

Decades not years

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Fixed Income
Rates

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Publications used in this presentation

US yields & leverage

How more debt and slow growth reduce rates



15 Jul 18

Bonds in 2025

Lessons from Japan



06 Aug 19

Decade of denial

Fixed Income Asset Allocation



09 Jan 20

Fiscal fallacies

Bonds are not potatoes



20 Jan 20

Captain America

Yield curve control next



20 Mar 20

Prisoner's Dilemma

Debt mutualisation is happening anyway



31 Mar 20

The last straw

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06 Apr 20

Revisiting Bonds in 2025

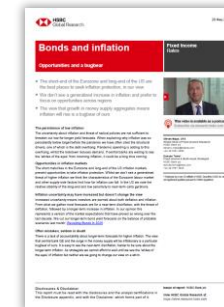
Cutting our US bond yield forecasts



29 Apr 20

Bonds and inflation

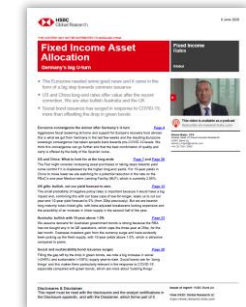
Opportunities and a bugbear



20 May 20

Germany's big U-turn

Fixed Income Asset Allocation



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Down, down, deeper and down

US rates – an alternative scenario



04 Jun 20

US bonds – the QE quandary

Three common misconceptions



29 Jun 20

Commitment device

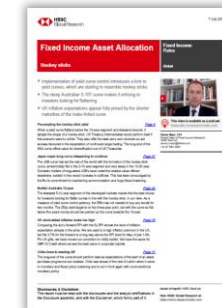
Yield curve control update



06 Jul 20

Hockey sticks

Fixed Income Asset Allocation



07 Jul 20

(continued) Publications used in this presentation

Q&A on QE Quandary

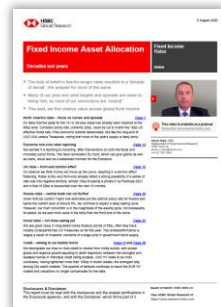
Answers to client questions on the constraints of QE



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Decades not years

Fixed Income Asset Allocation



05 Aug 20

Real yields are a residual

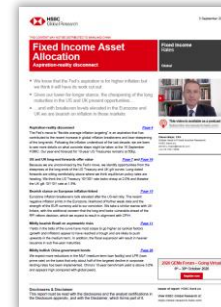
Let go of the traditional meaning



26 Aug 20

Aspiration-reality disconnect

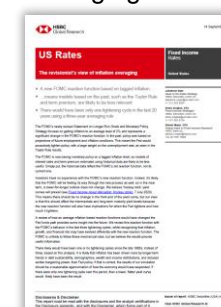
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03 Sep 20

US Rates

The revisionist's view of inflation averaging



14 Sep 20

QE in the Eurozone

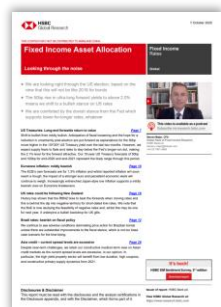
Five more years



05 Oct 20

Looking through the noise

Fixed Income Asset Allocation



07 Oct 20

Eurozone zombie paradox

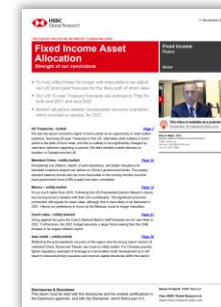
Japanification is supportive for high yield credit



20 Oct 20

Strength of our convictions

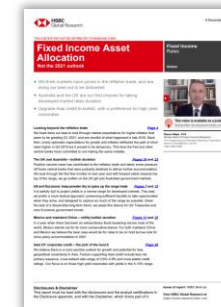
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Not the 2021 outlook

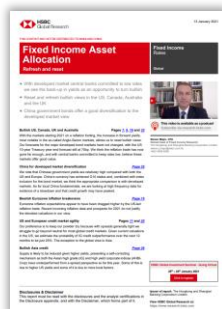
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09 Dec 20

Refresh and reset

Fixed Income Asset Allocation



13 Jan 21

Forecasting myths 2.0

US bond yields – another look at misconceptions



29 Jan 21

Decades not years

- Negative real yields are an outcome
- Global indebted economy: more debt associated with lower yields
- Aspiration of higher inflation and 'quick fixes'...
- ... has to be weighed against the need to contain nominal yields
- Post-pandemic 'scarring' more significant than near-term recovery

Decades not years Fixed Income Asset Allocation



05 Aug 20

Real yields are a residual Let go of the traditional meaning



26 Aug 20

“

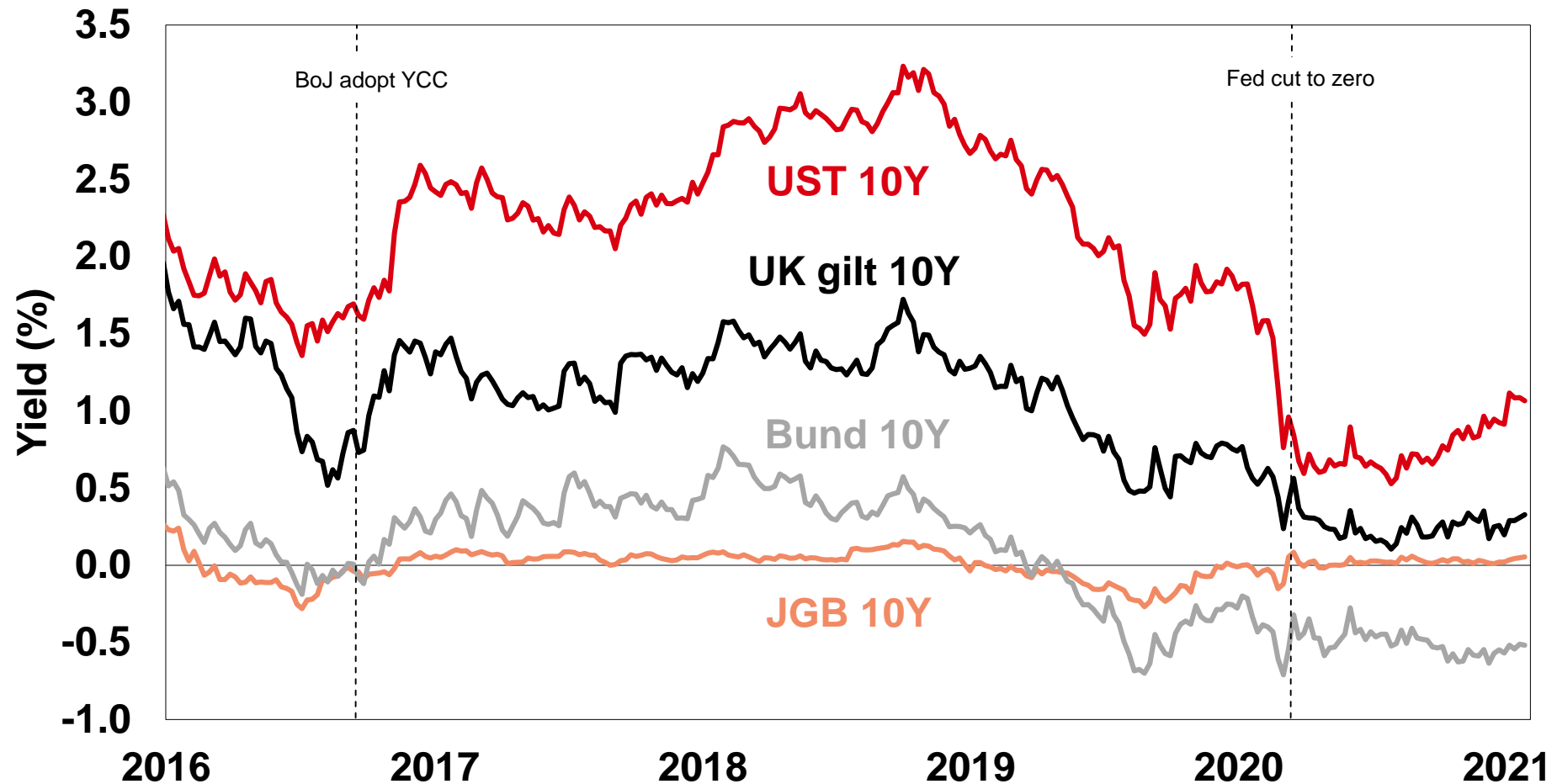
... whatever you think will happen over the next year, the ultimate costs of this pandemic are much larger than your short-run calculations suggest

”

**Scarring Body and Mind: The Long-Term Belief-Scarring Effects of COVID-19:
Kozlowski, J., Veldkamp, L. and Venkateswara, V. (August 2020)**

see Fixed Income Asset Allocation: Looking through the noise, 7 October 2020

G4 10Y yields have converged on the Japanification scenario



Source: HSBC, Bloomberg

see *Fixed Income Asset Allocation: Hockey sticks*, 7 July 2020

Japanification checklist

- Debt overhang
- Demographic challenges
- Persistently low inflation
- Zero interest rates for decades
- Outsized central bank balance sheet
- Hockey stick yield curves
- Poor productivity
- Zombification in the private sector

