The Major bond letter

#14. Across the pond

Free to View
Fixed Income - Rates

Global

The idiom “across the pond” generally refers to Brits and Americans viewing one another from either side of the Atlantic Ocean. The US economy is more than seven times the size of its UK counterpart, which normally justifies us spending more time looking at the world’s leading bond market.

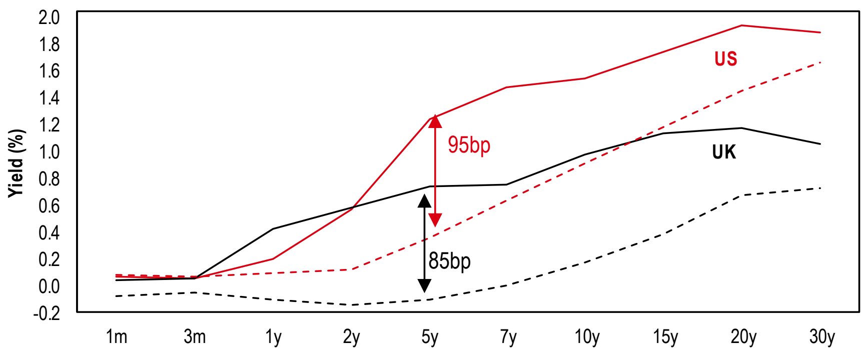
Sometimes, however, the shoe can be on the other foot. Expectations for interest rates in the UK have recently appeared to lead those in the US. Short-dated UK yields were moving sharply higher weeks ahead of the US equivalents, which required the 22 September FOMC, and its hawkish turn, to propel them higher.

Since peaking at the beginning of November, UK short yields have fallen back, a result of the Bank of England appearing to delay the lift-off from practically zero interest rates, whilst the US equivalents have probed new highs for the year.

The flat UK yield curve is consistently reflecting the view that we are late in the cycle, that if and when rates do go up, they won’t get very far. Inverted curve slopes – that appear in money markets and further up the bond curves – tell us that increases in rates could even be a “mistake” that will later have to be reversed.

In both the UK and US it’s the highly interest-rate sensitive five-year maturity that has increased the most this year (Figure 1), in two waves: from January to March and September to now. What a contrast to the 30-year maturities which are not so far from where they started the year (shown by dotted lines in Figure 1).

Figure 1. UK gilt curve and read-across to US



Source: HSBC, Bloomberg. Note: Dashed yield curves show 4 January 2021 levels.

The UK also tells us something about falling longer-run equilibrium or natural rates. Bond yields look through the newsflow and cyclical data patterns, attaching a higher weight to the longer-run structural drivers that we have highlighted in our research.

In short, debt levels, ageing populations, wealth inequalities, and disruptive technologies mean that a single rate hike has much more impact than in previous cycles.

This is a Free-to-View version of a report by the same title published on 29-Nov-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Steven Major, CFA
Global Head of Fixed Income Research
The Hongkong and Shanghai Banking Corporation Limited

Disclosures & Disclaimer
This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

View HSBC Global Research at:
https://www.research.hsbc.com

Central banks know all this, of course. They have shown that they are learning from past mistakes, which include tightening policy too far. So, let's do a thought experiment with an example. If the implied path for short rates in any given country was to be four hikes followed by two cuts, then presumably the central bank should keep things simple and just hike twice.

With rates at the effective lower bound there will anyway be an asymmetry to expectations – i.e. it is more likely they will go up than fall. We try not to be influenced by the perennial over-optimism bias and look at markets probabilistically. Two years ago, when rates were higher and markets were fully expecting one rate cut over a given period, we preferred to see it as a 25% chance of four cuts.

Maybe it suits central banks to get what they want without doing anything. If everyone expects tighter policy they might start to behave differently, and the rates on fixed rate mortgages and other loans will anyway move in advance of the rate decisions.

The key challenge for central banks in the coming months will be trying to determine 1) how much of the inflation increase has been due to the supply bottlenecks; and 2) how much of it is down to previous fiscal largesse.

