15 November 2012

Yield Forecast Update

Event risks continue to dominate sentiment

Review

- Risk appetite has declined over the past month. Markets are concerned about the slow progress made in Europe and the continued weakness in European data. In the US, prospects of tough negotiations related to the fiscal cliff are weighing on sentiment.
- Global yield curves have flattened on the back of bullish sentiment in the fixed income markets. Consequently, longer dated yields are at the low end of ranges that have prevailed over the past six months.
- The rally in core markets has caused wider ASW spreads and periphery-to-core spreads have widened again, although not dramatically. Global equity markets have softened and positioning data confirms the negative bias.

International rates

- We do not expect further easing in the near term from the Fed or the ECB apart from what has already been announced. Further, we now expect the BoE to be on hold for the near future, as data indicates some economic stabilisation.
- Short-end rates have very limited further room to decline. We expect fixings and two-year swap rates to level out close to the current levels. Our rate forecast is broadly unchanged and deploys a more or less flat path over the next six to 12 months.
- We continue to look for some curve steepening in six to 12 months driven by moderate increases in long-end rates. Curve steepening will be most pronounced in USD and driven mostly by tenors beyond 10 years. Our 10-year forecasts are above the forward market.

Scandi rates

- Given the recent deterioration in market sentiment and the renewed strengthening of the DKK, we postpone our expectations for independent Danish interest rate hikes until spring 2013. Next year, as event risk eventually recedes and global growth picks up, the appetite for DKK assets should subside again and EUR/DKK move back towards central parity. We believe this will reignite expectations of independent Danish central bank hikes.
- As pricing on the Riksbank is already aggressive given its unwillingness to cut rates further, the curve is unlikely to steepen in the short run unless we see a global sell-off at the long end. In the longer term, the Swedish yield curve remains flat on a relative basis and we expect Swedish short rates to converge towards European short rates.
- Norges Bank now expects to hike rates to 1.75%, from 1.50% currently, sometime between March and August 2013. Norwegian swap rates are high relative to swap rates in the eurozone. Relative to domestic government bond yields, however, they are relatively low. We expect the general economic development in Norway to put upward pressure on domestic swap rates.

Next Yield Forecast update is due on 14 December 2012

Quick links

Policy rate outlook

Country	Spot	+3m	+6m	+12m
USD	0.25	0.25	0.25	0.25
EUR	0.75	0.75	0.75	0.75
GBP	0.50	0.50	0.50	0.50
DKK	0.20	0.20	0.40	0.40
SEK	1.25	1.00	1.00	1.00
NOK	1.50	1.50	1.75	1.75

Source: Danske Bank Markets

10-year bond yield outlook

Country	Spot	+3m	+6m	+12m
USD	1.60	1.80	2.00	2.30
DEM	1.35	1.50	1.75	1.90
GBP	1.75	1.90	2.10	2.30
DKK	1.12	1.30	1.60	1.80
SEK	1.44	1.50	1.80	2.00
NOK	2.06	2.15	2.20	2.20

Source: Danske Bank Markets

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Eurozone forecast

Growth and inflation

The growth outlook for the euro area remains downbeat with leading indicators continuing to signal contraction. The sharp deterioration in PMIs has halted and there seems to be a stabilisation. German Ifo figures continue their decline, with the forward-looking expectation component now at the lowest level in three years. The eurozone has been in a light recession since Q4 11 and we do not expect growth to return until the beginning of 2013. For 2012 as a whole, we expect a drop in GDP of 0.4%. Unemployment will continue to new highs. Inflation is set to decline to below 2% in 2013 (now 2.5%).

Forecast table

EUR	Spot	+3m	+6m	+12m
	Money market			
ECB	0.75	0.75	0.75	0.75
3M	0.19	0.18	0.18	0.18
	German government bonds			
2-year	-0.02	0.05	0.10	0.10
5-year	0.38	0.55	0.65	0.70
10-year	1.35	1.50	1.75	1.90
	Swaprates			
2-year	0.39	0.40	0.40	0.40
5-year	0.84	0.95	1.00	1.05
10-year	1.66	1.80	2.00	2.15

Source: Danske Bank Markets

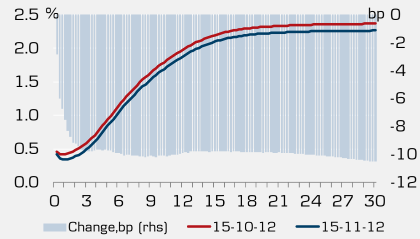
Monetary policy and money markets

The markets continue to centre attention on the implementation of the ECB's new bond buying OMT programme. However, the central bank is awaiting the Spanish request. Without any strong market pressure and since Spain has completed this year's funding, it might carry over into next year. We expect the ECB's refi and deposit rates to remain unchanged. The 3M Euribor fixing has moved gradually lower, reaching 0.19%. If the ECB does not cut the deposit rate, the room for 3M fixings to move lower is very limited.