Eurozone zombie paradox

Japanification is supportive for high yield credit



20 Oct 20

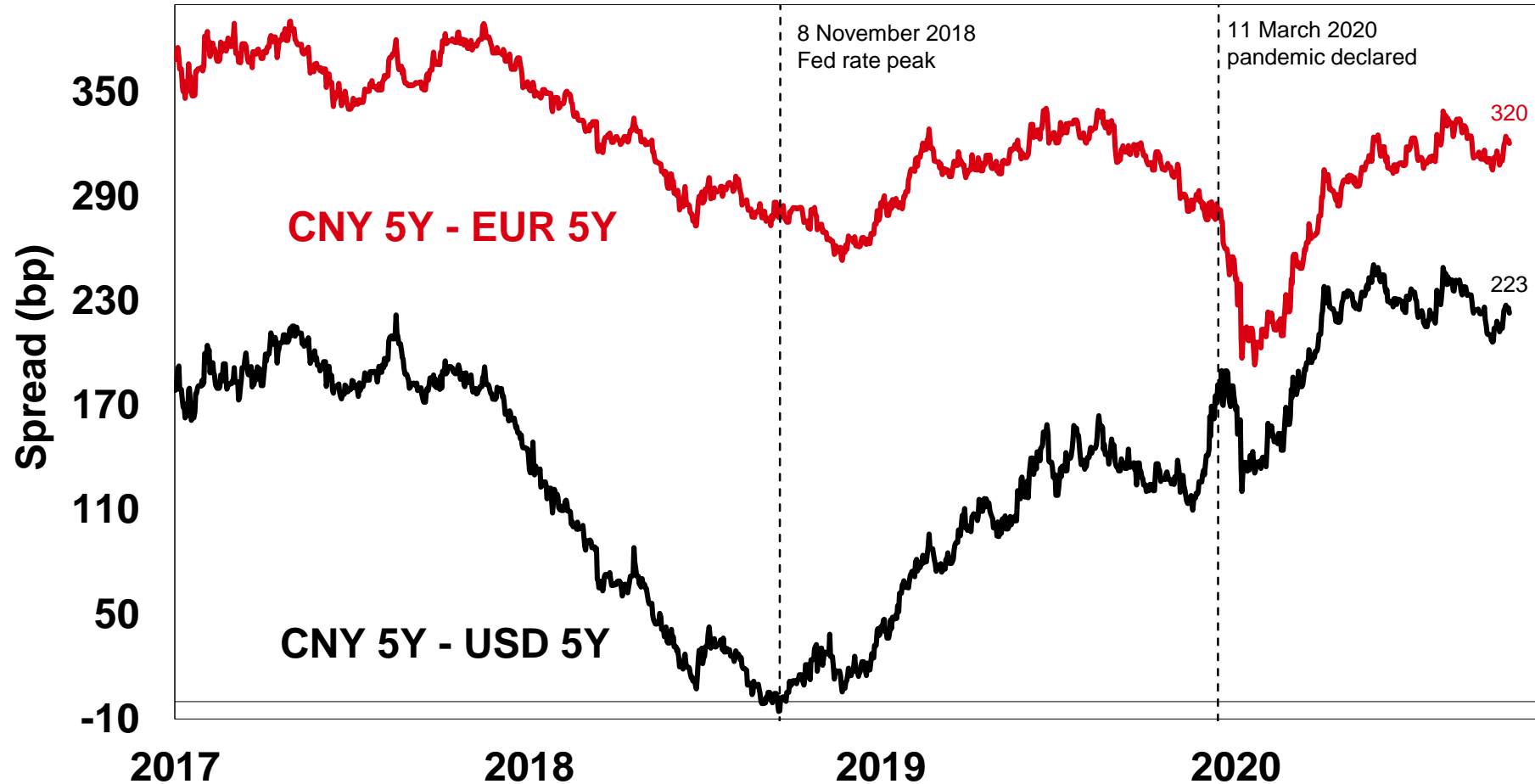
Bonds in 2025

Lessons from Japan



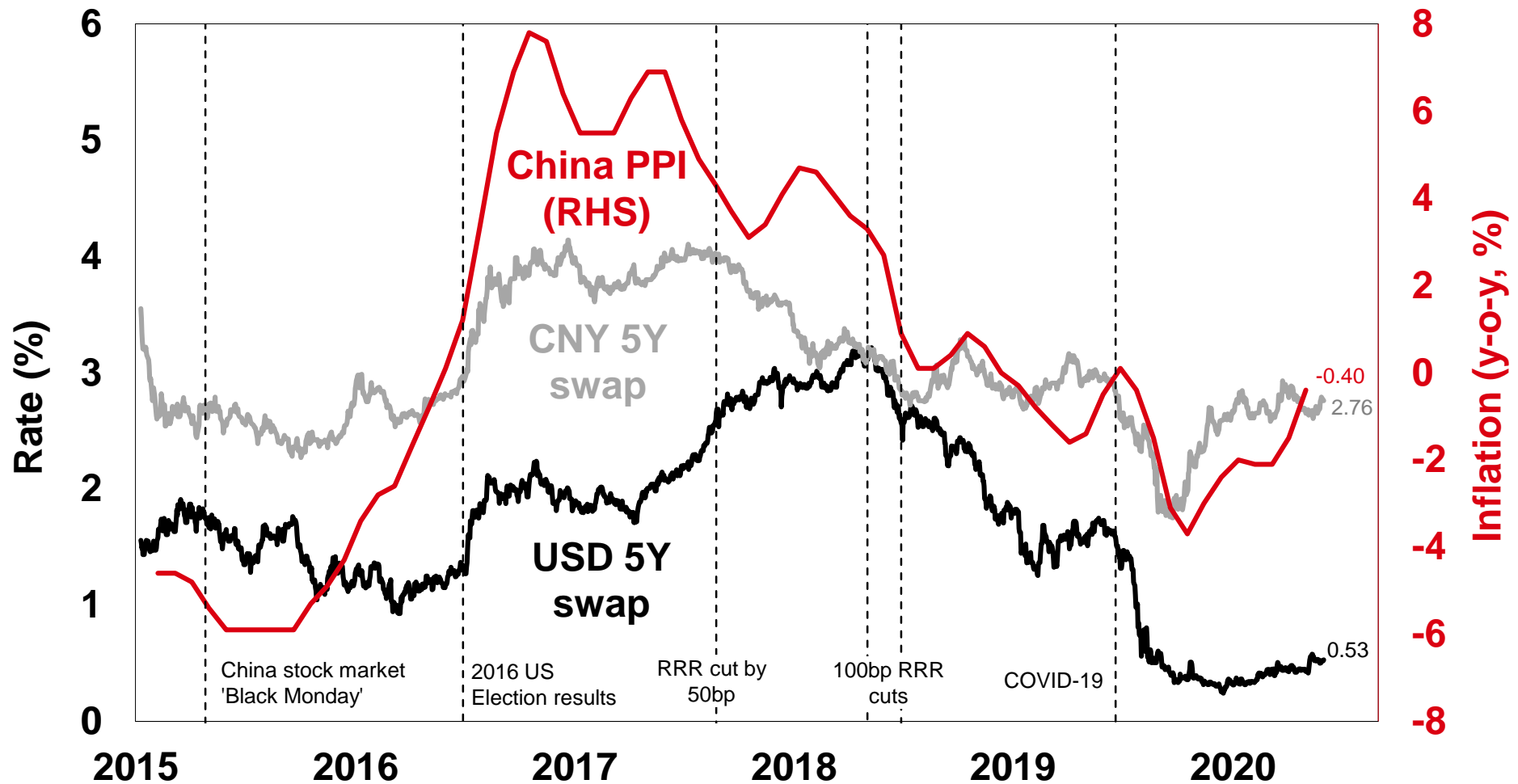
06 Aug 19

But China has diverged



Source: HSBC, Bloomberg. Note: CNY non-deliverable IRS used.

