New ECB and DN forecasts

Interest rates have risen by up to 30bp in Europe since our November forecast, driven primarily by the hawkish ECB policy meeting in December. We have again raised our forecasts for the ECB and Danmarks Nationalbank (DN), the Danish central bank. However, these and our Fed forecast remain more dovish than what markets are pricing for, so our market rates forecast is lower than the general market pricing across all maturities.

Risk category			X
Complex		X	
Non-complex			

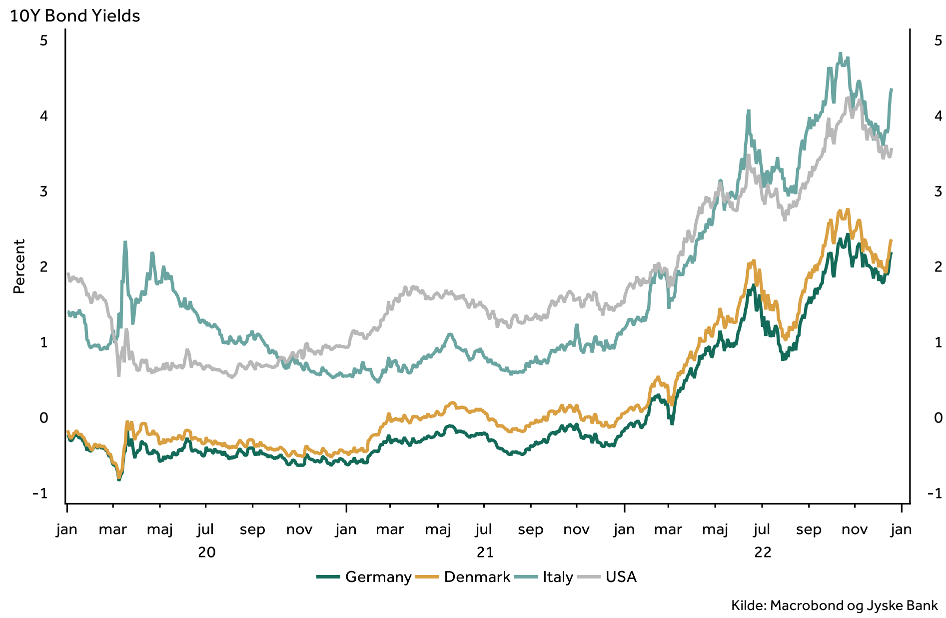
Please see the last pages for explanation.

- Interest rates moving higher in Europe and lower in the US
- Markets in doubt about hawkish Fed signals
- ECB and DN forecasts raised
- Higher yields on Danish mortgage bonds in December

Interest rates moving higher in Europe and lower in the US

Danish and German government bond yields have moved some 30bp higher since our rates forecasts from the end of November, the largest increases materialising in the wake of the hawkish ECB policy meeting last week and also due to the Bank of Japan's surprise move last night to widen the target range for the 10Y Japanese government bond yield. DKK and EUR swap rates have not risen by as much as government bond yields, causing swap spreads to contract to the lowest level since H1. We still see a potential for lower swap spreads, which are also affected by factors such as massive sovereign issues in the eurozone, particularly in January and February, which all else being equal tends to push government bond yields a good deal higher. This may also cause yield spreads within the eurozone to widen further – not least when the ECB starts to reduce its bond portfolio in March.

Figure 1:
Rising rates in Europe and widening spreads



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Important Investor Information:
See end of document.

We have again upgraded our forecasts for the ECB and DN (by 25bp). The ECB is expected to hike rates by 50bp in February and by 25bp in March and May, while

DN is expected to widen the policy rate spread by 10bp, presumably in February. To read more on these issues, click here and here. Still, our forecasts remain slightly less aggressive for DKK and EUR than what the market is pricing for. We thus still forecast a further increase in short-term DKK and EUR money market rates in the near term, but not by as much as what markets are pricing for. On the other hand, DKK and EUR government bond yields and swap rates are expected to drop more sharply in 2023 when it becomes more evident that the ECB and DN need to cut rates towards the end of 2023.

