Daiwa's View

Yields fell back due to weak University of Michigan index

- Concerns about stagflation?

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Concerns about stagflation?

Yields fell back due to weak University of Michigan index

Last week, the US long-term yield rose to 1.37% at one point, reflecting comments by Fed Vice Chair Richard Clarida and the jobs report. However, it fell back substantially to the 1.2% level, probably because of the huge drop in the University of Michigan's Consumer Sentiment Index (falling from an estimate of 81.2 to an actual reading of 70.2, the lowest level since 2011). This implies a wider gap between the unprecedented economic boom indicated by the supply side, such as the ISM indices, and stronger awareness of frugality among consumers suffering from inflation and the Delta variant. We feel this index has made us somewhat more aware of concerns about stagflation.

US Treasury Yields (%)

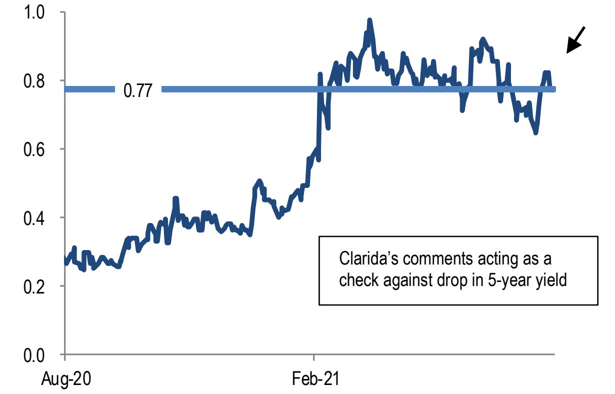
	5Y	5Y OIS	5Y5Y	5Y5Y OIS	10Y	10Y OIS
12-Aug-21	0.82	0.74	1.96	1.61	1.36	1.15
14-Aug-21	0.77	0.68	1.82	1.49	1.28	1.08
Change	-0.05	-0.06	-0.14	-0.12	-0.08	-0.07

Source: Bloomberg; compiled by Daiwa Securities.

At any rate, yields declined tremendously, as if the DJIA had plunged by as much as 1,000 points. (In fact, the DJIA continued to hit record highs last week without posting a single drop.) The stock market may be looking for the typical narrative that low interest rates are favorable to stock prices. However, seeing yields fall this much while stock prices hit record highs, we are forced to recognize the stock effects from cumulative bond purchases via major central banks' QE since the outbreak of the pandemic.

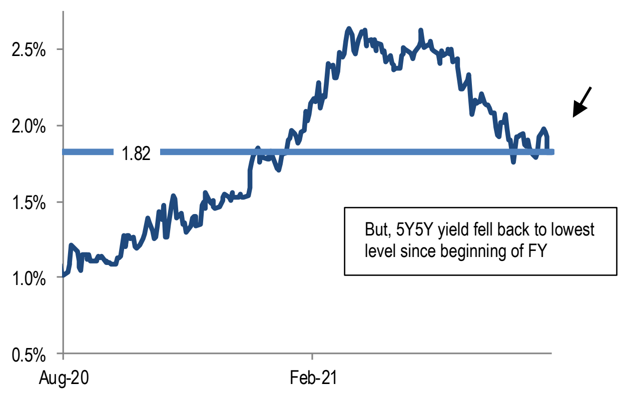
The breakdown shows that the 5-year forward 5-year yield has already returned to the level of two weeks ago when the long-term yield logged the 1.1% level (right-hand chart below). The reason behind the long-term yield staying in the upper 1.2% range in this situation is that the aforementioned comments by Clarida on 4 August are acting as a check against a drop in the 5-year yield.

5-year US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

5-year Forward 5-year US Yield



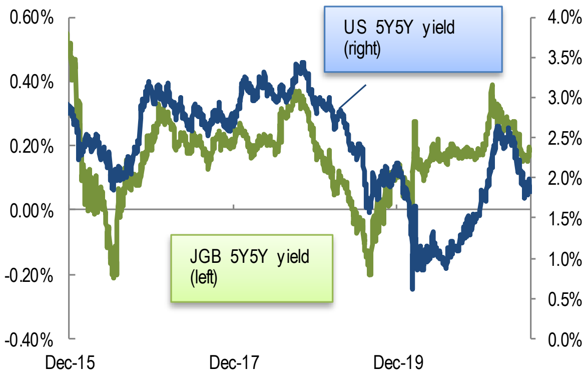
Source: Bloomberg; compiled by Daiwa Securities.

However, the Fed's hawkish stance reminds us of the possibility of a policy mistake (a high-pressure economy misstep), which is likely to lead to a decline in superlong yields. If this causes a surge in stock and real estate prices, we can say that the current situation is truly deadlocked. Therefore, we can't completely shake the feeling that the Fed is already in checkmate.

These circumstances provide further reason for our thinking that the important items to be confirmed this week are the FOMC minutes to be released on the 18th and the results of the surveys of primary dealers/market participants due out on the following day (the 19th). At a press conference after the July FOMC meeting, Fed Chair Jerome Powell disclosed that participants had an in-depth discussion about the timing, pace, and structure of QE tapering. The statement at the July FOMC meeting obviously shows that the Fed has an aggressive stance towards tapering. If the minutes indicate an intention to pick up the pace of reduction in the purchase amounts in order to secure discretion regarding the rate-hike timing, this, combined with the aforementioned comments by Clarida, will create a situation in which it is difficult for short-term/intermediate yields to decline further and easy for them to rise.

Reflecting the drop in US yields, the price of long-term JGB futures rose to Y150.30 (up Y0.1) in the night market. Expectations of rate hikes by the BOJ are low to begin with, meaning that a rise in the 5-year forward 5-year yield would be required for a rise in the 10-year JGB yield. A correlation has been confirmed between the US and Japan with respect to the 5-year forward 5-year yield. Also, the upward momentum of the 5-year forward 5-year US Treasury yield is now temporarily weak. In light of this situation with US yields, it is highly likely that the 10-year JGB yield will also continue to move in a narrow 0-0.05% range in the near term.

5-year Forward 5-year Yield in Japan and US



Source: Bloomberg; compiled by Daiwa Securities.

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