11 April 2019

Yield Outlook

10Y Bund yields set to remain close to zero through 2019

In the previous issue of *Yield Outlook*, 13 March, we argued that the ECB would help keep short and long yields low – and close to current levels – for the remainder of 2019. First, the ECB extended its forward guidance, definitively closing the door on any potential rate hike in 2019. Second, the central bank opted to launch a series of new long-term loans for European banks (TLTROs) when the existing loan programme expires later this year. The programme is partly to ensure that Italian banks in particular would not experience funding problems in coming years. Third, the ECB clearly signalled an easing bias. The ECB is thus prepared to take further measures if the economy fails to recover. We have made no major changes to our yield forecasts in this issue of Yield Outlook. If anything, we are now even more certain that both short-term and long-term rates are set to stay low for the rest of 2019 and far into 2020.

ECB concerned about 'negative effects' of negative interest rates

First of all, the ECB took another step forward during the past week. At a conference, Draghi announced that the ECB is looking into measures to soften the impact of negative interest rates on earnings in many European banks. At the end of the day, the large excess liquidity created by previous bond purchases in the financial system must be placed with the ECB at minus 0.40%. Since the banks broadly offer zero rather than negative interest rates especially on household deposits, their interest margins have narrowed substantially, eroding bank earnings. There are fears that this extra cost could ultimately make it difficult for banks to expand lending operations, and negative interest rates may therefore have the opposite effect of the one intended and act as on obstacle to economic growth.

One potential measure would be to allow banks to avoid a negative interest rate on the part of the excess liquidity that is currently placed at minus 0.4% with the ECB. Such a tiering system is already in use in Denmark, Switzerland and Japan. We do not expect such a system to necessarily lead to a lending boom from European banks. But it would send a clear signal that the ECB is looking for ways to change the system (although this was found too complex to do back in 2016) because it is well aware that negative interest rates are set to persist for a very long time – potentially for many years. In principle, tiered interest rates would also make it easier for the ECB to further reduce the lowest or marginal rate of interest. The ECB's key policy rate is 'only' minus 0.4%. Policy rates in Denmark and Switzerland stand at minus 0.65% and minus 0.75%, respectively.

A tiering system for overnight deposits with the ECB would, not least, benefit German banks, as they have large household deposits. So, one could say that there is something in it for the Germans, given that the TLTROs have mainly targeted southern Europe.

German economy set to remain sluggish

Second, and even more importantly, the European economy has remained decidedly sluggish, forcing the ECB to keep rates low for a very long time. PMI figures dropped further in March from an already recessionary 49.3 to a six-year low of 47.5. The overall PMI index was pulled lower in particular by a fall in the important 'new orders' index.

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Forecasts table

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Policy rate outlook

Country	Spot	+3m	+6m	+12m
USD	2.50	2.50	2.50	2.50
EUR	-0.40	-0.40	-0.40	-0.40
GBP	0.75	0.75	0.75	0.75
DKK	-0.65	-0.65	-0.65	-0.65
SEK	-0.25	-0.25	-0.25	-0.25
NOK	1.00	1.25	1.25	1.50

10-year government bond yield outlook

Country	Spot	+3m	+6m	+12m
USD	2.51	2.60	2.60	2.70
EUR	-0.01	0.00	0.05	0.30
GBP	1.10	1.20	1.35	1.45
DKK	0.08	0.10	0.15	0.40
SEK	0.40	0.45	0.55	0.65
NOK	1.74	1.80	1.80	2.00

Note: EUR = Germany

10-year swap rates outlook

Country	Spot	+3m	+6m	+12m
USD	2.49	2.60	2.60	2.70
EUR	0.52	0.55	0.60	0.85
GBP	1.30	1.40	1.55	1.65
DKK	0.63	0.65	0.70	0.95
SEK	0.91	0.90	0.95	1.05
NOK	2.04	2.15	2.15	2.35

Sources: Danske Bank

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The intra-eurozone slowdown is due, not least, to Brexit, which remains unresolved, and continuing German weakness. Furthermore, the open eurozone economy is suffering from the downturn in the global manufacturing cycle.

Germany is the epicentre of the slowdown, with the economy still suffering from the past two quarters of stagnation and negative quarterly growth rates. Manufacturing new orders now stand at their lowest level since the financial crisis, and both Ifo and PMI data are signalling that manufacturers have started to cut staff. Indeed, there is much to suggest Germany's weakness is not solely due to problems relating to new environmental standards in the car industry, as was thought earlier.

Meanwhile, we continue to see an increasing divergence in PMIs, with the service PMI remaining steady at 52.7 in March, which indicates a domestic pick-up on the back of rising wages and fiscal stimuli.

Hence, we basically expect a domestic demand driven expansion to take off later in 2019, though getting the eurozone economy back up to speed would also require a rebound in manufacturing. We actually got some positive signals from both leading Chinese indicators and potential progress towards a US-China trade agreement. We also still do not expect a hard Brexit. However, the uncertainty in the global economy was underlined when the IMF revised down its global growth forecast to a post-financial crisis low of 3.3%.

ECB has removed uncertainty from the market

In the bond markets, this creates a clear incentive to hunt for extra return. Investors are focusing on carry trades. The obvious strategy is to buy high-yield Italian government bonds, as Italian banks are set to benefit from the new TLTROs. However, investors are also being pushed further out the yield curve in safe havens like Germany.