Yield curve

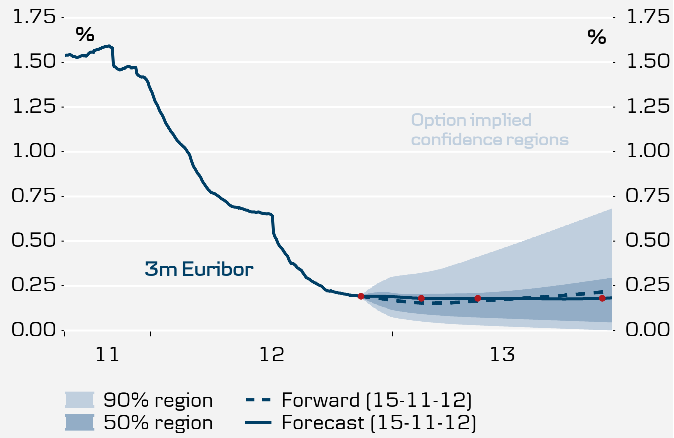
Following the ECB's announcement of the OMT programme, the systemic risks in Europe have declined. However, a deeper-than-expected contraction in European survey data and the intensifying focus on the US fiscal cliff, risks are now skewed for rates remaining in the lower end of the range until year-end. Going into next year, we expect rates to move higher as event risks recede and global growth picks up speed. That said, the potential for higher rates remains fairly limited, as Europe will be lagging the expected global growth recovery and because the ECB remains on an easing bias. We expect curves to steepen along with the gradual increase in long rates. Our six- and 12-month forecasts are unchanged but now above the forward market, after the recent decline in rates.

EUR swap curve



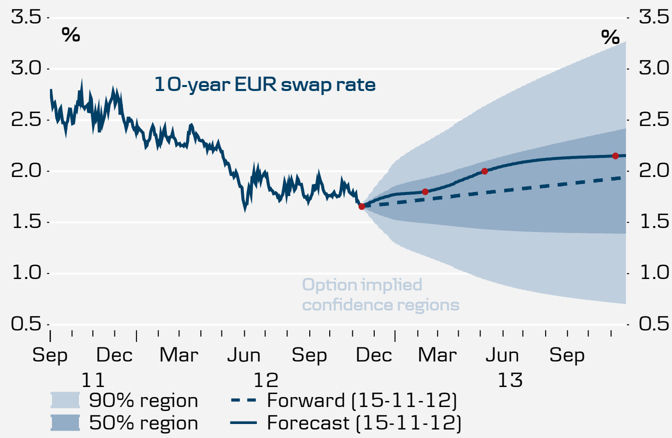
Source: Danske Bank Markets

3M Euribor



Source: Reuters EcoWin, Danske Bank Markets

10-year EUR swap rates



Source: Reuters EcoWin, Danske Bank Markets

US forecast

Growth and inflation

Focus in the US is centred on political uncertainty and, with the election behind us, the negotiations on the fiscal cliff have kicked off. We expect the negotiations to be tough and we are likely to get close to the December deadline before a deal is struck. There is also a non-negligible risk that the US will at least temporarily fall off the cliff. The heightened uncertainty seems to have led businesses to cut back on investments but, outside this, economic data has continued to improve.

Monetary policy and the money market

Barack Obama was re-elected President for the coming four years and the tail risk of a regime shift at the Fed has gone. Ben Bernanke's term will expire on 31 January 2014 and as it stands the current vice Chair Janet Yellen is on the shortlist to be nominated to take over the seat from Bernanke. This will ensure a continuation of the current easy monetary policy in the years to come. Short term, we expect the FOMC to decide at its December meeting to replace the current twist programme, which expires in January with a similar amount of outright treasury purchases. This would keep the monthly purchases at USD85bn per month. We see limited downside to USD Libor fixings from the current level. In general, we expect the money market curve to remain relatively stable on the forecast horizon, as the Fed continues to anchor short-term forward rates.

