

Yield Outlook

ECB rate cuts approaching

A backdrop of geopolitical unrest in the Middle East, rising commodity prices and surprisingly strong US data have fuelled rising yields across the globe in the past month. Shifts in US yields remain the decisive factor for developments. In the space of just one month, the benchmark US 10Y Treasury yield has increased from 4.30% to 4.60%, triggering memories of last autumn, when the same yield peaked a tad above 5%.

That being said, we assess the current dynamic to be different to that prevailing in the autumn in several ways. Firstly, the term premium on long yields – compensation for holding long versus short bonds – has remained largely unchanged in recent months, in contrast to the autumn, when investor fears over the rapidly growing US government debt contributed to pushing the premium higher, which had a knock-on effect on Europe. While the risk of yet another boost to the bond market's 'risk premium' cannot be ruled out, we are generally not expecting any major shifts in the short term.

Our view is that yield increases will soon come to a stop and that the now very elevated expectations for growth and inflation in the US have raised the probability of an imminent decline in yields. The pendulum has simply swung too far.

ECB ready to cut interest rates in June – and the Fed will not change that

European yields have experienced a knock-on effect from rising US yields, which in mid-April briefly sent the 10Y Bund yield above 2.5%. In contrast to the US, however, markets have had no real reason to doubt that rate cuts are approaching. At its April meeting, the ECB explicitly signalled an upcoming easing of monetary policy (read June), with the one caveat that labour market, inflation and growth data continue to develop roughly as expected. We assess there to now be a very strong internal consensus in the ECB for a 0.25 percentage point rate cut in June, so the next big question is just how quickly subsequent easings will unfold.

And here uncertainty remains high. Inflation in Europe continues to fall (2.4% y/y in March), but domestically driven inflation remains unduly high at 4.4% y/y in March. What the ECB lacks here is clarity on whether Europe's high level of wage growth will be absorbed by corporate profit margins or, alternatively, if companies will instead pass rising costs on to consumers. The continuing uncertainty on underlying inflationary pressures in the eurozone may determine whether the ECB opts to proceed with greater caution on rate cuts after June. Our main scenario is that rate cuts will come at a 0.25 percentage points per quarter pace at the meetings in September, December and likewise in 2025. In our eyes, the risk is that the pace slackens.

Shortcuts

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Central bank policy rates

Country	Spot	+3m	+6m	+12m
USD	5.50	5.25	5.00	4.50
EUR	4.00	3.75	3.50	3.00
GBP	5.25	5.00	4.75	4.25
DKK	3.60	3.35	3.10	2.60
SEK	4.00	3.75	3.50	3.00
NOK	4.50	4.50	4.25	3.50

10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	4.57	4.55	4.45	4.35
EUR	2.45	2.35	2.35	2.35
GBP	4.24	4.20	4.20	4.20
DKK	2.49	2.45	2.45	2.45
SEK	2.44	2.45	2.50	2.70
NOK	3.78	3.70	3.65	3.65

Note: EUR = Germany

10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	4.19	4.15	4.05	3.95
EUR	2.76	2.65	2.65	2.65
GBP	3.97	3.90	3.90	3.90
DKK	2.91	2.85	2.85	2.85
SEK	2.85	2.80	2.85	2.90
NOK	3.98	3.80	3.75	3.75

Source: Danske Bank (all three tables)

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Part of the market puts great significance on the historical coupling between monetary policy in the US and Europe in its assessment of how quickly the ECB can allow itself to normalise interest rates. This dynamic is obvious in the correlation between short European and US yields, which have been rather elevated of late. However, we are not worried that the ECB’s decision to cut rates in June will be influenced by the situation in the US. The source of Europe’s inflation is different to that of the US, and after a year of weak economic growth, Europe appears more mature for lower interest rates. A pronounced decoupling from the Fed could eventually be problematic for the ECB (for example, by boosting EUR/USD), but its significance should be relatively limited as long as the gap is short-lived. However, should the Fed, contrary to expectations, refrain from cutting interest rates in 2024 (or perhaps even raise them), that would be a different story.

Fixed-income markets focused on the Fed, US data and geopolitics in the near term

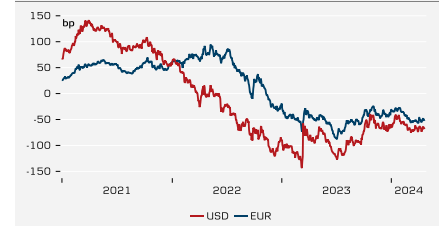
Market focus in the next month will mainly be on economic data and monetary policy signals from the US, which tend to direct yield developments in the rest of the world. Strong inflation and labour market data for March weakened the prospects of an imminent rate cut, but will they cause the Fed to push cuts further back at its meeting at the start of May?

Geopolitically, eyes will mostly be on Iran and whether it ratchets up Middle East tensions further in response to Israel’s attack. For financial markets, the main risk here is probably whether key shipping routes, such as the Strait of Hormuz, become unnavigable or if Iranian energy infrastructure becomes a target. As long as tensions do not escalate in this direction, market significance is unlikely to be widespread or persistent – just as with similar historical conflicts.

