

Daiwa's View

US yields staying at lower limit, while JGB yields remain inert

- I. US yields must be close to lower limit, but...
- II. Buy-on-dips recommended for JGBs

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Daiwa Securities Co. Ltd.

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US yields staying at lower limit, while JGB yields remain inert

Yesterday, the US 10-year yield fell back to the lower 1.2% range. I regard 1.25% as the approximate level of the lower limit under the circumstances, but the yield has stayed at that level for a long time, which is surprising.

Currently, the 10-year yield is balanced with the 5-year yield of 0.70% and the 5-year forward 5-year yield of 1.86%. Of note is the 5-year forward 5-year yield, which declined to a level that is far below the longer-run projection (2.5%) in the dot chart. A similar trend has also been observed with the 20-year forward 10-year yield, which also fell to 2.13%, far below the longer-run projection. If we view the Fed's rate hike stance as being basically unchanged¹ and the longer-run projection not declining from the current 2.5% to more than about 2%, the hurdle for more purchases would be high.

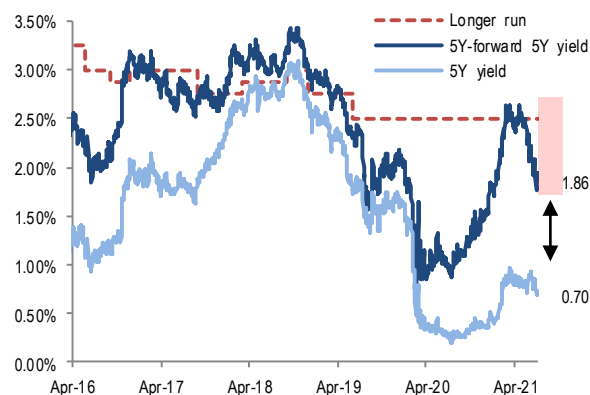
We can't downplay the fact that yields have fallen back to their current levels after trying to rise many times, despite current market circumstances. We don't know whether the cause is concern about risk-off sentiment emanating from China or the stock effects from cumulative bond purchases via QE since the outbreak of the pandemic. (I suspect the latter is the cause.) However, forward real yields are declining, which warrants attention.

US Treasury Yields (%)

UST	5y	(5y OIS)	5y5y	(5y5y OIS)	10y	(10y OIS)
Current level	0.70	0.61	<u>1.86</u>	1.49	1.24	1.04

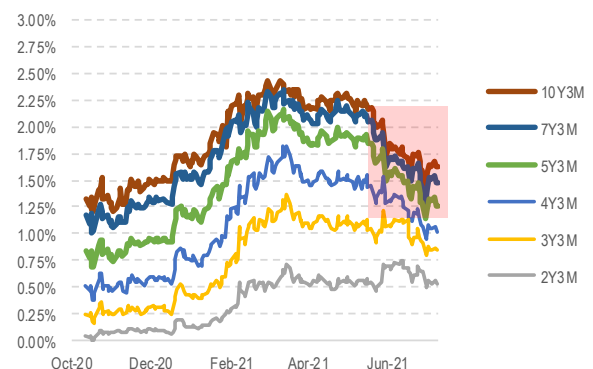
Source: Bloomberg; compiled by Daiwa Securities.

US Treasury 5Y Yield, 5Y-forward 5Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

US OIS Yield (forward OIS yield – FF rate)



Source: Bloomberg; compiled by Daiwa Securities.

¹ If the Fed's exit strategy is subject to a setback, the 5-year yield will decline.

◆ JGB

Next, observing the 10-year JGB yield via the 5-year yield and the 5-year forward 5-year yield, we see that they have done a complete round trip. There is little room for argument regarding the 5-year yield being in a fixed position of around -0.1% , which is not surprising (with the current level being -0.13% , there is a little room for upside). Here, too, of note is the 5-year forward 5-year yield, which has returned to 0.17% , the average value of actual yields since the introduction of the yield curve control (YCC) policy in September 2016.

If we assume that the 5-year yield is at around -0.1% , a 5-year forward 5-year yield of around 0.17% would mean a 10-year yield at a low single-digit level in positive territory. Another 2-3 bp rise each in the 5-year yield and the 5-year forward 5-year yield is within the range of what can be assumed. Meanwhile, since the introduction of the YCC policy, the 5-year forward 5-year yield has only stayed above 0.3% when the BOJ's moves for more flexible operations became a topic in the latter half of 2018 and the first half of 2021. Therefore, we are unlikely to see a return of such a situation with yields for the time being. If so, needless to say 0.1% , and even 0.05% , would seem to be a high hurdle for the 10-year yield.

For reference, another 'round-trip' situation has been observed with the 20-year yield (10-year forward 10-year yield). Currently, the 10-year forward 10-year yield has returned to 0.8% , the average level during last year (right-hand chart below). Assuming that the 10-year yield is in shallow positive territory, a 10-year forward 10-year yield of 0.8% means a 20-year yield of around 0.4% .

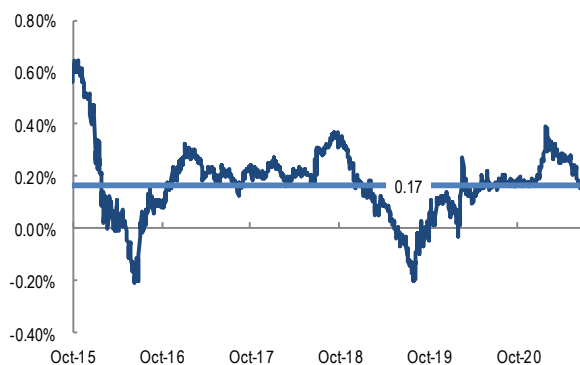
The size of a supplementary budget has been discussed. However, if this doesn't hit the mark, volatility in the JGB market, which has returned to last year's average level, will likely remain low. We don't need to aggressively hit offer prices for 10-year and 20-year JGBs now, but we should buy solidly on dips.

JGB Yields (%)

JGB	5y	(5y OIS)	5y5y	(5y5y OIS)	10y	(10y OIS)
Current level	-0.12	-0.08	0.17	0.06	0.02	-0.01

Source: Bloomberg; compiled by Daiwa Securities.

JGB 5Y-forward 5Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

JGB 10Y-forward 10Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

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