

# Markets Directorate Interest Rate Flash

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## Falling yields at the end of the year!

Source: Bloomberg				Source: Bloomberg				Source: Bloomberg			
Short term interest rates EUR (%)	19.12.23	19.10.23	difference	IRS euro Forward start (%)	19.12.23	19.10.23	difference	Base rate (%)	19.12.23		
Estr	3.9010	3.905	0.00	1Y Forward	IRS 2Y	2.25	3.42	-1.17	Eurozone	4.50	
EURIBOR1m	3.8530	3.855	0.00		IRS 4Y	2.26	3.34	-1.07	US	5.50	
EURIBOR3m	3.9230	4.002	-0.08	2Y Forward	IRS 3Y	2.24	3.26	-1.02	Great-Britain	5.25	
EURIBOR6m	3.9220	4.126	-0.20		IRS 7Y	2.39	3.39	-1.00	Canada	5.00	
IRS EUR (%), source: Bloomberg				CAP on 3month EURIBOR (%), source: Bloomberg				19.12.23		New-Zealand	5.50
IRS 2Y	2.98	3.87	- 0.89	3Y 3.00% strike	Premium (%)			1.04	Japan	0.10	
IRS 3Y	2.71	3.68	- 0.96	3Y 4.00% strike				0.30			
IRS 5Y	2.54	3.52	- 0.98	5Y 3.00% strike				1.86			
IRS 10Y	2.54	3.53	- 0.99	5Y 4.00% strike				0.75			
Zero cost (ZC) collar 3 month EURIBOR (%), calculation by K&H based on Bloomberg data				Running premium paid quarterly on 0% strike floor purchase on 3 month EURIBOR (%) calculation by K&H based on Bloomberg data				19.12.23		Hungary	11.50
19.12.23		19.12.23		19.12.23		19.12.23		Turkey	40.00		
collar 3Y	2.05-3.00	IRS+floor 3Y	3.08	floor 3Y	0.1			Romania	7.00		
collar 5Y	1.80-2.90	IRS+floor 5Y	2.85	floor 5Y	0.14						
collar 7Y	1.75-2.88	IRS+floor 7Y	2.71	floor 7Y	0.17						
collar 10Y	1.80-2.90	IRS+floor 10Y	2.73	floor 10Y	0.19						

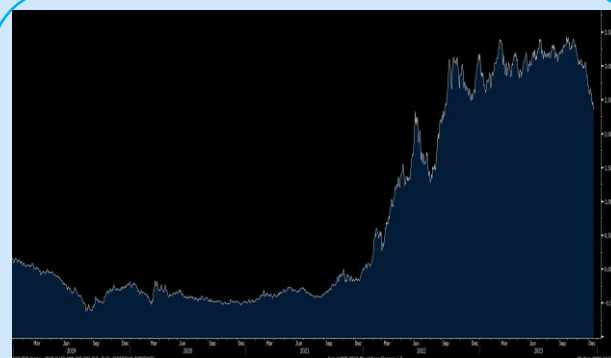
## Market commentary and significant price evolutions

The latest macroeconomic data for the Eurozone and the US point to a more favourable inflation trajectory in an environment of weakening economic growth in the near term. Therefore, we expect both the Fed and the ECB to start their rate cut cycle in the second quarter of 2024. For the ECB, this is slightly earlier than what we had anticipated so far. That means there will be one additional rate cut for the ECB in 2024. After all, after its policy meeting of 15 December, the ECB indicated that the dampening effect on inflation of the monetary tightening that has been implemented is becoming more and more visible and that inflation in 2025 will fall towards the inflation target of 2% in 2025. Specifically, we now take into account a first rate cut by the ECB in June 2024, followed by an easing cycle in steps of 25 basis points. This brings the ECB's deposit rate from the current 4% to 2.75% by the end of 2024.

In light of the weakening growth dynamics in the U.S. in the fourth quarter of 2023 and probably also in the first quarter of 2024, we also expect the Fed to start its easing cycle in the second quarter. This expectation is reinforced by the Fed's policy meeting of 13 December. Our expectation is between the market expectation (six expected rate cuts in 2024), and the Fed's own guidance (three).

US and German 10-year bond yields have fallen sharply over the past month to around 3.9% and 2%, respectively. We consider that in part a temporary market exaggeration. Since we assume that market expectations are getting a bit ahead of themselves, we expect in response a moderate upward correction in 10-year bond yields (both US and German) by the end of the first quarter of 2024. After that correction, the downward trend in bond yields will resume.

As a result, the slope of the US yield curve (10-year bond yields relative to policy rates) is expected to shift from the current inverse curve to a more or less flat curve by the end of 2024. Given the stronger initial inversion, however, the German yield curve will still be inverse at the end of 2024 and may only flatten thereafter.



The historical evolution of the 5-year EUR IRS (white).



EU YOY GDP at 0.00% (yellow), inflation at 4.93% (orange)

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