We see long European yields trading flat in the time ahead

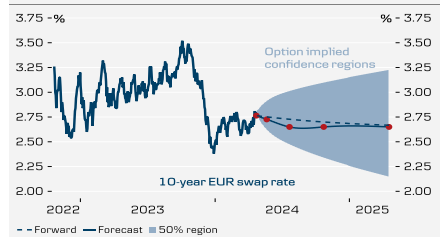
We assess the risk of long yields to be downside due to the now aggressive expectations priced for growth and inflation in the US. Nevertheless, we raise our 12-month forecast for US 10Y Treasury yields a notch from 4.25% to 4.35%, a decline of around 0.25 percentage points from the current level. We maintain our forecast for 10Y Bund yields at 2.35%, in line with the current level. We expect short European yields to fall in the coming months as the ECB’s first rate cut in June draws closer.

10Y-2Y (swap) yield curves



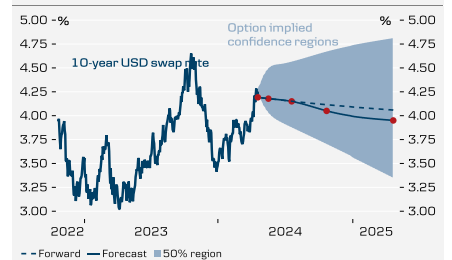
Note: Past performance is not a reliable guide to future returns
Source: Macrobond Financial, Danske Bank

Forecast: 10Y EUR swap rates



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Forecast: 10Y USD swap rates



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Forecast*

	Horizon	Policy rate	3m xlbbr	6m xlbbr	2y gov	5y gov	10y gov	2y swap	5y swap	10y swap
USD**	Spot	5.50			4.95	4.62	4.57	4.86	4.37	4.19
	+3M	5.25			4.80	4.50	4.55	4.65	4.25	4.15
	+6M	5.00			4.50	4.35	4.45	4.30	4.05	4.05
	+12M	4.50			4.00	4.15	4.35	3.80	3.85	3.95
EUR*	Spot	4.00	3.89	3.85	2.96	2.47	2.45	3.30	2.87	2.76
	+3M	3.75	3.60	3.60	2.75	2.35	2.35	3.15	2.75	2.65
	+6M	3.50	3.40	3.35	2.50	2.25	2.35	2.90	2.65	2.65
	+12M	3.00	2.90	2.85	2.20	2.10	2.35	2.65	2.50	2.65
GBP**	Spot	5.25			4.45	4.16	4.24	4.71	4.16	3.97
	+3M	5.00			4.25	4.00	4.20	4.45	3.90	3.90
	+6M	4.75			4.05	3.90	4.20	4.25	3.80	3.90
	+12M	4.25			3.80	3.75	4.20	4.00	3.65	3.90
DKK	Spot	3.60	3.82	3.90	2.91	2.53	2.49	3.40	3.02	2.91
	+3M	3.35	3.55	3.55	2.80	2.45	2.45	3.30	2.95	2.85
	+6M	3.10	3.25	3.30	2.55	2.35	2.45	3.05	2.85	2.85
	+12M	2.60	2.75	2.75	2.25	2.20	2.45	2.80	2.70	2.85
SEK	Spot	4.00	3.92		2.98	2.45	2.44	3.37	2.94	2.85
	+3M	3.75	3.83		2.70	2.45	2.45	2.90	2.70	2.80
	+6M	3.50	3.58		2.55	2.40	2.50	2.85	2.65	2.85
	+12M	3.00	3.12		2.35	2.45	2.70	2.65	2.70	2.90
NOK	Spot	4.50	4.73	4.90	4.09	3.79	3.78	4.69	4.20	3.98
	+3M	4.50	4.60	4.60	3.90	3.65	3.70	4.40	3.95	3.80
	+6M	4.25	4.25	4.25	3.70	3.55	3.65	4.20	3.85	3.75
	+12M	3.50	3.80	3.80	3.30	3.40	3.65	3.80	3.70	3.75

* German government bond yields and euro swap rates ** Based on OIS/SOFR swap rates.

Note: Past performance is not a reliable guide to future returns

Source: Danske Bank

Overview

<p>USD</p>	<ul style="list-style-type: none"> The US central bank (the Fed) has maintained the Fed funds rate at 5.25-5.50% since July 2023. We envisage no more rate hikes, but recent very strong data developments have created some uncertainty on just how long high interest rates might persist. Higher real interest rates open the door to rate cuts from June 2024 (new call), but the risk of a delayed start is significant. We expect the short end to reflect the rate cuts, while long yields will decline gradually. 	
<p>EUR</p>	<ul style="list-style-type: none"> The ECB hiking cycle has come to an end, and we believe the next step is likely to be rate cuts. The first rate cut of 25bp has been clearly signalled for June, after which we expect similar cuts in September and December. Europe's economy was weak in 2023, but growth is now picking up. Labour markets are hot and inflationary pressures remain high. We expect swap curves to steepen over the coming year due to (1) flat long yields and (2) falling short-end rates. 	
<p>DKK</p>	<ul style="list-style-type: none"> The Danish central bank has maintained a policy rate spread to the ECB of 40bp since early 2023, and we expect this to continue for now. The CD rate was raised to 3.6% in September. We expect the Danish central bank to cut its policy rates from June 2024 in tandem with the ECB. In line with our Eurozone outlook, we expect the DKK yield curve to steepen from here as rate cuts draw closer. 	
<p>GBP</p>	<ul style="list-style-type: none"> The Bank of England (BoE) has raised key policy rates markedly over the past year to 5.25%. GDP growth has increased recently but underlying inflationary pressures have continued to ease. In line with our ECB/Fed outlook, we estimate that policy rate cuts are drawing closer in the UK, with the first BoE cut likely coming in June. We expect swap curves to steepen due to a decline in short-end interest rates. 	
<p>SEK</p>	<ul style="list-style-type: none"> Since kicking off its tightening cycle in early 2022, the Riksbank has raised its repo rate to 4%. We expect no further rate hikes from here. The Swedish economy performed better than expected in 2023 and GDP growth has trended up recently. We expect higher Swedish long yields for the coming year while the short end will likely reflect the start of the rate cutting cycle. In our view, the market is a tad too optimistic on when the Riksbank will ease monetary policy. 	
<p>NOK</p>	<ul style="list-style-type: none"> As expected, Norges Bank kept interest rates steady in March, thus lifting the interest rate path slightly. We have postponed our expectations for the first rate cut from June to September and expect rate cuts of 3x25bp by year-end. While we expect a relatively modest decline in Norwegian long yields, the short end of the curve looks likely to fall significantly if our Norges Bank outlook materialises, though we believe risks to this outlook are to the upside. 	

