

Yield Outlook

Central banks to set the agenda over summer

- We expect long-term US yields to continue to tick up over the next 3-6 months as the US recovery gains speed and markets really begin to discuss the timing of Fed QE tapering. We now expect two rates hikes in H2 2022 after the more hawkish message from the Federal Reserve this week.
- However, yields will probably range trade with a slight upside risk over summer, as markets remain uncertain of whether the increase in inflation is transitory. The latest Fed message also adds upside
- We continue to expect 10Y US Treasury yields to hit 2.0% on a 6M horizon and 2.2% 12 months from now.
- While reopening has also come to the eurozone, the ECB chose to maintain the exceptionally high pace of QE buying through Q3 21. As such, we expect 10Y Bund yields to edge up a modest 10bp to -0.15% over the next three months and to rise a further 45bp to 0.3% on a 12M horizon. Higher long yields are likely to materialise mainly late in our forecast period – in 2022.
- While we do not expect the ECB, the BoE or the Swedish Riksbank to change policy rates over the next two years, the Norwegian central bank, Norges Bank, looks set to hike in September and December 2021. The Danish central bank, Danmarks Nationalbank, will likely deliver a unilateral Danish rate cut of 10bp, taking key policy rates to -0.6%, within the next few months.

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Central bank 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	-0.50	-0.60	-0.60	-0.60
SEK	0.00	0.00	0.00	0.00
NOK	0.00	0.25	0.50	1.00

10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	1.57	1.70	2.00	2.20
EUR	-0.17	-0.10	0.00	0.30
GBP	0.81	1.00	1.10	1.50
DKK	0.12	0.20	0.25	0.55
SEK	0.35	0.45	0.55	0.70
NOK	1.54	1.70	1.85	2.00

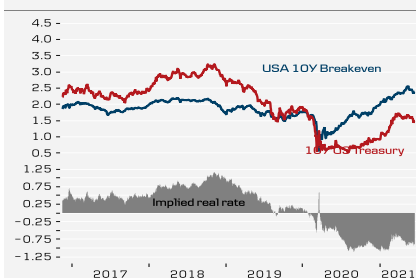
Note: EUR = Bunds

10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	1.55	1.70	2.00	2.20
EUR	0.12	0.25	0.35	0.65
GBP	1.06	1.25	1.35	1.75
DKK	0.42	0.52	0.60	0.90
SEK	0.78	0.90	0.95	1.05
NOK	1.76	2.00	2.15	2.30

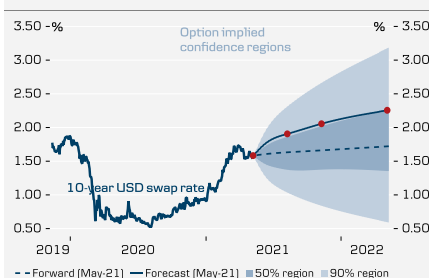
Source: Danske Bank for all three tables

While long-term interest rate and inflation expectations have fallen slightly over the past month...



Source: Macrobond Financial, Bloomberg, Danske Bank. Note: Past performance is not a reliable indicator of current or future results

...we expect US yields to tick up again in autumn/winter



Source: Danske Bank, Macrobond Financial. Note: Past performance is not a reliable indicator of current or future results

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Yields moving higher in 2021...

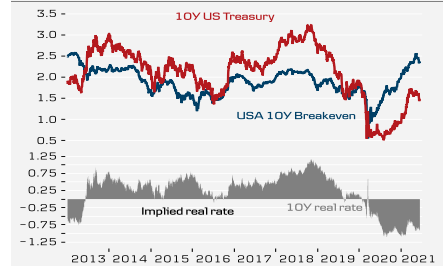
Reopening and inflation have been the main events in the global bond markets in 2021 so far, driving long-term yields higher in both Europe and the US. The US 10Y Treasury yield has risen by just over 50bp to currently around 1.5%. In Germany, the corresponding Bund yield is up by about 35bp to currently -0.25%

As we have touched upon in previous issues of *Yield Outlook*, nominal rates and yields have been driven higher by a combination of the better economic outlook and, especially, higher inflation expectations. The same applies to the repricing of the Fed's and, to a lesser extent, the ECB's interest rate forecasts. This latter factor also contributed to sending 5Y yields higher in both the US and the eurozone.

... but the upward trend is now being paused

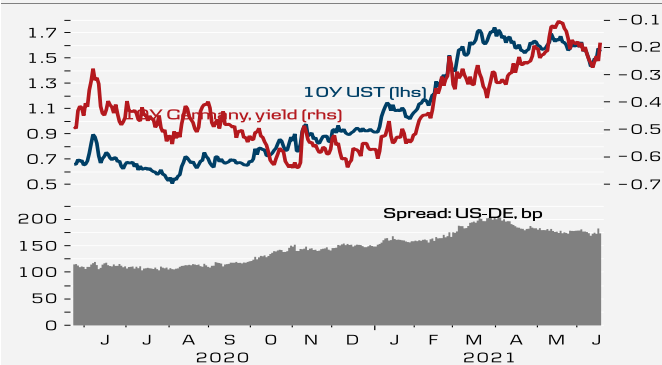
Over the past month, however, yields and inflation expectations have dropped a bit. The 10Y US Treasury yield has dropped to 1.55% after briefly hitting 1.75% earlier this year. The 10Y Bund yield is once more at -0.20% after climbing to -0.10% in mid-May. Yields have gone lower despite the continued reopening of society and the US inflation rate reaching 5.0% in May.

Inflation expectations and yields have levelled off following upward trends earlier in the year



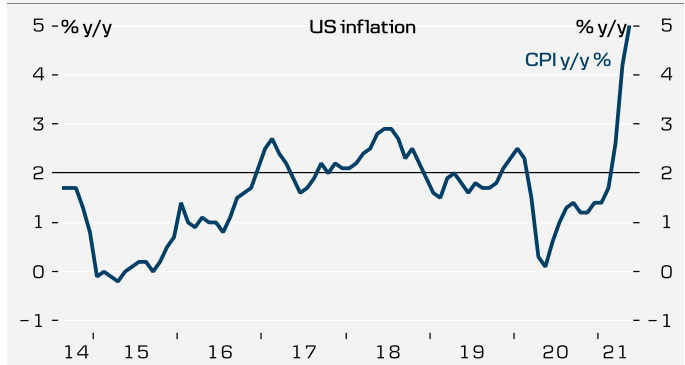
Source: Danske Bank, Macrobond Financial. Note: Past performance is not a reliable indicator of current or future results

10Y yields levelling off...



