

Yield Outlook

Coronavirus triggers more Fed cuts and keeps 10Y yields at record-low levels for time being

New macro outlook: from V- to U-shaped recovery

We based the previous issue of *Yield Outlook – Coronavirus to keep yields low for now but higher 10Y yields in H2 20* from 19 February on the view that the virus would mainly be a China issue and that we should see a V-shaped recovery in the Chinese/global economy. For more, see *Research – V-shaped scenario for global growth on back of coronavirus*, 3 March.

We admit this view turned out to be wrong. The coronavirus has now spread to a large part of the world and a rapid V-shaped recovery now looks overly optimistic. Hence, our macro economists this week updated their macro view. They now look for a U-shaped rather than a V-shaped recovery. For more, see *The Coronavirus Crisis – U-shaped rather than L-shaped global recovery*, 4 March.

Central banks have started to ease

Furthermore, markets have priced in aggressive easing from global central banks. This gained momentum after Fed Chair Jerome Powell's press release late on Friday 28 February, which said 'The coronavirus poses evolving risks to economic activity. We will use our tools and act as appropriate to support the economy' and, subsequently, slashed rates by 50bp. Like Fed Chair Powell, President Christine Lagarde of the ECB has also published a press release saying 'We stand ready to take appropriate and targeted measures, as necessary and commensurate with the underlying risks'. The G7 also met with global central banks to discuss the situation.

Following this week's 50bp emergency cut, we expect the Fed to cut rates twice more: by 25bp at each of the March and April meetings. Our forecast implies a cut of 25-30bp less than the market expects.

What will the ECB do?

We have already seen rate cuts from Australia, Canada and the US and more is coming. The Bank of England is widely expected to cut rates by 25bp or 50bp on 26 March. However, the big uncertainty is whether the ECB is willing to cut rates further at the ECB meeting on 12 March. Had the interest level been positive, we believe there would be little doubt that it would cut rates. However, with the depo rate at -0.50%, whether the ECB is willing to go deeper into the negative given the potential negative impact on the European banking sector is uncertain. The ECB has also argued that monetary policy in the eurozone is already strongly accommodative. Another solution could be to step up the monthly QE purchases in corporate and government bonds. This could mitigate negative developments in corporate bond spreads and, not least, mitigate Italian bond spreads not continuing to widen. In our view, the last thing Europe needs is a new debt crisis.

However, when we weigh up the pros and cons, we arrive at the conclusions that the ECB will be hesitant to go deeper into negative next week and that the ECB will see the current QE programme as adequate. Instead, we should expect targeted new liquidity measures to secure funding for banks. However, we underline that uncertainty is high, things can change quickly from day to day and we rule out nothing ruled out.

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Policy rates

Country	Spot	+3m	+6m	+12m
USD	1.25	0.75	0.75	0.75
EUR	-0.50	-0.50	-0.50	-0.50
GBP	0.75	0.25	0.25	0.25
DKK	-0.75	-0.75	-0.65	-0.65
SEK	0.00	-0.25	-0.25	-0.25
NOK	1.50	1.50	1.50	1.50

10Y government bond yields

Country	Spot	+3m	+6m	+12m
USD	0.92	0.90	1.20	1.40
GER	-0.69	-0.60	-0.45	-0.20
GBP	0.33	0.30	0.40	0.60
DKK	-0.64	-0.57	-0.40	-0.15
SEK	-0.31	-0.15	-0.05	0.15
NOK	1.02	1.20	1.40	1.60

Note: EUR = Germany

10Y swap rates

Country	Spot	+3m	+6m	+12m
USD	0.82	0.90	1.20	1.40
EUR	-0.24	-0.15	0.00	0.25
GBP	0.56	0.50	0.60	0.75
DKK	-0.12	0.00	0.15	0.40
SEK	0.23	0.35	0.45	0.65
NOK	1.35	1.60	1.80	2.00

Source: Danske Bank

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Rate cut in Sweden but not in Norway

In our local markets, we have made changes to our calls. We no longer expect a rate hike in Norway but believe the bar for rate cut(s) is still relatively high given the weakening currency and room for fiscal easing. However, market pricing is very different and the money market expects a lowering of the policy rate by up to 75bp.

It has been our view for a long time that the combination of low inflation and low wage growth could be potential triggers for a new move below zero in Sweden. However, the Riksbank's reluctance to move back below zero has convinced us that unchanged rates for a long time will be the most likely outcome. However, as we expect the coronavirus outbreak to shave off some growth in Sweden, we have now changed our call and expect the Riksbank to move to -0.25% at the April meeting. An extension of the current QE programme is also a possibility.

In Denmark, we have made no changes and we still expect a modest 10bp hike on a six-month horizon due to the FX intervention to support the DKK. If the ECB opts for rate cut(s), it is our expectation that Denmark will skip the first 10bp.

For more on the effect of the coronavirus on the Nordic countries, see *The Coronavirus Crisis – Nordics exposed to economic fallout from coronavirus*, 6 March.

Global central banks could disappoint

Overall, our view on the short-end implies that, in particular, the ECB and Fed will not fulfil market expectations. In Scandinavia, our view on Norway stands out relative to market expectations.

The table below shows our expectations and those of the market for changes in policy rate. We calculate the figures from OIS markets. Note there is no OIS market in Norway and market expectations for Norway are estimates.