Japanese and European yields keeping US yields in check

We have earlier argued that rising US 10Y yields would push European 10Y yields higher. However, we have become increasingly confident that causality in 2019 is likely to be the other way round. 10Y yields of close to zero in both Japan and Germany are pushing investors towards the US and keeping long US yields low – and this despite us not buying into the market's pricing of a US rate cut at the end of 2019. We do expect US 10Y yields to increase modestly, though. Our expectation is that the market will continue to kick rate cuts further down the road, but that they will not materialise.

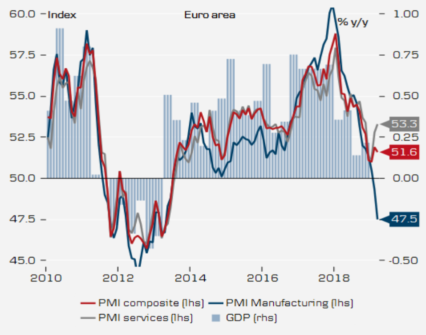
10Y Bund yields to remain close to zero through 2019

Multiple uncertainties, coupled with a visible weakening of the economy in 2019 and the latest announcements from the ECB, lead us to expect no noticeable increases in 10Y Bund yields over the coming 12 months.

We therefore expect the benchmark Bund yield to trade in a narrow range between -0.1% and 0.25% throughout 2019. Where precisely it would trade within that range will mainly depend on risk appetite. We would also stress that our economists no longer expect the Fed to hike interest rates in 2019. The Fed announced very clearly in March that it would be putting rate hikes on hold for the rest of 2019.

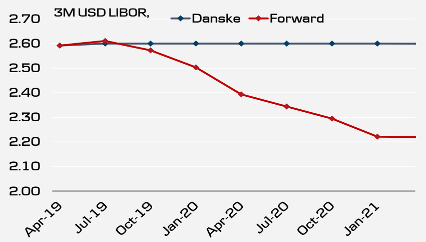
We expect to publish the next issue of Yield Outlook by mid-May 2019.

Eurozone growth looking none too bright for Q2 19



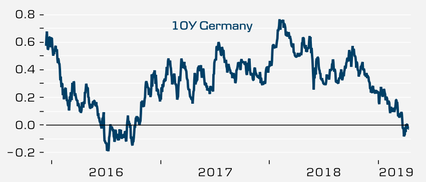
Source: Markit, Macrobond Financial

Unlike the market, we do not buy into rate cuts in the US



Source: Danske Bank

German 10Y yield set to remain close to zero for remainder of 2019



Source: Macrobond Financial

Forecasts

Forecasts

	Horizon	Policy rate	3m xlbor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	2.50	2.59	2.45	2.36	2.49	2.35	2.32	2.51
	+3m	2.50	2.60	2.55	2.45	2.60	2.45	2.40	2.60
	+6m	2.50	2.60	2.55	2.45	2.60	2.45	2.40	2.60
	+12m	2.50	2.60	2.60	2.50	2.70	2.50	2.45	2.70
EUR	Spot	-0.40	-0.31	-0.20	0.04	0.52	-0.58	-0.42	-0.01
	+3m	-0.40	-0.31	-0.15	0.10	0.55	-0.55	-0.35	0.00
	+6m	-0.40	-0.31	-0.15	0.15	0.60	-0.55	-0.30	0.05
	+12m	-0.40	-0.31	-0.05	0.25	0.85	-0.45	-0.20	0.30
GBP	Spot	0.75	0.82	0.98	1.14	1.30	0.69	0.84	1.10
	+3m	0.75	0.84	1.15	1.35	1.40	0.85	1.00	1.20
	+6m	0.75	0.84	1.20	1.45	1.55	0.90	1.10	1.35
	+12m	0.75	0.84	1.30	1.55	1.65	1.00	1.20	1.45
DKK	Spot	-0.65	-0.32	-0.12	0.14	0.63	-0.63	-0.45	0.08
	+3m	-0.65	-0.32	-0.05	0.20	0.65	-0.60	-0.35	0.10
	+6m	-0.65	-0.32	-0.05	0.25	0.70	-0.60	-0.30	0.15
	+12m	-0.65	-0.32	0.05	0.35	0.95	-0.50	-0.20	0.40
SEK	Spot	-0.25	0.01	0.12	0.41	0.91	-0.48	-0.22	0.40
	+3m	-0.25	-0.05	0.12	0.45	0.90	-0.43	-0.15	0.45
	+6m	-0.25	-0.05	0.15	0.45	0.95	-0.40	-0.10	0.55
	+12m	-0.25	-0.05	0.15	0.50	1.05	-0.40	-0.05	0.65
NOK	Spot	1.00	1.53	1.73	1.87	2.04	1.34	1.47	1.74
	+3m	1.25	1.78	1.90	1.95	2.15	1.00	1.50	1.80
	+6m	1.25	1.89	2.15	2.15	2.15	1.25	1.70	1.80
	+12m	1.50	2.10	2.30	2.25	2.35	1.40	1.80	2.00

** German government bonds are used, EUR swap rates are used*
Source: Danske Bank

Eurozone forecasts

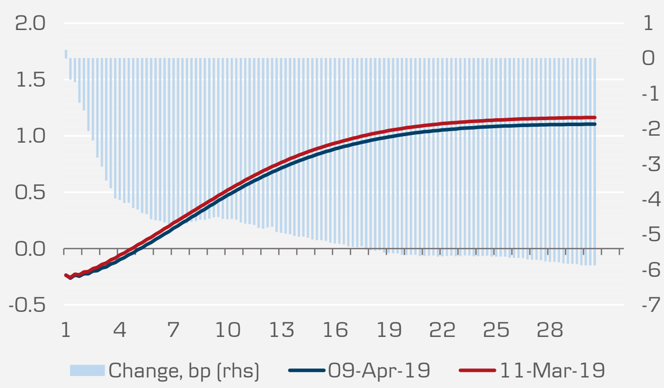
- The Eurozone economy is generally weak at the moment, though we are seeing nascent signs of improvement, primarily in the service sector. We therefore still expect the economy to pick up further over the course of the year, but uncertainty is exceptionally high.
- A rate hike from the ECB in the next 12 months is no longer on the cards. Long yields, as represented by 10Y Bunds, are likely to trade in a narrow range of -0.10% to +0.25% throughout 2019.

