DBS Focus

G3 rates: Seeking refuge

Strategy/G3/Rates

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- *Competitive easing amidst a slow global growth backdrop reinforces the lower for (even) longer narrative*
- *However, we are reluctant to chase already low G3 rates and prefer to stay neutral on duration*
- ***Implications for forecast**: We have re-centered our G3 rates forecasts lower to reflect heightened near-term uncertainties*
- ***Implications for investment**: Opportunistically taking duration risks may be the best way to handle already depressed G3 yields*

G3 rates: Safety first

Flight to safety amidst a highly uncertain outlook will keep G3 yields lower for longer. The list of worries has increased in recent months as investors now have to deal with the re-escalation of China-US trade war (after a brief truce), the risks of a hard Brexit, EM stress (largely Argentina) and political uncertainties in Hong Kong. G10 central banks, which are already facing growth moderation, now have to contend with these ongoing headwinds. **It is not possible to insure against trade war (or political risks) by easing monetary policy. However, central banks will try** to limit the fallout by making financial conditions even looser. Unfortunately, lower rates (or dovish guidance) from any of the G3 central banks tend to have knock-on impact unto other developed market rates as **competitive easing gets triggered.** With these dynamics reinforcing the lower for longer narrative, **we have re-centered our G3 yields forecasts lower. SGD and HKD rates have also been tweaked accordingly.**

G3 curves: Reflecting pessimism

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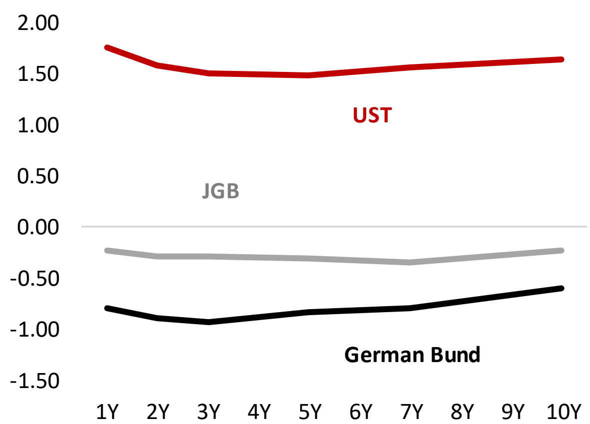
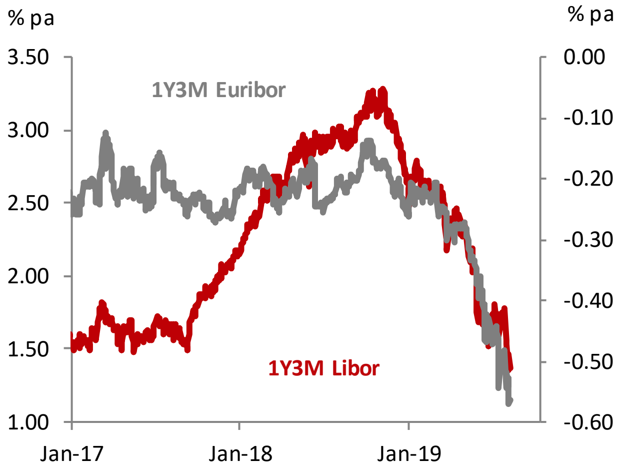


Source: Bloomberg

The Fed and ECB U-turn

Over the course of a year, the Fed and the European Central Bank (ECB) both U-turned (or are about to) on policy. The Fed delivered the first cut in a decade last month and will likely deliver more if financial conditions tighten or trade tensions worsen. Firm US data does not seem to matter at this time as the market focused on downside risks. Urgency for the Fed to deliver more "insurance cuts" is building after the recent tit-for-tat measures between China and the US (see Macro Strategy, 6th August 2019). US equity markets also had a more serious wobble when the RMB crossed 7 versus the USD and the US named China a currency manipulator. **Trump may not have direct influence over the Fed. But by ratcheting up trade war rhetoric, the resulting uncertainty would prompt more "insurance cuts."**

