

## Daiwa's View

## JGB yield outlook for 2023

- 10-year JGB yield could reach 0.72% if trading band is widened again in mid-2023, which would provide a buying opportunity

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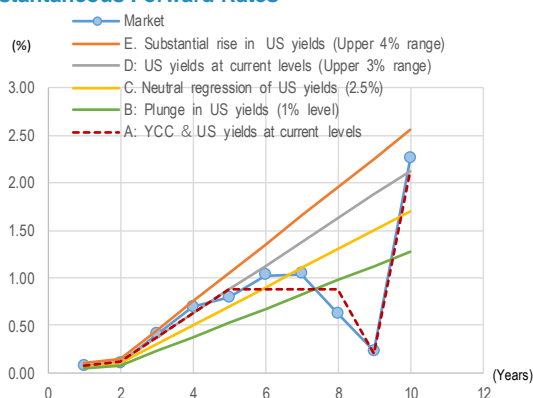
**10-year JGB yield could reach 0.72% if trading band is widened again in mid-2023, which would provide a buying opportunity**

## JGB yield outlook for 2023

In the *Daiwa's View* report published on 16 November 2022, we [estimated](#) what the JGB yield curve would be when the BOJ ends the YCC policy (10-year JGB yield of 0.75%). Afterwards, we gained a clearer (albeit still vague) picture of the BOJ's new operations ([its stance of defending the front end](#)) through [modifications to its implementation of the YCC](#) in December 2022, increases to purchase amounts in *Rinban* operations, fixed-rate purchase operations, and [fixed-rate funds-supplying operations \(funds-supplying operations against pooled collateral\)](#). It is not easy to forecast what yen yields will be in 2023 when there is speculation about changes in monetary policy after the new BOJ Governor takes office. (In all humility, we must admit that no one can forecast that.) However, the more unstable the policy becomes, the more important it is to forecast the divergence from the yield curve when the YCC ends. In this report, we examine the yield outlook by once again estimating the yield curve when the YCC ends.

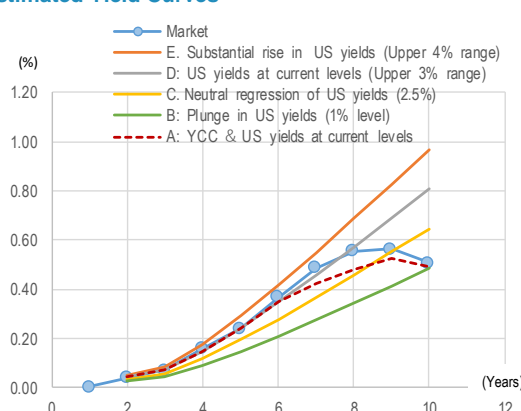
- ◆ Estimated yield curves when YCC ends  
We generate instantaneous forward rates based on a few assumptions<sup>1</sup> and simple scenarios. Based on this, we derive estimated yield curves. In this analysis, the gray line (D) shows the instantaneous forward rate when the YCC is removed right away, and the 10-year JGB yield based on the instantaneous forward rate is expected to rise to around 0.8%. In the case of a substantial rise in the US long-term yield (orange line: E), the 10-year JGB yield is also expected to rise to around 1%. In contrast, in the case of a decline in the US yield to 3% or lower (yellow line: C), the 10-year JGB yield is estimated to remain slightly above 0.6%. In the case of a drop in the US yield to the 1% level (green line: B), the 10-year JGB yield is estimated at 0.5% or lower in its natural state (charts below).

## Instantaneous Forward Rates



Source: Bloomberg; compiled by Daiwa Securities.

## Estimated Yield Curves



Source: Bloomberg; compiled by Daiwa Securities.

<sup>1</sup> We assume that (1) the same levels apply as now in the initial two years, (2) there is a linear rise in instantaneous forward rates with remaining maturities of two years or longer, and (3) superlong JGB yields move in line with the US long-term yield.

The chart below provides a general idea of the 10-year JGB yield level based on three different scenarios—involving an end to YCC, a 10-year yield cap of 75bp, and a 10-year yield cap of 50bp, respectively.

#### General Picture of 10-year JGB Yield Levels Based on Scenarios Involving US Rates and BOJ Monetary Policy (%)

10Y JGB yield	E : Substantial rise in US yields (Upper 4% range)	D : US yields at current levels (Upper 3% range)	C : Neutral regression of US yields (Around 2.5%)	B : Plunge in US yields (Upper 1% range)
End to YCC	1.00	0.80	0.65	0.50
YCC capped at 75bp	0.75	0.72	0.62	0.50
YCC capped at 50bp	0.50	0.50	0.46	0.42

Source: Bloomberg; compiled by Daiwa Securities.

