Negative Yield Bonds

Negative-Yield Bonds are bonds that cause its buyers to lose money when they mature. Unlike other bonds, the ones issuing such bonds as debt are paid to borrow it.

This article will give more details about Negative Yield Bonds within the context of the Civil Service Examination.

Details about Negative Yield Bonds

Before we go into the details of negative yield bonds, it is important to have a basic understanding of bonds and how they work.

Bonds are debt instruments issued by corporations or governments to raise capital. The bonds are purchased by investors at face value. In return the investors get paid an investment rate (coupon rate) for holding the bond. Once the maturity period for a bond is over, the investors get back the face value of the bond or principal amount invested

The price of the bond and the return on investment they can yield is largely determined by the economy and monetary condition in an economy.

Usually, an investor, for example, will buy a bond at Rs. 105 and receive the Rs. 110 face value at maturity. In the case of negative yield bonds an investor will buy such bonds at Rs 110 and get back Rs 105 upon maturity.

Reasons for buying negative yield bonds

If there is little return for investment regarding negative yield bonds then why are their investments made? The reasons are as follows:

Asset Allocation and Pledged Assets: Hedge funds and investment firms which manage mutual funds must meet specific requirements, including that of asset allocation. Asset allocation is defined as investments within the the fund having been allocated to bonds for portfolio discussion

This allocation is designed to reduce or limit the risk of loss from other investments. Thus these funds must own bonds despite the negative yield some of them might bring.

Safe Haven Assets: In addition if the negative yield bond’s loss is comparatively less than that of another investment then then such bonds are still an interesting prospect. In times of economic uncertainty (or crisis), some investors focus on buying bonds are they are regarded as safe investments or safe-haven assets.

Alternatively during an economic crisis, an investor will likely accept a negative yield bond as they might be less of a loss when compared to other instruments in the equity markets.

Risk Deflation: There are some investors who believe that they can get good returns even through negative yields. For example a rise in the currency exchange rate will balance out the negative bond yield.

To put it simply, When buying government bonds, an investor would convert the money they are investing in that particular country's currency and when they are selling those bonds they would convert it back to their local currency.

When dealing in domestic bonds the investors would be prepared for low interest rates or prices in the economy that would allow them to make better use of their savings.

Relevant Questions Regarding Negative Yield Bonds

Who benefits from negative interest rates?

If a central bank implements negative rates, that means interest rates fall below 0%. In theory, negative rates would boost the economy by encouraging consumers and banks to take more risk through borrowing and lending money.

How are negative yield bonds profitable?

Traders would be willing to buy a negative-yielding bond if they thought that the yield might dive deeper into negative territory. Fixed-income prices and yields move inversely, so if a bond yield gets even more negative, the bond price would rally, allowing the trader to make a profit.