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Source: Danske Bank

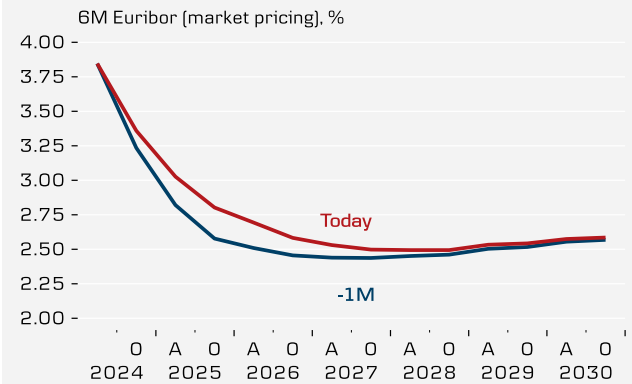
Eurozone forecast

EUR forecast summary

EUR	Spot	--Forecast--			--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Deposit	4.00	3.75	3.50	3.00			
Euribor (3M)	3.89	3.60	3.40	2.90	-7	0	-9
Euribor (6M)	3.85	3.60	3.35	2.85	-4	-1	-17
Government Bonds							
2-year	2.96	2.75	2.50	2.20			
5-year	2.47	2.35	2.25	2.10			
10-year	2.45	2.35	2.35	2.35			
Swap Rates							
2-year	3.30	3.15	2.90	2.65	2	-9	-14
5-year	2.87	2.75	2.65	2.50	-3	-7	-13
10-year	2.76	2.65	2.65	2.65	-8	-5	-2

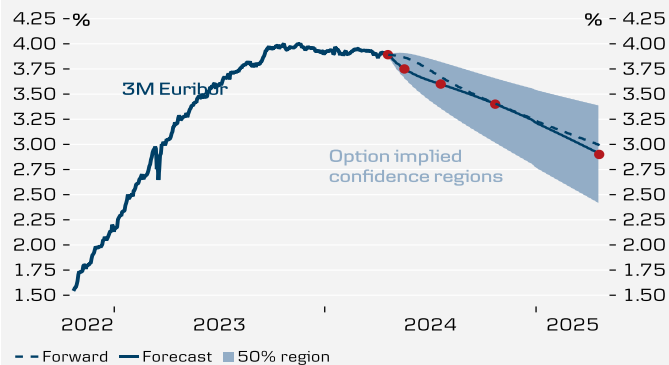
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1M change in EUR swap rates



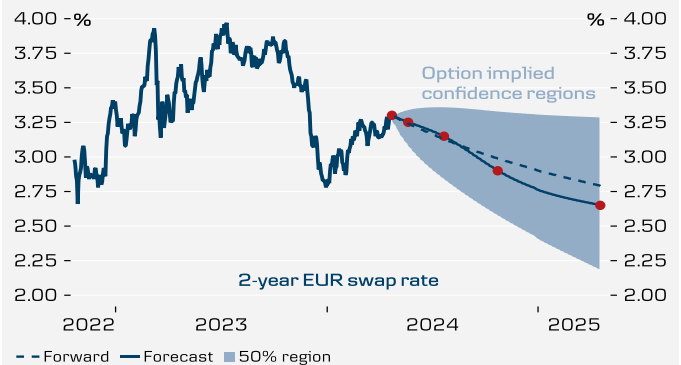
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3M Euribor rates



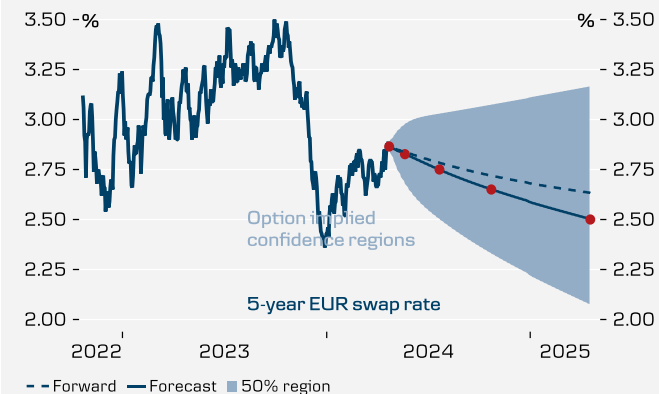
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Source: Danske Bank

