

Daiwa's View

Term premium has declined once more into negative territory

- Term premium has lost one third of gain achieved during Jul-Oct

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Daiwa Securities Co. Ltd

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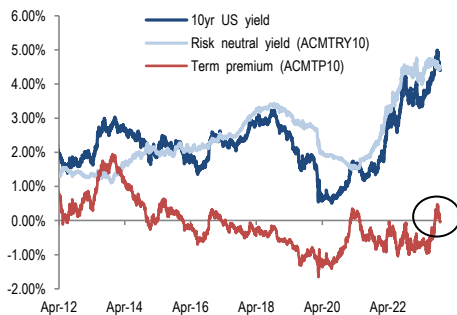
Decline in term premium

On 21 November, the term premium of 10-year US Treasuries declined to -0.02%. During a period of about three months, the term premium had surged by 1.43%, rising from -0.95% on 19 July (when the 10-year US yield was at 3.75%) to 0.48% on 20 October (4.91%). However, over the past month, the term premium has lost one third of that gain.

The New York Fed has just released the results of [the latest Survey of Primary Dealers](#), which has been compiled every time the FOMC meeting is held. Using this, we confirm the median of the “10-year average FF rate” projection. It can be confirmed that the median was 2.95% as of the July FOMC meeting and 3.00% as of the November FOMC meeting, indicating that the figure rose by only 5bp (right-hand chart below). Based on this, it is likely correct to conclude that the sharp fluctuations in the long-term yield since the July FOMC meeting were led by the term premium.

Given the change in consensus regarding longer-run rate, as well, we forecast that the pace of decline in the 10-year yield could slow from around 3%

However, if yield fluctuations are being caused by a change in the consensus regarding the longer-run FF rate, instead of the term premium, they could be more persistent. Regarding this point, we confirm responses to the Survey of Primary Dealers. The median of the longer-run FF rate projection rose from 2.5% to 2.75% (up 25bp), and the 75th percentile projection rose from 2.66% to 3% (up 34bp), suggesting the possibility that part of the rise in the long-term yield since July (around 25-35bp) was caused by a change in the consensus regarding the longer-run rate. Even if we assume that the 10-year yield will decline in line with next year's anticipated rate cuts by the Fed, based on the latest survey results, we should keep in mind that the pace of the decline in the 10-year yield could slow from around 3%.

10yr US Yield


Source: Bloomberg; compiled by Daiwa.

Survey of Primary Dealers

Jul		
	10-yr Average FF Rate	Longer Run
25th Percentile	2.75%	2.50%
Median	2.95%	2.50%
75th Percentile	3.12%	2.66%
# of Respondents	24	24
Nov		
	10-yr Average FF Rate	Longer Run
25th Percentile	2.90%	2.50%
Median	3.00%	2.75%
75th Percentile	3.19%	3.00%
# of Respondents	24	24

Source: New York Fed; compiled by Daiwa.

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