

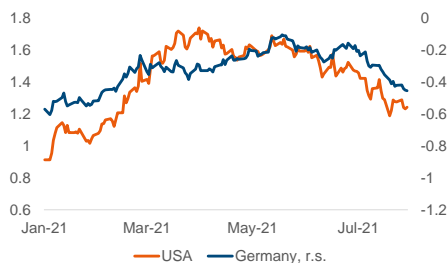
Week Ahead

Focus: Bond markets

Analyst:

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10y government yields, in %



Source: Market data providers, Erste Group Research

What's going on in the bond market?

Contrary to all expectations, and thus also ours, bond yields have fallen over the past months in both Europe and the US. At the beginning of June, the 10-year German Bund was trading at a yield of -0.18%; now it is -0.45%. The yield on the 10-year US Treasury bond even fell by 36bp in the same period. One can only speculate about the causes, because this reaction cannot be deduced from the published data. The strong spread of the delta variant of the coronavirus and the renewed increase in the number of infections on both sides of the Atlantic do pose a potential risk to the economy, as this could slow down the economic recovery, but probably not to a great extent. The same applies to the supply bottlenecks in various sectors, which lead to delivery delays.

Yields on the bond market, however, have currently fallen to a level last seen in February. However, the economic situation is not comparable: In February, vaccination against COVID-19 was just starting, but now the vaccination coverage of the population and especially of the risk groups is already high, making new containment measures unlikely. Moreover, the second quarter has already seen great progress in economic recovery. The development of other asset classes also speaks against the economic outlook as the cause of the decline in yields. The stock markets are storming from one high to the next, corporate bond spreads and the gold price have fallen.

As Fed Chairman Powell correctly noted in the recent press conference in this context, technical factors like to be used as an explanation when no others are available. This time, however, it is not quite so, as there is circumstantial evidence of a cause coming from the market. Starting in February, speculative positions in German and US government bond futures rose for months. Obviously, there was great unanimity about the direction of the bond market. This is not surprising. For with rising vaccination figures and falling contagion figures, there was really only one direction for the economy and thus the bond market. It is very likely that even just a waning of the euphoria (delta, production bottlenecks) was therefore enough to trigger first a countermovement and then a chain of position liquidations, thus pushing yields down.

As mentioned above, we had not expected this development on the bond market either. At the same time, however, from our point of view, the fundamental economic outlook has not changed much. The economy will remain strong and, at least in the US, there is considerable uncertainty regarding the medium-term development of inflation. In addition, both the ECB and the US Fed will reduce their support for the bond market, albeit slowly. So for us, the coming environment remains negative for the bond market and we continue to expect yields to rise – more so in the US than in Europe. However, recent events call for a lower starting point for our forecasts.

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Note: Past performance is not necessarily indicative of future results

Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
Eurozone						
EA	2-Aug	10:00	PMI Index	Jul F	62.6 Index	62.6 Index
DE	2-Aug	9:55	PMI Index	Jul F	65.5 Index	65.6 Index
FR	2-Aug	9:50	PMI Index	Jul F	58.1 Index	58.1 Index
IT	2-Aug	9:45	PMI Index	Jul		62.2 Index
USA						
	2-Aug	16:00	PMI Index	Jul	60.9 Index	60.6 Index
	4-Aug	14:15	ADP Employment	Jul	688.1 Tsd	691.5 Tsd
	6-Aug	14:30	Wages y/y	Jul	3.9%	3.6%
	6-Aug	14:30	Unempl. Rate	Jul	5.7%	5.9%
	6-Aug	14:30	Chg. Non-Farm Payrolls	Jul	872.1 Tsd	850.0 Tsd
China						
	2-Aug	3:45	PMI Index	Jul	51.1 Index	51.3 Index

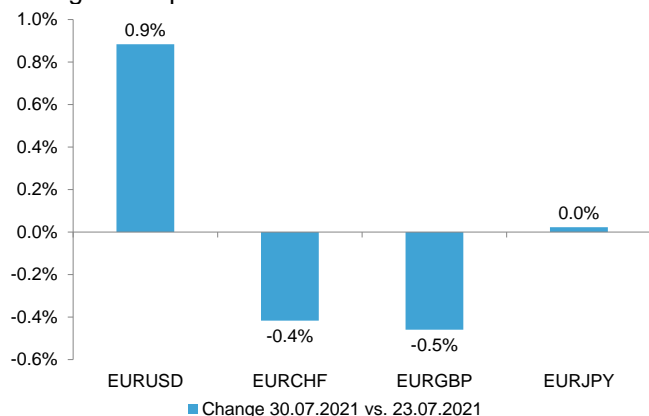
Central bank events

	Date	Time	Event
ECB	30-Jul	18:00	ECB survey of monetary analysts, July 2021
Fed	8-Aug	16:00	Richard Clarida, speech: <i>Outlooks, Outcomes and Prospects for US Monetary Policy</i> , Peterson Institute