Causality has run from China in the past



Source: HSBC, Bloomberg

Considerations for 10-yr US Treasury forecast

- Forward guidance and potential 'caps' for yields
- Long-dated forwards versus equilibrium policy rate
- Possibility of negative rates in the next few years
- Average Inflation Targeting (AIT): aspirations vs reality

Bonds and inflation Opportunities and a bugbear



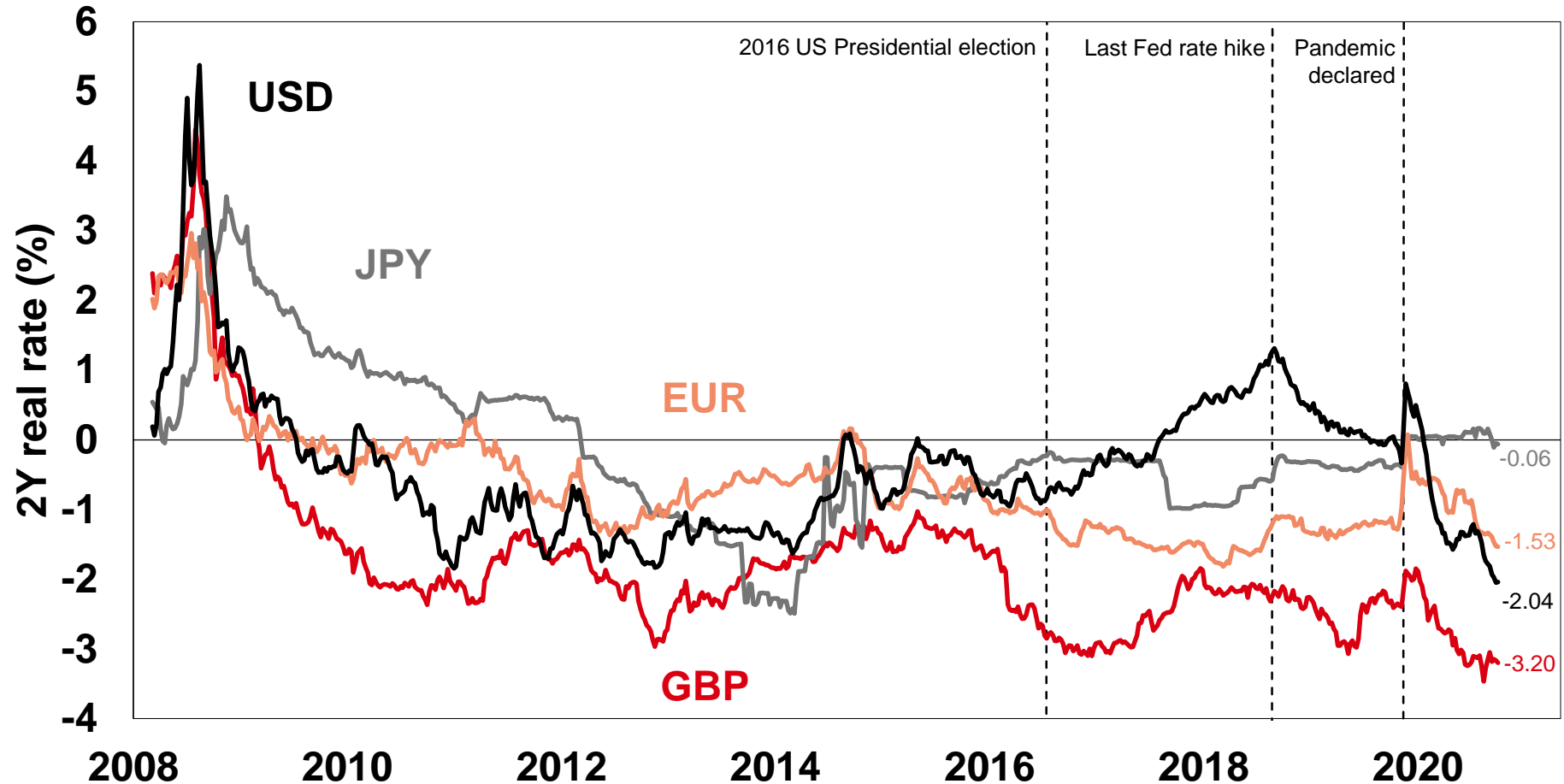
20 May 20

Down, down, deeper and down US rates – an alternative scenario



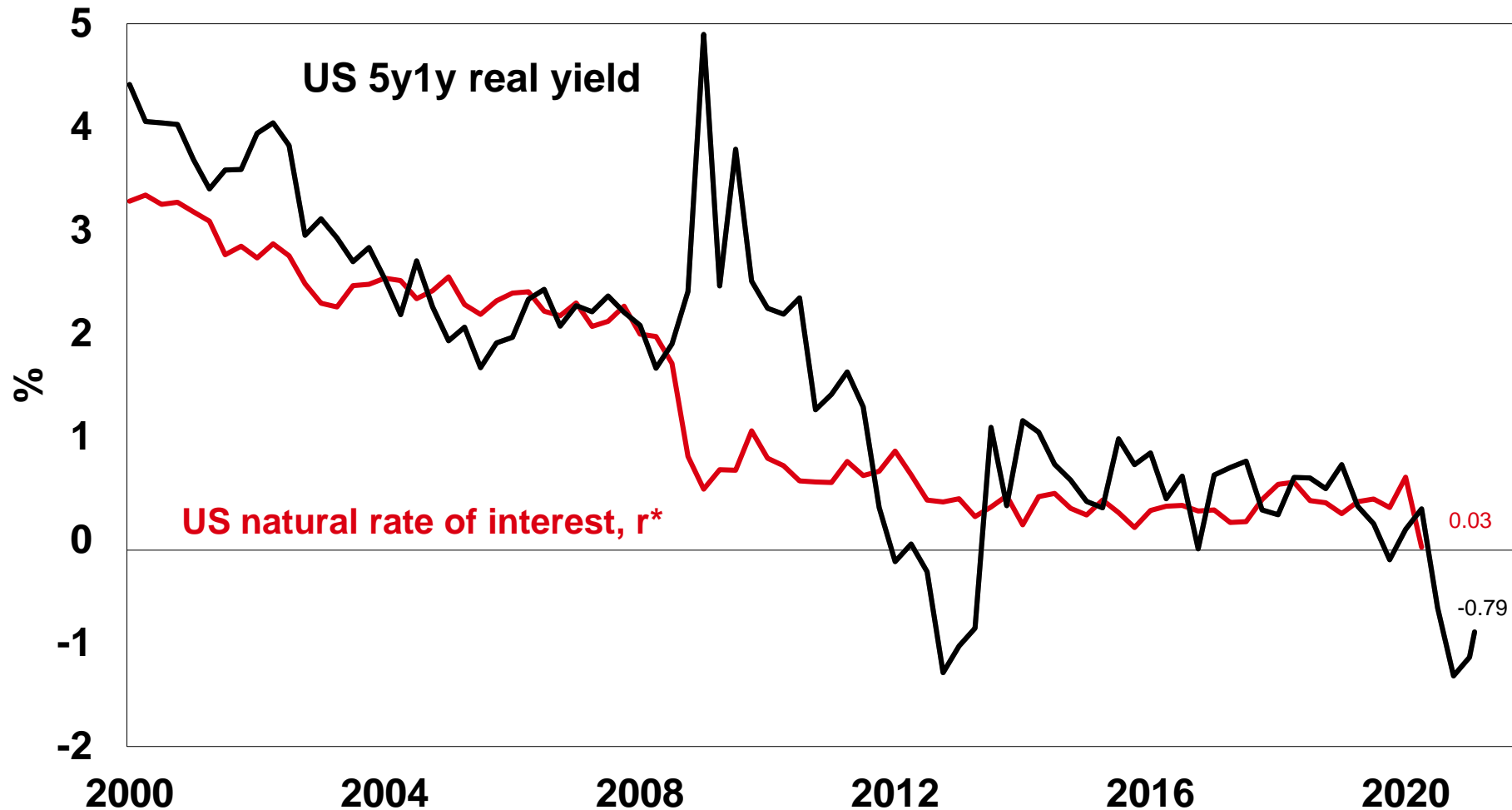
04 Jun 20

Negative real yields are an outcome



Source: HSBC, Bloomberg. Note: real rate = nominal swap rate - inflation swap rate

