Market View
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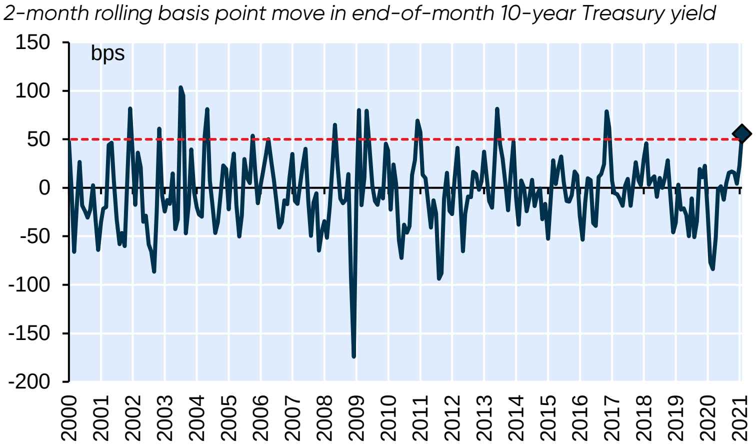
Putting these extraordinary rate moves in context

By Taylor Schleich

We've witnessed a truly extraordinary move in interest rates over the past couple of days (and months), with the 'reflation' trade in full effect. At the start of the year, a 10-year Treasury yielded under 1%. Fast forward two months and we're just shy of 1.50%—something of a psychological threshold. For the Treasury market, moves of this nature aren't entirely unprecedented, though they've certainly become rarer as yields have in been in structural decline for years. We've counted 15 prior episodes over the past two decades when rates have jumped more than 50 bps over two months. Importantly, these all occurred in relatively higher interest rate environments. In percentage terms, the ~60% rate rise through Feb takes the cake. As for GoCs, the move has been even more striking. The yield on a 10-year Canada bond has more than doubled since the start of the year, a two-month rise of 76 bps. That's the single largest two-month sell-off since 2000. You have to go back to the early '90s to find a bigger move—a time when the federal government's borrowing costs were up in the double digits. Moreover, decades of trading data would show that Canada bonds are typically lower beta than US Treasuries. That is, when Treasuries rally/sell-off, GoCs usually move directionally by a smaller amount. That hasn't been the case this go 'round, as Canada-US 10s are out >20 bps since the start of the year.

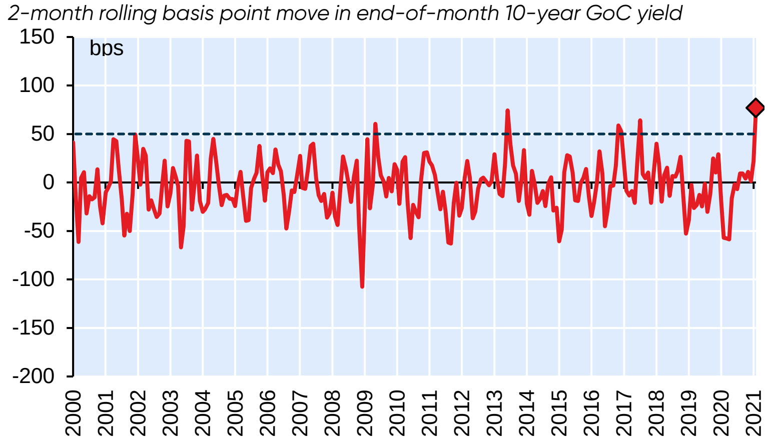
What does the empirical record tell us about what where we might be headed from here? Firstly, rate moves of this magnitude rarely persist beyond two months. Of the 15 occurrences since 2000 where US 10-year rates rose by more than 50 bps over two months, the following two months saw an average interest rate *decline* of roughly 5 bps. Only once, during the 2013 taper tantrum, did the following two months see continued rate increases of more than 15 bps. It's not immediately clear what the catalyst will be that stops the bearish move in its tracks, but there a number of risk factors that could step in, including a continued decline in equity prices, resurgence of COVID-19, stalling commodity price growth, inability to pass the US$1.9 trillion stimulus package and/or central banks stepping in to put a lid on rates. As for Canada-US, persistence in differential moves is somewhat more common. But even here the empirical record shows widenings are, on average, halted after outsized (15+ bp) moves in the prior two months. Moreover, continued widening often coincides with policy rate hiking cycles. While the BoC and Fed are likely to remain on the sidelines (on policy rates) for the next two years, many are suggesting it will be the BoC who moves first. We're fading that narrative owing to: (1) a relatively stronger US economy and quicker closure of America's output gap; (2) a strengthening Canadian dollar (that we expect to continue); and (3) the potential to cool housing via macroprudential measures as opposed to rate hikes.

Chart 1: A 50 bp rise in rates is not unheard of empirically...
2-month rolling basis point move in end-of-month 10-year Treasury yield



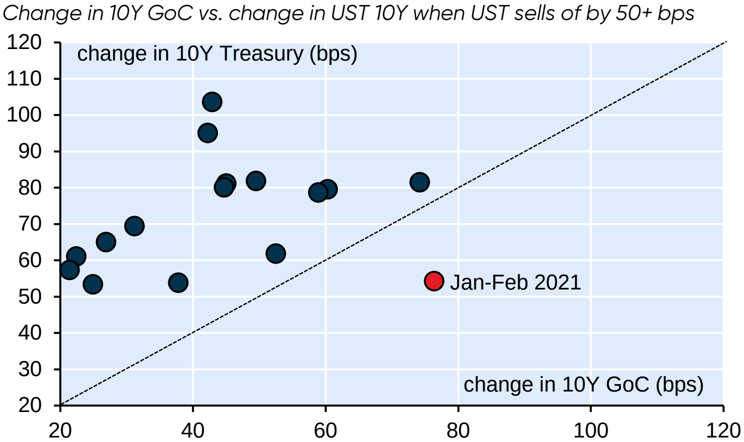
Source: NBF, Bloomberg

Chart 2: ... though more uncommon in lower-beta GoCs
2-month rolling basis point move in end-of-month 10-year GoC yield



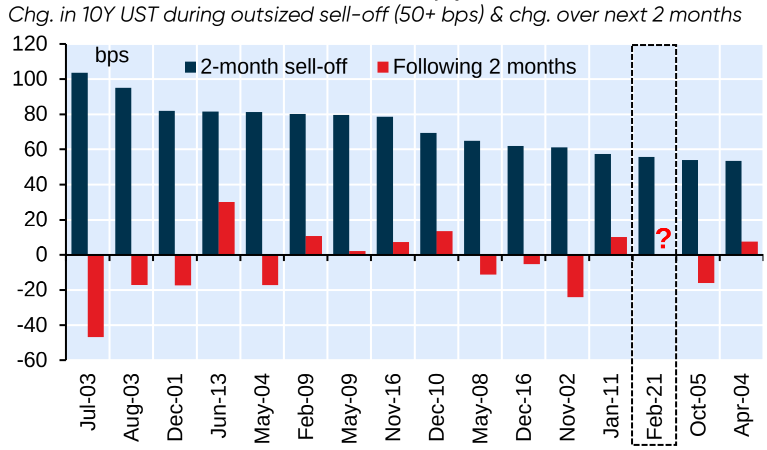
Source: NBF, Bloomberg

Chart 3: For Canada-US differentials, 2021 is an outlier
Change in 10Y GoC vs. change in UST 10Y when UST sells of by 50+ bps



Source: NBF, Bloomberg

Chart 4: Outsized rate moves rarely persist
Chg. in 10Y UST during outsized sell-off (50+ bps) & chg. over next 2 months



Source: NBF, Bloomberg

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