

Lessons from the US and Japan

Nomura Sales and Trading Desk

Andy Chaytor – Rates Desk Strategist
andy.chaytor@nomura.com

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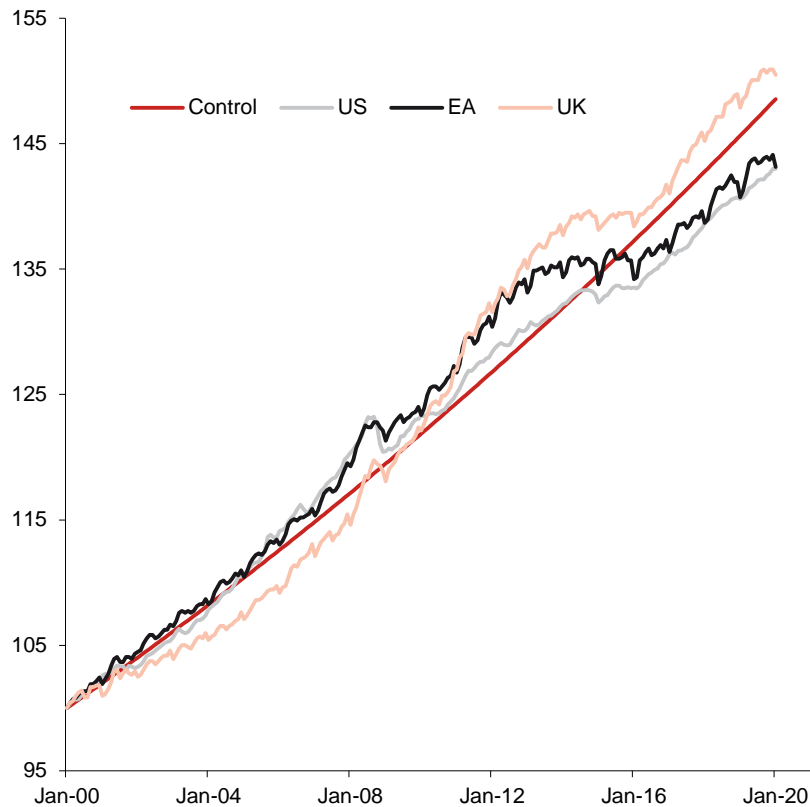
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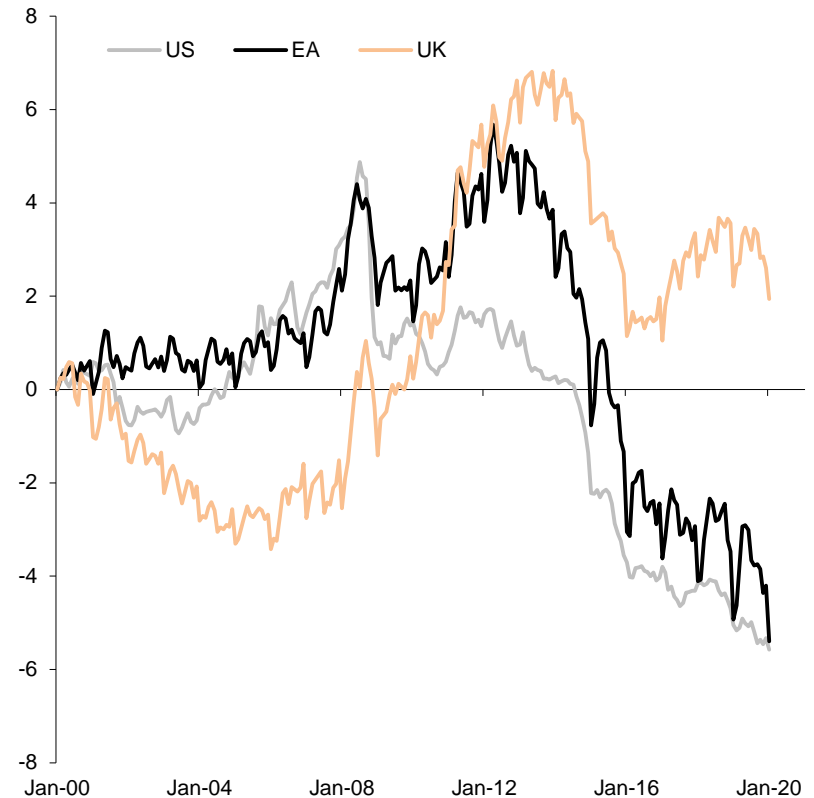
Inflation goals proving tough to hit – unless you have Brexit

While the ECB struggles with returning inflation to its goal, other CBs are having their own troubles. US inflation looks very similar to Europe, UK doesn't for now but is flattered by Brexit and Japan ruins my chart so doesn't get on here.

