Daiwa Securities

Daiwa's View

Increased trust in Fed's stance towards reining in inflation

- Curbing rise in inflation expectations and 10-year US yield
- Causing dollar appreciation, not yen depreciation

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Increased trust in Fed's stance towards reining in inflation

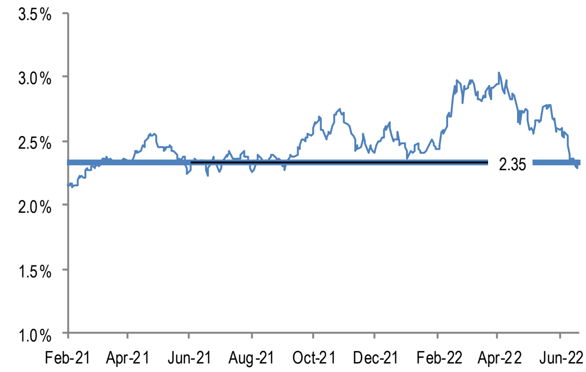
Curbing rise in inflation expectations and 10-year US yield

Yesterday, the 10-year US Treasury yield rebounded to around 3% amid partial unwinding of a recession trade, which had developed somewhat rapidly. Meanwhile, the 10-year breakeven inflation rate (BEI) remained largely flat at 2.35% (5-year BEI: 2.58%; 5-year forward 5-year BEI: 2.08%). Based on this, it would be more appropriate to view yesterday's price movements as being speed adjustments to recession concerns, which had grown rapidly, rather than interpreting them as being caused by the Fed's change in its stance towards reining in inflation.

Regarding the Fed's stance towards containing inflation, in the minutes of the June FOMC meeting (released on the night of 6 Jul), the Fed stated that "a significant risk now facing the Committee was that elevated inflation could become entrenched if the public began to question the resolve of the Committee to adjust the stance of policy as warranted," which appears especially important. This can be seen as reinforcing the "unconditional commitment" that was shown in the Monetary Policy Report released on 17 June. Accordingly, this should be reconfirmed as a factor that will have a long-term impact on the market. As long as the Fed's resolution is trusted, we are unlikely to see a full-scale rise in BEIs. In line with this, rises in the 10-year yield are likely to be curbed more than before. Points of reference for a rebound in the 10-year US yield are the 50-day moving average (3%) and the centerline of the Bolinger Bands (3.12%). A focus of attention in the rebound stage is whether the yield exceeds 3.12%, the threshold for determining trends.

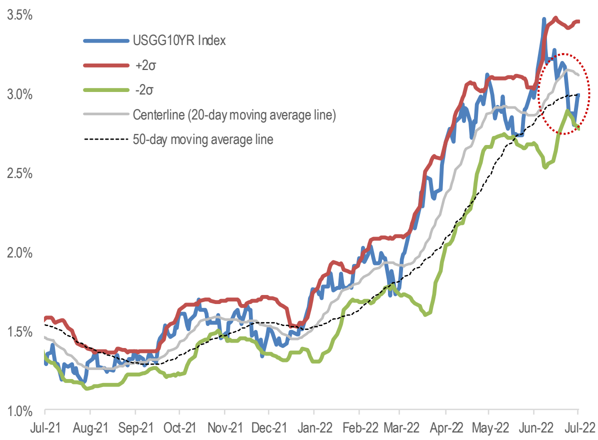
Minutes of Jun FOMC meeting (disclosed on 6 Jul 2022)
・Many participants judged that a significant risk now facing the Committee was that elevated inflation could become entrenched if the public began to question the resolve of the Committee to adjust the stance of policy as warranted. On this matter, participants stressed that appropriate firming of monetary policy, together with clear and effective communications, would be essential in restoring price stability.

10Y US Inflation Expectations (BEI)



Source: Bloomberg; compiled by Daiwa Securities.

10Y US Yield, Bolinger Bands (20-day cycle)



Source: Bloomberg; compiled by Daiwa Securities.

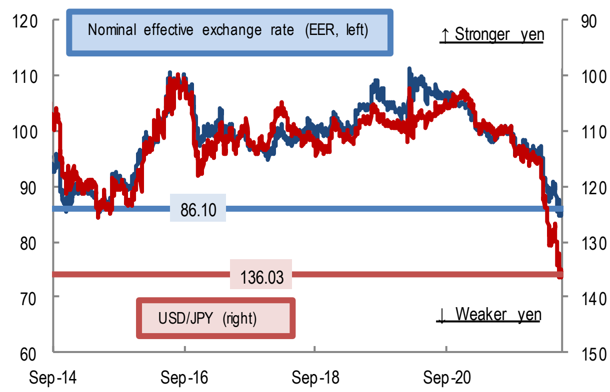
Causing dollar appreciation, not yen depreciation

◆ What we are seeing recently is dollar appreciation, not yen depreciation

Another point to confirm regarding the impact from the Fed's change in stance is that it is causing dollar appreciation (rather than yen depreciation). In particular, if JGB market participants view 'bad depreciation of the yen' as a decisive factor for policy revisions by the BOJ, this point needs to be clearly recognized.

As shown by the chart below, which denotes the USD/JPY exchange rate and the nominal effective exchange rate since September 2014, the USD/JPY rate can be regarded as an exchange rate until the situation in Ukraine became serious (the nominal effective exchange rate had almost the same trajectory as the USD/JPY rate). Since April 2022, however, the USD/JPY rate has shown rapid deprecation of the yen, clearly diverging from the nominal effective exchange rate. In other words, it is 'dollar appreciation' that has been progressing since the start of the Ukraine issue, not 'yen depreciation.'

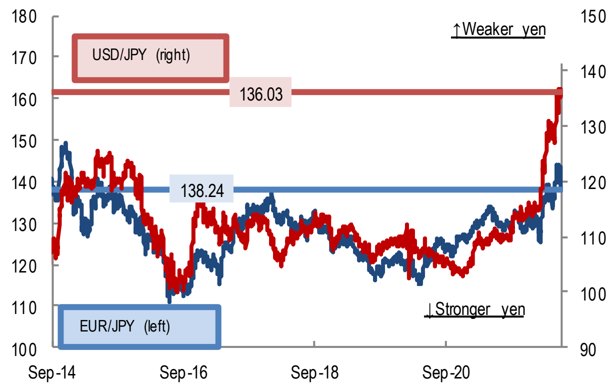
USD/JPY, Nominal Effective Exchange Rate (Y)



Source: Bloomberg; compiled by Daiwa Securities.

Of course, it is true that the yen has been weakening somewhat significantly from a historical perspective even on a nominal effective exchange rate basis. However, in terms of the 'forex yardstick' used thus far, it is at a level of Y125/$, not Y136/$. There has also been an increasing tendency to sell regardless of rate hikes recently, regardless of whether the currency is the euro or the Australian dollar. We can avoid missteps if we monitor the Dollar Index and cross-yen pairs together with the USD/JPY rate. However, if we make judgments based only on the 'USD/JPY rate,' we will misread the importance of the situation.

USD/JPY, EUR/JPY (Y)



Source: Bloomberg; compiled by Daiwa Securities.

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