

# Yield Outlook

## Long yields peaked in October

In the previous edition of *Yield Outlook* from 28 October we wrote: ‘The (upward) pressure on long yields (is) set to ease as central bank rates and inflation approach a turning point’, and tentatively concluded ‘that peak yield was probably reached in October and that long yields could retreat in 2023’.

Yield movements in November tend to confirm this view, with long yields declining somewhat. 10Y US Treasury yields briefly touched 4.30% in October and German yields 2.5%, but these two benchmark rates are now back at 3.65% and 1.90%, respectively.

We continue to assess that yields peaked in October and that long yields could retreat further in 2023, as inflation expectations decline slightly and the anticipated recession takes hold. In the short term, however, we view the recent fall in yields as overdone and so see the potential for a new uptick in long yields in the coming 1-3 months.

This is still primarily driven by the prospect of more rate hikes ahead from the ECB and the US central bank (the Fed). Our forecast is for the ECB to hike by 50bp both in December and in February next year, with a final 25bp in March, taking the policy rate to 2.75%. Our expectations for the ECB are slightly more modest than current market pricing, which indicates ECB rates should rise by an additional 15bp to slightly below 3%. Thus in the coming 3-6 months, the market will presumably price in more than our forecast. In contrast, our US forecast is for interest rates to be upped by a further 75bp hike at the December meeting and an additional 50bp in March, bringing the Fed funds target range to 5.00-5.25% - the highest level since 2007. Our forecast is a little above market pricing for the December meeting, where consensus leans more towards ‘only’ 50bp. The next inflation figures and, not least, November’s labour market report will be crucial to determining whether we see a 75bp or a 50bp hike.

In the coming quarters, long yields will be particularly dependent on shifts in the current rate of inflation and, not least, on whether the ECB/Fed begin to signal that peak interest rates are close at hand or indeed have already been reached. We will also be carefully monitoring the ECB for any announcements about an upcoming halt to reinvestments (QT), which could happen as early as the December meeting. As we progress further into 2023 and the central banks signal that interest rates have peaked, the market will begin to focus on when we can expect the first rate cut from the Fed and the ECB.

### Multiple yield drivers in 2023

Otherwise, we essentially expect the same factors to dominate long yields in 2023 as we discussed in the previous edition of *Yield Outlook*.

#### 1. Still high inflation

Inflation remains very high, although we are beginning to see nascent signs of inflation potentially having peaked. US core inflation actually rose a little less than expected in October and many commodity prices, including oil and metal prices and especially freight rates, have fallen considerably.

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#### Central bank policy rates

Country	Spot	+3m	+6m	+12m
USD	4.00	4.75	5.25	5.25
EUR	1.50	2.50	2.75	2.75
GBP	3.00	3.75	3.75	3.75
DKK	1.25	2.25	2.50	2.50
SEK	2.50	2.75	2.75	2.75
NOK	2.50	2.75	2.75	2.75

#### 10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	3.64	4.00	4.00	3.60
EUR	1.97	2.20	2.20	2.00
GBP	3.12	3.40	3.40	3.20
DKK	2.22	2.45	2.45	2.25
SEK	1.97	2.10	2.35	2.65
NOK	3.17	3.40	3.35	3.15

Note: EUR = Germany

#### 10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	3.66	4.05	4.05	3.65
EUR	2.69	2.90	2.90	2.70
GBP (OIS)	3.35	3.60	3.60	3.40
DKK	2.83	3.10	3.10	2.90
SEK	2.75	3.10	3.25	3.30
NOK	3.33	3.60	3.55	3.35

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

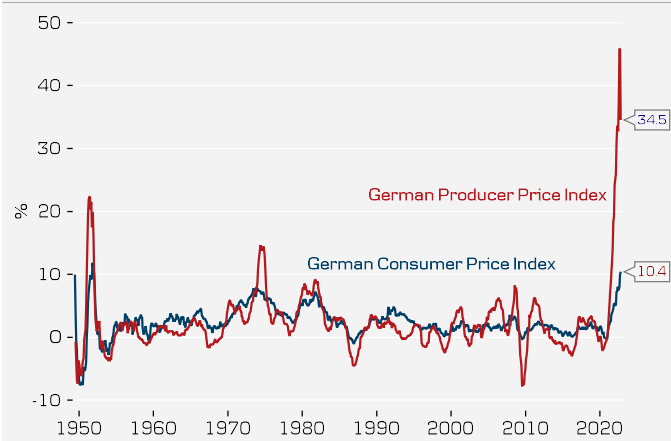
Source: Danske Bank for tables above

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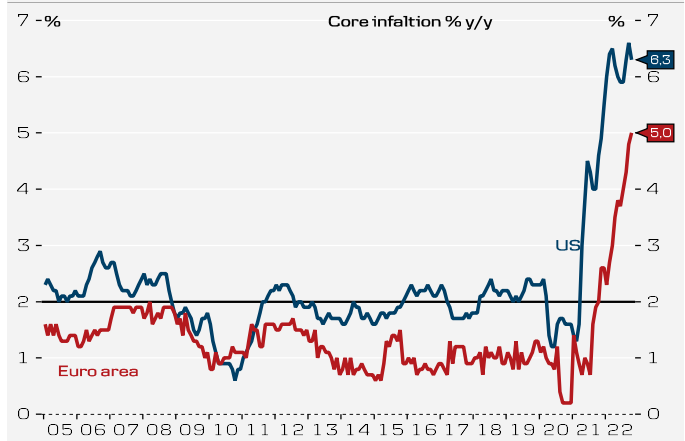
Falling gas and electricity prices falling have also been important for Europe, but whether that will be sufficient for companies to waive price rises in the coming months following the dramatic increases in input prices in September and October remains unclear. German producer prices rose by 34.5% in October and while that is down from the record 45.8% y/y in September, it remains a historically significant price shock that will be difficult for many companies to absorb without raising prices.