Danske Bank forecast and market pricing (policy rates)				
	Current policy rate, %	Market expectations in 12M. %	Danske Bank forecast in 12M. %	
Federal reserve	1.25	0.47		0.75
ECB	-0.50	-0.69		-0.50
BoE	0.75	0.34		0.25
Riksbank	0.00	-1.16		-0.25
Norges Bank	1.50	0.80		1.50
Nationalbanken	-0.75	-0.83		-0.65

Source: Danske Bank

10Y rates set to stay low in H1 but still higher in H1

In respect of the long end, we have not changed our view that 10Y rates will stay low in H2 due to the coronavirus outbreak. Even though 10Y US treasury yields are already trading at an all-time low, we do not rule out a new move lower in yields. US treasuries are the number one safe assets as of today and as long as risk appetite is low and news on the coronavirus outbreak continues to be negative, we should expect downward pressure.

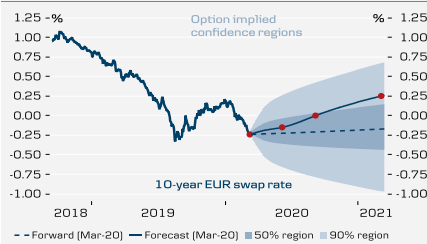
However, given that we have a less aggressive Fed and we now look for a U-shaped recovery, we still expect yields to be higher in the second part of 2020. However, we have lowered the profile on a three-, six- and 12- month horizon compared with our previous forecasts, as we no longer expect a V-shaped recovery.

We keep an upward sloping profile for 10Y yields and rates in 2020. We expect the 10-year government yield in Germany to fall to -20bp in the second half of 2020, down from zero previously.

We still expect 10-year US treasury yields to rise, although we have capped a large part of the upside we forecast previously. This reflects that we now have a more aggressive Fed call compared with that given in *Yield Outlook – Coronavirus to keep yields low for now but higher 10Y yields in H2 20*, 19 February, but also that the market is expecting a much lower Fed funds than we forecast. We now have a 1.4% 12M forecast for 10Y US treasury yields. Before our forecast was 1.90%.

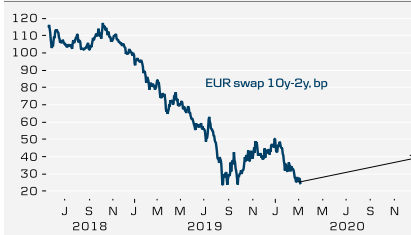
We also continue to expect the 2-10Y yield curve to steepen in both Bunds and US treasuries in 2020 but less than we expected previously.

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



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

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



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

Tipping point

We underline that the world economy might be at a tipping point and the risk of a global recession is growing day by day. We base our forecasts on a U-shaped recovery. If the development turns out to be more L-shaped, we believe growth will stay low/negative for an extended period. This could trigger even lower central bank rates, both in Scandinavia and internationally, than the market currently expects.

In such a scenario, we believe risk assets would continue to perform very poorly and the demand for safe-assets would continue. Central banks would step up or reopen their QE programmes and the downward pressure on longer dated yields could intensify even though fiscal policy is being used more actively. In particular, there is still room to push down US Treasury yields, as we believe we are getting closer to a situation where the Fed’s next step will be a new QE programme.

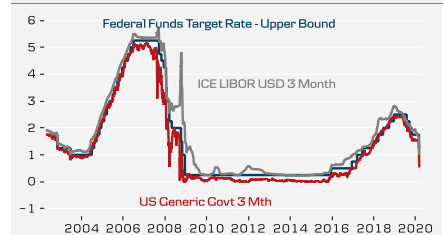
But no negative US policy rates

Importantly, even in an L-shaped/global recession scenario, we see very little probability of US policy rates becoming negative. Remember, US policy rates did not go negative after the financial crisis.

First, US money-market funds plays a pivotal role in the US financial system for financials and corporates as a liquidity and savings instrument. During the financial crisis, when money-market funds for the first time ‘broke the buck’ due to losses on Lehman bonds, it created many problems. Hence, the net asset value (NAV) fell below the USD1 level for the first time ever. This created much stress in the system, as money-market funds were considered extremely safe. Then some years ago, the money-market funds system changed to make it even safer. Hence, it is no longer possible to have corporate debt in money-market funds but only government debt (T-bills).

However, if the Fed slashes rates below zero, the effective yield on short-dated T-bills would fall below zero and money-market funds would experience severe stress.

Little probability of a target rate below 0.25%



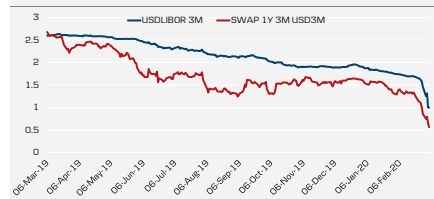
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank, Bloomberg, Macrobond Financial

Considering that T-bills typically trade 20-30bp below the upper band in the Federal funds target, a cut to zero will be difficult. Following the financial crisis, the target rate was set no lower than 0.25% (Federal Funds target – upper band). The market is currently pricing that 3M USD Libor will fall to 0.50%. Hence, in our opinion, there is room to price in only another 25bp in rate cuts in the US.

In addition, the Fed, together with the Bank of England, has been very critical of the concept of negative rates. In its view, it puts a lot of stress on the banking sector and hampers the monetary transmission mechanism. Remember, the Fed focused very much on ‘recapitalising’ the banking sector in 2008, which was not the case in Europe. Going below zero would mitigate such purposes.

