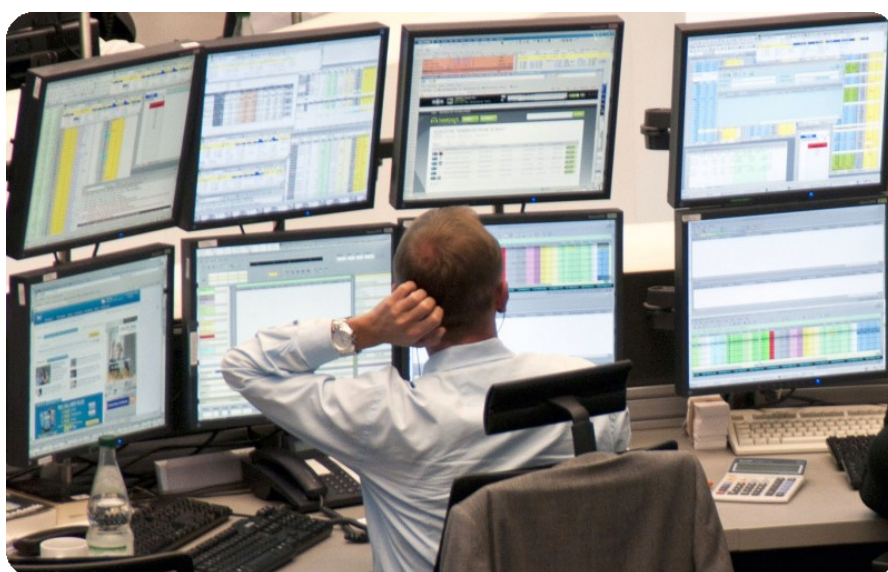


Rates Outlook 2021: Money for nothing

Our outlook for rates in 2021 is relatively optimistic. That said, there are numerous drags that will contain those market rates. A large debt overhang is one. Pushing in the other direction is re-pricing from heavy supply and a potentially jumpy inflation dynamic



Executive summary

Our Rates Outlook for 2021 looks at the primary drivers for the markets next year.

The US deficit is eye-watering. And it needs to be financed. Such are the sizes involved that it is not difficult to see how this could be a problem. That said, for as long as there is offsetting demand it does not need to be a determining factor the bond market.

We are upbeat for 2021. Hence the call for the US 10yr to get to the 1 to 1.25% range. If the stars align, we could go higher. But there are drags coming from Europe. And also the structure of the curve is not looking very bearish for bonds.

A widening in the Treasury-Bund spread is a classic recovery outcome. It reflects a scenario where the US takes the lead role in pulling developed markets out of slowdowns and recessions. This has started to happen, which is good. And there is more to come in 2021.

As we prepare to say goodbye to Libor, its rates are trading in very close proximity to risk-free rates, which suggests a minimal credit risk premium in the rate. There is a clear

risk that Libor comes under rising pressure through 2021.

On the European side, we forecast 10Y EUR swap rates to rise to only 0.05% next year, equivalent to -0.25% for 10Y Germany. Inflation is going nowhere fast, ECB demand for bonds continues to grow, and fiscal stimulus is insufficient to boost long-term growth expectations.

Money markets will remain under the spell of high excess liquidity levels. This means ever lower Euribor fixings and commercial paper rates. We do not anticipate the ECB will cut its policy rate, but cheaper liquidity injections are on the cards.

Given the shallow rise in EUR interest rates we are forecasting for 2021, we expect curve dynamics to remain equally muted.

Supply remains the main driver of swap spreads, but 2021 will be uneventful on this front. Instead, technical factors should cheapen long-dated swap spreads relative to shorter ones

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