

Yield Outlook

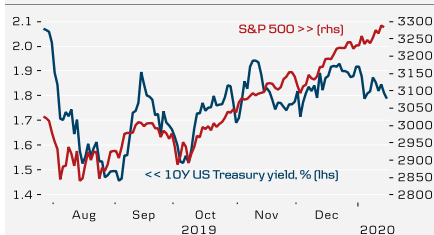
Slightly higher 10Y yields in 2020, but primarily in H2

December was characterised by an improved risk picture. The US and China agreed on a phase-1 deal, Boris Johnson won a landslide victory in the UK parliamentary election and Brexit fears are almost gone. At the same time, the market started to factor in a stabilisation in the global business cycle. It created a positive sentiment and was a strong driver for equities and bond yields.

However, the US killing of Iranian military leader Suleimani put a serious damper on the positive sentiment. It caused fear of an Iranian retaliatory attack and the oil price shot up. However, the Iranians chose a cautious strategy and the bombing of a US base was done in such a way that the risk of loss of life was very small. Even Trump did his best not to escalate the situation afterwards. The tragic shooting of the Ukrainian passenger plane over Iranian airspace further dampened Iran's appetite for retaliation. Today, the Iran-US conflict has little effect on the financial markets.

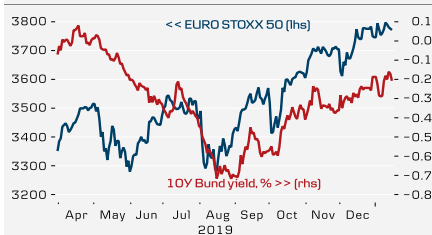
The favourable risk appetite in financial markets is thus back and interest rates have been moving moderately upwards with equities in the new year in Europe. US long-term interest rates, on the other hand, have been trading at a narrow range and are slightly lower than in December, partly because of continued modest US inflation.

Higher US equity prices not reflected in the US treasury market



Source: Macrobond Financial, Danske Bank

...but bunds yields have moved slightly higher



Source: Macrobond Financial, Danske Bank

Still room for slightly higher yields in 2020

In 2020, we expect a further - but still modest increase - in the German 10-year yield following the increases in the fourth quarter and at the beginning of the year. The 10-year government yields in Germany are expected to rise above zero in the second half of 2020. The 10-year US government yields are expected to rise to over 2%.

We also continue to expect that the 2-10 year yield curve will steepen slightly in 2020. The ECB continues to keep the short end of the curve down, while there is still a number of driving forces, see the next page, pointing to higher 10-year yields.

Quick links

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Policy rates

Country	Spot	+3m	+6m	+12m
USD	1.75	1.50	1.50	1.50
EUR	-0.50	-0.50	-0.50	-0.50
GBP	0.75	0.75	0.50	0.50
DKK	-0.75	-0.75	-0.75	-0.65
SEK	-0.25	0.00	0.00	0.00
NOK	1.50	1.50	1.75	1.75

10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	1.93	1.90	1.90	2.10
EUR	-0.22	-0.20	-0.10	0.10
GBP	0.80	0.80	0.80	1.00
DKK	-0.18	-0.13	-0.02	0.20
SEK	0.09	0.15	0.30	0.50
NOK	1.53	1.55	1.65	1.95

Note: EUR = Germany

10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	1.88	1.85	1.85	2.05
EUR	0.17	0.20	0.30	0.50
GBP	0.99	0.95	0.95	1.15
DKK	0.28	0.32	0.42	0.65
SEK	0.63	0.70	0.80	1.00
NOK	2.03	2.05	2.15	2.45

Source: Danske Bank

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Finally, Danmarks Nationalbank is expected to raise its key interest rate by 10bp during 2020. Danmarks Nationalbank intervened in favour of the krone in December and the EUR/DKK level might indicate that it continued in January. There has been a modest amount of intervention but it does indicate that the current deposit rate of -0.75% has simply become too low compared to the ECB's monetary policy rate of -0.5%.

Yield drivers in 2020

We have not materially changed the yield drivers for 2020 compared to the view we presented in the last issue of *Yield Outlook* that we published on 20 December.

Hence, we keep the view that

- the global manufacturing cycle is improving,
- pricing of the ECB will be key especially later in 2020,
- the term premium is simply too low today given cyclical and risk picture.

First, we still argue that the global economy now shows tentative signs of stabilisation, following the headwinds over the summer and autumn last year. Hence, we expect the global manufacturing sector to enter a modest recovery in 2020, but it will certainly not be a sprawling recovery. Still this is a brighter outlook than we faced just a few months ago, when global indicators pointed downward and the global economy faced significant trade and Brexit uncertainties.

Second, we do not assume that the market will continue to price in a more aggressive ECB over the next six months. However, for H2 20, we assume the money-market curve could steepen slightly (higher 1Y1Y rate) as risk factors abate, not least as time simply passes. In the graph to the right, we have represented the forward curve with the 1Y1Y rate. Market pricing today implies that in one year the 1Y1Y rate will be approximately 10bp higher. If we take into account the relationship between the 1Y1Y rate and the 10Y EUR rate over the past six months, it would, all else being equal, tend to push the 10Y rate some 15-20bp higher.

Third, we still have focus on the so-called term-premium as a measure used to gauge the additional premium that investors require to invest in long-term versus short-term risk-free debt. The term-premium has been an important factor behind the decline and subsequent rise in long-dated yields in 2019. For more, see *FI Strategy: Term premium has been the dominant driver of Bunds since 2012*, 10 November.

