

# Yield Outlook

## Tapering and slowdown pointing in opposite directions for yields

- We expect market attention in the coming months to remain focused on 1) whether the spike in inflation is in fact temporary, 2) whether economies and GDP growth have peaked and 3) whether central banks will seriously begin to signal tapering of bond purchases in 2022.
- However, the economic outlook has become muddier, and recent developments in China could potentially send shockwaves through global financial markets and push long yields down in the coming months.
- Nevertheless, in our view, the combination of still high ongoing inflation, the continuing pick-up in the US economy and a tapering decision by the US central bank (the Fed) is likely to put upward pressure on long US yields, in particular, in the next three months, leading us to expect US 10Y Treasury yields to hit 1.5% by the end of the year.
- We expect an initial US rate hike to be on the cards late 2022 or so and the upward pressure on yields to remain in place. Hence, we expect US 10Y yields to hit 2% in 12 months' time.
- Higher US yields should tend to push European yields higher, and we are maintaining our 12-month forecast of 0.1% for German 10Y yields.

### Links

[Forecast table](#)  
[Forecast Euro area](#)  
[Forecast USA](#)  
[Forecast UK](#)  
[Forecast Denmark](#)  
[Forecast Sweden](#)  
[Forecast Norway](#)

### 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	0.50	0.75	1.25

### 10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	1.33	1.45	1.50	2.00
EUR	-0.32	-0.25	-0.20	0.10
GBP	0.79	0.90	1.00	1.30
DKK	-0.01	0.05	0.05	0.35
SEK	0.28	0.35	0.40	0.50
NOK	1.40	1.50	1.60	1.90

Note: EUR = Germany.

### 10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	1.36	1.50	1.55	2.05
EUR	0.07	0.12	0.15	0.45
GBP	0.99	1.15	1.25	1.55
DKK	0.35	0.39	0.40	0.70
SEK	0.75	0.83	0.85	0.93
NOK	1.69	1.80	1.90	2.20

Sources: Danske Bank all three tables

### Long European yields have ticked up in the past month ...



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

### ... as European inflation expectations have risen



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

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## Muddier outlook for fixed income markets

Coming months are likely to see several factors clearly pointing in opposing directions for global long yields.

Pulling in one direction are the central banks, who are now looking beyond the pandemic. Both the ECB and the Fed are likely to buy fewer bonds in the market in 2022 than they have in 2021. An initial US rate hike is also beginning to put its head above the horizon, with the market pricing the first hike in early 2023. Inflation and, not least, inflation expectations are continuing to tick up, particularly in Europe as bottlenecks emerge in more and more markets. We also see increasing signs of wage growth picking up in some countries, including the US.

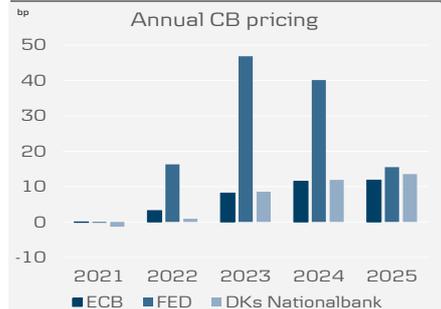
Pulling in the opposite direction are increasing worries that the global economy may shift down a gear after the strong growth fuelled by the reopening in the spring and over the summer. Much attention is focused on China and the problems plaguing the Chinese property giant Evergrande. Rising commodity prices, meanwhile, are creating concern that household purchasing power may be eroded, which would hit consumer spending and, ultimately, economic growth. Bottlenecks and their impact on inflation may mean we are heading for a stagflation scenario of high inflation and low GDP growth. Fears are also increasing about Covid-19 potentially hampering growth. We see rising infection rates in some countries with high vaccination ratios, like the UK and Israel, while Asia continues to experience lockdowns due to virus outbreaks, plus vaccine rollouts in Asia are lagging.

We expect market focus during the remainder of the year to shift between the factors supporting higher yields and those that point to lower yields. In other words, the picture has become somewhat muddier in recent months. Looking 6 and 12 months ahead, we still expect the global economy, and particularly the US economy, to continue to grow, with an initial rate hike moving steadily closer. We should also see fewer bond buybacks from both the ECB and the Fed. Overall, this would tend to push long yields higher both in the US and in Europe. We continue to expect US 10Y Treasury yields to rise to 2% and 10Y Bund yields to return to 0.1% on a 12M horizon. In the next two sections, we consider in more detail the likely short and long-term drivers of global fixed income markets.

### Central banks looking beyond the pandemic

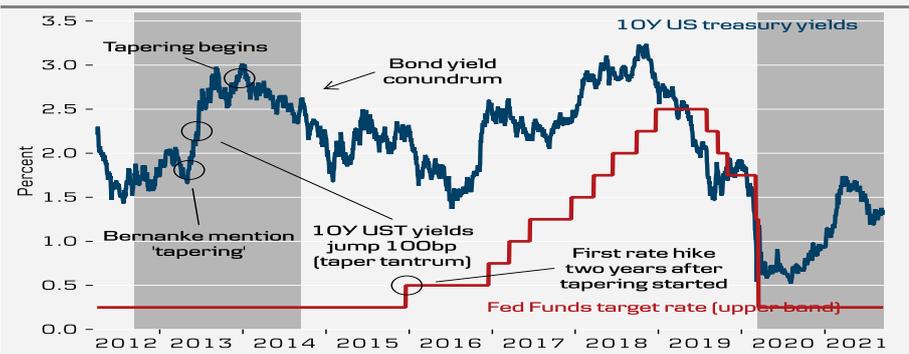
As always, we expect central banks will play a key role in both the European and US fixed income markets in the coming 12 months. Essentially, both the ECB and the Fed are moving – cautiously – away from the extraordinary policy easing via bond buybacks that was introduced last year during the pandemic.

