

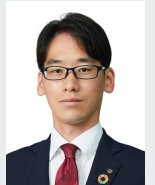
Daiwa Memorandum

FICC Research Dept.

Overseas yield decline affects superlong JGB yields

- No significant change in market pricing for BOJ rate hikes even after holidays
- Overseas superlong yields show signs of stabilizing, albeit at high levels
- 30-year JGB yield above 4% remains a risk scenario

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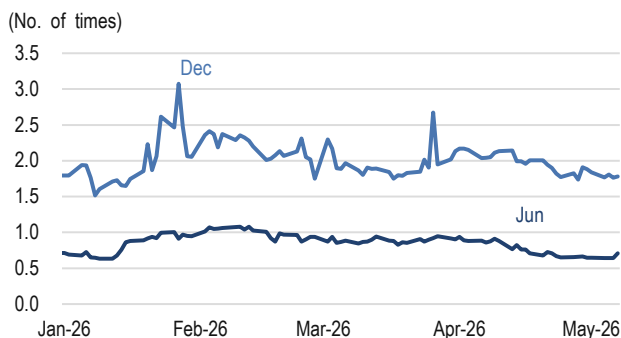
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In the JGB market on 7 May, yields fell across the entire curve, partly influenced by a slight decline in the 10-year US yield compared to levels seen before Japan's Golden Week holidays. However, the decline in the 2-year yield was relatively small compared with other maturities, and market pricing for rate hikes within this year remains largely unchanged (Chart 1). The 2-year forward 1-year OIS rate, which is often regarded as the terminal rate priced in by the market, has also remained stable at around 2% (Chart 2).

Looking at forex trends, which could affect the market's pricing of rate hikes, there were periods when the USD/JPY rate swung significantly toward a stronger yen, likely due to [dollar-selling/yen-buying intervention](#) before the holidays and additional intervention during the holidays. The fact that rate hike expectations have not receded even as the USD/JPY rate fell indicates the market's view that any yen strengthening from intervention will not last, and that a rate hike is still necessary. From another perspective, the stability in rate hike pricing can be seen as an indication that market concerns about the BOJ being "behind the curve" are not worsening, which should contribute to yield stability in the long-term and superlong zones.

From the perspective of superlong JGB yield stability, the influence of overseas superlong yields is very significant. In this regard, it is noteworthy that while the 30-year US yield temporarily surpassed the 5% threshold during Japan's holidays, it has since fallen back below 5%. This movement is due to the break-even inflation (BEI) rate fluctuating in response to crude oil prices, which have risen and fallen with developments in the Middle East situation (Chart 3). Depending on developments in the Middle East, there is a possibility that crude oil prices could rise again, leading the 30-year US yield to re-test the 5% level, but if oil prices remain stable at current levels, yields can also be expected to stabilize.

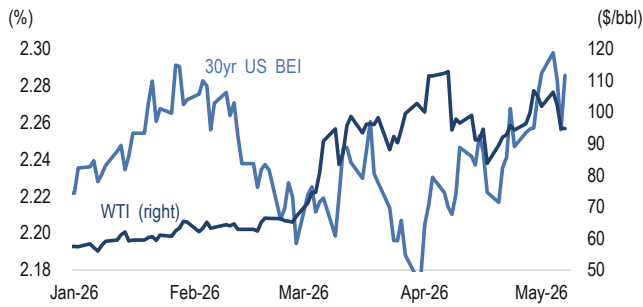
Chart 1: Market Pricing of BOJ Rate Hikes


Source: Bloomberg; compiled by Daiwa.

Chart 2: 2yr1yr OIS Rate

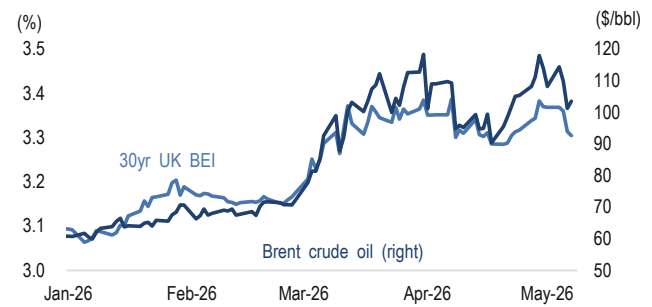

Source: Bloomberg; compiled by Daiwa.

Chart 3: 30yr US BEI, Crude Oil Prices



Source: Bloomberg; compiled by Daiwa.

Chart 4: 30yr UK BEI, Crude Oil Prices



Source: Bloomberg; compiled by Daiwa.

Similar movements have also been observed in UK yields— during Japan's holidays, the 30-year UK yield temporarily rose to 5.7%, its highest level in 28 years. With local elections held in the UK on the 7th, and amid a scenario in which the ruling Labour Party would suffer a substantial loss of seats and pressure would intensify on Prime Minister Keir Starmer to resign, concerns over political instability appear to have contributed to the rise in yields. The results are not yet known at this point, but expectations that the Labour Party will lose a substantial number of seats remain unchanged. Such UK-specific political developments also appear to have contributed to the rise in yields. Even so, the 30-year BEI has generally moved in line with crude oil prices as in the US, indicating that crude oil prices have a significant impact on yields (Chart 4). While developments in UK politics warrant continued attention, in any case, stable crude oil prices are likely to contribute to yield stabilization in the long-term and superlong zones of the global bond market.

From the perspective of bond supply and demand, the quarterly auction schedule announced by the US Treasury Department on 6 May was in focus. As the market had expected, the planned issuance amounts were kept unchanged from the previous announcement across all maturities (Chart 5). Regarding the statement on future auction sizes, some market participants had apparently expected wording changes that would suggest increases in the near future, but the statement maintained the wording that “Treasury anticipates maintaining nominal coupon and FRN auction sizes for at least the next several quarters.”

On the other hand, wording suggesting the possibility of future increases in issuance amounts was also retained—“Treasury continues to evaluate potential future increases to nominal coupon and FRN auction sizes.” Thus, caution remains over a future loosening in US Treasury supply/demand conditions. However, the increased likelihood that issuance amounts will remain unchanged for the next several quarters should support bond supply/demand conditions.

Chart 5: Anticipated Auction Sizes of US Treasuries (\$bn)

	2yr	3yr	5yr	7yr	10yr	20yr	30yr
Feb-26	69	58	70	44	42	16	25
Mar-26	69	58	70	44	39	13	22
Apr-26	69	58	70	44	39	13	22
May-26	69	58	70	44	42	16	25
Jun-26	69	58	70	44	39	13	22
Jul-26	69	58	70	44	39	13	22

Source: US Treasury Department; compiled by Daiwa.

Going forward, continued caution is warranted regarding the risk of higher yields in the long-term and superlong zones due to a rise in crude oil prices driven by developments in the Middle East, concerns over fiscal policy in various countries, and market concerns that the BOJ may fall behind the curve. It is also necessary to consider that, with domestic and overseas equities remaining robust and the Nikkei Stock Average setting a new all-time high, conditions are not conducive to a full-fledged decline in yields. However, if crude oil prices stabilize at current levels, given that domestic rate hike expectations have not receded and that the 30-year US yield has fallen back below 5%, we would continue to view a rise in the 30-year JGB yield above 4%—driven by a further increase in the term premium—as a risk scenario.

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