**Will European companies pass high purchasing prices (producer prices) on to consumers?**



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

**Signs of US core inflation having peaked for now**



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

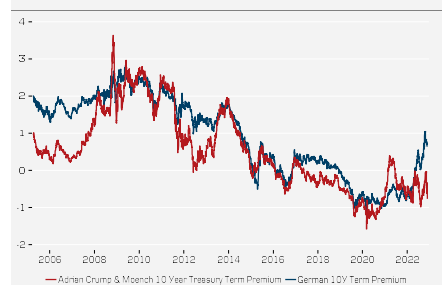
**2. Increasing supply of bonds**

The next few years will likely see a growing supply of bonds to finance inflation relief packages, the green transition and increased military spending (NATO contribution) in many countries. Meanwhile, there are several central banks no longer prepared to buy bonds and who may instead become sellers in the market. Here in Yield Outlook, we have often argued that long yields should increase due to a rising term premium – in other words, the additional premium investors require to buy, for example, a 10Y bond rather than 10 1Y bonds over the next 10 years. The term premium cannot be read in the market data, but it can be estimated using various econometric techniques that involve yield volatility, inflation expectations, etc.

**3. Will the ECB continue to reinvest in the bond market (QT)?**

Thirdly, as mentioned, the market will likely focus on central bank announcements, especially from the ECB, on their large holding of bonds from QE programmes. While the programmes have now ended, reinvestments continue to be made when bonds expire, which means that the ECB is not siphoning off market liquidity and that it remains an active buyer in the bond market. The ECB confirmed at its October meeting that it had no plans to halt reinvestments from the huge Pandemic Emergency Purchasing Plan (PEPP) before the end of 2024 at the earliest. However, the discussion around the original Asset Purchase Programme (APP) is more relevant here and likely to be taken up at the December meeting. Whether the outcome will be the ECB deciding to stop reinvestments (QT) later in 2023 remains uncertain. Nevertheless, the mere fact the discussion is taking place is an upside risk to long yields in the coming months at a time of increasing supply.

**Term premium continues to rise in Germany, but more stable in the US**



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

#### 4. Uncertain macro picture with high inflation and looming recession

Our economists have just published their *Big Picture*, which takes a closer look at the prospects for the global economy. The outlook for the euro area looks particularly negative, with the economy expected to contract by some 0.9% in 2023 followed by zero growth in 2024. The picture emerging is of an economy heading for a double-dip recession. Recession and slow growth often go hand in hand with low inflation, but pronounced increases in energy prices point to inflation running at 7.6% and 3.2% in 2023 and 2024, respectively, in the euro area. Nor do we expect core inflation to dip below 2% before late 2024. High inflation also means we probably cannot expect a rate cut from the ECB before sometime in the spring/summer of 2024 at the earliest – and that despite the outlook for recession and zero growth in 2023/2024.

The economic picture looks a little more upbeat in the US, albeit with the prospect of negative growth in 2023 (-0.2%), but followed by modestly positive growth of 0.5% in 2024. The US is, and will remain, much less affected by high gas and electricity prices than Europe. Conversely, monetary policy rates look set to peak at a somewhat higher level, so in 2023 the market will begin to focus on the first rate cut from the Fed. That initial cut will probably not come until 2024, but a US rate cut in 2023 can certainly not be ruled out.

#### Weak growth expectations for the global economy. Danske Bank estimate.

	2023				2024				2021-2024			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2021	2022	2023	2024
	% q/q				% q/q				% y/y			
G4	0.2	0.3	0.2	0.4	0.6	0.7	0.8	0.8	6.5	2.7	1.6	2.2
US	0.0	-0.6	-0.5	0.0	0.3	0.3	0.5	0.6	6.0	1.9	-0.2	0.5
Euro Area	-0.7	0.1	-0.4	-0.6	-0.2	0.4	0.7	0.3	5.3	3.3	-0.9	0.0
China	1.0	1.2	1.3	1.3	1.3	1.3	1.3	1.3	8.6	3.3	4.9	5.3
Japan	0.1	0.0	0.0	0.1	0.4	0.3	0.3	0.3	1.7	1.4	0.7	0.9

Source: Danske Bank

#### Long yields have likely already peaked

We expect long yields to trend higher in the coming months. Still high inflation numbers and, not least, central banks continuing to hike interest rates are expected to be the dominating drivers. The market's focus on ECB QT and a generous supply of bonds in 2023 point in the same direction.

However, as we mentioned in our introduction, we estimate that long yields peaked in October. Overall, we now expect 10Y US Treasury yields to rise by around 30bp to 4.0% in the course of the next three months. Meanwhile, we expect 10Y Bund yields to increase by around 20-30bp to 2.20% in the coming months.

Looking 6-12 months ahead, we estimate the market will seriously begin to focus on European and US recessions pushing inflation lower and that this will eventually provide scope for lower monetary policy rates, putting renewed downward pressure on long yields. We take the view that the expected increase in yields in the coming months will reverse, but long yields falling more in H2 23 than assumed in our forecast is definitely a possibility.