EUR forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
EUR	Spot	+3m	+6m	+12m	+3m	+6m	+12m
			Money Market				
Refi	0.00	0.00	0.00	0.00	-	-	-
Deposit	-0.40	-0.40	-0.40	-0.40	-	-	-
3M	-0.31	-0.31	-0.31	-0.31	1	1	-2
6M	-0.23	-0.24	-0.24	-0.24	0	-1	-4
			Government Bonds				
2-year	-0.58	-0.55	-0.55	-0.45	-	-	-
5-year	-0.42	-0.35	-0.30	-0.20	-	-	-
10-year	-0.01	0.00	0.05	0.30	-	-	-
			Swap rates				
2-year	-0.20	-0.15	-0.15	-0.05	3	1	4
5-year	0.04	0.10	0.15	0.25	3	-1	5
10-year	0.52	0.55	0.60	0.85	-1	0	16

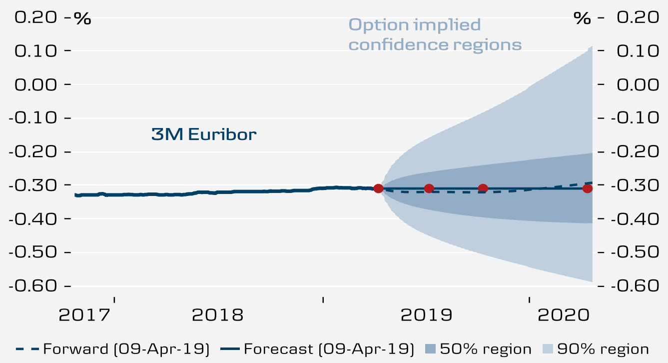
Source: Danske Bank

1M Change in 6M Euribor



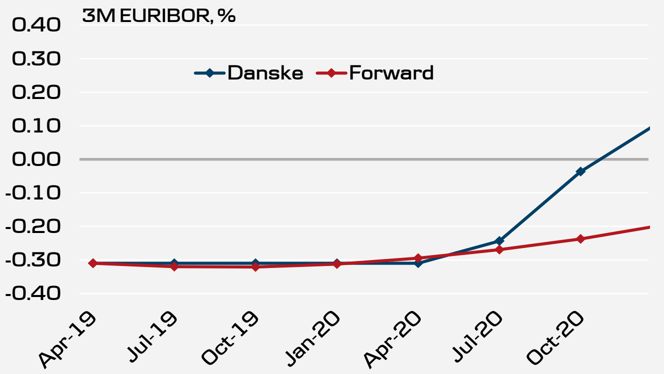
Source: Danske Bank

3M Euribor



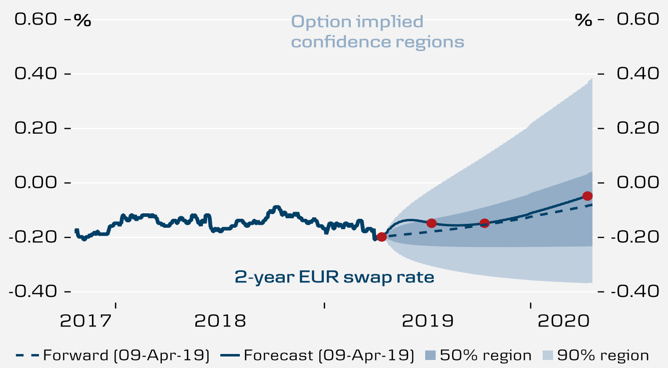
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



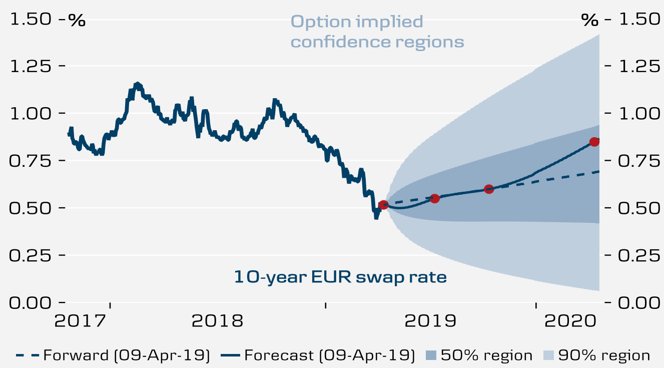
Source: Macrobond Financial, Danske Bank

