Economic Indicators

This report delves into the current dynamics of U.S. G-Bond yields rising and its potential impacts on Vietnam. We explore the driving factors behind the surging yields, including term premiums, short-term rate adjustments, economic outlook, the influence of Treasury supply versus overseas demand, and Fitch's downgrade on U.S. ratings. Additionally, we analyze the perspective of Federal Reserve leaders regarding rising yields and their potential to act as a substitute for rate hikes.

Global yields surge: implications on Vietnam

US yield surge: implications on Vietnam

In a recent speech on October 19th, Fed Chair Powell discussed the increasing U.S. G-bond yields and their potential as a substitute for rate hikes due to their impact on tightening financial conditions. However, he reiterated the FOMC board's commitment to gradually returning inflation to 2%, which requires a ''higher for longer'' interest environment given the ''stickier inflation'' as a result of the deglobalization and ''friend-shoring'' trends.

This U.S. G-bond yields rising and ''longer high'' fed fund rate would create more fund outflow from Vietnam (as attractive high yields) and prolonged upward pressure on USDVND (persisted negative interest rate between USD – VND). Moreover, escalating geopolitical risks are enhancing the attractiveness of US G-Bonds as safe-haven assets. Vietnam may find it challenging to counter this trend. In recent weeks, Vietnamese G-Bond trading and newly issued yields have been on the rise (Figure 5), despite the majority of their buyers being domestic investors (more than 90% of trading volume). The domestic market is also influenced by these global dynamics.

Japan G-bond yields reach decade high

In late September, Japanese government bond yields, specifically the 5-year and 10-year ones, surged to their highest levels in a decade. This increase occurred despite the Bank of Japan's (BOJ) efforts to prevent excessive yield hikes not supported by higher inflation expectations. Thus, a surge in JGB yields could attract inflow from foreign market, indirectly effect the inflow to Vietnam.

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I. US yield surge: implications on Vietnam

This report delves into the current dynamics of U.S. G-Bond yields rising and its potential impacts on Vietnam. We explore the driving factors behind the surging yields, including term premiums, short-term rate adjustments, economic outlook, the influence of Treasury supply versus overseas demand, and Fitch's downgrade on U.S. ratings. Additionally, we analyze the perspective of Federal Reserve leaders regarding rising yields and their potential to act as a substitute for rate hikes.

In a recent speech on October 19th, Fed Chair Powell discussed the increasing U.S. G-bond yields and their potential as a substitute for rate hikes due to their impact on tightening financial conditions. However, he reiterated the FOMC board's commitment to gradually returning inflation to 2%, which requires a ''higher for longer'' interest environment given the ''stickier inflation" as a result of the deglobalization and ''friend-shoring'' trends.

Currently, 10-year U.S. G-Bond yields are surging (similar to other developed markets, Figure 1), approaching their highest level since 2007 at 5%. This surge is widely believed to be driven primarily by the rising "term premium," which aims to compensate for mid and long-term uncertainties. Additionally, several factors contribute to this rise:

1. Term Premiums: The surge in G-Bond yields can be attributed, in part, to term premiums. Uncertainty regarding future inflation, interest rates, and the overall economic outlook has led to increased yields as investors demand a higher return to compensate for this uncertainty. If the surge was driven by the outlook of higher inflation or interest rate, this would be a substitution for a rate hike, otherwise, if it relies on the optimism of the economic outlook, it would require a hawkish stance.

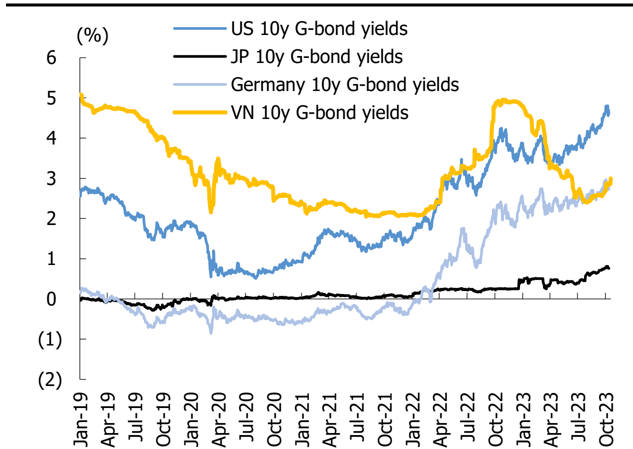
2. Short-Term Rate Adjustments: The Federal Reserve's strategy of raising short-term interest rates (fed fund rate) has contributed to the surge in G-Bond yields. This shift in the yield curve affects the pricing of long-term bonds.

