Rates: Some inflation with your recovery, sir?

The context could not be more stark; a 10% increase in US nominal GDP versus a sub-2% 10yr yield. The first bit is virtually nailed on, and comes with 3-4% of inflation on the side, keeping real yields deeply in negative territory. The only way to partially square this circle is for US market yields to rise, and eurozone ones too, on post-Covid positivity

These burgers in New Jersey might cost a little bit more in the coming months

Why US yields remain under considerable upward pressure; we'll hit 2%, and sail above

It does not really matter how fast yields have risen. What matters is where we are now relative to fair value. And while fair value is a tricky concept, it is far less complicated when there is such a significant deviation between where things are versus where things could or should be.

We have struggled in recent years with this in the sense that market yields have tended to trade below nominal GDP growth rates, when in fact they should trend together. In fact, market yields have even struggled to keep up with inflation resulting in low to negative real yields. But here and now, the differential is so stark that the only way is up for US yields in the months ahead.

What matters is where we are now relative to fair value

Using rounded numbers, 2021 will see growth of some 6-7%. That does not include inflation. And while the GDP deflator is the truest measure here, headline consumer price inflation (CPI) presents a cleaner measure of the negative impact on the real spending power of fixed coupons to be received on bond holdings.

CPI inflation will hit 3-4% this year. Add growth and inflation together and we get a nominal expansion approaching 10%. US yields are also a nominal concept, in the sense that they comprise a real yield and an inflation expectation.

Whichever way you swing this breakout, today's US 10yr yield of sub-2% looks well short of nominal economy expansion of closer to 10%.

Our prognosis which eyes the approach of 3% in the US 10yr should bring the 1% level into play for the eurozone

Of course, that 10% spurt is transitory so we should not expect the 10yr yield to match it. But what we should expect is for the 10yr yield to remain under considerable rising pressure.

Not only should the US 10yr achieve a 2 handle, but that 2-point-something can well morph towards 3

Not only should it achieve a 2 handle, but that 2-point-something can well morph towards 3 should the macro recovery remain secure enough to continue with above-trend growth beyond the anticipated Q3 spurt as the economy really re-opens. In fact, we have massaged up our forecasts to reflect this. They show the 2.5% to 3% range featuring in the US 10yr yield by the second half of 2022. Now that is some time away from now, and stuff can happen along the way. But it makes clear that a nearer-term break above 2% is coming.

For the eurozone, the numbers are not quite as stark but the theme is similar. The US also tends to act as a lead indicator for the eurozone. A wider re-opening in the third quarter for the US will likely be matched by the same for the eurozone by the fourth.

The dream of describing the Eurozone 10yr swap rate in percentage terms rather than in basis points is on

The Eurozone 10yr swap rate broke above zero about a month ago from -30bp in December. It is now approaching 10bp. Realistically it should not even think about going negative again for the foreseeable future. Rather it should have a focus on 1%. That sounds dramatic, and well above where we are right now, but the journey should be 25bp and then 50bp in the next 6-12 months. Once there, the dream of describing the 10yr in percentage terms ahead is on.

Policy stimulus is pushing firmly in the same direction

As a final point, let's not forget the remarkable underpinning to recovery coming from governments and central banks; this has been absolutely crucial.

On both sides of the Atlantic, the official sector has chosen recovery over worries about the build of debt to finance it. Bond markets too have played a good game by happily digesting supply and coming back for more. The Federal Reserve and the European Central Bank have been important buyers too.

A growth-plus inflation-spurt in fact helps to ease debt worries when looked at as a percentage of nominal GDP. At the same time, a ceiling of tolerability for ever-higher yields is also there, as sustainable debt dynamics demand that bond yields remain low relative to medium-term nominal expansion and not just versus 2021 growth.

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