

Yield Outlook

Coronavirus to keep yields low for now but higher 10Y yields in H2 20

December and the beginning of January were 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 disappeared. At the same time, the market started to factor in a stabilisation or even an improvement in the global business cycle, which created a very positive risk sentiment.

Demand for duration and carry was very strong in the beginning of the year, when many sovereigns and companies issued new bonds.

However, the positive sentiment got a serious blow in the second part of January when the coronavirus broke out and investors compared the situation to the SARS outbreak in 2002-2003. The new disease pushed down both yields and equity markets.

That said, equity markets have so far performed well in 2020 and both the Euro Stoxx 50 and the S&P index in the US are in positive territory. It seems fair to conclude that the risk markets have been able to shrug off the worst fear and view the virus as being contained.

However, the reaction has been somewhat differently in global bond markets, where 10Y Treasury and German Bund yields have dropped 20 to 25bp over the past month. The rates markets have also started to price in more aggressive rate cuts in the US and even the ECB might lower its policy rate by some 5bp according to market pricing.

The support to bond markets has gone hand in hand with falling inflation expectations, as the oil price and other commodity prices have been pushed lower on commodity demand concerns especially in China.

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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	0.50	0.50	0.50
DKK	-0.75	-0.75	-0.65	-0.65
SEK	0.00	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	1.54	1.55	1.60	1.90
GER	-0.42	-0.40	-0.20	0.00
GBP	0.61	0.60	0.80	0.95
DKK	-0.39	-0.37	-0.15	0.05
SEK	-0.01	0.15	0.30	0.45
NOK	1.41	1.50	1.70	1.90

Note: EUR = Germany

10Y swap rates

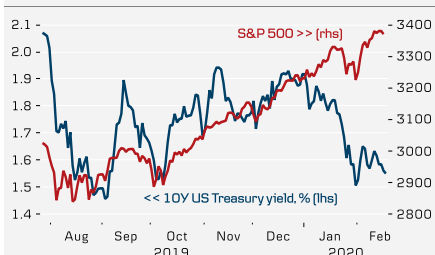
Country	Spot	+3m	+6m	+12m
USD	1.50	1.50	1.55	1.85
EUR	-0.07	0.00	0.20	0.40
GBP	0.79	0.80	1.00	1.10
DKK	0.06	0.15	0.35	0.55
SEK	0.42	0.55	0.70	0.85
NOK	1.78	1.90	2.10	2.30

Source: Danske Bank

Chief Analyst

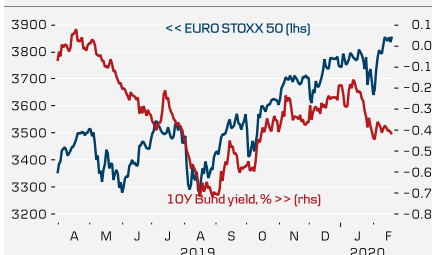
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Higher US equity prices not reflected in the US treasury market



Source: Macrobond Financial, Danske Bank

...and also lower Bund yields despite performance for European equities



Source: Macrobond Financial, Danske Bank

We expect a V-shaped recovery in China

For the next couple of months there is little doubt that the coronavirus and the resulting economic effects will set the direction for yields and rates in both Europe and the US.

Our macroeconomists expect a big hit to Chinese growth in Q1 and PMI is set to nosedive in February and March. Quarter-on-quarter GDP growth could fall to around zero in Q1. However, we look for a sharp rebound of PMI in Q2. Even though we expect markets to ‘see through’ the weak Chinese data, it will keep a lid on yields the next couple of months in our view and new lows towards what we saw last year should not be ruled out. Especially, if the positive risk sentiment in equity markets reverses.

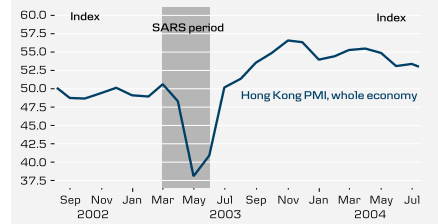
That said, Chinese growth should move up again in Q2 and Q3. This was the same pattern we saw when SARS hit in 2003 in Hong Kong. The rest of the world is set to feel the impact as well due to lower Chinese demand and supply-chain disruptions.

In particular, a sharp decline in tourism is likely to affect the rest of Asia. Our macroeconomists see signs that global inventory levels were low going into 2020. These could become even lower due to supply disruptions, which points to a decent rebound once the cycle turns up again. For more see [Research: V-shape scenario for global growth on back of coronavirus](#), 3 February 2020.

The expected recovery also means that the current downward pressure on yields should abate as safe-haven flows slow. We should also expect the market to price out the current 5-6bp cut priced in the EUR money market. The past couple of years we have seen a close relationship between the EUR money market curve and 10Y Bund yields and EUR rates. For more see the next section.

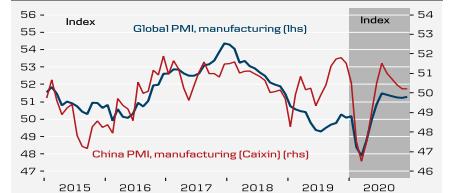
There are clear signs that the spread of the disease is slowing down. The graphs below show the number of new infected totally and outside the Hubei region. However, the uncertainty relating to our predictions is high and risk sentiment could weaken the next couple of months when especially Chinese data are set to come out on the weak side.