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

Only room to price in 25bp more of expected rate cuts in the US



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

Source: Danske Bank

Forecasts*

	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	1.25	1.00	0.62	0.68	0.82	0.58	0.67	0.92
	+3m	0.75	0.81	0.65	0.75	0.90	0.60	0.70	0.90
	+6m	0.75	0.85	0.75	0.85	1.20	0.70	0.80	1.20
	+12m	0.75	0.85	0.85	1.05	1.40	0.80	1.00	1.40
EUR*	Spot	-0.50	-0.47	-0.48	-0.43	-0.24	-0.86	-0.86	-0.69
	+3m	-0.50	-0.41	-0.30	-0.25	-0.15	-0.65	-0.65	-0.60
	+6m	-0.50	-0.41	-0.25	-0.10	0.00	-0.60	-0.50	-0.45
	+12m	-0.50	-0.41	-0.15	0.00	0.25	-0.50	-0.40	-0.20
GBP	Spot	0.75	0.50	0.45	0.47	0.56	0.16	0.21	0.33
	+3m	0.25	0.29	0.50	0.55	0.50	0.20	0.25	0.30
	+6m	0.25	0.29	0.50	0.55	0.60	0.20	0.25	0.40
	+12m	0.25	0.29	0.60	0.70	0.75	0.30	0.40	0.60
DKK	Spot	-0.75	-0.48	-0.35	-0.30	-0.12	-0.84	-0.79	-0.64
	+3m	-0.75	-0.38	-0.15	-0.10	0.00	-0.65	-0.58	-0.57
	+6m	-0.65	-0.32	-0.10	0.05	0.15	-0.55	-0.42	-0.40
	+12m	-0.65	-0.32	0.00	0.15	0.40	-0.45	-0.32	-0.15
SEK	Spot	0.00	0.10	-0.01	0.05	0.23	-0.36	-0.54	-0.31
	+3m	-0.25	-0.10	-0.15	0.00	0.35	-0.65	-0.55	-0.15
	+6m	-0.25	-0.10	-0.15	0.10	0.45	-0.65	-0.45	-0.05
	+12m	-0.25	-0.10	-0.10	0.20	0.65	-0.55	-0.35	0.15
NOK	Spot	1.50	1.59	1.26	1.18	1.35	0.80	0.80	1.02
	+3m	1.50	1.80	1.50	1.45	1.60	1.00	1.00	1.20
	+6m	1.50	1.80	1.50	1.55	1.80	1.00	1.10	1.40
	+12m	1.50	1.80	1.60	1.75	2.00	1.10	1.30	1.60

* German government bond yields and EUR swap rates used

Source: Danske Bank

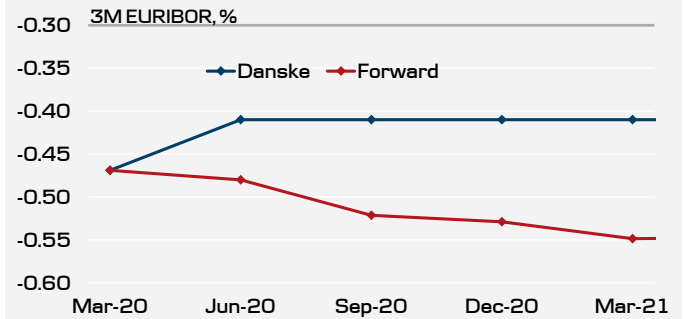
Eurozone forecasts

EUR forecast summary

06/03/2020	--- 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	-0.47	-0.41	-0.41	-0.41	9	14	17
6M	-0.43	-0.36	-0.36	-0.36	10	12	15
Government Bonds							
2-year	-0.86	-0.65	-0.60	-0.50	-	-	-
5-year	-0.86	-0.65	-0.50	-0.40	-	-	-
10-year	-0.69	-0.60	-0.45	-0.20	-	-	-
Swap rates							
2-year	-0.48	-0.30	-0.25	-0.15	19	24	33
5-year	-0.43	-0.25	-0.10	0.00	17	16	39
10-year	-0.24	-0.15	0.00	0.25	8	21	42

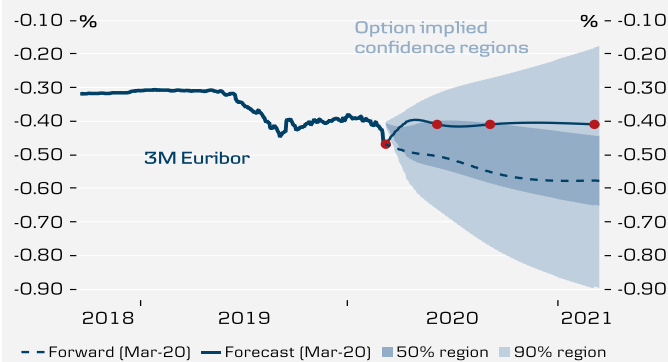
Source: Danske Bank

Danske Bank forecast and forwards



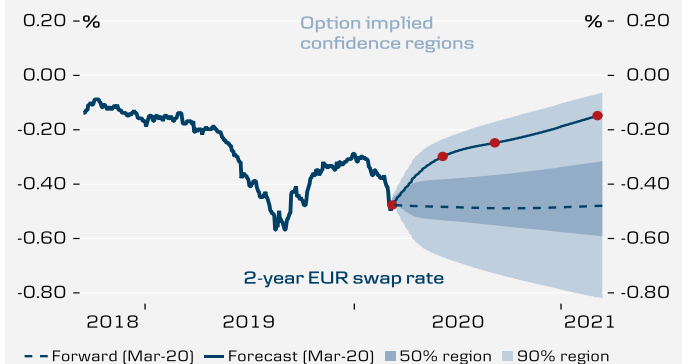
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Euribor



