

The Great Capitulation

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10 July 2016

On Friday, the U.S. 10-year closed at 1.36, almost a hundred basis points down from its level on Dec. 15, when the Fed made what was supposed to be the first of many rate hikes. The 10-year index bond is back below zero, at $-.08$. German *nominal* rates are now sharply negative all the way out to 10 years, at -0.19 . It's all pretty awesome. What's it all about?

People are still out there blaming central banks for imposing “artificially low” rates, which is kind of amazing and depressing. Artificially low compared to what? If central banks were engaged in excessive monetary ease, the results should be visible in the form of rising inflation – which was in fact what the critics of QE claimed would happen. But it didn't, and now I have no idea what their criterion for a not-artificially low rate is, other than one they like better than the low returns the economy actually seems willing to offer.

But why are returns so low – and why have they fallen so much this year?

A key point, I would argue, is that there is no indication this time around of a flight to safety, with investors demanding higher rates of return on riskier assets and plowing into safe assets. Nothing much is happening to spreads on riskier corporate bonds:



It's also interesting that despite Brexit and all the talk about bank worries and friction over austerity within the euro area, spreads of riskier euro bonds against Germany have settled down (from Ycharts.com):

Italy-Germany 10 Year Bond Spread Chart

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5d 1m 3m 6m YTD 1y 5y 10y Max

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So we don't seem to be looking at a risk-off situation, with government bonds as a safe haven.

What's consistent with the data, instead, is the notion that investors are throwing in the towel and accepting secular stagnation as the new normal. Almost 8 years after Lehman, no sign of a really strong recovery in sight anywhere; perceived private-sector investment opportunities remain weak. Stock and land prices are pretty high, but probably because of low discounting rather than expected high returns.

Call it the Great Capitulation.