2Y EUR swap rates



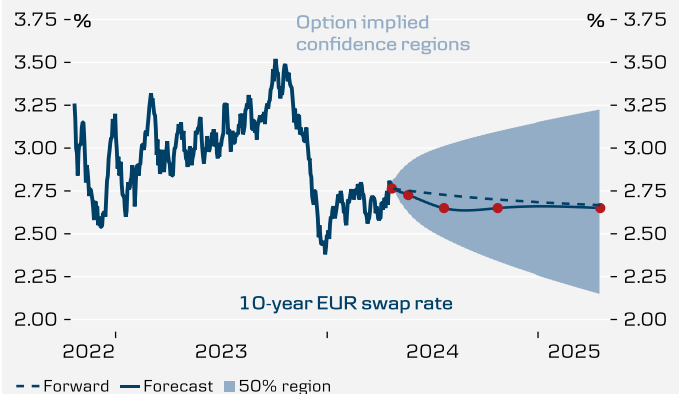
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Source: Danske Bank

5Y EUR swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y EUR swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

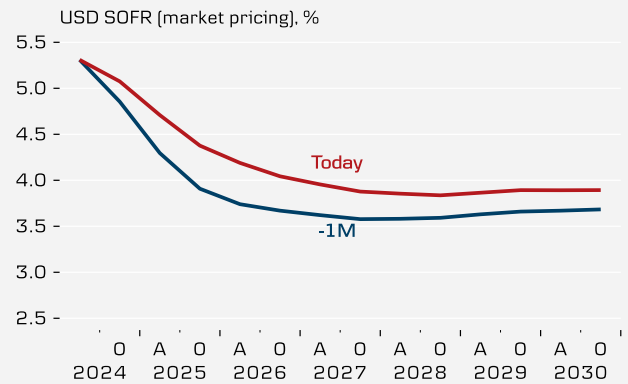
US forecast

USD forecast summary

USD	Spot	--Forecast--			--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Fed Funds	5.50	5.25	5.00	4.50			
SOFR	5.31	5.05	4.80	4.30	-21	-29	-42
Government Bonds							
2-year	4.95	4.80	4.50	4.00			
5-year	4.62	4.50	4.35	4.15			
10-year	4.57	4.55	4.45	4.35			
Swap Rates							
2-year	4.86	4.65	4.30	3.80	-7	-27	-53
5-year	4.37	4.25	4.05	3.85	-4	-17	-25
10-year	4.19	4.15	4.05	3.95	0	-7	-11

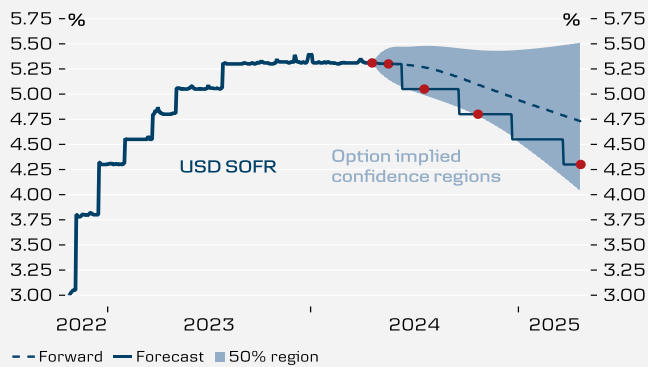
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Source: Danske Bank

1M change in USD swap (SOFR) rates



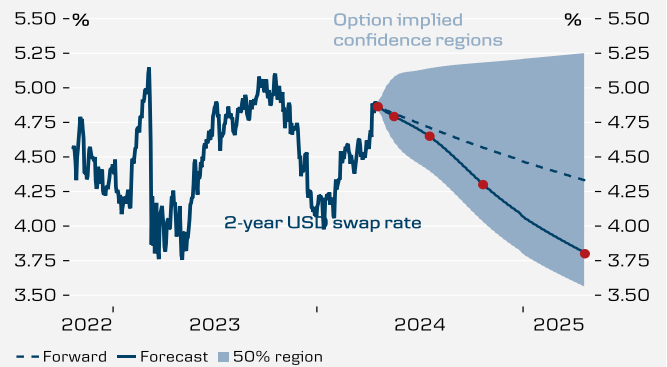
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SOFR rates



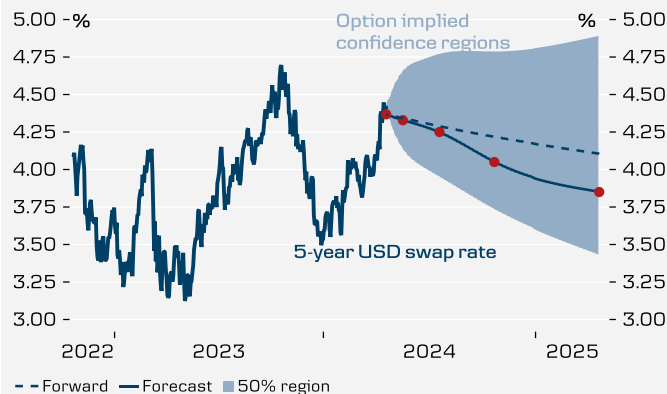
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2Y USD swap rates