Markets are pricing the first Fed hike in early 2023 – expected year-on-year change in overnight rates



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

Central banks fear a new 'taper tantrum'



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

However, both banks measure their words carefully. The fear is we might see a repeat of the ‘taper tantrum’ in 2013. Back then, the decision to taper bond buybacks triggered an increase in long yields of around 100bp in just three months. An equivalent increase now would result in a marked tightening of global monetary policy and is definitely not something either the ECB or the Fed want in the current situation, with policy accommodation still needed.

We have long expected the US Fed to officially announce at its September meeting that tapering would commence at the end of 2021 and that the current QE programme, with the Fed buying bonds at a monthly rate of USD120bn, would be wound down by summer 2022. However, the latest US jobs report was disappointing, and several Fed members have noted that a tapering decision may be postponed. Nevertheless, most members emphasise that they definitely expect tapering to kick off this year, which also remains our expectation. What will be interesting is just how quickly tapering will be implemented, and what the strategy of subsequently normalising interest rates will be.

With the US funding requirement set to remain significant in 2022, the market should probably expect a somewhat larger net supply of Treasuries post-QE in 2022 than has been the case this year.

With respect to the ECB, central bank president Lagarde announced at the ECB meeting on 9 September that purchases through the Pandemic Emergency Purchase Programme (PEPP) would be ‘moderately lower’ in Q4 21, following exceptionally large purchases in Q2 and Q3 21. This suggests purchases may return to their Q1 21 level this year – in other words, around EUR60bn per month. However, that is still a very significant amount, and the ECB will probably continue to buy back the entire gross supply of eurozone government bonds during the remainder of 2021.

However, we still do not know what will happen when the PEPP expires at the end of Q1 next year, though the ECB has indicated an announcement could be made at its December meeting. As Lagarde wants at all costs to avoid a ‘taper tantrum’, with strongly rising long yields and spread widening in southern Europe, we expect purchases in the original Public Sector Purchase Programme (PSPP) will be ramped up in connection with the PEPP expiring next year. With the European economy presumably well clear of the pandemic, we have difficulty envisaging the PEPP merely being extended after its planned cessation next year. However, QE purchases are set to remain very significant due to reinvestments being made as bonds mature. All in all, we believe ECB QE purchases will contribute less to keeping European yields down in 2022 than has been the case in 2021.

### **High inflation and low real interest rates**

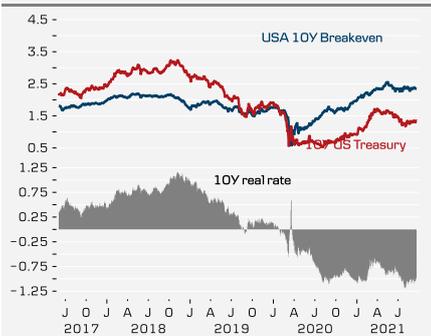
Both the ECB and the US Fed are currently turning a blind eye to overly high inflation, as the assumption is that the spike should prove temporary due to base effects (low inflation in 2020) and various bottlenecks issues triggered by extraordinary demand in connection with reopening.

Nevertheless, we have witnessed a pronounced increase in commodity prices across the entire spectrum over the past six months. This will almost inevitably feed through to other prices in coming quarters. We have also seen a significant rise in electricity, natural gas and CO<sub>2</sub>-quota prices recently. What these increases mean for the inflation outlook in 2022 remains unclear, though the risk is increasing day by day that inflation is not merely ‘transient’, but gaining a foothold in a broader sense. Here, we should note that long-term inflation expectations in the markets, particularly in Europe, have recently increased. Additionally, more and more companies are reporting labour shortages, and despite the disappointing US job growth in August, wage growth rose more than expected. On the

other hand, we should also remember that if commodity prices do not continue to increase, or even fall a little, then that would pull inflation lower in 2022.

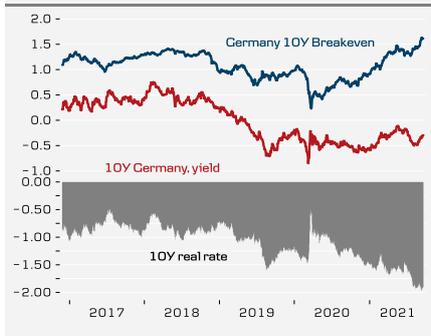
Fixed income markets are seemingly not particularly worried about rising inflation and inflation expectations. The charts below show real interest rates in the German and US markets. We note that especially German real rates have fallen further in the past month as German inflation expectations (break-evens) have increased. Hence, there is a clear expectation that central banks will keep nominal rates in check using a combination of low central bank rates and QE buybacks.

10Y real interest yields are now somewhat below minus 1% in the US ...



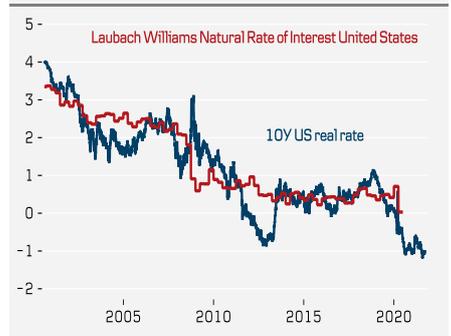
Note: Past performance is not a reliable guide to future returns.  
Source: Danske Bank, Macrobond Financial

... and close to minus 2% in Germany



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

US 10Y real interest yields are now far below the neutral real interest rate (r\*)



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

We have assumed that inflation expectations will move slightly higher from current levels as economic growth truly feeds through to labour markets in both Europe and the US. We also expect to see more signs of bottlenecks impacting underlying inflation. We assume that real interest rates will rise from current levels as the US starts to taper its asset purchases and we approach March 2022, when the ECB's Pandemic Emergency Purchase Programme (PEPP) ends. Current real market interest rates look quite low compared with more theoretical neutral interest rates (r\*).