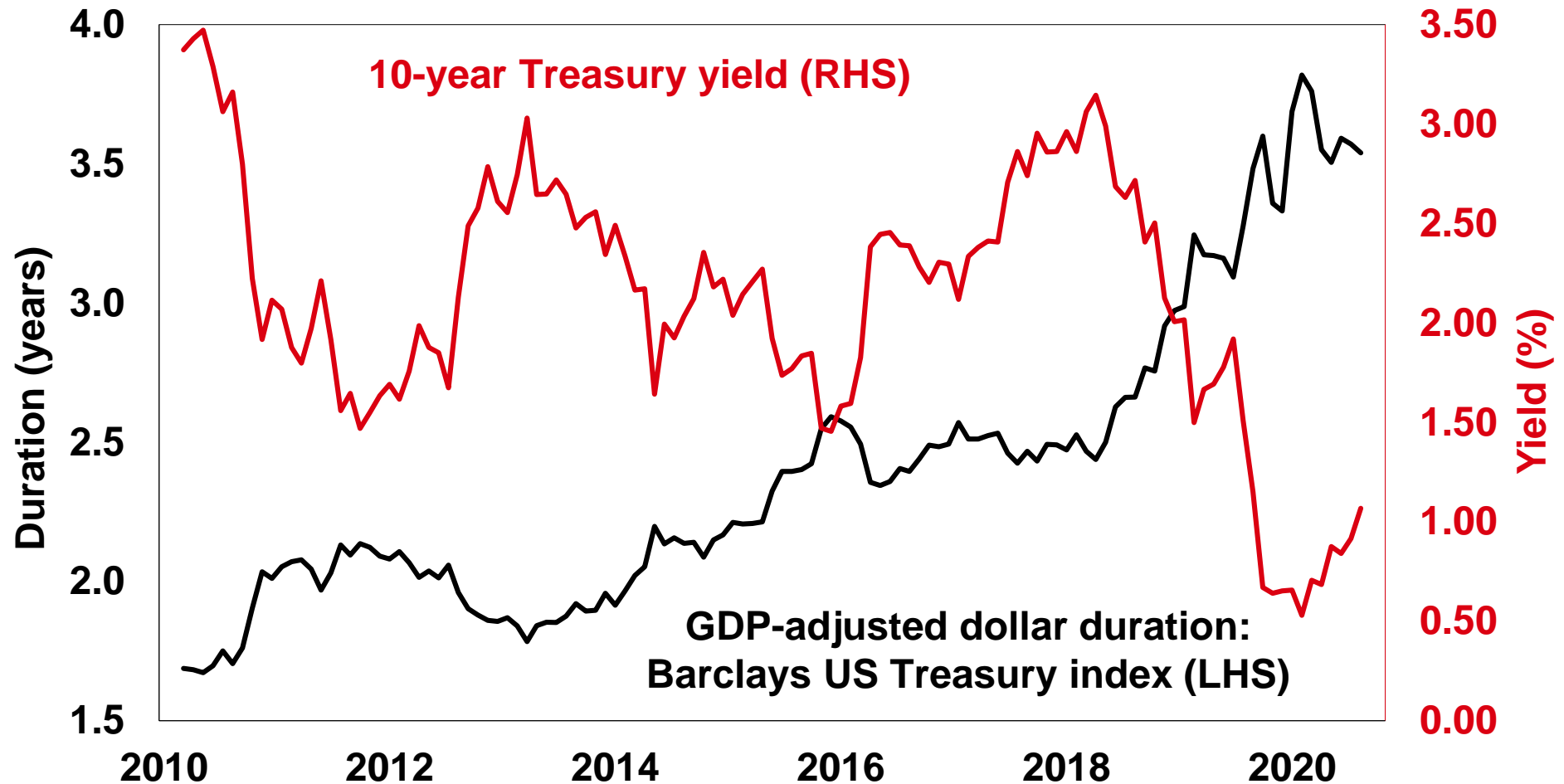
North star for r^* – the US Treasury 5y1y real yield



Source: HSBC, NY Fed, OECD. Note: Calculations use the methodology outlined in Holston, Laubach and Williams (2017), "Measuring the Natural Rate of Interest: International Trends and Determinants". Latest r^* data as of start-Q2 2020, real yield as of 1 February 2021.

see Real yields are a residual: Let go of the traditional meaning, 26 August 2020

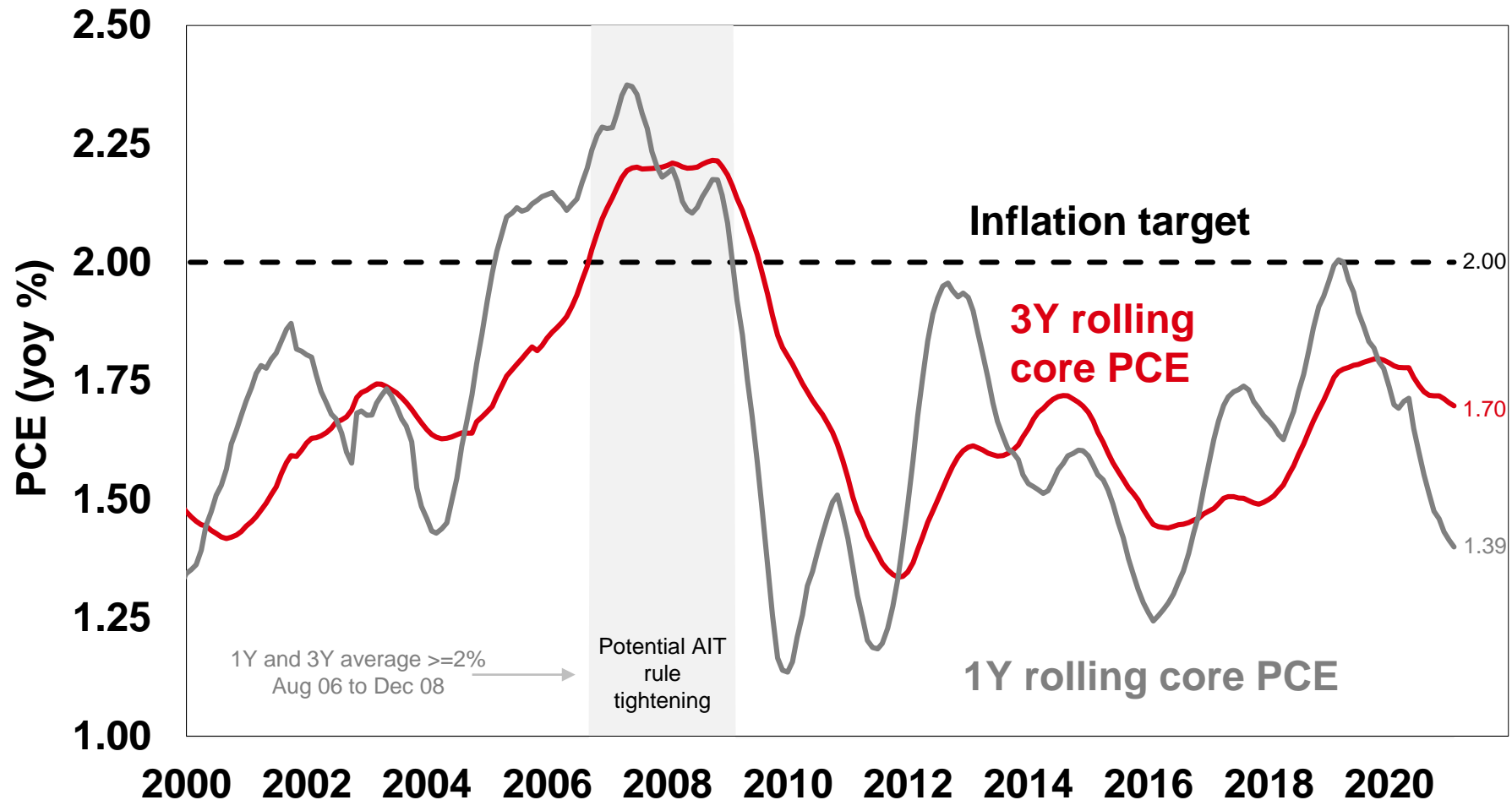
More duration supply, lower yield levels



Source: HSBC, Bloomberg. Monthly data used.

see Weekly Analysts' Meeting: Overdone vs under-appreciated, 1 December 2020

High hurdle for rate hikes given the new Fed framework



Source: HSBC, Bloomberg.

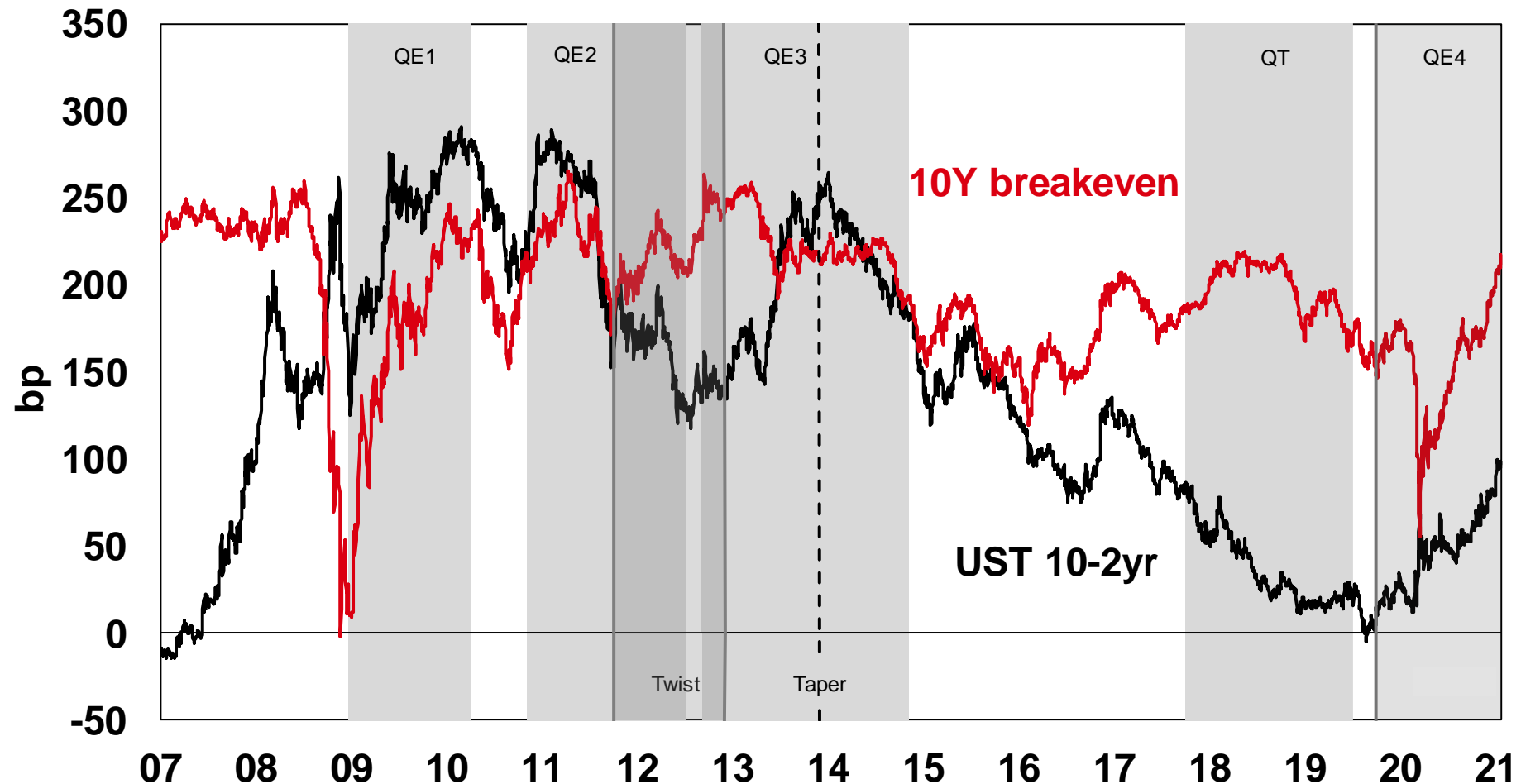
see *Forecasting myths 2.0: US bond yields - another look at misconceptions*, 29 January 2021

