

Daiwa's View

Inflation indicators also warrant attention

- Level of longer-run federal funds rate projection, stopper for current yield rises, may change

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Daiwa Securities Co. Ltd.

Level of longer-run federal funds rate projection, stopper for current yield rises, may change

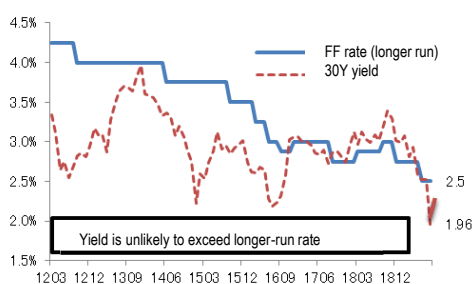
Inflation indicators also warrant attention

Yields are climbing, which reminds us of similar moves when the BOJ conducted its Comprehensive Assessment for Quantitative and Qualitative Monetary Easing in 2016. However, the current trend is unlikely to continue because (1) US yields are serving as one cause of the current yield rises and (2) the upside potential of the 30-year US yield is now much more limited than in 2016. While the longer-run US federal funds rate was projected at 2.875% in 2016, it is currently estimated at just 2.5%, showing a big difference (left-hand chart below). If the longer-run projection serves as a stopper for the rising 30-year US yield, the pace of the JGB yield uptrend would also slow.

In the sense that the longer-run projection could stop the rise in US yields, August US CPI readings to be announced today need to be examined closely. The longer-run projection consists of two factors—inflation expectations and the natural rate of interest. If inflation expectations change, the downtrend of the longer-run figure (projected by market) may stop. As Fed chair Jerome Powell pointed out, US CPI readings have recently been favorable in a straightforward manner (right-hand chart below; market consensus for Aug core CPI +2.3% y/y), although this has been disregarded amid the global slowdown. Once the market resumes watching inflation indicators, the figures may serve as a factor to cause market confusion.

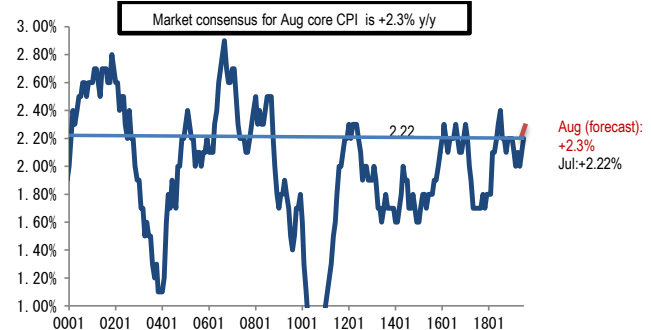
We have been focusing on the “[opportunistic reflation](#) strategy” advocated by Fed governor Lael Brainard, as it has potential to raise yields in the future. If the favorable employment environment absorbs (bad) price increases due to tariffs imposed on Chinese products, the chance is not zero that inflation expectations will be adaptively formed in the US. Without prejudgment, we intend to check the US CPI—how the Fed’s sturdy new strategy will influence longer-run projections that should stop the current yield rises. This is also an important point for JGBs posting yield increases.

Chart: US Longer-run Federal Funds Rate and 30Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

Chart: US Core CPI



Source: Bloomberg; compiled by Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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 The Financial Futures Association of Japan
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