Sovereign Bonds

Central banks holding a fifth of their governments' debt

Scale of challenge becomes clear as policymakers face unwinding assets after decade of stimulus

Large-scale purchases of bonds in the decade since the financial crisis have left central banks, including the Federal Reserve, Bank of Japan, Bank of England and European Central Bank, owning a fifth of their respective governments' total debt © FT montage

YESTERDAY by: Kate Allen and Keith Fray in London

Leading central banks now own a fifth of their governments' total debt, a sign of the scale of the challenge they will face in unwinding unprecedented stimulus measures deployed over the past decade.

Since the financial crisis emerged, the world's biggest central banks have carried out large-scale purchases of bonds and other securities in a bid to boost the global economy by driving down borrowing costs for households and businesses.

In total, the six central banks that have embarked on quantitative easing over the past decade — the US Federal Reserve, the European Central Bank, the Bank of Japan and the Bank of England, along with the Swiss and Swedish central banks — now hold more than $15tn of assets, according to analysis by the FT of IMF and central bank figures, more than four times the pre-crisis level.

Of this, more than $9tn is government bonds — one dollar in every five of the $46tn total outstanding debt owed by their governments.

The ECB's total balance sheet recently topped that of the Fed in dollar terms. It now holds $4.9tn of assets, including nearly $2tn in eurozone government bonds.

The BoJ's balance sheet has also just topped that of the Fed, with $4.53tn of holdings, of which 85 per cent are Japanese government securities.

The Fed's balance sheet has expanded significantly several times in the past, including during the second world war when it soaked up debt sales in a bid to improve market conditions. But the current era is the first time in history that such a large group of central banks have undertaken such a substantial volume of co-ordinated buying over the space of nearly a decade.

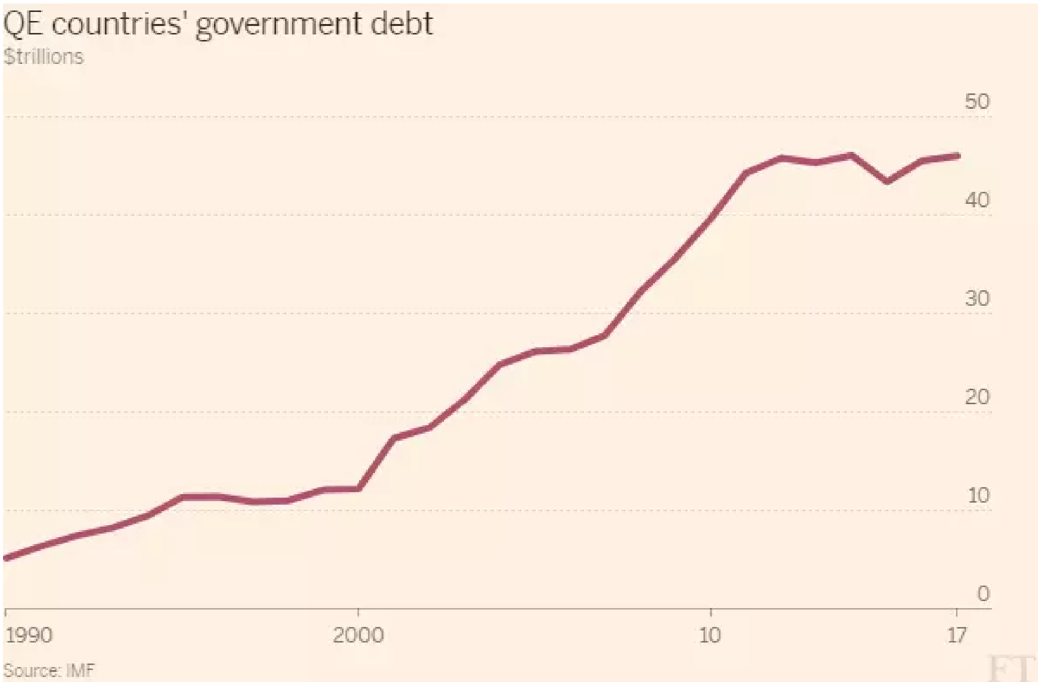
What was originally intended as a temporary emergency measure has now evolved into a significant challenge for policymakers as they contemplate how to return the global economy to normal monetary conditions.

With the world's leading monetary policymakers preparing for their annual global gathering at Jackson Hole next week, markets are closely watching Mario Draghi, ECB president, for any indication that he is preparing to withdraw the eurozone's $2tn bond-buying programme.

The Fed could give investors a hint about its stance on monetary policy tightening when the minutes of its July meeting are published on Wednesday.

David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy at the Washington-based Brookings Institution think-tank, said policymakers were going about the process of withdrawing stimulus "with great care and trepidation", after their fingers were burnt by the 2013 taper tantrum.

Jackson Hole will be an important moment for markets if "Draghi or [Fed governor Janet] Yellen want to use it to send a message" about monetary policy, he said.



Central banks' bond buying has profoundly affected markets around the world, pushing investors into a hunt for yield that has resulted in an era of unprecedentedly low volatility, with junk bonds the best-performing asset since the financial crisis, cash flowing into emerging markets, and equity indices hitting a series of record highs.

Richard Turnill, global chief investment strategist at the world's largest asset manager BlackRock, said that "barring unforeseen crises, we have seen the low in bond yields and the end of a 35-year bull market in bonds".

Although QE "has helped inflate all asset prices", it is not the only factor influencing government bond prices, Mr Turnill said. He cited regulatory changes since the financial crisis which require some investors to hold more assets of high credit quality, as well as below-trend economic and productivity growth and high savings levels, particularly in emerging markets.

"Our expectation is that bond yields will rise very gradually, as policy normalisation will be a very gradual process over time," he said.

More than half of the Federal Reserve's $4.47tn balance sheet consists of US Treasuries, with mortgage-backed securities guaranteed by government agencies such as Fannie Mae and Freddie Mac making up a further 40 per cent.

Central banks' bond-buying has helped push sovereign yields to record lows and in some cases into negative territory, with bondholders paying governments to own their paper.

Globally, government bonds delivered a total return of 48.8 per cent in the decade since the financial crisis, according to data from Bloomberg Barclays indices.

A paper published last year suggested that European government bond yields had declined by around 13 basis points as a result of asset-purchase programmes. Yields fall as prices rise.