“ To be clear, ‘inflation that averages 2% over time’ represents an ex-ante aspiration, not a description of a mechanical reaction function...”

Richard Clarida, Federal Reserve Vice-Chair, speaking at Petersen Institute, 31 August 2020

see Fixed Income Asset Allocation: Aspiration-reality disconnect, 3 September 2020

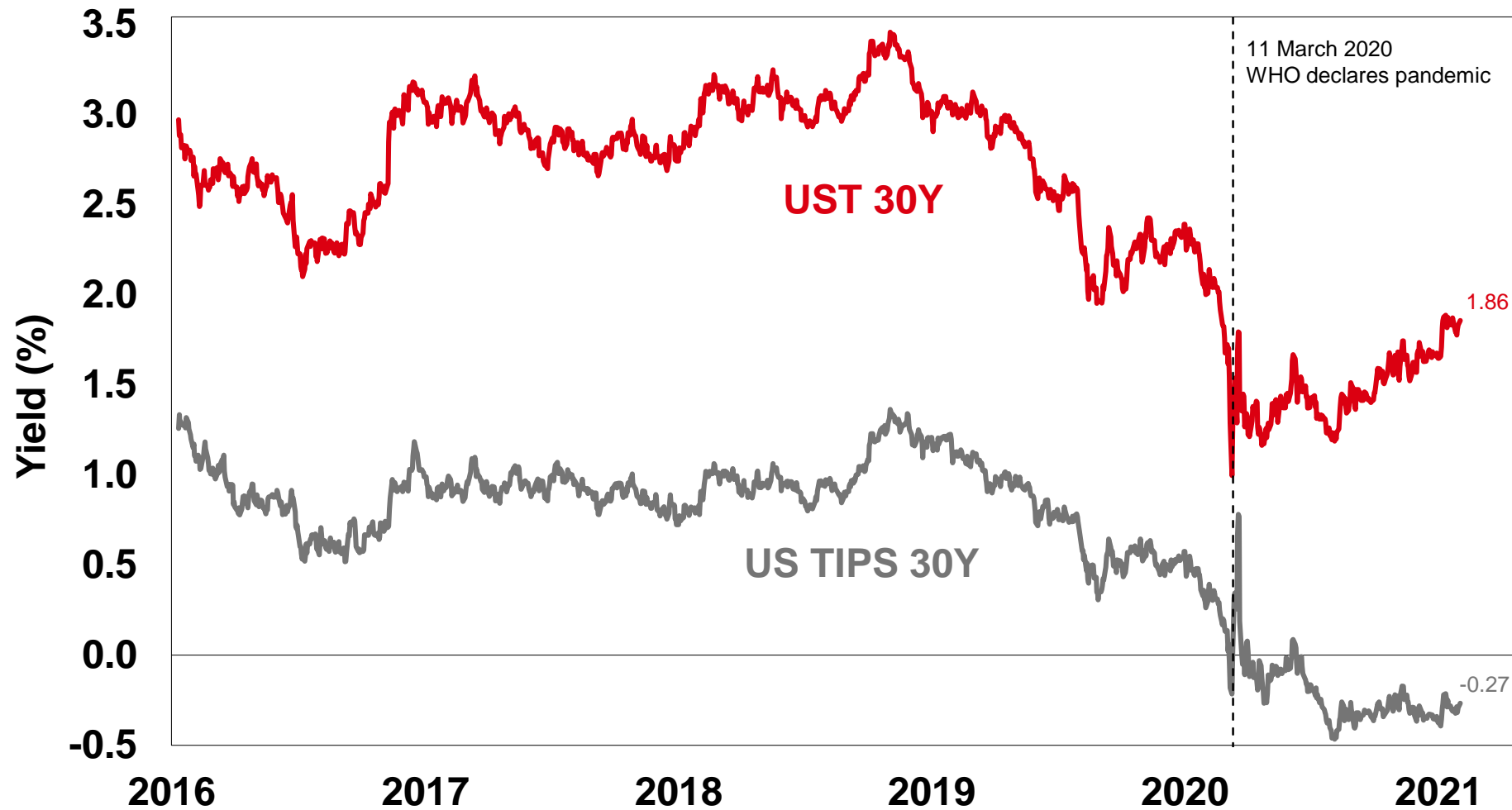
US BEs have been increasing like in 2009



Source: HSBC, Bloomberg

Note: see breakdown: US yields defied the term premium, 5 June 2018; and Fixed Income Asset Allocation, 17 September 2019

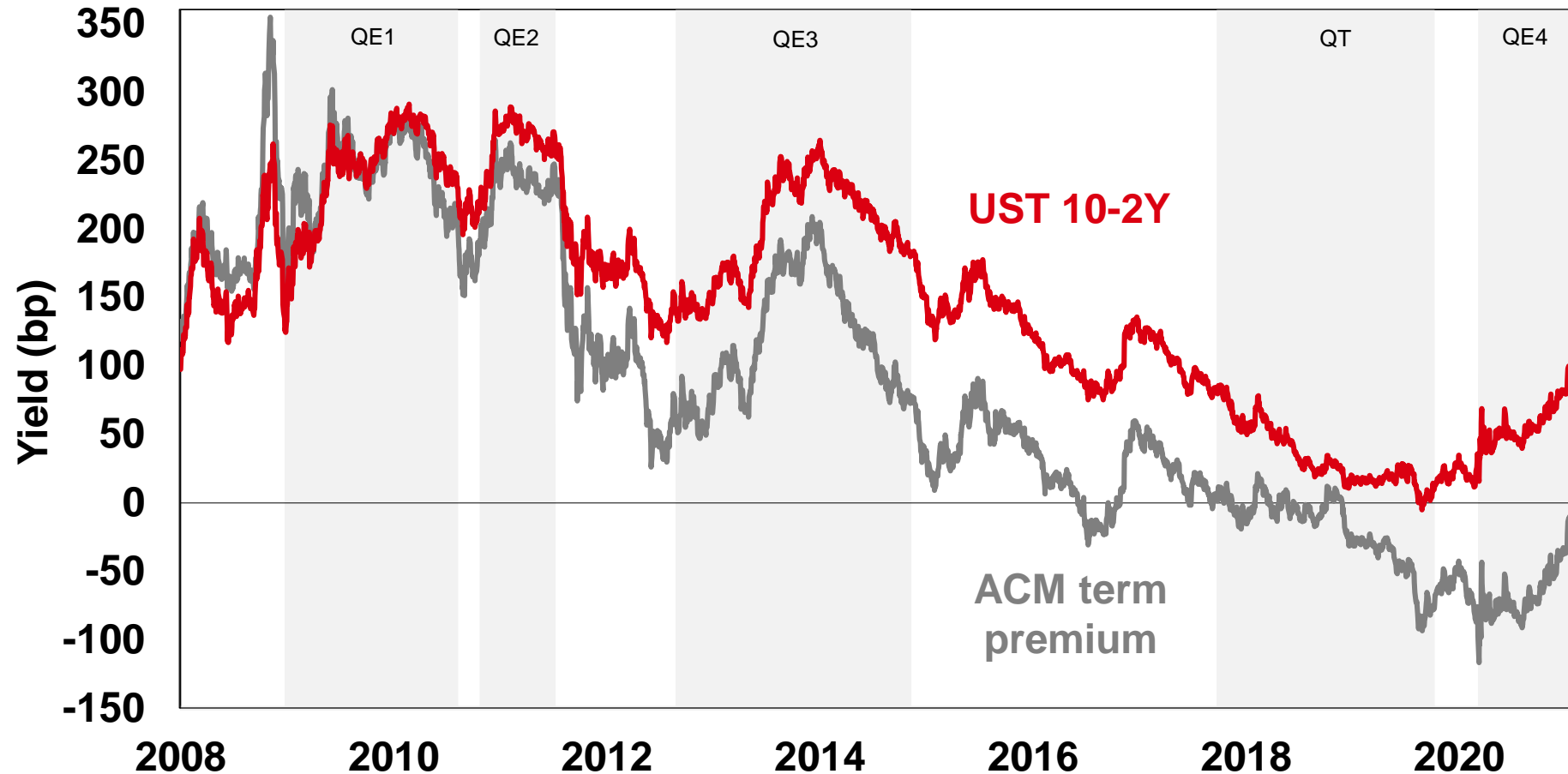
Wider inflation break-evens from higher nominal yields



