ECONOMIC RESEARCH

The NewsLine

October 27, 2015

} MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

REVISION OF INTEREST RATES FORECAST

Low oil prices lead to low inflation, leads to low bond yields

Dr. Michael Heise
Phone +49.69.3800-16143
michael.heise@allianz.com
Allianz SE
https://www.allianz.com/economic-research/en

Allianz Research
https://twitter.com/AllianzResearch

Bond yields in Germany, the benchmark for the eurozone, are once again on the decline. In contrast to our previous forecast, ten-year Bund yields have come down to 0.5%. The main reason for this decline is the unexpected renewed drop in oil prices which has brought inflation back to zero and which has triggered speculation about further monetary policy easing by the ECB. We have reduced our forecasts for ten-year bond yields from 1.0% to 0.7% at the end of 2015 and from 1.8% to 1.5% at the end of 2016.

This revision is basically motivated by a lower forecast for inflation of 0.1% in 2015 (annual average headline inflation in EMU) and 1.2% in 2016, which is in turn based on a lower level and trajectory for oil prices. This has also pushed inflation expectations down. In our view these are transitory deviations from the inflation benchmark of below, but close to 2% that could be ignored by monetary policy. The ECB, however, has signaled its concern about the recent developments and thereby given rise to expectations of further quantitative easing. In our view, the impact of further easing on both actual inflation and inflation expectations is likely to be muted.

	End December 2014 inflation: annual average	End December 2015 inflation: annual average	End December 2016 inflation: annual average
Inflation (in %)			
EMU consumer price inflation	0.4	0.1	1.2
Interest rates (in %)			
3m money market rate (EMU)	0.1	0.0	0.1
10yr German government bond yield	0.5	0.7	1.5
Exchange rate			
USD/EUR	1.21	1.10	1.15
Commodities			
Brent (USD/barrel)	55.9	50.0	60.0
DAX	9,800	≈ 11.500	≈ 12.500

For 2016, however, we do expect a moderate increase in oil prices and a corresponding uptick in consumer price inflation. Under the assumption that consumer prices rise by 1.2% on average, short- and medium-term inflation expectations will also move up. This, along with the change in the Fed's policy stance, will create moderate upward pressure on bond yields – notwithstanding the fact that the ECB will continue its bond purchase program. We expect bond yields and inflation to rise in parallel, so the level of real interest rates will remain at practically zero. The challenge of low interest rates for savings products and pension assets is therefore here to stay.

We do not see major consequences of the lower forecast of interest rates for the euro-dollar exchange rate as the Federal Reserve is also treading cautiously with its change of course and is likely to take countermeasures should the dollar rise strongly. We therefore stick to our forecast that the euro will be moderately weaker in the next couple of months but will climb to 1.15 USD/EUR by end-2016.

These assessments are, as always, subject to the disclaimer provided below.

ABOUT ALLIANZ

Together with its customers and sales partners, Allianz is one of the strongest financial communities. About 85 million private and corporate customers insured by Allianz rely on its knowledge, global reach, capital strength and solidity to help them make the most of financial opportunities and to avoid and safeguard themselves against risks. In 2014, around 147,000 employees in over 70 countries achieved total revenues of 122.3 billion euros and an operating profit of 10.4 billion euros. Benefits for our customers reached 104.6 billion euros.
This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an aging society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.