Source: Danske Bank, Macrobond Financial. Note: Past performance is not a reliable indicator of current or future results

...even with US inflation reaching 5% mark



Source: Danske Bank, Macrobond Financial

What is making long-term yields fall?

We see several reasons for the recent drop in yields, but as we explain elsewhere, we expect long-term yields to continue moving higher in the autumn and winter months. Especially, after the recent new more hawkish rhetoric from the Federal reserve.

1. Still dovish tones from the central banks

Both the ECB and, not least, the Fed have maintained that the inflation spike in Q2 21 is transitory and due in part to last year's very low level of inflation, in part to the temporary effects of reopening. In other words, the Fed has emphasised in very clear terms that it is too early to start talking about tapering its asset purchases though it opened the box slightly this week. The ECB took much the same stance at its policy meeting last week when the central bank announced it would continue the extraordinarily high pace of its asset purchases into Q3 21, even though it has become more optimistic about economic growth.

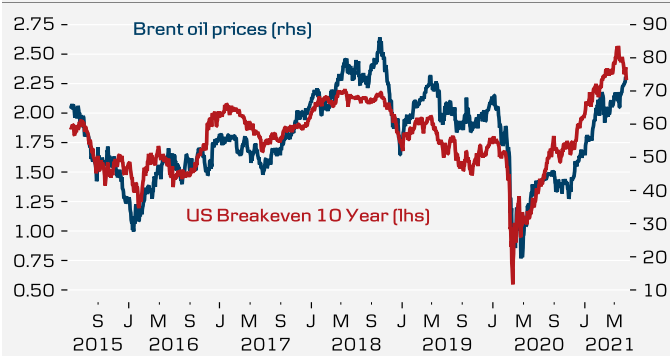
2. Growing confidence that inflation has peaked

We also believe that the market is currently buying the narrative that the central banks are correctly arguing that the spike in inflation is transitory and that it is currently peaking.

In addition, inflation expectations, both in the market and among US households, as mentioned previously, have gone a bit lower despite the still rising oil prices. Historically, there has been a close correlation between inflation expectations (break-evens) and oil prices. This could be the initial indication that the market has begun to fear that growth-curbing effects of higher commodity prices could erode household purchasing power.

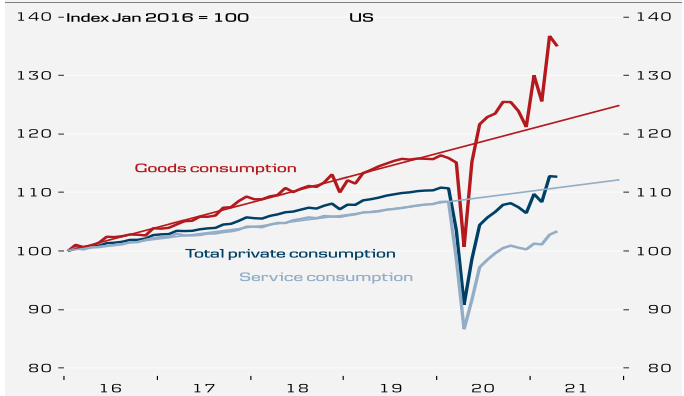
It may also be an indication that the market is expecting consumer spending to gradually shift away from goods consumption to service consumption in step with the reopening of the global economy. Such a shift could alleviate some of the pressure or even relieve the cases of overheating currently seen in the global manufacturing industry. The right-hand chart below illustrates such a scenario for the US economy.

Lower inflation expectations (10Y break-evens) despite higher oil prices



Source: Danske Bank, Macrobond Financial. Note: Past performance is not a reliable indicator of current or future results

Reduced goods consumption and increased service consumption going forward might relieve pressure on commodity inflation



Source: Danske Bank, Macrobond Financial

3. Market already positioned for higher yields

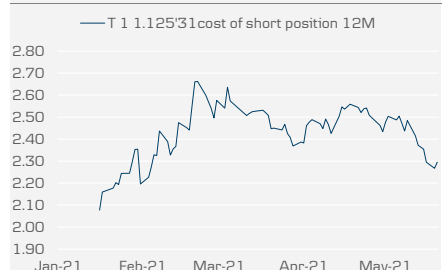
Perhaps the main reason for the drop in long-term yields is the fact that the market has already positioned for higher US yields. Given the steep US yield curve, this is an ‘expensive’ position costing the investor money each day yields do not go up. The right-hand chart illustrates the cost of being short a 10Y US Treasury bond when considering not only the yield but also the ‘roll’ on the curve in the equation.

Specifically, we saw yields going lower after the release of the higher-than-expected US inflation data on 10 June. This is a typical reaction when market position has become stretched in one direction or the other.

Drop in yields is transitory

However, we do not expect the factors mentioned above will continue to dominate fixed income markets. In the following, we discuss three factors, which we believe will drive the agenda of the global fixed income markets.

High cost of being positioned for higher US yields (10Y) due to curve roll, % 12M



Source: Danske Bank. Note: Past performance is not a reliable indicator of current or future results

1. More hawkish signals from the Fed's June meeting

The US central bank is seeing through inflation overshooting the target for now, as it expects the increase in inflation to be transitory due to the base effects of low inflation last year.

However, base effects are no longer the only factor pushing inflation higher in the US and Europe. Commodity prices are soaring right now, with the surge broadly based across the spectrum and encompassing both exchange-traded and non-exchange-traded commodities. This will almost inevitably feed through into other prices in coming quarters.

Reopening of both the US and European economies is also proceeding as planned, and unemployment has again started to come down. We expect GDP growth of 7.5% in the US and 4.7% in the eurozone for 2021.

