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Daiwa Securities

Daiwa's View

US long-term yield rose to 3.1%

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◆ US long-term yield posted slight steepening, reaching 3.1%

Yesterday, the US long-term yield rose to 3.1%. We have continued to see an uptrend recently, with slight steepening or a rise across the curve. Given (1) the rebound in the price of WTI crude oil futures to $95 and (2) the strong correlation between US yields and crude oil prices, we think the rise in yields can be partially explained by these factors. For example, between 15 August and last night, 30-year inflation expectations had risen by 21bp (2.23→2.44%), which corresponded to the rise in the 30-year US yield during the same period (3.10→3.31%).

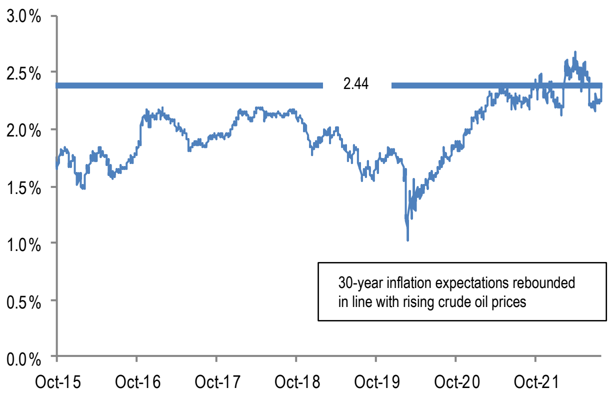
That said, we tend to read too much into the meaning of such price movements because they are occurring at a sensitive time, immediately before Fed Chair Jerome Powell's speech at Jackson Hole. In particular, one major US financial institution has released a report saying that Chair Powell would not follow the approach taken by ex-chair Paul Volcker. (If so, would he follow that taken by Arthur Burns?) This is arousing suspicions that the Fed might eventually accept high inflation over a long period of time in excess of its mandate (while making excuses along the way).

As we have already reported, if the Fed's unconditional commitment expressed after the June FOMC meeting were to waver (i.e., if conditions were to be added after the fact), that would, of course, weaken the basis for the yield level that is formed on the assumption that inflation expectations will be 2% plus something extra. That said, inflation expectations have not diverged decisively from the Fed's mandate. I suspect what is really going on is that the market is waiting for the Jackson Hole symposium in order to discern the Fed's stance on taming inflation. It isn't yet clear whether the current rise in yields was led by doubts about the Fed's stance or by the rebound in crude oil prices.

10Y US Yield, Inflation Expectations

Source: Bloomberg; compiled by Daiwa Securities.

30Y US Inflation Expectations



Source: Bloomberg; compiled by Daiwa Securities.

◆ Analysis by New York Fed

Yesterday, a new survey was announced by the New York Fed. It states: "Our analysis of the relative importance of supply-side versus demand-side factors finds 60 percent of U.S. inflation over the 2019-21 period was due to the jump in demand for goods while 40 percent owed to supply-side issues that magnified the impact of this higher demand." This will probably be one of studies that will serve as the basis for determining the stance the Fed will announce at Jackson Hole.

Generally speaking, inflation led by the demand side can typically be controlled relatively easily through monetary tightening by central banks, but it is difficult for central banks to deal with inflation led by the supply side. Of course, as is well-known, ongoing high inflation in the US is caused by both the demand side and the supply side. (That's why the above-mentioned analysis by the New York Fed was conducted.) However, the findings of the New York Fed's analysis yesterday stating that more than half of elevated inflation can be explained by the demand side strengthens the basis for arguing that the Fed will (should) become more hawkish in order to rein in inflation.

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