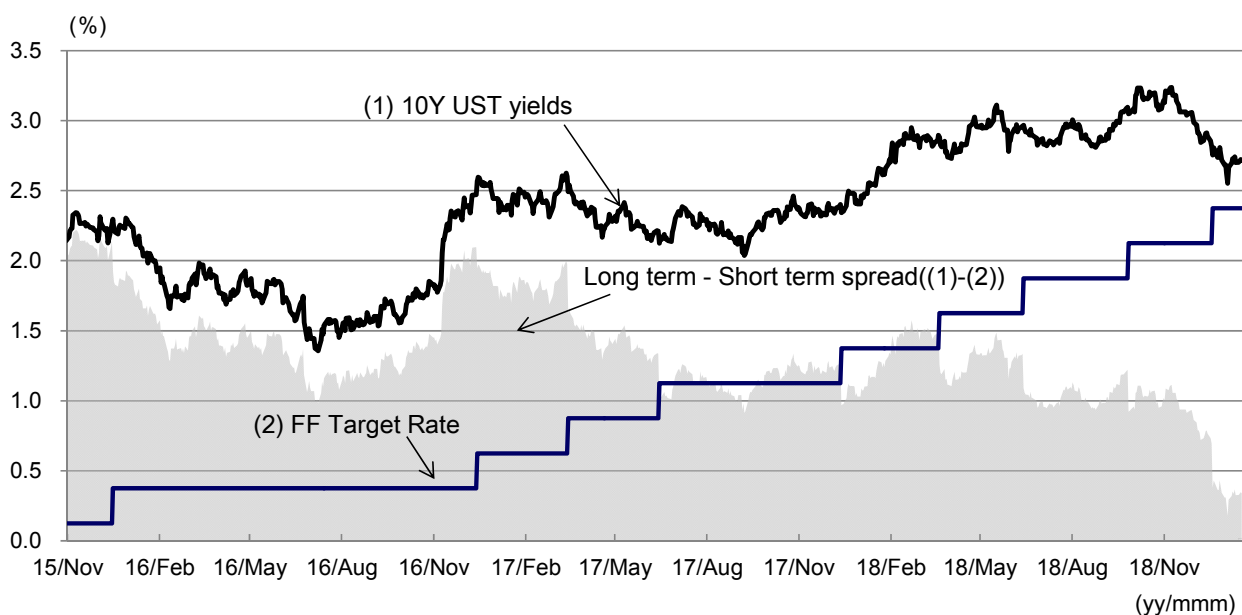


Have global yields re-entered a downward phase?

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There was a major change in views concerning the outlook for monetary policy in the US financial markets from the end of the year to the beginning of 2019. **Chart 1** illustrates the movement in 10-year US Treasury yields and the federal funds (FF) rate. The US started hiking interest rates from December 2015 and, as a result of rate hikes in each quarter of 2018, 10-year yields reached a level of 3.2%. The rise in yields also affected the stock market and emerging market economies. However, following the FOMC's December 2018 rate hike, concerns about a weak global economy culminated in 10-year yields dipping to the 2.5%-level, virtually wiping out the long term-short term spread. There was speculation in the market that the US Fed will take a break from hiking interest rates in 2019, and that the pace of balance sheet contraction will ease. The temporary pause in rate hikes also prompts concerns about a return of 2016. In 2016, the pause in rate hikes occurred in the early stages of the cycle and rate hikes resumed a year later. This time, the pause follows the ninth rate hike, which gives rise to the idea that interest rates may have peaked. The short-term money markets are already pricing in an interest rate cut. In concert with such movement, 10-year JGB yields have also turned negative once again, and European yields have also turned downwards. It is possible that long-term interest rates in Japan, the US and Europe have already turned downwards. Japan, the US and Europe were all tightening monetary policy up until the latter half of 2018

[Chart 1: US 10-year Treasury yields and FF rate]

