

# Yield Outlook

## QE from ECB and Fed to keep global long-term yields steady for now – upside on 12-month horizon

During the late summer, the central banks again took centre stage. Firstly, the US Federal Reserve announced a new flexible inflation target that will allow inflation to increase temporarily above the 2% target. The move comes after a period of sub-target inflation. Expectedly, we will learn more about the actual new structure after today's FOMC meeting.

With inflation persistently below 2% during large parts of 2019 and 2020, there are no indications that the Fed is in any way trying to move short-term rates higher, even if the US economy were to rebound.

The market is pricing for the Fed Funds Rate to remain at the current level until end 2024. The money market curve indicates a fair probability of the US also introducing negative interest rates – we see the chance of that as very slim, however. Fed chair Jerome Powell has several times rejected the notion of negative interest rates in the US, even during the very severe crisis in Q2 20. Moreover, negative interest rates were not an issue during the Fed's review of its monetary policy strategy.

Yet, the Fed can only control the short end of the curve. Rates further out the curve are driven by supply and demand, neutral real yields ( $r^*$ ) and inflation forecasts. The latter rose during the summer, especially in the US, as positive sentiment returned to the financial markets along with growing confidence in global central banks' ability to drive up inflation.

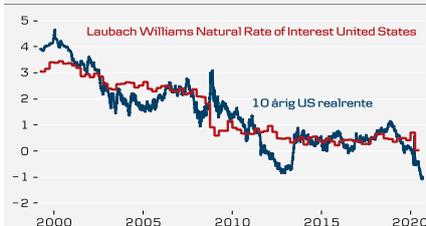
However, as the charts below show, US inflation forecasts (break evens) have risen, but nominal yields have not. As a result, neutral yields have dropped to around minus 1%. While there is no doubt that the US economy needs negative interest rates right now, we do not expect this to apply for the next 10 years. We expect the 10Y swap rate to climb to 1.1% over the next 12 months from the current level of just below 0.7%. Part of the increase is likely to reflect a slight move upwards in 10Y expected real yields in addition to inflation forecasts moving higher. The rest we would attribute to a reduction in safe haven purchases by investors, for example when a COVID-19 vaccine becomes available – expectedly in 2021.

### Inflation forecasts and nominal yields have moved in different directions



Source: Bloomberg, Danske Bank

### ...and US real yields have dropped sharply to below neutral yields



Source: Bloomberg, Danske Bank

### Links

- [Forecasts table](#)
- [Forecasts for the Eurozone](#)
- [Forecasts for the US](#)
- [Forecasts for the UK](#)
- [Forecast for Denmark](#)
- [Forecasts for Sweden](#)
- [Forecasts for Norway](#)

### Policy rates

Country	Spot	+3m	+6m	+12m
USD	0.25	0.25	0.25	0.25
EUR	-0.50	-0.50	-0.50	-0.50
GBP	0.10	0.10	0.10	0.10
DKK	-0.60	-0.60	-0.60	-0.60
SEK	0.00	0.00	0.00	0.00
NOK	0.00	0.00	0.00	0.00

### 10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	0.66	0.70	0.80	1.10
GER	-0.48	-0.45	-0.40	-0.25
GBP	0.18	0.30	0.40	0.50
DKK	-0.35	-0.35	-0.30	-0.15
SEK	0.02	0.05	0.10	0.20
NOK	0.69	0.85	0.95	1.15

Note: EUR = Germany

### 10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	0.67	0.70	0.80	1.10
EUR	-0.22	-0.20	-0.15	0.00
GBP	0.36	0.45	0.55	0.65
DKK	0.00	0.00	0.00	0.15
SEK	0.31	0.35	0.35	0.45
NOK	0.96	1.15	1.30	1.50

Note: EUR = Germany

Source [all three charts]: Danske Bank

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As mentioned, the development in inflation expectations and nominal yields has prompted a quite significant fall in expected 10Y US real yields to -1% (see right-hand chart on the previous page). Over the past four to five years, most neutral real yield ( $r^*$ ) estimates have remained at around 0.5%. Note, though, that the latest estimate from Laubach and Williams dropped to near zero (see chart).

In other words, we do not believe neutral US yields have dropped to minus 1% because of the virus and we have assumed that US real yields will rise over the next 12 months.

As for macroeconomic developments, our economists believe the economic recovery is on track. For more on this, see *The Big Picture: Global recovery on track*, 14 September.

## QE purchases absorbing increased US supply of bonds

Supply and demand should not be ignored, whether in the US or the Eurozone. The Fed has eased the pace of its asset purchases a bit in recent months. We would not be surprised if at today's meeting or later this year it decides to scale up its purchases. It would be a strong signal that the Fed is serious about allowing inflation to exceed the 2% target temporarily.

Such a move would help flatten the US yield curve, even though covering the US budget deficit would require selling a substantial amount of bonds. The expected larger QE purchases by the Fed is one reason why we expect US 10Y yields to remain close to current levels for the next six months. A potential move higher for US 10Y yields would expectedly occur in H2 21.