Source: HSBC, Bloomberg

see *Forecasting myths 2.0: US bond yields - another look at misconceptions*, 29 January 2021

Curve and term premium move broadly together



Source: HSBC, Bloomberg, Adrian, Crump and Moench (ACM)

see Forecasting myths 2.0: US bond yields - another look at misconceptions, 29 January 2021

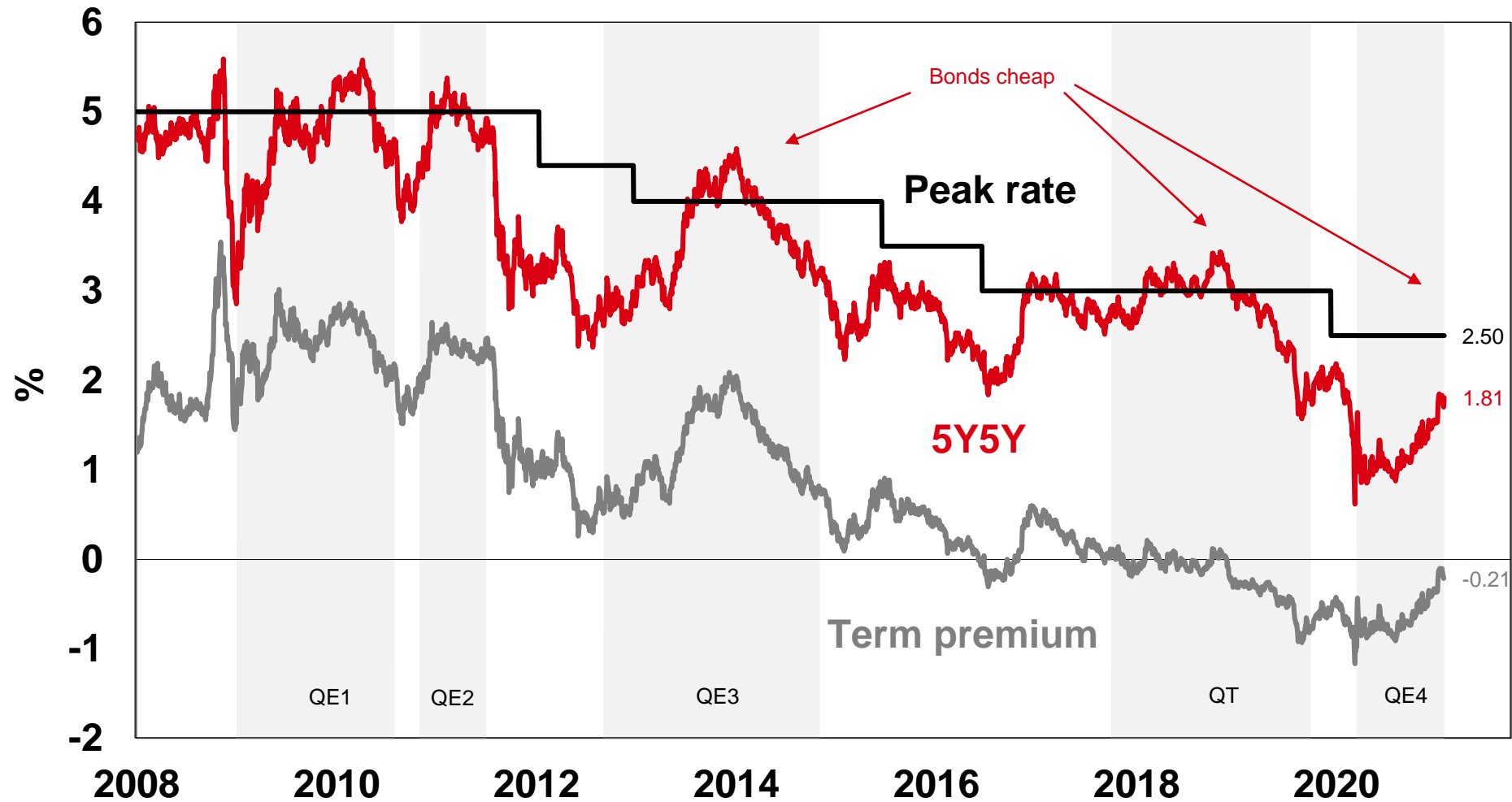
US 10-year fair value with zero lower bound (ZLB)

Maturity	1	2	3	5	10
Yield curve as at 1 February 2021	0.08%	0.11%	0.17%	0.43%	1.08%
3Y at ZLB, then 2Y to tighten to 2.5%	0.13%	0.13%	0.13%	0.64%	1.49%
3Y at ZLB, then 2Y to tighten to 2%	0.13%	0.13%	0.13%	0.52%	1.19%
3Y at ZLB, then 2Y to tighten to 1.5%	0.13%	0.13%	0.13%	0.41%	0.89%
3Y at ZLB, then 2Y to tighten to 1%	0.13%	0.13%	0.13%	0.30%	0.59%
5Y at ZLB, then 2Y to tighten to 1%	0.13%	0.13%	0.13%	0.13%	0.44%
7Y at ZLB, then 2Y to tighten to 1%	0.13%	0.13%	0.13%	0.13%	0.29%
Stay at ZLB forever	0.13%	0.13%	0.13%	0.13%	0.13%
2Y at -2%, then 2Y to tighten to 1%	-2.14%	-2.14%	-1.82%	-0.85%	0.01%

Source: HSBC, Bloomberg. Note: tightening scenarios assume period from today, not Fed meeting dates.

see Fixed Income Asset Allocation: Looking through the noise, 7 October 2020

UST 5Y5Y well below peak rate and longer-run 'dot'



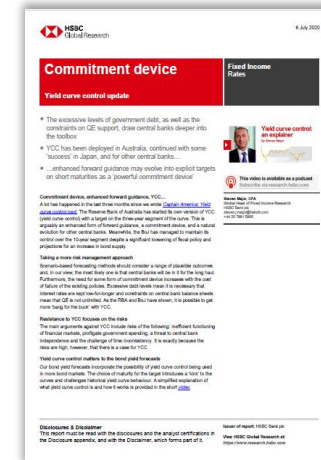
Source: HSBC, Bloomberg, NY Fed, Adrian, Crump and Moench (ACM).

Note: 'Peak rate' is based on previous rate peaks and expected nominal GDP. Grey shaded area indicates QE programmes.

What comes next?

