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GOVERNMENT BONDS AS SAFE HAVEN ASSETS

Tomasz Wieladek
Chief European Macro Strategist
T. Rowe Price

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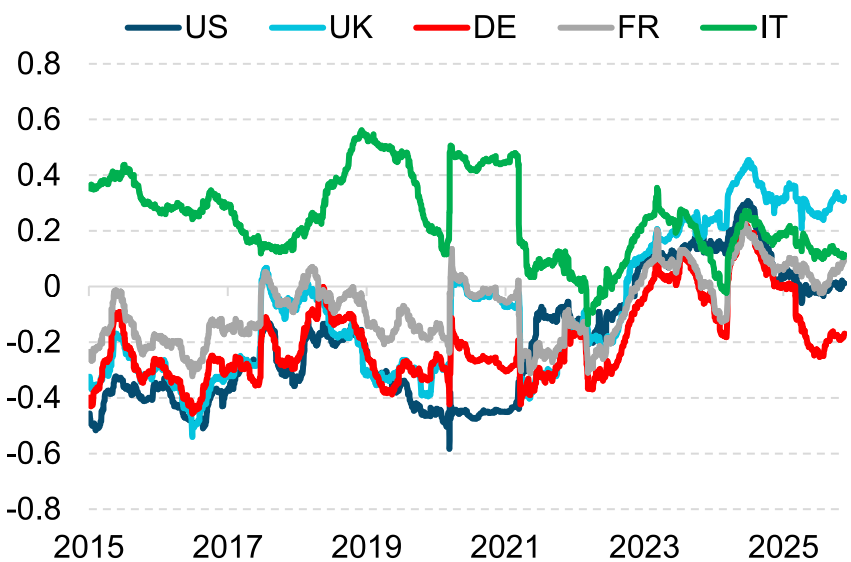
The stock-bond correlation changed recently

- **Stock-bond correlations moved into positive territory recently**
  - Government bonds normally rally, when stocks sell off – correlation should be negative
  - But bonds started to trade positively with risk – correlation is positive
  - The UK correlation is the highest, but back in negative territory for Bunds

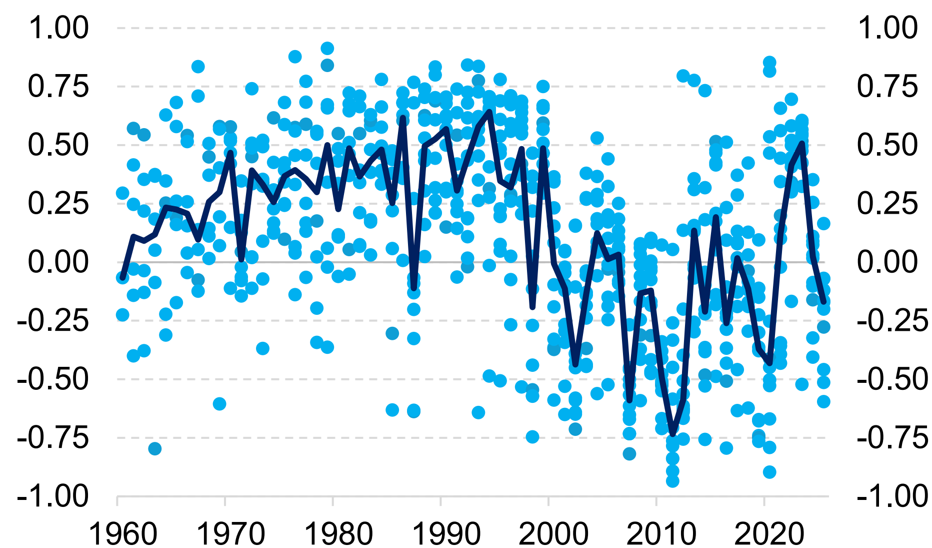
- **The negative stock-bond correlation since 2000 is a historical outlier**
  - Stock-bond correlations across countries only became negative since late 1999s
  - Data going back to 1890 shows that stock-bond correlations are normally positive