3. Economic Outlook: Optimism regarding the future performance of the US economy potentially shifts investors' appetite toward riskier investment, reallocating funds from G-bond to C-bond, lending, or equity. This increases the G-bond sell-off and raises its yields.

4. Excessive Supply from the Treasury: The substantial bond supply from the US Treasury has played a significant role in driving up yields. This surge is largely driven by government budget deficits, resulting in increased bond issuances. Notably, this increase in supply is not met with a corresponding rise in demand from major overseas buyers (Figure 2). Furthermore, the ongoing reduction of the Federal Reserve's balance sheet (approximately $1.00 trillion over the past 18 months) contributes to these dynamics by decreasing its bond holdings.

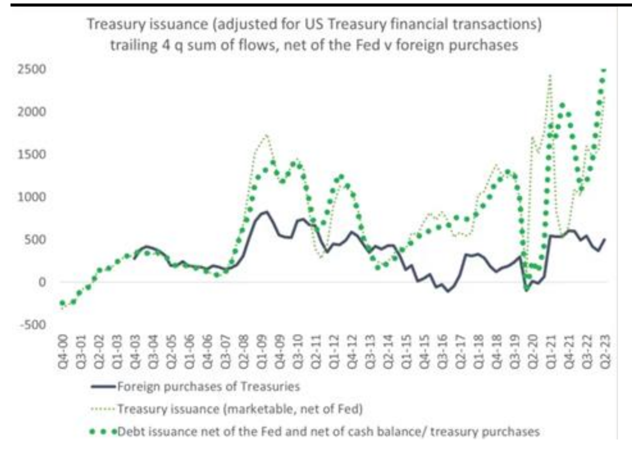
5. Fitch downgrades U.S. long-term rating: the rising G-bond yields could due to the recent degradation on U.S. rating in August. Fitch's key drivers: erosion of governance, rising general government deficits, general government debt to rise, and medium-term fiscal challenges unaddressed.