We expect a similar pattern for China in Q2



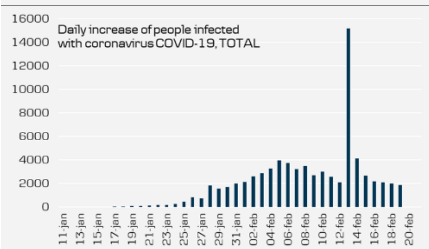
Source: Macrobond Financial, Markit, Danske Bank

We expect a V-shaped development in PMIs



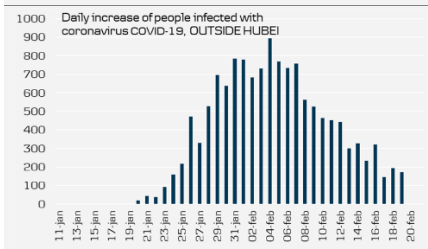
Source: Macrobond Financial, Markit, Danske Bank

Signs that the number of new infected are slowing



Source: Danske Bank

Especially, it seems that the spreading outside Hubei is slowing down



Source: Danske Bank

Our scenario assumes that the spread of the virus slows down in February - which seems to be confirmed - and is contained by March/April. While there are clear signs of a slowing spread of the disease, uncertainty relating to our predictions is high.

We keep an upward sloping profile for 10Y yields and rates

In 2020, we still expect a rise in the German 10-year yield given our macro view. The 10-year government yields in Germany are expected to rise to zero in the second half of 2020. The 10-year US treasury yields are also still expected to rise, although we have capped some of the upside and now have a 1.90% target. Before we expected US treasury yields to move above 2%. Note we expect a rate cut from both the Fed and the BoE in H1 20.

We also continue to expect the 2-10Y yield curve to steepen in 2020. The ECB continues to keep the short end of the curve down, while there are still a number of driving forces, cf. discussion on next page, pointing to higher 10-year yields.

Danmarks Nationalbank is expected to raise its key interest rate by 10bp during the next three to six months. Danmarks Nationalbank intervened in favour of the krone in December and January. 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%.

No changes are expected in Sweden after the Riksbank clearly locked in policy rates at zero when the repo rate was lifted to zero at the December meeting. However, risk is tilted towards a new rate cut into negative, especially after the latest low inflation print for January.

In Norway, we still find it most likely that Norges Bank will hike rates a final time. Wage growth is still quite high; growth is mainly slowing down due to capacity constraints and inflation surprised on the upside in January. We have pencilled in the 25bp rate hike to 1.75% at the June meeting. However, given the slowdown in Norwegian growth, the lower oil price and the global uncertainty about the coronavirus we underline that risks are extraordinarily high.

Yield drivers in 2020

We have not changed materially the yield drivers for 2020 compared to the view we presented in the December issue of *Yield Outlook* that we published on 20 December 2019.

Hence, we keep the view that,

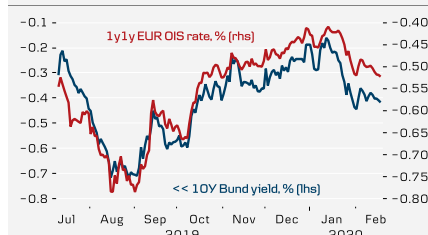
1. The global manufacturing cycle is improving and that the effects from the coronavirus are temporary
2. Pricing of ECB will be key, especially later in 2020
3. The term-premium is simply too low today given the cyclical and risk picture

Firstly, 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, albeit not a sprawling one. The coronavirus has introduced more uncertainty especially for the next two quarters.

Secondly, we do not assume that the market will continue to price in rate cuts from the ECB over the next six to 12 months. Hence, 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.

Thirdly, we still have focus on the so-called term-premium, which is used to gauge the additional premium that investors require to invest in long-term versus short-term risk-free debt. The term-premium was an important factor behind the decline and subsequent rise in

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



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

long-dated yields in 2019. For more, see *FI Strategy: Term-premium has been the dominant driver of Bunds since 2012*, 10 November 2019.

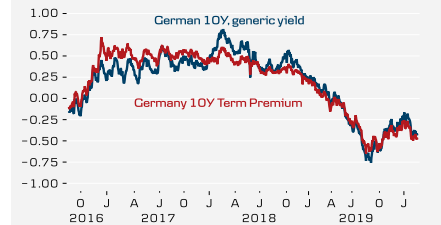
The term premium for 10Y German government bonds is currently negative by around 50bp. Hence, investors pay to hold long-dated bonds relative to buying short-dated bonds on a consecutive basis. The ECB's QE programme is trying to compress the term-premium and with the open-ended ECB QE programme and 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 current coronavirus-driven safe-haven buying of bonds, especially in Germany, might reverse in 2020, as investors continue to move towards more risky assets.

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

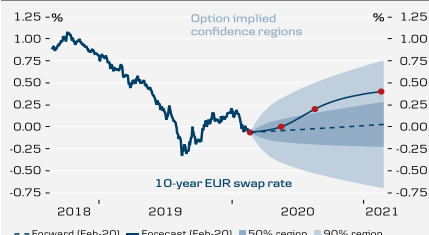
Overall, we expect German Bund yields to stabilise around the current level for the next couple of months. However, we continue to see 10-year Bund yields higher on a six to 12-month horizon, as we expect the cyclical outlook to improve in the second part of 2020 and as the term-premium moves higher. We expect 10-year Bund and 10-year Treasury yields to hit 0% and 1.9%, respectively, in H2 20. However, risk is seen on the downside given the uncertainty especially for the Chinese economy.

Term-premium* important for 10Y Bund yields



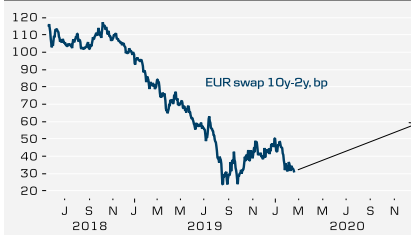
* Based on Danske Bank Term-Premium model for Germany. Source: Bloomberg, Danske Bank. Note: past performance is not a reliable guide to future returns.