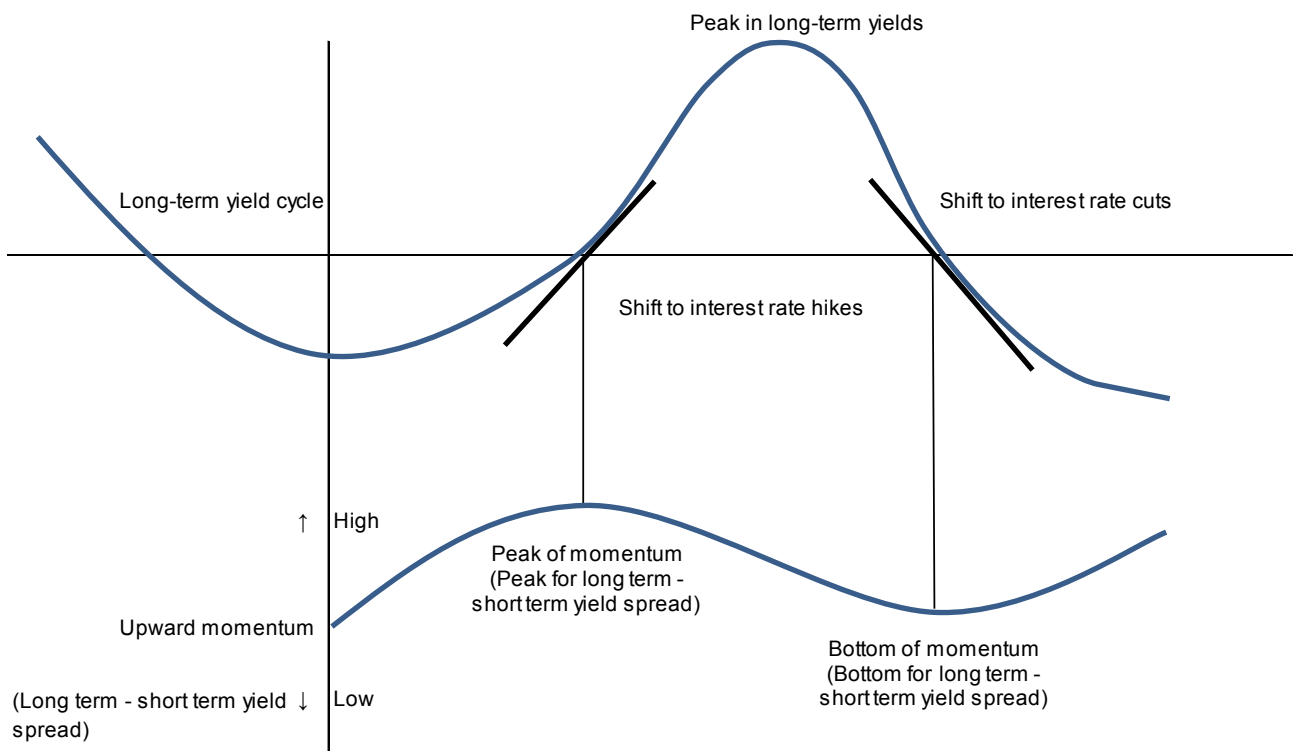


Source: Made by Mizuho Research Institute Ltd. (MHRI) based upon Bloomberg

and there were undeniably views that yields were rising. There was consensus for the scenario that the US would continue to hike interest rates, the ECB would hike rates from the second half of 2019, and Japan would also head towards normalization aimed at the exit from accommodative monetary policy. However, expectations have changed since the beginning of 2019 with the prospect that the next step for monetary policy might not only be a tightening but could also be an easing. This has caused a major shift in market participants' positions and is having considerable impact on long-term interest rates as well as the foreign exchange markets.

When central banks hike interest rates and the market also expects interest rate hikes to continue, long-term yields will also rise at the same time. However, long-term yields fell in December even though the Fed hiked interest rates, a pattern usually seen in the final stages of an interest rate hike cycle. **Chart 2** illustrates the long-term yield cycle and the long term–short term yield spread that is aligned with economic momentum. Long-term yield levels are cyclical, but economic momentum (long term–short term yield spread) increases following a bottoming out of yields up until there is a shift to interest rate hikes i.e., in terms of the chart, when the slope of the tangent to the long-term yield cycle curve is at its steepest. Subsequently, economic momentum declines as interest rate hikes progress and the long term–short term yield spread contracts. Then, long-term yields peak out and start to fall. When the decline in the slope of the tangent to the long-term yield cycle curve its at its steepest, the long term–short term yield spread is also the tightest, which coincides with the timing to start interest rate cuts. The situation today is that long term yields have already peaked out, while economic momentum is in decline and the long term–short term yield spread has contracted. This suggests there is scope for interest rate cuts.