### Long-term yields set to tick up but primarily in 2022

Overall, we still expect to see a further increase in long-term eurozone and US yields.

The question is when. Fixed income markets could be seen to be getting a bit ahead of themselves, focusing on cyclical trends possibly having peaked over the summer of 2021 and inflation looking set to peak this autumn. We could also see growing concern about rising European power and gas prices beginning to look like a tax on households. Furthermore, the development in China could hit general risk appetite in the financial markets, pushing long-term yields back down.

All in all, we expect 10Y US Treasury yields to rise to 1.5% by the end of the year, edging further up towards 2% during 2022 as the initial policy rate hike moves really close.

As mentioned, we expect 10Y Bund yields to increase to 0.1% on a 12M horizon, with most of the increase materialising at the end of the forecast period.

As already mentioned, we expect the first rate hike from the Fed in December 2022, which will likely be followed by more hikes in 2023. We do not expect the ECB to change policy rates in the next few years.

See also the Danish version of Yield outlook called *Renteudsigter* that we published September 2q. In there, we discuss our view on the Danish fixed income market including the mortgage bond market seen from a borrowing perspective.

**We expect to publish the next issue of *Yield Outlook* in mid-October 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	0.33	0.93	1.36	0.22	0.83	1.33
	+3m	0.25	0.11	0.30	1.00	1.50	0.20	0.90	1.45
	+6m	0.25	0.11	0.40	1.10	1.55	0.30	1.00	1.50
	+12m	0.25	0.19	0.90	1.35	2.05	0.80	1.25	2.00
EUR*	Spot	-0.50	-0.55	-0.45	-0.26	0.07	-0.72	-0.64	-0.32
	+3m	-0.50	-0.54	-0.50	-0.30	0.12	-0.70	-0.65	-0.25
	+6m	-0.50	-0.54	-0.50	-0.25	0.15	-0.70	-0.60	-0.20
	+12m	-0.50	-0.54	-0.40	-0.05	0.45	-0.60	-0.40	0.10
GBP	Spot	0.10	0.07	0.56	0.83	0.99	0.26	0.46	0.79
	+3m	0.10	0.07	0.60	0.95	1.15	0.25	0.55	0.90
	+6m	0.10	0.07	0.55	0.95	1.25	0.20	0.60	1.00
	+12m	0.10	0.07	0.70	1.20	1.55	0.35	0.85	1.30
DKK	Spot	-0.50	-0.22	-0.11	0.05	0.35	-0.54	-0.45	-0.01
	+3m	-0.60	-0.28	-0.20	-0.03	0.39	-0.55	-0.48	0.05
	+6m	-0.60	-0.28	-0.22	0.00	0.40	-0.55	-0.44	0.05
	+12m	-0.60	-0.28	-0.12	0.20	0.70	-0.45	-0.24	0.35
SEK	Spot	0.00	-0.02	0.10	0.42	0.75	-0.26	-0.01	0.28
	+3m	0.00	-0.02	0.05	0.48	0.83	-0.30	0.03	0.35
	+6m	0.00	-0.02	0.05	0.45	0.85	-0.30	0.05	0.40
	+12m	0.00	-0.02	0.05	0.50	0.93	-0.25	0.10	0.50
NOK	Spot	0.00	0.51	1.24	1.57	1.69	0.72	1.20	1.40
	+3m	0.50	0.89	1.25	1.65	1.80	0.80	1.30	1.50
	+6m	0.75	1.18	1.55	1.75	1.90	1.10	1.40	1.60
	+12m	1.25	1.52	1.85	1.95	2.20	1.40	1.60	1.90

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

\* German government bond yields and euro swap rates

Source: Danske Bank

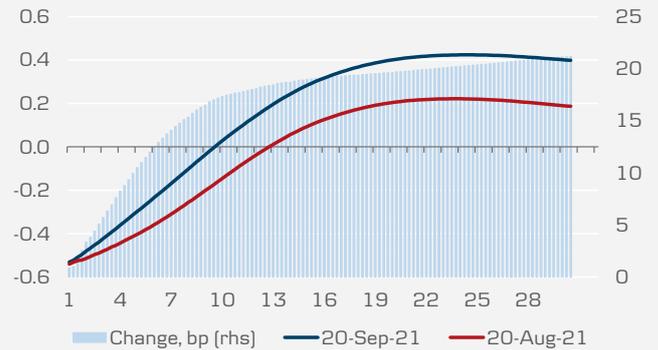
# Eurozone forecast

## EUR forecast summary

21/09/2021	--- Forecast ---				--- Fost 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	-6
6M	-0.53	-0.52	-0.52	-0.52	-1	-4	-10
<u>Government Bonds</u>							
2-year	-0.72	-0.70	-0.70	-0.60	-	-	-
5-year	-0.64	-0.65	-0.60	-0.40	-	-	-
10-year	-0.32	-0.25	-0.20	0.10	-	-	-
<u>Swap rates</u>							
2-year	-0.45	-0.50	-0.50	-0.40	-8	-11	-7
5-year	-0.26	-0.30	-0.25	-0.05	-7	-10	8
10-year	0.07	0.12	0.15	0.45	2	2	26

