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Falling bond yields save taxpayers $500bn

Eric Platt in New York

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The collapse in sovereign bond yields has saved taxpayers more than $500bn in annual interest expenses, allowing countries to rein in budget deficits and continue government-backed programmes that would have otherwise been shelved, according to a new report.

Stimulus from the European Central Bank and Bank of Japan has unleashed a rally across fixed income markets, with nearly $13.2tn of debt trading with a yield below zero at the end of last week. Japan, France, Germany and Switzerland are now paid to issue short-dated sovereign bonds.

"Benefits have effectively been transferred from global investors to sovereign issuers, as sovereign borrowing costs have dropped," said Robert Grossman, an analyst with rating agency Fitch. "Should rates remain low for an extended period, it would likely erode earnings power for many large investment institutions and pension funds."

The drop in borrowing costs, spread throughout developed and emerging markets, has also squeezed investor income, an analysis of 34 countries with $38tn of debt by Fitch shows.

The report compared average yields for the 34 countries in July to the yield on similar bonds in 2011, when investors were consumed by fears of a debt crisis in Europe. The median 10-year government bond now yields 1.17 per cent, down from 3.87 per cent five years ago. Japan has saved more than $95bn a year as a result of the decline in rates, while the US, UK and Germany collectively pay $104bn less annually, the study estimates.

Fitch notes that the effects materialise as higher coupon bonds mature and are refinanced with low or negative yields.

"Governments are taking advantage of very low interest rates and very easy financing conditions to lock in debt at these historic low rates," said David Tan, head of the global rates team at JPMorgan Asset Management. "Central banks are doing their bit to stimulate their economies . . . not just in Europe or Japan, but across a whole range of countries."

Central banks have cut interest rates more than 670 times since Lehman Brothers filed for bankruptcy in 2008, or roughly one reduction every three trading days of the year, according to JPMorgan. The Bank of Japan and the European Central Bank have both cut interest rates into negative territory.

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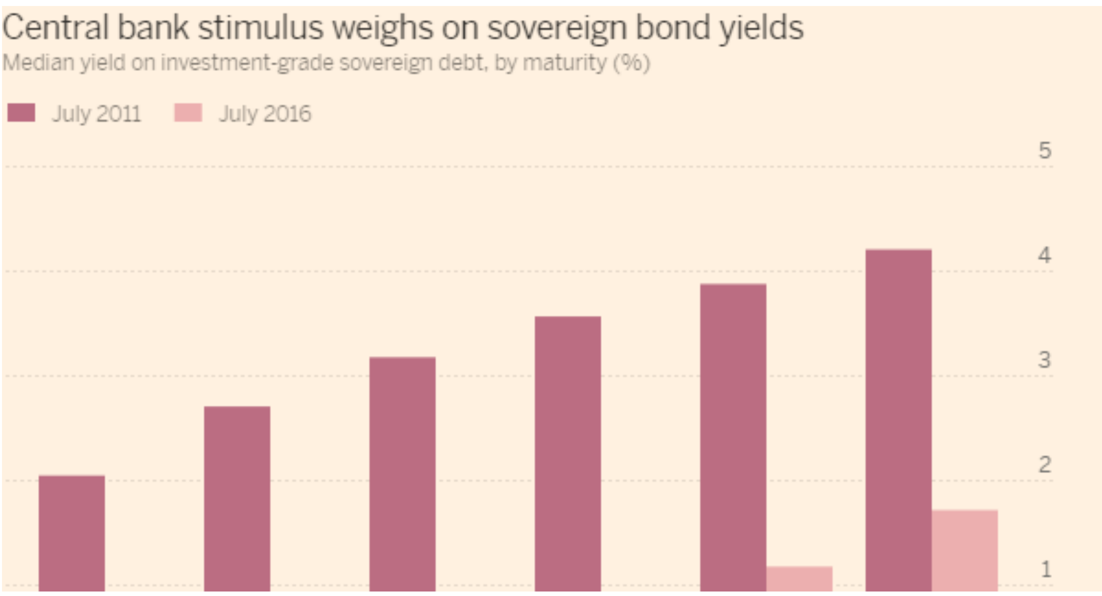
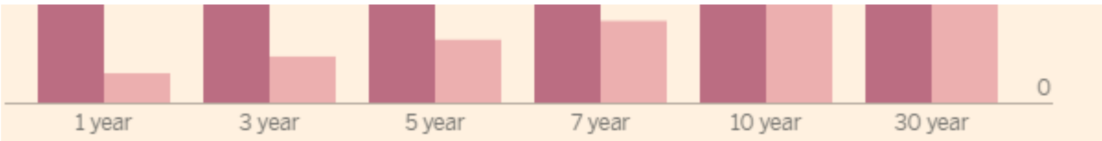
Concern that central banks' policies are reaching the limits of their effectiveness in stimulating economies is shifting the focus on to whether governments will take advantage of the record low borrowing costs to provide a fiscal stimulus.

Some sovereign borrowers have raced to lock in lower borrowing costs, with both France and Spain issuing 50-year debt.

While fixed income markets have rallied this year — bond prices rise as yields fall — investors have been concerned by mounting risks. Lower rates have added stresses to pension funds and to the retail investors readying for retirement in search of stable and safe income streams, often in the form of government bonds.

Vinay Pande, a managing director with UBS Wealth Management, said the drop had made "the present value of our future liabilities much higher".





Fitch included 34 countries with more than $50bn of debt in its analysis

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