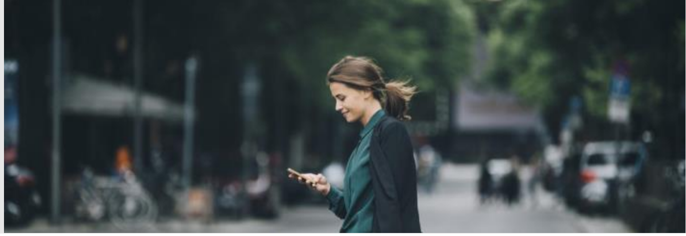
WEEKLY UPDATE

United States: what the yield curve tells about the economic outlook



Short rates rising more than long yields.
For several months, indicators in the United States have been flagging a strong economic recovery and longer than expected inflationary pressures. Markets have responded by revising expectations of how fast the Fed will normalise monetary policy. They now expect a cycle of policy rate hikes starting in March and totalling 7 quarter-point hikes by the end of the year. In line with these revised expectations, short-term interest rates have risen, with two-year rates now over 1.5% after a fresh spurt early in the year. Long-term yields have also risen, but less sharply, taking the 10-year yield to 2% (see chart 1). This has substantially tightened the long-short spread, exacerbating a trend already seen since mid-2021 and raising fears among some commentators that the US could be heading for recession.

Yield curve could be a leading indicator of recession.
If the recent trend continues, we could even see the curve invert: i.e. short-term bills will start to pay higher returns than long-term bonds. Any such movement would be read as indicating investors distrust the outlook and a possible early sign of a looming economic recession. The last three US recessions were all preceded by an inversion of the yield curve (see chart 2), supporting this thesis. In current circumstances, the actual motivation for curve inversion would be fears the Fed may have to over-hike its interest rates to calm persistent inflation, even at the risk of tipping the economy into recession.

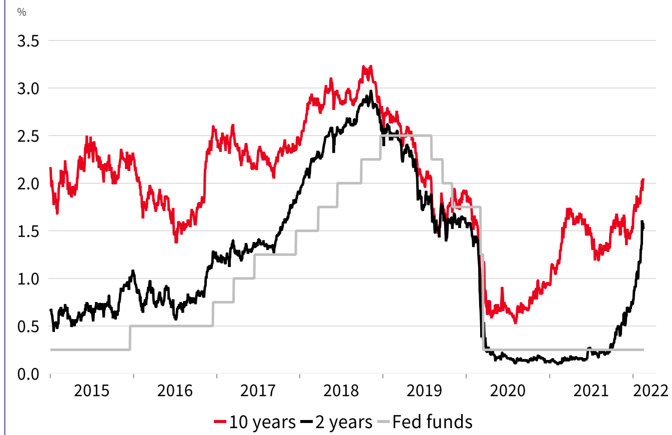
But this is to overlook some factors that continue to hold down long-term interest rates.
US long yields are feeling downward pressure from ongoing demand for United States debt, still seen as a risk-free benchmark asset. Several factors are driving this demand. The first is structural. Financial entities (banks, pension funds, etc.) need ever more risk-free assets, partly to comply with tighter regulatory demands. A second factor is the still massive asset purchase programmes run by central banks. The Fed is set to end its purchases soon and could even start running down its balance sheet in coming months. However, other central banks are in a different phase and could continue their purchases, sustaining high demand for US bonds. A third and final factor, which seems to have been in play since the turn of the year, is growing uncertainty on financial markets stoked by recent geopolitical tensions, spurring a quest for risk-free assets. This factor may fade somewhat over coming weeks.

Conclusion

The US yield curve has been flattening for months, with the process accelerating since the start of the year. Although upside surprises on inflation raise questions about the economic outlook, it seems premature to worry about a US recession. Some of the factors affecting the long-end of the curve should fade, leaving us with a scenario closer to the current economists' consensus of close to 4% growth in 2022.

In the United States, a convergence of 2-year and 10-year sovereign rates

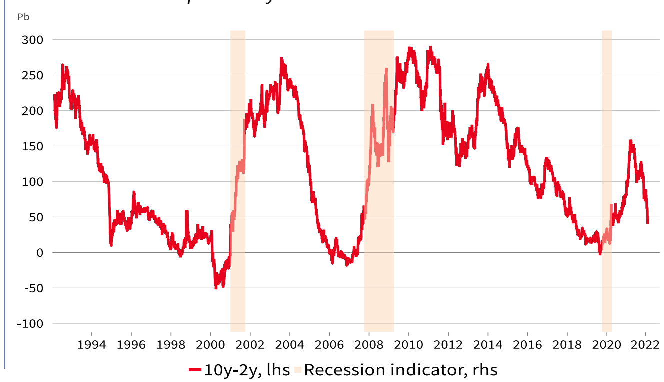
United States: 2 years and 10 years US rates & Fed funds



Sources: SGPB, Macrobond, Fed 16/02/2022

United States yield curve inversions tend to precede recessionary periods

United States: Slope of the yield curve & recession indicator



Sources: SGPB, Macrobond, Fed, NBER28/10/2021

SOCIETE GENERALE
Private Banking

OUR MACRO COMMENTS

Events of the week

In general, when confronted with turbulent equity markets, investors reduce their exposure and seek refuge in gold. Facing uncertainties related to the tensions in Ukraine and the prospect of a longer than expected inflation in the United States, gold has thus reached highs this week. It traded at almost $1900 per ounce – its highest level in 8 months.

