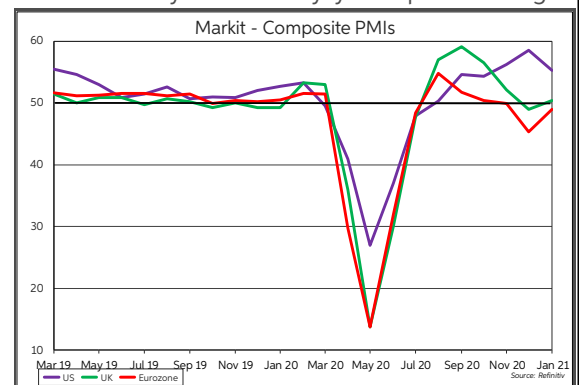


Bonds Back on the Future

- **It is usually the case that equities hog the limelight, while the obscure world of fixed income markets is largely ignored.** However, interest rate markets are a crucial asset class and can tell us a lot about what investors really think. Most attention year-to-date has yet again focused on the continuing rally in stock markets, which have enjoyed a good start to 2021. However, steepening yields curves and a firming of longer-dated interest rate futures contracts have gone largely unnoticed. Long-term interest rates, though, are very important, especially in many mainland European economies and the US, particularly in terms of their influence on mortgage rates and debt financing costs.
- **Short-term bond yields and interest rates remain very well anchored by central banks commitment to maintain very loose monetary conditions over the next couple of years, in particular current super-low interest rates.** The exception has been the UK, where the BoE has squashed expectations that it could move to negative interest rates in 2021-22. This is no longer being priced by markets so short-sterling contracts and two year UK swap rates have firmed by around 15bps in the past month. Elsewhere, though, there has been little movement in short-term yields or rates.
- **Further out the maturity curve, however, there have been significant moves in markets. Investors now think that there could be a steady rise in US rates from mid-2023 onwards.** Last autumn, the view in markets was that three month US rates would not rise to 1% until end 2026 from their current level of 0.2%. Now futures contracts are pricing in that rates will get to 1% by autumn 2024 and hit 1.75% by end 2026. Meanwhile, ten year Treasury yields have climbed to 1.2%, their highest level since the Covid-19 pandemic began, and well up on last summer's low of 0.5%. Meantime, 30-year Treasury yields are now touching 2%. In the UK, ten year gilt yields have risen by 30bps year-to-date, in line with a firming of longer dated interest rate futures contracts. The move higher has been less pronounced in the Eurozone at about 15-20bps for long term interest rate futures and ten year bund yields.
- **Expectations of stronger economic growth and risks of rising price pressures lie behind the increase in rates. There has been a better than expected performance by economies in recent months, despite a tightening of Covid-19 restrictions on activity, including new lockdowns, as coronavirus cases surged again.** The IMF suggests that economies are learning to adapt better to these restrictions on activity with the passage of time. Meantime, there are growing expectations of what the IMF has called "a vaccine-powered strengthening of activity" later in the year. While neither development points to an early tightening of monetary policy, markets now think that when rates do start to rise, the pace of tightening will be quicker than previously envisaged. The key in this regard is whether vaccines do indeed pave the way for a robust recovery in activity to take root as 2021 progresses, following the subdued start to the year. Price pressures could also rise where pent-up demand is released but supply is constrained. Bond yields could move even higher in these circumstances. If 10 year Treasury yields push through resistance at 1.2%, the next stop could be near the 1.5% level.
- **This week, we get a raft of US data, the highlight of which will be the Flash PMIs for February.** Both the manufacturing and services PMI printed strongly throughout the past 4 months, despite surging new Covid cases and tighter restrictions on activity. The forecast is for this trend to continue, with both indices forecast to edge only slightly lower, while remaining firmly in expansion mode in February. In terms of hard data, retail sales are expected to rise by 1.2% in January, having contracted in the two previous months, as household incomes were supported by increased government transfers. Industrial production is projected to expand for the fourth consecutive month in January, albeit at a slower pace of 0.4%. A raft of housing data are also due. On the monetary policy front, the minutes from the January FOMC meeting will be released.
- **Turning to the UK, the first reading of the February PMIs feature as well.** The manufacturing PMI is expected to remain well above 50, despite reports of some UK businesses struggling to come to terms with the new trading arrangement with the EU. The services PMI is forecast to edge slightly higher to 42 from 41.2 as the sector continues to be more adversely impacted by the recently extended national lockdown. Staying with survey data, GfK consumer confidence is forecast to remain at a subdued level in February. In terms of hard data, retail sales are projected to fall by 1% in January as the UK entered its third national lockdown. The January reading of CPI inflation is also due. The headline rate is forecast to remain subdued at 0.5%.
- **In the Eurozone, the flash PMIs are also due.** Similar to the UK, it is envisaged that the services PMI will remain below the key 50 threshold, while the manufacturing PMI is forecast to remain in positive territory. On a national level, the German ZEW is expected to fall to 60 from 61.8 in February. The minutes from the latest ECB policy meeting will be released also.