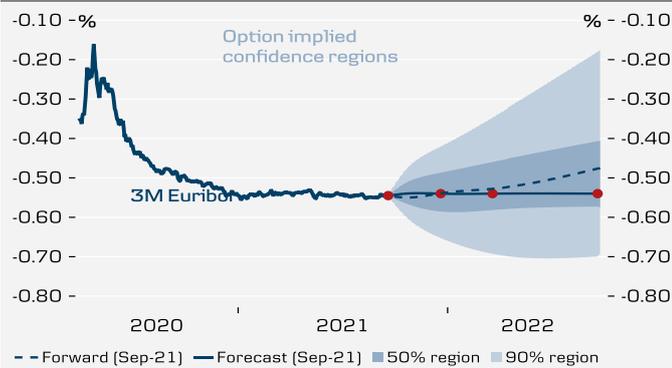
Source: Danske Bank

## 1M change in EUR swap rates



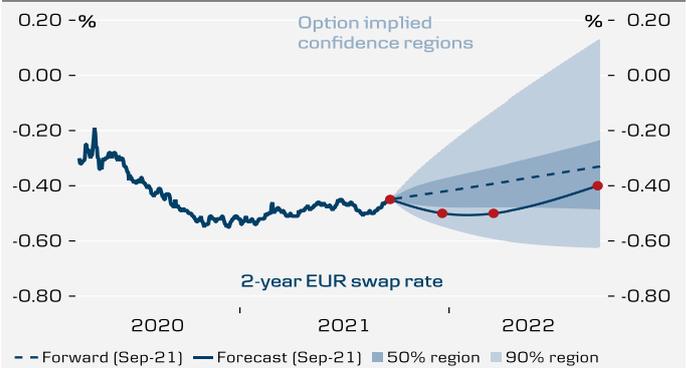
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Euribor rates



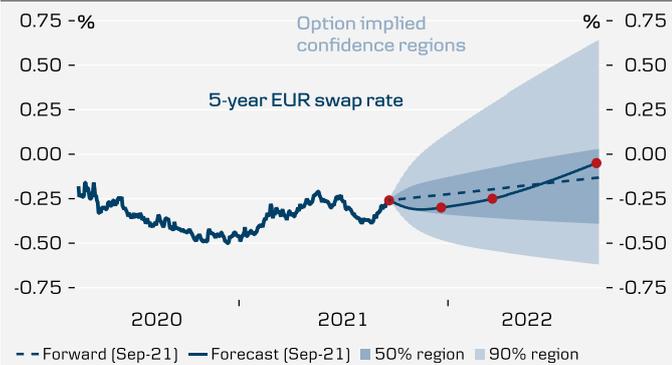
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y EUR swap rates



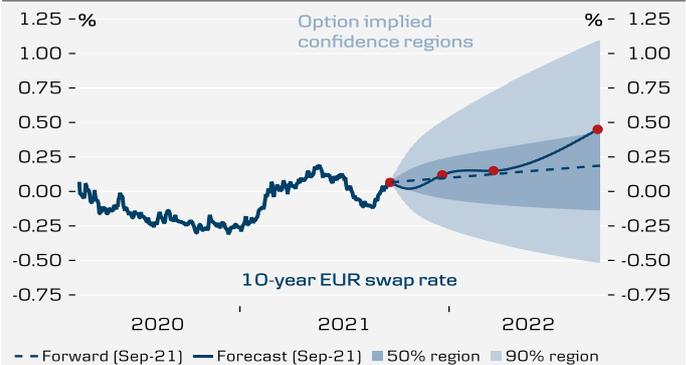
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 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

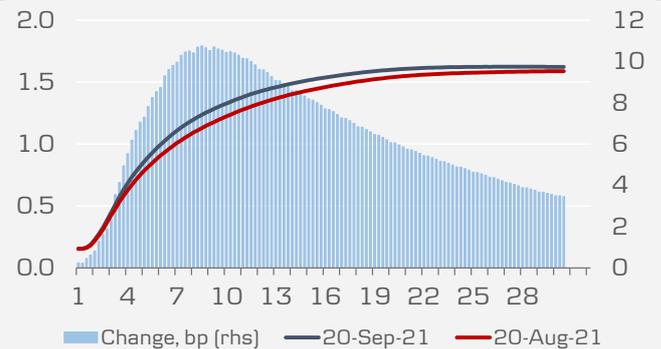
# US forecast

## USD forecast summary

21/09/2021	--- 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	0.12	0.11	0.11	0.19	-7	-5	-8
<b>Government Bonds</b>							
2-year	0.22	0.20	0.30	0.80	-	-	-
5-year	0.83	0.90	1.00	1.25	-	-	-
10-year	1.33	1.45	1.50	2.00	-	-	-
<b>Swap rates</b>							
2-year	0.33	0.30	0.40	0.90	-12	-12	12
5-year	0.93	1.00	1.10	1.35	-1	1	11
10-year	1.36	1.50	1.55	2.05	9	10	51

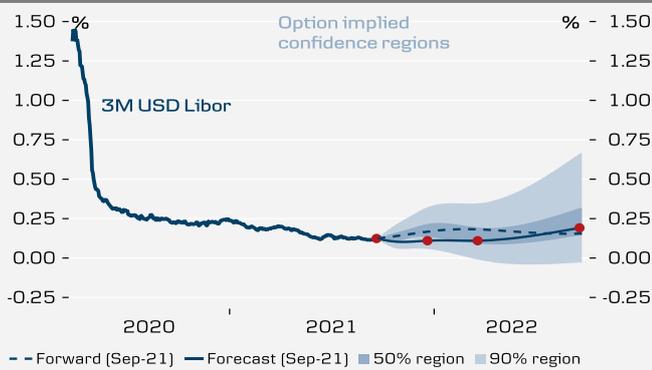
Source: Danske Bank

## 1M change in USD swap (3M) rates



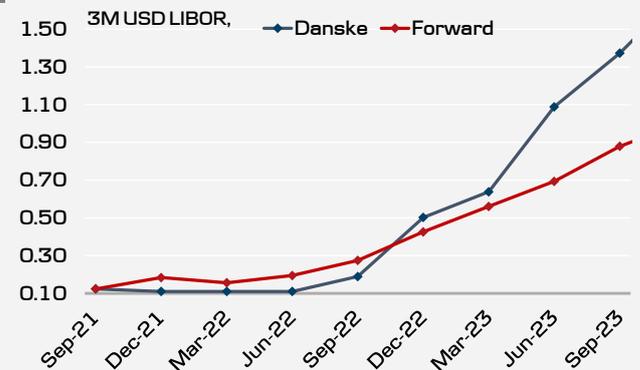
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M USD Libor rates



