

Daiwa's View

Will the ECB taper around the same time as the Fed?

- Both the Fed and ECB may begin tapering in 4Q

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Daiwa Securities Co. Ltd.

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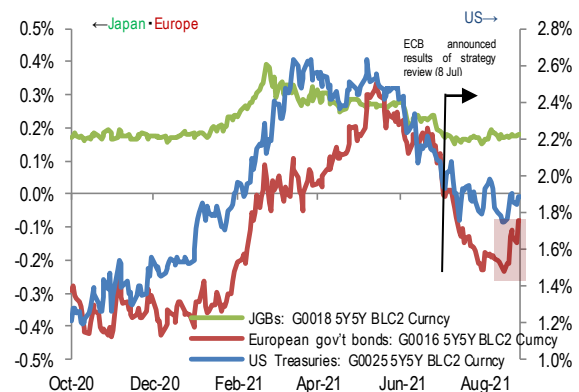
US Treasury yields bear steepened somewhat yesterday. The catalyst was probably not conditions in the US but rather hawkish comments on quantitative easing from ECB officials and the consequent sharp bear steepening of euro zone yields. Robert Holzmann, Governor of Austria's central bank, commented "If enough people share my opinion, we will certainly advise the Executive Board to slow down purchases in the fourth quarter and more so in the first." Although Governor Holzmann is a well-known hawk, his comment suggests the ECB may begin tapering around the same time as the Fed.

That being said, the strong reaction of euro zone yields last night was probably in large part a rebound from the excessive decline in the forward yields of euro zone sovereigns that had occurred after the ECB announced the results of its strategy review on 8 July (see Chart below). After that announcement, the 5-year forward 5-year German Bund yield declined from slightly positive down to -0.23% (it closed yesterday at -0.08%). Mr. Holzmann's comment provided an opportunity for a retracing of yields that had overshot somewhat.

Robert Holzmann, Governor of Austria's central bank (31 Aug 2021)

• We are now in a situation where we can think about how to reduce the pandemic special programs -- I think that's an assessment we share. ...If enough people share my opinion, we will certainly advise the Executive Board to slow down purchases in the fourth quarter and more so in the first.

5Y-forwarded 5Y Yield in Japan, US, Europe



Source: Bloomberg; compiled by Daiwa Securities.

Mr. Holzmann also touched on the future flexibility of QE, noting that although QE was necessary during the pandemic, it is unlikely to play a role in solving inflation issues. The Pandemic Emergency Purchase Program (PEPP) was initiated without strict adherence to the capital key and thus far has been used to support government bonds issued by peripheral EU members, but Mr. Holzmann suggested that the Asset Purchase Program (APP) cannot have the same level of flexibility.

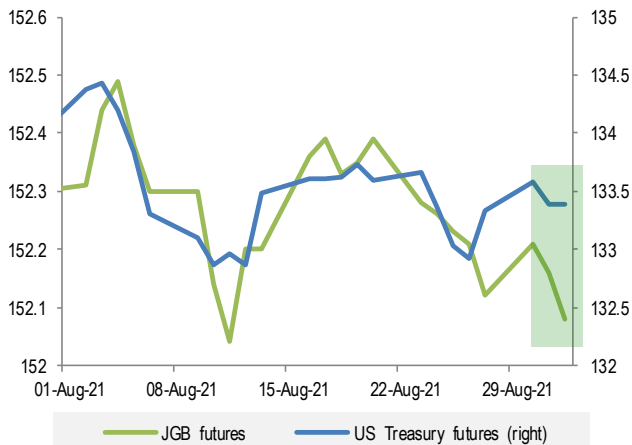
His comments affected spreads on bonds issued by peripheral euro zone governments, and spreads on Italian government bonds over German Bunds widened from 105bp to 109bp. This widening of spreads on bonds issued by peripheral euro zone members did not ripple through the broader euro zone credit market. Yesterday's widening of spreads on periphery government bonds can probably be attributed to the ending of excessive support provided to deal with the pandemic.

◆ JGBs: Will the Diet be dissolved in mid-September?

JGB futures declined to 152.08 in overnight markets. Given their correlation with Treasury futures, last night's decline was a large one (see lower left Chart). Although this could be explained in part by their correlation with euro zone government bond futures, it does not make sense that JPY yields would be purely correlated with euro zone yields, which were retracing their overshoot in reaction to the ECB's announcing the results of its strategy review. We think the decline in JGB futures was mostly a reaction to Japan-specific factors.

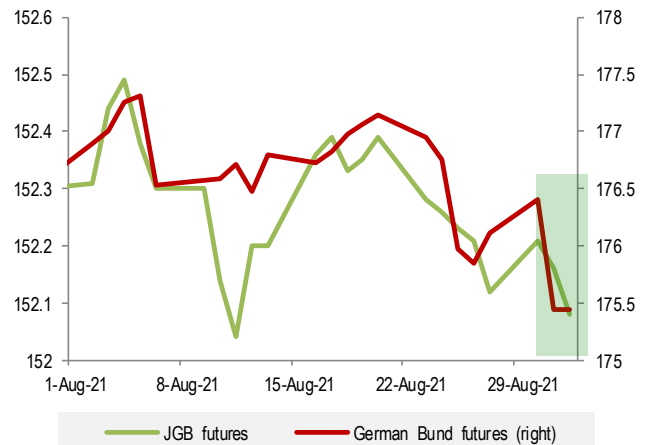
Last night, the *Mainichi Newspapers* reported that Prime Minister Suga wants to dissolve the Diet in mid-September and delay the LDP leadership election, and the *Asahi Shimbun* and the *Yomiuri Shimbun* carried similar stories the next morning. If these reports are true, then the election order that had become the consensus within the party after the Yokohama mayoral election of holding the LDP leadership election first followed by the lower house election may be reversed soon. This of course will affect the schedule for forming a supplementary budget. The political plot is thickening and the denouement is coming soon. Don't assume that you know how it will end.

Long-term Government Bond Futures (Japan, US)



Source: Bloomberg; compiled by Daiwa Securities.

Long-term Government Bond Futures (Japan, Germany)



Source: Bloomberg; compiled by Daiwa Securities.

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