Yield curve

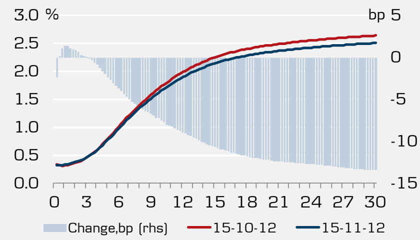
With fiscal cliff jitters increasing and the year end approaching, the short-term outlook for the US rate markets has become more tricky. Rates have moved lower lately and the near-term outlook depends mainly on the progress of the negotiations at Capitol Hill. Any signs of compromise would be positive for market sentiment and send rates up. However, for every day that passes without such signs, we believe the downward pressure on rates will intensify. We see some short-term downside to rates but expect an increase when a fiscal deal is reached. In 2013, we look for gradually rising 10-year rates, driven from the long end of the curve, as the recent stabilisation and signs of improvement in global macro data continue to materialise. Overall, we look for a steepening of the curve. Our six- and 12-month forecasts are above forwards in the 10- and 30-year segments and below the forwards in the two-year segment.

Forecast summary

USD	Spot	+3m	+6m	+12m
		Money market		
FED	0.25	0.25	0.25	0.25
3M	0.31	0.30	0.30	0.30
		Government bonds		
2-year	0.25	0.25	0.25	0.25
5-year	0.63	0.70	0.85	1.00
10-year	1.60	1.80	2.00	2.30
		Swap rates		
2-year	0.37	0.35	0.35	0.35
5-year	0.76	0.85	0.95	1.10
10-year	1.64	1.85	2.00	2.30

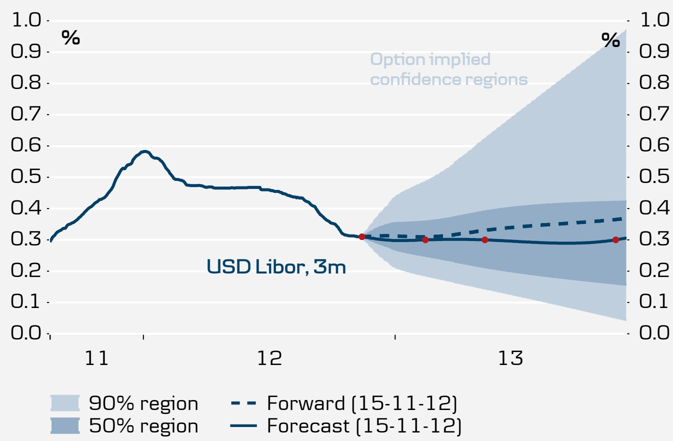
Source: Danske Bank Markets

USD swap curve



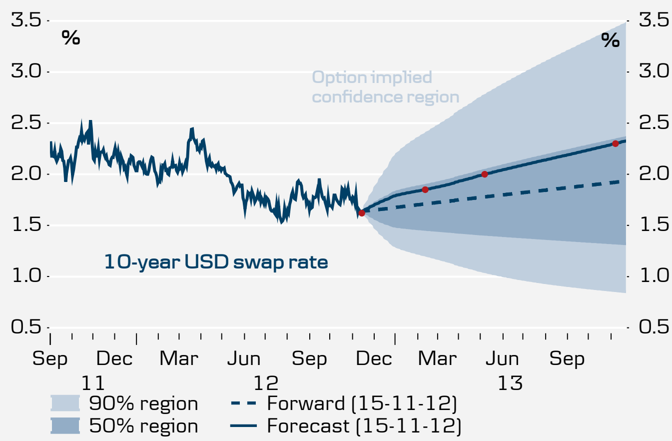
Source: Danske Bank Markets

3M USD Libor rates



Source: Reuters EcoWin, Danske Bank Markets

10-year USD swap rates



Source: Reuters EcoWin, Danske Bank Markets

UK forecast

Growth and inflation

The first estimate of Q3 GDP indicated that the UK is technically out of recession with a rise of 1.0% q/q. The seemingly strong number for Q3 comes partly from a rebound in activity following the Jubilee holiday-related disruptions in Q2 and thus the Q3 number more correctly reflects an improvement of underlying growth of 0.2 – 0.4% q/q. The leading indicators draw a cloudier picture where especially the fall in service PMI for October from 52.2 to 50.6 has surprised on the downside. The manufacturing and construction PMIs remain below 50, supporting that the underlying activity remains soft and that Q4 GDP growth is likely to slow significantly relative to Q3. We do, however, expect growth to pick up slowly in 2013. The latest inflation number is still above the 2% target with CPI in October of 2.7% y/y. The outlook is for a gradual decline towards 2% in 2013.