However, most important are the more hawkish signals from the Federal Reserve meeting on 16 June, at which the Fed emphasised the improvement in the US labour market, which looks set to continue in coming months. For the first time since the start of the current economic recovery, the Fed also discussed tapering of QE purchases. We now expect tapering to be a prominent theme at the Fed's September meeting, with actual tapering likely to start in Q4 21. Come summer 2022, the Fed will probably no longer be buying bonds. We expect the Fed to deliver two policy rate hikes of 25bp in H2 22. Previously we did not expect the Fed to begin hiking until in 2023.

Markets are currently pricing around a fifty-fifty chance of a rate hike in 2022 and close to two hikes in 2023, followed by slightly less than two hikes in 2024. We expect markets to begin pricing more tightening into the US yield curve over the course of the next 6-12 months.

2. ECB also set to taper at some point

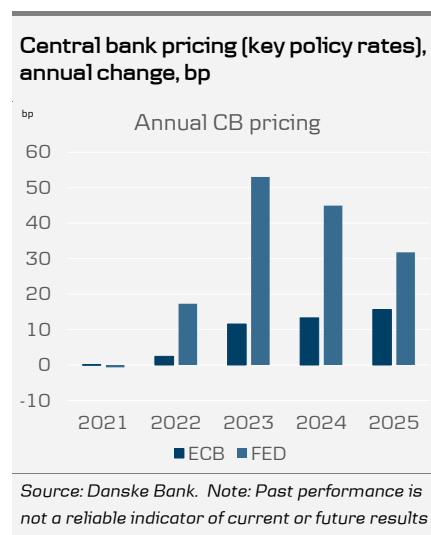
As mentioned, the ECB decided to extend its exceptionally high pace of bond buying into Q3 21. However, given the outlook for economies to reopen and higher inflation and inflation expectations, we expect the pace of Pandemic Emergency Purchase Programme (PEPP) buybacks to normalise after Q3 21. In fact, purchases could well slow somewhat in Q4 21 and Q1 22. This would depend on whether the ECB keeps within the EUR750bn overall limit of the PEPP or whether it chooses to expand and/or extend the programme, which is set to expire by the end of Q1 22.

Our overall expectation is that the ECB will essentially be able to keep a relatively tight rein on European rates and yields for the rest of 2021. We expect the 10Y Bund yield to rise by around 10bp to -0.15% in the coming three months and hit 0% by the end of the year. Looking 12 months ahead, we continue to expect a further 30bp increase. This reflects both slightly higher US yields and the PEPP likely having expired 12 months from now.

3. Easy fiscal policy to prompt large US funding requirement

US fiscal policy, in particular, has been eased significantly. This has kick-started demand, not least among US households, as low-income households with a high propensity to consume have also received significant transfers. Biden has launched three fiscal policy packages. First came the USD1,900bn COVID-19 relief package. Next came the 'jobs package', which includes major infrastructure projects. The final package is the 'American families package', which raises spending on education, pre-schools and hospitals and also provides paid parental leave and much else besides.

While the last two relief packages are partly financed through higher taxes – in contrast to the first package – they will weigh on US budgets for many years to come. This also means



that the market, not just this year but for many years yet, will have to absorb very significant bond issues alongside the likely tapering of the Fed's QE programmes in Q4 21 and in 2022.

10Y US yields set for a further move upward

All in all, we continue to expect long US yields to increase further. The big question is when that might happen. Our take from January and February is that fixed-income markets are in the vanguard at the moment. As such, the US yield increases we are pencilling in three to six months from now could very well materialise sooner.

However, we do not expect a further significant move upward in long US yields to materialise until autumn or Q4 this year. For now, central banks are keeping rates and yields anchored. We also expect base effects to help slow year-on-year inflation rates slightly in coming months. Hence, the discussion about whether or not the increase in inflation is transitory is set to continue in coming months.

We expect 10Y US Treasury yields to rise to 1.7% three months from now and 2% by the end of the year.

As mentioned, we expect 10Y Bund yields to increase to 0.3% on a 12M horizon, with most of the increase materialising in 2022.

We expect to publish the next issue of *Yield Outlook* in mid-August 2021.

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	0.12	0.28	0.97	1.55	0.20	0.89	1.57
	+3m	0.25	0.11	0.30	1.10	1.70	0.20	1.00	1.70
	+6m	0.25	0.11	0.40	1.20	2.00	0.30	1.10	2.00
	+12m	0.25	0.28	0.85	1.55	2.20	0.75	1.45	2.20
EUR*	Spot	-0.50	-0.55	-0.47	-0.26	0.12	-0.67	-0.59	-0.17
	+3m	-0.50	-0.54	-0.45	-0.25	0.25	-0.65	-0.55	-0.10
	+6m	-0.50	-0.54	-0.45	-0.15	0.35	-0.65	-0.45	0.00
	+12m	-0.50	-0.54	-0.40	0.15	0.65	-0.60	-0.20	0.30
GBP	Spot	0.10	0.08	0.36	0.75	1.06	0.12	0.39	0.81
	+3m	0.10	0.07	0.40	0.85	1.25	0.15	0.50	1.00
	+6m	0.10	0.07	0.45	1.05	1.35	0.20	0.70	1.10
	+12m	0.10	0.07	0.60	1.30	1.75	0.35	0.95	1.50
DKK	Spot	-0.50	-0.21	-0.11	0.06	0.42	-0.52	-0.40	0.12
	+3m	-0.60	-0.30	-0.15	0.02	0.52	-0.50	-0.38	0.20
	+6m	-0.60	-0.30	-0.17	0.10	0.60	-0.50	-0.30	0.25
	+12m	-0.60	-0.30	-0.12	0.40	0.90	-0.45	-0.05	0.55
SEK	Spot	0.00	-0.04	0.03	0.35	0.78	-0.28	-0.31	0.35
	+3m	0.00	-0.04	0.07	0.45	0.90	-0.30	0.00	0.45
	+6m	0.00	-0.04	0.05	0.45	0.95	-0.30	0.05	0.55
	+12m	0.00	-0.04	0.05	0.50	1.05	-0.25	0.15	0.70
NOK	Spot	0.00	0.20	1.00	1.50	1.76	0.64	1.20	1.54
	+3m	0.25	0.55	1.15	1.70	2.00	0.80	1.35	1.70
	+6m	0.50	0.89	1.45	1.75	2.15	1.10	1.40	1.85
	+12m	1.00	1.43	1.65	1.95	2.30	1.30	1.60	2.00