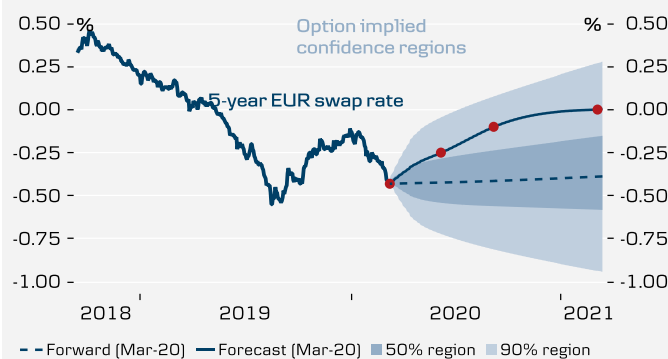
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Source: Danske Bank

2Y EUR swap rates



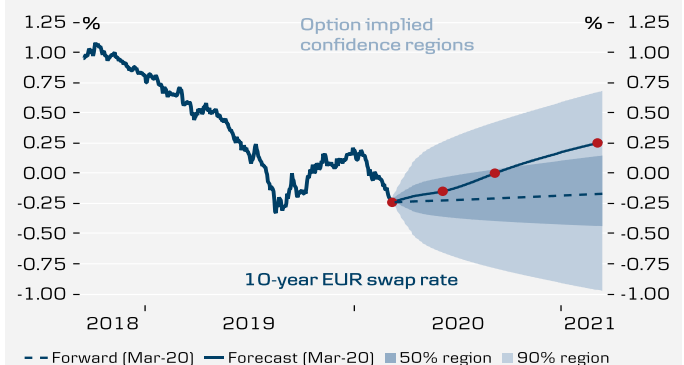
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

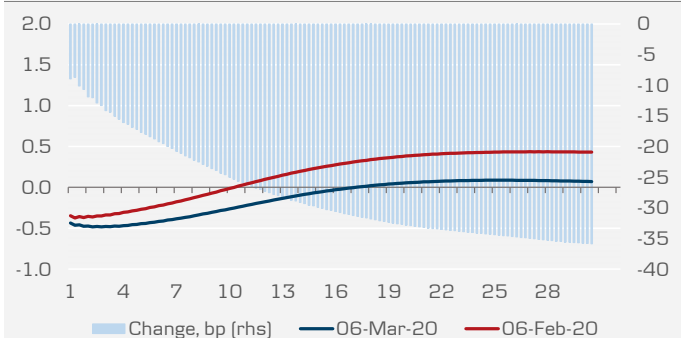
US forecasts

USD forecast summary

06/03/2020	--- Prognose ---				· Afvigelse fra forward i bp		
USD	Spot	+3m	+6m	+12m	+3m	+6m	+12m
<u>Pengemarked</u>							
Fed Funds	1.25	0.75	0.75	0.75	-	-	-
3M	1.00	0.81	0.85	0.85	13	28	32
<u>Statsobligationer</u>							
2-årig	0.58	0.60	0.70	0.80	-	-	-
5-årig	0.67	0.70	0.80	1.00	-	-	-
10-årig	0.92	0.90	1.20	1.40	-	-	-
<u>Swaprenter</u>							
2-årig	0.62	0.65	0.75	0.85	8	18	26
5-årig	0.68	0.75	0.85	1.05	8	17	34
10-årig	0.82	0.90	1.20	1.40	7	36	53

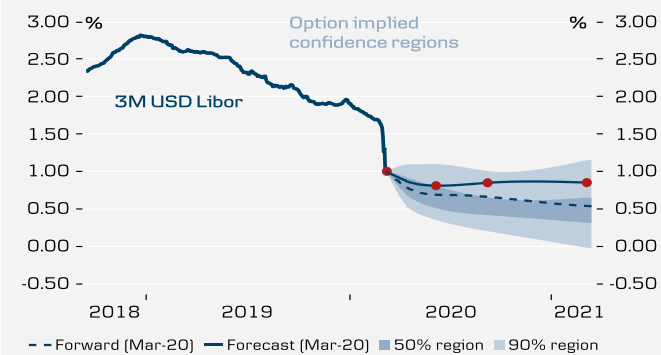
Source: Danske Bank

1M change in 3M USD Libor



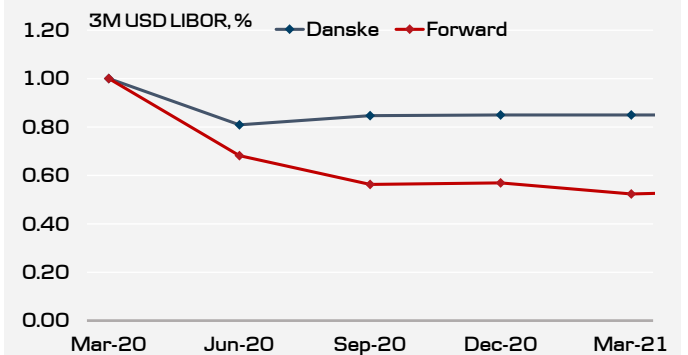
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M USD Libor rates



