Daiwa Securities

Daiwa's View

US yield outlook for FY23 (revised on 22 Jun)

- We forecast US 10-year yield of 3.5% at end-2023 and 3.25% at end-Mar 2024
- Now may be the last buying opportunity

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp

Senior Strategist
Ryoma Kawahara
(81) 3 5555-8777
ryoma.kawahara@daiwa.co.jp
Daiwa Securities Co. Ltd.

US yield outlook for FY23 (revised on 22 Jun)

We forecast US 10-year yield of 3.5% at end-2023 and 3.25% at end-Mar 2024

We have revised our outlook for US yields in light of yesterday's revision to our outlook for US monetary policy. Our new forecast for the US 10-year yield is 3.50% at end-2023 (up 50bp vs. our previous forecast) and 3.25% at end-March 2024. Our outlook reflects two new factors—(1) a 25bp rise in the level of the terminal rate (from 5.25% to 5.5%) due to an anticipated rate hike at the July FOMC meeting and (2) a 3- to 5-month delay in the timing of rate cuts compared to the previous projection (from Dec 2023 to Mar-May 2024). (We estimate that both factors will have the effect of raising the yield by around 25bp each.)

As previously reported, there are certain limitations with the inversion of the 10-year yield and the federal funds rate. With the negative yield now close to the limit of what is sustainable, a revision to the terminal rate will likely have a direct impact on the 10-year yield. In *Daiwa's View* reports, we view it as highly likely that, in the end, the Fed will not raise the upper limit of the federal funds rate to 5.75% because two additional rate hike projections in 2023 shown in the new dot plot (median) for the June FOMC meeting consist of one strong signal and one weak signal. We forecast that the Fed will probably implement the last additional rate hike in July, and then enter a period of maintaining the policy interest rate following the Jackson Hole conference in August and the FOMC meeting in September.

Of course, it is true that risks with the yield outlook are increasing in two different directions. Over the next six months, both of the following are possible—(1) increased pricing in of the second additional rate hike and (2) increased speculation about a rate cut at an early stage. The 10-year yield is expected to approach 4% in the former case and 3.5% in the latter case. While the market is factoring in a terminal rate of 5.5%, the 10-year US yield is likely to move in a range centering on 3.75%.[1]

US Yield Outlook as of 22 Jun 2023 (%)

	22-Jun	FY23								
		Jul-Sep			Oct-Dec			Jan-Mar		
	(Actual: Bloomberg)	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end
FF (upper limit)	5.25	5.00	6.00	5.50	4.00	6.00	5.50	3.00	6.00	5.25
2y	4.71	3.75	5.50	4.75	3.25	5.25	4.50	2.50	5.00	3.50
5y	3.96	3.00	4.50	4.00	2.75	4.25	3.50	2.50	4.25	3.25
10y	3.72	3.00	4.25	3.75	2.75	4.25	3.50	2.50	4.25	3.25

Source: Compiled by Daiwa Securities.

[1] When expressing this by breaking it down into the 10-year breakeven inflation rate (BEI) and the real yield, a 10-year real yield of around 1.45% and real yield of 1.1-1.7% are estimated for a 10-year BEI of around 2.3%.

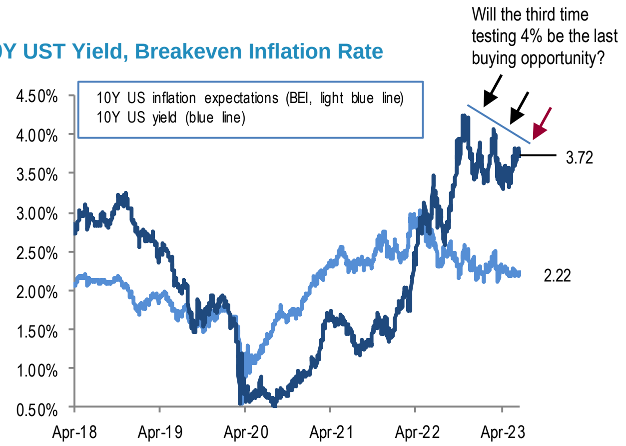
Current movement testing 4% could be the last buying opportunity

◆ Is this the last opportunity to buy?

We feel it is highly likely that the current uptrend in the US long-term yield will be the last opportunity to buy during this rate-hike cycle. Looking back on developments since last year, the 10-year yield hit 4% twice, and both times this occurred when the Fed became more hawkish and the market increased speculation about a substantial rise in real yields due to rate hikes. As the Fed raised its projection for the upper limit of the federal funds rate to 5.7% in the dot plot for the June FOMC meeting, the 10-year yield is now testing 4%, which is the third time in the current cycle. However, we get the impression it is unlikely that the Fed will raise the terminal rate to a level higher than 6% during 2H FY23 (of course, this depends on data). If this were to be the last rise in the terminal rate, this third time testing 4% could be the last buying opportunity.

Moreover, during the current rate-hike cycle, the 30-year US yield has exceeded 4% only during 17 October-11 November 2022. We are focusing on the fact that the 30-year yield has not exceeded 4% since the beginning of 2023 (on a closing price basis). Even when the 10-year US yield topped 4% on 2 March 2023 on a closing price basis, the 30-year yield did not exceed 4%. The fact that the 30-year yield, which tends to be traded based on a long-term perspective, is forming a peak at 4% serves as an important reference factor when examining the investment attractiveness of the 10-year yield of 4% in the current rate-hike cycle.

10Y UST Yield, Breakeven Inflation Rate



Source: Bloomberg; compiled by Daiwa Securities.

30Y UST Yield

Source: Bloomberg; compiled by Daiwa Securities.

Appendix: Outlook for Monetary Policy and Balance Sheet Reductions (QT) as of 21 Jun 2023

FOMC meeting	Policy rate (median of range)	Balance sheet reductions (QT)
Sep-22	0.75% hike (3.125%)	Maximum roll-off cap of $95bn/m (US Treasuries: $60bn/m, MBS $35bn)
Nov-22	0.75% hike (3.875%)	
Dec-22	0.50% hike (4.375%)	
Feb-23	0.25% hike (4.625%)	
Mar-23	0.25% hike (4.875%)	
May-23	0.25% hike (5.125%)	
Jun-23	-	
Jul-23	0.25% hike (5.375%) Terminal rate: 5.25%～5.50%	
Sep-23	-	
Nov-23		
Dec-23		
Jan-24		
Mar-24	0.25% cut (5.125%)	Suspension of balance sheet reductions (Continuation of MBS roll-off)
May-24	0.25% cut (4.875%)	
Jun-24	0.25% cut (4.625%)	
Jul-24	0.25% cut (4.375%)	
Sep-24	0.50% cut (3.875%)	
Nov-24	0.50% cut (3.375%)	
Dec-24	0.50% cut (2.875%)	
Jan-25	0.25% cut (2.625%) Terminal rate: 2.50%～2.75%	

Source: Compiled by Daiwa Securities.
Note: Official schedule for FOMC meetings from Mar 2024 onwards undisclosed.

IMPORTANT

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:
https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association