* German government bond yields and euro swap rates

Source: Danske Bank

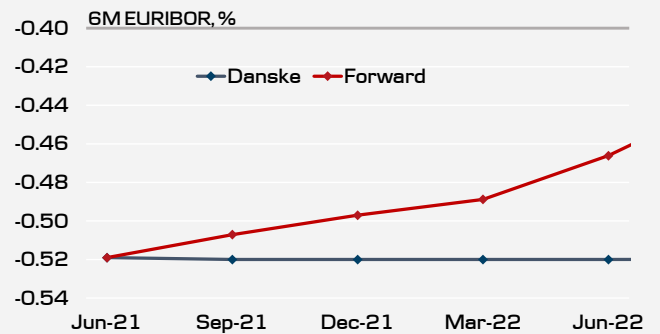
EUR forecast

EUR forecast summary

17/06/2021	--- Forecast ---				--- Fcst vs Fwd in bp ---		
EUR	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
Refi	0.00	0.00	0.00	0.00	-	-	-
Deposit	-0.50	-0.50	-0.50	-0.50	-	-	-
3M	-0.55	-0.54	-0.54	-0.54	0	-1	-2
6M	-0.52	-0.52	-0.52	-0.52	-1	-2	-5
<u>Government Bonds</u>							
2-year	-0.67	-0.65	-0.65	-0.60	-	-	-
5-year	-0.59	-0.55	-0.45	-0.20	-	-	-
10-year	-0.17	-0.10	0.00	0.30	-	-	-
<u>Swap rates</u>							
2-year	-0.47	-0.45	-0.45	-0.40	0	-3	-4
5-year	-0.26	-0.25	-0.15	0.15	-3	-6	26
10-year	0.12	0.25	0.35	0.65	10	16	40

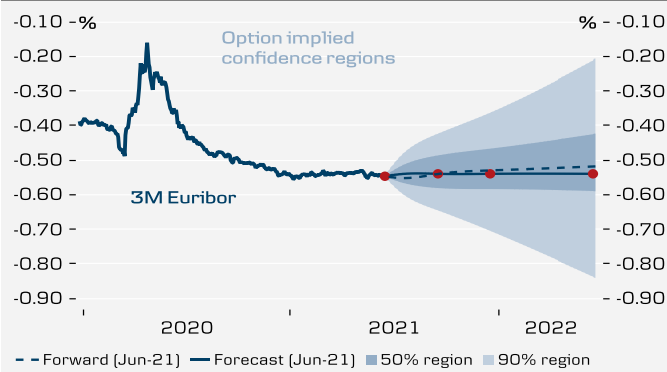
Source: Danske Bank

Danske Bank forecast and forwards



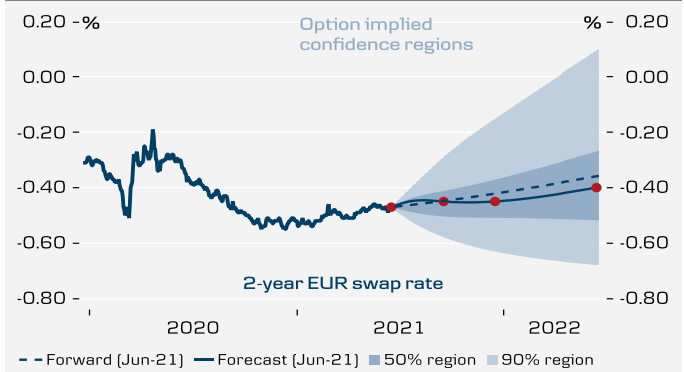
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Euribor



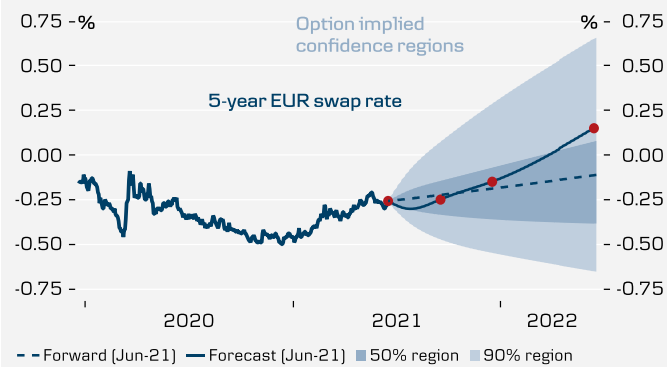
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y EUR swap rates



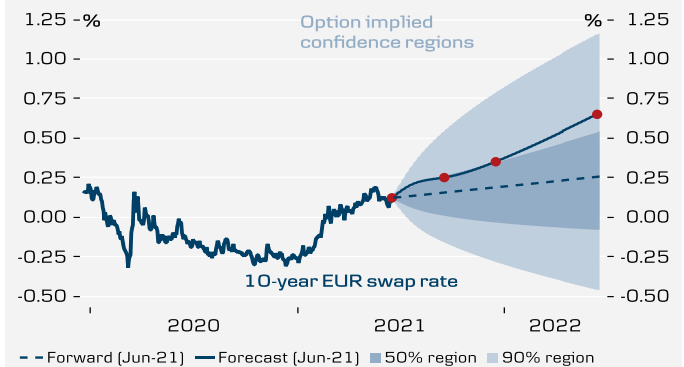
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

