

Daiwa's View

Superlong JGBs: Points of reference after policy revisions becoming fixed

- Points of reference for superlong JGBs—20Y: 1+2→1.5%;
30Y: 1+2+2.25→1.75%

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Daiwa Securities Co. Ltd.

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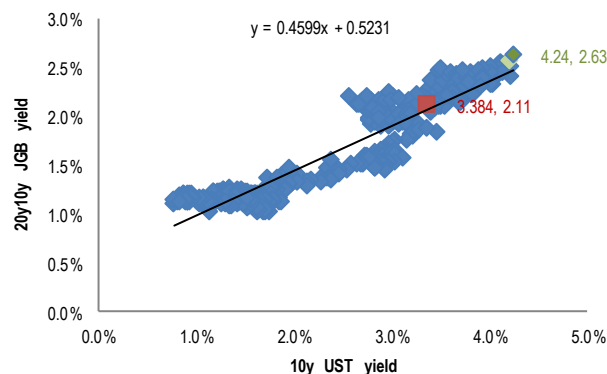
◆ Superlong JGBs and policy revisions

One focus of attention regarding superlong JGBs is whether the previous correlation with global yields will be maintained after policy revisions by the BOJ. While the topic of policy revisions has a direct impact on the short-term/long-term sector, its impact on the superlong sector is highly uncertain, as fundamentals are the most important elements there.

◆ 20Y10Y JGB yield is correlated with global yields

In that respect, we confirm the correlation since November 2020 between the US long-term yield and the 20Y-forward 10Y JGB yield (20Y10Y JGB yield), which is a specific element of the 30Y JGB yield. Firstly, the 20Y10Y JGB yield reached a peak at 2.63% on 24 October 2022, when the US yield set a record high on a closing basis at 4.24%. Secondly, the 20Y10Y JGB yield was at 2.11% yesterday, which was largely consistent with the regression line with the US long-term yield (chart below). These facts imply that the correlation between superlong JGB yields and US yields has not changed substantially since the BOJ's surprise Monetary Policy Meeting (MPM) in December 2022.

US Long-term Yield, 20Y10Y JGB Yield

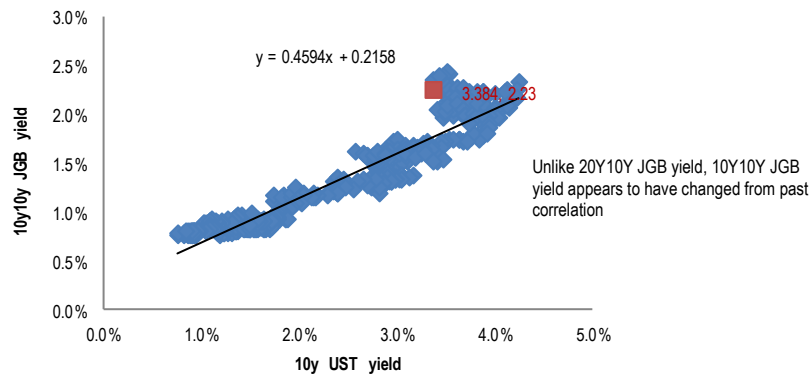


Source: Bloomberg; compiled by Daiwa Securities.

◆ Adjusted 10Y10Y JGB yield is also correlated with global yields

Meanwhile, the 10Y-forward 10Y JGB yield (10Y10Y JGB yield, which is approximately equal to the latter half of the 20Y yield) is currently around 2.23%, which has diverged to some extent from the regression line derived from the correlation with the US long-term yield (chart on next page). If we regard this divergence as important, one would tend to draw the conclusion that some kind of significant change has happened in the 20Y sector since the emergence of speculation about policy revisions.

US Long-term Yield, 10Y10Y JGB Yield

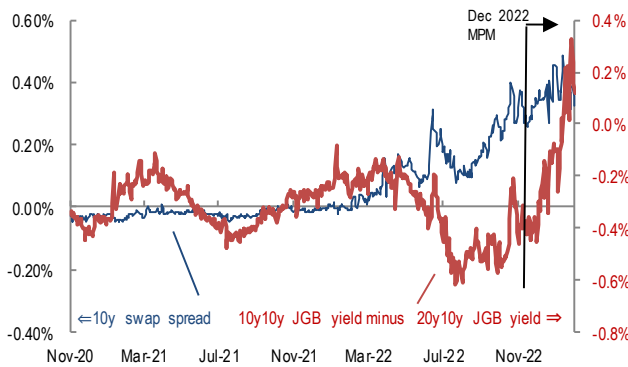


Source: Bloomberg; compiled by Daiwa Securities.

That said, it is obvious that the 10Y10Y JGB yield (the latter half of the 20Y yield) is impacted to some extent by the fact that the upper limit of the 10Y JGB yield (the first half of the 20Y yield) is artificially capped by the YCC at 0.5%. In particular, a rapid rise has been seen in the 10Y10Y JGB yield level vs. the 20Y10Y JGB yield level since the MPM in December 2022, when most market participants started to anticipate the removal, or loss of effectiveness, of the YCC in the near future (left-hand chart below). This implies that there is an increased need to adjust for the impact of the 0.5% cap on the 10Y yield when examining the 10Y10Y JGB yield.

