



What a long, strange sell-off it's been

By Taylor Schleich

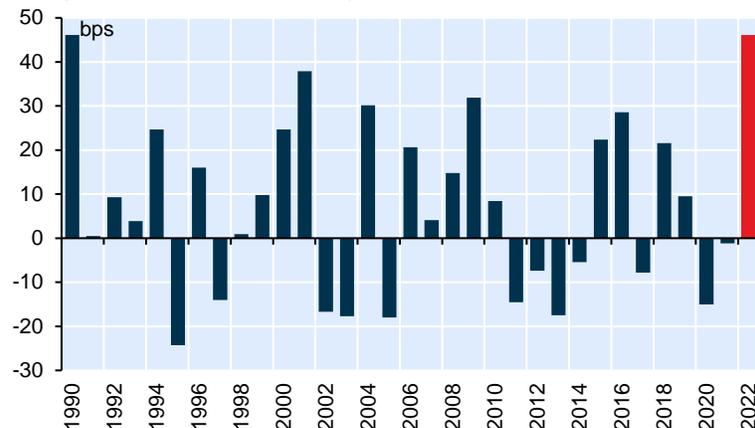
Although central bank monetary tightening cycles are still in their early stages, markets are already writhing as they brace for the steady dose of rate hikes still to come this year. As economic data continue to come in hotter than projected, expectations for the pace/magnitude of normalization has ratcheted up. Rising real yields and inflation expectations have sent nominal rates on a path that haven't seen in decades. As a preview to our May *Fixed Income Monitor*, here's some perspective on the rapid repricing we've seen over the last four months.

A short-lived rally early last week wasn't enough to break the momentum that yields have demonstrated this year. After Friday's close, we can officially say April 2022's 10-year Canada sell-off was the largest for the month of April in over 30 years (Chart 1). In its own right, that would be noteworthy but it's even more impressive when you consider the repricing we'd already undergone. Indeed, going back to 1990, January's sell-off was the 31st largest on record, while the ~60 bp sell-off in March was outpaced by just three other months (all were in the early 1990s; Chart 2). Add up these monthly moves and you'll find that the first four months of 2022 saw largest YTD rise in yields since 1994 (Chart 3).

But this is all in the rear-view mirror. What do we expect moving forward? Clearly, calling the peak on interest rates isn't an easy game—we have first-hand experience of that. And with central bank tightening just now ramping up and inflation remaining too hot, yields could stay under pressure near-term. But history shows us it has typically paid to fade these large repricings. For example, we have six other empirical episodes (i.e., excluding 2022) of 10Y GoC yields rising more than 50 bps through the first third of the year. All but once, yields ended the year lower than they were at the end of April. Moreover, recent rate moves look like even bigger outliers when compared to interest rate behaviour in past BoC rate hiking cycles. On average, yields tend to *decline* in the months following the first hike. Only once have yields risen by 50 bps this quickly after tightening began. Moreover, 100 weekdays after hike #1, 10Y yields were no higher than at the time of the first hike *in all cycles*. Today, two months after the BoC's March hike, 10Y rates are up over 110 bps (Chart 4). Undoubtedly, for pressure to ease we'll need to see the economy/inflation easing. But as we've [discussed in detail before](#), rate hikes work. We have no doubt that the aggressive tightening discounted by markets will take a large bite out of demand, particularly given Canada's acute [interest rate sensitivity](#). While we may not see significant cooling for months, rates have become increasingly attractive, and we'd be looking to add duration on yield back-ups from here.

Chart 1: This was the largest April sell-off in over 30 years...