Monetary policy and the money market

The Bank of England (BoE) kept its asset purchase target at GBP375bn at the November meeting. If the economy turns out as we expect – a slow growth recovery and inflation above the target but declining – we think more QE is unlikely. No doubt though, that the MPC stands ready with additional QE if the outlook for the UK economy deteriorates further. The BoE has also introduced the Funding for Lending Scheme (FLS). It provides banks with a cheaper source of funding linked to the extent to which they expand lending to the UK real economy. Thirty banks and building societies have signed up with a total FLS-eligible lending at GBP1,326bn (giving access to GBP85-90bn of funding up to four years). The conditions in the money market are currently easing and LIBOR rates have continued to fall since mid-June and we see moderate downside from current levels.

Yield curve

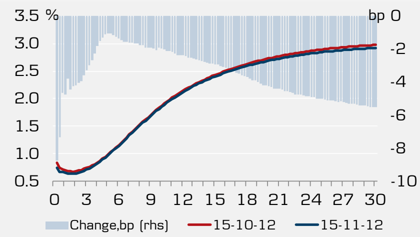
UK curves have tracked global markets over the past couple of months and yields have overall traded sidewise. With a relatively weak macro outlook and great external uncertainties from the US and the Eurozone, we do not think the outlook is for a sharp rise in rates in the coming quarters. Rather we think UK rates will remain fairly range bound. The 2-10 curve is expected to remain unchanged over the next three months and then to gradually begin to steepen.

Forecast table

GBP	Spot	+3m	+6m	+12m
		Money market		
Base rate	0.50	0.50	0.50	0.50
3M	0.52	0.50	0.50	0.50
		Government bonds		
2-year	0.25	0.25	0.25	0.30
5-year	0.74	0.80	0.90	1.00
10-year	1.74	1.90	2.10	2.30
		Swap rates		
2-year	0.65	0.70	0.70	0.75
5-year	0.97	1.05	1.15	1.25
10-year	1.85	2.05	2.25	2.45

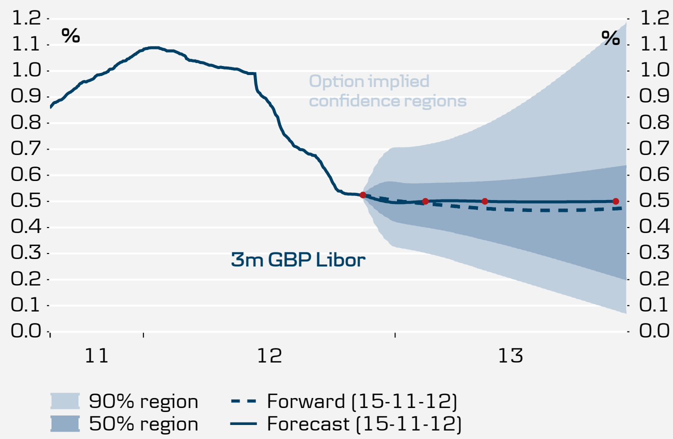
Source: Danske Bank Markets

GBP swap curve



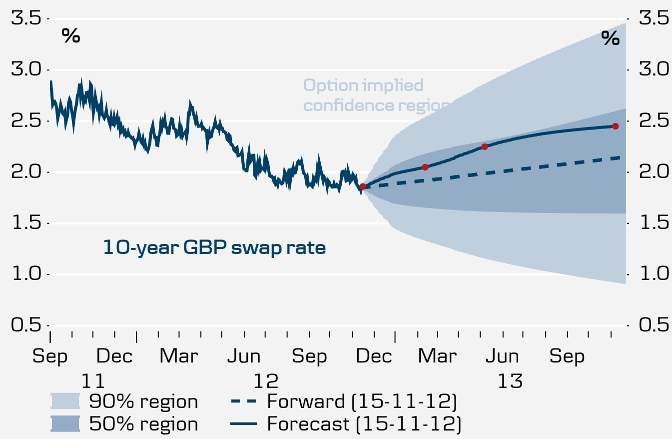
Source: Danske Bank Markets

3m GBP Libor rates



Source: Reuters EcoWin, Danske Bank Markets

10-year UK swap rates



Source: Reuters EcoWin, Danske Bank Markets

Denmark forecast

Growth and inflation

The indicators continue to paint a mixed picture of the Danish economy. Exports and industrial production showed rather sharp declines in September and sentiment among industrial companies is deteriorating. The continued crisis in Europe is clearly being felt in Denmark as well. On the other hand, indicators of household spending have been slightly higher in recent months and the housing market looks as though it is improving a little. In our view, it is likely growth will continue to be low but not low enough to trigger a substantial decrease in employment. The budget for 2013 has been agreed. We believe it will be neutral for growth but has significantly lowered the outlook for inflation, as both existing and planned indirect taxes will be scrapped and replaced by higher income tax.