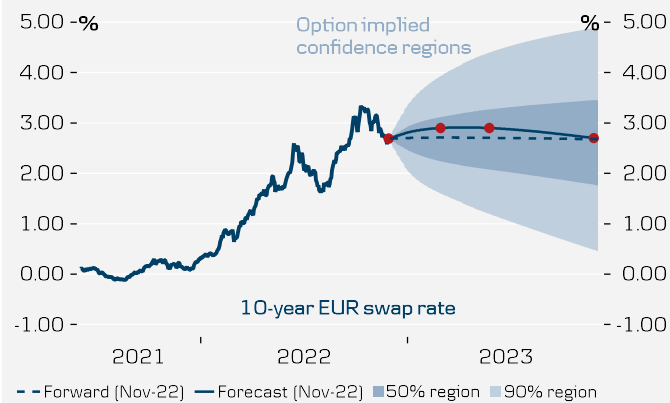
#### Two alternative scenarios in 2023

As mentioned, we expect stable-to-declining long yields in 2023 as the market begins to focus on central bank rates peaking and perhaps the first rate cut prompted by the economic recession. The risk is that we underestimate the depth of the recession and the scale of the

negative fallout on inflation and the labour market. In this scenario, yields could fall substantially more in 2023 than we have assumed, with the ECB potentially cutting rates as early as 2023 and 10Y Bund yields likely declining to 1-1.5%. Should electricity and gas prices remain at current levels or even fall further, overall eurozone inflation could be negative in a year's time.

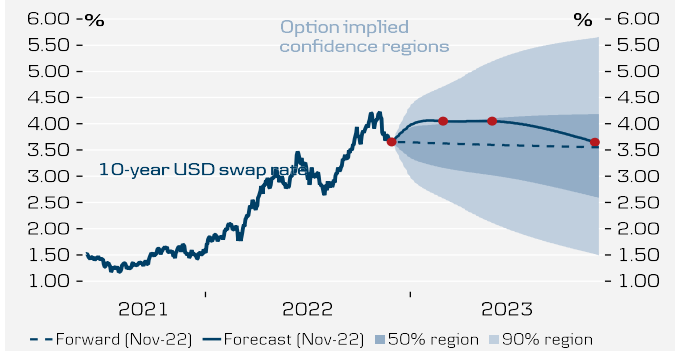
On the other hand, we might also be underestimating wage growth and just how strong underlying inflationary pressures are. High inflation could also trigger more pronounced fiscal policy easing than we have assumed. Recent movements in UK yields show the market has difficulty absorbing strong fiscal policy stimulation at a time when inflation is very high. In this scenario, the ECB could raise interest rates to 4% or more, with long yields potentially rising on a similar scale.

Forecast: 10Y EUR swap rates



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

Forecast: 10Y USD swap rates



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

Forecast\*

	Horizon	Policy rate	3m xlibor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	4.00	4.73	4.79	3.93	3.66	4.42	3.82	3.64
	+3m	4.75	5.33	5.20	4.45	4.05	4.80	4.30	4.00
	+6m	5.25	5.40	5.10	4.25	4.05	4.70	4.10	4.00
	+12m	5.25	5.26	4.80	4.05	3.65	4.40	3.90	3.60
EUR**	Spot	1.50	1.92	2.93	2.73	2.69	2.18	2.01	1.97
	+3m	2.50	2.88	2.95	2.90	2.90	2.25	2.20	2.20
	+6m	2.75	2.91	2.95	2.90	2.90	2.25	2.20	2.20
	+12m	2.75	2.89	2.75	2.70	2.70	2.05	2.00	2.00
GBP**	Spot	3.00		4.37	3.85	3.35	3.29	3.29	3.12
	+3m	3.75		4.50	4.00	3.60	3.50	3.50	3.40
	+6m	3.75		4.50	4.00	3.60	3.50	3.50	3.40
	+12m	3.75		4.30	3.80	3.40	3.30	3.30	3.20
DKK	Spot	1.25	2.21	3.09	2.89	2.83	2.31	2.17	2.22
	+3m	2.25	2.97	3.15	3.05	3.10	2.40	2.35	2.45
	+6m	2.50	3.00	3.15	3.05	3.10	2.40	2.35	2.45
	+12m	2.50	3.00	2.95	2.85	2.90	2.20	2.15	2.25
SEK	Spot	2.50	2.42	3.20	2.93	2.75	2.47	2.12	1.97
	+3m	2.75	2.80	3.30	3.25	3.10	2.45	2.30	2.10
	+6m	2.75	2.85	3.25	3.25	3.25	2.50	2.45	2.35
	+12m	2.75	2.85	3.15	3.20	3.30	2.40	2.50	2.65
NOK	Spot	2.50	3.56	3.94	3.49	3.33	3.52	3.31	3.17
	+3m	2.75	3.38	3.80	3.60	3.60	3.40	3.40	3.40
	+6m	2.75	3.10	3.70	3.50	3.55	3.30	3.30	3.35
	+12m	2.75	3.10	3.50	3.30	3.35	3.10	3.10	3.15

\* German government bond yields and euro swap rates \*\* Based on OIS swap rates. Note 3M GBP Libor is no longer published

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

Source: Danske Bank

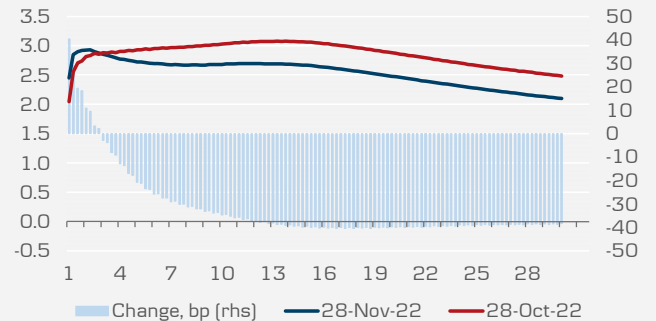
# Eurozone forecast

## EUR forecast summary

EUR	28/11/2022	--- Forecast ---			--- Fcst vs Fwd in bp ---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money Market</b>							
Deposit	1.50	2.50	2.75	2.75	-	-	-
3M	1.92	2.88	2.91	2.89	11	-20	-21
6M	2.37	3.04	3.05	2.99	3	-16	-9
<b>Government Bonds</b>							
2-year	2.18	2.25	2.25	2.05	-	-	-
5-year	2.01	2.20	2.20	2.00	-	-	-
10-year	1.97	2.20	2.20	2.00	-	-	-
<b>Swap rates</b>							
2-year	2.93	2.95	2.95	2.75	-7	-4	-9
5-year	2.73	2.90	2.90	2.70	14	16	3
10-year	2.69	2.90	2.90	2.70	19	20	2