Figure 1. U.S. 10-year G-bond term premium



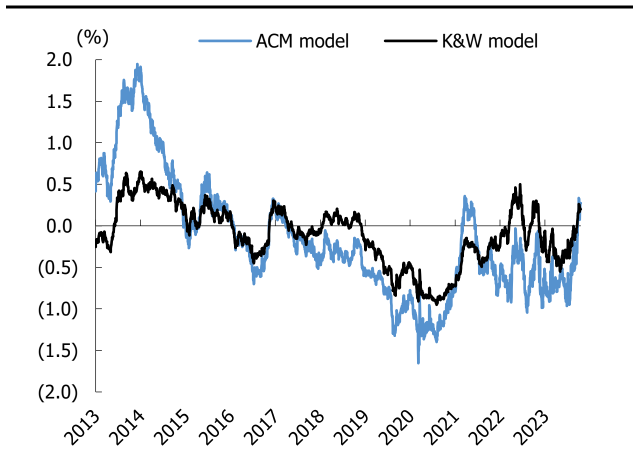
Source: Bloomberg, KIS

Figure 2. US Treasury issuance vs foreign demand



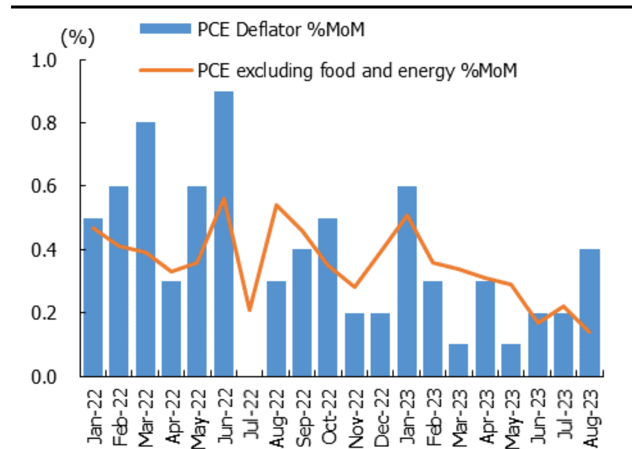
Source: FT, KIS

Figure 3. U.S. 10-year Treasury term premium



Source: Bloomberg, KIS

Figure 4. U.S. monthly PCE



Source: Bloomberg, KIS

Fed Officials' Perspective: Federal Reserve leaders have differing opinions on the factors driving rising yields and their implications:

Supporting a Pause in Rate Hikes: Some leaders argue that the surge in US 10-year yields has tightened financial conditions. This could provide room for the Federal Reserve to consider a pause in its monetary policy adjustments. If these elevated yields primarily reflect investors' reduced appetite for risk, rather than a reflection of exceptionally strong economic growth, it suggests that financial

conditions are tighter than they might otherwise be. A pause in rate hikes can be seen as a prudent response in such a scenario.

Disagreement and Hike more: On the contrary, some leaders find the recent increase in yields perplexing. They posit that it may be propelled by growing optimism regarding the economy's performance over the next five to ten years, rather than fiscal pressures or economic weakness. In their view, this optimism has driven yields upward. Hence, a hawkish stance must be preserved.

The outcome regarding the possibility of one more 25bps hike in the December FOMC meeting remains uncertain, with Fed governors divided into dovish (2/7), hawkish (3/7), and centrist (3/7) factions. However, the expectation of a "longer high" interest rate environment is confirmed.

Implications for Vietnam:

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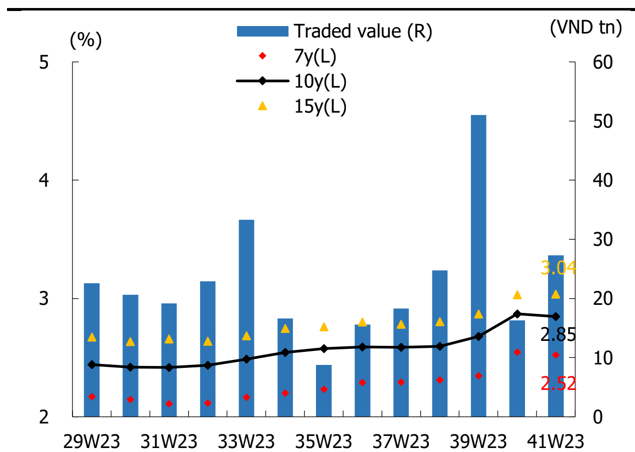
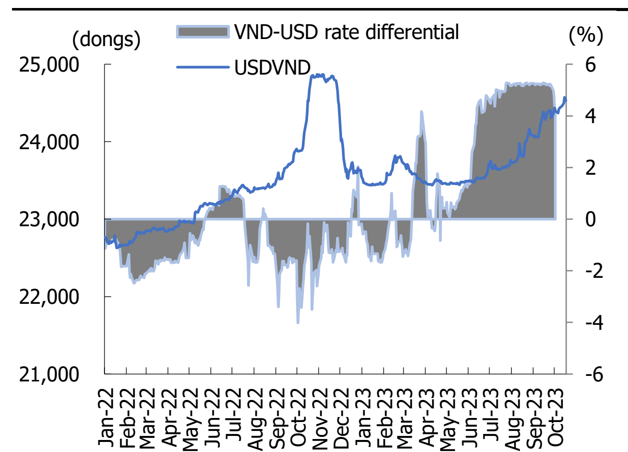
Figure 5. VN trading G-bond yields



