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The 6th cycle for the "5th jinx" ends as global yields enter downward phase

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As a practitioner in the global financial markets for almost 40 years, I have been talking about the "5th jinx" relating to the link between policy interest rate hikes in Japan, the US and Europe, as shown in **Chart 1**, for more than 10 years. This refers to a feature of the increased alignment in the financial markets in Japan, the US and Europe since the move to a floating exchange rate regime in the 1970s. Experience tells that Japan is always the last of the three regions to hike interest rates, which is then followed by a global recession in the following year. In **Chart 1,** the periods of inverse yields are from 1979, 1989, 2000 and 2006. These periods roughly overlapped with periods when Japan was the last to hike interest rates following interest rate hikes in both the US and Europe,

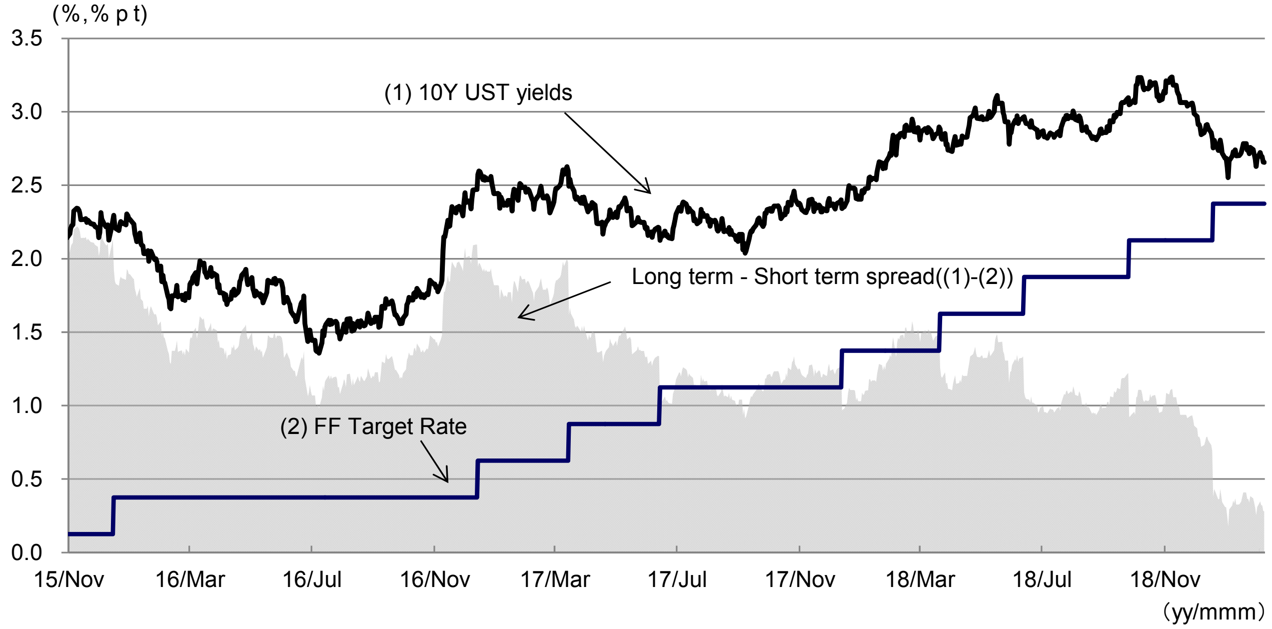
[Chart 1: '5 jinxes' for the financial markets and the outlook for the 6th jinx]

	Official discount rate when the US started tightening	Official discount rate when Germany (EU) started tightening	Official discount rate when Japan started tightening	Environment following Japan's interest rate hike	State of oil price
1st Early 1970s	Jan-1973 (Second) 4.5% → 5%	Oct-1972 (First) 3% → 3.5%	Apr-1973 (Last) 4.25% → 5%	Global recession from 1974 Bankhaus Herstatt problem	First oil shock
2nd Late 1970s	Aug-1977 (First) 5.25% → 5.75%	Mar-1979 (Second) 3% → 4%	Apr-1979 (Last) 3.5% → 4.25%	Global downturn from 1980 Latin American problem	Second oil shock
3rd Late 1980s	Sep-1987 (First) 5.5% → 6%	Jul-1988 (Second) 2.5% → 3.0%	May-1989 (Last) 2.5% → 3.25%	Global downturn from 1990 S&L, LBO problems	Iraq war Sharp rise in oil price
4th Late 1990s	Jun-1999 (First) 4.75% → 5% (FF rate)	Nov-1999 (Second) 2.5% → 3% (ECB Policy interest rate)	Aug-2000 (Last) 0% → 0.25% (O/N Call rate)	2001 Dot.com bubble burst	Price of oil reaches 10 year high
5th Mid 2000s	Jun-2004 (First) 2.5% → 2.75% (FF rate)	Dec-2005 (Second) 2% → 2.25% (ECB Policy interest rate)	Jul-2006 rate hike (Last) 0% → 0.25% (O/N Call rate)	2007 Subprime crisis	Oil price surges
6th Now	Dec-2015 (First) 0.25%→ 0.50% (FF rate)	Some talk about an exit strategy	No sign of an exit		