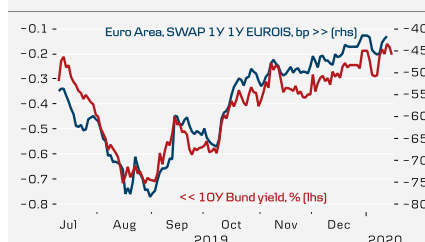
The term-premium for 10Y German government bonds is currently negative by around 30bp. Hence, investors pay to hold long-dated bonds relative to buying short-dated bonds on a consecutive basis. The ECB's QE programme is trying to compress the term-premium and with the open-ended ECB QE programme and the sizeable reinvestment programme, upside for the term-premium is capped in 2020.

However, QE is not the only factor affecting the term-premium. We expect a positive risk picture in 2020. Hence, the safe-haven buying of bonds, especially in Germany, might reverse in 2020, as investors continue to move towards riskier assets.

Yields set to rise further and the curve to steepen in H2 20

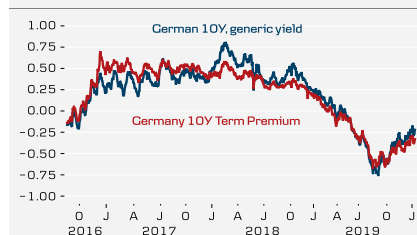
Overall, we expect German yields to stabilise around the current level after the recent rise. However, we continue to see 10Y Bund yields higher on a six- to 12-month horizon, as we expect the cyclical outlook to improve in the second part of 2020 and as the term-premium

Still close correlation between 1Y1Y (ECB expectations) and 10Y rates and yields



Source: Danske Bank

Term-premium* important for 10Y Bund yields



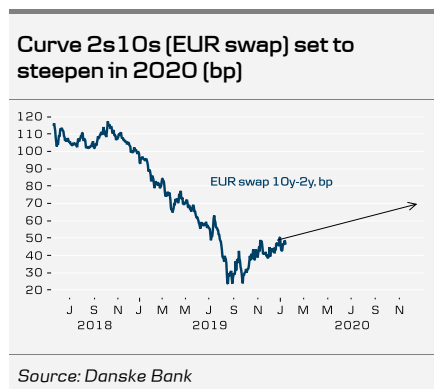
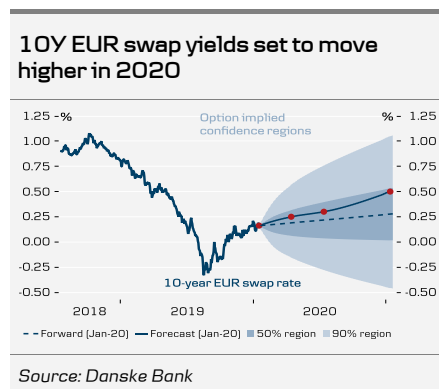
* Based on Danske Bank Term-Premium model for Germany

Source: Bloomberg, Danske Bank

moves higher. We expect 10Y Bund and 10Y Treasury yields to hit 0.1% and 2.1%, respectively, in H2 20. The risk is now seen on the upside compared with our forecasts.

On the other hand, we see a small probability that 10Y interest rates will hit new bottom levels during 2020. In our view, this will require the ECB to start reducing interest rates again. We see this possibility as modest given the opposition already today from a number of ECB members in relation to the current easy monetary policy.

However, in the event of a recession in the global economy or in the euro area, the 10-year interest rate should be expected to fall to the levels we saw back in August and September.



We expect to publish the next issue of *Yield Outlook* in mid-February 2020.

Forecasts*									
	Horizon	Policy rate	3m xlbbr	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	1.75	1.83	1.63	1.61	1.75	1.56	1.61	1.79
	+3m	1.50	1.65	1.60	1.60	1.85	1.50	1.60	1.85
	+6m	1.50	1.65	1.55	1.60	1.85	1.50	1.60	1.90
	+12m	1.50	1.65	1.55	1.80	2.05	1.50	1.80	2.10
EUR	Spot	-0.50	-0.39	-0.30	-0.14	0.16	-0.59	-0.50	-0.20
	+3m	-0.50	-0.41	-0.30	-0.15	0.25	-0.60	-0.50	-0.15
	+6m	-0.50	-0.41	-0.30	-0.05	0.30	-0.60	-0.40	-0.10
	+12m	-0.50	-0.41	-0.20	0.05	0.50	-0.50	-0.30	0.10
GBP	Spot	0.75	0.75	0.67	0.75	0.88	0.47	0.47	0.68
	+3m	0.50	0.54	0.70	0.75	0.90	0.40	0.45	0.70
	+6m	0.50	0.54	0.70	0.75	0.95	0.40	0.45	0.75
	+12m	0.50	0.54	0.80	0.80	1.15	0.50	0.50	1.00
DKK	Spot	-0.75	-0.41	-0.18	-0.02	0.27	-0.58	-0.44	-0.21
	+3m	-0.75	-0.42	-0.18	0.00	0.37	-0.60	-0.43	-0.12
	+6m	-0.75	-0.42	-0.18	0.10	0.42	-0.60	-0.32	-0.05
	+12m	-0.65	-0.32	-0.05	0.20	0.65	-0.45	-0.20	0.15
SEK	Spot	0.00	0.21	0.24	0.39	0.66	-0.29	-0.21	0.17
	+3m	0.00	0.15	0.30	0.45	0.90	-0.30	-0.15	0.35
	+6m	0.00	0.15	0.25	0.50	0.90	-0.35	-0.10	0.45
	+12m	0.00	0.15	0.25	0.55	1.05	-0.35	-0.05	0.60
NOK	Spot	1.50	1.95	1.93	1.89	1.95	1.43	1.36	1.43
	+3m	1.50	2.18	2.05	2.00	2.10	1.50	1.40	1.55
	+6m	1.75	2.24	2.05	2.15	2.15	1.50	1.55	1.60
	+12m	1.75	2.24	2.15	2.15	2.45	1.60	1.60	1.90