USD rates have climbed higher this week but have fallen by 10-20bp on aggregate since the end of November. The FOMC meeting was kept in a somewhat hawkish tone, but the markets interpreted his stance as slightly more dovish as Fed chair Powell was more open to the size of the upcoming rate hikes. As the Fed remains data-dependent, we would expect extensive market volatility in connection with upcoming key indicators as well – even the not so important ones. Our Fed forecast is unchanged: Rate hikes of 25bp in February and March, while rates will be cut by 25bp at each FOMC meeting from September (for a total of 200bp). Hence, we still expect USD rates to fall by more than what the markets are pricing for.

Markets in doubt about hawkish Fed signals

USD rates have climbed higher this week but have fallen by 10-20bp in aggregate since the end of November. Rates moved lower in part because US inflation fell by more than was expected in November and because markets are in doubt about the hawkish Fed signals from the December FOMC meeting.

As expected, the Fed hiked rates by 50bp to 4.25–4.50% in December, signalling further rate hikes in 2023 and a possibility of "higher for longer". This is reflected in the Fed's new dot plot, which was raised for 2023-2025.

- 2023: Additional rate hikes of 75bp (+50bp relative to September) and with 17 out of 19 Fed members expecting the Fed funds rate to top 5%.
- 2024 and 2025: Rates 100bp lower in both years, although this is still higher than the September forecast.

The dot plots are substantially higher than what markets are pricing for, especially 2023 and 2024, while markets are pricing for a 36bp hike at the next FOMC policy meeting on 1 February and hikes totalling a little over 50bp by March.

The Fed's inflation forecast was raised for 2023 and 2024 and is slightly above the Fed's 2% target. During the press conference, Powell attempted to strike a more hawkish tone in light of the higher-than-expected inflation, that the Fed is focused on pushing inflation lower and that there is an upside risk to inflation because the labour market remains very strong. The markets, however, focused extensively on the lowering of the GDP estimate to 0.5% in 2023 (from 1.2% in September), which in practice reflects expectations of a mild recession in the US. Powell was more open about the size of the next rate hikes because the Fed will still be data-dependent, and markets interpreted his stance as slightly more dovish. Therefore, we would expect extensive market volatility including in connection with upcoming key indicators – even the not so important ones.

Our Fed forecast is unchanged: Rate hikes of 25bp in February and March, while rates will be cut by 25bp at each FOMC meeting from September (for a total of 200bp). Hence, we still expect USD rates to fall by more than what the markets are pricing for.

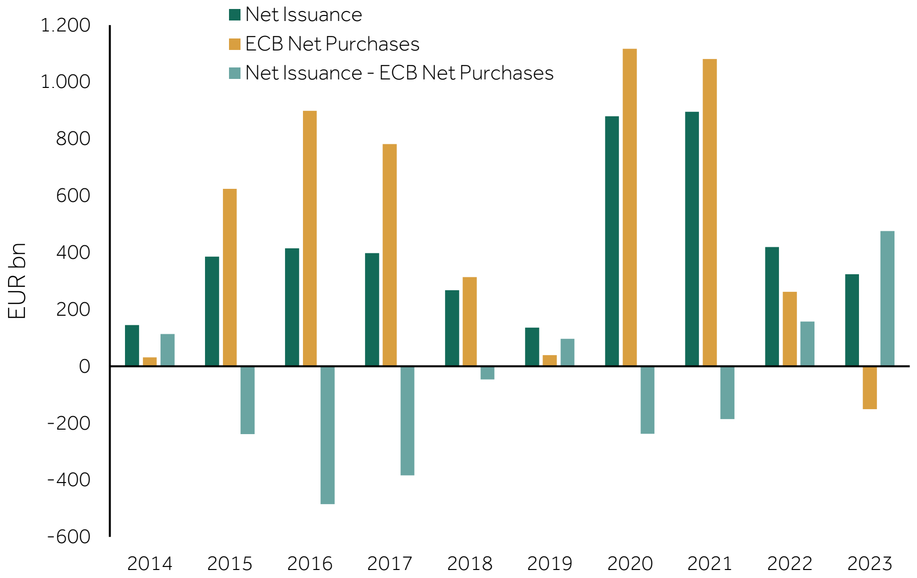
Figure 2:
10Y US Treasury yield expected to drop sharply in 2023

