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Daiwa's View

Ongoing rise in US Treasury yields led by term premium

➢ As long as a sense of caution about intervention in USD/JPY rate lingers, we cannot feel relieved that it is peaking out

Fixed Income Research Section
FICC Research Dept.

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

Daiwa Securities Co. Ltd.

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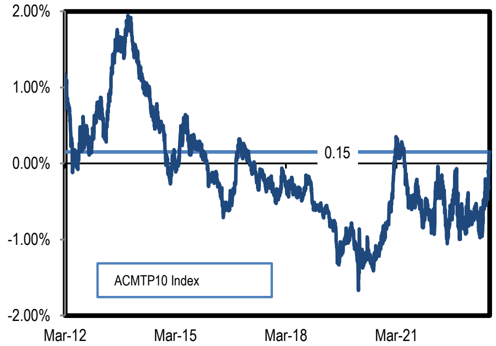
Ongoing rise in US Treasury yields led by term premium

Yesterday, the US long-term yield rose to 4.68%, the highest level since 2007. Considering the current situation in which the Fed is presenting its view of a 2.5% real policy rate "world" and providing a de facto forward guidance of "high for long," the current level of the US long-term yield consisting of a BEI of 2.35% and a real yield of 2.33% does not feel unreasonable. Meanwhile, we have the impression that the rise in the term premium that we pointed out before is continuing. This still needs to be monitored carefully.

When we reported about "Higher US Treasury yields led by term-premiums" on 21 August (the English report was issued on 22 Aug), the 10-year US term premium had risen by 59bp from -0.96 (on 19 Jul) to -0.37 (on 17 Aug). The term premium has been rising since then. As of 29 September (the latest data), it had risen to +0.15%. Compared to 19 July, it had risen by as much as 111bp (-0.96→0.15). This is the third highest rise, only ranking below the approximately 200bp rise at the time of the "taper tantrum" of 2013 and the approximately 180bp rise at the time of President Biden's fiscal shock in 2021.

10yr UST Term Premium (ACM model)



10yr US term premium rose by 111bp, from -0.96% to 0.15%, in a little over two months (which is largely explained by the 93bp rise in US long-term yield, from 3.75% to 4.68%, during the same period)

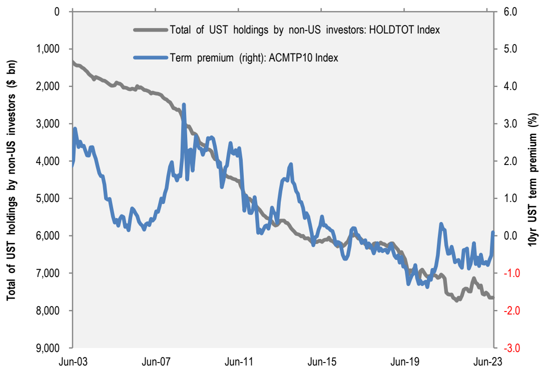
Source: Bloomberg; compiled by Daiwa Securities.

Of course, the change in the term premium is caused by various factors. There can be little doubt that the biggest factor is the expansionary fiscal stance of the Biden administration and the subsequent surge in UST issuance. That said, in addition to Biden's fiscal stance, we should also recognize the relationship with UST holdings by major non-US investors. In the past, the UST term premium tended to decline as holdings by non-US investors increased. However, this trend appears to be changing.

In particular, we need to recognize the relationship with UST holdings by Japanese and Chinese investors, which are the world's largest holders. China's UST holdings increased rapidly starting in November 2001, when the nation joined the WTO. At one point, when its holdings exceeded those of Japanese investors, China temporarily became the world's largest buyer of USTs. However, currently its UST holdings have been declining at a rapid rate due to US-China decoupling, distribution of foreign reserves, and intervention operations probably aimed at maintaining the value of the yuan at no higher than 7.35, which is widely recognized as a defensive line (right-hand chart below).

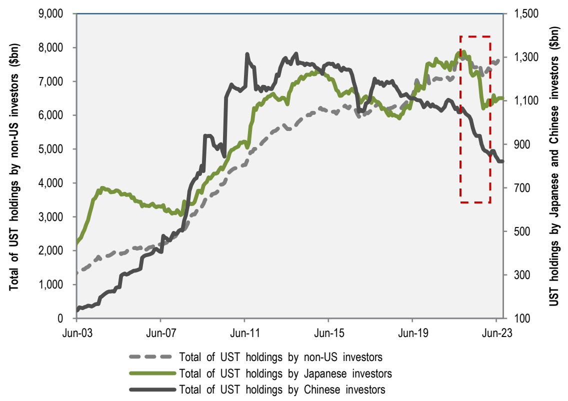
Furthermore, when Japanese authorities implemented yen buying/dollar selling intervention on 22 September 2022 for the first time since June 1998, they sold USTs in order to secure funds for intervention. This led to a temporary sharp decline in Japan's UST holdings. We cannot ignore the fact that the rise in the US long-term yield to 4.34% in October 2022 and the underlying factor of the term premium widening +1ppt at that time occurred around the time that Japan's UST holdings declined sharply.

Term Premium, UST Holdings by Non-US Investors



Source: Bloomberg; compiled by Daiwa Securities.

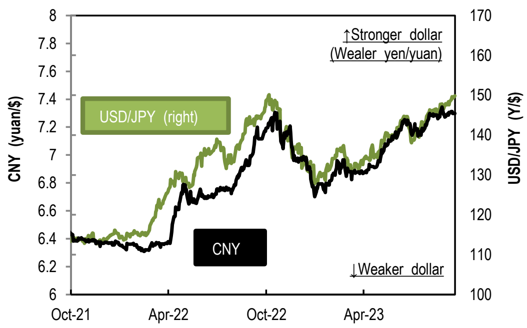
UST Holdings by Japanese and Chinese Investors



Source: Bloomberg; compiled by Daiwa Securities.

Amid the resurgence of higher US yields and dollar appreciation, UST holdings by Chinese investors are currently continuing to decline, and the likelihood of intervention by Japanese authorities is increasing. I will leave the detailed analysis about the timing of the actual intervention and ways of securing funds for intervention to forex analysts. The fact that should be recognized here by bond market participants (at least with regard to 2022) is that the deterioration of supply and demand with USTs (rise in term premium) and the uptrend with yields hit a peak around the time that Japanese fiscal authorities implemented currency intervention. As long as a sense of caution about intervention with the USD/JPY rate lingers, it would be premature to think that the widening tendency of the UST term premium has ended.

USD/JPY Rate, USD/CNY Rate



Source: Bloomberg; compiled by Daiwa Securities.

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