10Y EUR swap yields set to move slightly higher later in 2020 as we get more clarity on the virus outbreak



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

Curve 2s10s (EUR swap) set to steepen in 2020 (bp)



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

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

Forecasts*

	Horizon	Policy rate	3m xibor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	1.75	1.69	1.44	1.39	1.50	1.40	1.38	1.54
	+3m	1.50	1.60	1.45	1.50	1.50	1.40	1.50	1.55
	+6m	1.50	1.60	1.45	1.50	1.55	1.40	1.50	1.60
	+12m	1.50	1.60	1.55	1.65	1.85	1.50	1.65	1.90
EUR*	Spot	-0.50	-0.40	-0.38	-0.31	-0.07	-0.65	-0.63	-0.42
	+3m	-0.50	-0.41	-0.30	-0.25	0.00	-0.60	-0.60	-0.40
	+6m	-0.50	-0.41	-0.30	-0.05	0.20	-0.60	-0.40	-0.20
	+12m	-0.50	-0.41	-0.20	0.05	0.40	-0.50	-0.30	0.00
GBP	Spot	0.75	0.76	0.72	0.72	0.79	0.53	0.48	0.61
	+3m	0.50	0.54	0.70	0.70	0.80	0.40	0.40	0.60
	+6m	0.50	0.54	0.70	0.75	1.00	0.40	0.45	0.80
	+12m	0.50	0.54	0.80	0.80	1.10	0.50	0.50	0.95
DKK	Spot	-0.75	-0.40	-0.25	-0.17	0.06	-0.65	-0.57	-0.39
	+3m	-0.75	-0.39	-0.15	-0.10	0.15	-0.60	-0.53	-0.37
	+6m	-0.65	-0.32	-0.15	0.10	0.35	-0.55	-0.32	-0.15
	+12m	-0.65	-0.32	-0.05	0.20	0.55	-0.45	-0.20	0.05
SEK	Spot	0.00	0.16	0.14	0.21	0.42	-0.30	-0.30	-0.01
	+3m	0.00	0.15	0.25	0.30	0.55	-0.30	-0.25	0.15
	+6m	0.00	0.15	0.20	0.40	0.70	-0.35	-0.15	0.30
	+12m	0.00	0.15	0.20	0.50	0.85	-0.35	-0.05	0.45
NOK	Spot	1.50	1.86	1.83	1.75	1.78	1.39	1.33	1.41
	+3m	1.50	2.12	1.95	1.85	1.90	1.50	1.40	1.50
	+6m	1.75	2.16	1.95	2.05	2.10	1.50	1.60	1.70
	+12m	1.75	2.18	2.05	2.15	2.30	1.60	1.70	1.90

* German government bond yields and EUR swap rates used

Source: Danske Bank

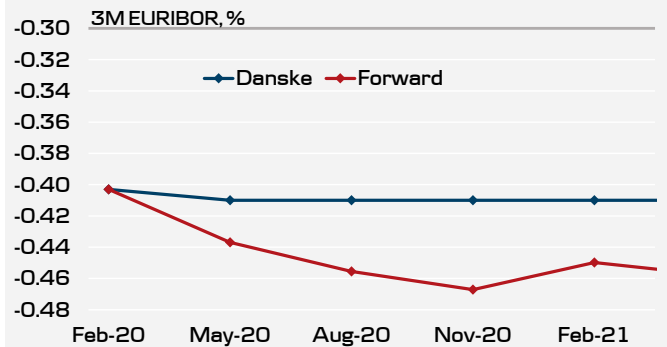
Eurozone forecasts

EUR forecast summary

19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
EUR	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money Market</u>							
Refi	0.00	0.00	0.00	0.00	-	-	-
Deposit	-0.50	-0.50	-0.50	-0.50	-	-	-
3M	-0.40	-0.41	-0.41	-0.41	3	5	4
6M	-0.36	-0.36	-0.36	-0.36	2	4	3
<u>Government Bonds</u>							
2-year	-0.65	-0.60	-0.60	-0.50	-	-	-
5-year	-0.63	-0.60	-0.40	-0.30	-	-	-
10-year	-0.42	-0.40	-0.20	0.00	-	-	-
<u>Swap rates</u>							
2-year	-0.38	-0.30	-0.30	-0.20	8	8	16
5-year	-0.31	-0.25	-0.05	0.05	4	3	29
10-year	-0.07	0.00	0.20	0.40	4	22	38