## Focus on short rates and increased QE buying in the Eurozone

Like short-term US rates, short European rates do not look likely to increase for many years ahead. As such, also in Europe mainly factors affecting the yield curve beyond the 5Y point are likely to set the direction for yields. At -0.2%, inflation is running far below the ECB's inflation target of 2%. Nonetheless, there is not much to indicate that the ECB is prepared to follow the Fed's example and introduce a flexible inflation target. Indeed, this might not make much sense, with inflation running miles away from 2%.

On the other hand, there is a lot to indicate that the ECB will extend/expand the existing QE programmes further into H2 21. Further rate cuts from the ECB do not seem to be on the cards for now. That said, given the current low inflation and recent EUR strengthening, we would definitely not rule out the possibility of short rates going even lower. Markets are currently pricing a 10bp cut in the ECB's key policy rate to -0.60% in 2021.

## Yields set to edge up slightly in H2 21

With central banks anchoring the front end of the yield curve, a clear limit has been placed on how far long yields can rise. Either the market has to start believing in earlier policy rate hikes or the 5Y-10Y yield curve has to rise markedly for, for example, 10Y yields to increase significantly.

However, looking ahead to H2 21, we expect slightly higher 10Y yields. While we expect the 5Y-10Y curve to steepen a little, we also believe that 5Y yields will tick up. As the global economy presumably begins to escape from its COVID-19 shackles in 2021, we expect the market to bring forward the first rate hike a little. As mentioned, we also expect a repricing of the current very low real yields, mainly via higher nominal yields.

Overall, we expect 10Y Bund yields to increase to -0.25% 12 months from now. We expect no noticeable changes in 10Y Bund yields for the remainder of 2020.

### Eurozone inflation forecasts have dropped slightly during past month (%)



Source: Macrobond Financial, Bloomberg

However, we generally see upside risks to yields due to the increase in inflation expectations. Any positive news on the outlook for a COVID-19 vaccine could send yields up slightly, reducing the current safe-haven attraction of the US, German and Nordic government bond markets.

On the other hand, a potential second wave of infections and lockdowns could prompt renewed yield falls in the US and Europe. We see the largest downside to US yields.

### No changes in short-term policy rates in the pipeline

Short-term policy rates are now at zero or in negative territory broadly all over the western world. We find it difficult to see markets truly starting to speculate about policy rate hikes within the next 12 months, whether in the US, the Eurozone, the UK or Scandinavia. However, Norway could be the exception that proves the rule, with the Norwegian economy recovering quickly supported by a very expansionary fiscal policy, slightly higher oil prices and, not least, a booming housing market. We continue to expect the first rate hike from the Norwegian central bank in late 2021.

The DKK has strengthened against the EUR over summer as equity prices have increased and Danish investors have sold foreign currency/bought the DKK forward to hedge the increase in FX risk prompted by the foreign currency value of assets rising. If this situation continues, it could eventually trigger a unilateral rate hike from the Danish central bank, Danmarks Nationalbank (DN). While our baseline scenario is that the DN will not cut rates within the next 12 months, a unilateral Danish rate hike of 10bp or 15bp has definitely become more likely over the past month, following a fall in EUR/DKK to 7.44.

However, policy rates are one thing, money market rates are another. Three-month Euribor fixings have fallen further over the summer and are now as low as -0.48%, which is close to the ECB's deposit rate of -0.50%. The fall in short-term money market rates is the result of the ECB's large QE programmes having pumped a large volume of EUR liquidity into the banking system, pushing money market rates down. We expect liquidity to remain high in all markets and believe the fall in Euribor fixings will tend to pull other fixings such as Cibor, Stibor and Nibor lower.

Stibor and Nibor fixings have already edged down slightly, and 3M Stibor has dipped into negative territory. We expect Cibor fixings to fall back a little in coming quarters.