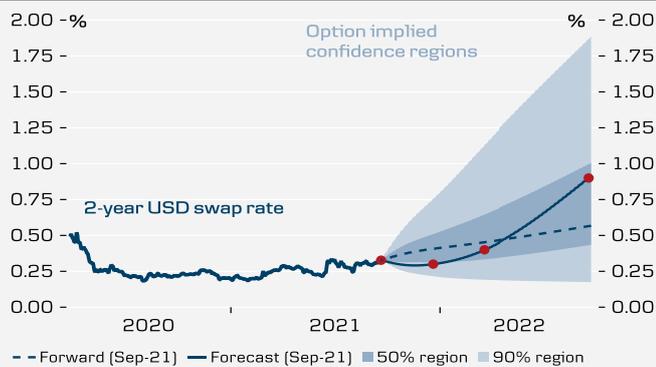
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



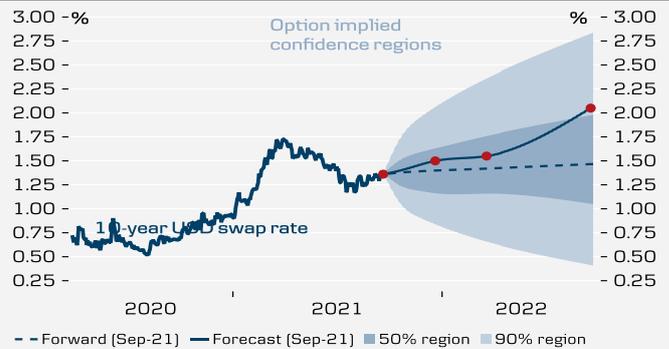
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 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

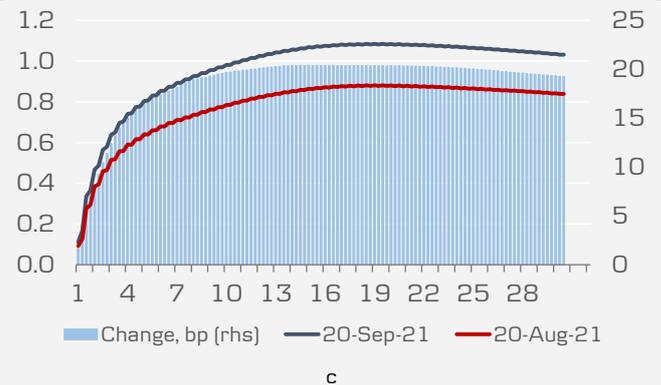
# UK forecast

## GBP forecast summary

GBP	--- 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	0.07	0.07	0.07	0.07	-7	-27	-47
<u>Government Bonds</u>							
2-year	0.26	0.25	0.20	0.35	-1	-12	-6
5-year	0.463	0.55	0.6	0.85	7	10	29
10-year	0.79	0.90	1.00	1.30	8	14	37
<u>Swap rates</u>							
2-year	0.56	0.60	0.55	0.70	-3	-21	-16
5-year	0.83	0.95	0.95	1.20	8	2	12
10-year	0.99	1.15	1.25	1.55	14	20	47

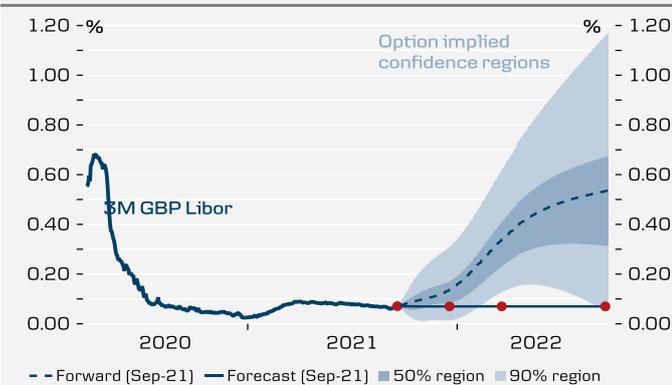
Source: Danske Bank

## 1M change in GBP swap (6M) rates



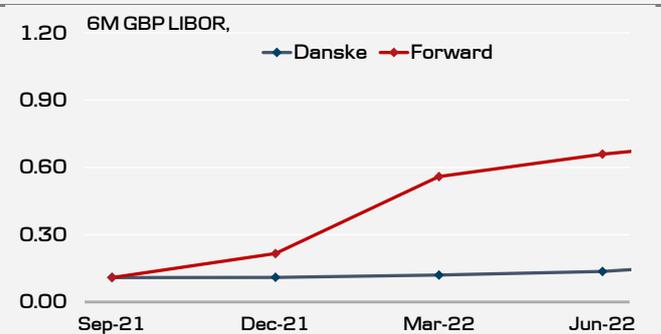
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M GBP Libor rates