Source: Bloomberg & Jyske Bank

ECB and DN forecasts raised

Danish and German government bond yields have moved some 30bp higher since our rates forecasts from the end of November, the largest increases materialising in the wake of the hawkish ECB policy meeting last week and also due to the Bank of Japan's surprise move last night to widen the target range for the 10Y Japanese government bond yield. DKK and EUR swap rates have not risen by as much as government bond yields, causing swap spreads to contract to the lowest level since H1. We still see a potential for lower swap spreads, which are also affected by factors such as massive sovereign issues in the eurozone, particularly in January and February, which all else being equal tends to push government bond yields a good deal higher. This may also cause yield spreads within the eurozone to widen further – not least when the ECB starts to reduce its bond portfolio in March.

Figure 3:
Massive EUR-denominated sovereign issues in 2023 while the ECB reduces the bond portfolio



Source: ECB, Macrobond, Investeringsbanker & Jyske Bank

The background for the hawkish ECB policy meeting in December was a combination of the following:

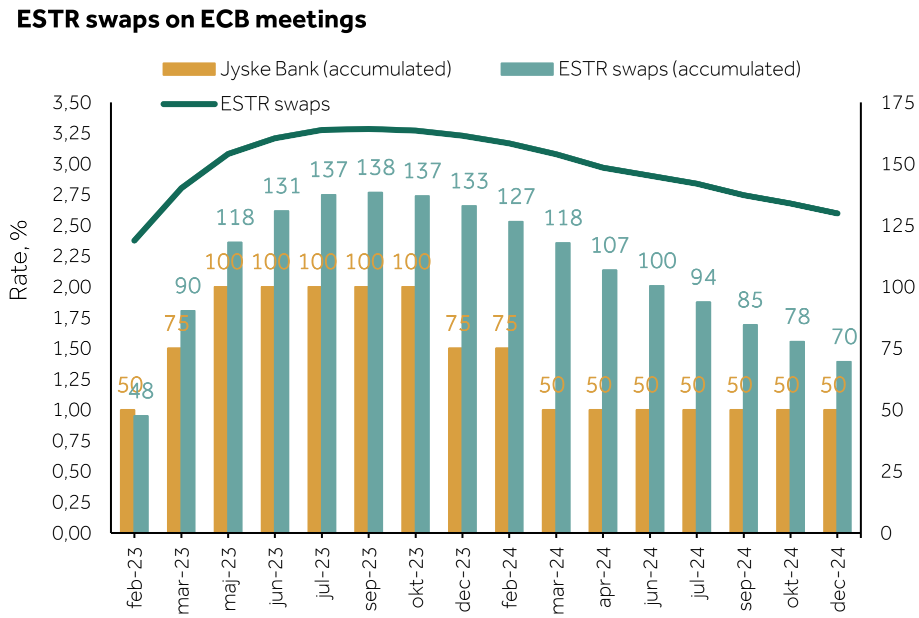
1. The expected 50bp rate hike and ECB comments about a steady flow of significant additional rate hikes.
2. Reduction of the APP holdings (QT) set to begin in March at an average of EUR 15 bn per month until June, at which time the pace will be redetermined.
3. Upward revision of the 2022-2024 inflation forecast for headline and core inflation and for inflation in 2025 of over 2% (2.3%).
4. Hawkish comments by ECB President Lagarde, including that the ECB monetary policy has not become less aggressive ("ANYONE THINKING THE ECB IS PIVOTING IS WRONG"), which only sent market rates even higher.

After the meeting, unnamed sources were quoted as saying that more than one third of ECB members had supported a 75bp rate hike. In other words, the hawks and the doves likely reached a compromise of "only" a 50bp rate hike in December in return for a sooner-than-expected start to QT and hawkish rhetoric. Villeroy, the French central bank governor, later said that market rates have dropped too low, which underlines the determination of the ECB to hike rates a good deal more.

Re. QT: According to the ECB, bonds worth EUR 357 bn will be maturing over the next 13 months, equal to an average of EUR 27.5 bn per month. The lowest monthly amount during the period is EUR 15.6 bn. In practice, this means the ECB will be reducing its balance sheet by EUR 15 billion per month through QT. Add to that the repayment of TLTROs, the outstanding amount being more than EUR 1,800 bn (of which more than EUR 1,100 bn will mature by the end of June. This will help to widen FRA/OIS, although it is currently priced to widen too much.