**We expect to publish the next issue of *Yield Outlook* mid-October.**

**Downward pressure on 3M money market rates has sent 3M Stibor into negative territory, %**



Source: Bloomberg, Macrobond Financial

**3M Cibor-Euribor spread has widened, %**



Source: Bloomberg, Macrobond Financial

Forecast\*

	Horizon	Policy rate	3m x1bor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	0.25	0.25	0.21	0.31	0.67	0.13	0.25	0.66
	+3m	0.25	0.23	0.23	0.35	0.70	0.15	0.30	0.70
	+6m	0.25	0.23	0.23	0.45	0.80	0.15	0.40	0.80
	+12m	0.25	0.23	0.33	0.65	1.10	0.25	0.60	1.10
EUR*	Spot	-0.50	-0.48	-0.47	-0.42	-0.22	-0.69	-0.69	-0.48
	+3m	-0.50	-0.47	-0.45	-0.40	-0.20	-0.70	-0.65	-0.45
	+6m	-0.50	-0.47	-0.45	-0.35	-0.15	-0.70	-0.60	-0.40
	+12m	-0.50	-0.47	-0.35	-0.15	0.00	-0.60	-0.40	-0.25
GBP	Spot	0.10	0.06	0.04	0.15	0.36	-0.13	-0.12	0.18
	+3m	0.10	0.07	0.15	0.25	0.45	0.00	0.00	0.30
	+6m	0.10	0.07	0.20	0.35	0.55	0.05	0.10	0.40
	+12m	0.10	0.07	0.25	0.55	0.65	0.10	0.30	0.50
DKK	Spot	-0.60	-0.23	-0.20	-0.19	0.00	-0.56	-0.53	-0.35
	+3m	-0.60	-0.25	-0.20	-0.20	0.00	-0.62	-0.52	-0.35
	+6m	-0.60	-0.25	-0.20	-0.15	0.00	-0.62	-0.48	-0.30
	+12m	-0.60	-0.26	-0.15	0.05	0.15	-0.52	-0.30	-0.15
SEK	Spot	0.00	-0.03	-0.06	0.06	0.31	-0.35	-0.29	0.02
	+3m	0.00	0.00	0.00	0.20	0.35	-0.30	-0.10	0.05
	+6m	0.00	0.00	0.00	0.25	0.35	-0.30	-0.05	0.10
	+12m	0.00	0.05	0.00	0.35	0.45	-0.30	0.05	0.20
NOK	Spot	0.00	0.27	0.45	0.66	0.96	0.29	0.39	0.69
	+3m	0.00	0.26	0.65	0.85	1.15	0.40	0.55	0.85
	+6m	0.00	0.26	0.80	0.95	1.30	0.50	0.65	0.95
	+12m	0.00	-0.32	0.90	1.20	1.50	0.60	0.85	1.15

Note: \* German government bonds are used, EUR swap rates are used

\* German government bond yields and EUR swap rates

Source: Danske Bank

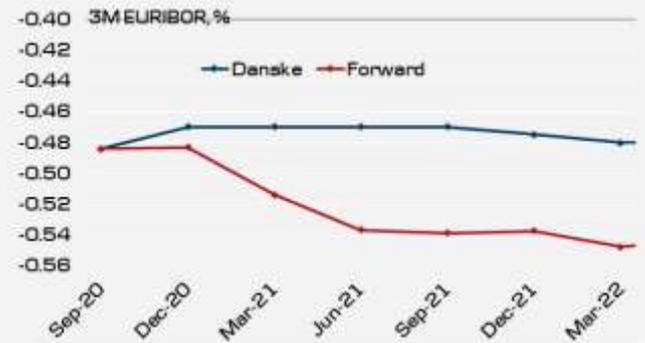
# Eurozone forecast

## EUR forecast summary

14/09/2020	-- Forecast --				-- Fcst vs Fwd in bp --		
EUR	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money Market</b>							
Ref	0.00	0.00	0.00	0.00	-	-	-
Deposit	-0.50	-0.50	-0.50	-0.50	-	-	-
3M	-0.48	-0.47	-0.47	-0.47	1	4	7
6M	-0.46	-0.45	-0.45	-0.45	1	2	3
<b>Government Bonds</b>							
2-year	-0.69	-0.70	-0.70	-0.60	-	-	-
5-year	-0.69	-0.65	-0.60	-0.40	-	-	-
10-year	-0.48	-0.45	-0.40	-0.25	-	-	-
<b>Swap rates</b>							
2-year	-0.47	-0.45	-0.45	-0.35	2	3	12
5-year	-0.42	-0.40	-0.35	-0.15	1	0	22
10-year	-0.22	-0.20	-0.15	0.00	0	3	14

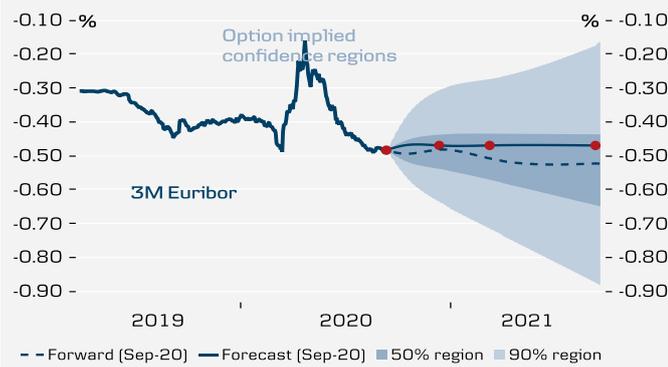
Source: Danske Bank

## Danske Bank forecast and forwards



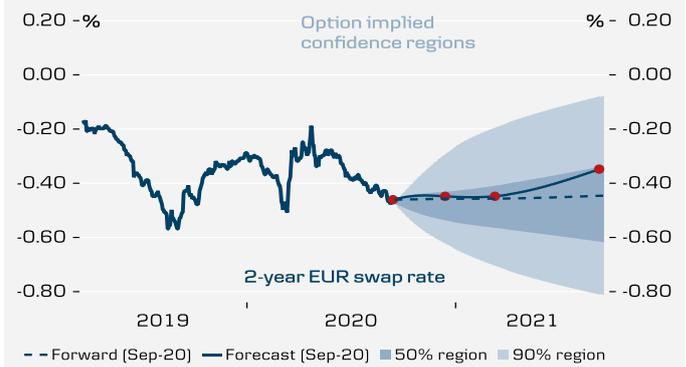
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Euribor