2Y EUR swap rates



Source: Danske Bank

10Y EUR swap rates



Source: Danske Bank

US forecasts

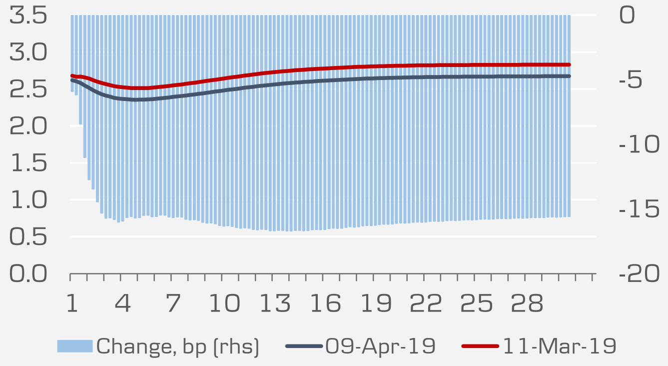
- The Fed has signalled it will be 'patient' about raising rates again until we have seen a rebound in the global economy and higher inflation.
- However, we still expect two Fed hikes this year in June and December given our positive macro outlook. Risks are clearly for fewer or no rate hikes, though. In light of our Fed forecast, we also see some upside for long US yields. We expect the 2y10y curve to invert within 12 months.

USD forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m
			Money Market				
Fed Funds	2.50	2.50	2.50	2.50	-	-	-
3M	2.59	2.60	2.60	2.60	-1	3	21
			Government Bonds				
2-year	2.35	2.45	2.45	2.50	-	-	-
5-year	2.32	2.40	2.40	2.45	-	-	-
10-year	2.51	2.60	2.60	2.70	-	-	-
			Swap rates				
2-year	2.45	2.55	2.55	2.60	15	19	33
5-year	2.36	2.45	2.45	2.50	10	11	16
10-year	2.49	2.60	2.60	2.70	10	10	18

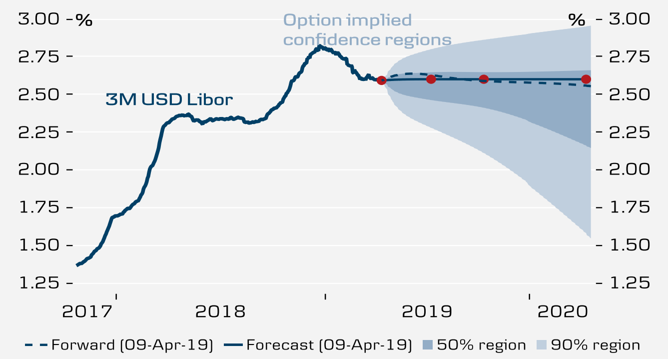
Source: Danske Bank

1M Change in 3M USD Libor



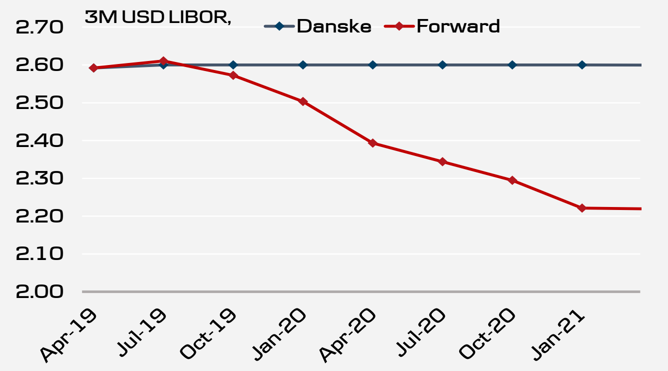
Source: Danske Bank

3M USD Libor rates



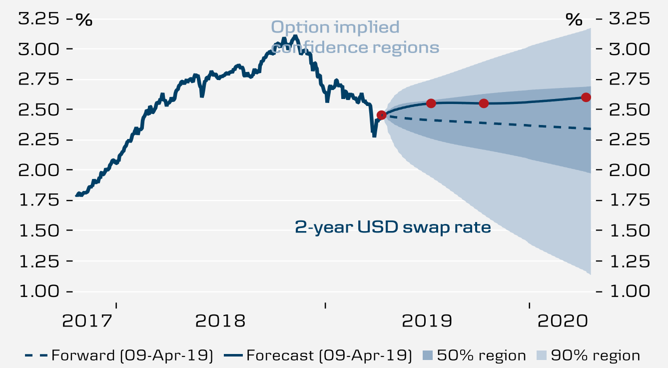
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



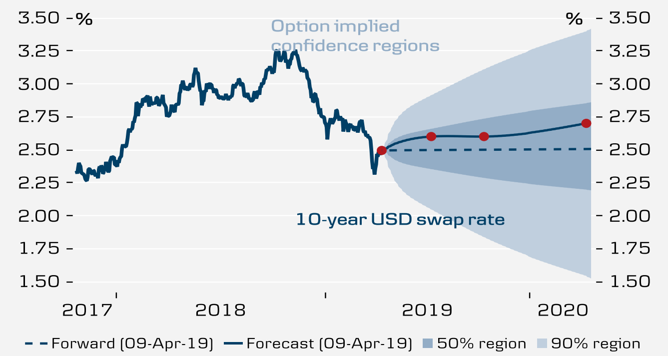
Source: Macrobond Financial, Danske Bank

2Y USD swap rates



Source: Danske Bank

10Y USD swap rates



Source: Danske Bank

UK forecasts

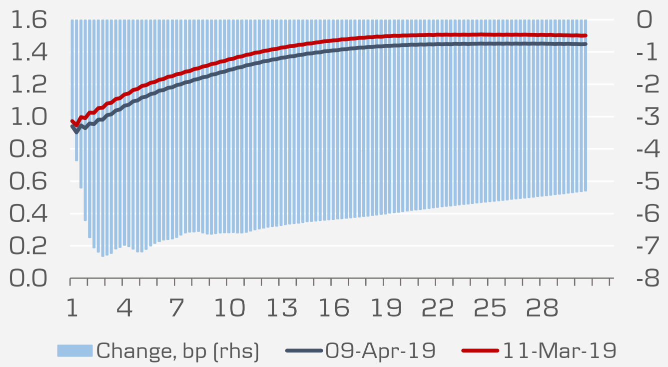
- While we do not expect a 'hard' Brexit, we no longer expect the Bank of England to hike rates within the next 12 months.
- Long yields likely to tick slightly upwards in 2019 as the market begins to price rate hikes in 2020.