Stock Bond correlation by country



Source: Bloomberg Finance L.P. As of November 19th

International Stock-Bond Correlation



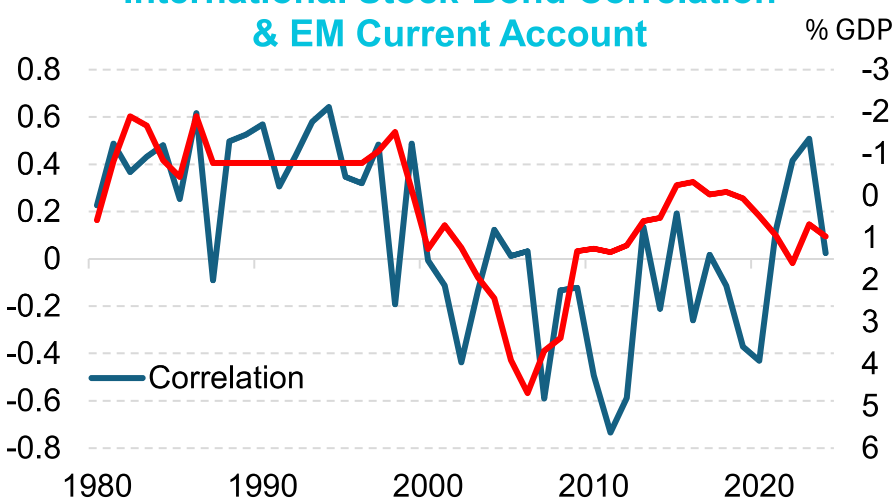
Source: Macrobond, IMF. As of November 19th

What can explain the move to positive correlations?

- **Theory suggests inflation and risk premia as explanations**
  - When inflation is low, monetary policy reacts to growth ➔ negative stock-bond correlation
  - When inflation is high, bonds and stocks tend to move in the same direction
  - Weakening of institutional credibility (Liz Truss/Liberation day) can lead to risk premia

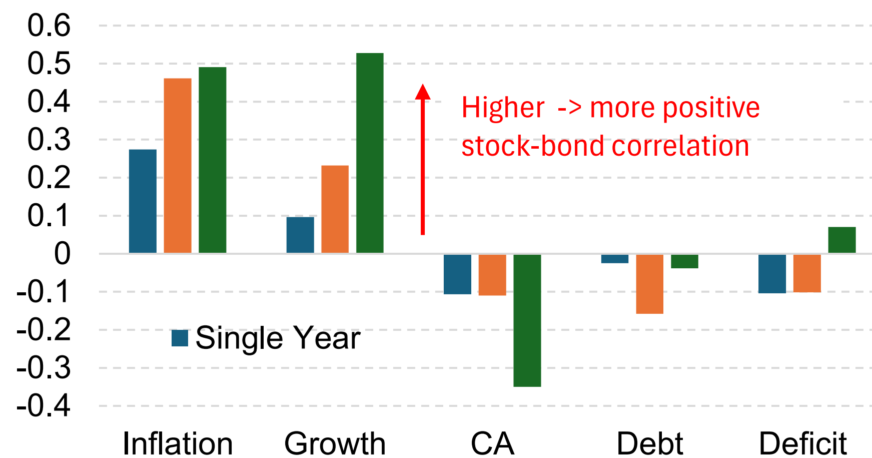
- **The evidence points to inflation as a viable explanation**
  - EM Current accounts moved to surplus during this time ➔ Supporting disinflation
  - EM FX reserves in DM government debt ➔ 'Safe' perception due to strong demand