Source: Danske Bank

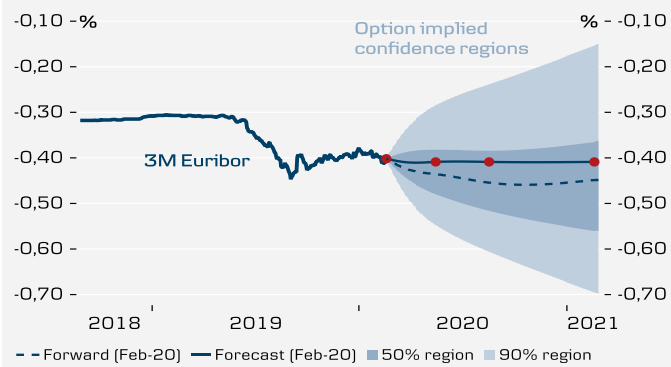
Danske Bank forecast and forwards



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

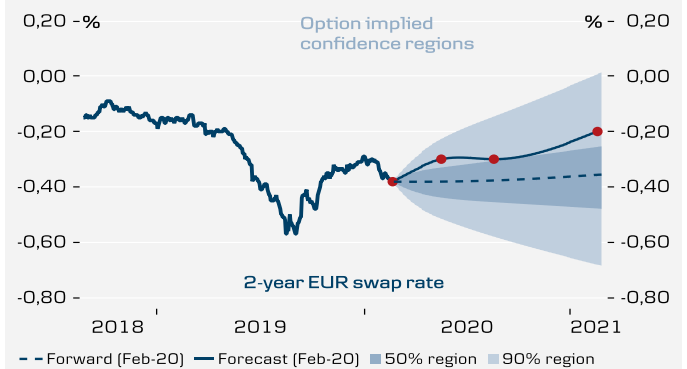
3M Euribor



Source: Danske Bank

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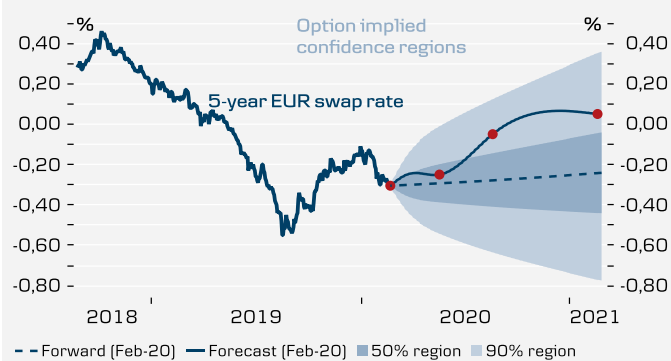
2Y EUR swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

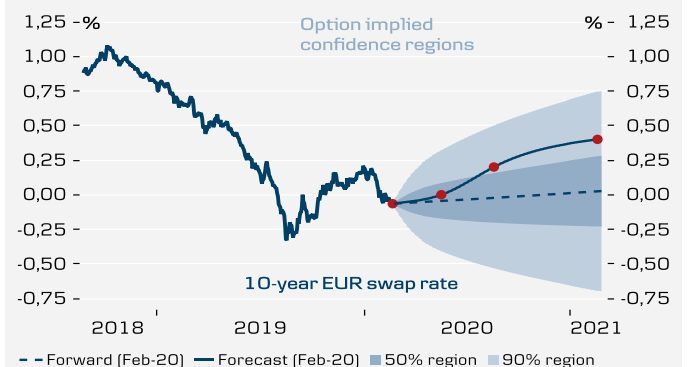
5Y EUR swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y EUR swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

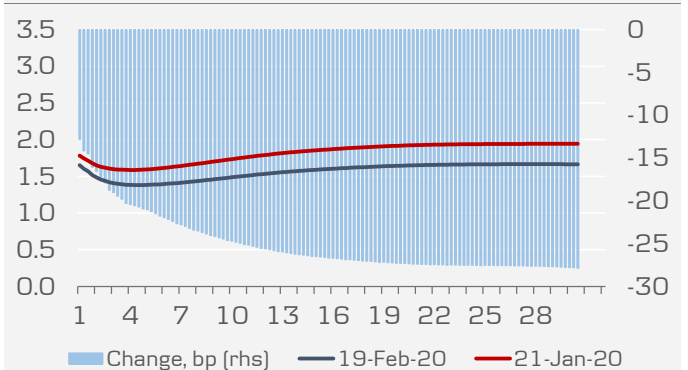
US forecasts

USD forecast summary

19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Fed Funds	1.75	1.50	1.50	1.50	-	-	-
3M	1.69	1.60	1.60	1.60	-1	10	28
Government Bonds							
2-year	1.40	1.40	1.40	1.50	-	-	-
5-year	1.38	1.50	1.50	1.65	-	-	-
10-year	1.54	1.55	1.60	1.90	-	-	-
Swap rates							
2-year	1.44	1.45	1.45	1.55	7	11	25
5-year	1.39	1.50	1.50	1.65	13	13	28
10-year	1.50	1.50	1.55	1.85	0	5	33

Source: Danske Bank

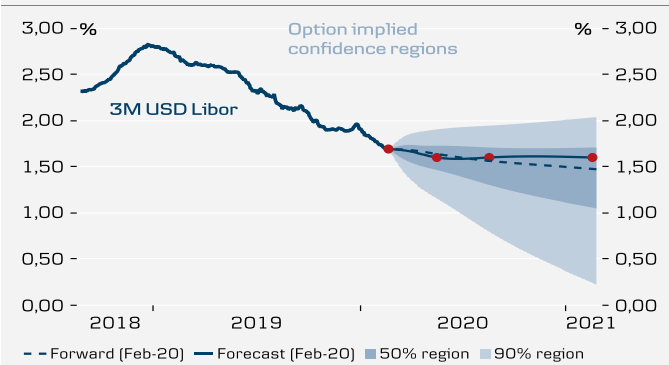
1M change in 3M USD Libor



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

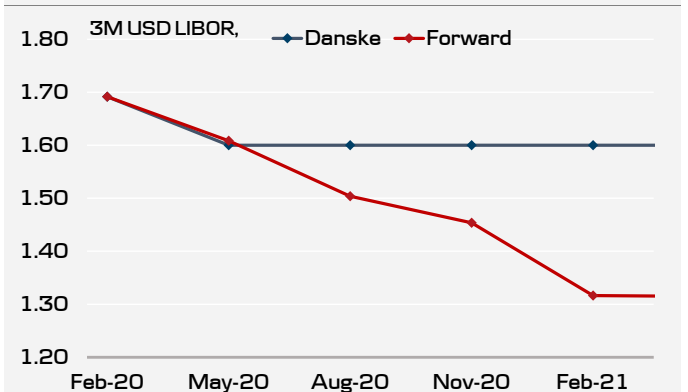
3M USD Libor rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