UK forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
GBP	Spot	+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Repo	0.75	0.75	0.75	0.75	-	-	-
3M	0.82	0.84	0.84	0.84	1	0	-4
Government Bonds							
2-year	0.69	0.85	0.90	1.00	15	21	31
5-year	0.839	1	1.1	1.2	14	23	31
10-year	1.10	1.20	1.35	1.45	2	15	19
Swap rates							
2-year	0.98	1.15	1.20	1.30	15	17	21
5-year	1.14	1.35	1.45	1.55	19	27	18
10-year	1.30	1.40	1.55	1.65	8	21	28

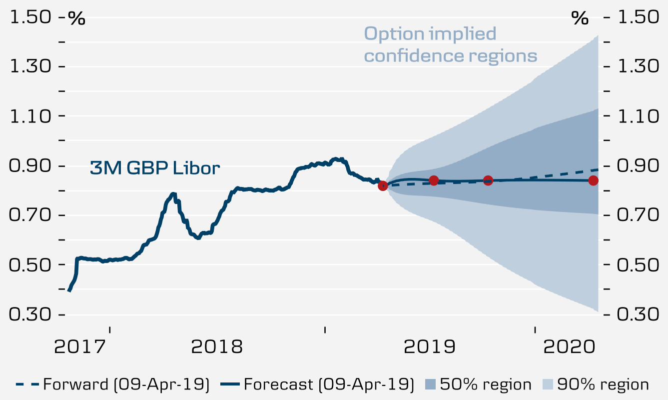
Source: Danske Bank

1M Change in 6M GBP Libor



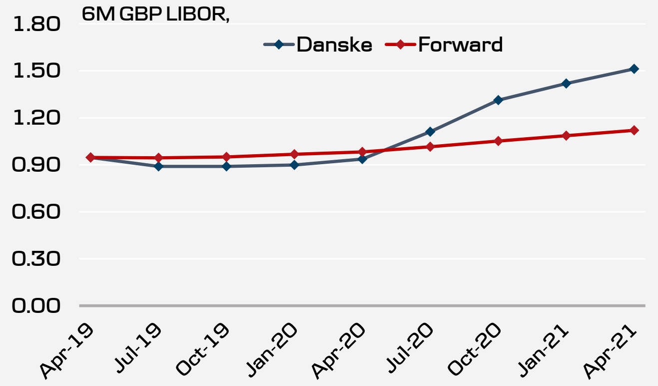
Source: Danske Bank

3M GBP Libor rates



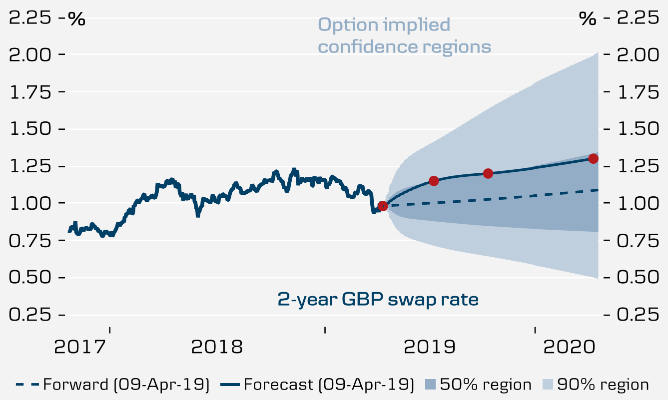
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



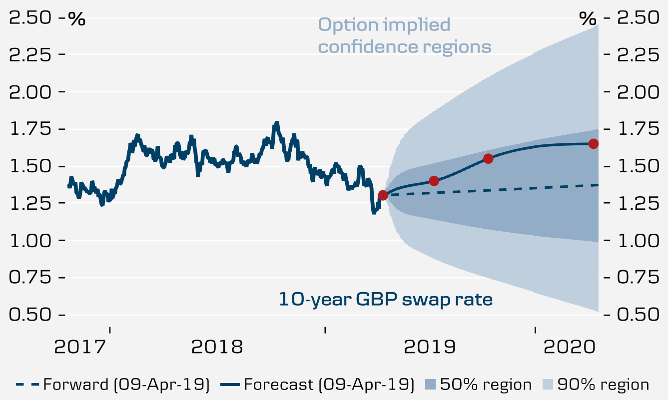
Source: Macrobond Financial, Danske Bank

2Y UK swap rates



Source: Danske Bank

10Y UK swap rates



Source: Danske Bank

Denmark forecasts

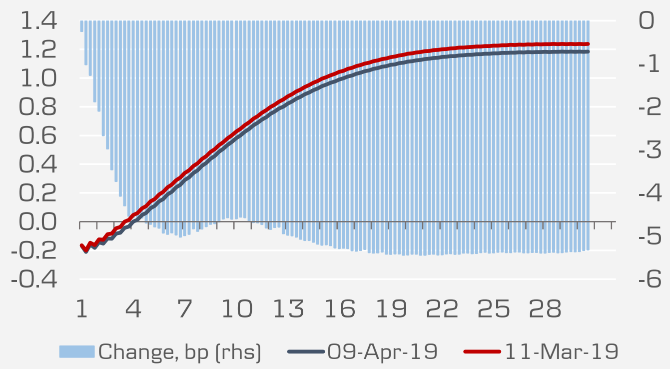
- No rate hikes for the next 12 months, as we expect Danmarks Nationalbank to shadow the ECB 100%.
- Banks' net position set to be significantly higher in 2019, putting downward pressure on short rates, including CIBOR.
- 10Y yields set to follow Bunds, potential for modest spread narrowing.