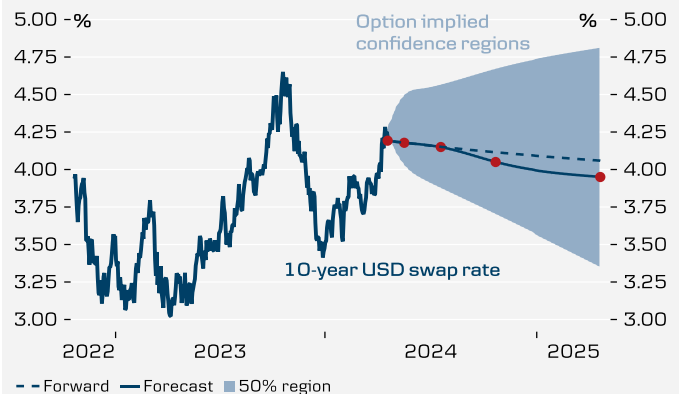
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5Y USD swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y USD swap rates



Note: Past performance is not a reliable guide to future returns
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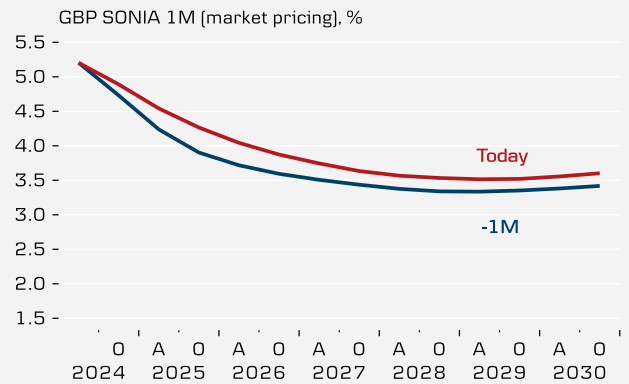
UK forecast

GBP forecast summary

GBP	Spot	--Forecast--			--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Bank rate	5.25	5.00	4.75	4.25			
SONIA (1M)	5.20	4.95	4.70	4.20	-10	-19	-33
Government Bonds							
2-year	4.45	4.25	4.05	3.80			
5-year	4.16	4.00	3.90	3.75			
10-year	4.24	4.20	4.20	4.20			
Swap Rates							
2-year	4.71	4.45	4.25	4.00	-11	-16	-17
5-year	4.16	3.90	3.80	3.65	-17	-19	-20
10-year	3.97	3.90	3.90	3.90	-3	0	5

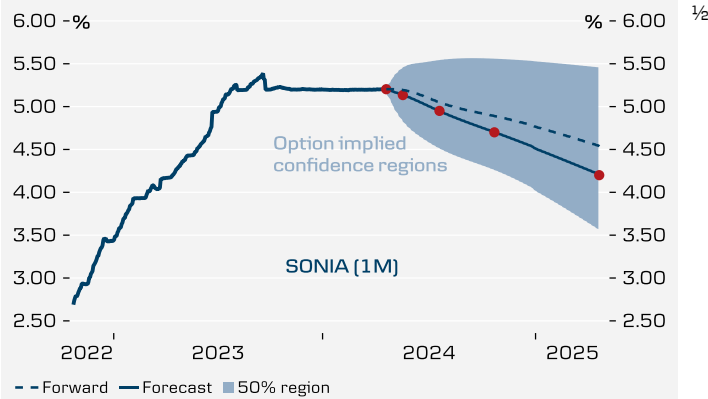
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

1M change in GBP swap (OIS)



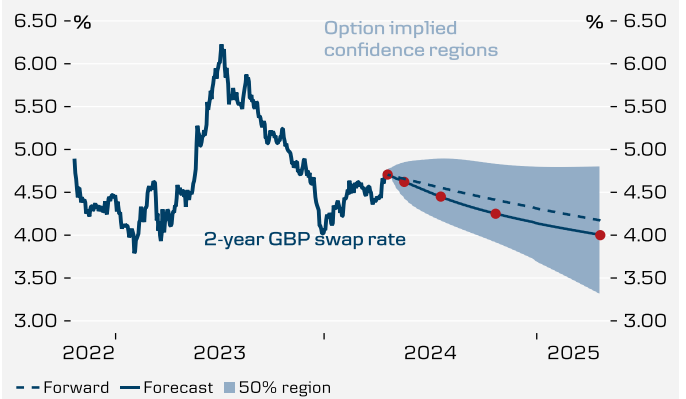
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Source: Danske Bank

SONIA (1M)



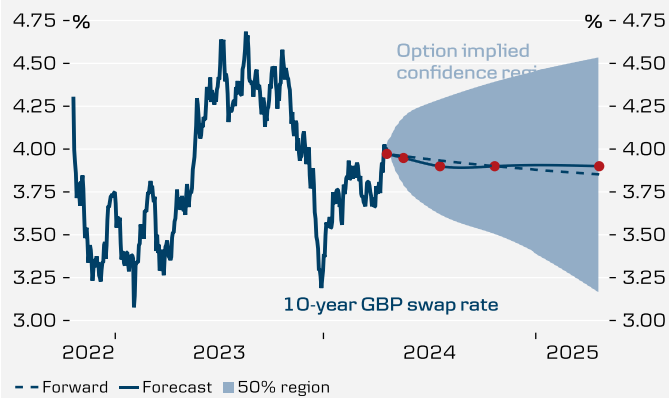
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y UK swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y UK swap rates