* German government bond yields and EUR swap rates used
Source: Danske Bank

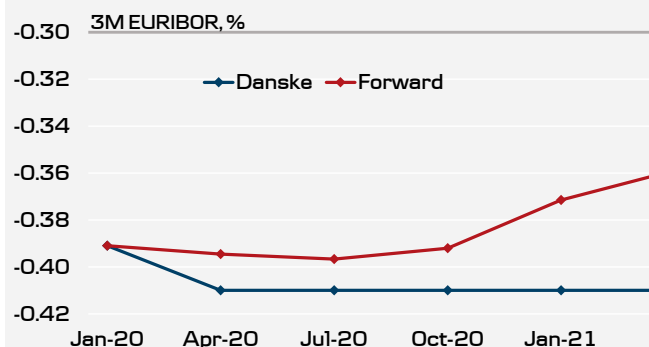
Eurozone forecasts

EUR forecast summary

15/01/2020	Spot	+3m	+6m	+12m	+3m	+6m	+12m
--- 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	-0.50	-0.50	-0.50	-0.50	-	-	-
3M	-0.39	-0.41	-0.41	-0.41	-2	-1	-4
6M	-0.33	-0.36	-0.36	-0.36	-3	-3	-7
Government Bonds							
2-year	-0.59	-0.60	-0.60	-0.50	-	-	-
5-year	-0.50	-0.50	-0.40	-0.30	-	-	-
10-year	-0.20	-0.15	-0.10	0.10	-	-	-
Swap rates							
2-year	-0.30	-0.30	-0.30	-0.20	-2	-3	2
5-year	-0.14	-0.15	-0.05	0.05	-3	-6	9
10-year	0.16	0.25	0.30	0.50	6	8	22

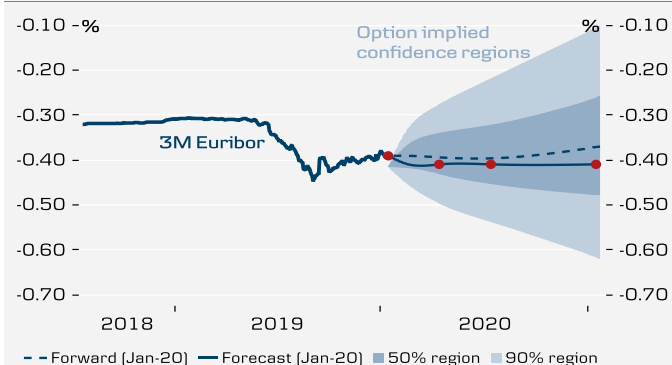
Source: Danske Bank

Danske Bank forecast and forwards



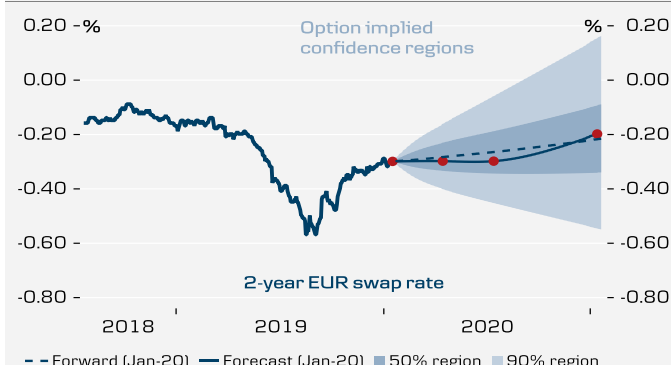
Source: Danske Bank

3M Euribor



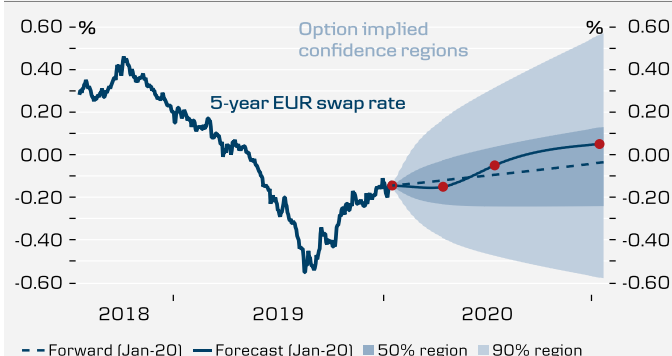
Source: Macrobond Financial, Danske Bank

2Y EUR swap rates



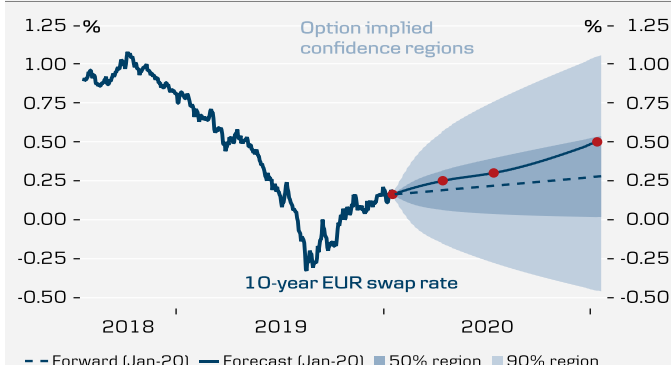
Source: Macrobond Financial, Danske Bank