We have again upgraded our forecasts for the ECB and DN (by 25bp): The ECB is expected to hike rates by 50bp in February and by 25bp in March and May, while DN is expected to widen the policy rate spread by 10bp, presumably in February. To read more on these issues, click here and here.

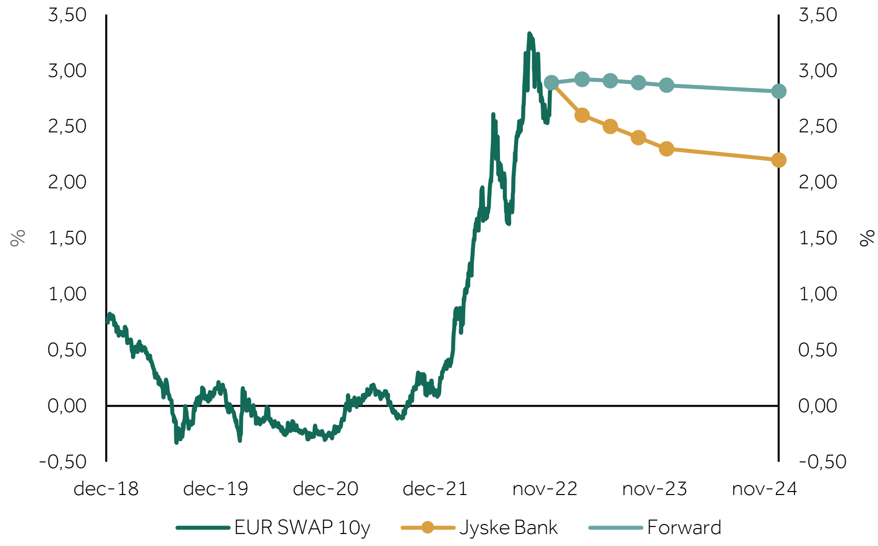
Figure 4:
ECB forecast more dovish than what the markets are pricing for



The forecasts remain slightly less aggressive than what the market is pricing for. We thus still forecast a further increase in short-term DKK and EUR money market rates in the near term, but not by as much as what markets are pricing for. On the other hand, government bond yields and swap rates are expected to drop more sharply in 2023 when it becomes more evident that the ECB and DN need to cut rates towards the end of 2023.

Near term, we see an upside risk for rates, because the ECB may be hiking more aggressively, rate forecast upgrades and speculation about higher rates, including at the long end due to the massive sovereign issues expected in especially in January and February as well as QT by the ECB in the following period. Adjustments by the BoJ may also impact rates in other currencies. Expect widening spreads in the eurozone in step with rising rates

Figure 5:
10Y EUR swap rate expected to fall more sharply in 2023

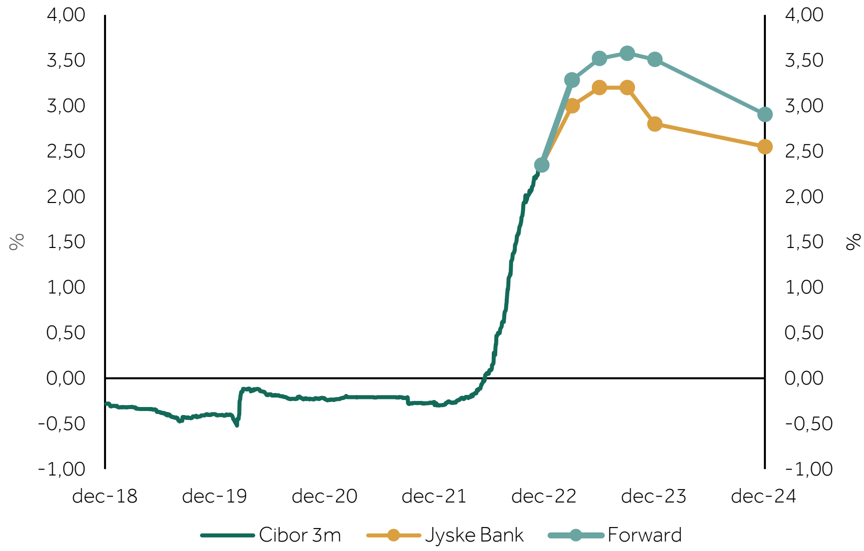


Source: Bloomberg & Jyske Bank

Short-term Danish money-market rates are expected to rise in the near term in tandem with EUR rates and in step with DN rate hikes, and to fall later in 2023 and in 2024 when we expect DN to cut rates.