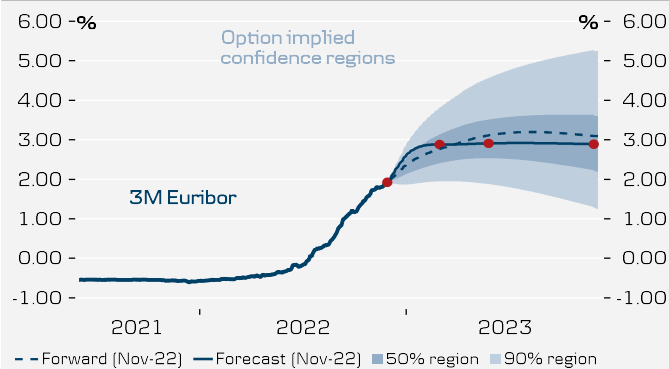
Source: Danske Bank

## 1M change in EUR swap rates



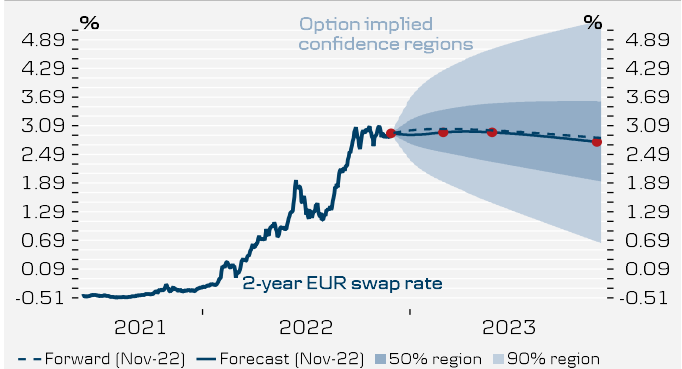
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Euribor rates



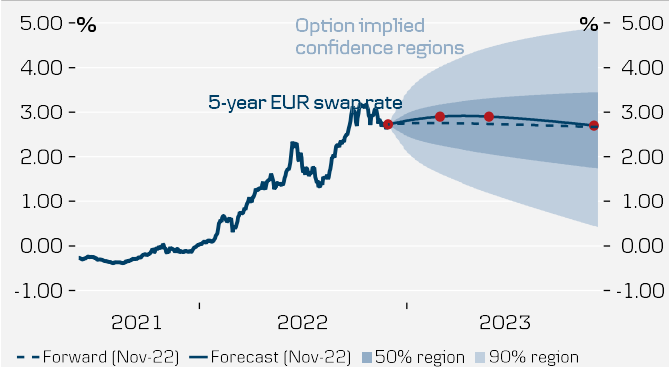
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y EUR swap rates



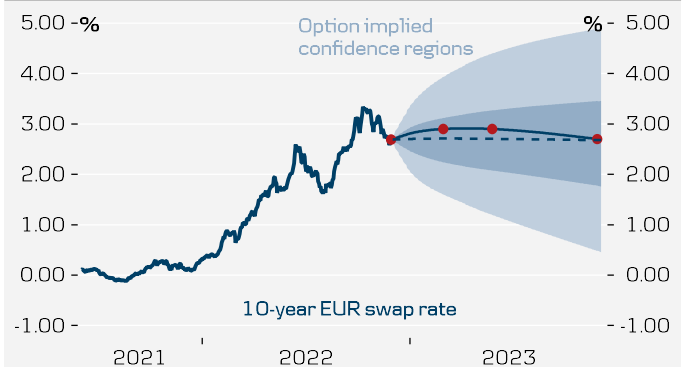
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 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

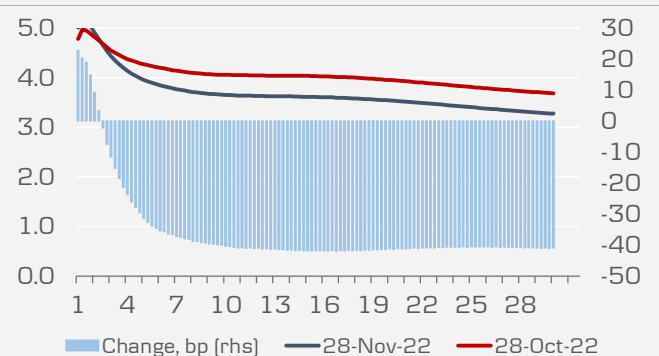
# US forecast

## USD forecast summary

28/11/2022	--- Forecast ---				--- Fcst vs Fwd in bp ---		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
Fed Funds	4.00	4.75	5.25	5.25	-	-	-
3M	4.73	5.33	5.40	5.26	21	3	28
<u>Government Bonds</u>							
2-year	4.42	4.80	4.70	4.40	-	-	-
5-year	3.82	4.30	4.10	3.90	-	-	-
10-year	3.64	4.00	4.00	3.60	-	-	-
<u>Swap rates</u>							
2-year	4.79	5.20	5.10	4.80	56	68	88
5-year	3.93	4.45	4.25	4.05	60	50	52
10-year	3.66	4.05	4.05	3.65	43	48	19

