FINANCIAL TIMES

Draghi says 'get used to' bond volatility

Claire Jones in Frankfurt, Thomas Hale and Michael Hunter in London

Mario Draghi fuelled a sharp sell-off in eurozone bonds on Wednesday, after the European Central Bank president said debt markets had to "get used" to volatility in an era of ultra-low interest rates.

Yields on benchmark eurozone sovereign debt, which move inversely to prices, spiked to their highest level so far this year. The yield on German 10-year Bunds hit 0.897 per cent, the highest level since October last year. the yield has risen 32 basis points in two days, a jump not seen since 1998, according to Citi.

The movements mark the latest bout of instability to hit Europe's sovereign debt markets since the ECB launched its €1.1tn quantitative easing programme.

"There was some latent hope that Mr Draghi might try to smooth the market volatility," said Justin Knight, a fixed-income strategist at UBS. "The fact that he was not only relaxed about higher yields but said that we would have to get used to higher volatility, suggested he was super-relaxed — and that has played into market sentiment."

The ECB sovereign bond buying scheme initially pushed European borrowing costs sharply lower, but its effects were suddenly thrown into reverse at the end of April when Bund yields leapt higher. There was no obvious single trigger, but strategists blamed market distortions as well as shifts in investor sentiment, and Mr Draghi's comments on Wednesday reignited that turbulence.

"The market is so illiquid that you have very violent and quick movements — it's not a very efficient market these days because QE is distorting everything," said Yoram Lustig, a fund manager at Axa Investment Managers.

The ferocity of the recent bond rout has drawn parallels with the "taper tantrum" sparked by the US Federal Reserve's plans to end QE in 2013, and reawakened concerns that global bond markets are heading into a more uncertain era after a three-decade bull run.

The market moves sparked by Mr Draghi's comments rippled across the Atlantic, sending the US 10-year Treasury yield 11 basis points higher to 2.37 per cent, the highest since November last year.

Treasuries have historically tended to push other global bond markets around, but the eurozone has led movements since the ECB first announced plans to start QE.

Before Mr Draghi's remarks, positive economic data, investor concerns over bond market liquidity and [anticipation of a deal between Greece and its creditors] had already encouraged investors to shed their exposure to Bunds. The sell-off gathered pace following the ECB president's comments, made at a press conference in Frankfurt at mid-afternoon local time.

"We should get used to periods of higher volatility. At very low levels of interest rates, asset prices tend to show higher volatility," Mr Draghi said. "The [ECB's policy making] governing council was unanimous that we should look through these developments and maintain a steady monetary policy stance."

The council left its benchmark interest rate at its record low of 0.05 per cent on Wednesday. It continues to charge 0.2 per cent on a portion of banks' deposits held at the ECB.

The central bank's staff nudged up their forecast for inflation this year while expectations for growth in 2017 were a little lower.
The latest forecasts show inflation at 0.3 per cent in 2015, 1.5 per cent in 2016, and 1.8 per cent in 2017. Meanwhile, growth is expected to hit 1.5 per cent this year, before rising to 1.9 per cent in 2016 and 2 per cent in 2017.

Signs the threat of a serious bout of deflation is receding in the eurozone are yet to impact the ECB's plans to continue buying debt at its current pace until September 2016.

The ECB president on Wednesday signalled the governing council had every intention of keeping to the schedule unveiled in January, saying that planning exit strategies was a "really high-class problem."

"We're really far from that, so we are not discussing anything about that," Mr Draghi said.

Additional reporting by Ralph Atkins and Joe Rennison
This story has been amended since original publication