- Eventual austerity and financial repression at a minimum
- There is no “quick fix”, we cannot afford higher rates
- Yield curve control to contain yields
- Lower-for-longer rates outlook is a base case
- Many questions remain for the post-pandemic economy

Commitment device Yield curve control update



06 Jul 20

Captain America Yield curve control next



20 Mar 20

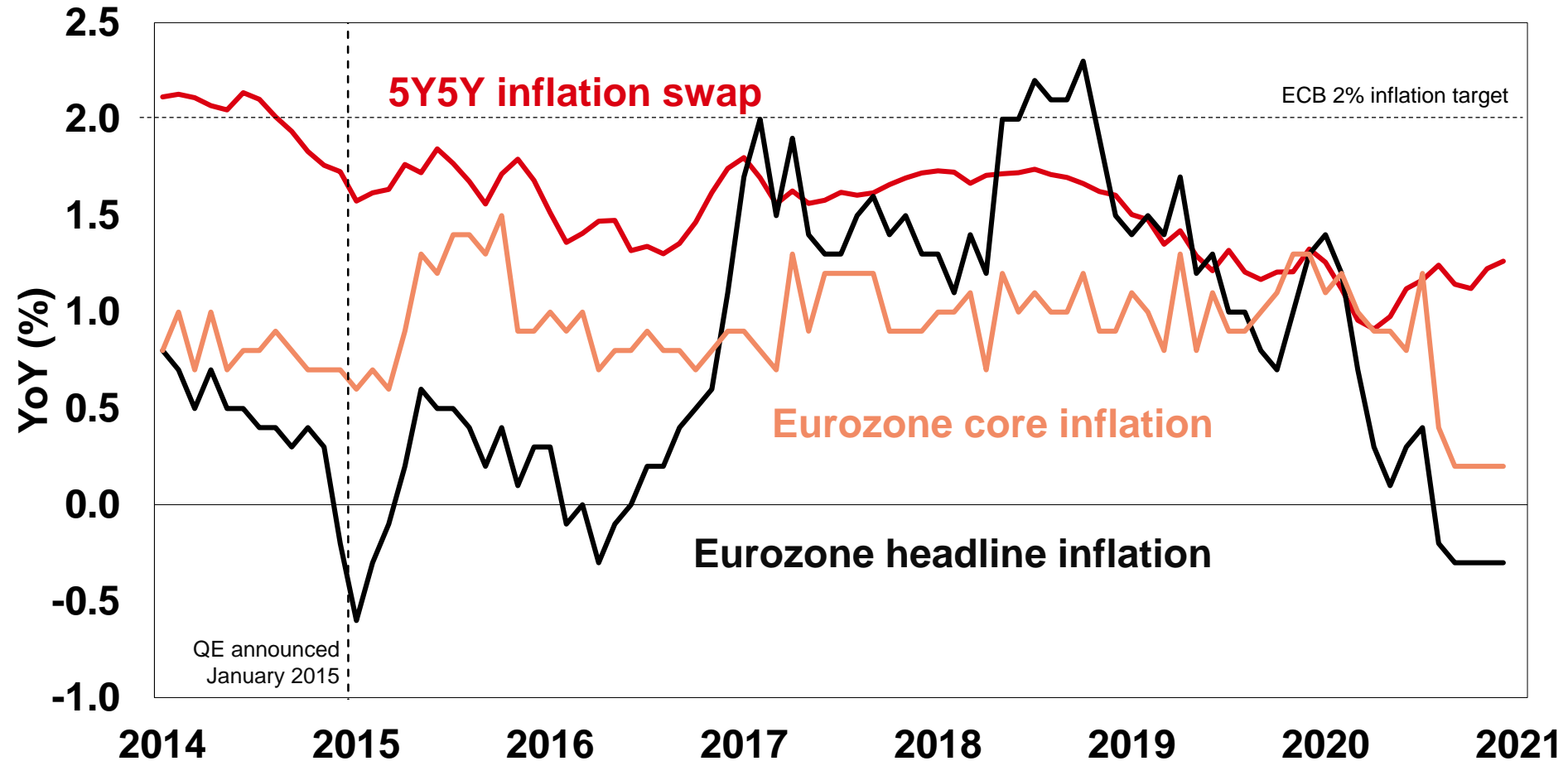
“

Taken together, the scale of the increase in economic slack means that the net impact on inflation dynamics is assessed to be substantially negative in the staff projections, even when allowing for the pro-inflationary impact of some damage to supply capacity.

”

Philip Lane, Member of the Executive Board of the ECB, Expanding the pandemic emergency purchase programme, 5 June 2020

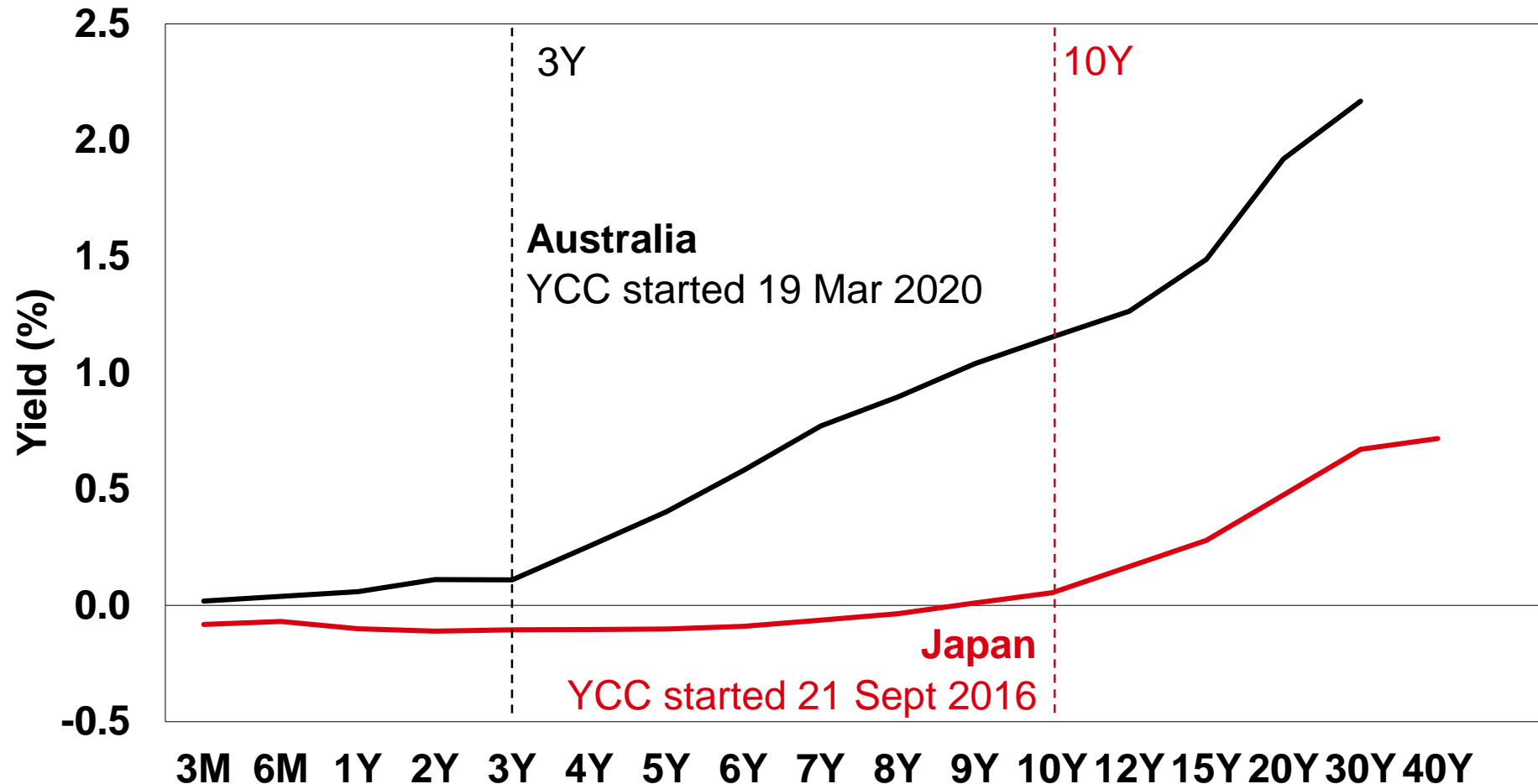
Eurozone inflation expectations never recovered after 2015