US PCE, EA/UK CPI vs. a 2% y/y control index



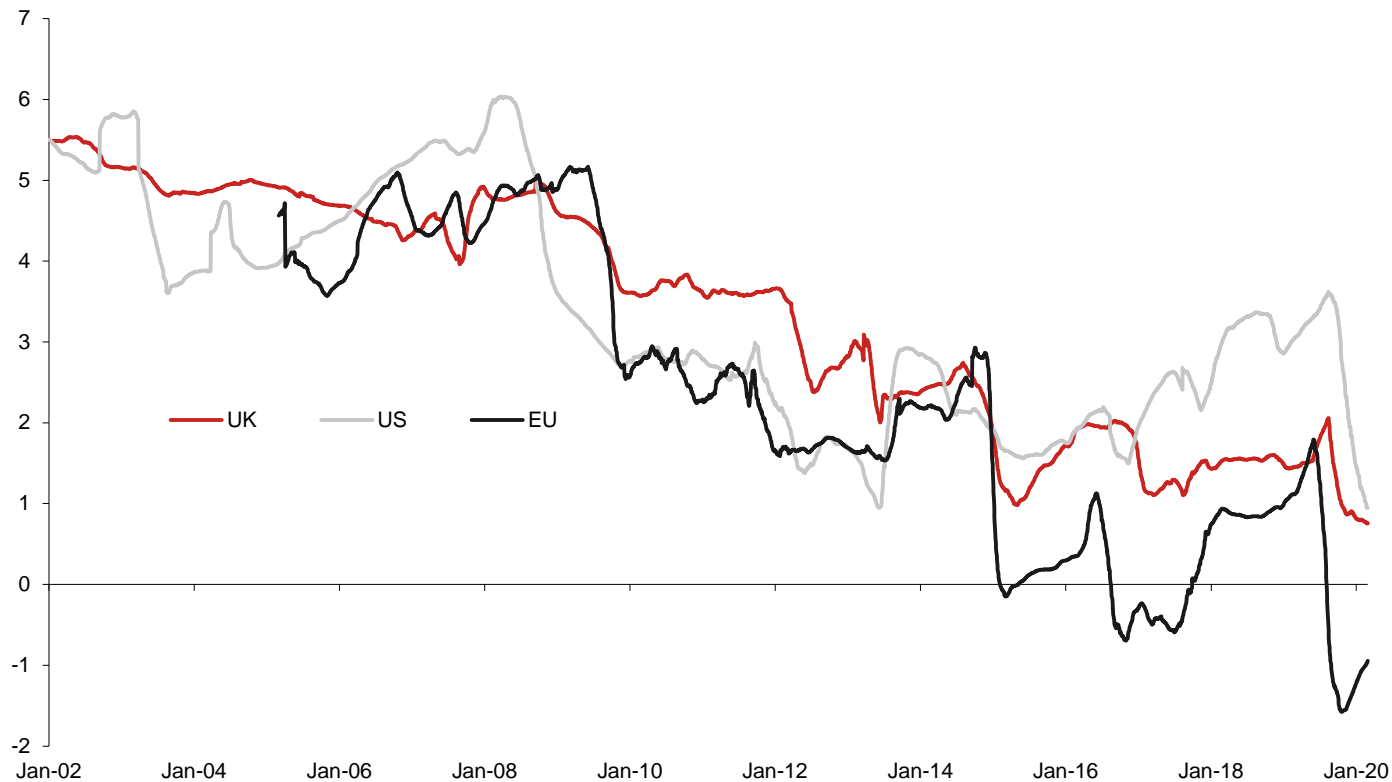
Difference from control



Collapsed neutral rates make everything harder

I look at a *market-implied* neutral rate and this shows the level of challenge for CBs and in particular the focus on unconventional policies to lower 'shadow' rates.

Rolling 260-day regressions of 5y rate against the 5f1y / 10f1y curve



US Review - thoughts

- Do not expect new tools to be 'unveiled' rather a focus on using existing ones more effectively.
- QE at its most effective when 'leveraging' fiscal spending. Clear evidence that potential QE downsides have not realised can allow for more aggressive actions going forward which might partially offset the lower level of rates. 'Shock and awe'.
- We think that they will avoid full-throated price-level-targeting given clear operational issues. There are softer steps in that direction we believe there are exploring such as target ranges (and cycle-dependent range placement).
- Worth noting that much like the ECB, the Fed have undergone such reviews before; 2003 and 2013.
- Fed have generally been against YCC apart from in a very limited form where it effectively is extreme forward guidance (but only lasts that long).

Japanese Review - thoughts

- Key point about the Japanese review culminating in 2016 was that it was focused on sustainability of easing, not expansion of easing.
- The primary shift in Quantitative and Qualitative Easing with Yield Curve Control (QQE & YCC) was to move the focus away from the front-end and out the yield curve.
- Measuring success by extra easing given to the economy or extra inflation generated will suggest QQE with YCC did not work. However, measuring it by the BoJ's ability to maintain an easy posture for a long period will yield a more positive assessment.
- One key attribute of YCC is that it is a 'real' phenomenon, not a 'nominal phenomenon'. This is true to the extent that the future movement of the yield targets was explicitly linked to price expectations.
- An implicit characteristic of QQE with YCC as per above is that it effectively downgrades the monetary policy as the key actor to create 'reflation' more as a support actor. This must be considered within the context of Abenomics.

Appendix A-1

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