Daiwa's View

Substantial steepening in line with "sell the fact" dictum

- Rise in yields amid Fed's tighter stance to tame inflation = Good opportunity to buy on dip

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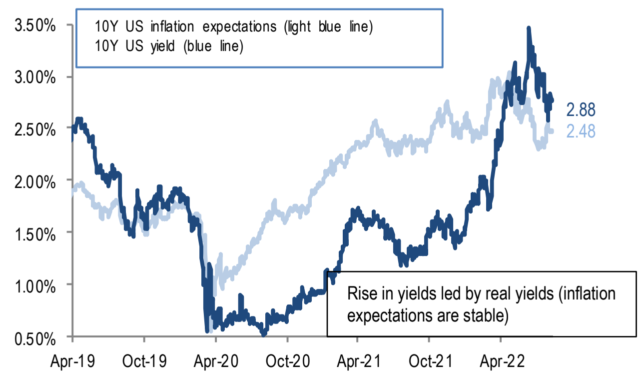
While CPI and PPI data were lower than market estimates, the bond market was dominated by two elements: the "sell the fact" dictum and Fed officials warning about an early pivot. The 2-year US yield logged 3.29% → 3.07% →3.22%, substantially paring the decline following the warning by Fed officials. Meanwhile, the US long-term yield rose significantly, showing volatile movements (2.81% → 2.6% → 2.88%). That said, one notable point here is that yields rose led by real yields (in a desirable way) as the breakeven inflation rates remained low and stable (10-year rate of 2.48%, 5-year forward 5-year rate of 2.25%). This appears to be largely influenced by Fed officials' remarks, which gave a clearer warning than before.

In particular, Minneapolis Fed President Neel Kashkari said on 10 August that the Fed would aim for the 2% target whether we are in a recession or not. It was surprising that he clearly showed a stance of accepting a recession, as explicit statements on the subject had been avoided up to that point. Of course, a recession itself has been tacitly accepted since the Fed showed its unconditional commitment. He seems to have deftly delivered this rubber-stamping of the market's strong awareness of a recession at a time when financial conditions were turning to an accommodative level. Certainly, CPI and PPI readings are the first positive hints. However, the statement confirmed that data on a single month basis is unlikely to serve as a fundamental factor in changing the Fed's policy outlook.

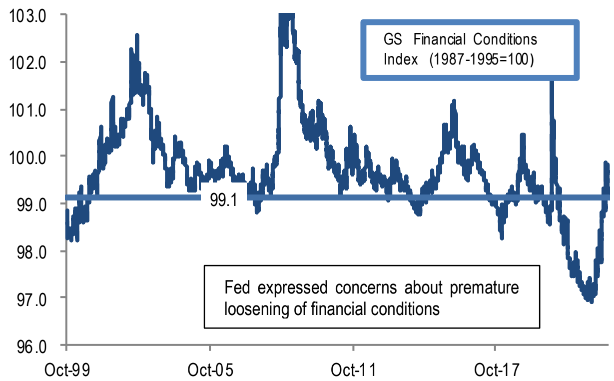
In addition, the fact that we can continue to trust the Fed's stance to tame inflation means a certain degree of safety to buy the US long-term yield, which has risen close to 3%. It is vital to confirm that a rise in yields is not triggered by a decline in trust in the Fed. We think that a rise in yields occurring when the Fed's strict stance to rein in inflation is reconfirmed (not caused by a resurgence of inflation concerns) is a good dip-buying opportunity.

10Y US Yield, Breakeven Inflation Rate



Source: Bloomberg; compiled by Daiwa Securities.

10Y Breakeven Inflation Rate (BEI)



Source: Bloomberg; compiled by Daiwa Securities.

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