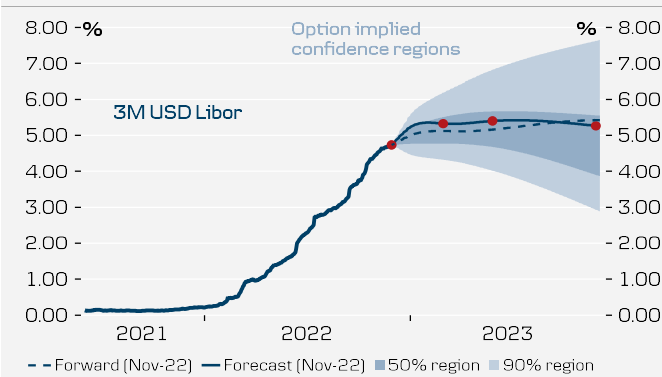
Source: Danske Bank

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



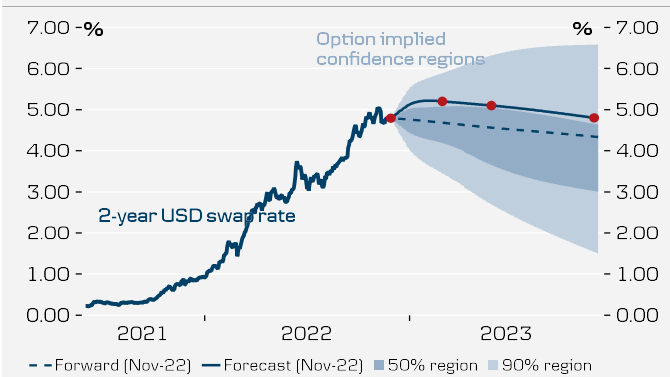
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M USD Libor rates



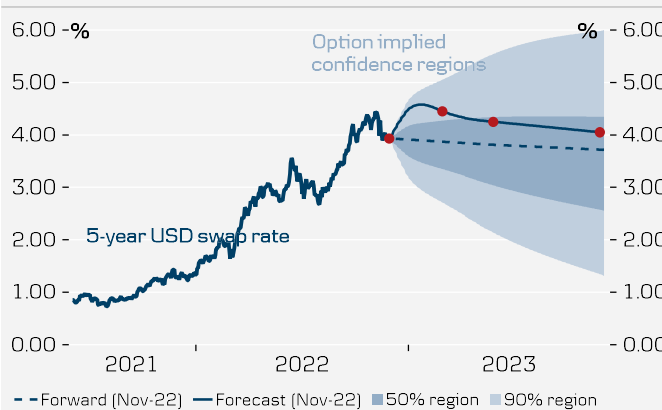
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y USD swap rates



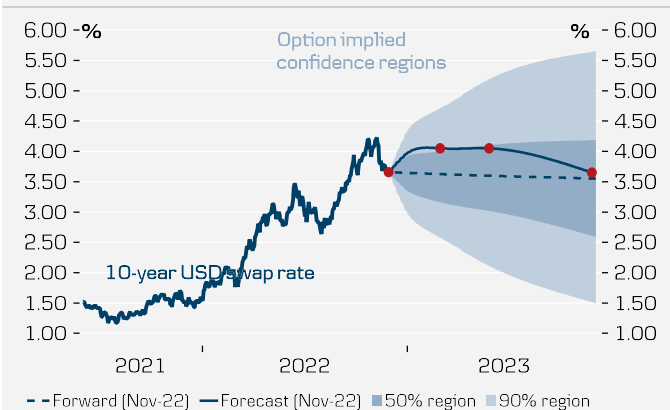
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 5Y 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

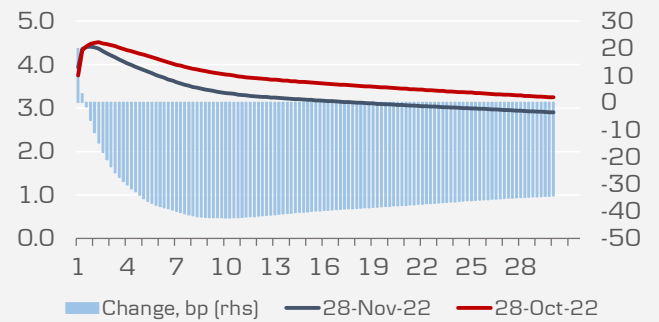
# UK forecast

## GBP forecast summary

28/11/2022	--- Forecast ---				--- Fcst vs Fwd in bp---		
GBP	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
<b>Bank rate</b>	3.00	3.75	3.75	3.75	-	-	-
<u>Government Bonds</u>							
<b>2-year</b>	3.29	3.50	3.50	3.30	28	49	8
<b>5-year</b>	3.289	3.5	3.5	3.3	23	31	3
<b>10-year</b>	3.12	3.40	3.40	3.20	24	26	-1
<u>Swap rates (SONIA OIS)</u>							
<b>2-year</b>	4.37	4.50	4.50	4.30	9	16	23
<b>5-year</b>	3.85	4.00	4.00	3.80	18	25	62
<b>10-year</b>	3.35	3.60	3.60	3.40	27	32	22

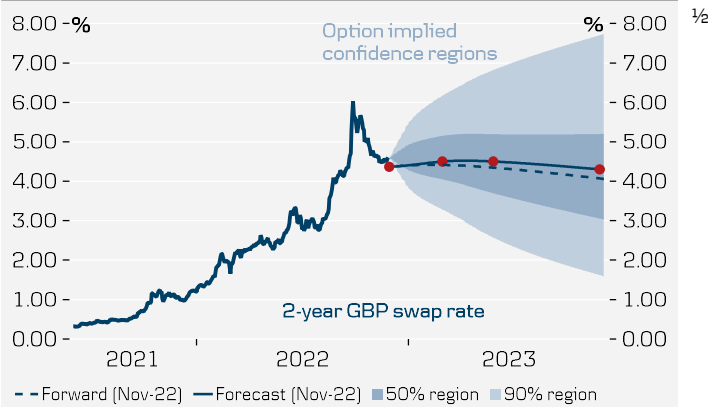
\* based on OIS swaps  
Source: Danske Bank