DKK forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
DKK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
			Money Market				
CD	-0.65	-0.65	-0.65	-0.65	-	-	-
Repo	0.05	0.05	0.05	0.05	-	-	-
3M	-0.32	-0.32	-0.32	-0.32	-1	-2	-4
6M	-0.17	-0.17	-0.17	-0.17	-1	-2	-6
			Government bonds				
2-year	-0.63	-0.60	-0.60	-0.50	-	-	-
5-year	-0.45	-0.35	-0.30	-0.20	-	-	-
10-year	0.08	0.10	0.15	0.40	-	-	-
			Swap rates				
2-year	-0.12	-0.05	-0.05	0.05	4	1	3
5-year	0.14	0.20	0.25	0.35	2	2	3
10-year	0.63	0.65	0.70	0.95	-2	-1	15

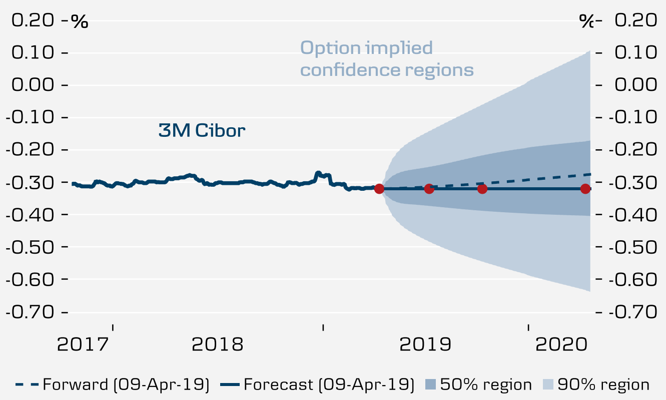
Source: Danske Bank

1M Change in 6M Cibor



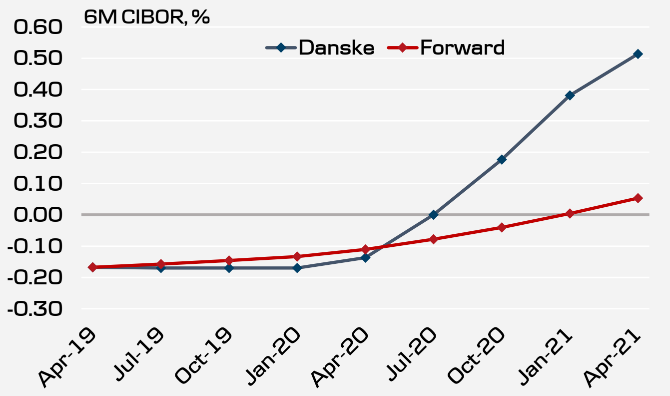
Source: Danske Bank

3M Cibor



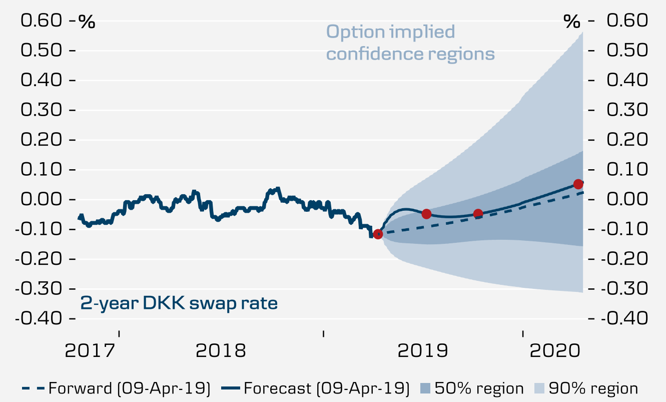
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



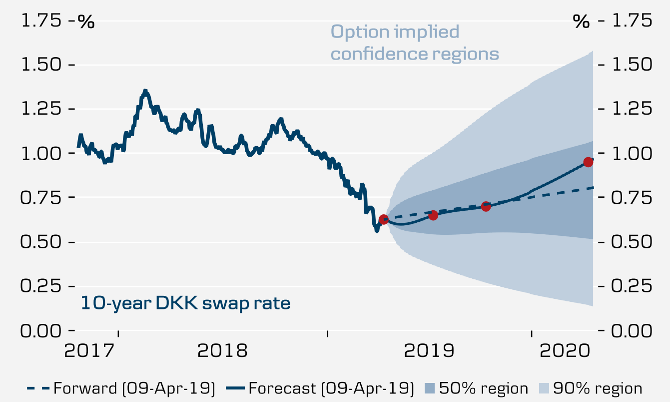
Source: Macrobond Financial, Danske Bank