Source: Made by Mizuho Research Institute Ltd. (MHRI) referred to as the five jinxes. The US has already taken the lead by hiking interest rates from 2015, while the ECB, in second position, had started to head towards the exit. In some respects, Japan also started to make cautious moves towards the exit in July 2018. However, the possibility of a change in the US stance towards interest rate hikes increased at the January 30 FOMC meeting. This means the "sixth cycle" has possibly ended before Europe and Japan have turned towards the exit. The exit strategies for Europe and Japan have been sealed off and they will most likely now have to wait until the US returns to another interest rate hike cycle. At the same time, the world appears to have entered a period of falling interest rates. The recent decline in yields on super long-term government bonds in Japan may be a harbinger of such trends. This should be seen as a major change from the perceived environment up until 2018.

US employment data, released on February 1, showed much greater improvement than the market forecasts, yet US long-term interest rates appear to have peaked in October 2018. It is possible that US, European and Japanese yields have subsequently fallen. Japanese, US and European monetary policy had a tightening bias up until the latter half of 2018 and there was consensus that yields were rising. However, the anticipated next step for monetary policy has not been limited to a tightening since 2019, and there is now the possibility of the next step being an easing on a worldwide level. This has caused market participants to make major changes in their positions, which tends to have major impact on long-term yields as well as the foreign currency markets.

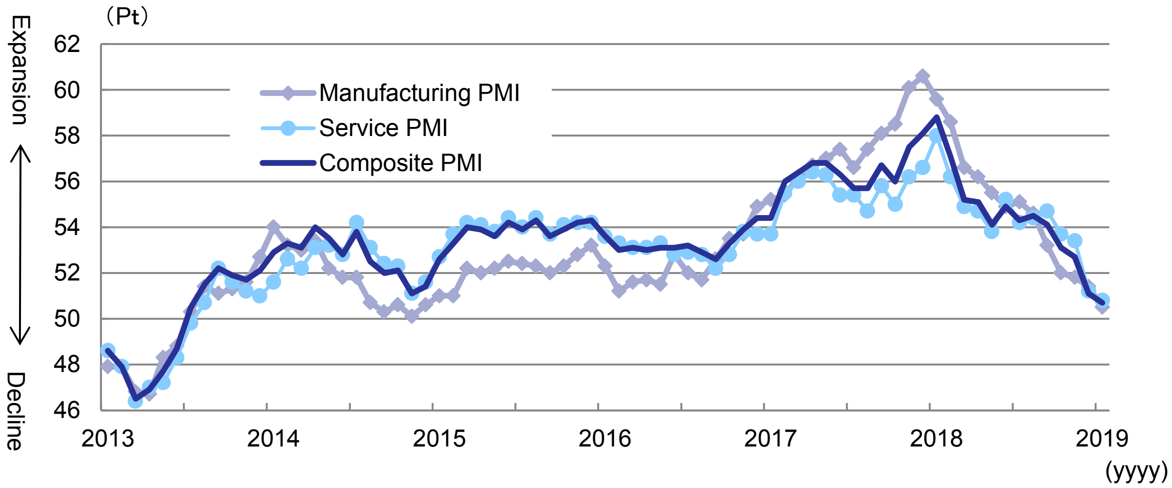
[Chart 2: 10-year US Treasury yields and the FF rate]



Source: Made by MHRI based upon Bloomberg

The economy continues to slow in Europe with the Eurozone PMI (composite PMI) falling to 50.7 in January 2019, the lowest level in five years (since July 2013). According to Markit, if this level continues, growth in real GDP will be no more than +0.1% q-o-q in the Jan-Mar quarter. The inflation rate is also falling, and the ECB has downwardly revised its risk assessment. The slowdown in the Eurozone is become clearer and is no longer in a position to discuss an exit in monetary policy. The Jan-Mar quarter will be a period to monitor prospective change in business sentiment in all regions of the world.

[Chart 3: Eurozone PMI]



Note: For PMI, a reading above 50 indicates expansion in business activity and below 50 indicates that it is generally declining.
Source: Made by MHRI based upon Markit