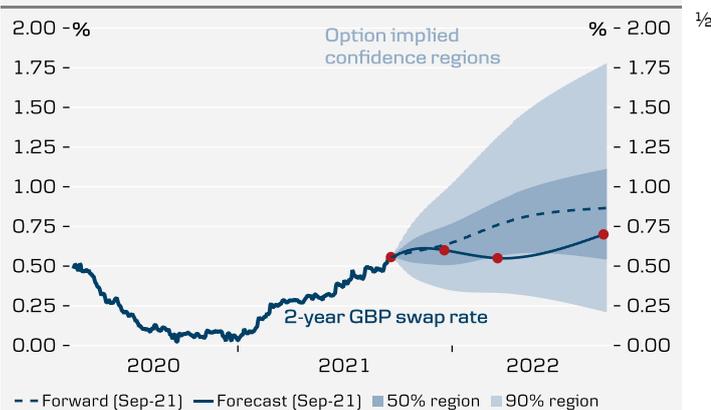
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



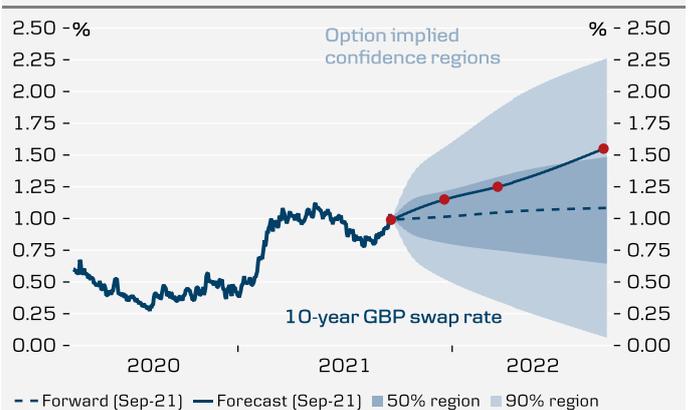
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y 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

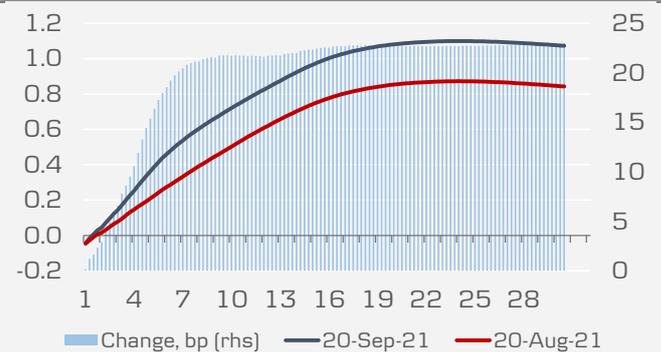
# Sweden forecast

## SEK forecast summary

21/09/2021	--- Forecast ---				--- Fcst vs Fwd in bp ---		
SEK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money market</b>							
Repo	0.00	0.00	0.00	0.00	-	-	-
3M	-0.02	-0.02	-0.02	-0.02	6	-6	-12
<b>Government bonds</b>							
2-year	-0.26	-0.30	-0.30	-0.25	-	-	-
5-year	-0.01	0.03	0.05	0.10	-	-	-
10-year	0.28	0.35	0.40	0.50	-	-	-
<b>Swap rates</b>							
2-year	0.08	0.05	0.05	0.05	-7	-12	-22
5-year	0.39	0.48	0.45	0.50	4	-4	-8
10-year	0.74	0.83	0.85	0.93	5	4	5

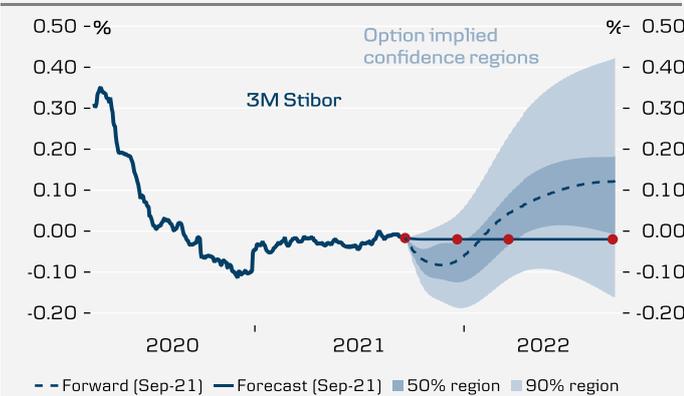
Source: Danske Bank

## 1M change in SEK swap ( 3M) rates



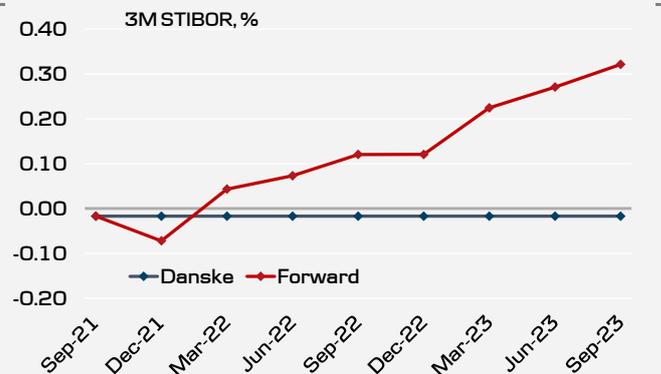
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Stibor rates



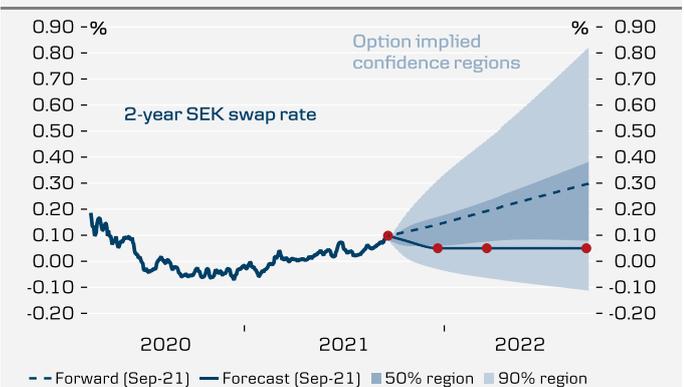
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



