Daiwa's View

JGB yields moving in line with US and European yields

➢ Their movements are correlated to a certain degree, but are the economic environments really that similar?

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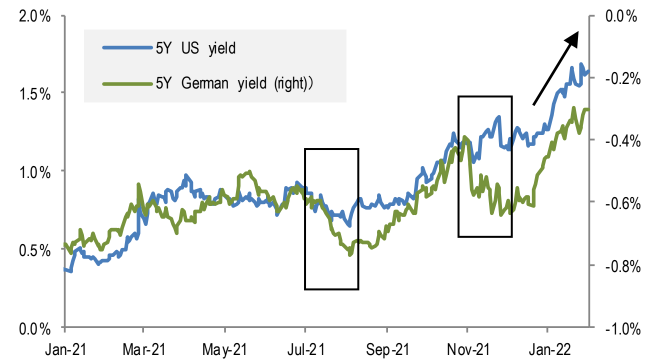
Their movements are correlated to a certain degree, but are the economic environments really that similar?

Yesterday, the 10-year JGB yield rose to 0.185% at one point (and closed at 0.17%). Yields in other maturities also climbed: the 2-year yield to –0.055%, the 5-year yield to –0.02%, the 20-year yield to 0.56%, and 30-year yield to 0.775%.

◆ JGB yields moving in line with 'average' for US and European yields; ECB Governing Council meeting on 3rd attracting attention

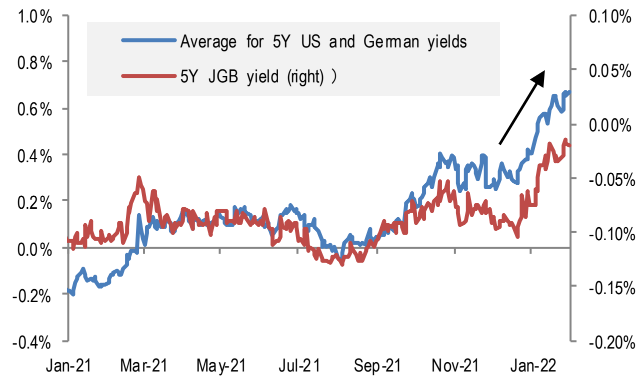
With the Fed signaling a hawkish stance, it is appropriate for the 5-year US yield to factor in five rate hikes in 2022. Meanwhile, comparing JGB yields with US/German yields and the average for US and German yields, we observe an uptrend in JGB yields almost in parallel with US and German yields (chart below). This suggests the possibility that the uptrend in the 5-year JGB yield is moving in line with global yield trends, and not necessarily the hawkish pivot by the BOJ.

5Y US and German Yields



Source: Bloomberg; compiled by Daiwa Securities.

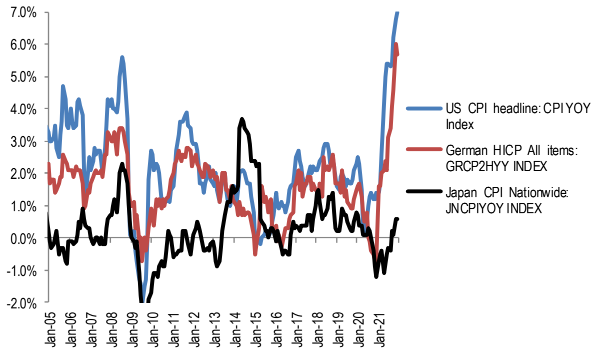
5Y JGB Yield, Average for 5Y US and German Yields



Source: Bloomberg; compiled by Daiwa Securities.

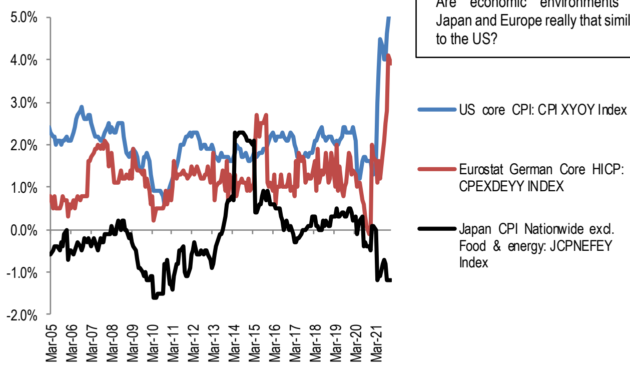
Of course, international financial markets move in tandem to a certain degree. However, movements this similar make one wonder if the economic environments in Japan and Europe are really that similar to the US, where inflation and wage hikes are intensifying. The German OIS market has now priced in 1.3 rate hikes by September 2022 and 2.5 hikes by December (0.1ppt per hike), according to Bloomberg WIRP. However, we judge that the rate-hike pricing is excessive, because we do not forecast that the ECB will decide on several rate hikes in 2022. If ECB President Christine Lagard warns against market pricing at the Governing Council meeting to be held on 3 February, trends in US and German yields may diverge similarly to how they did in July and November 2021, reflecting the differences in their monetary policy stances. If so, we may see a pause in the uptrend in the 5-year JGB yield, which tends to move in line with the 'average' for US and German yields.

Headline CPI in Japan, US, Germany



Source: Bloomberg; compiled by Daiwa Securities.

Core CPI in Japan, US, Germany



Source: Bloomberg; compiled by Daiwa Securities.

Are economic environments in Japan and Europe really that similar to the US?

We have been monitoring the IMF's Article IV Mission Concluding Statement for Japan for some time, and the latest statement (released on 27 Jan) asserts that "One option could be to steepen the yield curve by shifting the yield target from the 10-year to a shorter maturity." This appears to be attracting attention in the market as well as in the Diet. We get the impression that it is not a balanced approach to interpret this as the IMF proposing the scaling back of easing, fixating solely on the part about a shorter maturity.

First, the wording "shifting the yield target from the 10-year to a shorter maturity" has been maintained since 2019, and is not at all something that has been newly added in. While the BOJ may have suddenly shifted towards a hawkish stance, repetition of existing opinions should not mean that the BOJ is using the statement in order to send messages to the market by intentionally providing biased information to the IMF. When existing opinions are removed, we should speculate as to why they were removed. But we should not be overly eager to try to find major policy intentions from repeated opinions.

Second, this Article IV Mission Concluding Statement also proposes that "If the underlying inflation momentum remains weak, cutting the policy rate should be the first option," which is the same as the previous proposal. If people are going to emphasize proposals in the Article IV Mission Concluding Statement, they should also focus on this comment on rate cuts, together with that on shortening the maturity.

Of course, this proposal that "cutting the policy rate should be the first option" leads to the next part stating that "delinking the overshooting commitment from the monetary base could simplify communication" (which is also the same as the previous opinion). What we can say is that the IMF's Article IV Mission Concluding Statement is a comprehensive statement, including fiscal policy and trade policy, and, therefore, highlighting just one part of it tends to mislead the market. With the 5-year JGB yield approaching 0%, it may be easier to envision the zero percent target for the 5-year yield. But we need to be careful how we interpret these statements.

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