2Y DKK swap rates



Source: Danske Bank

10Y DKK swap rates



Source: Danske Bank

Sweden forecasts

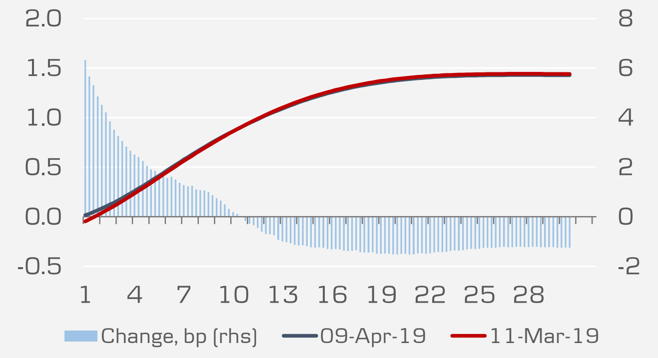
- Both survey-based and hard data confirm that Swedish growth continued to moderate in Q1. Manufacturers' assessments of order books are less upbeat than earlier which, considering recent softness in Europe, not least Germany, is not very surprising. In the meantime, inflation has turned out considerably below the Riksbank's forecast and we expect that to prevail going forward.
- Too low inflation and dovish signals from other central banks should suggest that the Riksbank will postpone further rate hikes keeping short rates pretty much stuck for some time to come. Also further out on the curve we see very limited room for rate movements.

SEK forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
SEK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
			Money market				
Repo	-0.25	-0.25	-0.25	-0.25	-	-	-
3M	0.01	-0.05	-0.05	-0.05	-7	-10	-19
			Government bonds				
2-year	-0.48	-0.43	-0.40	-0.40	-	-	-
5-year	-0.22	-0.15	-0.10	-0.05	-	-	-
10-year	0.40	0.45	0.55	0.65	-	-	-
			Swap rates				
2-year	0.12	0.12	0.15	0.15	-4	-5	-15
5-year	0.41	0.45	0.45	0.50	-1	-6	-12
10-year	0.91	0.90	0.95	1.05	-5	-4	-3

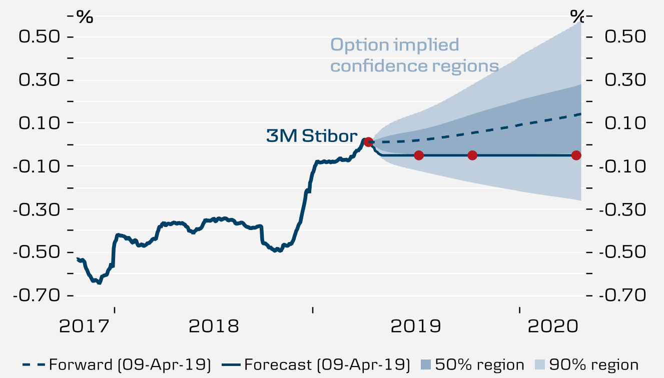
Source: Danske Bank

1M Change in 3M Stibor



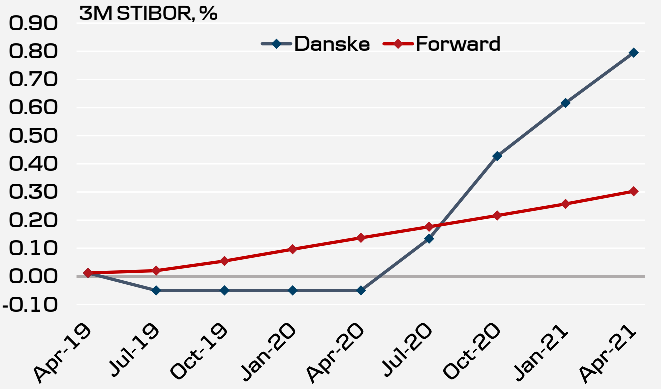
Source: Danske Bank

3M Stibor rate



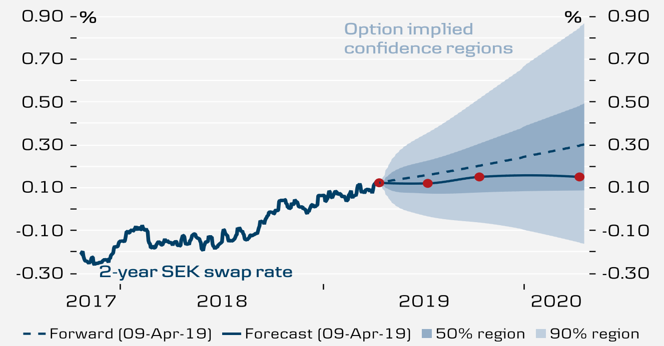
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



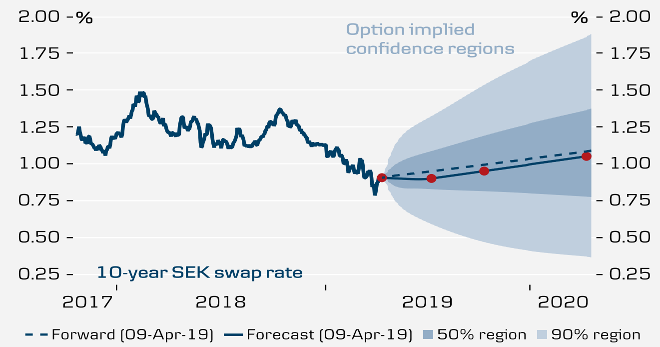
Source: Macrobond Financial, Danske Bank