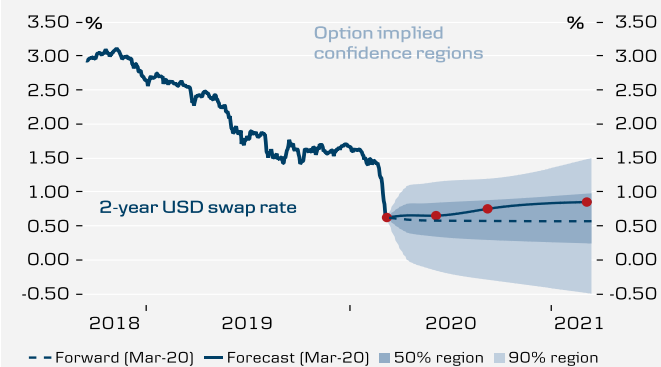
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



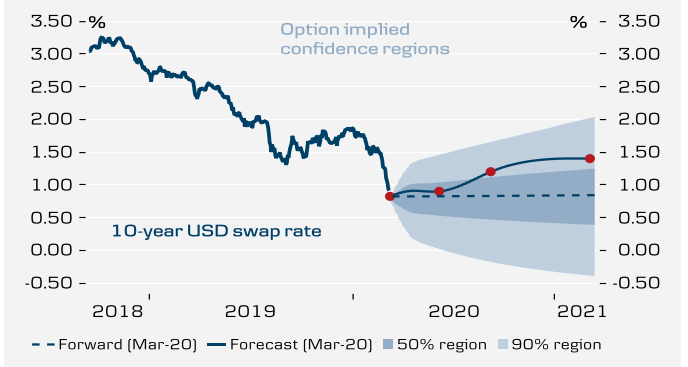
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

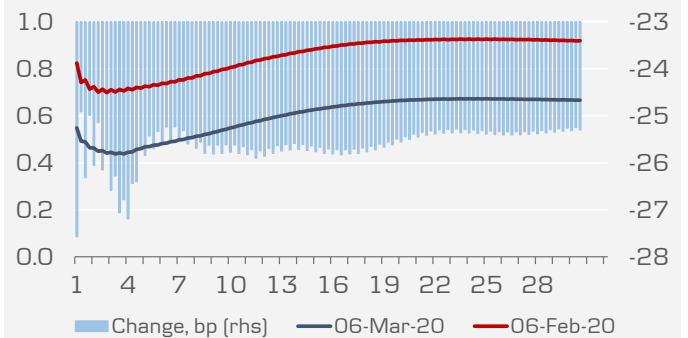
UK forecasts

UK forecast summary

06/03/2020		--- Forecast ---				--- Fcst vs Fwd in bp ---		
GBP	Spot	+3m	+6m	+12m	+3m	+6m	+12m	
Money Market								
Repo	0.75	0.25	0.25	0.25	-	-	-	
3M	0.50	0.29	0.29	0.29	-13	-8	-6	
Government Bonds								
2-year	0.16	0.20	0.20	0.30	8	10	18	
5-year	0.205	0.25	0.25	0.4	6	7	23	
10-year	0.33	0.30	0.40	0.60	-3	6	21	
Swap rates								
2-year	0.45	0.50	0.50	0.60	7	8	18	
5-year	0.47	0.55	0.55	0.70	8	7	11	
10-year	0.56	0.50	0.60	0.75	-6	3	16	

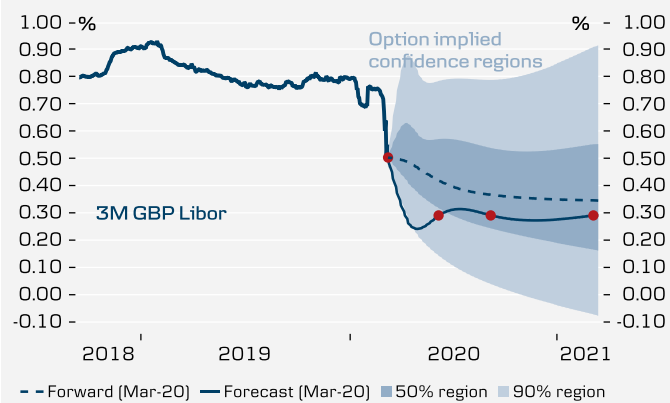
Source: Danske Bank

1M change in 6M GBP Libor



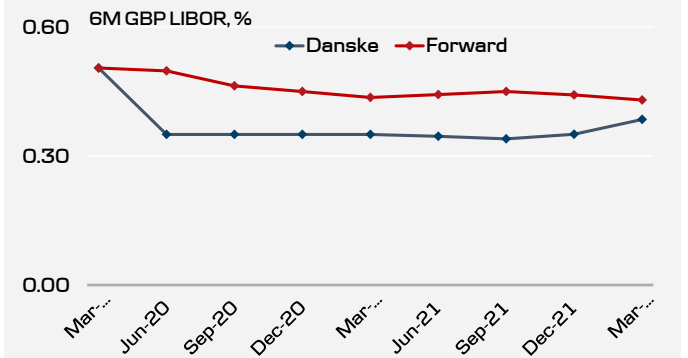
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M GBP Libor rates



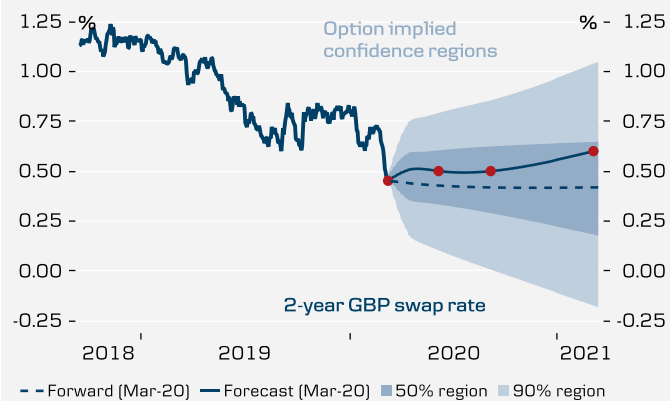
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