Market factoring in aggressive easing for the Fed and ECB



Source: Bloomberg

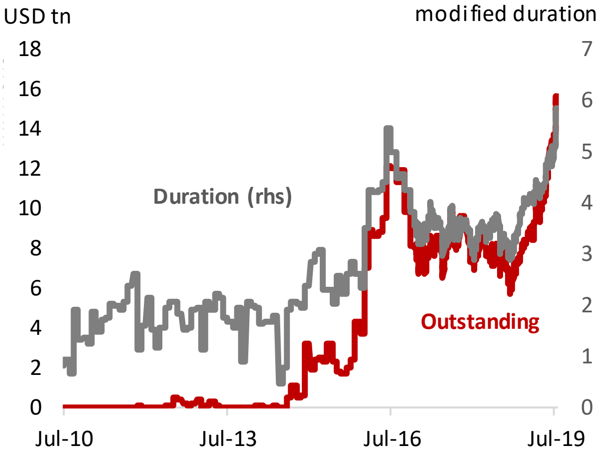
The ECB arguably faces greater urgency to ease policy. Aside from an extended period of weak data, inflation expectations (as measured by the EUR 5Y5Y inflation swap) also collapsed to an all-time low in June. Hints of upcoming asset purchases and rate cuts did not manage to lift this estimate much. **The downward distortion to EUR rates is acute amid a shortage of German papers and the prospect of the ECB looking to take even more supply off the table** supports the case for an extended period of depressed EUR interest rates. Fear of missing out at a time when the total amount of negative yielding debt exceeds USD 15tn is prompting a desperate search for yield in the developed market space. **USTs still offer very attractive relative and absolute yields despite the sizable rally over the past year.**

AAA-rated economies plus US	10Y Yields
Singapore	**1.65**
United States	1.52
Canada	1.09
Norway	1.02
Australia	0.86
Sweden	-0.41
Luxembourg	-0.45
Netherlands	-0.60
Denmark	-0.67
Germany	-0.71
Switzerland	-1.12

Source: Bloomberg, DBS

Competitive easing across the G10 space may be difficult to avoid. Looser monetary policy stances from the Fed and ECB have already dragged interest rates in the developed world lower. In any case, G10 interest rates tend to be highly correlated and we suspect that each central bank would face the risk that its currency would become inordinately strong if its interest rates become relatively high. Within the G10 space, "high" USD rates have supported the USD. **The Bank of Japan (BOJ) faces similar pressures** when the yen touched 106 (from 112 in April) versus USD even as 10Y JGB yields crashed below the bottom of the -0.2 to 0.2% policy range. Pressure to embark on deeper negative rates will mount. **This feedback loop of seemingly coordinated monetary policy across the G10 space may take some time to play out** and may well result in even lower yields from already depressed levels currently. **Lower for (even) longer is the theme.**

Negative yielding debt crosses USD 15tn



Source: Bloomberg, CEIC, DBS

It would probably take a spike in inflation expectations and / or fiscal stimulus from the large economies to arrest the fall in DM yields. The previous global adjustment took place in late-2016 when Trump won the presidential elections. With the market correctly anticipating that Trump's presidency will widen the US's fiscal deficit, yields adjusted higher. We think it may be more difficult for the US to repeat this feat. It would probably require the Europeans (especially the surplus economies) to embark on large scale fiscal spending to increase the supply of government papers sufficiently to nudge European government bond (EGB) yields higher. Otherwise, the default would be a grind lower in yields as ECB purchases dominate. Lastly, a cyclical rebound or a thaw in China-US trade tensions could result in a bounce in yields. However, better data appears to be elusive amid an escalation in the trade war.

Interest rate forecasts		end-2019	end-2020
US	3m Libor	2.10	2.10
	2Y	1.65	1.85
	10Y	1.75	2.20
	10Y-2Y	10	35
Eurozone	3m Euribor	-0.40	-0.40
	2Y	-0.80	-0.50
	10Y	-0.50	-0.20
	10Y-2Y	30	30
Japan	3m Tibor	0.05	0.05
	2Y	-0.20	-0.13
	10Y	-0.20	-0.10
	10Y-2Y	0	3
Singapore	3m Sibor	1.60	1.60
	2Y	1.65	1.65
	10Y	1.70	2.00
	10Y-2Y	5	35
Hong Kong	3m Hibor	1.80	1.80
	2Y	1.80	1.80
	10Y	1.55	2.00
	10Y-2Y	-25	20

Source: DBS

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).