5Y EUR swap rates



Source: Danske Bank

10Y EUR swap rates



Source: Danske Bank

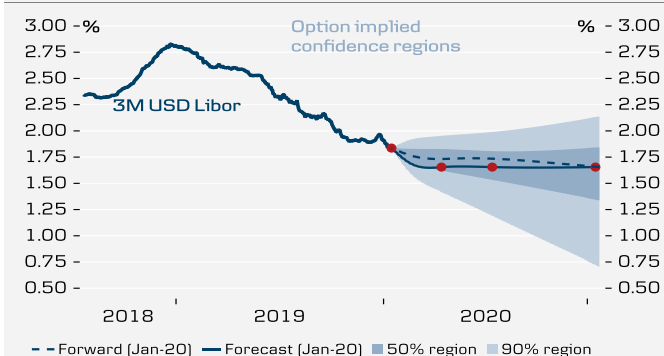
US forecasts

USD forecast summary

15/01/2020	Spot	+3m	+6m	+12m	+3m	+6m	+12m
--- Forecast ---							
--- Fcst vs Fwd in bp ---							
USD							
<u>Money Market</u>							
Fed Funds	1.75	1.50	1.50	1.50	-	-	-
3M	1.83	1.65	1.65	1.65	-8	-3	10
<u>Government Bonds</u>							
2-year	1.56	1.50	1.50	1.50	-	-	-
5-year	1.61	1.60	1.60	1.80	-	-	-
10-year	1.79	1.85	1.90	2.10	-	-	-
<u>Swap rates</u>							
2-year	1.63	1.60	1.55	1.55	2	-1	2
5-year	1.61	1.60	1.60	1.80	0	0	19
10-year	1.75	1.85	1.85	2.05	9	9	26

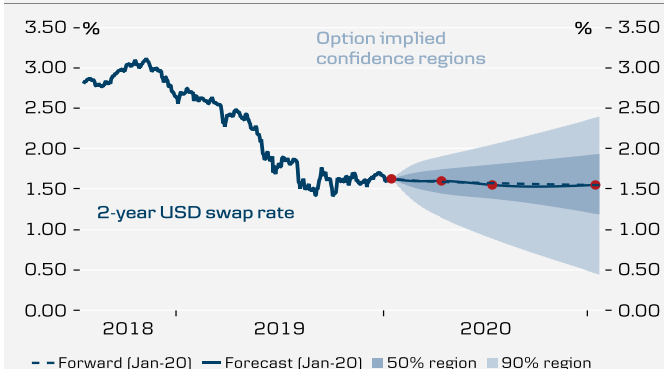
Source: Danske Bank

3M USD Libor rates



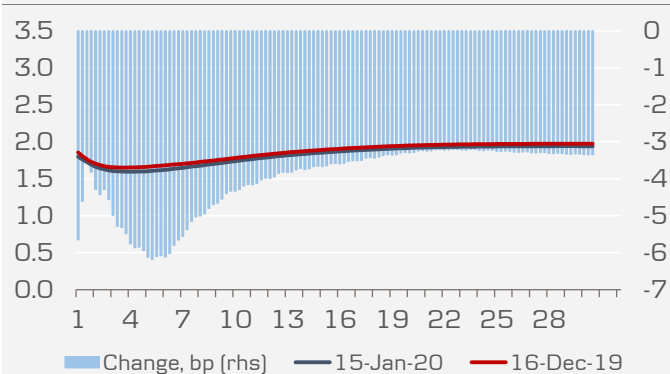
Source: Macrobond Financial, Danske Bank