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Source: Danske Bank

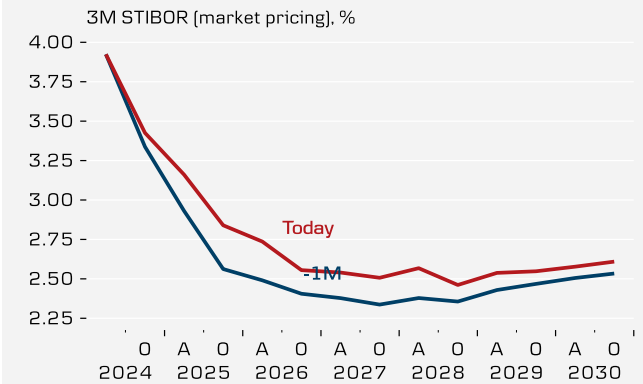
Sweden forecast

SEK forecast summary

SEK	Spot	--Forecast--			--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Repo	4.00	3.75	3.50	3.00			
STIBOR (3M)	3.92	3.83	3.58	3.12	16	15	-4
Government Bonds							
2-year	2.98	2.70	2.55	2.35			
5-year	2.45	2.45	2.40	2.45			
10-year	2.44	2.45	2.50	2.70			
Swap Rates							
2-year	3.37	2.90	2.85	2.65	-32	-24	-22
5-year	2.94	2.70	2.65	2.70	-17	-16	-2
10-year	2.85	2.80	2.85	2.90	-2	6	14

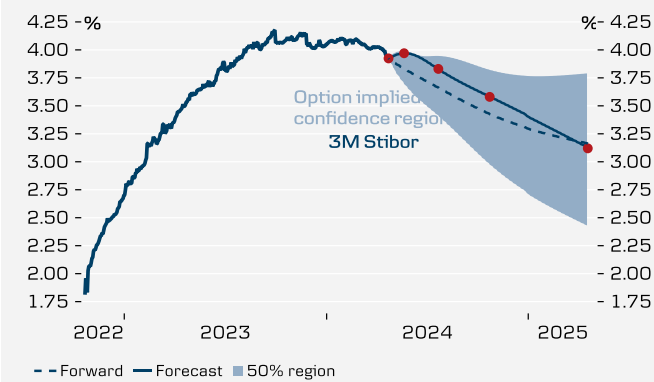
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Source: Danske Bank

1M change in SEK swap (3M)



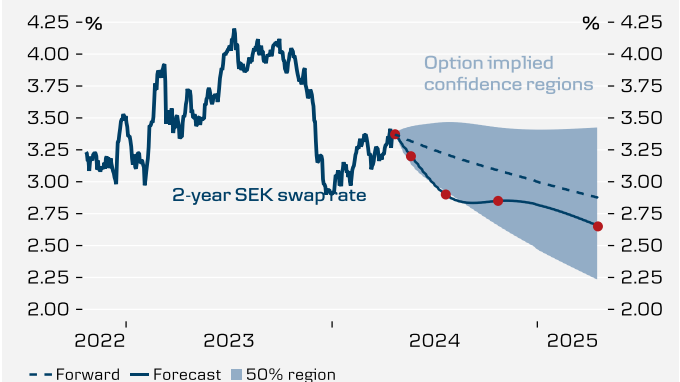
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Source: Danske Bank

3M Stibor rates



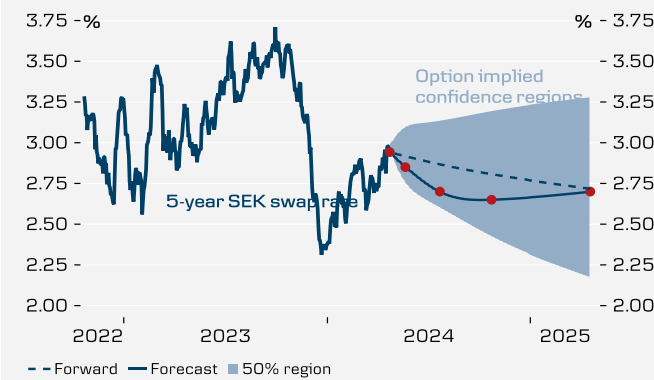
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y SEK swap rates



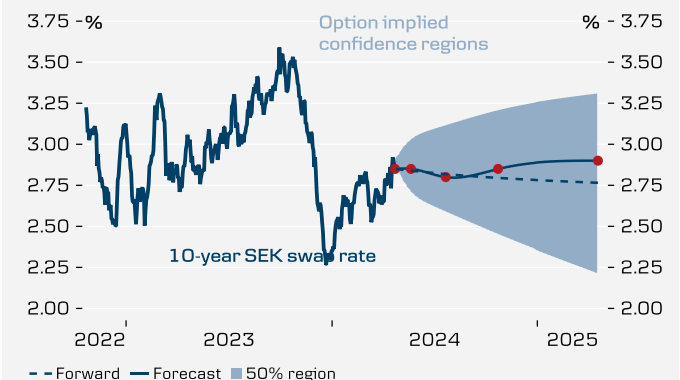
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Source: Danske Bank