Monetary policy and money markets

On the back of the recent burst of negative market sentiment and lack of outflow from Danish bonds, EUR/DKK has moved slightly lower once again. This follows a period where an independent rate hike was drawing closer, as the EUR/DKK hovered close to central parity and the central bank intervened moderately in the currency market. Given the recent deterioration in market sentiment and the renewed strengthening of the DKK, we postpone our expectations for independent Danish interest rate hikes until spring 2013. Next year, as event risk eventually recedes and global growth picks up, the appetite for DKK assets should subside again and EUR/DKK move back towards central parity. We expect this to reignite expectations for independent Danish central bank hikes. However, the central bank is likely to be patient and we do not expect hikes before the spring. Our 3M forecast is for unchanged policy rates, while our 6M forecast includes a 20bp increase in the lending rate to 0.4% and the certificate of deposit rate to 0.0%. As always, Nationalbanken normally needs to intervene by approximately DKK5-20bn before rates are changed.

Yield curve

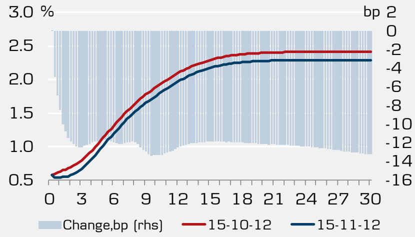
The spread between EUR and DKK swaps has narrowed slightly over the past few weeks reflecting the deterioration in risk sentiment. However, at the short end, a tiny tightening of the 3M CIBOR-EURIBOR spread has played its part as well. Near term, we expect the EUR-DKK swap spread to be relatively stable but it could tighten further if risk sentiment continues to deteriorate. At the short end, however, hedging flows relating to flex auctions could act as a temporary counteracting factor. Next year, we expect Danish swaps to widen slightly to EUR swaps, as risk sentiment improves and Danish rate hikes return to the agenda.

Forecast table

DKK	Spot	+3m	+6m	+12m
		Money market		
REPO	0.20	0.20	0.40	0.40
3M	0.30	0.30	0.45	0.45
		Government bonds		
2-year	-0.15	0.05	0.20	0.25
5-year	0.33	0.55	0.75	0.80
10-year	1.10	1.30	1.60	1.80
		Swap rates		
2-year	0.57	0.60	0.65	0.65
5-year	1.01	1.15	1.20	1.25
10-year	1.76	1.90	2.20	2.35

