Charts that Matter Bunds

German bonds rise with euro as investors head for Europe’s haven

Fund managers say ‘breakdown’ in usual market dynamics suggests global flight to Eurozone safe asset

This month the euro has jumped about 5% against the dollar © Simon Dawson/Bloomberg

Ian Smith in London

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The simultaneous surge in the euro and German government bonds this month suggests a "capital flight" to Eurozone's benchmark debt as a haven from trade war turmoil, say investors.

German bonds and the euro typically move in opposite directions, because optimism about the economy — which boosts the currency — hurts demand for the debt that is the euro bloc's de facto safe asset. That pattern held after the country's historic spending deal last month, which saw the euro surge and Bunds sell off.

But this month the euro has jumped about 5 per cent against the dollar, even as a transatlantic gap in bond yields widened, increasing the additional rate provided by Treasuries. Two-year US borrowing costs are now about 2 percentage points above those of Germany, up from about 1.7 percentage points in early March.

The usual correlation between euro and relative rates has "completely broken down in the past two weeks, as Bunds and the euro have both benefited from US policy-induced market concerns", said Mike Riddell, a bond fund manager at policy-induced market concerns”, said Mike Riddell, a bond fund manager at Fidelity International. This was “symptomatic of capital flight”, he added.

The simultaneous slump in US Treasuries and the dollar, which normally move in opposite directions, jangled nerves on Wall Street. But in Europe investors have been similarly struck by the surge in German Bund prices and the euro.

“Currency markets no longer care about interest rate dynamics,” said Benoit Anne, a strategist at MFS Investment Management, adding that a big relative rise in US market interest rates “traditionally would trigger a strongly bullish signal [for the dollar]”.

“There seem to be some global asset allocation shifts happening, with global investors looking at diversifying away from the US and looking at Europe and the rest of the world as a more attractive place to invest,” he added.

Fixed-income specialists say global investors are reappraising the appeal of Treasuries as a haven asset amid concerns over US policymaking.

Investors are looking outside of the US for a "safe, rule-of-law and we-can-rely-on-it government, with a well-run economy," said April LaRusse, head of investment specialists at Insight Investment.

She pointed to the heightened volatility of Treasuries in recent years. The Ice BofA Move index, a gauge of bond investors' expectations of future volatility in Treasuries, has remained at elevated levels since the 2022 bond market sell-off. Last week, it touched its highest in more than a year during the Treasuries rout.

But there remain big barriers to German Bunds replacing Treasuries as the global safe asset of choice, with the market just a fraction of the almost $30tn US government bond market. The historic scarcity of Bunds has seen them trading for long periods with a sub-zero yield.

Treasuries' status as the global reserve asset of choice is also tied to the dollar's dominant role in global finance and trade, even if commentators are saying this is being tested by a crisis of confidence in US policymaking.

Steven Major, global head of fixed income research at HSBC, said claims of a secular shift away from Treasuries miss that "the marginal buyer of Treasuries has increasingly been domestic investors" as some foreign investors pare back their holdings.

But there are signs, fund managers say, that big global investors are indeed looking to diversify their safe asset holdings, with Bunds one of the key beneficiaries as Germany increases issuance to fund its spending plans.

Short-term Bund yields tightened further on Thursday as the European Central Bank cut rates and traders bet on more cuts to come. The euro was little changed.

"There are some investors taking a look at Europe in a way they really haven't before," said Insight's LaRusse.

Additional reporting by Ray Douglas

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