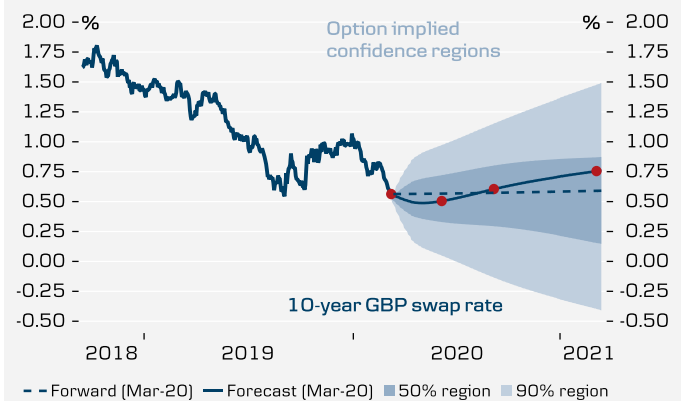
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

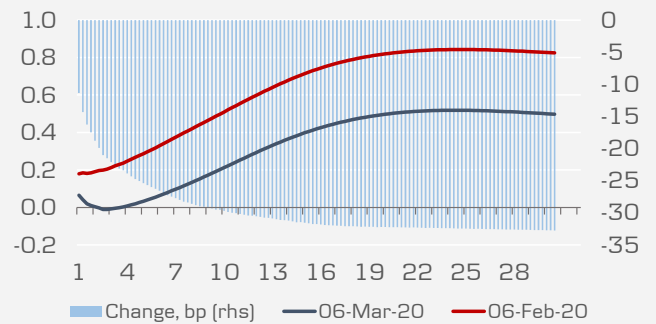
Sweden forecasts

SEK forecast summary

06/03/2020		--- Forecast ---				--- Fcst vs Fwd in bp ---		
SEK	Spot	+3m	+6m	+12m	+3m	+6m	+12m	
Money market								
Repo	0.00	-0.25	-0.25	-0.25	-	-	-	
3M	0.10	-0.10	-0.10	-0.10	-13	-9	-8	
Government bonds								
2-year	-0.36	-0.65	-0.65	-0.55	-	-	-	
5-year	-0.54	-0.55	-0.45	-0.35	-	-	-	
10-year	-0.31	-0.15	-0.05	0.15	-	-	-	
Swap rates								
2-year	-0.01	-0.15	-0.15	-0.10	-13	-12	-9	
5-year	0.05	0.00	0.10	0.20	-5	4	11	
10-year	0.23	0.35	0.45	0.65	10	19	35	

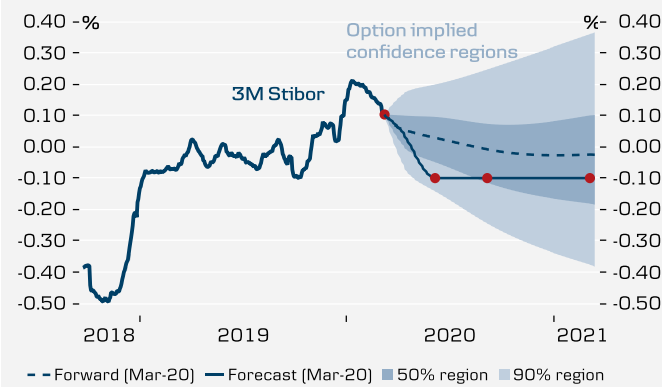
Source: Danske Bank

1M change in 3M Stibor



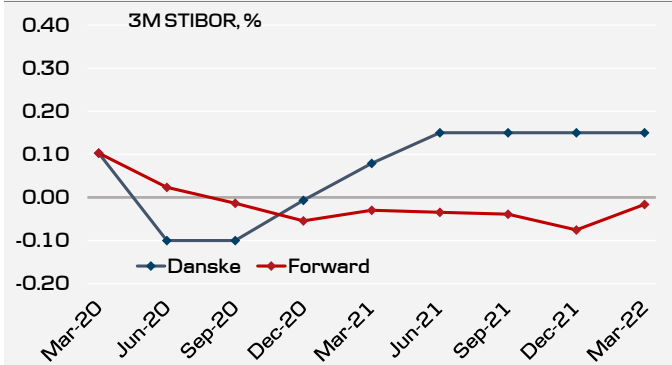
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Stibor rate



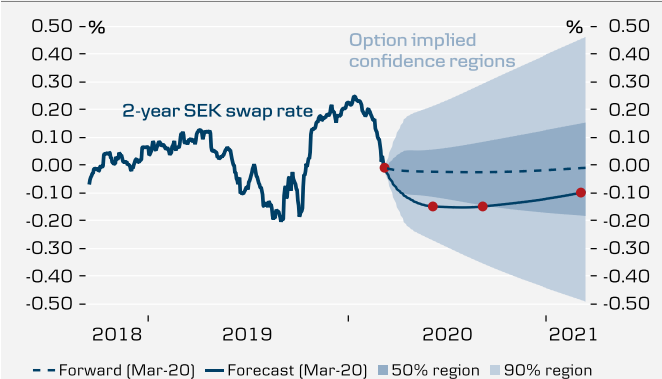
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



