

Daiwa's View

Bear steepening due to packed supply schedule

- Temporary normalization of excessively strong demand for bonds?
- String of comments speculating on scaling back monetary easing in Europe

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp



Daiwa Securities Co. Ltd.

Temporary normalization of excessively strong demand for bonds?

Bear steepening due to packed supply schedule

Yesterday, US and European government bond yields posted bear steepening, with the 10-year US Treasury yield rising 5bp. Looking at other risk assets, the NASDAQ Index ended higher, while the DJIA and commodities ended lower. This does not feel like a return to reflation trade.

Yesterday, yields rose at an accelerated pace due to the supply of an enormous number of corporate bonds combined with setups for Treasury auctions. From the outset, the issuance of a large number of corporate bonds was slated for the bond issuance window after Labor Day. That said, an enormous number of bonds totaling more than \$36.2bn were issued yesterday alone (chart on next page). This week's schedule for Treasury auctions is packed, with an auction yesterday for 3-year notes (\$58bn), another today for 10-year notes (\$38bn), and one tomorrow for 30-year bonds (\$24bn). On top of this, the number of corporate bonds supplied yesterday corresponded to the scale of a Treasury auction, which probably had a considerable impact on Treasury yields, as well.

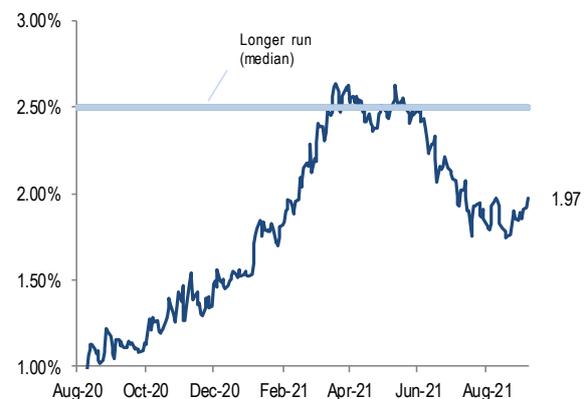
That said, the 10-year US Treasury yield is still in the upper 1.3% range, despite a d/d gain. Looking at the breakdown, the yield is balanced with a 5-year yield of 0.82% and a 5-year forward 5-year yield of 1.97%. These are at an appropriate level or lower in light of fundamentals. Therefore, we might be able to interpret this as the supply/demand balance being temporarily normalized by this concentrated supply during a time when there has been excessively strong demand for bonds due to QE. If yields rose due to this factor alone, the rise may be trimmed back down again after the end of this round of supply.

5Y US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

5Y-forward 5Y US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

Issuance List of US Corporate Bonds (7 Sep)

Date	Issuer	Coupon (%)	Maturity	Spread (bp)	Currency	Outstanding (\$ mn)
7-Sep	DANSKE BANK A/S	1.549	09/10/27	73	USD	1000
7-Sep	DANSKE BANK A/S	0.976	09/10/25	55	USD	1000
7-Sep	NESTLE HOLDINGS	1.500	09/14/28	40	USD	1000
7-Sep	NESTLE HOLDINGS	1.150	01/14/27	35	USD	500
7-Sep	NESTLE HOLDINGS	1.875	09/14/31	50	USD	1000
7-Sep	NESTLE HOLDINGS	2.5	09/14/41	60	USD	500
7-Sep	NESTLE HOLDINGS	0.606	09/14/24	18	USD	1,500
7-Sep	NESTLE HOLDINGS	2.625	09/14/51	68	USD	500
7-Sep	TORONTO DOM BANK	1.25	09/10/26	47	USD	1,400
7-Sep	TORONTO DOM BANK	2	09/10/31	67	USD	900
7-Sep	TORONTO DOM BANK	FRN	09/10/26		USD	300
7-Sep	TORONTO DOM BANK	FRN	09/10/24		USD	900
7-Sep	TORONTO DOM BANK	0.7	09/10/24	30	USD	1,000
7-Sep	TEXAS INSTRUMENT	2.7	09/15/51	75	USD	500
7-Sep	TEXAS INSTRUMENT	1.9	09/15/31	55	USD	500
7-Sep	BANCO SANTANDER	VAR	09/14/27	90	USD	1,500
7-Sep	TEXAS INSTRUMENT	1.125	09/15/26	30	USD	500
7-Sep	AMERICAN HONDA F	0.75	08/09/24	35	USD	1,000
7-Sep	JOHN DEERE CAP	FRN	07/10/23		USD	750
7-Sep	ADM	2.7	09/15/51	80	USD	750
7-Sep	JOHN DEERE CAP	0.625	09/10/24	22	USD	500
7-Sep	DXC TECH CO	2.375	09/15/28	125	USD	650
7-Sep	CATERPILLAR FINL	FRN	09/13/24		USD	750
7-Sep	DXC TECH CO	1.8	09/15/26		USD	700
7-Sep	CATERPILLAR FINL	0.6	09/13/24	22	USD	750
7-Sep	EFE	3.83	09/14/61	185	USD	500
7-Sep	CATERPILLAR FINL	1.15	09/14/26	37	USD	500
7-Sep	GA GLOBAL FNDING	FRN	09/13/24		USD	500
7-Sep	AMPHENOL CORP	2.2	09/15/31	87	USD	750
7-Sep	GA GLOBAL FNDING	1.95	09/15/28	85	USD	500
7-Sep	HOME DEPOT INC	2.75	09/15/51	82	USD	1,000
7-Sep	HOME DEPOT INC	1.875	09/15/31	57	USD	1,000
7-Sep	GA GLOBAL FNDING	0.8	09/13/24	45	USD	500
7-Sep	HOME DEPOT INC	1.5	09/15/28	42	USD	1,000
7-Sep	UNION PAC CORP	2.95	03/10/52	97	USD	850
7-Sep	RBC	1.05	09/14/26		USD	2,500
7-Sep	WASTE CONNECTION	2.95	01/15/52	105	USD	850
7-Sep	UNION PAC CORP	2.375	05/20/31	73	USD	1,000
7-Sep	WASTE CONNECTION	2.2	01/15/32	85	USD	650
7-Sep	MET TOWER	1.25	09/14/26	45	USD	500
7-Sep	PACKAGING CORP	3.05	10/01/51	110	USD	700
7-Sep	PECO ENERGY CO	2.85	09/15/51	88	USD	375
7-Sep	SOUTHERN GAS	3.15	09/30/51	123	USD	450
7-Sep	ENTERPRISE PRODU	3.3	02/15/53	137.5	USD	1,000
7-Sep	DBS GROUP HLDGS	1.194	03/15/27	37	USD	800
	Total					36,275