First, there may be signs of supply chain blockages easing – some highlight the decline in the Baltic freight index – but this is not something anyone really wants to forecast, given the huge levels of uncertainty related to the pandemic. It's certainly no easier given the backdrop of China's cooling economy, what it means for global commodity prices, and potential policy divergence.

Second, the UK perhaps provides a demand-side lead to the US, and this is on fiscal policy too, with the UK furlough scheme ending some months ago. By the time we get into 2022 it will be evident that many countries are in fact tightening fiscal policy relative to 2021, and we can already see the impact in some credit sectors from China's deleveraging.

Bond yields have factored in the likelihood that rates will rise at some point next year. Most importantly, the long-ends of the major developed markets are resolute in their conviction that policy rates cannot rise too far.

Given the Bank of England doesn't tend to hike in December, preferring to wait for the February forecasting round – and not forgetting Cshristmas is approaching – we probably have some time to consider the outlook for rates, on both sides of the pond.

Previous editions of 'The Major bond letter'

#1. *Eurozone common issuance*
#2. *How to spice it up in a dull market*
#3. *New year, old narrative*
#4. *Beneath the surface*
#5. *The bond market sell-off*
#6. *Treasuries and trees*
#7. *Inflation rationality*
#8. *Lucky number*
#9. *Stuck in the middle*
#10. *Taper and the Hole*
#11. *Every basis point counts*
#12. *Push back*
#13. Game of chicken

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), or strategist(s) who is(are) primarily responsible for this report, including any analyst(s) whose name(s) appear(s) as author of an individual section or sections of the report and any analyst(s) named as the covering analyst(s) of a subsidiary company in a sum-of-the-parts valuation certifies(y) that the opinion(s) on the subject security(ies) or issuer(s), any views or forecasts expressed in the section(s) of which such individual(s) is(are) named as author(s), and any other views or forecasts expressed herein, including any views expressed on the back page of the research report, accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Steven Major, CFA

Important disclosures

Fixed income: Basis for financial analysis

This report is designed for, and should only be utilised by, institutional investors. Furthermore, HSBC believes an investor's decision to make an investment should depend on individual circumstances such as the investor's existing holdings and other considerations.

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its fixed income research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies in corporate credit and based on country-specific ideas or themes that may affect the performance of these bonds in the case of covered bonds, in both cases on a six-month time horizon; 2) to identify trade ideas on a time horizon of up to four months, relating to specific instruments, which are predominantly derived from relative value considerations or driven by events and which, in the case of credit research, may differ from our long-term opinion on an issuer. Buy or Sell refer to a trade call to buy or sell that given instrument; HSBC has assigned a fundamental recommendation structure, as described below, only for its longer-term investment opportunities.

HSBC believes an investor's decision to buy or sell a bond should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of terms as well as different systems to describe their recommendations. Investors should carefully read the definitions of the recommendations used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the recommendation. In any case, recommendations should not be used or relied on in isolation as investment advice.

HSBC Global Research is not and does not hold itself out to be a Credit Rating Agency as defined under the Hong Kong Securities and Futures Ordinance.

Definitions for fundamental credit and covered bond recommendations

Overweight: For corporate credit, the issuer's fundamental credit profile is expected to improve within the next six months. For covered bonds, the bonds issued in this country are expected to outperform those of the other countries in our coverage over the next six months.

Neutral: For corporate credit, the issuer's fundamental credit profile is expected to remain stable for up to six months. For covered bonds, the bonds issued in this country are expected to perform in line with those of the other countries in our coverage over the next six months.

Underweight: For corporate credit, the issuer's fundamental credit profile is expected to deteriorate within the next six months. For covered bonds, the bonds issued in this country are expected to underperform those of other countries in our coverage over the next six months.

Definitions for trades (Rates & Credit)

Buy and **Sell** refer to a trade call to buy or sell a bond, option on an interest rate swap (**"swaption"**), interest rate cap or floor, inflation cap or floor, or Total Return Swap (**"TRS"**). The buyer/seller of a TRS receives/pays the total return of the underlying instrument or index at the end of the period and pays/receives the funding leg.

