Daiwa Securities

Daiwa's View

Adjustments to speed of flattening

- A 5-year/30-year spread at the 90bp level would be appropriate within the year

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Daiwa Securities Co. Ltd.

Adjustments to speed of flattening

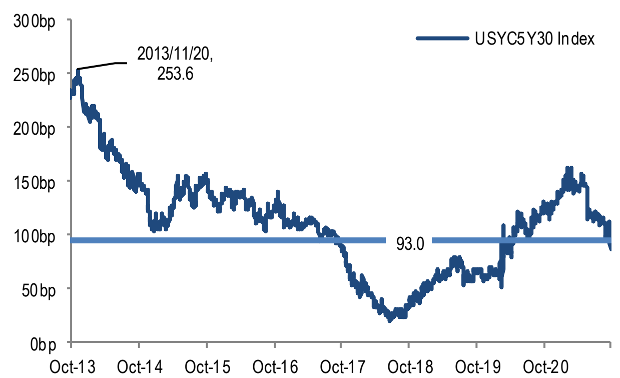
A 5-year/30-year spread at the 90bp level would be appropriate within the year

Yesterday, the 5-year/30-year US Treasury yield spread widened to 93bp, undergoing correction to a pace of flattening that is too fast. This flattening at a violent pace, which makes us consider an inverted yield curve (and recession) at the beginning of next year, is definitely too fast. A certain degree of correction to the pace is reasonable.

Bank of France Governor Francois Villeroy de Galhau said yesterday that "there is no reason, for example, for the European Central Bank to raise interest rates next year." ECB Executive Board member Philip Lane also stated, "I think it's challenging to reconcile some of the market views with our pretty clear rate forward guidance." Of course, it depends on the inflation outlook, but these comments imply that a recession due to central banks' policy mistakes is not an urgent risk. This serves as a factor in judging that this flattening at a very fast pace, which might lead to the pricing in of an inverted yield curve at the beginning of next year, is excessive. Meanwhile, yesterday's speech by Fed Governor Christopher Waller set aside a lot of room for discussion about inflation in the upside direction. As obviously indicated by this, we also need to be cautious about the risk of an acceleration in the pace of rate hikes depending on how inflation plays out over the next several months.

Before the surge in energy prices, a point of reference for the 5-year/30-year US Treasury spread was 100bp—a 5-year yield of 1% and a 30-year yield of 2%. If elements such as the surge in energy prices, the Fed's hawkish shift, and concerns about growth constraints are also considered, an estimated 5-year/30-year spread within the year at the 90bp level would be most appropriate. Of course, from the standpoint of the main direction of the market, it is nevertheless a fact that we are in the midst of a flattening trend.

5Y/30Y UST Spread



Source: Bloomberg; compiled by Daiwa Securities.

Comments by Officials

ECB Executive Board member Philip Lane
If you look at market pricing of the forward interest rate curve, I think it's challenging to reconcile some of the market views with our pretty clear rate forward guidance.

Bank of France Governor Francois Villeroy de Galhau
Total inflation is a bit above 2% but we are clearly convinced that inflation will come back below 2% between now and the end of next year. Today, there is no reason for the ECB to raise its interest rates next year.

Source: Bloomberg, others; compiled by Daiwa Securities.

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