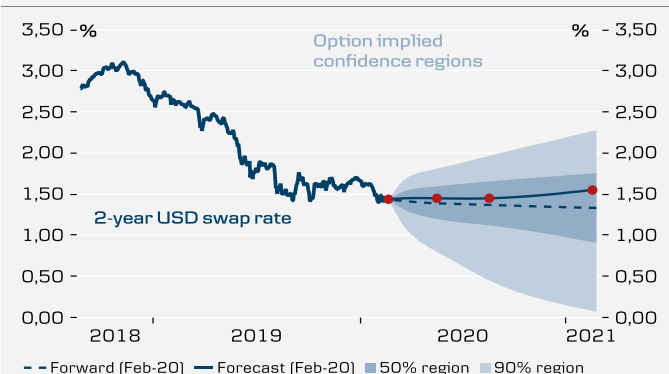
Danske Bank forecast and forwards



Source: Danske Bank

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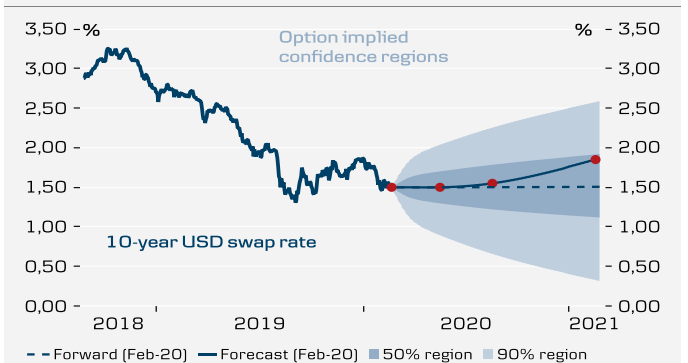
2Y USD swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y USD swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

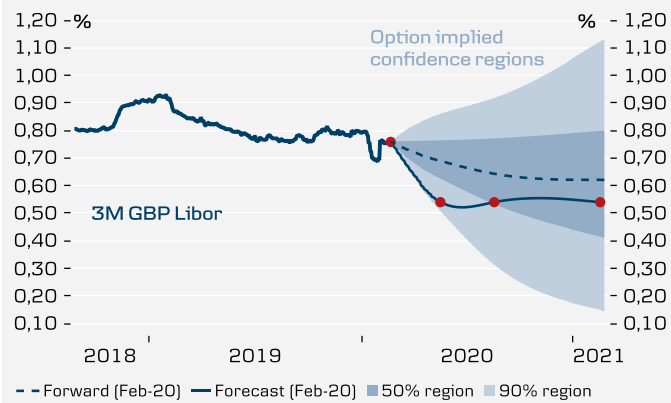
UK forecasts

UK forecast summary

19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
GBP	Spot	+3m	+6m	+12m	+3m	+6m	+12m
Money Market							
Repo	0.75	0.5	0.5	0.5	-	-	-
3M	0.76	0.54	0.54	0.54	-15	-10	-8
Government Bonds							
2-year	0.53	0.40	0.40	0.50	-4	-1	10
5-year	0.48	0.4	0.45	0.5	-2	5	9
10-year	0.61	0.60	0.80	0.95	-5	13	24
Swap rates							
2-year	0.72	0.70	0.70	0.80	0	1	10
5-year	0.72	0.70	0.75	0.80	-2	3	-1
10-year	0.79	0.80	1.00	1.10	1	20	29

Source: Danske Bank

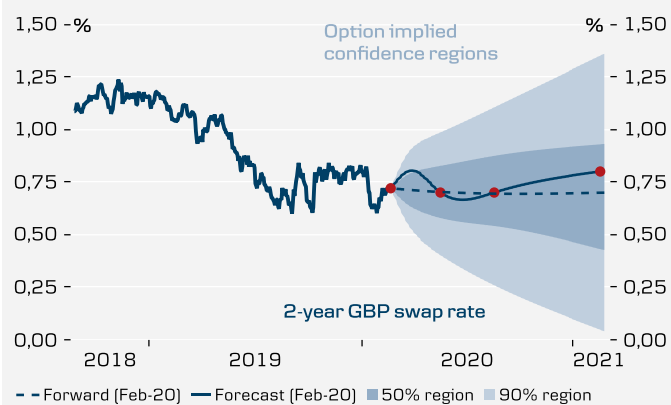
3M GBP Libor rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

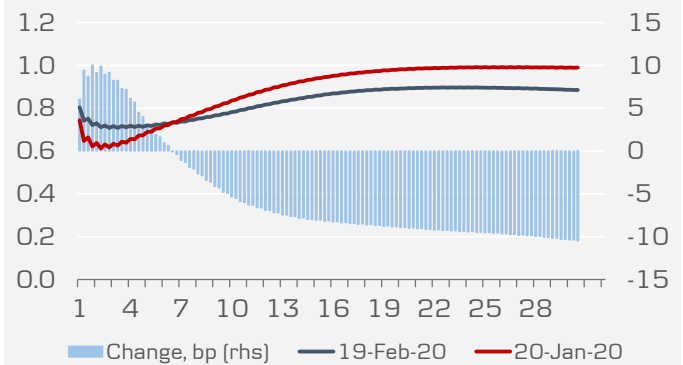
2Y UK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

