

Daiwa's View

Continued rise in forward rates

- Removal of tariffs could lead to another 20bp rise

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Daiwa Securities Co. Ltd.

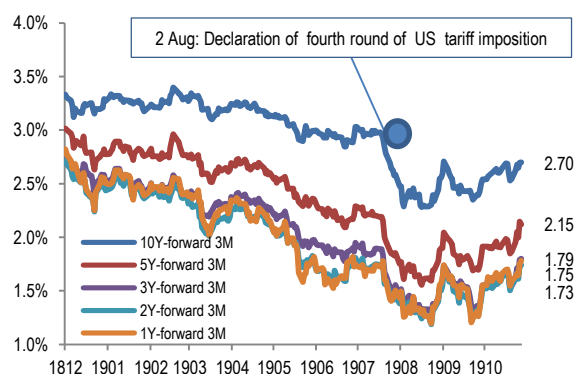
Removal of tariffs could lead to another 20bp rise

Continued rise in forward rates

Reflecting media reports that China and the US have agreed to roll back tariffs if a trade deal is reached, last night saw a rise in the 10-year US Treasury yield to 1.92% (up 10bp d/d) and the 30-year yield to 2.40% (up 8bp). In Europe, the 10-year French government bond yield also rose to 0.05% (up 9bp), rebounding to positive territory for the first time since July 2019.

As [uncertainty surrounding US-China trade talks has an impact on the natural rate of interest and the growth rate of the entire world](#), deterioration of the trade talks affects not only near-term policy rate trends but also the level of superlong yields. In fact, looking back at trends in the US 10-year forward 3-month yield, which indicates a component unique to superlong yields, the yield plunged by around 70bp from 2.92% to 2.29% when US President Donald Trump declared on 2 August that he would impose a fourth round tariffs on Chinese imports. Amid growing optimism about US-China trade talks, the US 10-year forward 3-month yield recovered to 2.70% yesterday for the first time since the declaration of the fourth round of tariffs. Assuming the US removes the fourth round of tariffs on Chinese imports, the point of reference for the 10-year forward 3-month yield will be 2.92%, which would be at the end-July level. If so, the yield could rise by another 20bp.

Chart: US Treasury Forward Yields (3M)

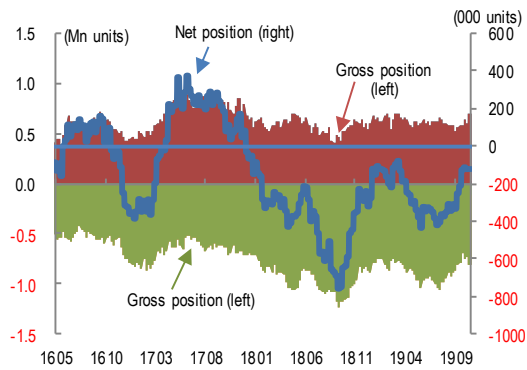


Source: Bloomberg; compiled by Daiwa Securities.

As to whether US yields will exceed the end-July levels (10-year yield of 2.01% and 30-year yield of 2.52%) following a continued rise, we think it is not quite that simple. According to the positioning of 10-year US Treasuries by speculative investors, we can confirm the unwinding of short positions on a net basis as a result of reduction in the gross short position and an increase in the gross long position (see charts below). Investors are becoming reluctant to accumulate short positions at this level.

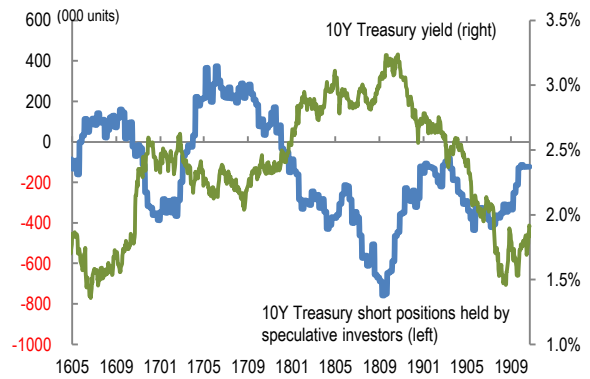
Yesterday, the 1-year forward 3-month yield and the 2-year forward 3-month yield rose to around 1.75%, corresponding approximately to the upper end of the target range of the federal funds rate. For a continuous rise in yields, the emergence of a rate hike outlook is necessary. However, Fed chair Jerome Powell dismissed the possibility of rate hikes at a press conference after the October FOMC meeting, saying that significant inflation would be necessary before raising interest rates. The hurdle for rate hikes is thus higher than that for rate cuts. After all, the rise in the 10-year yield is likely to be milder than before, despite steepening of the yield curve because the origin of the yield curve will probably be held down due to the clear intentions expressed by the financial authorities.

Chart: 10Y Treasury Positions Held by Speculative Investors (gross and net)



Source: Bloomberg; compiled by Daiwa Securities.

Chart: 10Y Treasury Short Positions Held by Speculative Investors



Source: Bloomberg; compiled by Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
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- 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**.
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- 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.

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Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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