Swap rates and government bond yields are set for a relatively sharper drop in 2023, when yield curves are expected to steepen once the markets start to price for DN rate cuts.

Figure 6:
3M Cibor expected to move higher short term and to drop later in 2023 and in 2024



Source: Bloomberg & Jyske Bank

Figure 7:
10Y DKK swap rate expected to fall more sharply in 2023

Source: Bloomberg & Jyske Bank

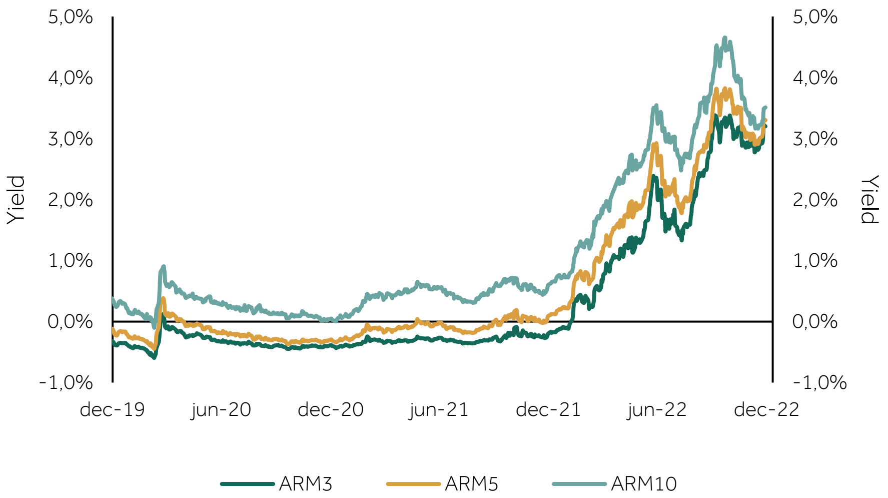
Higher yields on Danish mortgage bonds in December

Yields on Danish mortgage bonds have increased by more than 30bp since our November rates forecast, in step with rising global yields and widened credit spreads. The 5%'56 papers are still the series open for issuance in the 30Y callables segment.

Our forecast calls for Danish mortgage bond yields to decline in 2023, because we expect DN to be more dovish than the markets are pricing for. However, uncertainty is running high, partly for the following reasons:

1. The large sovereign issues in the eurozone may push yields well higher.
2. The Bank of Japan (BoJ) is in the process of gradually adjusting its monetary policy and last night surprised the market by expanding the target range for 10Y JGB yields to +/-0.5% from +/-0.25%. The change came after the Japanese government softened its 2% inflation target, allowing BoJ to start easing the extremely tough yield curve controls, which have applied control bands for various maturities since 2016. As Japanese investors react to the change, this may have spill-over effects in other currencies and could reduce investor interest from the world's largest creditor (Japan).

Figure 8:
Yields on Danish non-callable bullets rose in December



Source: Jyske Bank

Table 1: Jyske Bank Mortgage Rates Forecasts

Interest rate, %	Today	Per 1 Apr
ARM3	3,26	3,00
ARM5	3,34	3,10
ARM10	3,52	3,25
Price on 30-year fixed rate (5% 2056) with repayments	98,63	99,8

See current bond yelds here: www.jyskebank.dk/erhverv/ejendomsfinansiering/kurser