Source: Market Data Provider, ECB, Federal Reserve, Erste Group Research

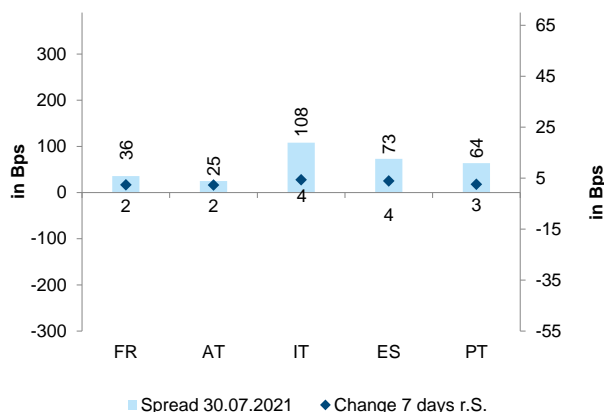
Forex and government bond markets

Exchange rates EUR: USD, CHF, GBP and JPY Changes compared to last week



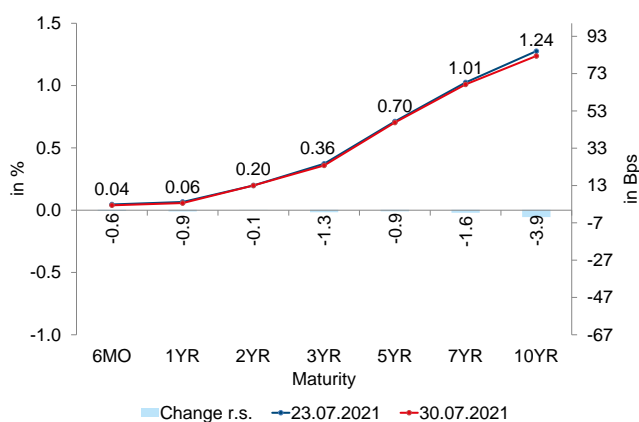
Source: Market Data Provider, Erste Group Research

Eurozone spreads vs. Germany 10Y government bonds



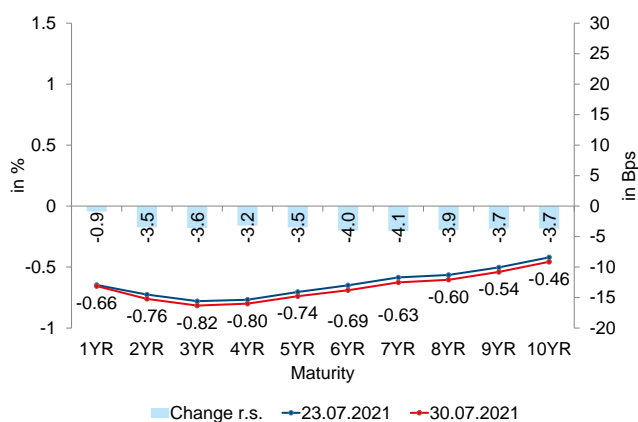
Source: Market Data Provider, Erste Group Research

US Treasuries yield curve Changes compared to last week



Source: Market Data Provider, Erste Group Research

DE Bund yield curve Changes compared to last week



Source: Market Data Provider, Erste Group Research

Forecasts¹

GDP	2019	2020	2021	2022
Eurozone	1.3	-6.5	4.4	4.1
US	2.3	-3.5	6.1	3.3

Inflation	2019	2020	2021	2022
Eurozone	1.2	0.3	1.8	1.4
US	1.8	1.2	4.0 ↑	2.2 ↑

Interest rates	current	Sep.21	Dec.21	Mar.22	Jun.22
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.54	-0.54	-0.54	-0.54	-0.54
Germany Govt. 10Y	-0.45	-0.30 ↓	-0.10 ↓	0.00	0.10
Swap 10Y	-0.06	0.00 ↓	0.20 ↓	0.30	0.40

Interest rates	current	Sep.21	Dec.21	Mar.22	Jun.22
Fed Funds Target Rate*	0.10	0.13	0.13	0.13	0.13
3M Libor	0.13	0.20	0.20	0.20	0.20
US Govt. 10Y	1.24	1.40 ↓	1.70 ↓	1.80 ↓	1.90 ↓
EURUSD	1.19	1.18	1.20	1.20	1.20

*Mid of target range

In case of changes to our forecasts compared to the previous issue, arrows show the direction of the change.

Source: Market Data Provider, Erste Group Research

¹ Note: In accordance with regulations, we are obliged to issue the following statement:
Forecasts are not a reliable indicator of future performance.

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