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



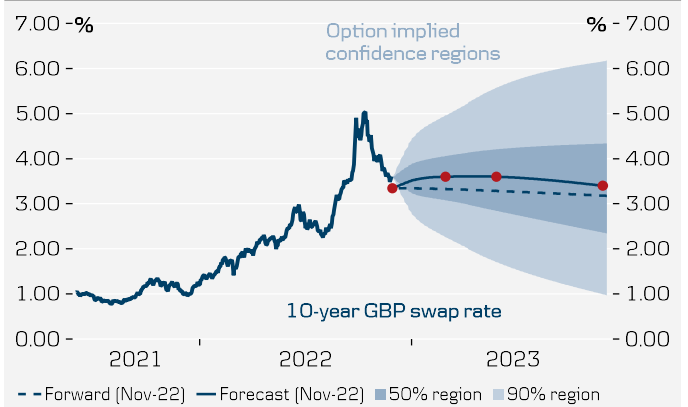
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 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



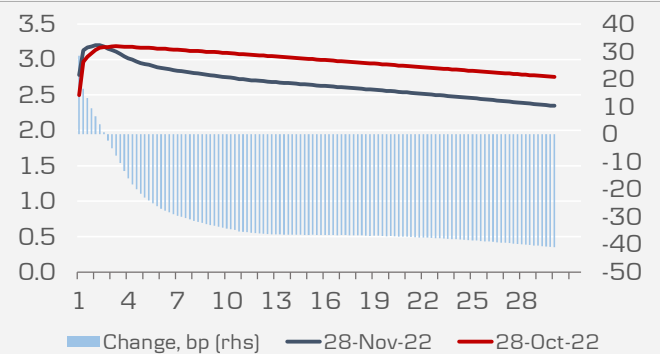
# Sweden forecast

## SEK forecast summary

28/11/2022	--- Forecast ---				--- Fcst vs Fwd in bp ---		
SEK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money market</b>							
Repo	2.50	2.75	2.75	2.75	-	-	-
3M	2.42	2.80	2.85	2.85	-31	-47	-40
<b>Government bonds</b>							
2-year	2.47	2.45	2.50	2.40	-	-	-
5-year	2.12	2.30	2.45	2.50	-	-	-
10-year	1.97	2.10	2.35	2.65	-	-	-
<b>Swap rates</b>							
2-year	3.20	3.30	3.25	3.15	3	1	5
5-year	2.93	3.25	3.25	3.20	32	35	38
10-year	2.75	3.10	3.25	3.30	35	52	63

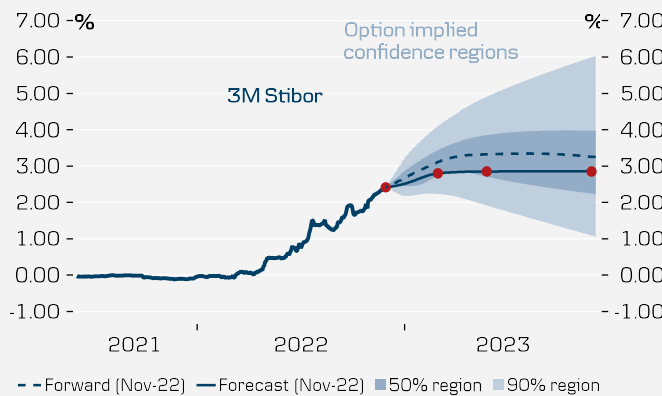
Source: Danske Bank

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



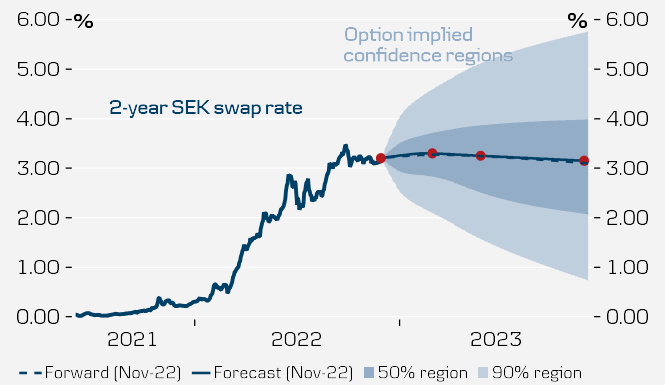
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Stibor rates



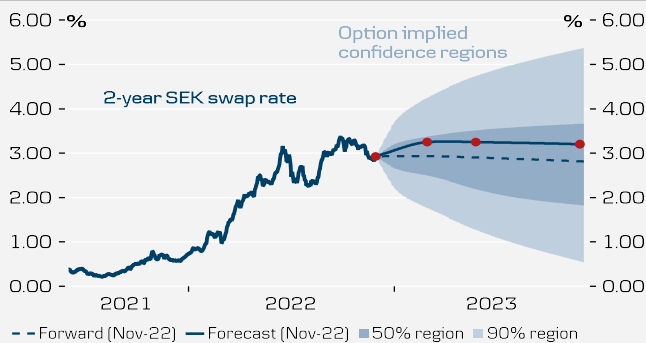
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y SEK swap rates