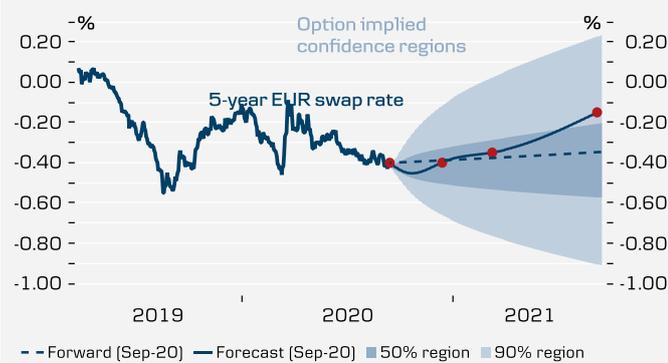
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Source: Danske Bank

## 2Y EUR swap rates



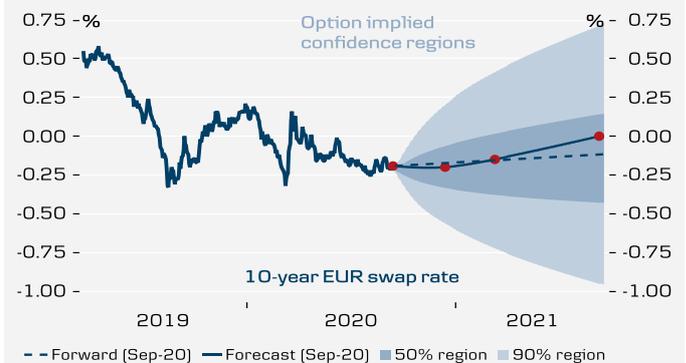
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 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

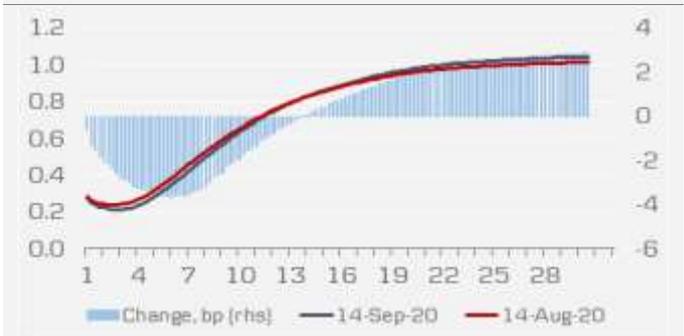
# US forecast

## USD forecast summary

14/09/2020		-- Forecast --				-- Fcst vs Fwd in bp --		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m	
<b>Money Market</b>								
Fed Funds	0.25	0.25	0.25	0.25	-	-	-	
3M	0.25	0.23	0.23	0.23	-7	2	5	
<b>Government Bonds</b>								
2-year	0.13	0.15	0.15	0.25	-	-	-	
5-year	0.25	0.30	0.40	0.60	-	-	-	
10-year	0.66	0.70	0.80	1.10	-	-	-	
<b>Swap rates</b>								
2-year	0.21	0.23	0.23	0.33	2	3	12	
5-year	0.31	0.35	0.45	0.65	1	9	23	
10-year	0.67	0.70	0.80	1.10	1	8	33	

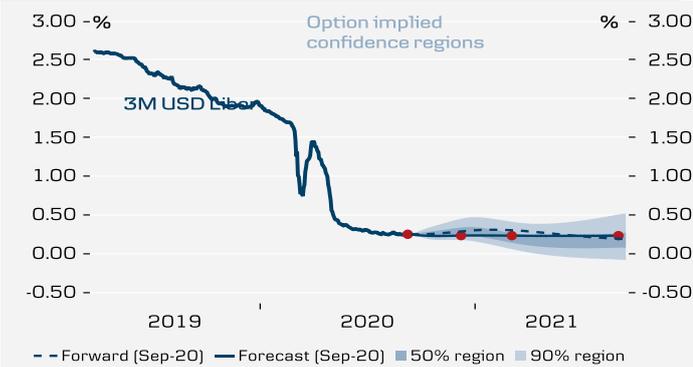
Source: Danske Bank

## 1M change in 3M USD Libor



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

## 3M USD Libor rates



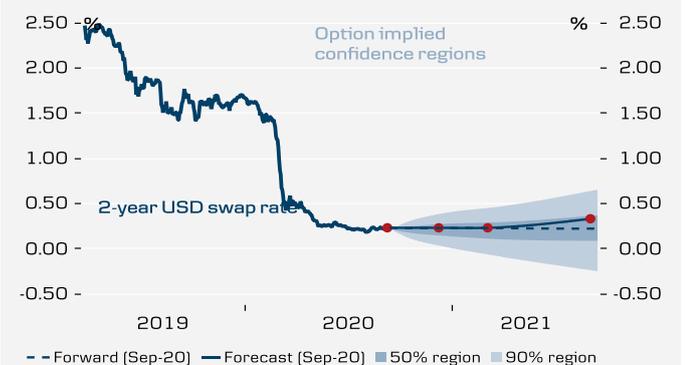
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