5Y SEK swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y SEK swap rates



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Source: Danske Bank

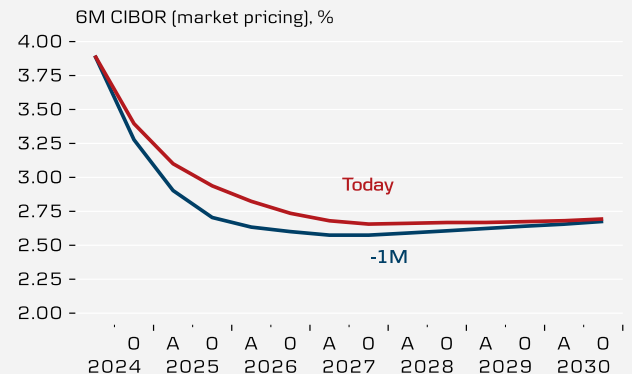
Denmark forecast

DKK forecast summary

DKK	Spot	--Forecast--				--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m	
Money Market								
Repo	3.75	3.50	3.25	2.75				
Deposit	3.60	3.35	3.10	2.60				
CIBOR (3M)	3.82	3.55	3.25	2.75	-1	-9	-28	
CIBOR (6M)	3.90	3.55	3.30	2.75	-7	-9	-34	
Government Bonds								
2-year	2.91	2.80	2.55	2.25				
5-year	2.53	2.45	2.35	2.20				
10-year	2.49	2.45	2.45	2.45				
Swap Rates								
2-year	3.40	3.30	3.05	2.80	5	-8	-15	
5-year	3.02	2.95	2.85	2.70	0	-4	-11	
10-year	2.91	2.85	2.85	2.85	-3	0	3	

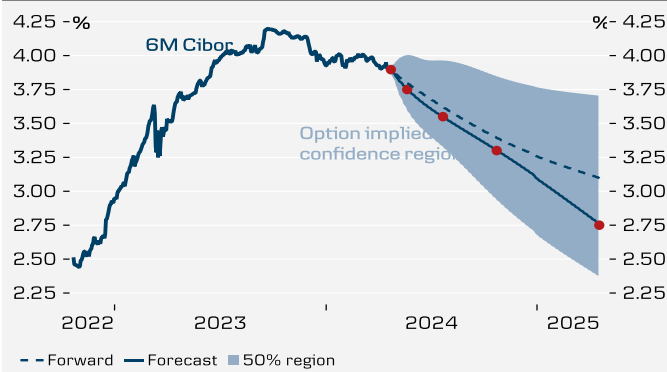
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1M change in DKK swap (6M)



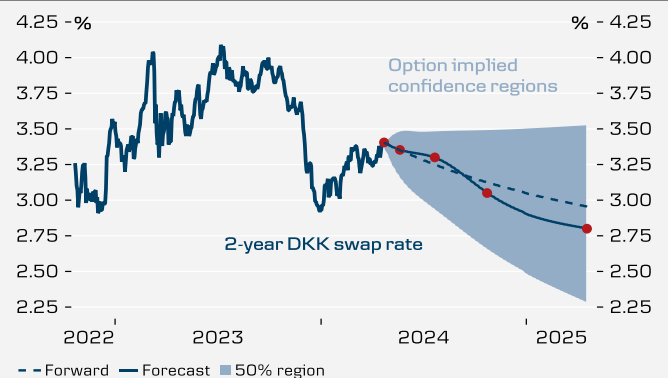
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6M CIBOR



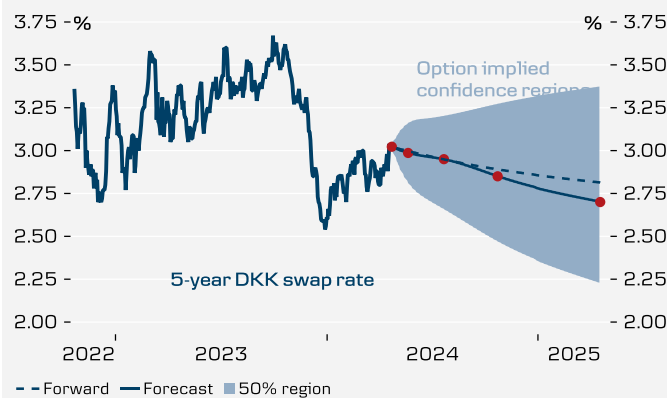
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Source: Danske Bank

2Y DKK swap rates



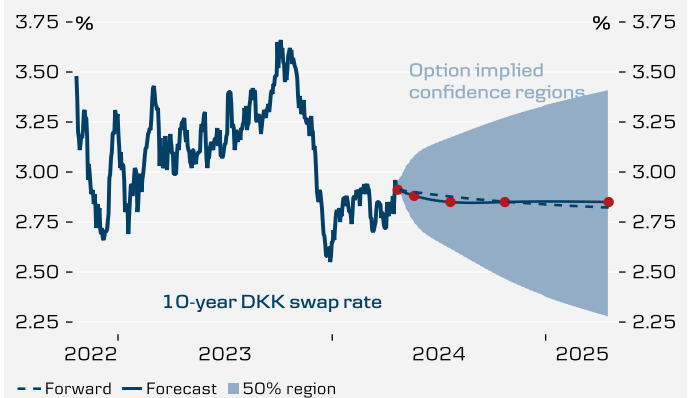
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