The release of some European corporate results could have reassured the markets this week. The volatility index, VIX, also known as the "fear index", however, increased in Europe. The encouraging results of some car suppliers and manufacturers, luxury goods and retail groups have indeed been overshadowed by the renewed tensions in Ukraine.

Figures of the week

	Current		Consensus	Previous
Inflation (in year on year variation, January)	5.5%	↑	5,4%	5.4%
Core inflation (in year on year variation, January)	4.4%	↑	4.3%	4.2%
Unemployment rate (December)	4.1%	→	4.1%	4.1%
Retail sales (in year on year variation, January)	9.1%	↑	8.7%	-1.7%
GDP (in quarter on quarter variation, Q4)	1.3%	↑	1.4%	-0.7%
Inflation (in year on year variation, January)	0.5%	↓	0.6%	0.8%
Inflation (in year on year variation, January)	0.9%	↓	1%	1.5%
ZEW survey on economic sentiment (February)	54.3%	↑	55%	51.7%
Retail sales (in month on month variation, January)	3.8%	↑	2%	-2,5%

Sources : Bloomberg, on 18 February 2022.

The week ahead

Monday

- Interest rates
- Composite PMI Index (February)
- Manufacturing PMI Index (February)
- Services PMI Index (February)

Tuesday

- Composite PMI Index (February)
- Consumers confidence (February)
- Monetary policy statement

Friday

- GDP (Q4)
- Durable goods order (January)

MARKETS PERFORMANCE

Interbank rate	Last.	-1W	-3M	YTD	-12M
€STER O/N	-0,58	-0,58	-0,57	-0,59	-0,56
USD SOFR O/N	0,30	0,05	0,05	0,05	0,05
JPY TONAR O/N	-0,02	-0,02	-0,04	-0,02	-0,01
GBP SONIA O/N	0,45	0,45	0,05	0,19	0,05
CHF O/N	-0,78	-0,78	-0,79	-0,78	-0,79

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	0,75	0,65	0,11	0,20	-0,20
10Y Bund	0,27	0,15	-0,24	-0,21	-0,46
10Y BTP	1,94	1,74	0,97	1,17	0,48
10Y JGB	0,22	0,19	0,07	0,07	0,06
10Y Bonos	1,28	1,12	0,46	0,56	0,21
10Y Swiss	0,31	0,19	-0,10	-0,13	-0,39
10Y Gilt	1,58	1,46	0,92	1,02	0,52
10Y USTnote	1,92	1,93	1,58	1,52	1,20

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	0,93	0,85	0,17	0,33	0,02
EUR Corporate Baa	1,34	1,25	0,51	0,66	0,42
GBP Corporate Baa	2,23	2,11	1,32	1,52	0,93
USD Corporate Aaa	2,70	2,66	2,13	2,13	1,91
USD Corporate Baa	3,28	3,20	2,53	2,60	2,20
USD EM aggreate	4,90	4,80	4,37	4,33	3,60

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	91,40	-1,4%	11,5%	15,6%	45,9%
Or, USD/oz	1 859	2,8%	-0,3%	1,7%	1,9%
Copper, USD/metric ton	9 995	1,6%	3,9%	3,2%	21,1%
Platinium, USD/onz	1 029	0,1%	-3,8%	6,4%	-16,1%
Palladium, USD/onz	2 241	-4,3%	10,4%	13,3%	-4,7%
Silver, USD/onz	22,90	1,7%	-8,3%	-0,8%	-15,4%

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,14	-0,4%	-0,3%	0,8%	-5,7%
EUR/CHF	1,06	0,1%	0,5%	2,3%	-1,9%
USD/GBP	0,73	-0,6%	-1,6%	-0,5%	1,7%
USD/JPY	115,95	0,6%	1,8%	0,7%	10,5%
USD/BRL	5,19	-2,9%	-4,3%	-6,8%	-3,2%
USD/CNY	6,35	-0,1%	-0,4%	0,0%	-1,6%
USD/RUB	74,57	-2,1%	2,3%	-0,5%	1,0%

Equity indices	Last.	-1W	-3M	YTD	-12M
MSCI AC World (USD)	1 164	0,3%	1,2%	0,3%	12,4%
Eurostoxx 50	4 155	1,7%	-4,9%	-3,3%	12,4%
Dax 40	15 425	2,2%	-4,2%	-2,9%	9,8%
CAC 40	7 012	0,9%	-1,1%	-2,0%	22,9%
FTSE 100	7 661	1,9%	4,3%	3,7%	16,3%
SMI	12 232	0,8%	-2,3%	-5,0%	12,4%
SP500	4 419	-1,8%	-5,6%	-7,3%	12,3%
TOPIX	1 963	1,7%	-3,8%	-1,5%	1,5%
iBovespa	113 572	1,2%	6,8%	8,3%	-4,9%
Hang Seng	24 907	1,4%	-1,7%	6,4%	-17,5%
Sensex 30	58 153	-0,8%	-4,2%	-0,2%	12,8%
MOEX	3 547	2,2%	-14,0%	-6,4%	3,5%
CSI 300	4 601	0,8%	-5,9%	-6,9%	-20,8%

Source: Macrobond, on 18 February 2022.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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