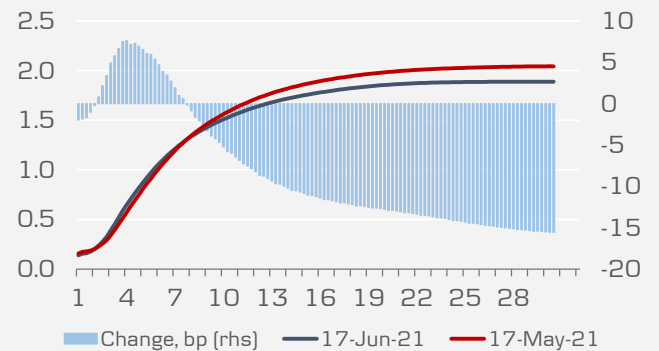
USD forecast

USD forecast summary

17/06/2021	--- Forecast ---				--- Fcst vs Fwd in bp ---		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
Fed Funds	0.25	0.25	0.25	0.25	-	-	-
3M	0.12	0.11	0.11	0.28	-3	-8	4
<u>Government Bonds</u>							
2-year	0.20	0.20	0.30	0.75	-	-	-
5-year	0.89	1.00	1.10	1.45	-	-	-
10-year	1.57	1.70	2.00	2.20	-	-	-
<u>Swap rates</u>							
2-year	0.28	0.30	0.40	0.85	-5	-5	15
5-year	0.97	1.10	1.20	1.55	4	4	20
10-year	1.55	1.70	2.00	2.20	10	34	43

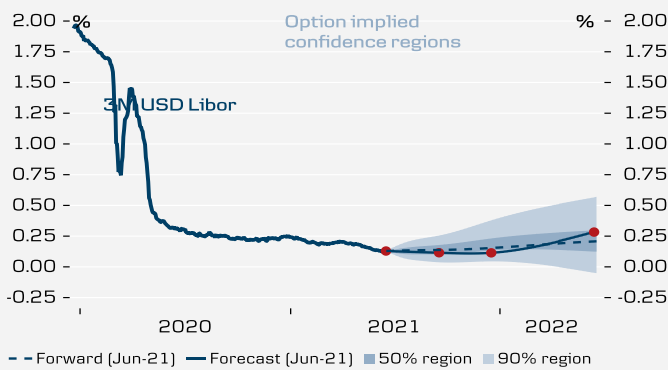
Source: Danske Bank

1M change in USD swap (3M)



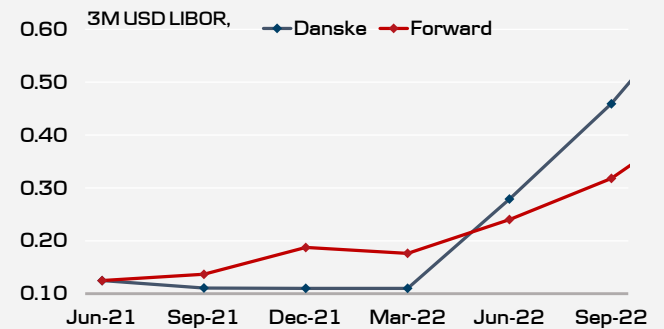
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M USD Libor rates



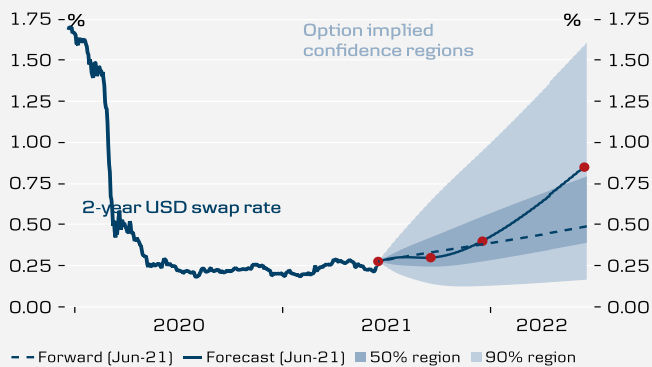
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



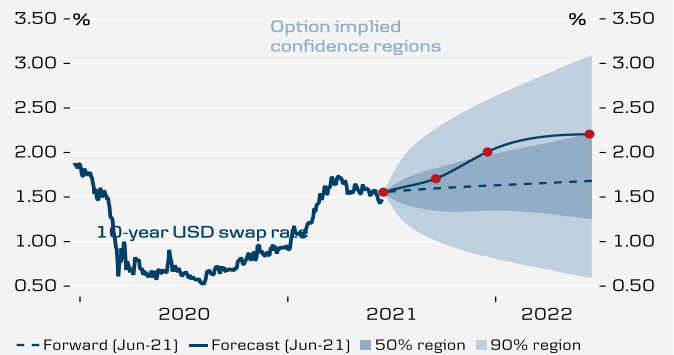
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

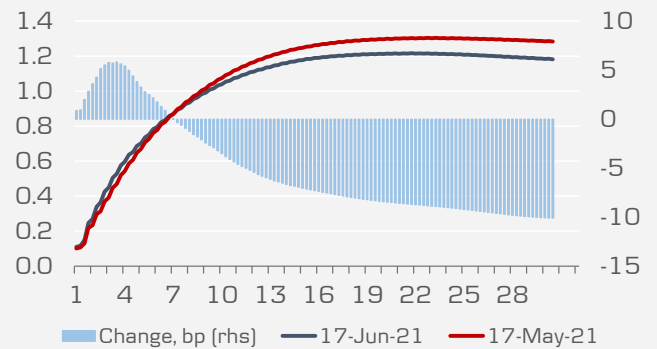
GBP forecast

GBP forecast summary

GBP	17/06/2021				--- Forecast ---			--- Fcst vs Fwd in bp ---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m			
<u>Money Market</u>										
Repo	0.10	0.1	0.1	0.1	-	-	-			
3M	0.08	0.07	0.07	0.07	-3	-6	-24			
<u>Government Bonds</u>										
2-year	0.12	0.15	0.20	0.35	0	1	10			
5-year	0.386	0.5	0.7	0.95	9	25	42			
10-year	0.81	1.00	1.10	1.50	12	18	49			
<u>Swap rates</u>										
2-year	0.36	0.40	0.45	0.60	-7	-9	-12			
5-year	0.75	0.85	1.05	1.30	3	18	10			
10-year	1.06	1.25	1.35	1.75	15	22	55			

