

Daiwa's View

Revision to our US yield forecast

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Daiwa Securities Co. Ltd.

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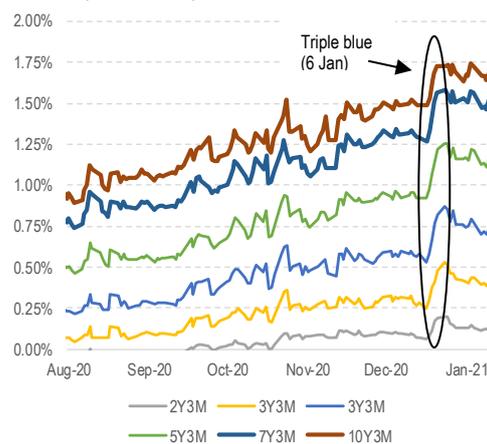
Revision to our US yield forecast

Reflecting a change in the OIS path due to fiscal policy under the “triple blue” Biden administration, we have revised our end-2021 forecast for the 10-year US yield from 1.06% to 1.23%, ranging from 0.6% to 1.45%.

Currently, the spread between the 10-year forward 3-month OIS and the effective federal funds rate (factoring in rate hikes) is 1.72%. Previously, the upper limit of rate hikes was at around 1.5%. Then, another rate hike was factored in around the same timing that [the long-shot triple blue scenario](#) became a reality when the Democratic Party gained two seats in the Georgia Senate runoff elections on 5 January (chart below). This appears to be a reflection of the fact that the triple blue situation has enabled the Democrats to enact an additional economic package by utilizing a budget reconciliation bill, while avoiding filibuster, even if the Republicans offer opposition.

Of course, the approach taken to legislation will depend on President Biden and Democratic leaders. Mr. Biden intended to prioritize gaining 60 bipartisan votes. Yesterday, Democratic House Speaker Nancy Pelosi said that the committee chairs intended to use a budget reconciliation bill. In any case, it is safe to say that assumptions regarding the fiscal path have changed due to the triple blue situation.

US OIS (3M futures)



Source: Bloomberg; compiled by Daiwa Securities.

Sticking with [the previous logic](#) in which yields are forecast based on two elements—the OIS path (rate-hike path) and the spread between the UST yield and the OIS—we have changed the upper limit of rate hikes and reflected the current market consensus that around three rate hikes will be implemented by end-2025. This raised the median of the 5-year OIS at end-2021 by 10bp compared to the previous forecast (0.4% → 0.5%) and the median of the 5-year forward 5-year OIS by 25bp (1.39% → 1.64%). Reflecting these changes, we have revised our end-2021 median forecast for the 10-year US yield from 1.06% to 1.23% (up 17bp).

Is it possible that the upper limit of rate hikes will climb further by the end of the year? Since President Joe Biden's American Rescue Plan announced on 14 January does not include long-term infrastructure investment or tax hikes, a new proposal is expected to be announced as early as February. The new proposal will likely include tax hikes. However, if the fiscal path changes further due to the exclusion of tax hikes from the new proposal, the upper limit of rate hikes could rise to around 2%. In this case, our forecast for the 5-year forward 5-year OIS rises to 1.76%. Adding the upper limit of the UST yield/OIS spread over the past year (0.4%) onto 1.76%, we can calculate an upper limit of the 5-year forward 5-year UST yield of 2.15%.

Will the upper limit of rate hikes rise further? At his post-FOMC press conference in September, Fed chair Jerome Powell explained that the central bank would maintain an accommodative policy until inflation overshoots even after rate hikes. Given the Powell doctrine, which contains a strong accommodative bias over the long term, it would be difficult for the 5-year forward 5-year UST yield to factor in longer-run projections in the dot chart (median of 2.5%, central tendency of 2.3-2.5%) at an early point.

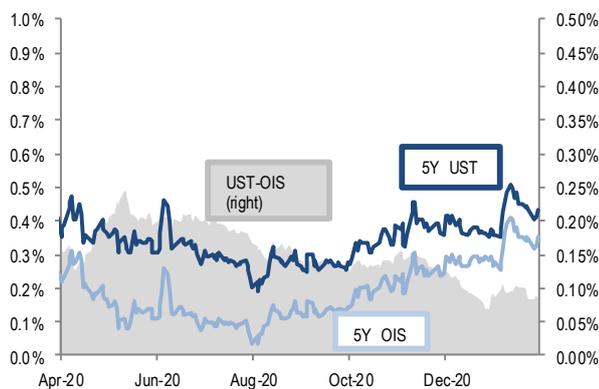
Considering the above, we have revised our end-2021 US yield forecasts as shown in the chart below. (Fractions are rounded up for the range.) Note that the Fed's QE and an [increase in excess reserves due to reduction in the Treasury General Account](#) are likely to create downward pressure on short-term/intermediate yields throughout 2021. We, therefore, forecast that yields will move at a slightly lower level than the main scenario for end-2021 until the end of FY20 (Mar 2021).

US Yield Forecasts (end-2021, %)

UST	5Y	(5Y OIS)	5Y5Y	(5Y5Y OIS)	10Y
Current (29 Jan)	0.43	0.35	1.75	1.47	1.05
Main scenario at end-2021	0.60	0.50	1.90	1.64	1.23
Upper limit scenario	0.70	0.60	2.15	1.76	1.45
Lower limit scenario	0.20	0.10	1.00	0.85	0.60

Source: Bloomberg; compiled by Daiwa Securities.

5Y US Yields (UST, OIS, UST-OIS)



Source: Bloomberg; compiled by Daiwa Securities.

5Y-forward 5Y US Yields (UST, OIS, UST-OIS)



Source: Bloomberg; compiled by Daiwa Securities.

Simulation for US 5Y Forward 5Y OIS (%)

Target period	End-2025	End-2026	End-2027	End-2028	End-2029	End-2030	End-2031	
0.25% / Upper limit of 1.75%	3y1yOIS	4y1yOIS	5y1yOIS	6y1yOIS	7y1yOIS	8y1yOIS	9y1yOIS	5y5yOIS
OIS forecast	0.85	1.10	1.35	1.60	1.75	1.75	1.75	1.64
0.25% / Upper limit of 2%	3y1yOIS	4y1yOIS	5y1yOIS	6y1yOIS	7y1yOIS	8y1yOIS	9y1yOIS	5y5yOIS
OIS forecast	0.85	1.10	1.35	1.60	1.85	2.00	2.00	1.76

Source: Bloomberg; compiled by Daiwa Securities.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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■ Credit Rating Agencies

[Standard & Poor's]

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The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

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[Moody's]

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The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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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), Daiwa Securities Living Investment Corporation (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%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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- 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

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