Source: Bloomberg (command: NIM3); compiled by Daiwa Securities.

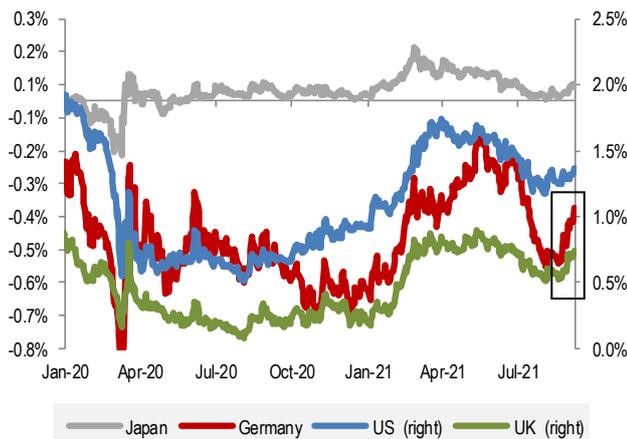
String of comments speculating on scaling back monetary easing in Europe

Meanwhile, a rise in European yields (10-year German yield up 5bp) appears to be a direct reflection of discussion about scaling back monetary easing. The market has already factored in the fact that tomorrow's ECB Governing Council meeting will discuss reduction of QE (PEPP) and the announcement of a slowdown in the pace of government bond purchases, something we have already issued a preview report on.

One new factor was an interview with a former ECB official in yesterday's MNI entitled [ECB Hikes May Be Closer Than Thought](#), which included the opinion that "the ECB may have to hike more quickly than it thinks in order to safeguard the financial system." This has further solidified the impression of a rapid hawkish shift by central banks which are falling behind the curve, a feeling that has been easily evoked since the June FOMC meeting. In the current environment in which the scaling back of monetary easing is expected to be discussed, this interview appears to have poured salt on the wound and had an impact on the market to a certain degree.

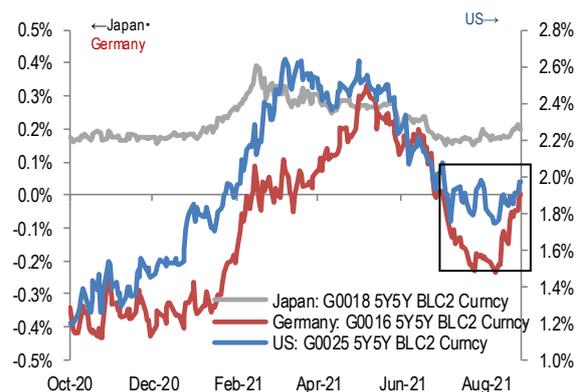
Ahead of the Governing Council meeting, German yields have already undergone a certain degree of correction due to hawkish comments by officials since the latter part of last month and a surge in yields around that time (the 10-year German yield rose from -0.50% on 20 Aug to -0.32% on 7 Sep). However, given the timing, which overlaps with the packed supply schedule in the US Treasury market, we need to be attentive to these developments. German yields are still in the range of 'reversal' from the excessive drop following the strategy review in July (charts below). However, if yields continue to rise from now on due to additional hawkish surprises, such surprises may also start to have a certain degree of impact on global yield trends beyond the reversal range.

10Y Government Bond Yield in Japan, US, Germany, UK



Source: Bloomberg; compiled by Daiwa Securities.

5Y-forward 5Y Yield in Japan, US, Germany



Source: Bloomberg; compiled by Daiwa Securities.

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