Daiwa Securities

Daiwa's View

Widening corporate bond spread mirrors direction of macro economy

➢ Greater likelihood of deterioration in real income

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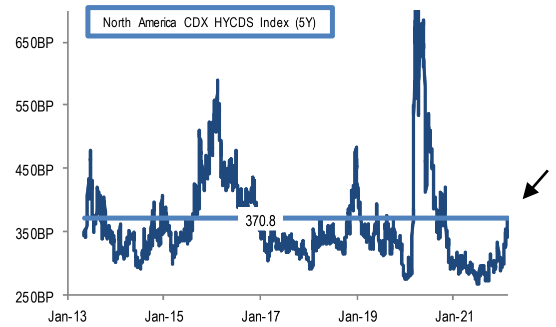
Yesterday, the CDX North America High Yield Index widened to 370bp.The iShares iBoxx High Yield Corporate Bond ETF, which was bought by the Fed after the outbreak of the pandemic, also fell to $82.6. As such, the corporate bond market is becoming more bearish, seeing clear outflows.

North America High Yield CDS Spread



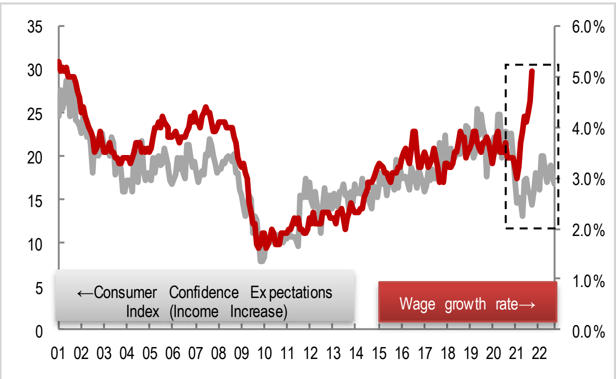
Source: Bloomberg; compiled by Daiwa Securities.

Price of iShares iBoxx High Yield Corporate Bond ETF

Source: Bloomberg; compiled by Daiwa Securities.

Escalating tensions in the Ukraine tend to be given as a factor behind the widening. However, it is highly likely that there are also impacts from macro factors. Examples can be seen in the Conference Board Consumer Confidence Expectations Index (Income Increase) and the Atlanta Fed's Wage Growth Tracker. Although the rate of wage hikes has recently risen to 5%, comparison with past cases when wages posted similar growth levels shows that the Consumer Confidence Expectations Index has not shown similar improvement (it has remained largely flat).

Conference Board Consumer Confidence Expectations Index (Income Increase), Atlanta Fed's Wage Growth Tracker

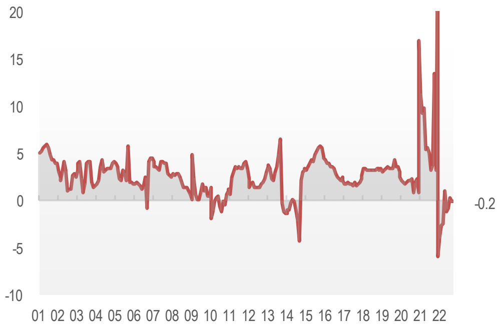


Source: Bloomberg; compiled by Daiwa Securities.

This data implies that a recent surge in US wages is actually just at a level where people manage to offset the impact of rising inflation. This inference is also proved by a decline in real consumer income for two consecutive months, which was announced by the US Bureau of Economic Analysis. Thus, it is highly possible that the data is mirroring the actual conditions of US consumers.

In other words, if the Fed slams on the brakes to reduce inflation, there is a high chance of the following developments—(1) first, wages come under pressure and disposable income worsens and (2) deterioration in the output gap cools the economy, which would constrain inflation. It would be natural to see reactions from corporate bond spreads, which are sensitive to economic trends.

US Real Consumer Income (monthly, y/y %)



Source: Bloomberg; compiled by Daiwa Securities.

From the viewpoint of an anticipated decline in real disposable income, it can be said that Japan and the US are moving toward somewhat similar situations. As is well known, concerns are growing in Japan about lower real disposable income due to cost-push inflation without commensurate wage increases. Also in the US, however, interest rate hikes by the Fed are expected to constrain the pace of wage hikes, which have abated the negative impact of cost-push inflation. This is leading to greater likelihood of deterioration in real income. Ultimately, central banks appear to have few tools to cope with cost-push inflation caused by surging resource prices.

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