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Goldman Goes All-In for Steeper U.S. Yield Curves as 2021 Theme

- **Prediction applies to both nominal and real U.S. yield curves**
- **Fed policy of letting inflation run hot helps drive view**

By Liz Capo McCormick

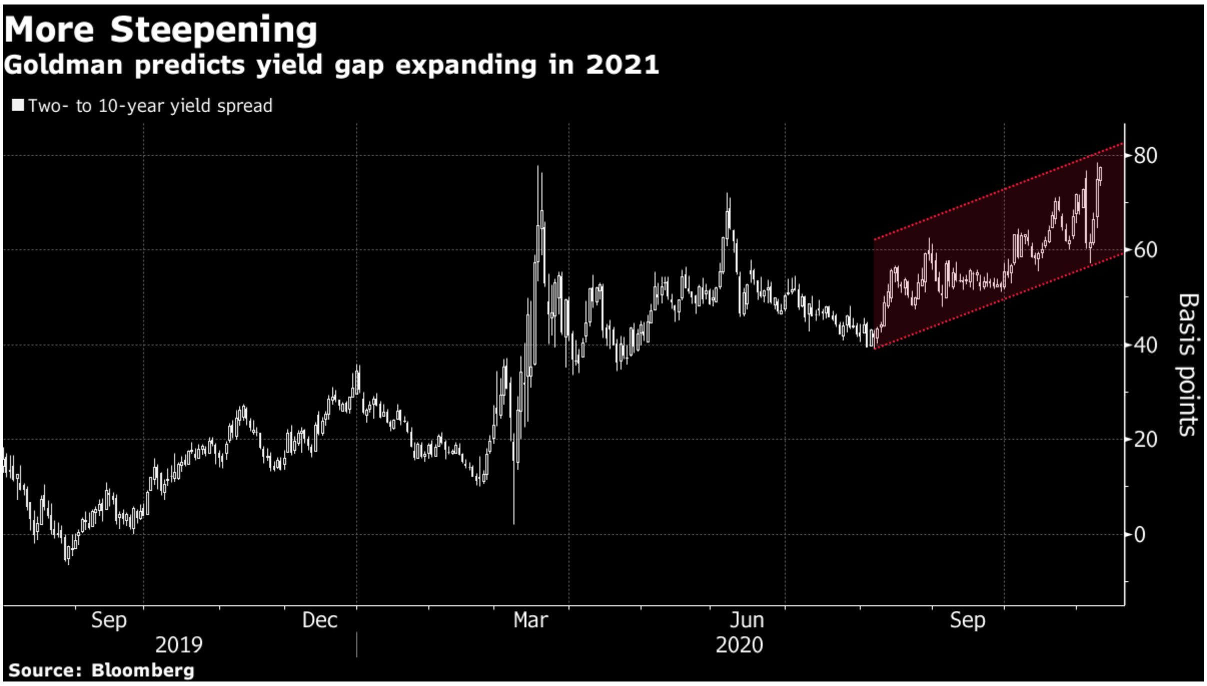
(Bloomberg) -- In its vision for key global 2021 investment themes, Goldman Sachs Group Inc. sees the U.S. yield curve steepening -- for nominal as well as real rates.

The forecast, laid out in the firm's annual year-ahead investment outlook, is already playing out in a big way to start this week. The Treasuries yield curve reached close to the steepest level since 2016 after positive coronavirus-vaccine news brightened the growth outlook for the year ahead.

The steepener is a projection that many on Wall Street have held for the past couple of months, with the Federal Reserve saying it will let the economy run hot to help spur inflation. That backdrop and a strong growth rebound from the pandemic have been spurring speculators to load up on steepening bets.

"As the economic recovery consolidates next year, we expect to see more differentiation across the curve, with policymakers committing to keeping front-end rates low, but higher expectations for real growth and inflation driving long-end rates higher," Goldman strategists including Zach Pandl wrote in the report, released Tuesday.

"This should be especially true in the U.S. due to the Federal Reserve's new average inflation targeting framework, which commits the central bank to holding off on rate hikes until inflation has reached its target and is on track to overshoot it."



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Goldman forecasts that 10-year Treasury yields will reach 1.3% by the end of next year, from about 0.96% now. Meanwhile, they foresee two-year yields just inching up from their present 0.18% level to 0.25%. That means the bank sees roughly 30 basis points of steepening for the 2- to 10-year curve -- now at about 78 basis points.

Real Yields

The firm's forecasts for the pace of inflation over the coming year would have the gap between real yields - -- which strip out the effects of inflation -- expanding as well.

Ten-year real yields have been consistently below zero since late March, touching an all-time low of minus 1.12% on Sept. 2, and now trade at minus 0.8%. Swings in real rates have mostly been driven by movements in inflation expectations in the wake of the Fed's shift in September to a new schema that aims for inflation to average 2% over time.

Five-year real rates stand at minus 1.2%. And given Goldman's economics team predicts that the real fed funds rate will average about -2.1% over the next five years, the strategists expect the five-year real yield will fall substantially further. Meanwhile, they foresee long-term real rates becoming less negative over the next year.

"We expect a steeper real yield curve, especially if our bullish oil price forecasts prove correct," the Goldman strategists wrote. The firm in another 2021 theme predicted that Brent crude oil prices end 2021 at $65 per barrel, a roughly 50% rise.

More highlights from Goldman's outlook include:

- Goldman Says Being Short Europe's Bonds Offers Best Risk-Reward
- Goldman Sees Oil Hitting Covid-19 Speed Bump Before Tightening

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