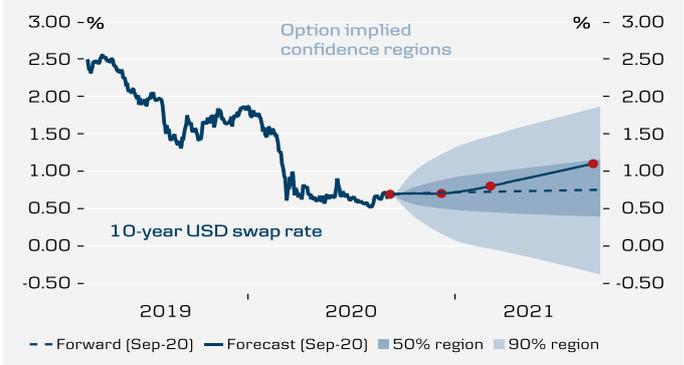
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y 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  
Source: Danske Bank

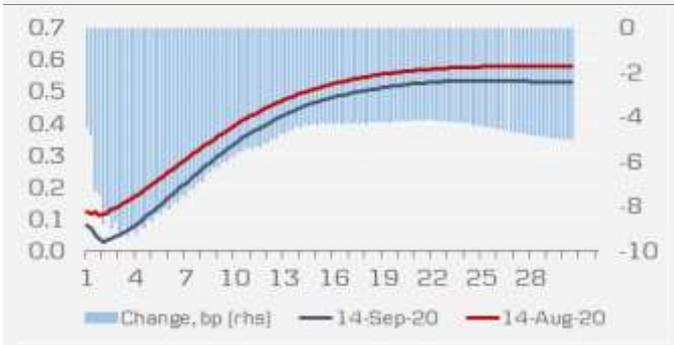
# UK forecast

## UK forecast summary

14/09/2020		-- Forecast --				-- Fcst vs Fwd in bp --		
GBP	Spot	+3m	+6m	+12m	+3m	+6m	+12m	
<b>Money Market</b>								
Reps	0.10	0.1	0.1	0.1	-	-	-	
3M	0.06	0.07	0.07	0.07	1	6	13	
<b>Government Bonds</b>								
2-year	-0.13	0.00	0.05	0.10	16	24	31	
5-year	-0.123	0	0.1	0.3	12	21	38	
10-year	0.18	0.30	0.40	0.50	7	14	17	
<b>Swap rates</b>								
2-year	0.04	0.15	0.20	0.25	10	16	18	
5-year	0.15	0.25	0.35	0.55	9	17	13	
10-year	0.36	0.45	0.55	0.65	8	16	23	

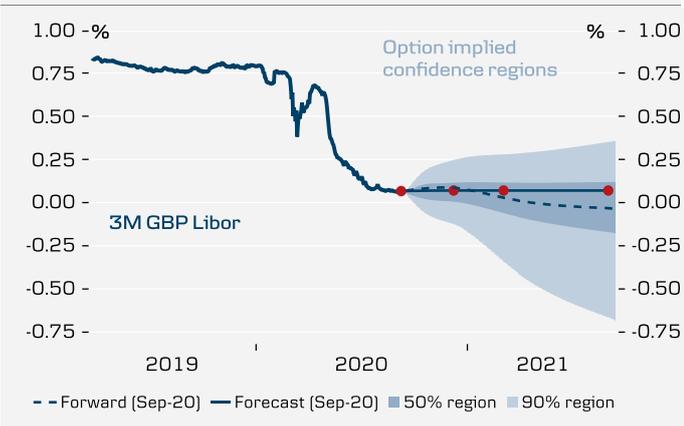
Source: Danske Bank

## 1M change in 6M GBP Libor



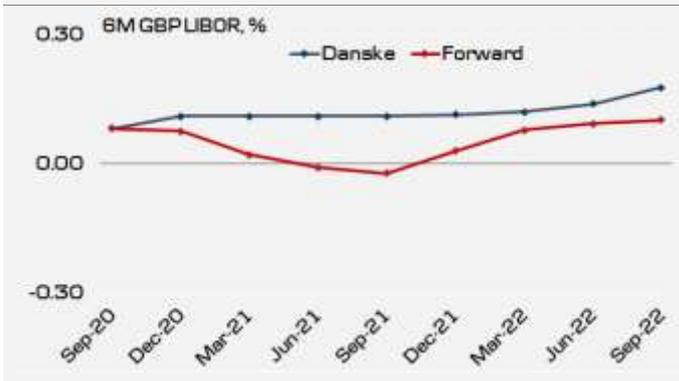
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M GBP Libor rate



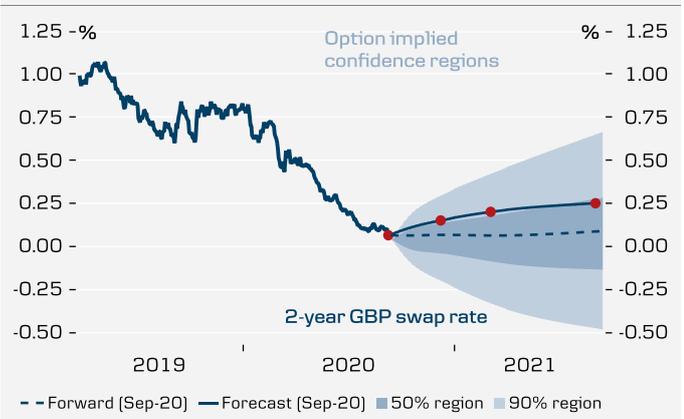
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