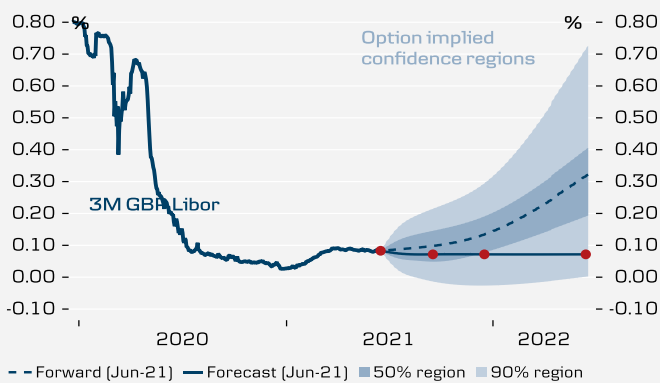
Source: Danske Bank

1M change in GBP swap (6M)



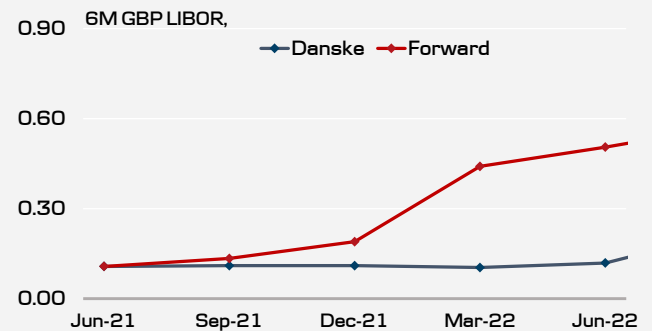
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M GBP Libor-rente



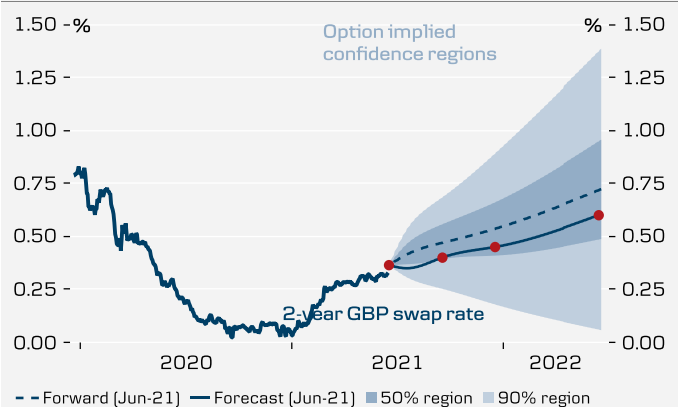
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank prognose og forwards



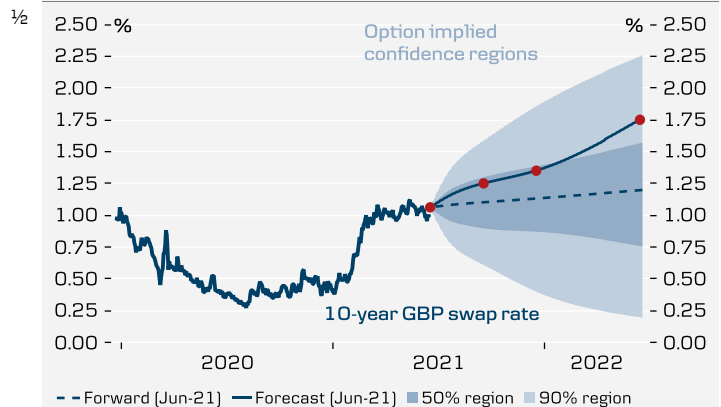
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

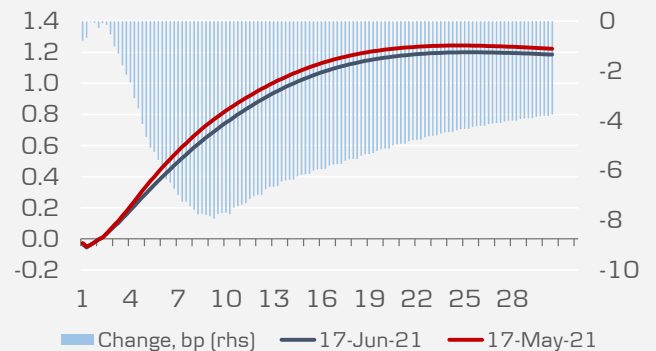
SEK forecast

SEK forecast summary

17/06/2021	Spot	--- Forecast ---			--- Fcst vs Fwd in bp ---		
SEK		+3m	+6m	+12m	+3m	+6m	+12m
Money market							
Repo	0.00	0.00	0.00	0.00	-	-	-
3M	-0.04	-0.04	-0.04	-0.04	-1	6	-8
Government bonds							
2-year	-0.28	-0.30	-0.30	-0.25	-	-	-
5-year	-0.31	0.00	0.05	0.15	-	-	-
10-year	0.35	0.45	0.55	0.70	-	-	-
Swap rates							
2-year	0.03	0.07	0.05	0.05	0	-6	-16
5-year	0.35	0.45	0.45	0.50	6	1	-5
10-year	0.78	0.90	0.95	1.05	8	9	11

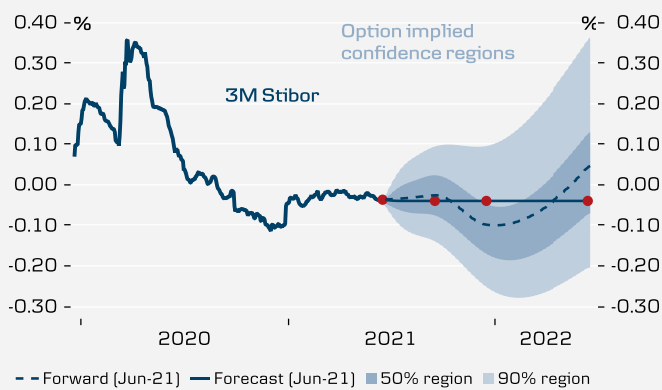
Source: Danske Bank

1M change in SEK swap (3M)