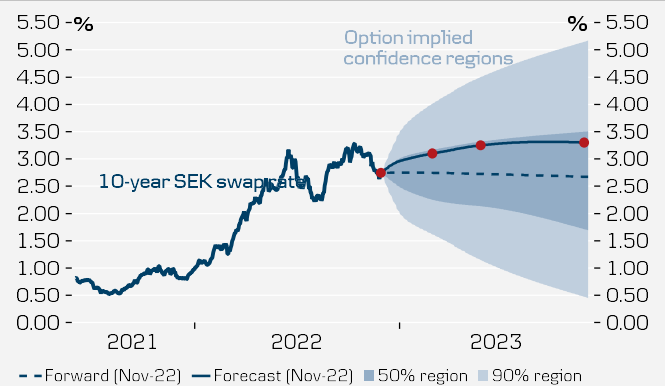
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 5Y 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

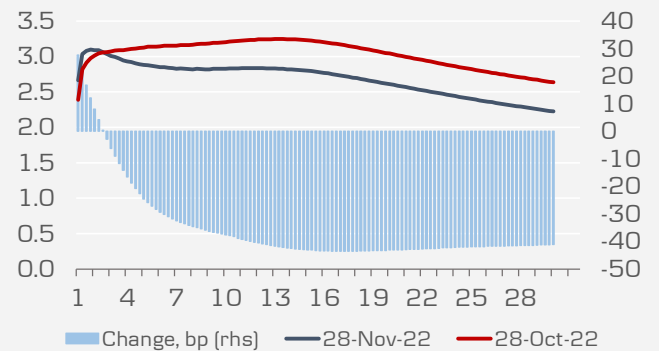
# Denmark forecast

## DKK forecast summary

28/11/2022	--- Forecast ---				--- Fcst vs Fwd in bp---		
DKK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
CD	1.25	2.25	2.50	2.50	-	-	-
Repo	1.40	2.40	2.65	2.65	-	-	-
3M	2.21	2.97	3.00	3.00	-1	-17	-15
6M	2.65	3.19	3.20	3.19	1	-9	0
<u>Government bonds</u>							
2-year	2.31	2.40	2.40	2.20	-	-	-
5-year	2.17	2.35	2.35	2.15	-	-	-
10-year	2.22	2.45	2.45	2.25	-	-	-
<u>Swap rates</u>							
2-year	3.09	3.15	3.15	2.95	-2	2	-3
5-year	2.89	3.05	3.05	2.85	14	17	3
10-year	2.83	3.10	3.10	2.90	25	26	8
30-year	2.23	2.45	2.25	2.20	23	5	4

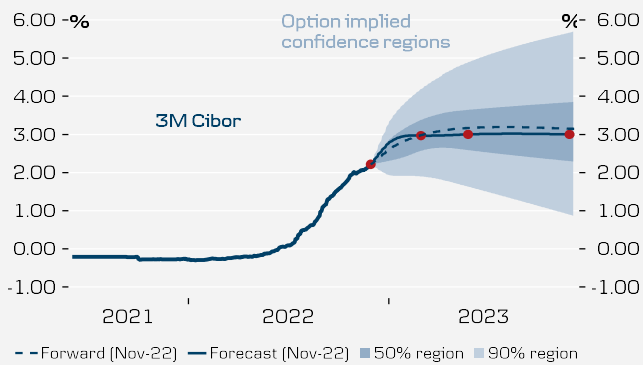
Source: Danske Bank

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



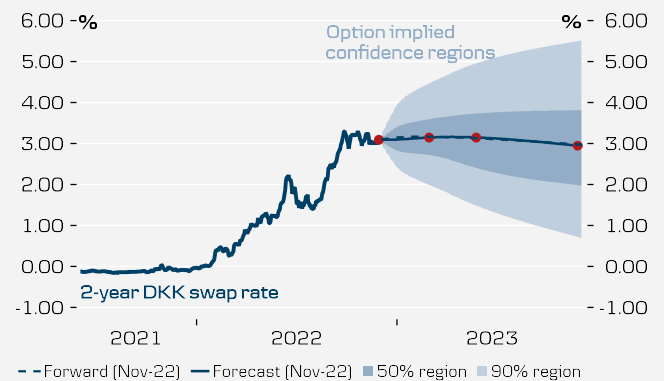
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Cibor rates



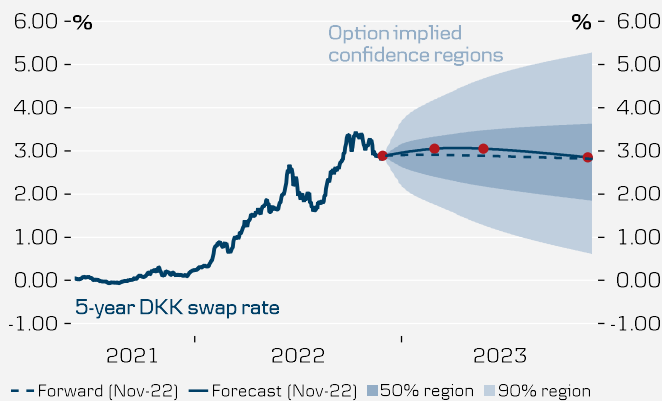
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y DKK swap rates



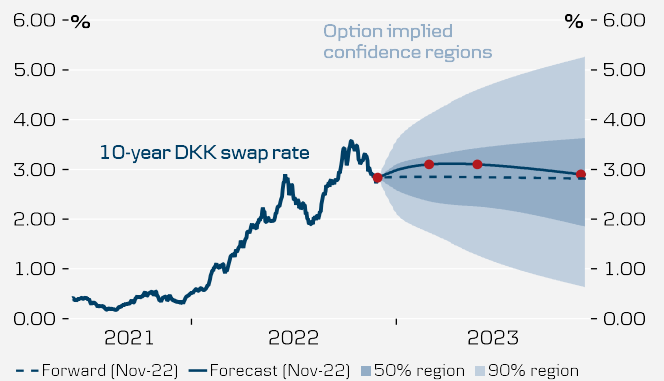
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 5Y 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