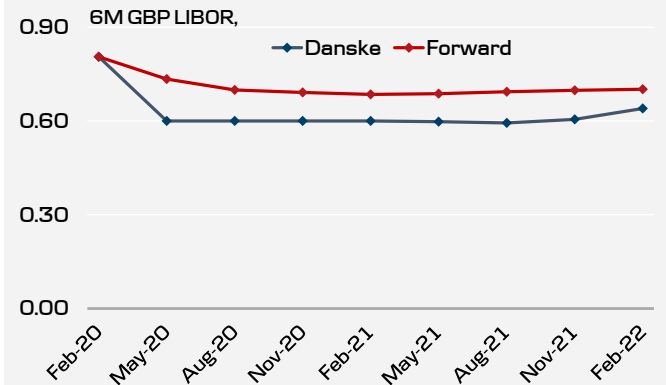
1M change in 6M GBP Libor



Source: Danske Bank

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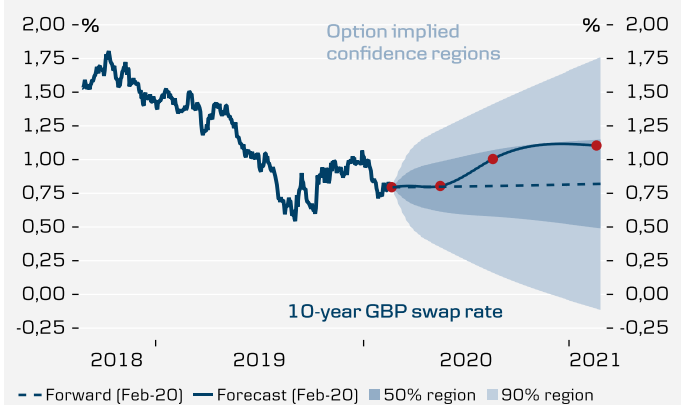
Danske Bank forecast and forwards



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y UK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

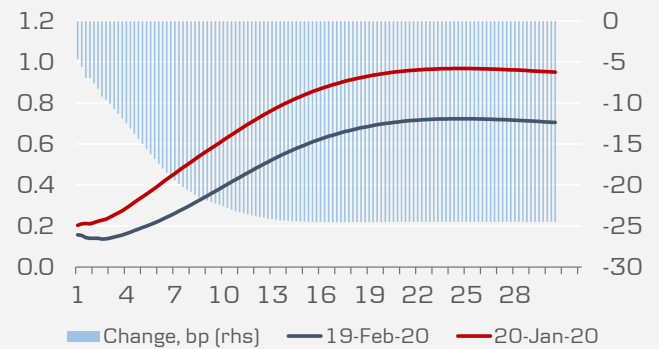
Sweden forecasts

SEK forecast summary

19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
SEK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Money market</u>							
Repo	0.00	0.00	0.00	0.00	-	-	-
3M	0.16	0.15	0.15	0.15	-1	0	2
<u>Government bonds</u>							
2-year	-0.30	-0.30	-0.35	-0.35	-	-	-
5-year	-0.30	-0.25	-0.15	-0.05	-	-	-
10-year	-0.01	0.15	0.30	0.45	-	-	-
<u>Swap rates</u>							
2-year	0.14	0.25	0.20	0.20	12	6	4
5-year	0.21	0.30	0.40	0.50	8	17	24
10-year	0.42	0.55	0.70	0.85	12	25	36

Source: Danske Bank

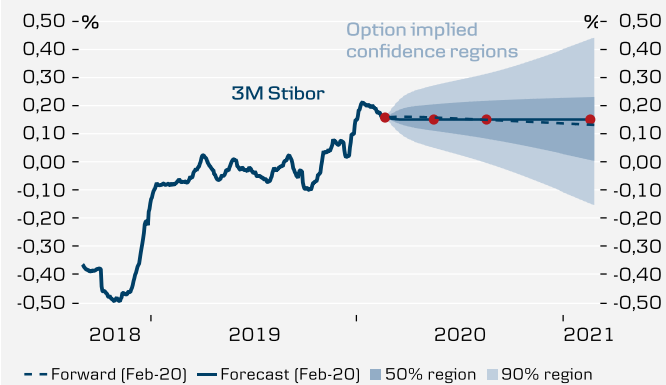
1M change in 3M Stibor



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

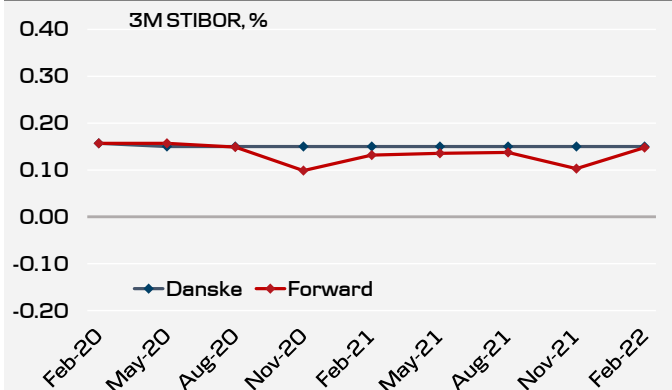
3M Stibor rate



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

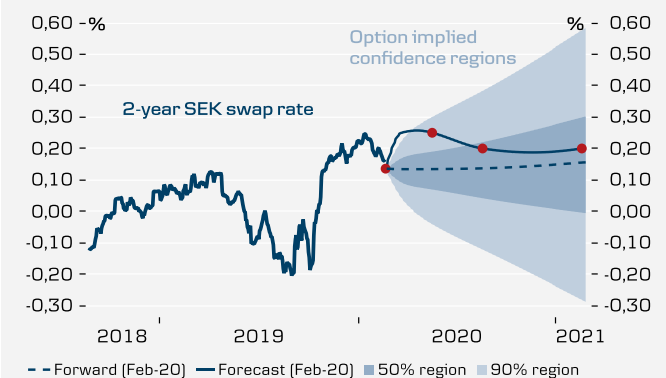
Danske Bank forecast and forwards



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

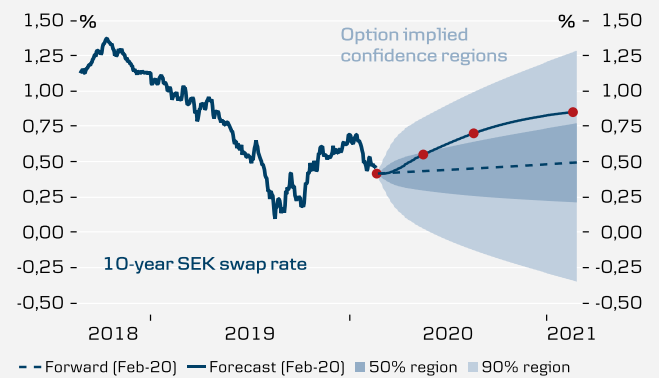
2Y SEK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y SEK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

