

Daiwa's View

Yield curve may flatten further depending on jobs report and strong dollar

- Tapering = Flattening?
- Strong dollar can no longer be explained by the 10-year yield

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Tapering = Flattening?

Yield curve may flatten further depending on jobs report and strong dollar

Yesterday, the US yield curve flattened again, with the 5-year/30-year yield spread sliding to 117bp for the first time since 21 June after the FOMC meeting.

Looking back at the 5-year/30-year yield spread in the previous tapering stage, the tapering itself started in January 2014, but the steepening peaked in November 2013, two months before the tapering started. We want to point out that, rather than steepen, the yield curve flattened before the start of tapering. With the manifestation of the phenomenon that people had been concerned about (i.e., priced in), the market reaction was based on buy-the-fact thinking.

This time as well, the tapering is already a done deal. Moreover, we are seeing a series of aggressive remarks by Fed officials with respect to projections for an earlier start/reduction pace. If things develop as before following a “tapering = flattening” pattern (although it is already occurring), an earlier start to tapering would mean an earlier shift to flattening.

If so, we may have to be aware of the possibility that the 5-year/30-year US Treasury yield spread will fall below the threshold of 115bp triggered by the US jobs report due out tonight. While the pace of flattening does feel a little too fast, given the quick change in the Fed's recognition implied by remarks by officials, this pace is not necessarily too fast.

US Treasury 5Y/30Y Spread

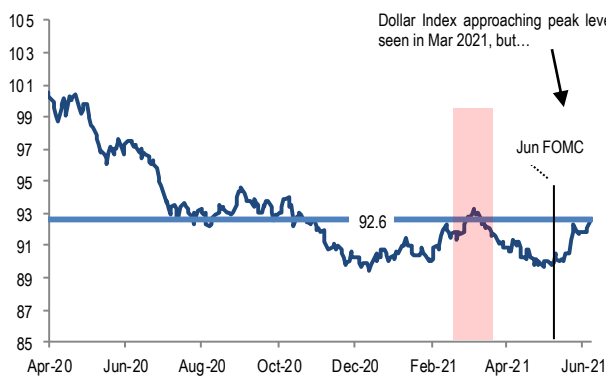


Source: Bloomberg; compiled by Daiwa Securities.

- ◆ Strong dollar can no longer be explained by the 10-year yield
Another point of concern among many market participants would probably be the strong dollar, which is currently showing signs of gaining further momentum. The Dollar Index (DXY) has now risen to 92.6, approaching the year-to-date peak level of 93.27 hit on 30 March (on Bloomberg closing basis).

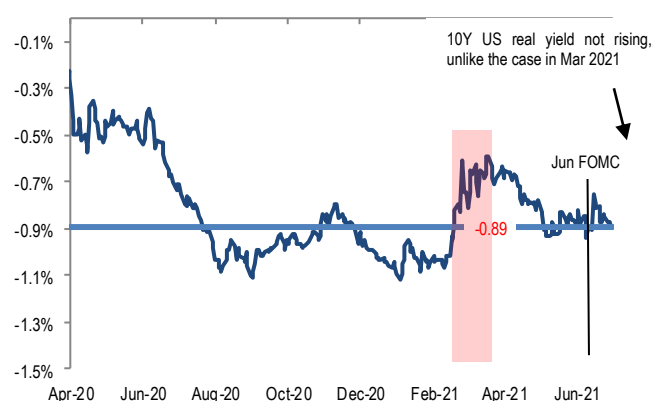
During February-March 2021, the 10-year US Treasury yield was at its peak level both in nominal and real terms. On 30 March, when the dollar was at its strongest in recent times, the 10-year yield and the real yield stood at 1.70% and -0.64%, respectively. Meanwhile, yesterday's levels (1.47% and -0.89%) were much lower than those in March. Nevertheless, the dollar has now strengthened close to the level seen around March. In other words, the current appreciation of the dollar can no longer be explained by the 10-year yield.

Dollar Index (DXY)



Source: Bloomberg; compiled by Daiwa Securities.

10Y US Real Yield (= TIPS yield)



Source: Bloomberg; compiled by Daiwa Securities.

Dollar Index, US Yield (%)

	30-Mar	2-Jul
DXY	93.27	92.57
10Y US yield	1.70	1.47
10Y US real yield	-0.64	-0.89
5Y US yield	0.9	0.89

Source: Bloomberg; compiled by Daiwa Securities.

With the Dollar Index having edged up around the June FOMC meeting (90.5 before the meeting), we think that this appreciation of the dollar is reflecting the Fed's hawkish shift. In fact, the 5-year US yield, which tends to reflect market forecasts for the policy rate path, is at 0.89%, almost the same level as the 0.9% on 30 March. This means that the Dollar Index may exceed the year-to-date peak if the market prices in an earlier rate hike due to tonight's jobs report.

As is well known, a strong dollar has the effect of calming domestic inflation via lower import prices. Of course, there are numerous factors behind the fluctuation of exchange rates besides yields. Therefore, it may be too simplistic to assume that the Fed's rate hike stance will lead to appreciation of the dollar. However, if the dollar strengthens in parallel with the Fed's aggressive exit strategy, the strong dollar will put downward pressure on long-term yields by way of reining in inflation expectations, which should put flattening pressure on the yield curve. So, [the Fed is, in a sense, almost in checkmate](#)¹ after all. If so, our appropriate investment behavior from now is clear—i.e., we should engage in flattener trades.

¹ Refer to Daiwa's View "[Is Fed almost in checkmate?](#)" dated 18 Jun 2018.

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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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- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITs: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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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 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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Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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