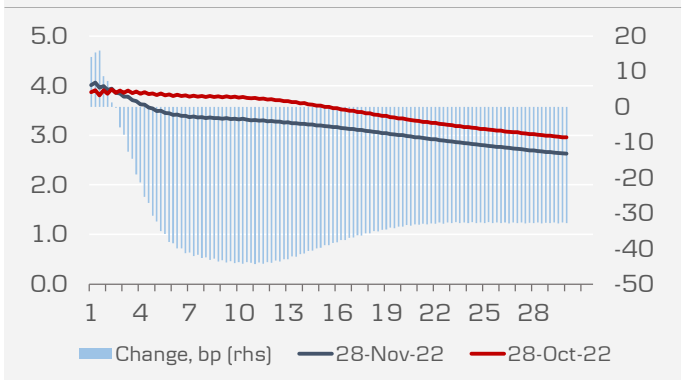
# Norway forecast

## NOK forecast summary

NOK	28/11/2022				--- Forecast ---			--- Fcst vs Fwd in bp---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m	+3m	+6m	+12m
<b>Money market</b>										
Deposit	2.50	2.75	2.75	2.75	-	-	-	-	-	-
3M	3.56	3.38	3.10	3.10	-26	-66	-62	-	-	-
6M	3.98	3.53	3.24	3.25	-50	-81	-62	-	-	-
<b>Government bonds</b>										
2-year	3.52	3.40	3.30	3.10	-	-	-	-	-	-
5-year	3.31	3.40	3.30	3.10	-	-	-	-	-	-
10-year	3.17	3.40	3.35	3.15	-	-	-	-	-	-
<b>Swap rates</b>										
2-year	3.94	3.80	3.70	3.50	-8	-10	-13	-	-	-
5-year	3.49	3.60	3.50	3.30	16	12	2	-	-	-
10-year	3.33	3.60	3.55	3.35	30	27	13	-	-	-

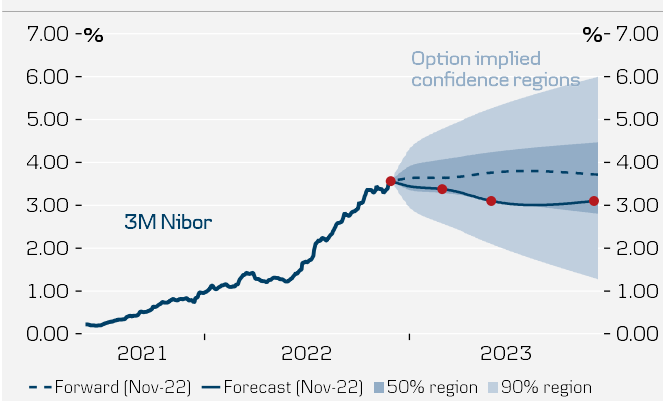
Source: Danske Bank

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



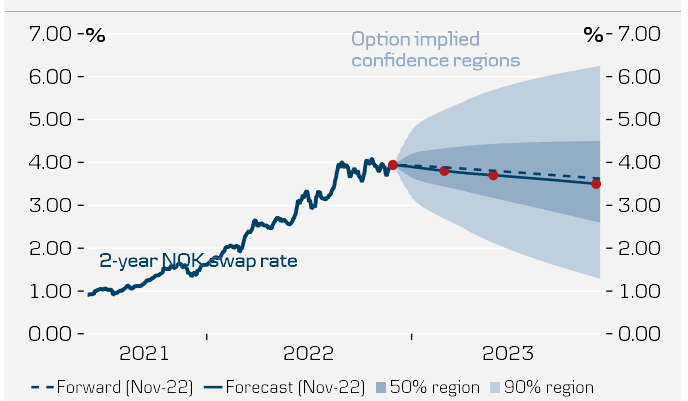
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 3M Nibor rates



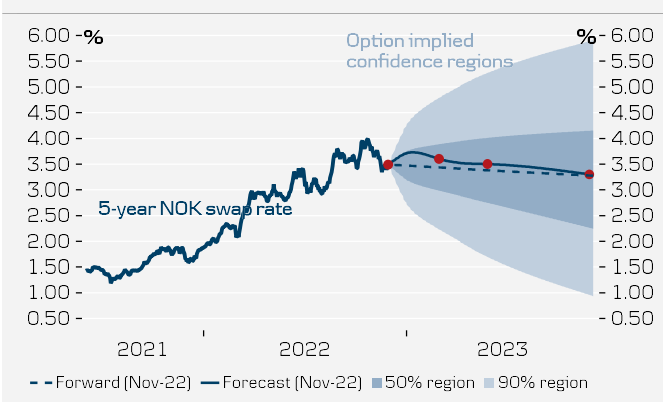
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 2Y NOK swap rates



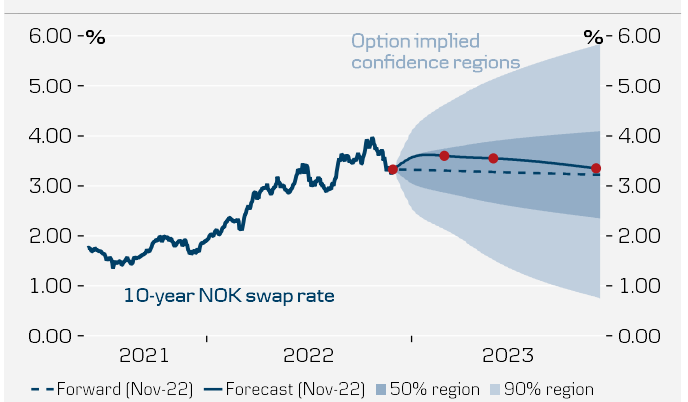
Note: Past performance is not a reliable guide to future returns  
Source: Danske Bank

## 5Y 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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