2Y USD swap rates



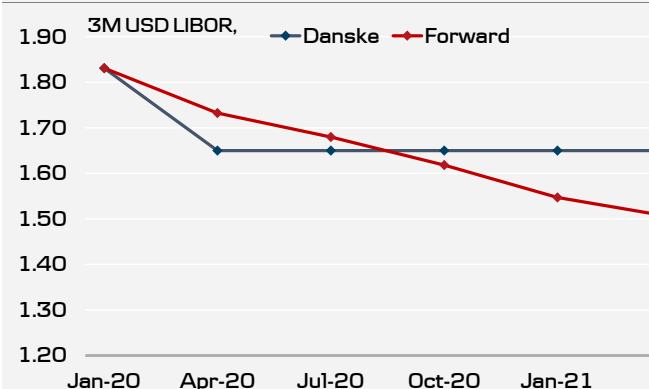
Source: Danske Bank

1M change in 3M USD Libor



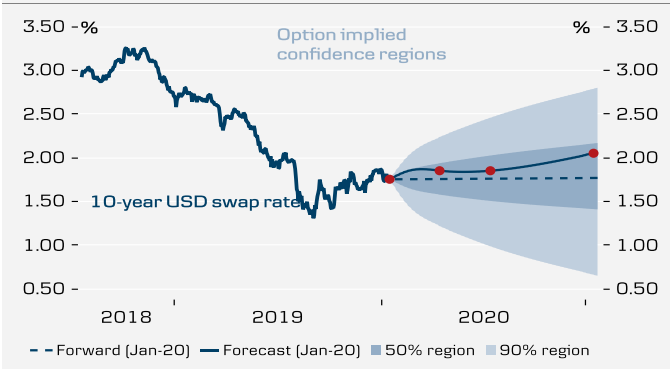
Source: Danske Bank

Danske Bank forecast and forwards



Source: Macrobond Financial, Danske Bank

10Y USD swap rates



Source: Danske Bank

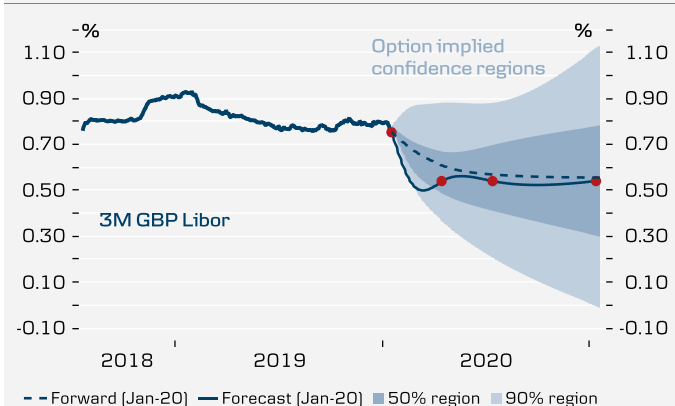
UK forecasts

UK forecast summary

15/01/2020	Spot	+3m	+6m	+12m	+3m	+6m	+12m
GBP							
Money Market							
Repo	0.75	0.5	0.5	0.5	-	-	-
3M	0.75	0.54	0.54	0.54	-7	-3	-2
Government Bonds							
2-year	0.47	0.40	0.40	0.50	-2	0	8
5-year	0.465	0.45	0.45	0.5	-2	-1	2
10-year	0.68	0.70	0.75	1.00	-6	-4	16
Swap rates							
2-year	0.67	0.70	0.70	0.80	6	6	13
5-year	0.75	0.75	0.75	0.80	1	0	-12
10-year	0.88	0.90	0.95	1.15	2	5	23

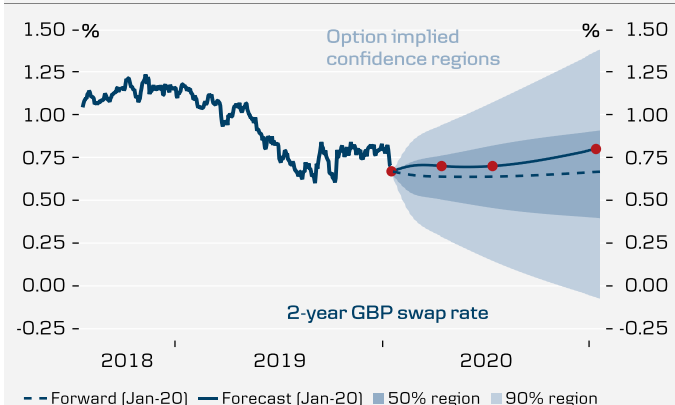
Source: Danske Bank

3M GBP Libor rates



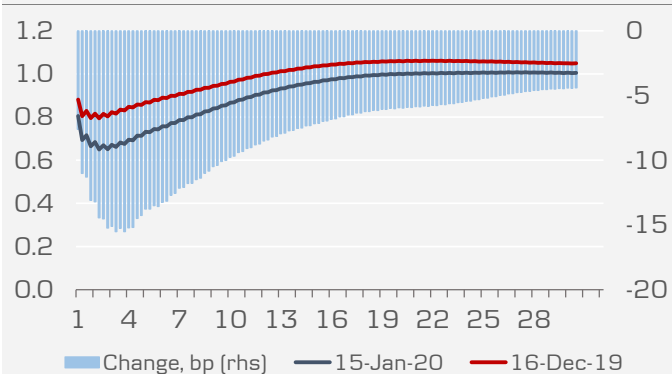
Source: Macrobond Financial, Danske Bank