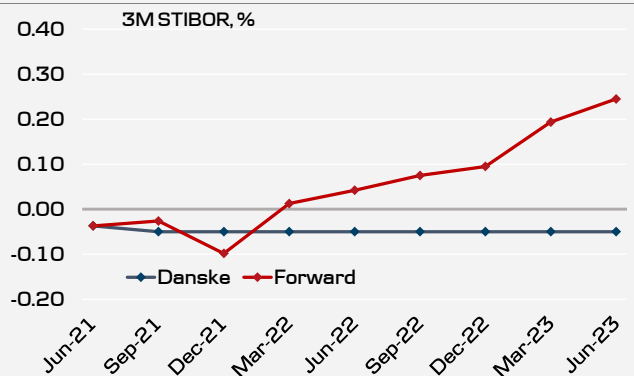
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Stibor rate



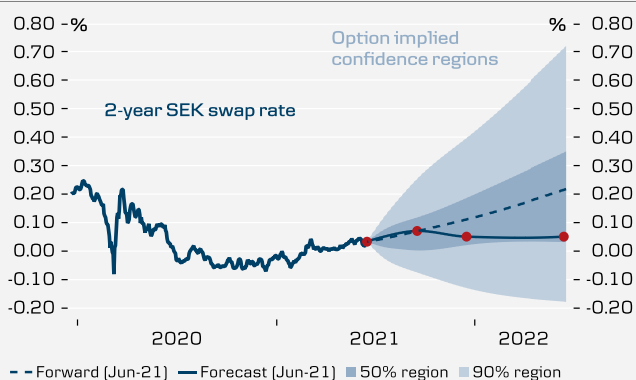
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



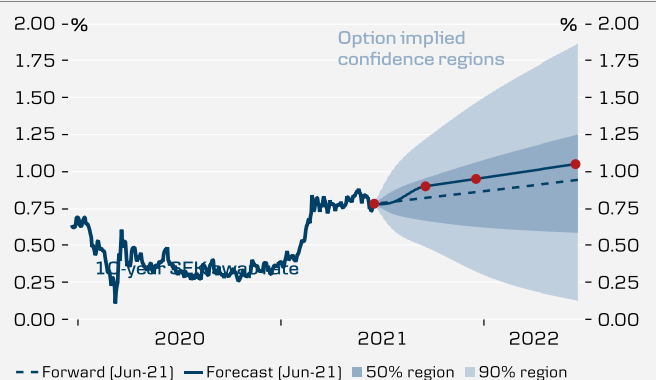
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

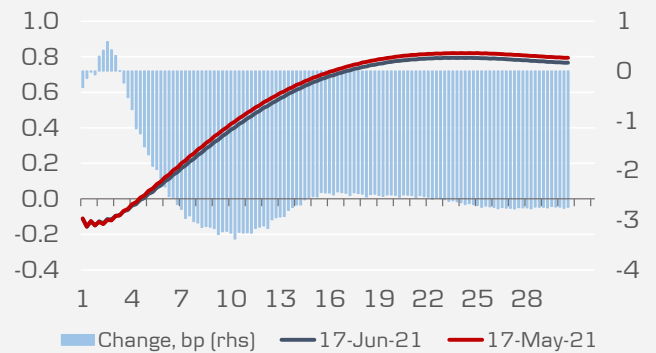
DKK forecast

DKK forecast summary

DKK	Spot	+3m	+6m	+12m	Fcast vs Fwd in bp		
					+3m	+6m	+12m
<u>Money Market</u>							
CD	-0.50	-0.60	-0.60	-0.60	-	-	-
Repo	-0.35	-0.45	-0.45	-0.45	-	-	-
3M	-0.21	-0.30	-0.30	-0.30	-5	-3	-4
6M	-0.12	-0.17	-0.17	-0.17	-4	-4	-4
<u>Government bonds</u>							
2-year	-0.52	-0.50	-0.50	-0.45	-	-	-
5-year	-0.40	-0.38	-0.30	-0.05	-	-	-
10-year	0.12	0.20	0.25	0.55	-	-	-
<u>Swap rates</u>							
2-year	-0.11	-0.15	-0.17	-0.12	-5	-8	-8
5-year	0.06	0.02	0.10	0.40	-7	-2	21
10-year	0.42	0.52	0.60	0.90	7	12	36
30-year	0.77	0.85	0.90	1.05	8	12	26

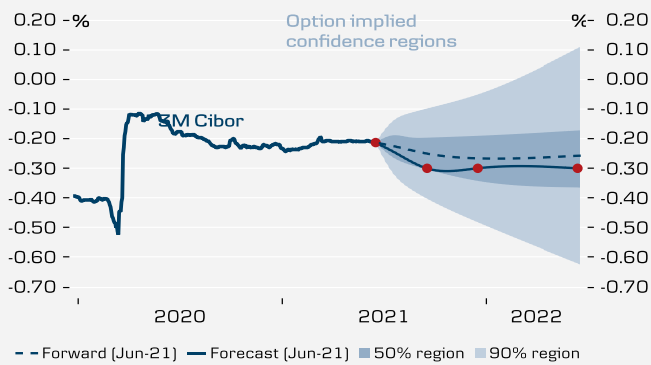
Source: Danske Bank

1M change in DKK swap (6M)



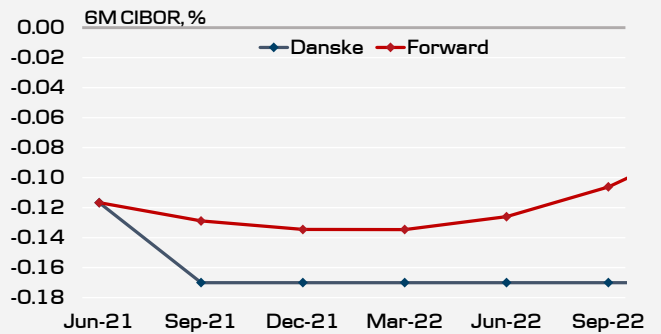
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Cibar



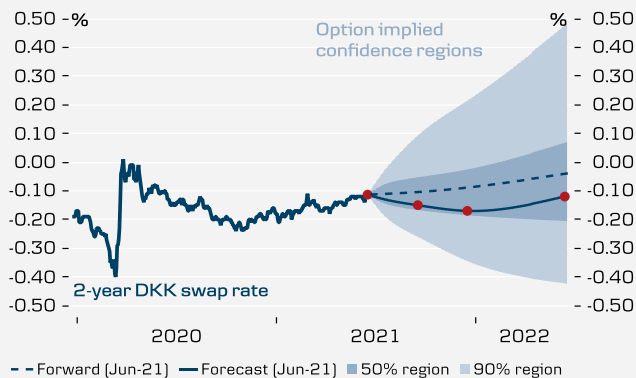
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