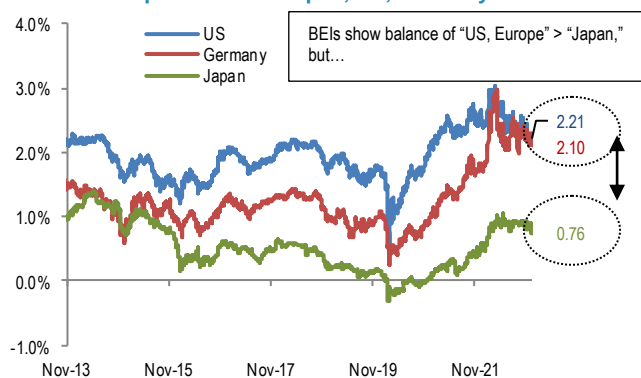
Our main scenario is that the BOJ will make further modifications to YCC (trading band of  $\pm 75$ bp) after the new governor takes office in April 2023<sup>2</sup>. We also forecast that the US long-term yield will decline in line with a pivot by the Fed (suspension of rate hikes, rate cuts). Once the Fed starts to cut rates, the JGB yield curve at the time of the end of YCC is expected to move towards the yellow line (C) in line with lower US yields. The final projected values change depending on the timing of (1) widening of the trading band and (2) the decline in US yields. However, if the trading band is widened before the decline in US yields, the 10-year JGB yield could temporarily touch 0.72%.

After that, however, the 10-year JGB yield is expected to decline towards the 0.6% level in line with an actual drop in the US long-term yield. If the aforementioned estimation for yield curves at the time of the end of YCC is generally correct, it is not viewed as very likely that we would see a resurgence of attacks on the YCC policy with the 10-year JGB yield capped at 0.75% after US yields move towards a full-scale neutral regression.

#### ◆ “BEI” + “real yields” also indicate around 0.75%

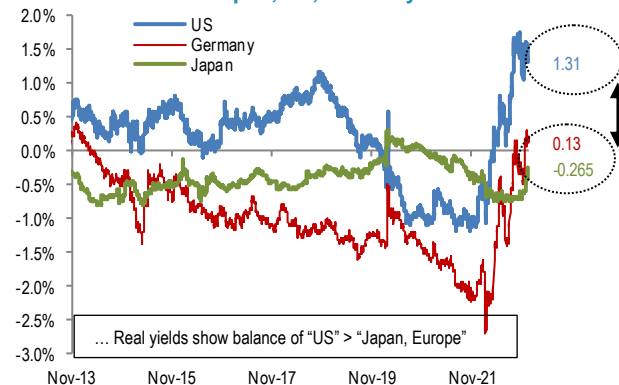
There is another reason for our forecast that the 10-year yield will not rise far above 1% after further modifications to YCC or the end to YCC—namely, the low 10-year breakeven inflation rate (BEI) in Japan. While 10-year BEIs in Europe and the US are at the lower 2% range, Japan's 10-year BEI remains at 0.76% (declining from 0.90% to 0.76% after modifications to YCC in Dec 2022). This indicates (1) limited upside potential for JGB yields compared to European and US yields, reflecting the difference in BEIs (around -1.5%) and (2) uncertainty among Japanese market participants that the price stability target will be achieved.

#### 10Y Inflation Expectations in Japan, US, Germany



Source: Bloomberg; compiled by Daiwa Securities.

#### FYI: 10Y Real Yield in Japan, US, Germany



Source: Bloomberg; compiled by Daiwa Securities.

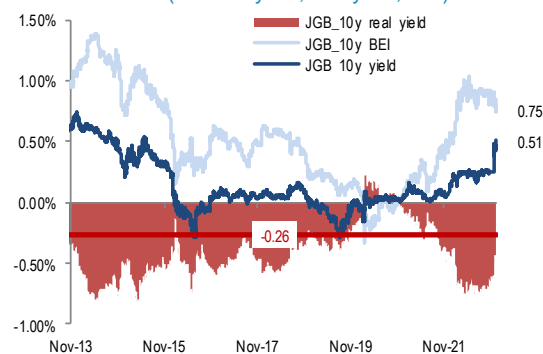
<sup>2</sup> Depending on the external environment, the BOJ might not conduct policy revisions that correspond to a virtual rate hike, but this is viewed as a sub scenario.