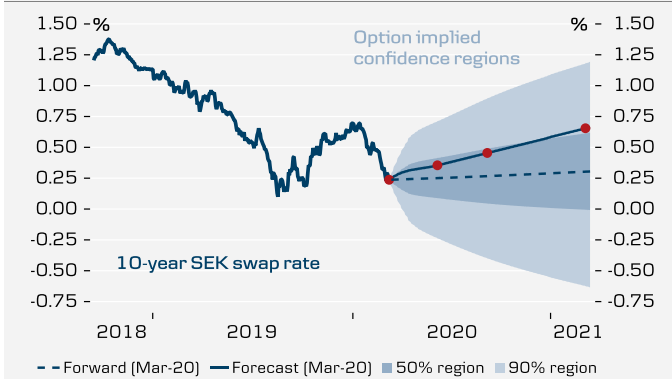
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

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

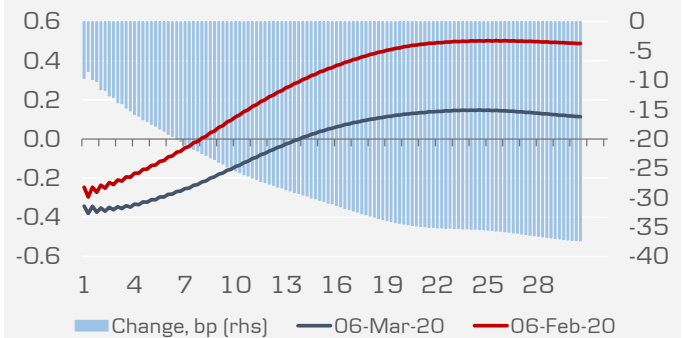
Denmark forecasts

DKK forecast summary

06/03/2020	--- Forecast ---				--- Fcst vs Fwd in bp ---		
DKK	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	-0.48	-0.38	-0.32	-0.32	9	15	18
6M	-0.34	-0.20	-0.17	-0.18	13	17	18
Government bonds							
2-year	-0.84	-0.65	-0.55	-0.45	-	-	-
5-year	-0.79	-0.58	-0.42	-0.32	-	-	-
10-year	-0.64	-0.57	-0.40	-0.15	-	-	-
Swap rates							
2-year	-0.35	-0.15	-0.10	0.00	20	25	34
5-year	-0.30	-0.10	0.05	0.15	19	33	40
10-year	-0.12	0.00	0.15	0.40	10	24	45
30-year	0.11	0.40	0.40	0.50	28	28	38

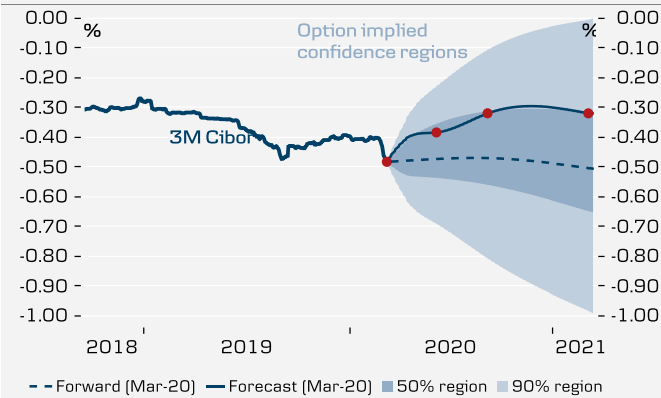
Source: Danske Bank

1M change in 6M Cibar



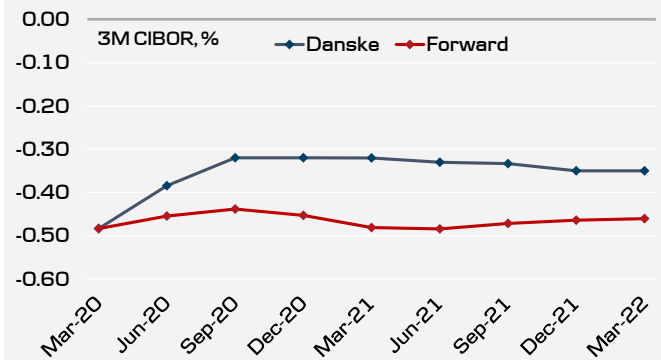
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Cibar



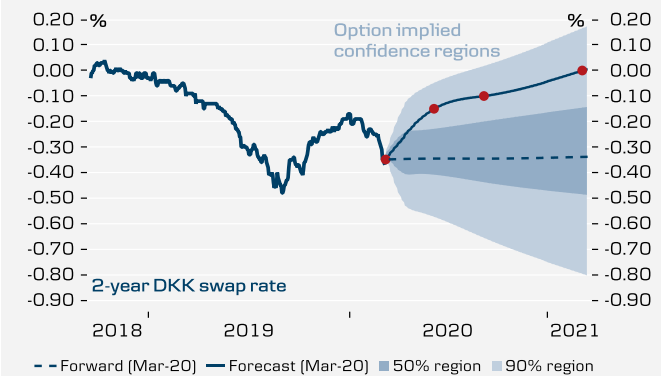
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Source: Danske Bank

Danske Bank forecast and forwards



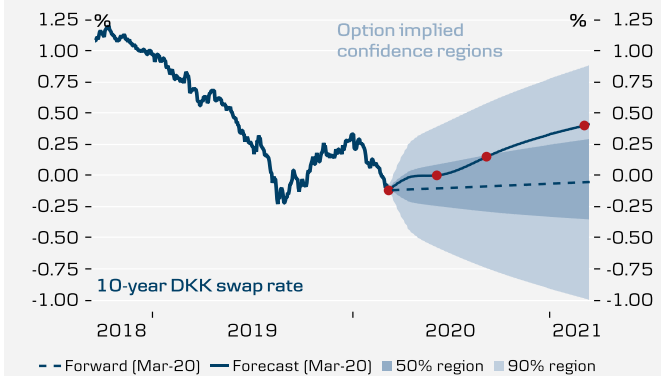
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y 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