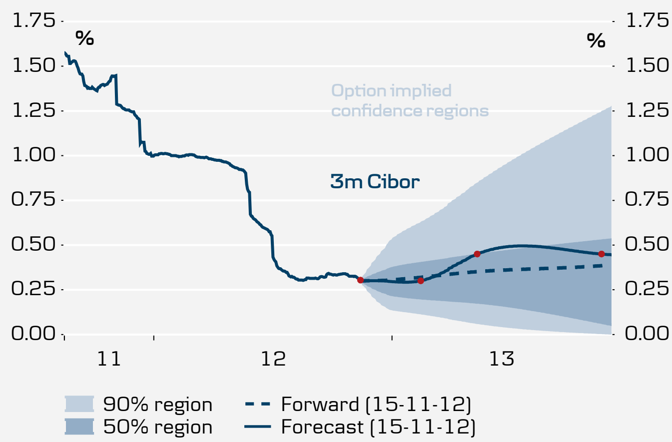
Source: Danske Bank Markets

DKK swap curve



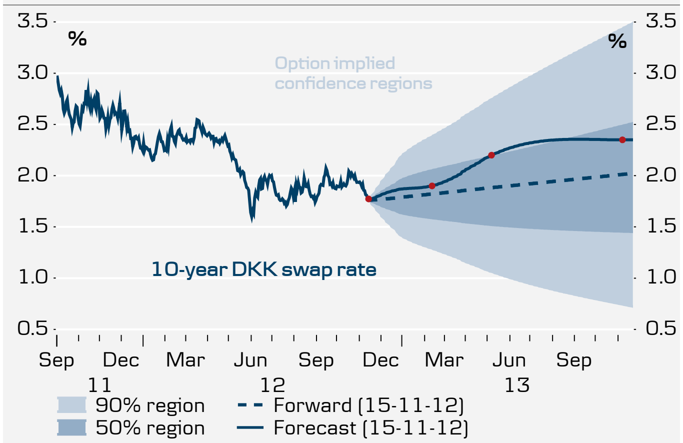
Source: Danske Bank Markets

3M Cibor rates



Source: Reuters EcoWin, Danske Bank Markets

10-year DKK swap rates



Source: Reuters EcoWin, Danske Bank Markets

Sweden forecast

Growth and inflation

An overwhelming part of Swedish data suggests that the economy is continuing to deteriorate into Q4. In particular, several Swedish exporters have announced redundancies on a scale that is worse than an average recession. Hence, there is an evident risk that unemployment is starting to rise significantly, with a possible negative impact on household purchasing power and the property market. As yet, there are no signs of the latter. In any case, growth prospects remain very subdued for the Swedish economy as long as debt problems in Greece and Spain put a lid on European demand and the outcome of US negotiations on the fiscal cliff remains uncertain. Swedish inflation is currently significantly below the Riksbank's inflation forecast. In principle, inflationary pressures should have bottomed out now. However, possible pressure on wages may prolong and enhance the low inflation environment.

Monetary policy and the money market

Minutes from the Riksbank meeting once again underlined the majority view that the risk/reward in cutting policy rates further is poor. The Riksbank remains very concerned about the household debt load – basically preconditioning policy on a stable debt ratio – and some board members have argued that the rise in unemployment is mainly structural and hence outside the realm of monetary policy. At the same time, macroeconomic figures, especially for the export-related part of the economy, have been disappointing. We think that in particular the labour market will have to deteriorate further to warrant more than one rate cut. We believe the money market curve could flatten somewhat.

Yield curve

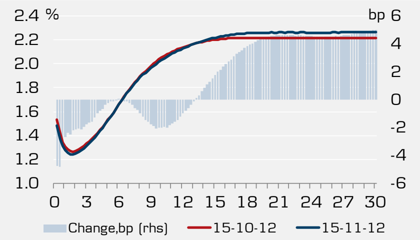
As pricing on the Riksbank is already quite aggressive (around 40bp in cuts expected in total) given its unwillingness to cut rates further, the curve is unlikely to steepen in the short run unless we see a global sell-off at the long end. However, in the longer run, the Swedish yield curve remains flat on a relative basis and we expect Swedish short rates to converge towards European short rates.

Forecast table

SEK	Spot	+3m	+6m	+12m
		Money market		
Repo	1.25	1.00	1.00	1.00
3M	1.45	1.20	1.20	1.30
		Government bonds		
2-year	0.70	0.60	0.70	0.80
5-year	0.94	0.85	1.10	1.20
10-year	1.44	1.50	1.80	2.00
		Swap rates		
2-year	1.25	1.10	1.20	1.30
5-year	1.52	1.35	1.60	1.70
10-year	2.02	2.10	2.25	2.45

