Daiwa Securities

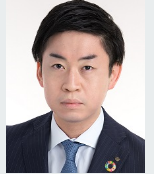
Daiwa's View

Remarks by Fed officials after release of FOMC minutes, and implications for market

- Disinflationary process has been bumpy, and rate cuts require patience, but January inflation data has not actually changed the outlook
- If main direction of rate cuts were unchanged (despite slight delay in rate cuts), 10-year real yield of above 2% and 2-year yield of around 5% would appear attractive

FICC Research Dept

Eiichiro Tani
81-3-5555-8780
eiichiro.tani@daiwa.co.jp



Kenji Yamamoto
81-3-5555-8784
kenji.yamamoto@daiwa.co.jp

Daiwa Securities Co. Ltd

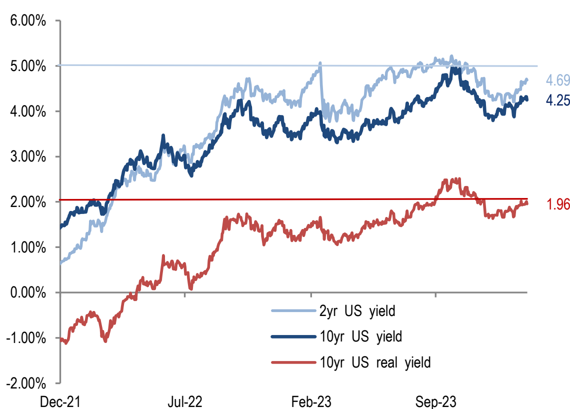
Last Friday (when Japan had a national holiday), the US long-term yield closed at 4.25%. Although a series of remarks were made by Fed officials, including Governor Christopher Waller, yields reversed course, continuing to fail to break out of the thresholds of 4.35% for the 10-year yield and 2% for the 10-year real yield.

The conciliatory message from Fed officials last week was that rate cuts required patience. However, they said that the federal funds rate was at around its peak and a rate cut would be implemented at some point this year. Of course, there were slight differences from official to official regarding the specific timing of rate cuts. However, if the main direction of rate cuts were to remain unchanged, a real yield level of higher than 2%, which is higher than the potential growth rate, would be attractive.

The 2-year yield has risen to 4.69%, just 31bp below the 5% mark. If the timing of rate cuts were temporarily delayed slightly, movements to reduce positions in short-term bonds would appear first from the standpoint of negative spreads. However, if, as expected, a rate cut were the next main scenario, a 2-year yield level of 5% (for which a high-for-long strategy for the nominal federal funds rate would be a prerequisite) would be seen very much as a dip-buying line.

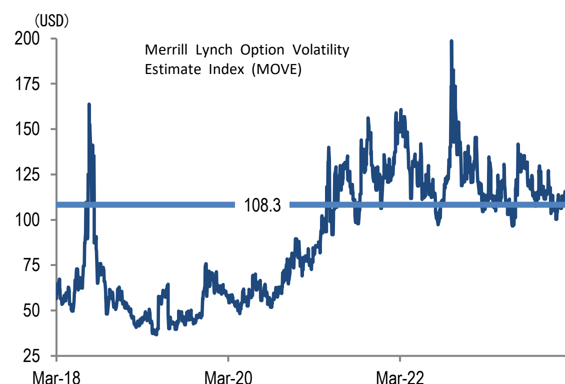
The MOVE Index declined to 108.3 at the end of last week, being restrained at a low level over the past three years despite upward pressure on yields. This probably reflects limited expectations for large price movements before reaching the thresholds of 4.5% for the 10-year yield and 5% for the 2-year yield. Regarding the hot topic of a reduction in rate cuts, if a 2-year yield of 5% were to serve as a wall, the number of expected rate cuts would likely decrease by one at most. And, that general level is expected to provide a good opportunity for a long entry.

2yr, 10yr US Yields



Source: Bloomberg; compiled by Daiwa.

US Bond Volatility Index



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