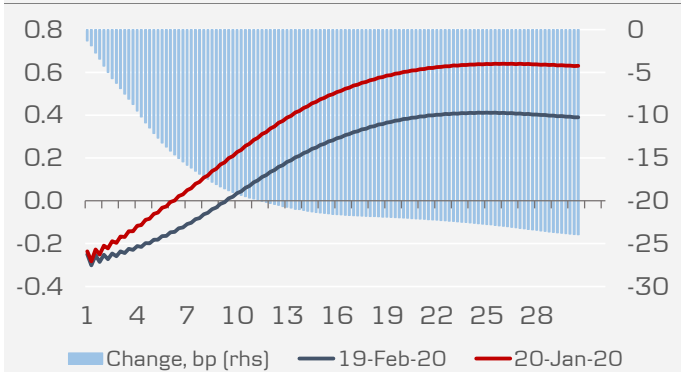
Denmark forecasts

DKK forecast summary

DKK	19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
	Spot	+3m	+6m	+12m	+3m	+6m	+12m	
Money Market								
CD	-0.75	-0.75	-0.65	-0.65	-	-	-	
Repo	0.05	0.05	0.05	0.05	-	-	-	
3M	-0.40	-0.39	-0.32	-0.32	0	6	7	
6M	-0.25	-0.20	-0.17	-0.18	5	8	7	
Government bonds								
2-year	-0.65	-0.60	-0.55	-0.45	-	-	-	
5-year	-0.57	-0.53	-0.32	-0.20	-	-	-	
10-year	-0.39	-0.37	-0.15	0.05	-	-	-	
Swap rates								
2-year	-0.25	-0.15	-0.15	-0.05	9	8	16	
5-year	-0.17	-0.10	0.10	0.20	5	24	30	
10-year	0.06	0.15	0.35	0.55	7	25	40	
30-year	0.39	0.50	0.60	0.80	11	20	39	

Source: Danske Bank

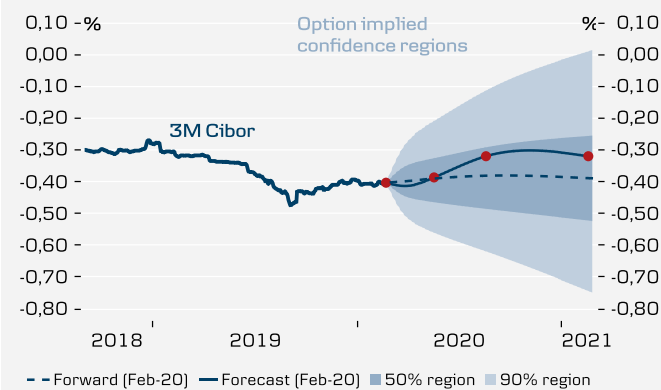
1M change in 6M Cibar



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

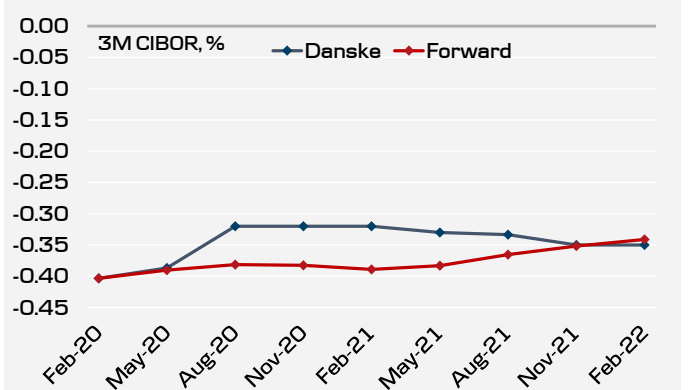
3M Cibar



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

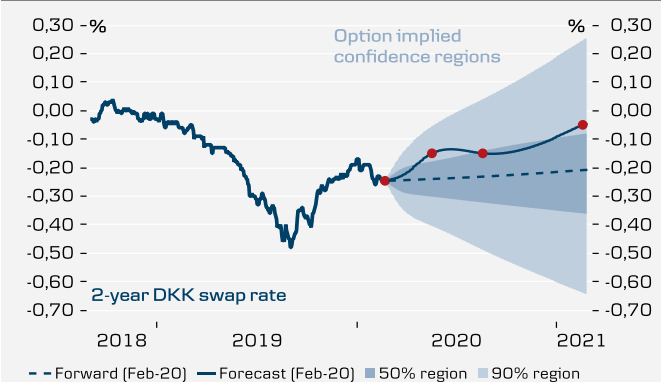
Danske Bank forecast and forwards



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

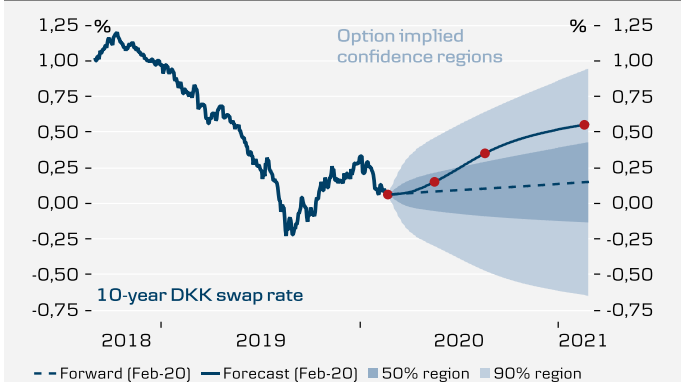
2Y DKK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y DKK swap rates