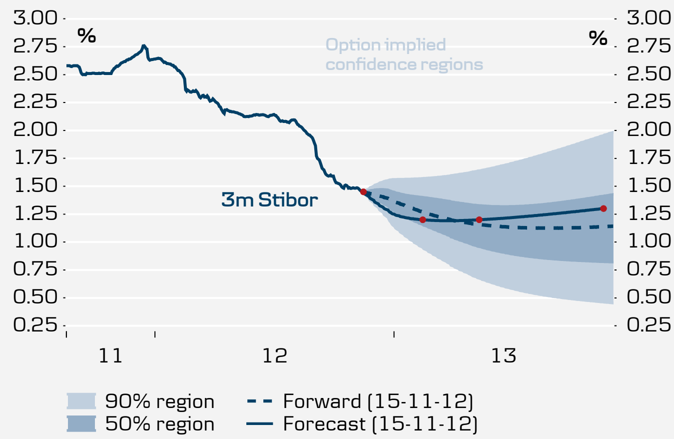
Source: Danske Bank Markets

SEK swap curve



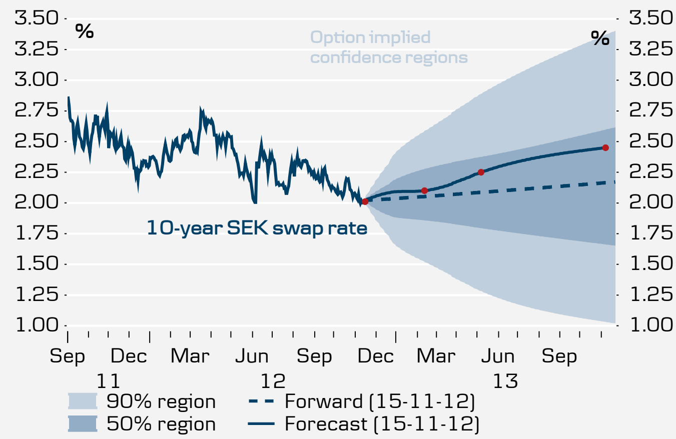
Source: Danske Bank Markets

3M Stibor rates



Source: Reuters EcoWin, Danske Bank Markets

10-year SEK swap rates



Source: Reuters EcoWin, Danske Bank Markets

Norway forecast

Growth and inflation

Norway's economy continues to be strong, fuelled in large part by the oil industry and the construction sector. In a survey carried out by Norges Bank in September 2012 (regionalt nettverk), the companies reported a marked increase in activity relative to the previous quarter. The outlook was, however, adjusted downwards, but only marginally so. There were reports of scarce resources particularly in the western part of the country, and also in the construction sector and for oil related businesses. Key economic figures have come in a bit mixed: On the weak side, we note the fifth PMI reading in a row below 50: The October figure came in at 48.7. Industrial production for September also had a weak reading at -5.6% m/m (seasonally adjusted). Retail sales for September, on the other hand, came in at 0.7%, which was stronger than expected. Credit growth (C2) came in at 6.9% which is around the level it has been at for the last half year. There is no shortage of credit in Norway. In our overall assessment, we put quite a bit of emphasis on the survey conducted by Norges Bank, which points to a continued strong Norwegian economy. Core CPI numbers came in at 1.1% y/y for October, 0.1% lower than anticipated. This is moreover about 0.15% lower than Norges Bank anticipated in its recent Monetary Policy Report (MPR3.12). We believe low import prices are a big part of the explanation for the low inflation in Norway.

Monetary policy and the money market

On 31 October, Norges Bank released expected rates for the coming three years (in MPR3.12). Relative to previous announcements the next rate increase was postponed one quarter: A rate increase to 1.75% is now expected to occur sometime between March 2013 and August 2013. The spread between the interbank lending rate (NIBOR) and Norges Bank's official rate (the folio rate) has decreased substantially since the summer of 2012. We now consider this spread to be normalised and we do not expect any material changes to the spread in the near future.

Yield curve

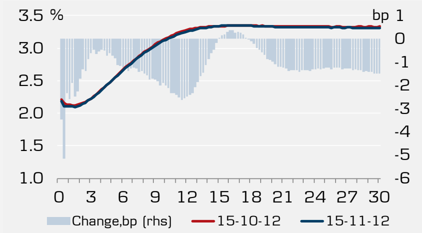
Norwegian swap rates are high relative to swap rates in the eurozone. Relative to domestic government bond yields, however, they are relatively low. We expect the general economic development in Norway to put upward pressure on domestic swap rates.

Forecast table

NOK	Spot	+3m	+6m	+12m
		Money market		
ON DEP	1.50	1.50	1.75	1.75
3M	1.93	1.95	2.15	2.15
		Government bonds		
2-year	1.50	1.70	1.70	2.00
5-year	1.57	1.60	1.70	2.10
10-year	2.06	2.15	2.20	2.20
		Swap rates		
2-year	2.12	2.20	2.45	2.45
5-year	2.51	2.70	2.85	3.05
10-year	3.13	3.30	3.55	3.60