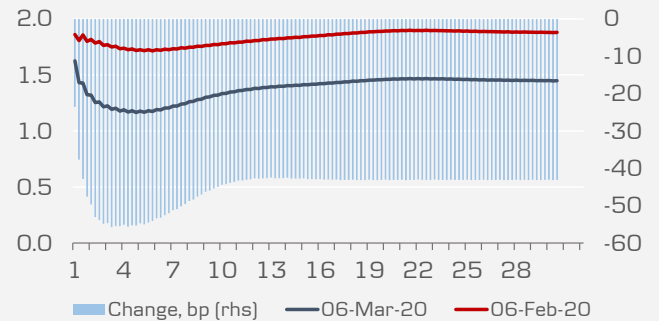
Norway forecasts

NOK forecast summary

06/03/2020							
NOK	Spot	--- Forecast ---			--- Fcst vs Fwd in bp ---		
		+3m	+6m	+12m	+3m	+6m	+12m
Money market							
Deposit	1.50	1.50	1.50	1.50	-	-	-
3M	1.57	1.80	1.80	1.80	43	61	74
6M	1.59	1.91	1.91	1.93	57	69	83
Government bonds							
2-year	0.80	1.00	1.00	1.10	-	-	-
5-year	0.80	1.00	1.10	1.30	-	-	-
10-year	1.02	1.20	1.40	1.60	-	-	-
Swap rates							
2-year	1.26	1.50	1.50	1.60	33	38	51
5-year	1.18	1.45	1.55	1.75	30	40	59
10-year	1.35	1.60	1.80	2.00	26	45	64

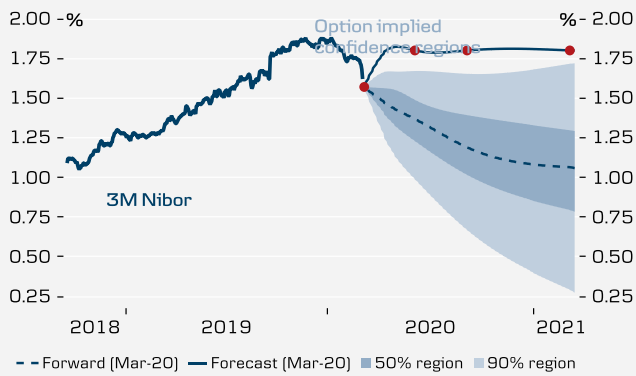
Source: Danske Bank

1M change in 6M Nibor



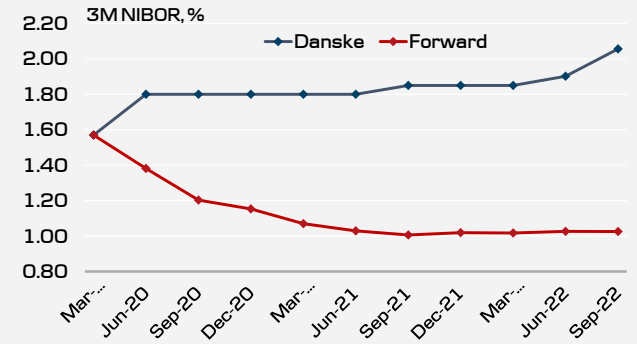
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

3M Nibor



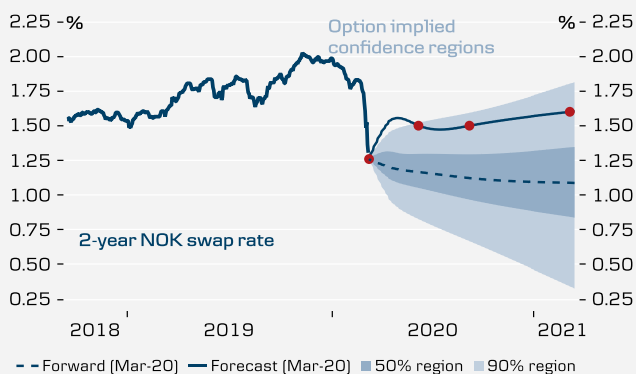
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

Danske Bank forecast and forwards



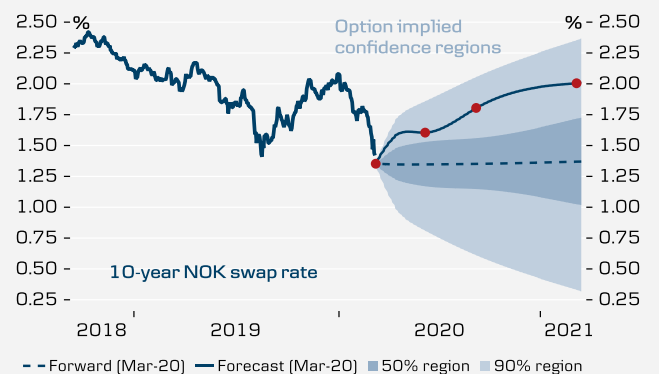
Note: Past performance is not a reliable guide to future returns
Source: Danske Bank

2Y NOK swap rate



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

10Y NOK swap rate



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

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