Source: Jyske Bank

Table 2: Jyske Bank Rates Forecasts

GOVERNMENT YIELDS

Denmark	Spot	Q1-23	Q2-23	Q3-23	Q4-23	Q4-24
Leading	1,75	2,40	2,65	2,65	2,40	2,15
Cibor 3m	2,35	3,00	3,20	3,20	2,80	2,55
Cibor 6m	2,79	3,15	3,25	3,20	2,80	2,70
GOVT 2y	2,65	2,35	2,20	1,90	1,80	1,90
GOVT 5y	2,51	2,25	2,00	1,85	1,85	2,05
GOVT 10y	2,52	2,20	2,10	2,00	1,90	1,85
GOVT 30y	2,13	1,75	1,65	1,55	1,45	1,55
GOVT 5y - 2y	-0,15	-0,10	-0,20	-0,05	0,05	0,15
GOVT 10y - 5y	0,02	-0,05	0,10	0,15	0,05	-0,20
GOVT 30y - 10y	-0,39	-0,45	-0,45	-0,45	-0,45	-0,30

SWAP RATES

Denmark	Spot	Q1-23	Q2-23	Q3-23	Q4-23	Q4-24
Cibor 3m	2,35	3,00	3,20	3,20	2,80	2,55
Cibor 6m	2,79	3,15	3,25	3,20	2,80	2,70
SWAP 2y	3,34	3,10	2,95	2,60	2,45	2,35
SWAP 5y	3,09	2,85	2,60	2,40	2,40	2,55
SWAP 10y	3,03	2,75	2,65	2,55	2,45	2,35
SWAP 30y	2,35	2,00	1,90	1,80	1,70	1,75
SWAP 5y - 2y	-0,25	-0,25	-0,35	-0,20	-0,05	0,20
SWAP 10y - 5y	-0,06	-0,10	0,05	0,15	0,05	-0,20
SWAP 30y - 10y	-0,69	-0,75	-0,75	-0,75	-0,75	-0,60

GOVERNMENT YIELDS

EUROZONE	Spot	Q1-23	Q2-23	Q3-23	Q4-23	Q4-24
Leading	2,00	2,75	3,00	3,00	2,75	2,50
Euribor 3m	2,06	2,80	3,05	3,05	2,65	2,40
Euribor 6m	2,59	3,00	3,10	3,05	2,65	2,55
GOVT 2y	2,49	2,20	2,00	1,65	1,50	1,60
GOVT 5y	2,30	2,05	1,80	1,60	1,60	1,80
GOVT 10y	2,27	2,00	1,90	1,80	1,70	1,65
GOVT 30y	2,14	1,85	1,75	1,65	1,55	1,65
GOVT 5y - 2y	-0,20	-0,15	-0,20	-0,05	0,10	0,20
GOVT 10y - 5y	-0,03	-0,05	0,10	0,20	0,10	-0,15
GOVT 30y - 10y	-0,14	-0,15	-0,15	-0,15	-0,15	0,00

SWAP RATES

EUROZONE	Spot	Q1-23	Q2-23	Q3-23	Q4-23	Q4-24
Euribor 3m	2,06	2,80	3,05	3,05	2,65	2,40
Euribor 6m	2,59	3,00	3,10	3,05	2,65	2,55
SWAP 2y	3,19	2,95	2,80	2,45	2,30	2,20
SWAP 5y	2,95	2,70	2,45	2,25	2,25	2,40
SWAP 10y	2,90	2,60	2,50	2,40	2,30	2,20
SWAP 30y	2,21	1,90	1,80	1,70	1,60	1,65
SWAP 5y - 2y	-0,24	-0,25	-0,35	-0,20	-0,05	0,20
SWAP 10y - 5y	-0,06	-0,10	0,05	0,15	0,05	-0,20
SWAP 30y - 10y	-0,69	-0,70	-0,70	-0,70	-0,70	-0,55

GOVERNMENT YIELDS

USA	Spot	Q1-23	Q2-23	Q3-23	Q4-23	Q4-24
Leading	4,50	5,00	5,00	4,75	4,25	3,00
Libor 3m	4,75	5,00	5,00	4,70	4,20	3,20
GOVT 2y	4,27	3,90	3,50	2,95	2,80	2,90
GOVT 5y	3,76	3,45	3,10	2,90	2,90	3,10
GOVT 10y	3,66	3,30	3,00	2,90	2,90	3,25
GOVT 30y	3,72	3,40	3,10	3,00	3,00	3,45
GOVT 5y - 2y	-0,51	-0,45	-0,40	-0,05	0,10	0,20
GOVT 10y - 5y	-0,10	-0,15	-0,10	0,00	0,00	0,15
GOVT 30y - 10y	0,06	0,10	0,10	0,10	0,10	0,20

Source: Bloomberg &Jyske Bank

Important Investor Information

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This report is an investment research report.