2Y UK swap rates



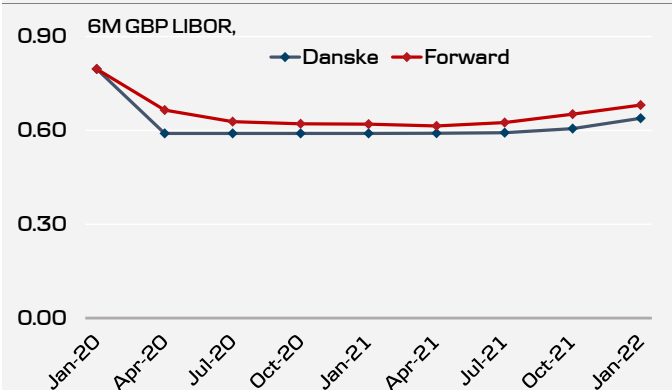
Source: Danske Bank

1M change in 6M GBP Libor



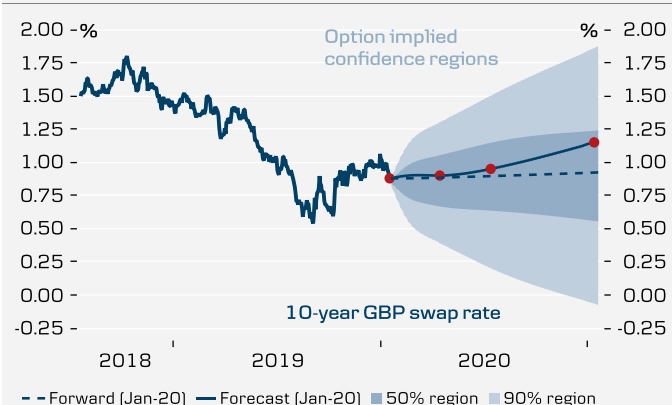
Source: Danske Bank

Danske Bank forecast and forwards



Source: Macrobond Financial, Danske Bank

10Y UK swap rates



Source: Danske Bank

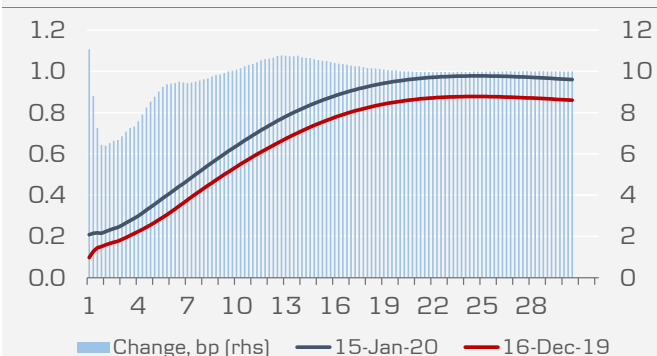
Sweden forecasts

SEK forecast summary

15/01/2020	SEK	Spot	+3m	+6m	+12m	--- Forecast ---	+3m	+6m	+12m	--- Fcst vs Fwd in bp ---	+3m	+6m	+12m
Money market													
Repo		0.00	0.00	0.00	0.00								
3M		0.21	0.15	0.15	0.15		-6	-8	-6				
Government bonds													
2-year		-0.29	-0.30	-0.35	-0.35		-	-	-				
5-year		-0.21	-0.15	-0.10	-0.05		-	-	-				
10-year		0.17	0.35	0.45	0.60		-	-	-				
Swap rates													
2-year		0.24	0.30	0.25	0.25		5	-1	-6				
5-year		0.39	0.45	0.50	0.55		4	7	6				
10-year		0.66	0.90	0.90	1.05		21	19	28				

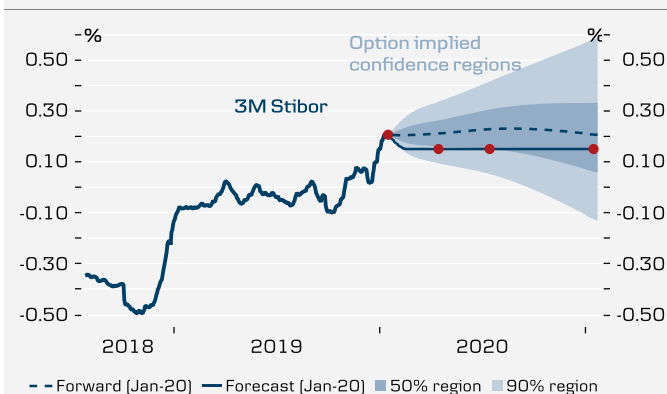
Source: Danske Bank

1M change in 3M Stibor



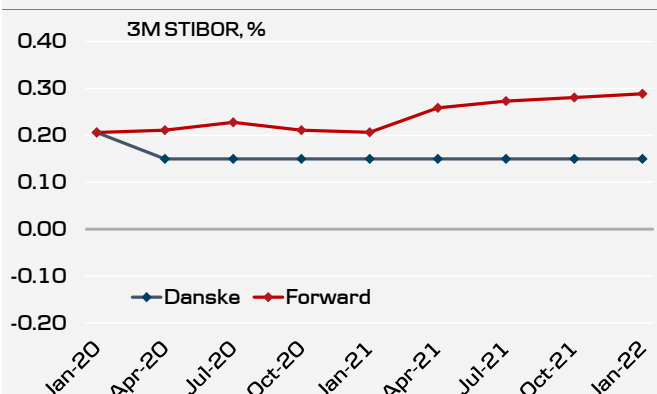
Source: Danske Bank

3M Stibor rate



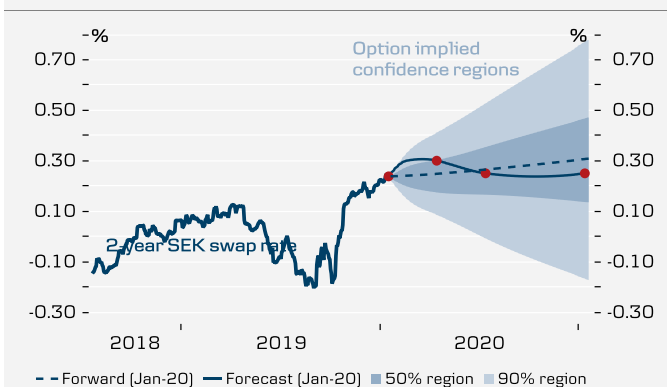
Source: Macrobond Financial, Danske Bank

Danske Bank forecast and forwards



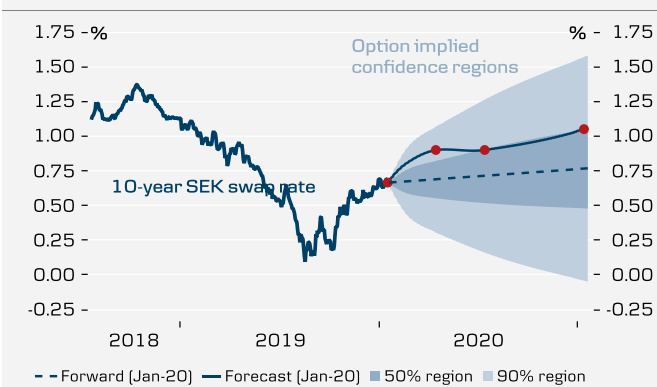
Source: Macrobond Financial, Danske Bank