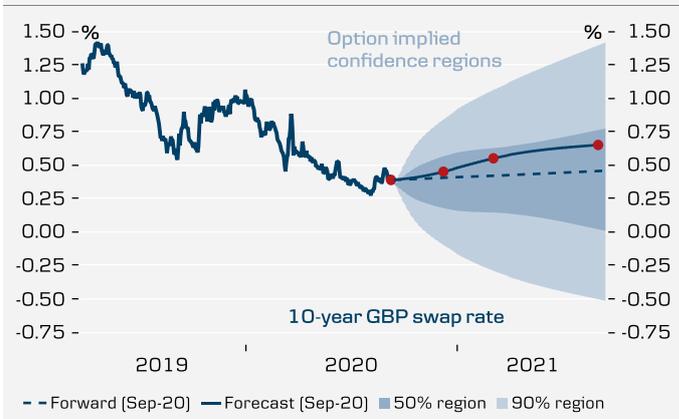
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y UK swap rates



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

## 10Y UK swap rates



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

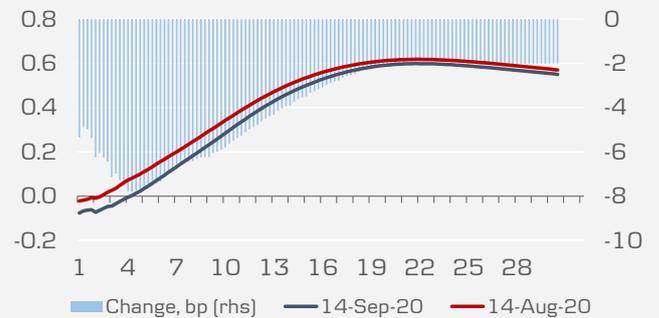
# Sweden forecast

## SEK forecast summary

SEK	Spot	Forecast				Fcast vs Fwd in bp		
		+3m	+6m	+12m	+3m	+6m	+12m	
<b>Money market</b>								
Repe	0.00	0.00	0.00	0.00	-	-	-	-
3M	-0.03	0.00	0.00	0.05	12	5	10	
<b>Government bonds</b>								
2-year	-0.35	-0.30	-0.30	-0.30	-	-	-	-
5-year	-0.29	-0.10	-0.05	0.05	-	-	-	-
10-year	0.02	0.05	0.10	0.20	-	-	-	-
<b>Swap rates</b>								
2-year	-0.06	0.00	0.00	0.00	5	4	0	
5-year	0.08	0.20	0.25	0.35	13	15	21	
10-year	0.31	0.35	0.35	0.45	2	-1	5	

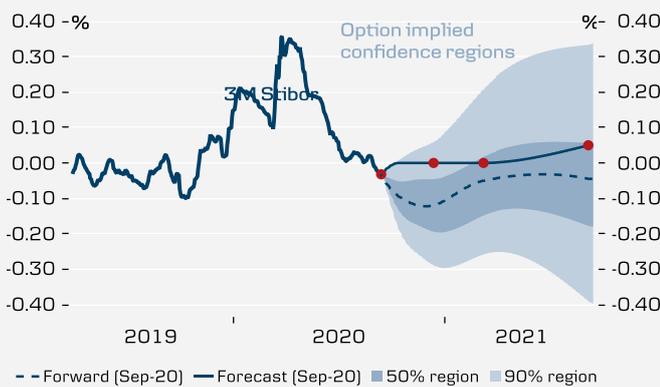
Source: Danske Bank

## 1M change in 3M Stibor



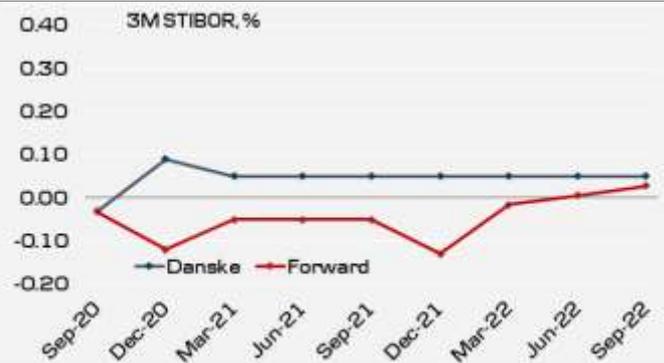
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Stibor rate



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

## Danske Bank forecast and forwards



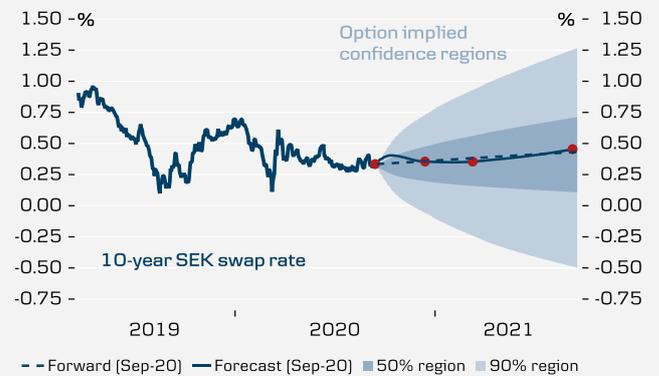
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y SEK swap rates