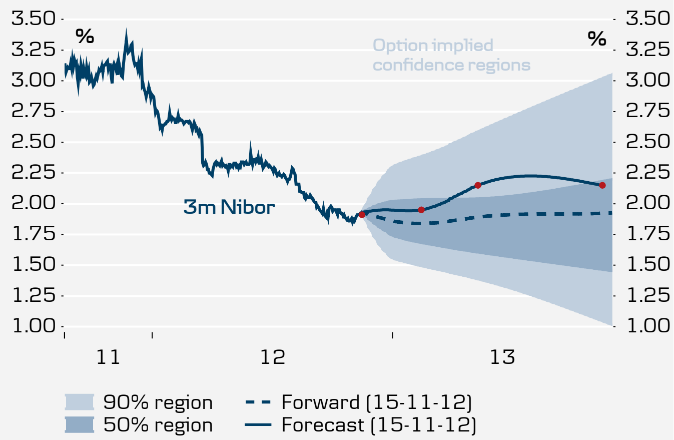
Source: Danske Bank Markets

NOK swap curve



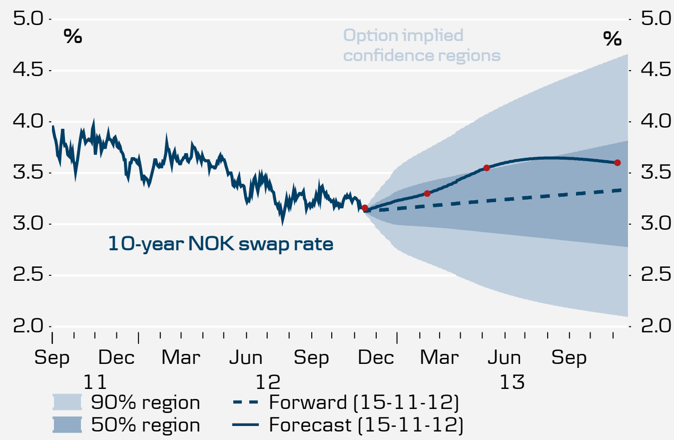
Source: Danske Bank Markets

3M Nibor rates



Source: Reuters EcoWin, Danske Bank Markets

10-year NOK swap rates



Source: Reuters EcoWin, Danske Bank Markets

Forecast table

	Horizon	Policy rate	3m xlbor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	0.25	0.31	0.37	0.76	1.64	0.25	0.63	1.60
	+3m	0.25	0.30	0.35	0.85	1.85	0.25	0.70	1.80
	+6m	0.25	0.30	0.35	0.95	2.00	0.25	0.85	2.00
	+12m	0.25	0.30	0.35	1.10	2.30	0.25	1.00	2.30
EUR*	Spot	0.75	0.19	0.39	0.84	1.66	-0.02	0.38	1.35
	+3m	0.75	0.18	0.40	0.95	1.80	0.05	0.55	1.50
	+6m	0.75	0.18	0.40	1.00	2.00	0.10	0.65	1.75
	+12m	0.75	0.18	0.40	1.05	2.15	0.10	0.70	1.90
GBP	Spot	0.50	0.52	0.65	0.97	1.85	0.25	0.74	1.74
	+3m	0.50	0.50	0.70	1.05	2.05	0.25	0.80	1.90
	+6m	0.50	0.50	0.70	1.15	2.25	0.25	0.90	2.10
	+12m	0.50	0.50	0.75	1.25	2.45	0.30	1.00	2.30
JPY	Spot	0.10	0.19	0.26	0.31	0.74	0.10	0.19	0.74
	+3m	0.10	0.20	0.25	0.30	0.80	0.10	0.20	0.80
	+6m	0.10	0.20	0.25	0.35	0.90	0.10	0.25	0.90
	+12m	0.10	0.20	0.25	0.45	1.05	0.10	0.35	1.05
CHF	Spot	0.00	0.03	0.07	0.26	0.87	-0.23	0.01	0.43
	+3m	0.00	0.05	0.15	0.30	1.05	-0.15	0.00	0.60
	+6m	0.00	0.05	0.15	0.40	1.15	-0.15	0.05	0.70
	+12m	0.00	0.05	0.20	0.50	1.25	-0.10	0.15	0.80
DKK	Spot	0.20	0.30	0.57	1.01	1.76	-0.15	0.32	1.10
	+3m	0.20	0.30	0.60	1.15	1.90	0.05	0.55	1.30
	+6m	0.40	0.45	0.65	1.20	2.20	0.20	0.75	1.60
	+12m	0.40	0.45	0.65	1.25	2.35	0.25	0.80	1.80
SEK	Spot	1.25	1.45	1.25	1.52	2.02	0.70	0.94	1.44
	+3m	1.00	1.20	1.10	1.35	2.10	0.60	0.85	1.50
	+6m	1.00	1.20	1.20	1.60	2.25	0.70	1.10	1.80
	+12m	1.00	1.30	1.30	1.70	2.45	0.80	1.20	2.00
NOK	Spot	1.50	1.93	2.12	2.51	3.13	1.50	1.57	2.06
	+3m	1.50	1.95	2.20	2.70	3.30	1.70	1.60	2.15
	+6m	1.75	2.15	2.45	2.85	3.55	1.70	1.70	2.20
	+12m	1.75	2.15	2.45	3.05	3.60	2.00	2.10	2.20

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

Source: Danske Bank Markets

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