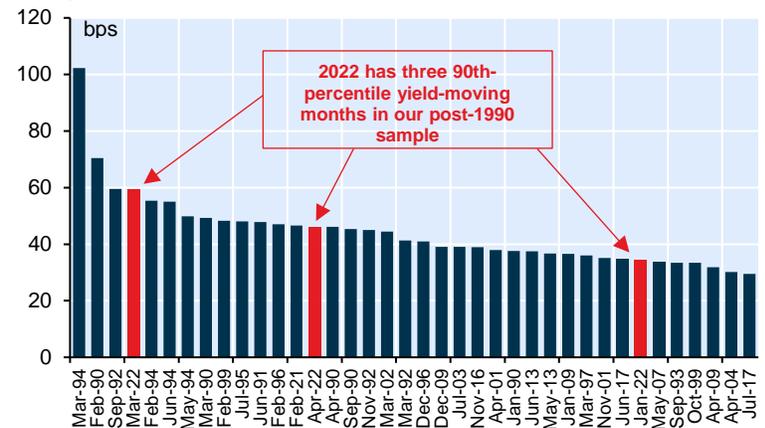
Change in 10-year GoC yield during calendar April since 1990



Source: NBF, Bloomberg

Chart 2: ...despite following the 4th largest sell-off since 1990

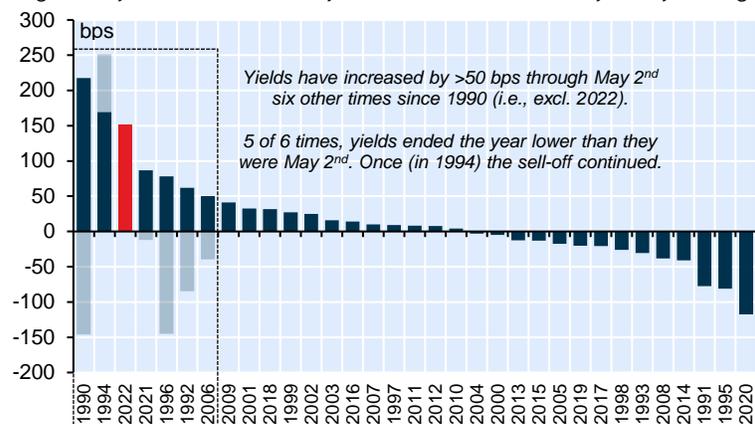
Change in 10Y GoC yield by calendar month (90th percentile months only)



Source: NBF, Bloomberg | Note: 38 largest monthly sell-offs since 1990 shown (388 total)

Chart 3: This has meant the largest YTD sell-off since 1994

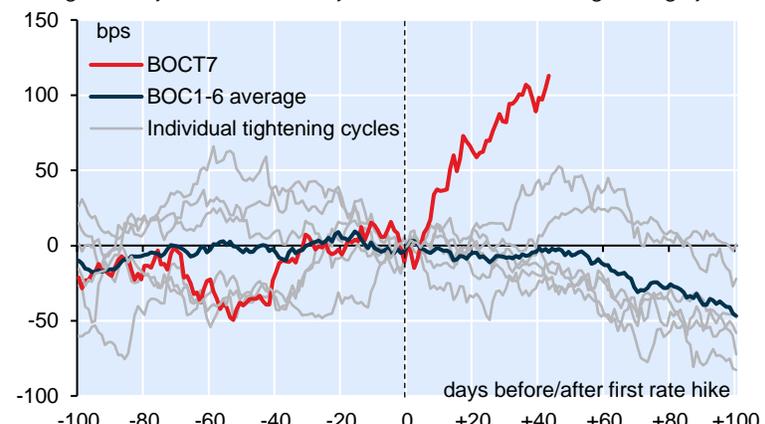
Chg. in 10Y yield from Jan 1 to May 2 (translucent bars are May-Dec yield chg.)



Source: NBF, Bloomberg | Note: Translucent blue bar denotes change in yield over the balance of the calendar year.

Chart 4: Rate moves during this hiking cycle are unprecedented

Change in 10Y yield relative to day of first rate hike in BoC tightening cycles



Source: NBF, Bloomberg | Note: BOC"X" refers to Bank of Canada rate hiking cycles since 1997. Note that T=0 refers to the date of the first hike of the rate hiking cycle.



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