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

## 10Y SEK swap rates



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

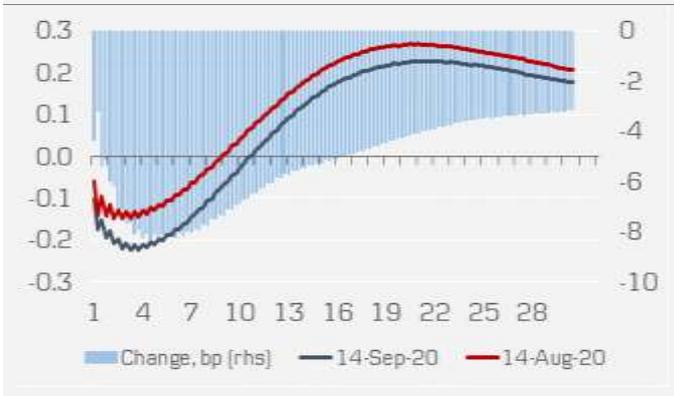
# Denmark forecast

## DKK forecast summary

14/09/2020	-- Forecast --				-- Fcst vs Fwd in bp --		
DKK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money Market</b>							
CD	-0.60	-0.60	-0.60	-0.60	-	-	-
Repo	0.05	0.05	0.05	0.05	-	-	-
3M	-0.23	-0.25	-0.25	-0.26	4	8	11
6M	-0.10	-0.09	-0.10	-0.12	6	9	11
<b>Government bonds</b>							
2-year	-0.56	-0.62	-0.62	-0.52	-	-	-
5-year	-0.53	-0.52	-0.48	-0.30	-	-	-
10-year	-0.35	-0.35	-0.30	-0.15	-	-	-
<b>Swap rates</b>							
2-year	-0.20	-0.20	-0.20	-0.15	2	3	9
5-year	-0.19	-0.20	-0.15	0.05	-1	3	21
10-year	0.00	0.00	0.00	0.15	-1	-2	9
30-year	0.18	0.20	0.30	0.50	2	12	32

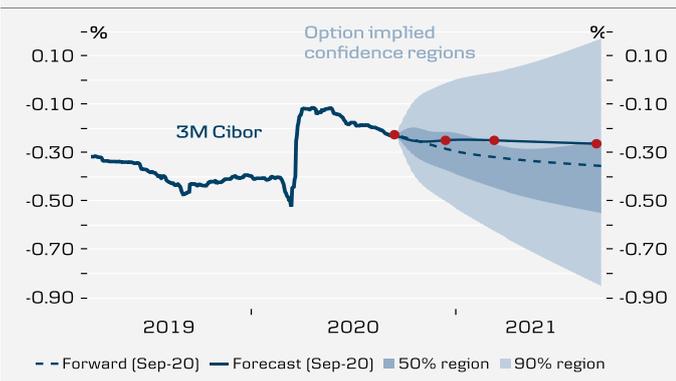
Source: Danske Bank

## 1M change in 6M Cibar



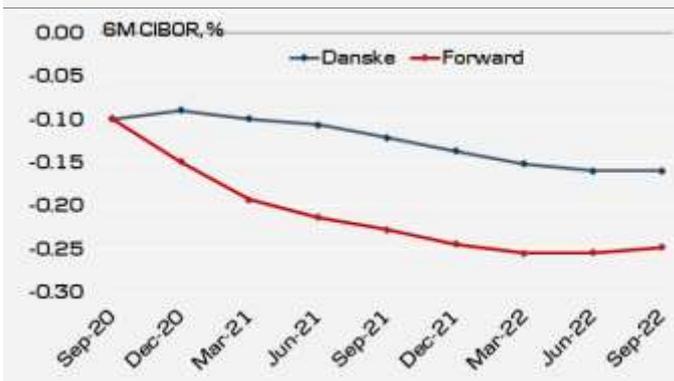
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Cibar



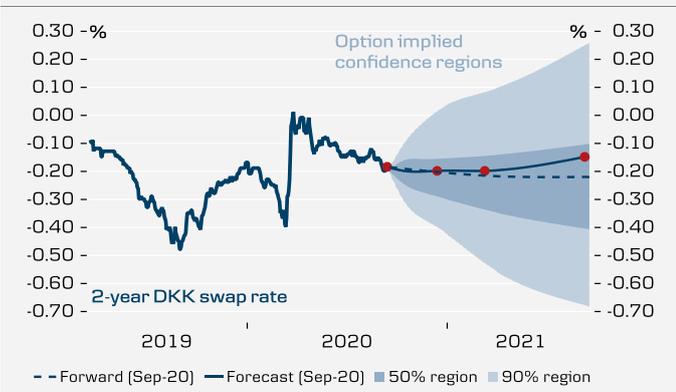
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



