Focus

3 december 2018

‘Even superfluous indicators can be valuable”

“Until recently, the shape of the yield curve was considered to be particularly relevant. But these and other similar indicators will remain superfluous in 2019”

Indicators are like pilot lights telling you whether a certain condition has been met. There’s a tendency these days to think they can predict future trends. Which isn’t to say that they have no use. A good indicator encourages us to think about the origin of what it has detected and hence to try to understand what lies ahead.

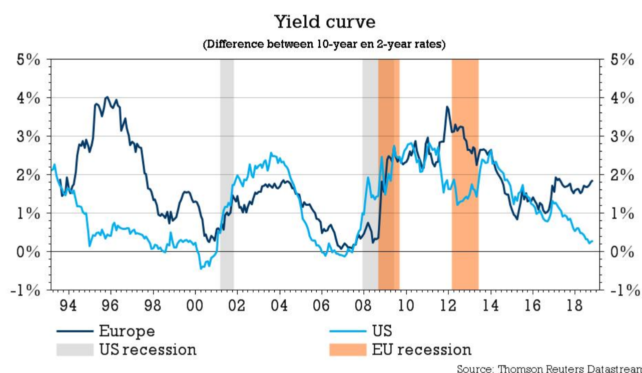
Why has the US yield curve lost its relevance?

Until recently, the shape of the yield curve – in particular the pattern of the yield spread between 2-year and 10-year Treasuries – was considered an especially relevant indicator.

If we analyse the historical evolution of this spread, we find that periods of recession have always been preceded by a drastically narrowed or even negative spread. Having stood at 280 basis points (2.80%) in 2010, the spread fell to 22 basis points (0.22%) in August, its lowest level since July 2007.

Negative territory. Now what?

If we were to tip into negative territory, i.e. the point at which investors start to demand more for holding a 2-year bond than a 10-year one, this tells us that they are not confident about future economic conditions. It would, in other words, signal a recession. Long rates are, however, influenced by elements that have nothing to do with the state of the economy but with demographic and other factors.



What about weak inflation and demographic ageing?

The relative ageing of the population is indeed encouraging investors to invest in bonds, as are American pension funds, for similar reasons. Pressure on long rates has nothing to do in this instance with any expectation of an economic slowdown.

Another factor to consider is the low level of inflation, despite sustained growth. Investors are not demanding a higher long-term return because they don’t expect inflation to rise.

The curve has lost some of its aura

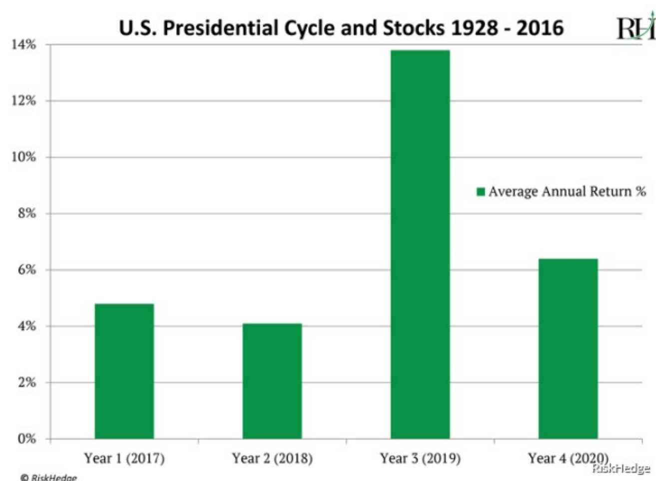
The combination of these elements –but probably also the Fed’s quantitative easing programme – has therefore undermined yet another economic theory. The flattening of the curve used to be viewed as an

extremely relevant signal of recession, but its importance has now diminished and it has become just one of the indicators to watch, like those relating to the state of the real estate market.

All the same, this doesn't alter the fact that the flattening curve is an anomaly suggesting that the massive injection of liquidity has totally distorted the markets and that interest rates will normalize at much lower levels than in the past.

The same goes for some other indicators

As the opinion polls were already suggesting, the mid-term elections were hardly an unequivocal success for the Republicans and their incumbent president Donald Trump. However, the result shouldn't make a huge difference as far as the stock markets are concerned. Based on historical data, earnings in the year ahead ought to come in at 17%



– an interesting forecast, to say the least, that comes from MarketWatch. There have been 18 mid-term elections since 1946, followed a year later by stock market gains (averaging 17%). These rises were not linked to the results of the election, since the mid-terms held since the Second World War have produced every possible permutation: a Republican president with a Democratic Congress, a Democratic president with a Republican Congress, a Republican president and Congress and a Democratic president and Congress.

Authors:	Bernard Keppenne
	Chief Strategist
	CBC Banque

Tom Simonts

Senior Financial Economist
KBC Group

E-mail: tom.simonts@kbc.be
Tel.: +32 2 429 37 22
Mobile: +32 496 57 90 38

Address: KBC Group
Havenlaan 2 (GCM)
B 1080 Brussels

A KBC Group partnership
Take a look at www.kbceconomics.be, www.kbcsecurities.com and www.kbcam.be

To subscribe to/unsubscribe from The Front Row's mailing list,
send an e-mail to frontrow@kbc.be with the subject line 'The Front Row' and/or 'Notendop'.

Disclaimer

This publication provides a general picture of the current economic situation and cannot be taken to constitute investment advice or a recommendation to invest in the financial instruments described, nor is any investment strategy proposed. In some cases, however, this publication may refer to and contain summaries of investment recommendations from other entities forming part of the KBC group.

The information contained in this publication may be reused, provided that this is requested in advance and KBC has given its explicit permission for such reuse. Reuse must be limited in all cases to the textual information. The information contained in this publication has been taken by KBC Bank from sources which it considers to be reliable. However, no guarantee is given concerning the accuracy, completeness or timeliness of that information. No guarantee can be given that any proposed scenarios, risks or forecasts reflect market expectations, or that they will actually materialise.

Neither KBC Group NV nor any other company forming part of the KBC group (nor any party appointed by them) can be held liable for any loss, direct or indirect, resulting from access to, consultation or use of the information and data contained in this publication or on the websites www.kbcam.be, http://www.kbcsecurities.be and www.kbcprivatebanking.be.

KBC Group NV – under the supervision of the Financial Services and Markets Authority – www.kbc.com