2Y SEK swap rates



Source: Danske Bank

10Y SEK swap rates



Source: Danske Bank

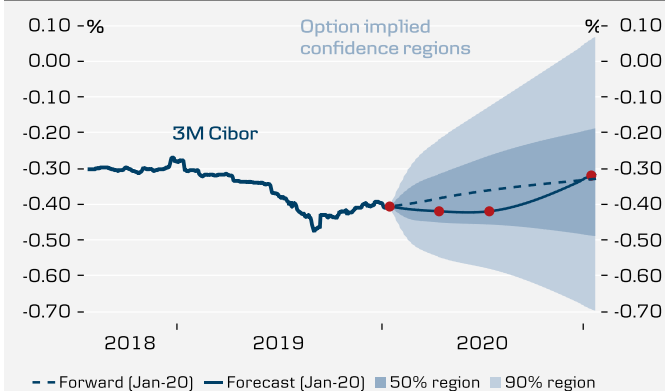
Denmark forecasts

DKK forecast summary

15/01/2020	Spot	+3m	+6m	+12m	+3m	+6m	+12m
--- Forecast ---							
--- Fcst vs Fwd in bp ---							
DKK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
CD	-0.75	-0.75	-0.75	-0.65	-	-	-
Repo	0.05	0.05	0.05	0.05	-	-	-
3M	-0.41	-0.42	-0.42	-0.32	-4	-6	1
6M	-0.24	-0.27	-0.25	-0.18	-5	-5	-1
Government bonds							
2-year	-0.58	-0.60	-0.60	-0.45	-	-	-
5-year	-0.44	-0.43	-0.32	-0.20	-	-	-
10-year	-0.21	-0.12	-0.05	0.15	-	-	-
Swap rates							
2-year	-0.18	-0.18	-0.18	-0.05	-2	-4	4
5-year	-0.02	0.00	0.10	0.20	0	7	12
10-year	0.27	0.37	0.42	0.65	7	10	27
30-year	0.65	0.70	0.77	1.00	5	11	33

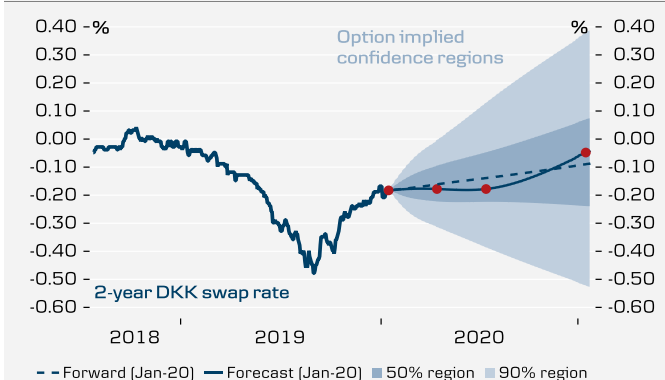
Source: Danske Bank

3M Cibor



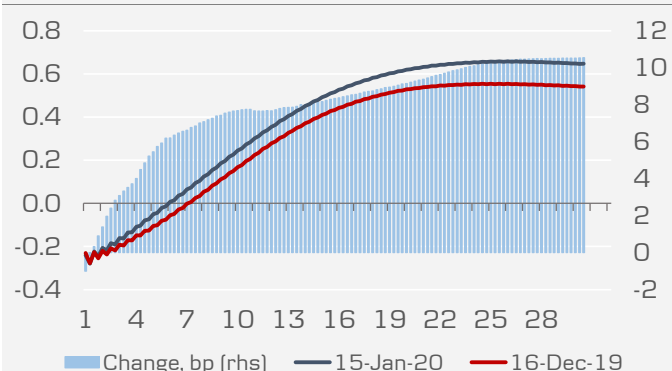
Source: Macrobond Financial, Danske Bank