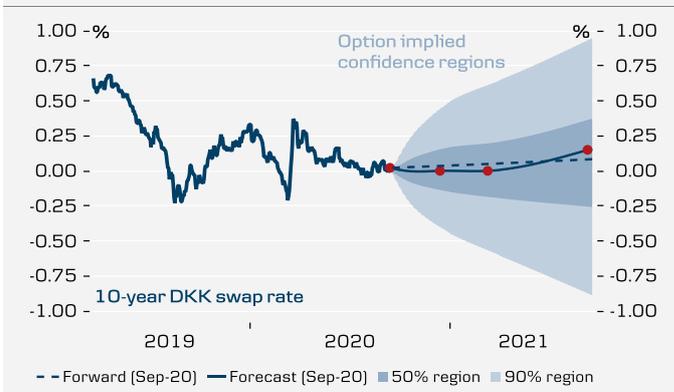
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y 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

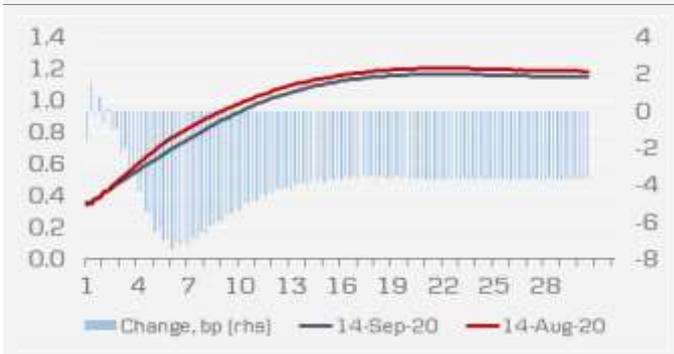
# Norway forecast

## NOK forecast summary

NOK	Forecast				Fcast vs Fwd in bp		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money market</b>							
Deposit	0.00	0.00	0.00	0.00	-	-	-
3M	0.27	0.26	0.26	0.32	-8	-7	-7
6M	0.34	0.35	0.35	0.46	-6	-6	-3
<b>Government bonds</b>							
2-year	0.29	0.40	0.50	0.60	-	-	-
5-year	0.39	0.55	0.65	0.85	-	-	-
10-year	0.69	0.85	0.95	1.15	-	-	-
<b>Swap rates</b>							
2-year	0.45	0.65	0.80	0.90	15	28	30
5-year	0.66	0.85	0.95	1.20	15	22	40
10-year	0.96	1.15	1.30	1.50	17	29	44

Source: Danske Bank

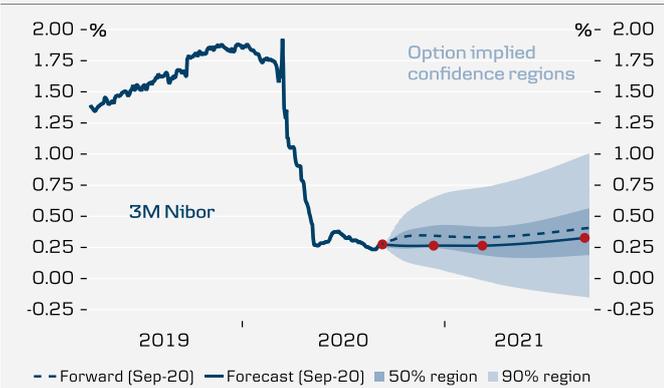
## 1M change in 6M Nibor



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

Source: Danske Bank

## 3M Nibor



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

Source: Danske Bank

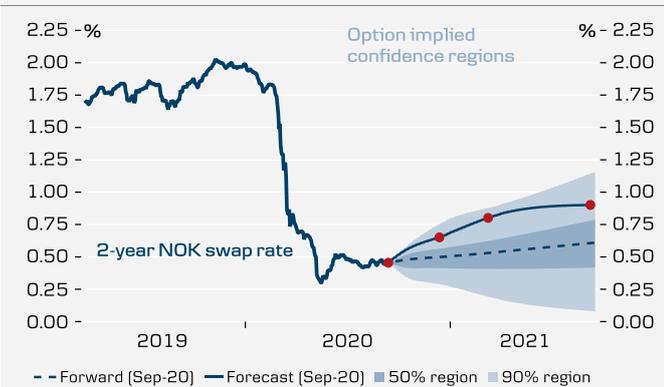
## Danske Bank forecast and forwards



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

Source: Danske Bank

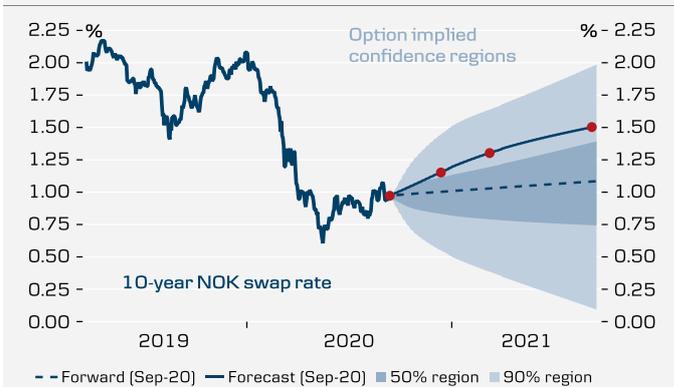
## 2Y NOK swap rate



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

Source: Danske Bank

## 10Y NOK swap rate



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

Source: Danske Bank

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