA and UK area

Chart 13. Probability of Inflation being in various regimes across major AEs (Percent)