2Y SEK swap rates



Source: Danske Bank

10Y SEK swap rates



Source: Danske Bank

Norway forecasts

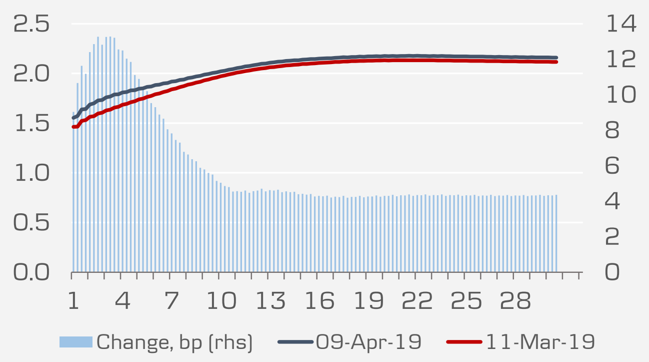
- The Norwegian economy continues to grow above potential. Norges Bank indicates a frontloading of interest rate hikes and a long-term level somewhat lower than earlier projected. Short-end market rates are significantly below Norges Bank's and our forecasts.
- Norges Bank's interest rate path suggests a high probability of a hike in June.

NOK forecasts summary

09/04/2019		--- Forecast ---			--- Fcst vs Fwd in bp ---		
NOK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
			Money market				
Deposit	1.00	1.25	1.25	1.50	-	-	-
3M	1.39	1.60	1.73	1.93	10	11	24
6M	1.53	1.78	1.89	2.10	13	18	31
			Government bonds				
2-year	1.34	1.00	1.25	1.40	-	-	-
5-year	1.47	1.50	1.70	1.80	-	-	-
10-year	1.74	1.80	1.80	2.00	-	-	-
			Swap rates				
2-year	1.73	1.90	2.15	2.30	13	34	43
5-year	1.87	1.95	2.15	2.25	6	23	29
10-year	2.04	2.15	2.15	2.35	9	7	23

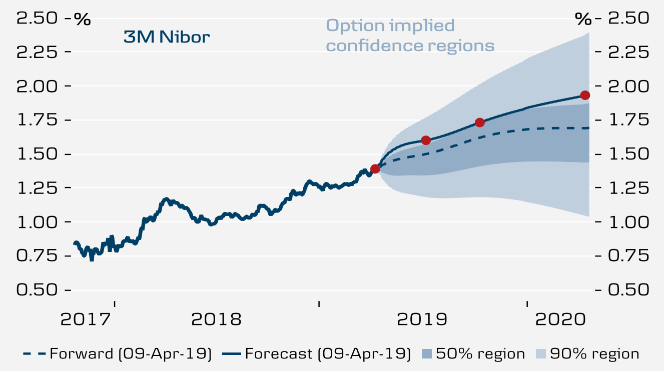
Source: Danske Bank

1M Change in 6M Nibor



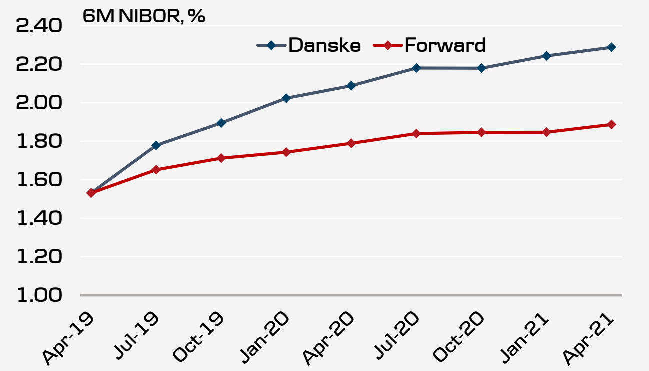
Source: Danske Bank

3M Nibor



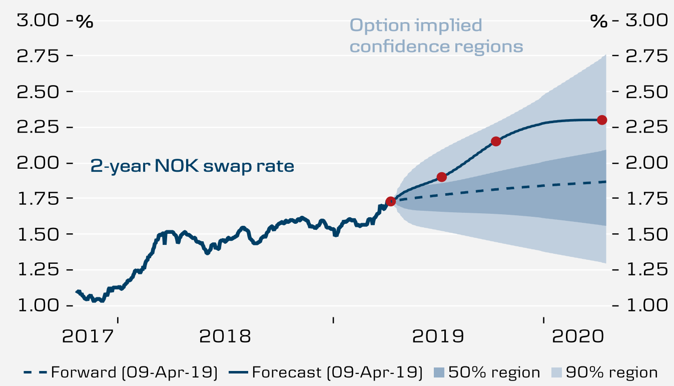
Source: Danske Bank

Danske Bank forecast and forwards



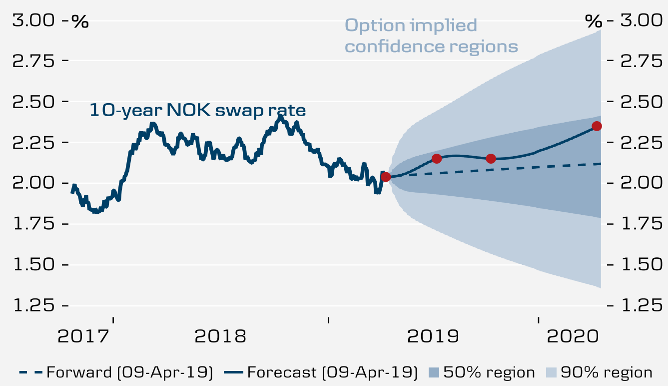
Source: Danske Bank

2Y NOK swap rate



Source: Danske Bank

10Y NOK swap rate



Source: Danske Bank

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