5Y DKK swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y DKK swap rates



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

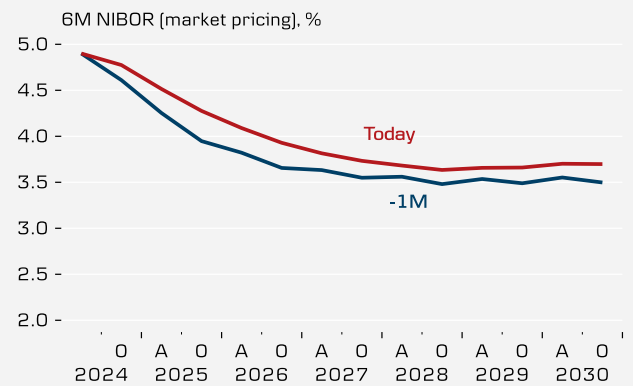
Norway forecast

NOK forecast summary

NOK	Spot	--Forecast--			--Fcst vs Fwd in bp--		
		+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Deposit	4.50	4.50	4.25	3.50			
NIBOR (3M)	4.73	4.60	4.25	3.80	-22	-48	-58
NIBOR (6M)	4.90	4.60	4.25	3.80	-35	-53	-71
Government Bonds							
2-year	4.09	3.90	3.70	3.30			
5-year	3.79	3.65	3.55	3.40			
10-year	3.78	3.70	3.65	3.65			
Swap Rates							
2-year	4.69	4.40	4.20	3.80	-18	-26	-44
5-year	4.20	3.95	3.85	3.70	-18	-21	-24
10-year	3.98	3.80	3.75	3.75	-15	-16	-9

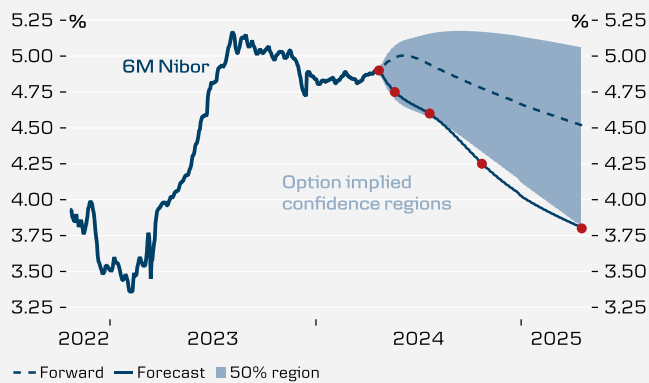
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

1M change in NOK swap (6M)



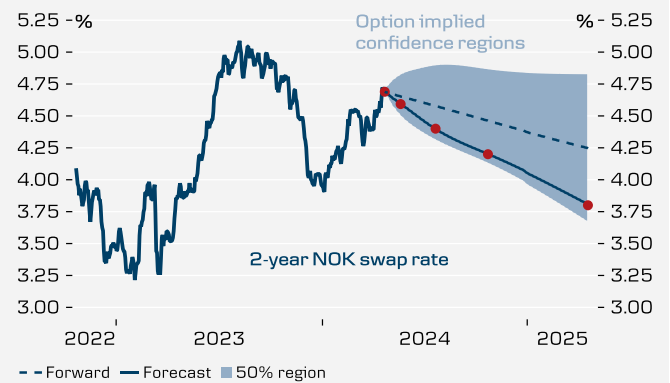
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

6M Nibor



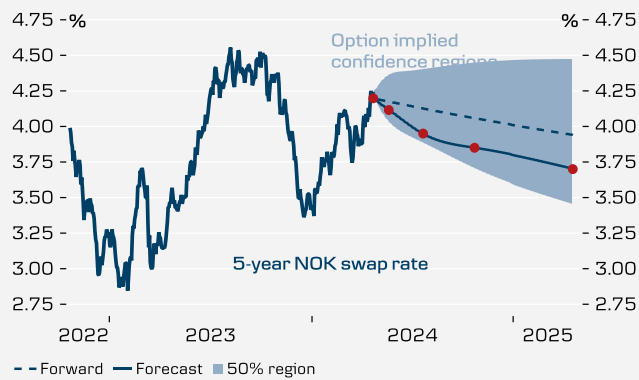
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y NOK swap rate



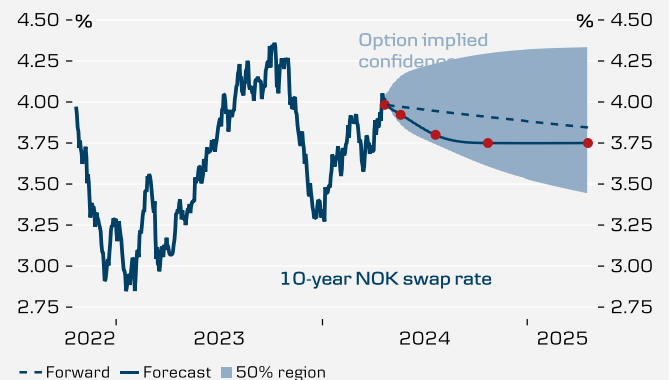
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

5Y NOK swap rate



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

10Y NOK swap rate



Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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Report completed: 19 April 2024 at 17:30 CET

Report disseminated: 19 April 2024 at 17:45 CET