

Daiwa's View

Good news is bad news

- Negative 2Y/10Y yield spread deepened the most since October 1981

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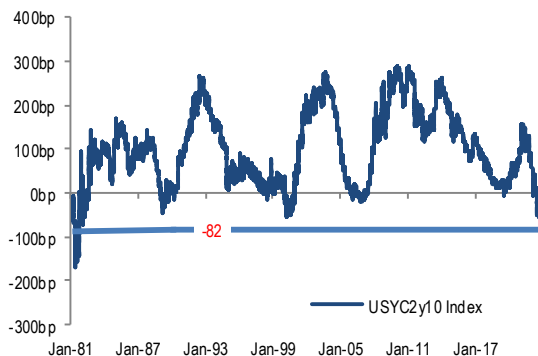
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In *Daiwa's View* reports, we have been paying particular attention to the ISM services index because it does a good job of reflecting US conditions. While the ISM manufacturing index is, of course, an excellent leading index, it is more of a leading indicator of global sentiment than of sentiment in the US.

Yesterday, it was announced that the ISM services index jumped to 56.5, higher than the market estimate of 53.5 (last month it was 54.4). Given this data together with the jobs report announced at the end of last week, we can say that the financial environment needs to be tightened further to slow the employment market. However, as we mentioned in yesterday's report, strong economic indicators amid further inversion of the yield curve lead to a situation in which "good news is bad news" and raises the probability of a hard landing. In fact, reflecting yesterday's data, projections for a 50bp rate hike in February 2023 have become predominant in the OIS market. On top of this, the 2Y/10Y spread deepened to -82bp for the first time since October 1981.

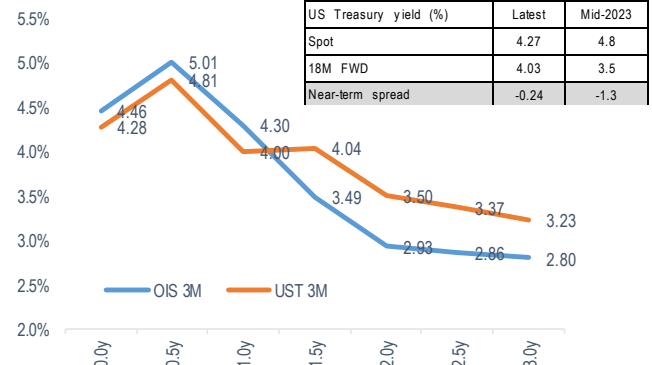
Looking at the Fed-focused near-term spread (the spread between 3M yield and 18M-forward 3M yield), we find that it remains negative at -24bp on a US Treasury yield basis and -95bp on an OIS yield basis. However, the negative spreads narrowed slightly compared to yesterday, indicating weaker concerns about near-term economic conditions. That said, the near-term spreads are expected to worsen to -130bp and -206bp in six months, respectively. This suggests that the market remains very concerned about a hard landing if the Fed implements additional rate hikes and it is unable to conduct rate cuts that revert the inverted yield curve back to normal by the end of 2023. Following the jobs report at the end of last week, the ISM services index data is major information that came out at a bad time.

2Y/10Y US Treasury Yield Spread



Source: Bloomberg; compiled by Daiwa Securities.

US 3M Forward Yields



Source: Bloomberg; compiled by Daiwa Securities.

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