Daiwa Securities

Daiwa's View

The market after US CPI and ECB meeting

➢ Stagflation scenario cannot be eliminated with central banks focusing on inflation

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◆ ECB's hawkish surprise

Yesterday's two noteworthy topics were the ECB Governing Council meeting and the US CPI. The ECB's forward guidance was revised in line with projections by our senior economist Maiko Noguchi. The linkage between rate hikes and QE was weakened—with the timing of rate hikes changing from "shortly" after bond purchases end to "some time after." This enables the ECB to delay rate hikes depending on data and the circumstances while sticking to its policy of ending QE (APP) itself in the Jul-Sep period. That said, with the ECB having clarified its stance about being more concerned with inflation than the situation in Ukraine, the market's pricing of rate hikes in 2022 has progressed to 1.6 times (x 25bp), which has intensified bear flattening of the yield curve. Due to declining expectations of QE, we saw widening of sovereign bond spreads in peripheral nations, such as Italy (146 → 163bp vs. 10-year German bonds). The XOVER CDS Index also widened from 371bp to 385bp.

◆ US CPI was in line with projections

Meanwhile, the US CPI was almost in line with advance projections. US yields rose by slightly above 3bp across the entire curve. The 10-year US yield momentarily touched 2%, but was bought back to the 1.9% level. We are continuing to see a mixture/coexistence of (1) a rise in short-term/intermediate yields in anticipation of the Fed's tightening caused by rising inflation and (2) upward pressure on long-term/superlong yields due to rising crude oil prices and inflation expectations. However, the Libor/OIS spread widened to 31bp yesterday, and the High-yield CDS Index widened again to 390bp. As such, financial conditions in the private sector are becoming tighter than the rise in Treasury yields. If the Fed were to shift to a more hawkish stance, new threats to growth would emerge. This would lead to developments in which the probability of a stagflation scenario would be increased.

◆ JGBs also under a certain degree of upward pressure, but there are new movements

The above-mentioned rise in European/US yields and inflation expectations is also putting a certain degree of upward pressure on JGBs, as the correlation with European/US yields is increasing. The ECB has changed its forward guidance for policy rates, saying that "the Governing Council expects the key ECB interest rates to remain at their present levels" (previously "at their present or lower levels"). This will likely increase speculation regarding a change in forward guidance by the BOJ. Meanwhile, with the beta in the superlong zone having recently turned in a downward direction, performance is particularly solid in the zone over 30 years. Currently, the 10-year/30-year spread is 38bp in the US, 18bp in Europe, and 69bp in Japan, indicating that the shape of the JGB yield curve is strikingly steep. It is possible that investors have finally focused on this zone, which has become significantly attractive following rapid steepening in February. Deepening of the USD/JPY currency basis caused by deterioration in the situation in Ukraine may also make JGB investment more attractive. Therefore, we should pay attention to trends with overseas investors, as well as Japanese investors, in the near term.

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