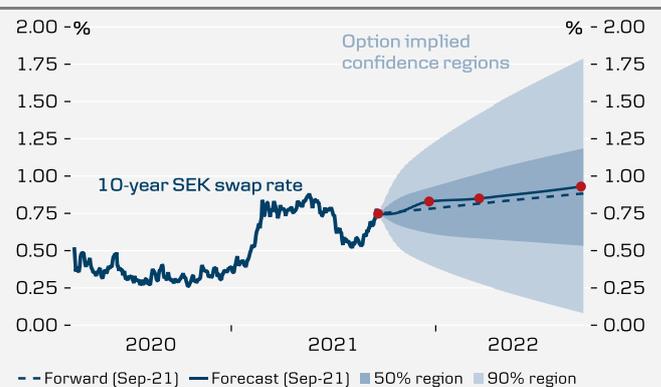
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y 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

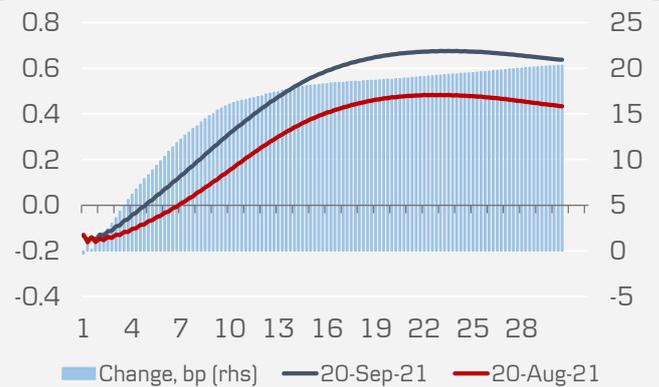
# Denmark forecast

## DKK forecast summary

21/09/2021	--- Forecast ---				--- Fcst vs Fwd in bp ---		
DKK	Spot	+3m	+6m	+12m	+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	-0.22	-0.28	-0.28	-0.28	-7	-4	-6
6M	-0.13	-0.17	-0.17	-0.17	-4	-3	-7
<u>Government bonds</u>							
2-year	-0.54	-0.55	-0.55	-0.45	-	-	-
5-year	-0.45	-0.48	-0.44	-0.24	-	-	-
10-year	-0.01	0.05	0.05	0.35	-	-	-
<u>Swap rates</u>							
2-year	-0.11	-0.20	-0.22	-0.12	-10	-14	-9
5-year	0.05	-0.03	0.00	0.20	-11	-10	4
10-year	0.35	0.39	0.40	0.70	1	-1	24
30-year	0.64	0.70	0.70	0.75	5	5	9

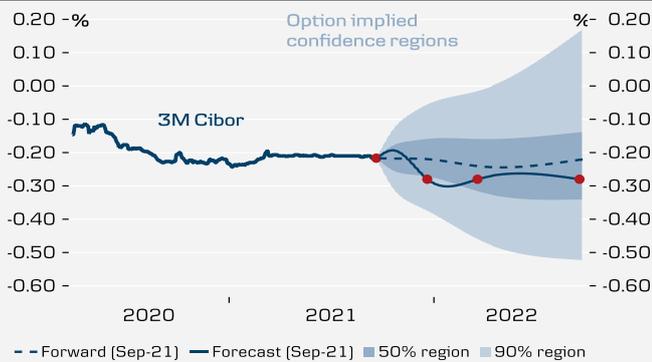
Source: Danske Bank

## 1M change in DKK swap (6M) rates



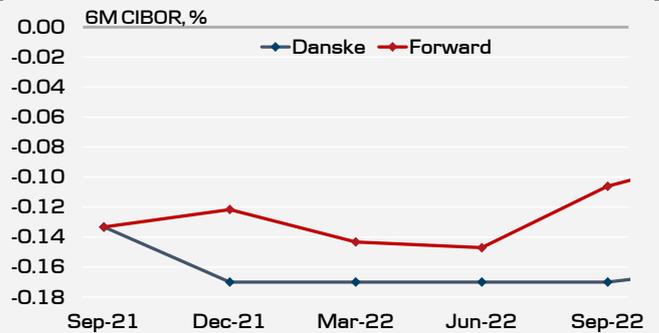
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Source: Danske Bank

## 3M Cibor rates



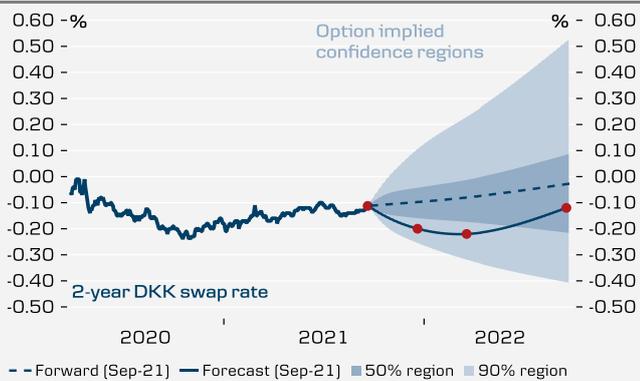
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## Danske Bank forecast and forwards