	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2021	2021	2021
Fed Funds	0.125	0.125	0.125	0.125
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.10	0.10	0.10	0.10
BoJ OCR	-0.10	-0.10	-0.10	-0.10
Current Rates Reuters, Forecasts AIB's ERU				

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q1	End Q2	End Q3
		2021	2021	2021
EUR/USD	1.2105	1.20	1.22	1.24
EUR/GBP	0.8747	0.87	0.88	0.89
EUR/JPY	127.08	126	127	128
GBP/USD	1.3838	1.38	1.39	1.39
USD/JPY	104.97	105	104	103
Current Rates Reuters, Forecasts AIB's ERU				

Date	UK & Irish Time (GMT+1)		Release	Previous	Forecast
This Week:	ECB Speakers:		de Guindos (Tue); Schnabel (Wed)		
	BoE Speakers:		Ramsden (Wed); Saunders (Thu)		
	Fed Speakers:		Bowman (Tue); Brainard (Thu)		
Mon 15th	EU-19:	10:00	Industrial Production (December)	+2.5% (-0.6%)	-0.6% (+0.1%)
Tue 16th	GER:	10:00	ZEW Economic Sentiment (February)	61.8	60
	EU-19:	10:00	Flash Employment (Q4)	+1.0% (-2.3%)	
	EU-19:	10:00	GDP (Q4: Second Reading)	-0.7% (-5.1%) (p)	-0.7% (-5.1%)
	US:	13:30	NY Fed/ Empire State Index (February)	3.5	5.5
	JPN:	23:50	Trade Balance (January) - Exports	¥751bn +2.0%	-¥600bn +6.6%
Wed 17th	UK:	09:30	CPI Inflation (January) - Core	+0.3% (+0.6%) +0.3% (+1.4%)	-0.4% (+0.5%) (+1.3%)
	UK:	09:30	PPI Output Prices (January) - Input Prices	+0.3% (-0.4%) +0.8% (+0.2%)	
	US:	13:30	Retail Sales (January) - Ex-Autos	-0.7% -1.4%	+1.2% +1.0%
			- Ex-Gas, Autos & Building Materials	-2.1%	+1.0%
	US:	14:15	Industrial production (January) - Capacity Utilisation	+1.6% 74.5%	+0.4% 74.8%
			- Manufacturing	+0.9%	+0.5%
	US:	15:00	NAHB Homebuilder Sentiment (February)	83	83
	US:	19:00	FOMC Meeting Minutes		
	EU-19:	10:00	Final HICP Inflation (January) - Ex- Food & Energy	+0.3% (+0.9%) +0.3% (+1.4%)	+0.3% (+0.9%) +0.3% (+1.4%)
	IRL:	11:00	CPI Inflation (January)	+0.3% (-1.0%)	-0.4% (-0.7%)
Thurs 18th	EU-19:	13:30	ECB Meeting Minutes		
	US:	13:30	Housing Starts (January) - Building Permits	+5.8% / 1.67m +4.2% / 1.70m	-1.0% / 1.65m -3.0% / +1.68m
	US:	13:30	Initial Jobless claims	+793,000	
	US:	13:30	Philly Fed Manufacturing Index (February)	26.5	20.0
	EU-19:	15:00	Flash Consumer Confidence (February)	-15.5	-14.7
	JPN:	23:30	CPI Inflation (January)	(-1.0%)	(-0.7%)
	UK:	00:01	Gfk Consumer Confidence (February)	-28	
	JPN:	00:30	Flash Jibun Manufacturing PMI (February)	49.8	
Fri 19th	GER:	07:00	Producer Prices (January)	+0.8% (+0.2%)	+0.7% (+0.2%)
	UK:	07:00	Retail Sales (January) - Ex-Fuel	+0.3% (+2.9%) +0.4% (+6.4%)	-1.0% -0.5%
	FRA:	07:45	Final HICP Inflation (January)	+0.3% (+0.8%)	+0.3% (+0.8%)
	FRA:	08:15	Flash Markit Composite PMI (February)	47.7	47.5
	GER:	08:15	Flash Markit Composite PMI (February)	50.6	51
	EU-19:	09:00	Flash Markit Composite PMI (February) - Manufacturing / Services	47.8 54.8 / 45.8	48.1 54.5 / 45.9
	UK:	09:00	Flash Markit Composite PMI (February) - Manufacturing / Services	41.2 54.1 / 39.5	42.0 54.0 / 40.5
	UK:	11:00	CBI Trend Orders (February)	-38	
	US:	09:00	Flash Markit Composite PMI (February) - Manufacturing / Services	58.7 59.2 / 58.3	58.0 58.5 / 57.5

♦ Month-on-month changes (year-on-year shown in brackets)
All forecasts AIB ERU, historical data in the Economic Diary derived from publicly available sources

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