2Y DKK swap rates



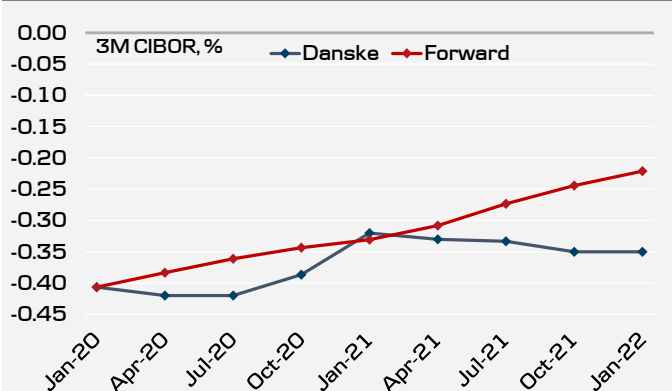
Source: Danske Bank

1M change in 6M Cibor



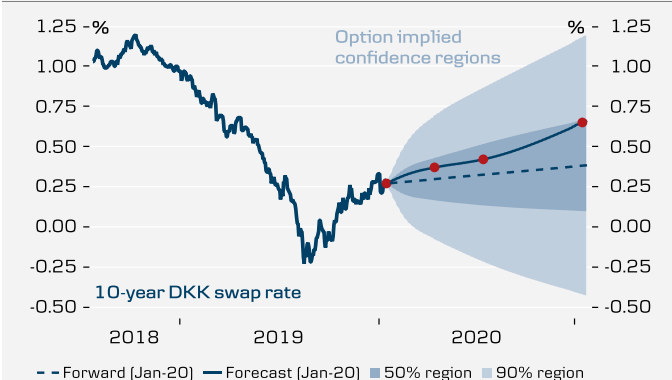
Source: Danske Bank

Danske Bank forecast and forwards



Source: Macrobond Financial, Danske Bank

10Y DKK swap rates



Source: Danske Bank

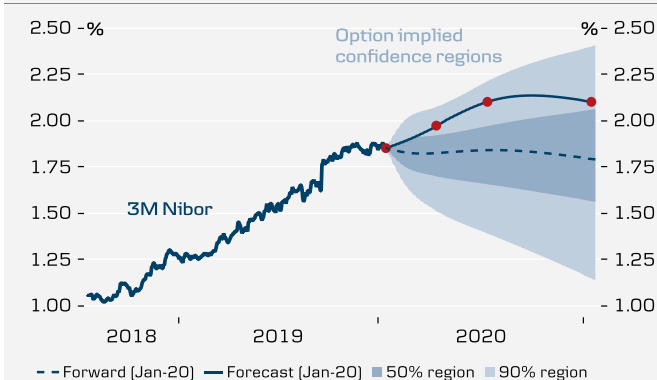
Norway forecasts

NOK forecast summary

19/12/2019	Spot	+3m	+6m	+12m	+3m	+6m	+12m
NOK							
Money market							
Deposit	1.50	1.50	1.75	1.75	-	-	-
3M	1.88	1.94	2.13	2.15	9	26	30
6M	1.98	2.19	2.28	2.29	23	34	35
Government bonds							
2-year	1.33	1.40	1.50	1.60	-	-	-
5-year	1.34	1.40	1.55	1.60	-	-	-
10-year	1.53	1.55	1.65	1.95	-	-	-
Swap rates							
2-year	1.96	2.05	2.10	2.20	10	15	25
5-year	1.97	2.00	2.15	2.15	3	18	17
10-year	2.03	2.05	2.15	2.45	2	12	41

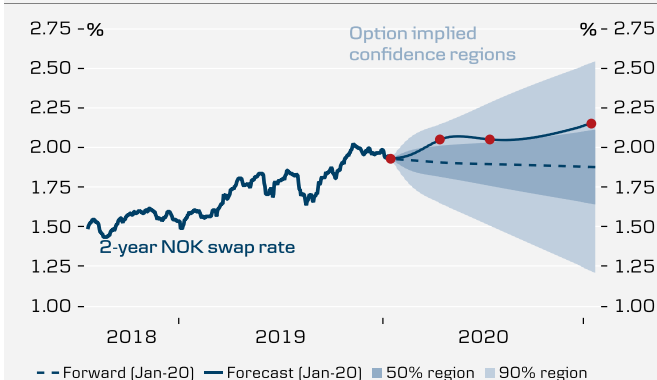
Source: Danske Bank

3M Nibor



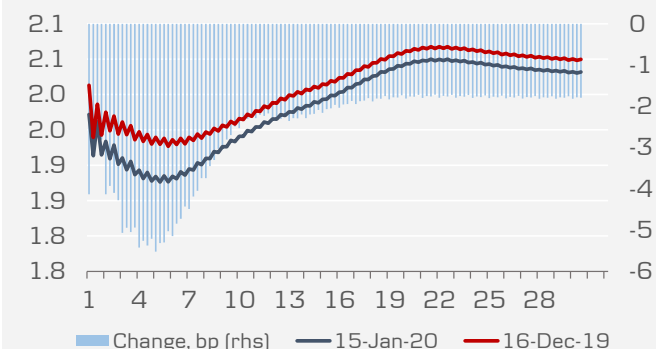
Source: Danske Bank

2Y NOK swap rate



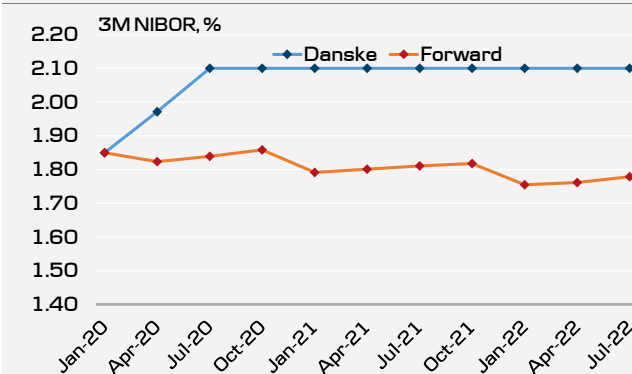
Source: Danske Bank

1M change in 6M Nibor



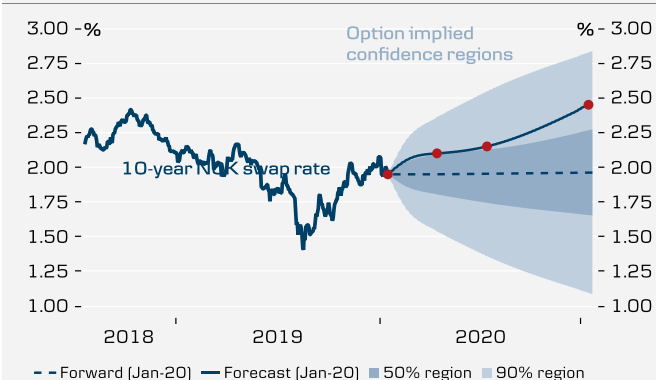
Source: Danske Bank

Danske Bank forecast and forwards



Source: Danske Bank

10Y NOK swap rate



Source: Danske Bank

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