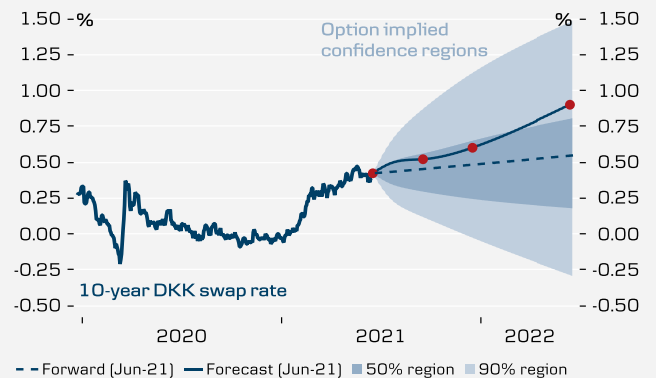
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

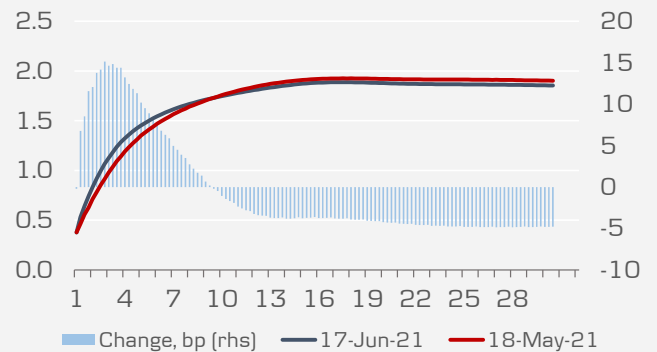
NOK forecast

NOK forecast summary

NOK	17/06/2021				--- Forecast ---			--- Fcst vs Fwd in bp ---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m	+3m	+6m	+12m
Money market										
Deposit	0.00	0.25	0.50	1.00	-	-	-	-	-	-
3M	0.20	0.55	0.89	1.43	5	11	36			
6M	0.36	0.69	1.03	1.57	0	12	35			
Government bonds										
2-year	0.64	0.80	1.10	1.30	-	-	-			
5-year	1.20	1.35	1.40	1.60	-	-	-			
10-year	1.54	1.70	1.85	2.00	-	-	-			
Swap rates										
2-year	1.00	1.15	1.45	1.65	-2	13	11			
5-year	1.50	1.70	1.75	1.95	11	8	17			
10-year	1.76	2.00	2.15	2.30	19	30	38			

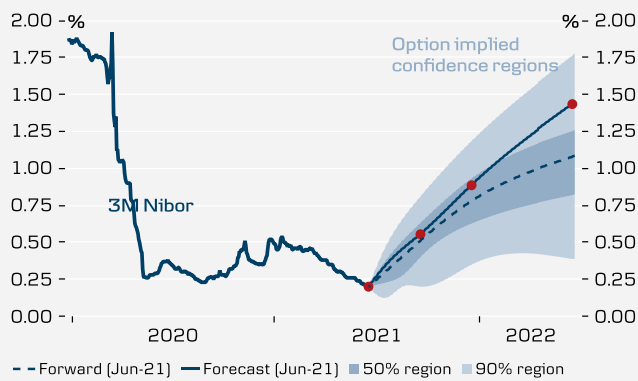
Source: Danske Bank

1M change in NOK swap (6M)



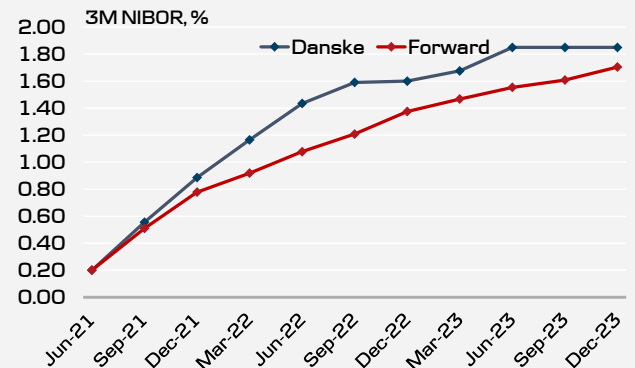
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Nibor



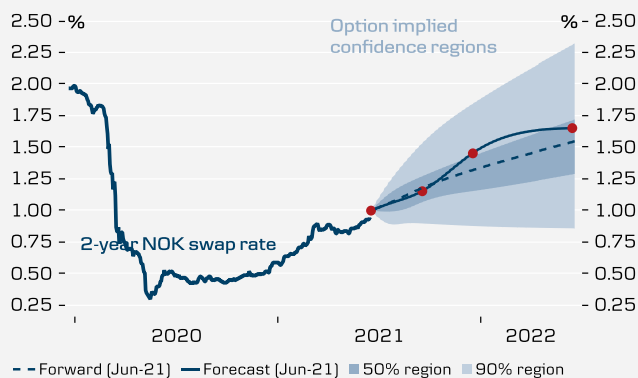
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



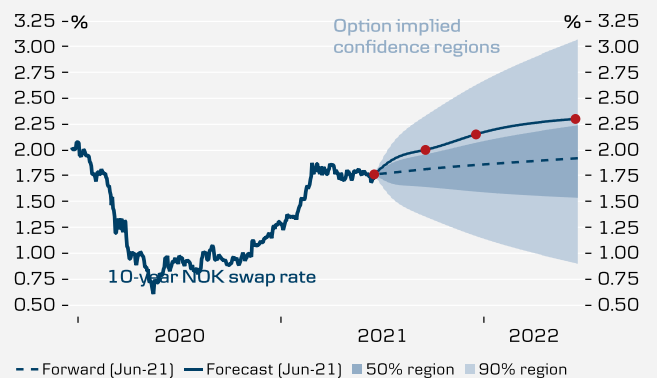
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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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