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Models

Jyske Bank employs one or more of the following models:

Rate

- Regression models with input from economic and financial data, including Jyske Bank's outlook on these (e.g. outlook on economic growth, inflation and monetary policy).
- Rate curve analysis, including slope of rate curve and curvature.
- Positioning, market psychological assessments, game theoretical scenario analysis and pattern recognition techniques are included in the assessment material.
- Danish mortgage bonds are modelled on the basis of an own-developed model based on RIO (mortgage model developed by ScanRate) consisting of a stochastic rate curve model to estimate future rate development and a statistic remortgaging model calibrated to borrowers' historical remortgaging behaviour. In the preparation of research reports, the relative valuation, supply/demand, debtor structure and parameters from Jyske Bank's mortgage model, for instance, are given weight.

FX

- Simple regression model where the value of the currency pair is determined via variables such as spreads between real rates, slope of rate curve, curvature, commodity prices and volatilities.
- Principal component analysis model where the value of the currency pair is determined via variables such as spreads between real and nominal swap rates, slope of rate curve and curvature.
- Jyske Markets' economic outlook on growth, inflation and monetary policy is included in the model variables.
- Positioning, market psychological assessments, game theoretical scenario analysis and pattern recognition techniques are included in the assessment material.

Recommendation concepts

Targets

Targets reflect the direction in which the exchange rate is expected to move over a given horizon (direction and strength). The target is an estimate of how in all probability we expect to see the exchange rate at the horizon stated. The target should therefore not be considered a precise minimum or maximum for the exchange rate in the period given.

Rates forecast

The Rates forecast reflects the expected direction of rates over a given horizon. The Rates forecast is an estimate of how in all probability we expect to see the rate at the horizon stated. The Rates forecast should therefore not be considered a precise minimum or maximum for the rate in the period given.

Recommendation

The individual client should together with the adviser always consider the recommendation and strategy selected relative to the client's risk profile and purpose.

Update of research report

Rate

The Rates forecast is prepared monthly with different horizons up to 24 months.

Recommendations and strategies are published and updated on ad-hoc basis.

FX

Targets with different horizons up to twelve months are set once a month.

Recommendations and strategies are published and updated on ad-hoc basis.

Risk

Investment as well as trading currencies and rates are associated with risk, so assessments and recommendations, if any, in this research report may be associated with risk. See the research report for an assessment of risk, if any. The risk factors and/or sensitivity analyses stated in the research report are not to be considered all-encompassing.

Return and price development

The future and historical returns estimated in the research report are stated as returns before costs and tax-related circumstances since returns after costs and tax-related circumstances depend on a number of factors relating to individual client relations, custodian charges, volume of trade as well as market-, currency- and product-specific factors. It is not certain that an expected future return stated will accord with the actual development. The stated expected future returns exclusively express our best assessment.
Past performance and price development are not reliable indicators of future performance and price development. Returns and/or price development may be negative. Forecasts included in the research report are not secure indicators of future performance.

The rates and prices stated in the material are the latest observed in the market, cf. the time stamp. For information on mortgage bonds please see Jyske Realkredit's website www.jyskerealkredit.dk/erhverv/kurser (in Danish only). The prices stated are therefore not the actual tradeable prices for the client.

Risk category

Green: An investment product type is in green category if the risk of losing all the invested amount is regarded as insignificant, and if the product type is simple to grasp.
Amber: An investment product type is in amber category if there is a risk of losing the invested amount partially or fully, and if the product type is simple to grasp.
Red: An investment product type is in red category if there is a risk of losing more than the invested amount, or if the product type is difficult to grasp.

Complexity

For a product to be characterised as "non-complex":

- It must be possible to sell, redeem or in any other way realise the product at a publicly accessible price.
- It must not involve actual or potential obligations for the client exceeding the expenses of acquisition.
- Pricing must be determined without reference to the prices of other securities as well as other indices and targets.
- Easily comprehensible, publicly accessible information about the characteristics of the product must be available.
- The product must not be a derivative instrument.