International Stock-Bond Correlation & EM Current Account



Source: Macrobond, IMF. As of November 19th

Correlation of Macro Variables with Stock-Bond Correlation



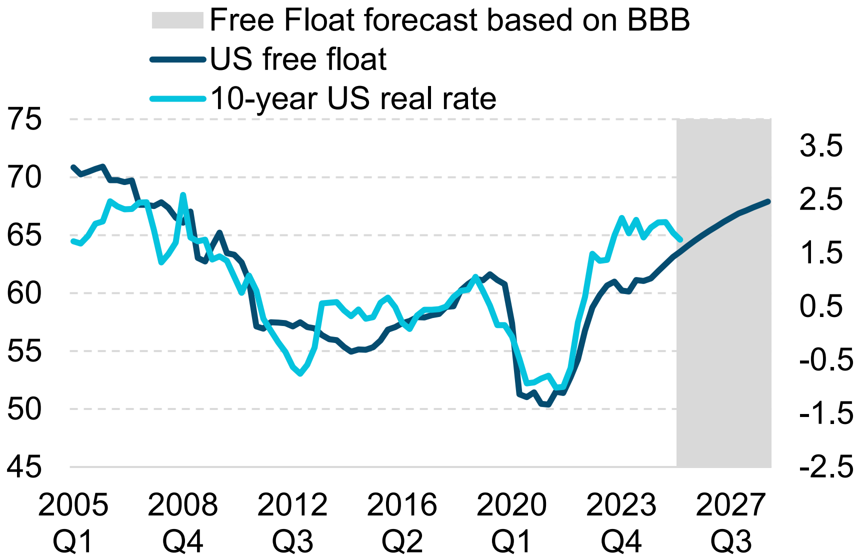
Source: Macrobond, IMF. As of November 19th

Higher bond issuance: Risk premia or crowding out?

- **More DM debt issuance will raise real rates**
  - UST free float (share private sector can buy) is highly correlated with US 10-year real rates
  - Free floats rising across DMs will put pressure on global real rates

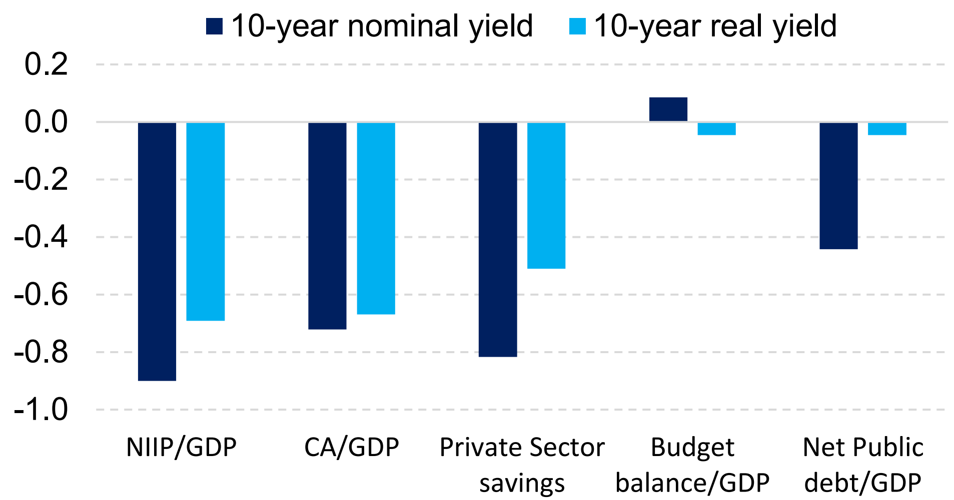
- **Positive correlation with risk may reflect crowding out, rather than risk premia**
  - Higher US real rates will attract flows from stocks, raising the correlation
  - Strong external positions tend lower GB yields & shield countries from these effects
  - Likely easier for those bond markets to still be considered 'safe' in the future

UST free float vs 10-year UST real rate



Source: Bloomberg Finance L.P, IMF. As of November 19th

Correlations of variables and 10-year GB yields (20-year averages) in DM economies



Source: Bloomberg Finance L.P, IMF, T. Rowe Price. As of November 19th

Discussion points

- How long will the effect of inflation on the stock-bond correlation last?
- Are fiscal risk premia the more relevant channel?
- Are Euro Area sovereigns vulnerable to crowding out?
- Could AI investment demand exacerbate these effects?

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