J.P.Morgan

CFA Trending Topics | April 2, 2018

Understanding the flattening yield curve and implications for bond issuance decision-making

The U.S. Treasury (UST) yield curve is the flattest it has been over the past ten years: the current difference between 2y and 10y UST yields is only 47bps (with a 176bp average and 291bp high) and the difference between 2y and 30y Treasury yields is just 71bps (with a 262bp average and 402bp high). Further to the flatness in the UST curve, 3m Libor has also recently spiked to its highest level since the financial crisis without an equivalent rise in term rates.

- The recent spike in 3m Libor when compared to Fed Funds has more to do with market technicals than systemic risk in the bank market (with bank CDS near all-time lows)
    - Likely linked to recent high issuance of 3m T-bills that has pushed up short term yields
    - Long term rates have not repriced higher indicating that the market does not expect 3m Libor to continue increasing at its current pace
- One negative of rising 3m Libor is increased interest burden for floating rate notes (FRNs) although J.P. Morgan estimates the burden may be limited to $11bn annually
- The investment grade bond market has already started to see a switch towards issuance of bonds with maturities of 20 years or longer
    - 24% of issuance YTD has been 20 years or longer, vs. 16-20% in the last 5 years

Key Takeaways

- Corporates should consider issuing long dated bonds as the curve is the flattest it has been over the past 10 years
- Rising 3m Libor when compared to Fed Funds appears to be related more to market technicals than worries of bank’s creditworthiness or systemic risk

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