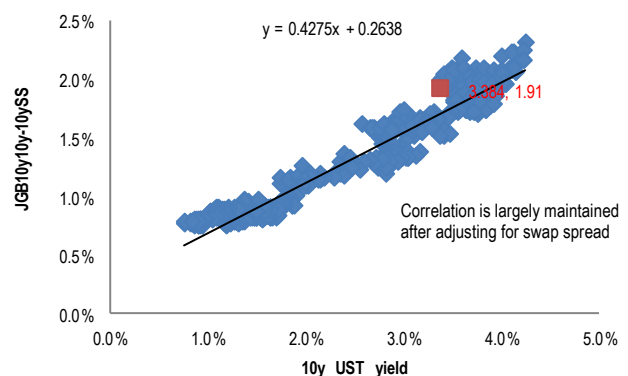
Therefore, we tentatively made a scatter chart of the US yield and the adjusted 10Y10Y JGB yield. Specifically, we regarded the 10Y swap spread (the difference between the 10Y swap OIS yield and 10Y JGB yield) as a distorted part of the 10Y JGB yield, and deducted the 10Y swap spread since the December MPM (when the overall yen bond market started to price in the removal, or loss of effectiveness, of YCC at full scale) from the 10Y10Y JGB yield. The adjusted data shows that the existing correlation has been largely maintained (right-hand chart below).

10Y Swap Spread, 10Y10Y JGB Yield Minus 20Y10Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

US Long-term Yield, Adjusted 10Y10Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

The examination above leads us to infer two important things. One is that it is highly likely that superlong JGB yields will rise (or decline) if the US long-term yield rises (or declines). This would not be a surprise in the sense that the existing relationship would likely be maintained. The other inference, which may be somewhat surprising, is that it is possible that the superlong JGB sector has finished factoring in the removal, or loss of effectiveness, of the YCC due to policy revisions, and, therefore, superlong JGB yields may not rise much even if the BOJ revises its policy in 2023 under the new BOJ Governor.

I was surprised that the market consensus regarding the 10Y JGB yield after removal of the YCC formed much earlier than previously expected due to the fact that the MPM in December 2022 had been so surprising (if the YCC were removed right now, the 10Y yield

would be around 0.7-1.0%). Of course, the announcement of the removal, or loss of effectiveness, of the YCC would cause short-term confusion. However, if superlong JGBs are currently pricing in the 10Y JGB yield level after the removal, or loss of effectiveness, of the YCC, it is highly likely that the topic of policy revisions by the BOJ itself has peaked out.

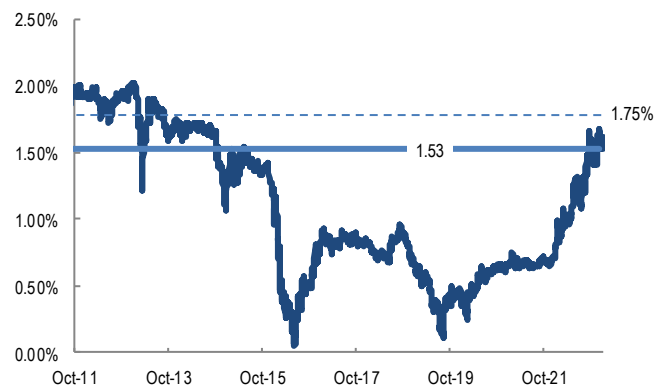
- ◆ Points of reference for superlong JGB yields: 20Y: 1+2→1.5%; 30Y: 1+2+2.25→1.75%?
In any case, if the correlation between US yields and superlong JGB yields is maintained, a general idea of the points of reference for the levels of the upper limits for the 20Y yield and the 30Y yield after the removal, or loss of effectiveness, of the YCC can be obtained by totaling the market consensus regarding the upper limit level for the 10Y yield after the removal, or loss of effectiveness, of the YCC. It could be said that the levels of $10Y1\%+10Y10Y2\% \cong 20Y1.5\%$ and $10Y1\%+10Y10Y2\%+20Y10Y2.25\% \cong 30Y1.75\%$ are appropriate to some extent as points of reference regarding the upper limits after the removal, or loss of effectiveness, of the YCC, although these are about 25bp lower than the levels before the introduction of unprecedented easing by Governor Haruhiko Kuroda.

20Y JGB Yield



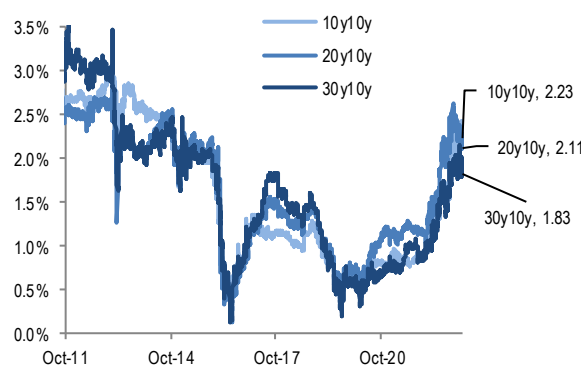
Source: Bloomberg; compiled by Daiwa Securities.

30Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

Superlong JGB Forward Yields



Source: Bloomberg; compiled by Daiwa Securities.

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