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

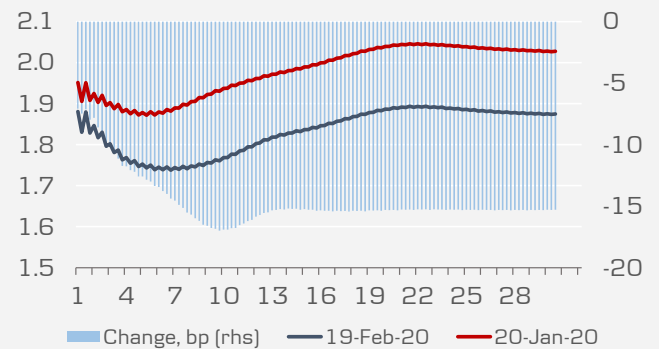
Norway forecasts

NOK forecast summary

19/02/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
NOK	Spot	+3m	+6m	+12m	+3m	+6m	+12m
Money market							
Deposit	1.50	1.50	1.75	1.75	-	-	-
3M	1.75	1.97	2.05	2.05	19	27	36
6M	1.86	2.12	2.16	2.18	26	30	40
Government bonds							
2-year	1.39	1.50	1.50	1.60	-	-	-
5-year	1.33	1.40	1.60	1.70	-	-	-
10-year	1.41	1.50	1.70	1.90	-	-	-
Swap rates							
2-year	1.83	1.95	1.95	2.05	15	17	31
5-year	1.75	1.85	2.05	2.15	11	32	43
10-year	1.78	1.90	2.10	2.30	12	32	51

Source: Danske Bank

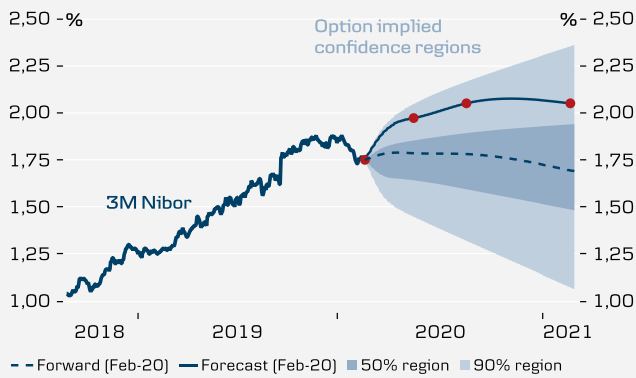
1M change in 6M Nibor



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

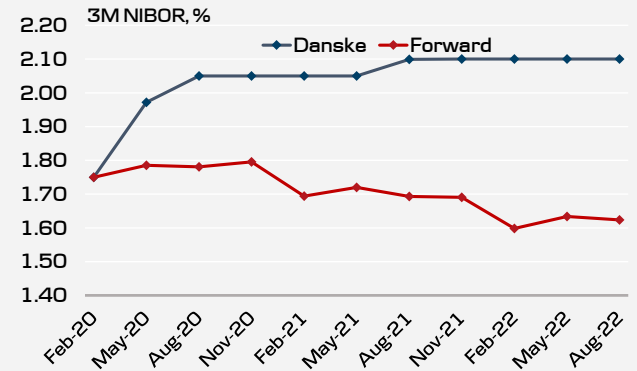
3M Nibor



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

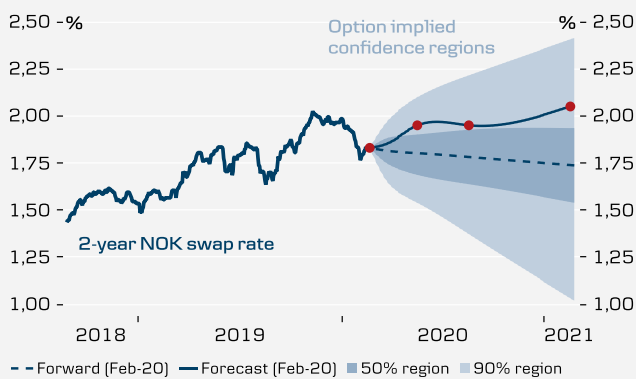
Danske Bank forecast and forwards



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

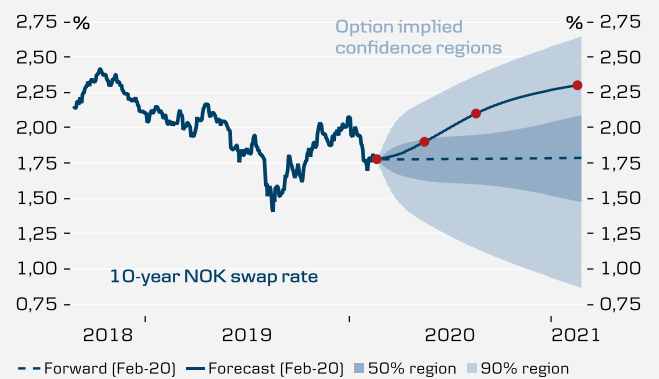
2Y NOK swap rate



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

10Y NOK swap rate



Source: Danske Bank

Note: past performance is not a reliable guide to future returns.

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