Buy protection and **Sell protection** refer to a credit default swap (CDS): the protection buyer/seller is effectively selling/buying the reference entity's credit risk.

Pay and **receive** refer to a trade call to pay or receive the fixed leg of an interest rate swap (IRS), a non-deliverable IRS, the first-named leg of a basis swap, the realised inflation leg of an inflation swap, or a forward rate agreement (FRA). An investor that executes a pay or receive trade is said to be **"paid"** or **"received."**

Payer and **receiver** refer to inflation caps or floors and to swaptions: a payer is an option giving the right but not the obligation to enter a paid position in an interest rate or inflation swap, and a receiver is an option giving the right but not the obligation to enter a received position in an interest rate or inflation swap.

ASW (also asset-swap, Buy on asset swap, Buy on an asset-swapped basis): Buy a bond packaged with a swap that is tailored to eliminate the bond's interest rate risk, effectively transforming the bond to a floating rate instrument whilst preserving the credit exposure to the bond issuer.

RASW (also reverse asset-swap, Sell on asset swap, Sell on an asset swapped basis): Sell a bond packaged with a swap that is tailored to eliminate the bond's interest rate risk, effectively transforming the bond to a floating rate instrument whilst preserving the credit exposure to the bond issuer.

Distribution of fundamental credit and covered bond recommendations

As of 30 Sept 21, distribution of all independent fundamental credit recommendations published by HSBC is as follows:

Overweight	25%	(56% of these provided with Investment Banking Services in the past 12 months)
Neutral	49%	(39% of these provided with Investment Banking Services in the past 12 months)
Underweight	25%	(35% of these provided with Investment Banking Services in the past 12 months)

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

Distribution of trades

As of 30 Sep 21, the distribution of all trades published by HSBC is as follows:

Buy	79%	(65% of these provided with Investment Banking Services in the past 12 months)
Sell	21%	(50% of these provided with Investment Banking Services in the past 12 months)

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 RASW 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.

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures.

To view a list of all the independent fundamental recommendations disseminated by HSBC during the preceding 12-month period, and the location where we publish our quarterly distribution of non-fundamental recommendations, please use the following links to access the disclosure page:

Clients of Global Research and Global Banking and Markets: www.research.hsbc.com/A/Disclosures

Clients of HSBC Private Banking: www.research.privatebank.hsbc.com/Disclosures

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

Non-U.S. analysts may not be associated persons of HSBC Securities (USA) Inc, and therefore may not be subject to FINRA Rule 2241 or FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts.

Economic sanctions imposed by the EU, the UK, the USA and certain other jurisdictions generally prohibit transacting or dealing in any debt or equity issued by Russian SSI entities on or after 16 July 2014 (Restricted SSI Securities). Economic sanctions imposed by the USA also generally prohibit US persons from purchasing or selling publicly traded securities issued by companies designated by the US Government as "Chinese Military-Industrial Complex Companies" (CMICs) or any publicly traded securities that are derivative of, or designed to provide investment exposure to, the targeted CMIC securities (collectively, Restricted CMIC Securities). This report does not constitute advice in relation to any Restricted SSI Securities or Restricted CMIC Securities, and as such, this report should not be construed as an inducement to transact in any Restricted SSI Securities or Restricted CMIC Securities.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research. HSBC Private Banking clients should contact their Relationship Manager for queries regarding other research reports. In order to find out more about the proprietary models used to produce this report, please contact the authoring analyst.

Additional disclosures

1 This report is dated as at 29 November 2021.
2 All market data included in this report are dated as at close 25 November 2021, unless a different date and/or a specific time of day is indicated in the report.
3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
4 You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

Legal entities as at 1 December 2020

'UAE' HSBC Bank Middle East Limited, DIFC; HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc.; 'France' HSBC Continental Europe; 'Spain' HSBC Continental Europe, Sucursal en España; 'Italy' HSBC Continental Europe, Italy; 'Sweden' HSBC Continental Europe Bank, Sweden Filial; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; HSBC Bank plc, London, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR; The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch; PT Bank HSBC Indonesia; HSBC Qianhai Securities Limited; Banco HSBC S.A.