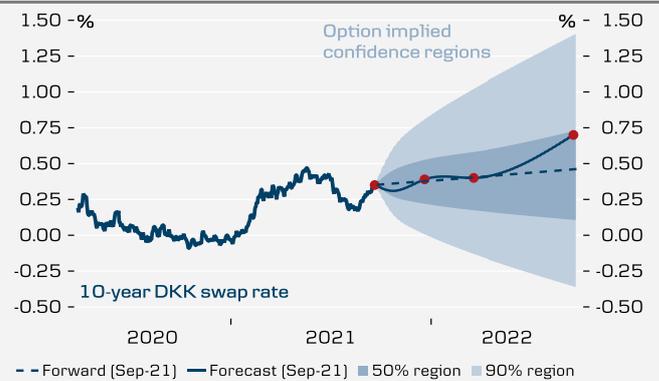
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y 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

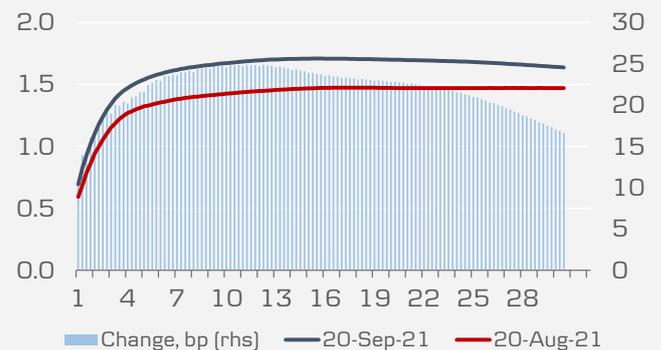
# Norway forecast

## NOK forecast summary

NOK	21/09/2021				--- Forecast ---			--- Fcst vs Fwd in bp ---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money market</u>										
Deposit	0.00	0.50	0.75	1.25	-	-	-	-	-	-
3M	0.51	0.89	1.18	1.52	6	15	18			
6M	0.69	1.04	1.31	1.65	6	14	19			
<u>Government bonds</u>										
2-year	0.72	0.80	1.10	1.40	-	-	-			
5-year	1.20	1.30	1.40	1.60	-	-	-			
10-year	1.40	1.50	1.60	1.90	-	-	-			
<u>Swap rates</u>										
2-year	1.25	1.25	1.55	1.85	-15	3	17			
5-year	1.58	1.65	1.75	1.95	0	6	19			
10-year	1.70	1.80	1.90	2.20	7	14	41			

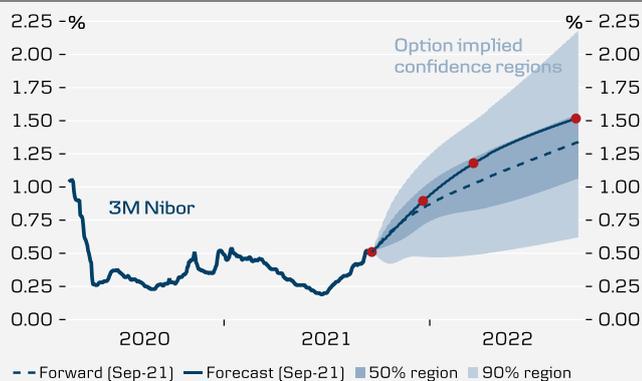
Source: Danske Bank

## 1M change in NOK swap (6M) rates



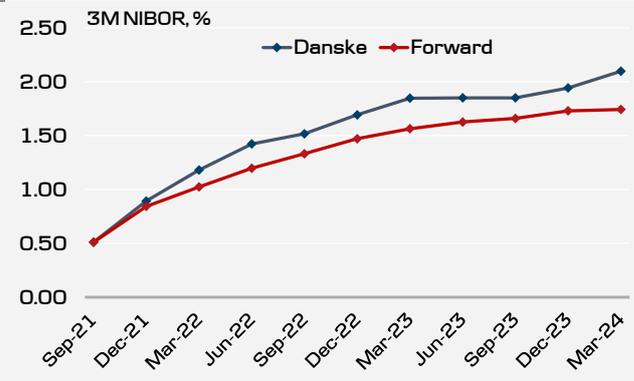
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Nibor rates



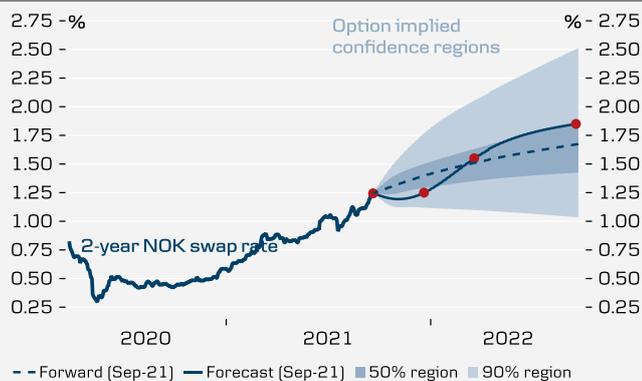
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Source: Danske Bank

## Danske Bank forecast and forwards



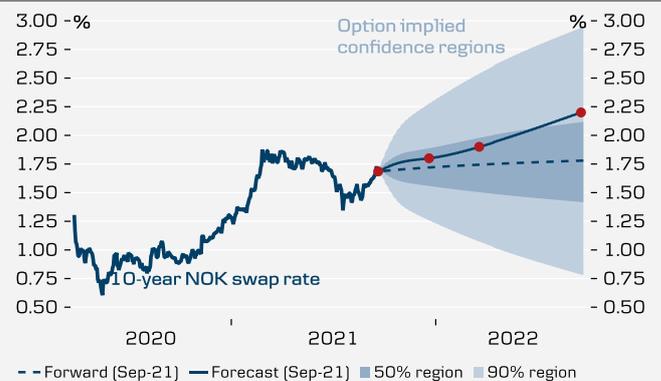
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y NOK swap rates



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

## 10Y NOK swap rates



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

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