Source: Bloomberg, HSBC

see QE in the Eurozone: Five more years, 5 October 2020

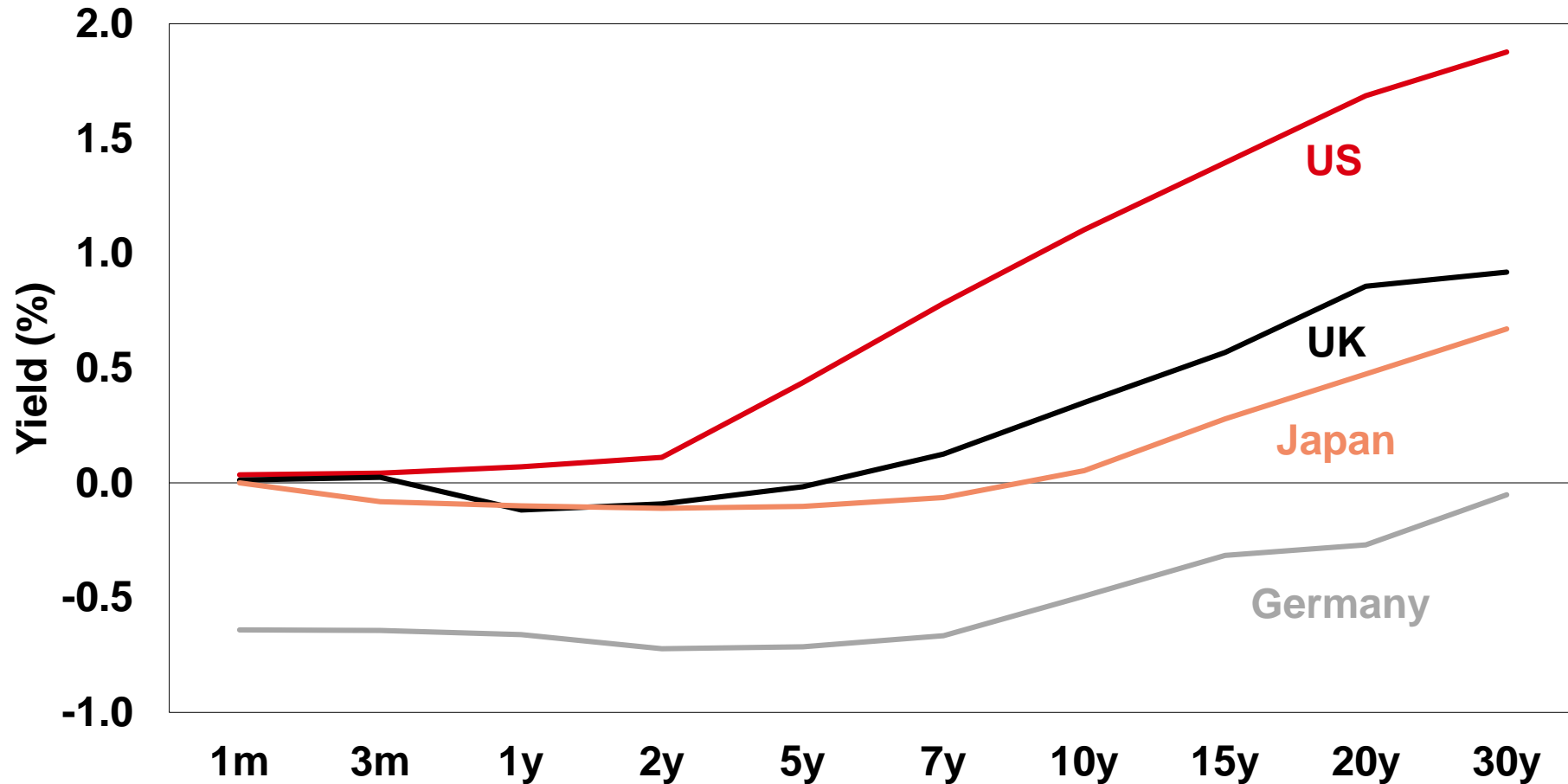
Japan and Australia yield curve 'kinks' determined by YCC



Source: HSBC, Bloomberg

see *Fixed Income Asset Allocation: Hockey sticks*, 7 July 2020

G4 yield curves converging – hockey sticks



Source: HSBC, Bloomberg

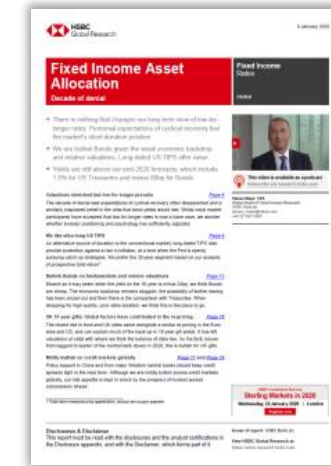
see *Fixed Income Asset Allocation: Hockey sticks*, 7 July 2020

Conclusion: Lower-for-longer is now base case

- Questions to answer:

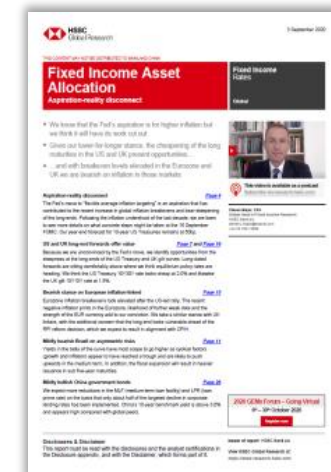
- What will the post-pandemic changes in belief systems look like?
- Will central banks explain how inflation is going to rise?
- Is there a tipping point from the move to fiscal dominance?
- Will there be a meaningful increase in investment spending ?

Decade of denial Fixed Income Asset Allocation



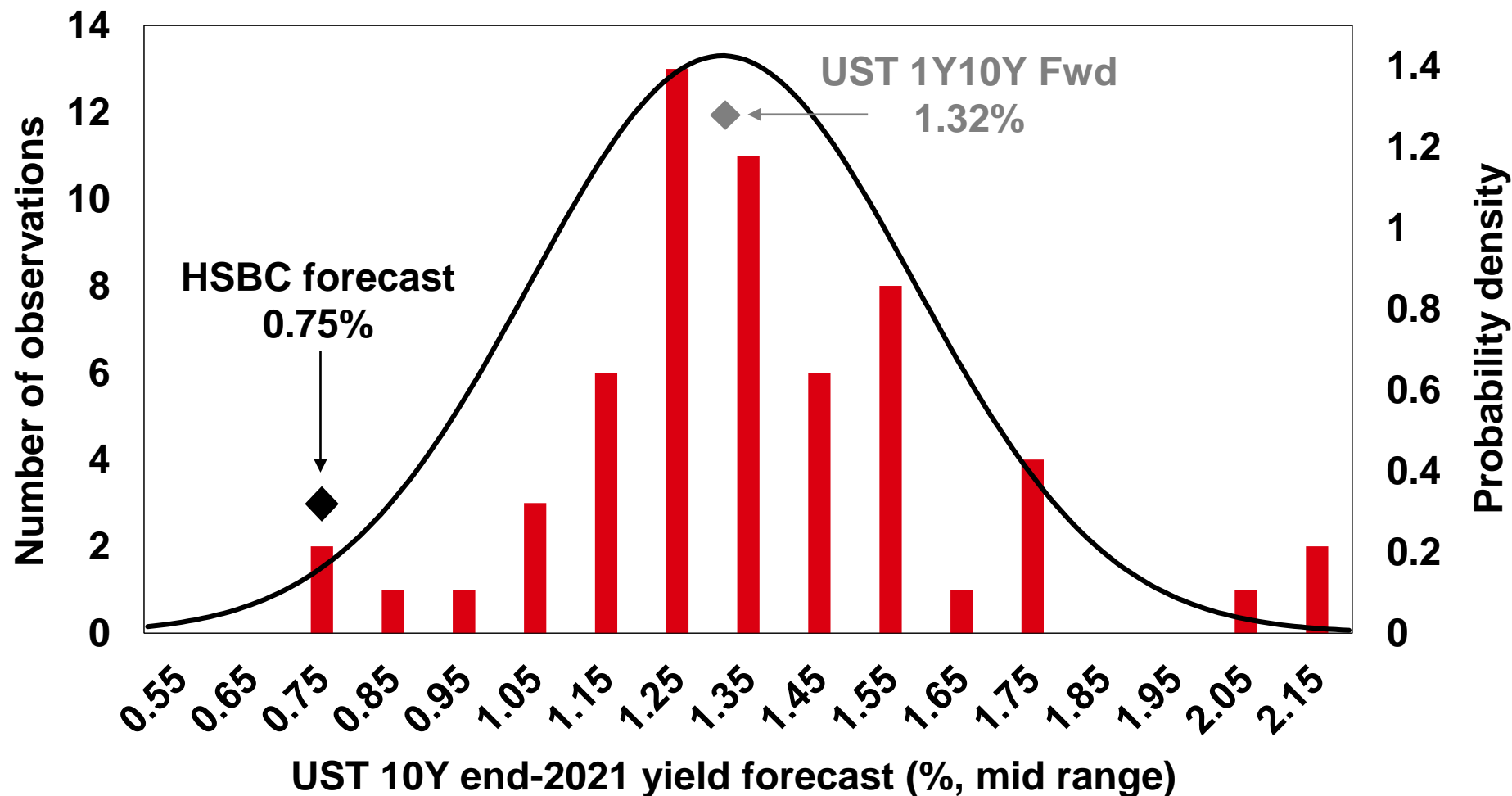
09 Jan 20

Aspiration-reality disconnect Fixed Income Asset Allocation



03 Sep 20

The current distribution of UST 10Y predictions for end-2021



Source: HSBC, Bloomberg. 59 forecasts used, as at 15 January 2021 survey date. Forward rate as of 1 February 2021.

see Forecasting myths 2.0: US bond yields - another look at misconceptions, 29 January 2021

Disclosure appendix

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	Count	Percentage	Count	Percentage
Overweight	126	27	70	56
Neutral	220	47	90	41
Underweight	126	26	47	37

Source: HSBC

For the purposes of the distribution above the following mapping structure is used: Over weight = Buy, Neutral = Hold and Under weight = Sell. For rating definitions under both models, please see "Definitions for fundamental credit and covered bond recommendations" above.

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	Count	Percentage	Count	Percentage
Buy	143	76	90	63
Sell	46	24	21	46

Source: HSBC

For the purposes of the distribution above the following mapping structure is used: Buy/Sell protection/Receive/Buy Receiver/Sell Payer = Buy; and Sell/Buy protection/Pay/Buy Payer/Sell Receiver = Sell. ASW is counted as a buy of the bond and a paid swap, and RA SW as a sell of the bond and a received swap. For rating definitions under both models, please see "Definitions for trades (Rates and Credit)" above.

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