The Kishida administration declared that it would discuss revisions to the accord (between the government and the BOJ) after the new BOJ Governor took office. In the course of making revisions, a more flexible inflation target may become one of the agendas for a price target suitable for Japan. If the BOJ were to move towards withdrawal of monetary easing (virtually equivalent to abandoning 2%) based on an inflation rate of 1% under the new accord, from the market's perspective, it would be seen as even more difficult than before for Japan's BEI to reach 2%. If a BEI of 1% were to become the de facto new upper limit and the BEI moved in the 0.5-1% range, a level for the 10-year JGB yield of 0.76%, which is currently observed in the market, would appear to be appropriate to some extent.

Furthermore, the 10-year real yield is currently at (only) 0.13% in the eurozone, where interest rates have shifted to tightening levels as the region has suffered from cost-push inflation of more than 10%. This fact also prevents us from forecasting developments with Japan's real yield going far above 0% for the time being. If the BEI were 0.75% and the real yield were 0%, the 10-year JGB yield would be estimated at around 0.75%. Therefore, this supports the appropriateness of the above estimation using the instantaneous forward rate that the 10-year JGB yield would remain around 0.8% even after the end of YCC.

If this is an approximate true value for the 10-year JGB yield in the current environment, and the cap were raised to 0.75% during the next modifications to the YCC, it seems likely that that would signify something close to effectively robbing the YCC policy of its effectiveness.

#### 10Y JGB Yields (nominal yield, real yield, BEI)



Source: Bloomberg; compiled by Daiwa Securities.

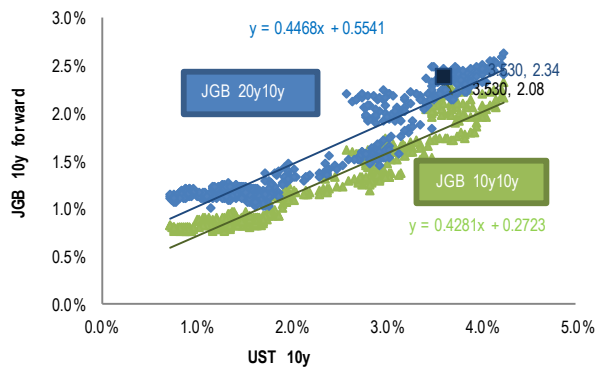
If we were to see reactionary moves to last year's rise in global yields during a downtrend after the Fed begins to cut rates, the 10-year JGB yield would be expected to rise temporarily to the 0.7% level in 2023, but then eventually decline to around 0.5%, the same as current levels. If the next modifications to the YCC were to lead to a 10-year JGB yield at the 0.7% level and a real yield surfacing to around 0%, that would provide an opportunity to buy.

#### Yield Outlook

		FY23											
		Jan-Mar			Apr-Jun			Jul-Sep			Oct-Dec		
		Upper limit	Lower limit	Term-end	Upper limit	Lower limit	Term-end	Upper limit	Lower limit	Term-end	Upper limit	Lower limit	Term-end
Japan	IOER	-0.10	-0.10		-0.10	-0.10		-0.10	-0.10		-0.10	-0.10	
	Uncollateralized /N rate	-0.08	0.00		-0.08	0.05		-0.08	0.05		-0.08	0.05	
	2y	-0.10	0.10	0.01	-0.10	0.10	0.02	-0.10	0.10	0.04	-0.10	0.10	0.02
	5y	0.05	0.30	0.22	0.05	0.30	0.23	0.05	0.40	0.25	0.00	0.40	0.20
	10y	0.25	0.50	0.48	0.25	0.50	0.49	0.25	0.72	0.65	0.20	0.72	0.50
	20y	0.90	1.40	1.25	1.00	1.50	1.30	1.00	1.50	1.40	0.85	1.50	1.15
US	30y	1.15	1.60	1.50	1.25	1.70	1.60	1.25	1.70	1.65	1.10	1.70	1.45
	10y	1.95	4.30	3.05	1.75	4.30	2.80	1.50	4.25	2.60	1.45	4.20	2.55

Source: Compiled by Daiwa Securities.

### JGB Superlong Forward Yields, 10Y UST Yield



Source: Bloomberg; compiled by Daiwa Securities.

### JGB Superlong Forward Yields



Source: Bloomberg; compiled by Daiwa Securities.

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