Daiwa's View

End to yield uptrend

➢ Beginning of market with inverted yield curve

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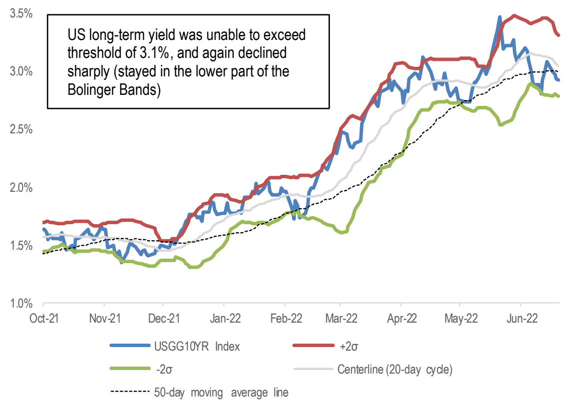
Reflecting brutally high core CPI and stronger concerns about rate hikes by the Fed, the US long-term yield rose to around 3.07% at one point yesterday. However, the yield declined to 2.90% after about two hours, and closed at around 2.93% without seizing the upward momentum. When the jobs report was released last Friday, the yield was unable to exceed the threshold of 3.10%. Even after the release of yesterday's brutally high CPI readings, the yield did not exceed 3.10%, and then posted a sharp decline. Therefore, the shift in the trend (the end to the uptrend) of the US long-term yield is obvious to everyone. This means that "inflation will likely still remain high, but yields will likely no longer rise."

Of course, the Fed is set to conduct large rate hikes from now on, and, therefore, we will not immediately see a sharp decline in the long-term yield. While the US long-term yield declined yesterday, the 2-year yield, which is strongly influenced by the Fed's rate-hike stance, rose substantially to 3.15% (up 10bp). As a result, the spread between the 2-year/10-year US yields deepened to -22bp at a stroke. This -22bp is deeper than the level before the Global Financial Crisis, and is a level unseen since December 2000, before the bursting of the tech bubble.

Ultimately, regarding both the yield curve inversion and the change in the long-term yield trend, the starting point for change was the Fed's "unconditional" stance towards reining in inflation. As the Fed has established its intention to accept a hard landing, if necessary, inflation expectations (BEI) are unlikely to rise (10-year BEI declined to 2.34% yesterday). Meanwhile, short-term yields are expected to rise substantially. Given the situation with the inverted yield curve, we think it is simply a matter of time before we have a recession, something that is clear to everyone. As mentioned before, the Jul-Sep quarter will likely provide a buying opportunity for bonds.

US Long-term Yield



Source: Bloomberg; compiled by Daiwa Securities.

2Y/10Y US Treasury Yield Spread

Source: Bloomberg; compiled by Daiwa Securities.

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