Issuer of report
The Hongkong and Shanghai Banking Corporation Limited
Level 19, 1 Queen's Road Central
Hong Kong SAR
Telephone: +852 2843 9111
Fax: +852 2801 4138
Website: www.research.hsbc.com

The Hongkong and Shanghai Banking Corporation Limited ("HSBC") has issued this research material. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Hong Kong Monetary Authority. If it is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate.

In the UK, this publication is distributed by HSBC Bank plc for the information of its Clients (as defined in the Rules of FCA) and those of its affiliates only. Nothing herein excludes or restricts any duty or liability to a customer which HSBC Bank plc has under the Financial Services and Markets Act 2000 or under the Rules of FCA and PRA. A recipient who chooses to deal with any person who is not a representative of HSBC Bank plc in the UK will not enjoy the protections afforded by the UK regulatory regime. HSBC Bank plc is regulated by the Financial Conduct Authority and the Prudential Regulation Authority. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (ABN 48 006 434 162, AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR.

In the European Economic Area, this publication has been distributed by HSBC Continental Europe or by such other HSBC affiliate from which the recipient receives relevant services

This material is distributed in Japan by HSBC Securities (Japan) Limited. HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. The information contained herein is under no circumstances to be construed as investment advice and is not tailored to the needs of the recipient. All US persons receiving and/or accessing this report and intending to effect transactions in any security discussed herein should do so with HSBC Securities (USA) Inc. in the United States and not with its non-US foreign affiliate, the issuer of this report. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. Only Economics or Currencies reports are intended for distribution to a person who is not an Accredited Investor, Expert Investor or Institutional Investor as defined in SFA. The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch accepts legal responsibility for the contents of reports pursuant to Regulation 32C(1)(d) of the Financial Advisers Regulations. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. Please refer to The Hongkong and Shanghai Banking Corporation Limited Singapore Branch's website at www.business.hsbc.com.sg for contact details. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV).

In Canada, this document has been distributed by HSBC Securities (Canada) Inc. (member IIROC), and/or its affiliates. The information contained herein is under no circumstances to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed judgment upon these materials, the information contained herein or the merits of the securities described herein, and any representation to the contrary is an offense. In Brazil, this document has been distributed by Banco HSBC S.A. ("HSBC Brazil"), and/or its affiliates. As required by Instruction No. 598/18 of the Securities and Exchange Commission of Brazil (Comissão de Valores Mobiliários), potential conflicts of interest concerning (i) HSBC Brazil and/or its affiliates; and (ii) the analyst(s) responsible for authoring this report are stated on the chart above labelled "HSBC & Analyst Disclosures".

Any recommendations contained in it are intended for the professional investors to whom it is distributed. This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. From time to time research analysts conduct site visits of covered issuers. HSBC policies prohibit research analysts from accepting payment or reimbursement for travel expenses from the issuer for such visits. The decision and responsibility on whether or not to invest must be taken by the reader. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

If you are an HSBC Private Banking ("PB") customer with approval for receipt of relevant research publications by an applicable HSBC legal entity, you are eligible to receive this publication. To be eligible to receive such publications, you must have agreed to the applicable HSBC entity's terms and conditions for accessing research and the terms and conditions of any other internet banking service offered by that HSBC entity through which you will access research publications ("the Terms"). Distribution of this publication is the sole responsibility of the HSBC entity with whom you have agreed the Terms. If you do not meet the aforementioned eligibility requirements please disregard this publication and, if you are a customer of PB, please notify your Relationship Manager. Receipt of research publications is strictly subject to the Terms and any other conditions or disclaimers applicable to the provision of the publications that may be advised by PB.

© Copyright 2021, The Hongkong and Shanghai Banking Corporation Limited, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited. MCI (P) 028/02/2021, MCI (P) 017/10/2021

[1183057]