[Chart 2: Yield cycle and upward momentum]



Source: Made by MHRI

Chart 3 shows the “flood map” for global yields (i.e., negative interest rates by maturity by country). The flooded regions for Japanese and European yields have recently spread again. At present, the market consensus is that even if there is a pause in US interest rate hikes, from a broad perspective this would be just a temporary break in the interest rate hike cycle. However, from a global perspective, the change in the global economic momentum could lead to views that we are in a period of downturn for global interest rates. It is important to note that such a change in expectations could trigger adjustments in positions and fluctuations in market conditions.

[Chart 3: The flood map for global yields (January 16, 2019)]

	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	11Y	12Y	13Y	14Y	15Y	20Y	30Y	40Y
Switzerland	-0.76	-0.78	-0.69	-0.63	-0.52	-0.45	-0.37	-0.31	-0.23	-0.15	-0.08	-0.01	0.04	0.09	0.14	0.30	0.43	0.46
Japan	-0.16	-0.16	-0.14	-0.14	-0.15	-0.14	-0.14	-0.11	-0.05	0.01	0.06	0.10	0.15	0.20	0.24	0.47	0.70	0.80
Germany	-0.56	-0.60	-0.58	-0.49	-0.37	-0.23	-0.12	-0.01	0.11	0.22	0.27	0.32	0.37	0.42	0.46	0.64	0.84	
Denmark	-0.55	-0.58	-0.48	-0.38	-0.29	-0.20	-0.11	-0.02	0.07	0.16	0.21	0.25	0.30	0.35	0.40	0.64		
The Netherlands	-0.60	-0.62	-0.57	-0.46	-0.33	-0.17	-0.04	0.08	0.22	0.33	0.38	0.43	0.49	0.54	0.59	0.69	0.88	
Finland	-0.41	-0.48	-0.47	-0.34	-0.19	-0.11	0.09	0.17	0.33	0.48	0.56	0.64	0.72	0.79	0.87	0.96	1.13	
Austria	-0.46	-0.50	-0.50	-0.32	-0.21	-0.06	0.10	0.26	0.35	0.44	0.54	0.64	0.73	0.83	0.93	1.05	1.31	
Sweden	-0.36	-0.38	-0.29	-0.20	-0.04	0.04	0.13	0.00	0.22	0.44	0.51	0.58	0.64	0.71	0.78	1.12		
France	-0.55	-0.48	-0.35	-0.21	-0.04	0.03	0.19	0.35	0.44	0.64	0.73	0.82	0.91	1.00	1.09	1.21	1.60	
Ireland	-0.44	-0.44	-0.27	-0.10	0.10	0.30	0.51	0.57	0.78	0.98	1.06	1.13	1.20	1.27	1.34	1.46	1.70	
Spain	-0.34	-0.24	-0.03	0.10	0.32	0.61	0.83	1.04	1.24	1.38	1.49	1.60	1.71	1.82	1.93	2.15	2.60	
Portugal	-0.37	-0.11	0.13	0.42	0.59	0.93	1.27	1.45	1.65	1.79	1.88	1.98	2.07	2.17	2.26	2.53	2.85	
Italy	0.10	0.32	0.91	1.25	1.63	1.95	2.21	2.29	2.53	2.76	2.83	2.90	2.97	3.05	3.12	3.44	3.65	
UK	0.82	0.83	0.83	0.87	0.97	1.02	1.06	1.12	1.22	1.31	1.35	1.39	1.43	1.47	1.51	1.74	1.81	1.71
Norway	1.01	1.09	1.18	1.26	1.35	1.43	1.54	1.63	1.71	1.79								
Canada	1.89	1.92	1.91	1.94	1.93	1.94	1.95	1.96	1.98	2.00	2.02	2.04	2.05	2.07	2.09	2.19	2.22	
Australia	1.88	1.82	1.79	1.84	1.95	2.04	2.13	2.19	2.27	2.27	2.33	2.38	2.44	2.49	2.55	2.70		
US	2.56	2.54	2.52	2.53	2.54	2.58	2.62	2.65	2.69	2.72	2.74	2.76	2.77	2.79	2.81	2.90	3.07	
China	2.45	2.61	2.75	2.87	2.97	3.05	3.12	3.16	3.19	3.20	3.23	3.26	3.28	3.31	3.34	3.45	3.72	
India	6.84	7.02	7.23	7.31	7.38	7.38	7.47	7.60	7.56	7.27	7.66	7.68	7.68	7.67	7.66	7.66	7.67	

	Below 0%
	0% or above ~ below 0.5%
	0.5% or above ~ below 1.0%
	Above 1.0%

Source: Made by MHRI based upon Bloomberg

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