Source: VBMA, KIS

Figure 6. USDVND rate differential



Source: Bloomberg, KIS

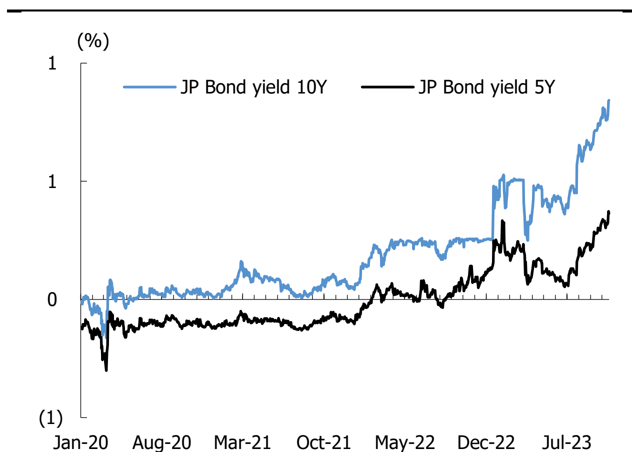
II. Japan G-bond yields reach decade high

In late September, Japanese government bond yields, specifically the 5-year and 10-year ones, surged to their highest levels in a decade. This increase occurred despite the Bank of Japan's (BOJ) efforts to prevent excessive yield hikes not supported by higher inflation expectations.

To counteract the rising yields, the BOJ purchased 300 billion yen (equivalent to USD 2.3 billion) worth of bonds with maturities between 5 and 10 years in late September. Additionally, the BOJ stated its intention to carry out more bond purchases in the future. This yield spike started in late July when the BOJ allowed the 10-year JGB yield to surpass the 0.5% upper limit, but they have an unofficial cap of 1% on 10-year JGB yields.

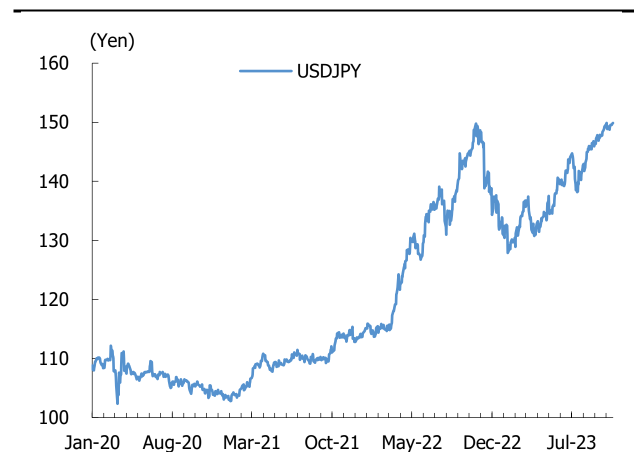
In simpler terms, Japanese government bond yields went up a lot in late September, even though the central bank tried to stop this from happening. They bought some bonds to lower the yields, but the yields still increased. This is because investors are concerned about the Japanese economy and inflation, causing them to sell bonds.

Figure 1. Vietnam PMI and IIP on monthly basic



Source: S&P Global, GSO, KIS

Figure 2. IIP main industry change



Source: GSO, KIS

The Federal Reserve's Beige Book, which was published on Wednesday, indicated that economic conditions in September remained relatively stable. There was a slight decrease in the demand for loans, but the quality of credit remained strong. The intense labor market pressure eased somewhat as employers exhibited less urgency in their hiring.

On the Japanese Yen front, investors are closely monitoring the actions of the Bank of Japan (BoJ) in the foreign exchange market, given that the Japanese Yen has depreciated to nearly 150.00 against the US Dollar. However, any intervention by the BoJ or other authorities may not be sufficient to reverse the trend, as the yen's weakness is rooted in the expansionary monetary policy approach being pursued.

Implication for Vietnam:

A surge in JGB yields could attract inflow from foreign market, indirectly effect the inflow to Vietnam. This is because foreign investors would be attracted to the higher yields offered by JGBs. A decline in foreign investment could hurt the Vietnamese economy by slowing down economic growth and job creation. Overall, the impact of a surge in JGB yields on the Vietnamese market is complex and will depend on a number of factors. However, it is important to be aware of the potential risks, such as a decline in the value of Vietnamese government bonds, a weakening of the Vietnamese dong, and a decline in foreign investment.

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