

Daiwa's View

Powell's speech completely lived up to expectations

➤ Powell ≠ Burns

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp



Daiwa Securities Co. Ltd.

Powell ≠ Burns

Powell's speech completely lived up to expectations

In Daiwa's View reports, we had discussed several times whether Fed Chair Jerome Powell was a new Arthur Burns, the former Fed Chair who caused high inflation to become entrenched in the 1970s. However, we will likely never say that again. In this year's [Jackson Hole speech](#), Chair Powell referred to the accomplishments of past legendary Fed chairs such as Paul Volcker and Alan Greenspan while stating candidly that (1) the Fed had learned a lesson from the stop-and-go policy in the 1970s that caused high inflation to become entrenched via premature removal of tightening policy, (2) the unconditional commitment that was announced after the June FOMC meeting remained unchanged, and (3) the process to rein in inflation would bring some pain. In my opinion, this year's speech was courageous and laudable, and completely lived up to my expectations without sugarcoating the possibility of pain. It left me feeling that people will come to realize that Powell is not another Burns.

There were stark contrasts in the way the market reacted to the Jackson Hole speech—US stocks (DJIA) plunged by more than \$1,000, and the North American High-yield CDS index rose from 475bp to 493bp, but the 10-year US yield was largely flat. As symbolized by yield movements that were largely flat, it appears there were no decisive surprises among market participants who had carefully interpreted the real intentions of Fed officials. However, it would seem that some participants in the risk asset market felt the hawkish shift by the Fed was somewhat abrupt. If this speech served as an opportunity to accurately communicate the Fed's intentions far and wide, [the second round of remedial action by the Fed](#) can be said to have been successful.

For reference, the 10-year US yield was largely flat (3.03% → 3.04%), which can be broken down into a 3bp drop in inflation expectations and a 4bp rise in the real yield. Forecasts for the rate hike at the September FOMC meeting remain largely unchanged at 2.6 times. (Forecasts for a 50bp hike and a 75bp hike are roughly even.) The ceiling (terminal rate) for the OIS yield is also unchanged at a level slightly below 3.8%. However, the period during which the federal funds rate is expected to remain high was extended slightly, as expected, which led to a rise in the 2-year US yield from 3.37% to 3.40% and slightly deepened the negative spread between the 2-year/10-year yields (from -34.6bp to -36.2bp). These reactions in the bond market appear to have generally reflected the Fed's improved credibility regarding inflation control as well as the pain that will come with the measures for taming inflation.

Currently, the federal funds rate is expected to remain high after being raised substantially. Therefore, the 10-year US yield is unlikely to plunge in the near term. However, seen over the long term, the rise in the Fed's credibility regarding inflation control will serve as a favorable factor stabilizing the viewpoint of bond investors, making it easy to continue seeing a 10-year yield above 3% as a good opportunity to buy. Regarding JGBs as well, the fact that the Fed has candidly acknowledged there will be some pain serves as a factor for worsening the outlook for the external environment when BOJ Governor Haruhiko Kuroda's term in office ends in April 2023. As with US Treasuries, we judge that it has become easier to buy JGBs than it was before the Jackson Hole conference.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association