

# Daiwa's View

## Pause in downtrend in US yields: Another factor

- 5-year US OIS yield temporarily at reasonable level
- 10-year JGB yield unlikely to fall below 0% for now

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Daiwa Securities Co. Ltd.

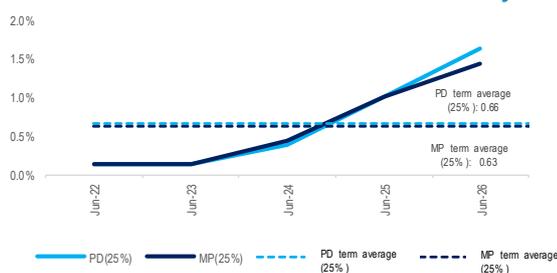
### 5-year US OIS yield temporarily at reasonable level

### US long-term yield hit another record low since start of fiscal year

At the end of last week, the 10-year US Treasury yield bounced back to 1.45% (up 0.02%) for the first time in one week. In [our report last Friday](#), we pointed out the possibility that the downtrend in US yields would let up soon, focusing on the average federal funds rate over the next ten years as forecast by market participants in a New York Fed survey (1.28%), on a rebound of inflation expectations (BEI), and on a drop in real yields (limited downside from the real yield of -0.94%). In today's report, taking a renewed look at the 5-year OIS yield, we point out the possibility that the downtrend in US yields has let up.

Currently, the 5-year US Treasury yield and the 5-year OIS yield stand at 0.74% and 0.65%, respectively. The April New York Fed surveys announced federal funds rate forecasts up to end-2027 (25<sup>th</sup> percentile, median, 75<sup>th</sup> percentile). (See chart on page 3.) Using this data makes it easy to get an idea of what's happening with the 5-year OIS yield. We made trial calculations for 5-year OIS yield forecasts among primary dealers and market participants in the US Treasury market by calculating the term average after regarding the year-end average as end-June data. As a result, the 25<sup>th</sup> percentiles were estimated at 0.66% and 0.63%, respectively (median: 0.87% and 0.81%). If this is correct, we can say that the currently observed 5-year OIS yield largely matches the 25<sup>th</sup> percentiles in the surveys. Therefore, this appears to imply that the yield has temporarily reached the point of reference for the lower limit.

### Federal Funds Rate Forecasts in New York Fed Surveys



Source: New York Fed surveys; compiled by Daiwa Securities.  
Notes: PD = primary dealers, MP = market participants.

### Federal Funds Rate Forecasts in New York Fed Surveys (%)

Primary dealers	Jun-22	Jun-23	Jun-24	Jun-25	Jun-26	Term average
25%	0.13	0.13	0.38	1.01	1.63	0.66
Median	0.13	0.13	0.76	1.44	1.88	0.87
75%	0.13	0.38	1.13	2.01	2.44	1.22
Market participants	Jun-22	Jun-23	Jun-24	Jun-25	Jun-26	Term average
25%	0.13	0.13	0.44	1.00	1.44	0.63
Median	0.13	0.13	0.63	1.26	1.88	0.81
75%	0.13	0.38	1.13	1.96	2.39	1.20

Source: New York Fed surveys; compiled by Daiwa Securities.  
Note: June data is calculated by averaging some raw data (year-end figures) for period.

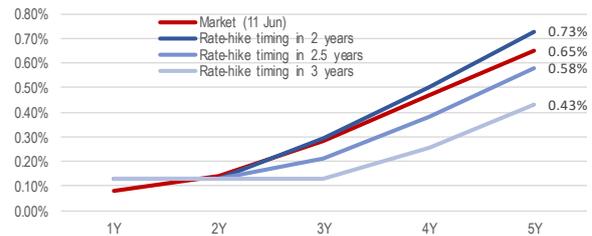
The charts below show our simulations for OIS yield levels according to different scenarios—2 rate hikes/year (50bp/year) and 2.5 rate hikes/year (75bp/year)—in three rate-hike timing patterns (in 2 years, in 2.5 years, and in 3 years). In the case of 2 rate hikes/year, which is the closest to the main scenario, the 5-year OIS yields (in ascending order of rate-hike timing) are estimated at 0.73%, 0.58%, and 0.43%, respectively. The currently observed 5-year OIS yield (0.65%) is at the level of an intermediate timing between a rate hike in 2 years and a rate hike in 2.5 years (i.e., around September 2023). A rate hike in the latter half of 2023 is largely in line with our forecasts and the market consensus estimate, implying that current market pricing assumptions are no longer extremely aggressive, in our view. For reference, the 5-year OIS yield rose to 0.89% on 2 April 2021.

**OIS by Rate-hike Scenario**

2 rate hikes/year (0.5%)				2.5 rate hikes/year (0.75%)			
Rate-hike timing	Year	OIS forward (1Y)	Term-average OIS	OIS forward (1Y)	Term-average OIS		
in 3 years	1	0.13%	0.13%	0.13%	0.13%		
	2	0.13%	0.13%	0.13%	0.13%		
	3	0.13%	0.13%	0.13%	0.13%		
	4	0.63%	0.26%	0.88%	0.32%		
	5	1.13%	<b>0.43%</b>	1.63%	0.58%		
in 2.5 years	1	0.13%	0.13%	0.13%	0.13%		
	2	0.13%	0.13%	0.13%	0.13%		
	3	0.36%	0.21%	0.51%	0.26%		
	4	0.88%	0.38%	1.26%	0.51%		
	5	1.38%	<b>0.58%</b>	2.01%	0.81%		
in 2 years	1	0.13%	0.13%	0.13%	0.13%		
	2	0.13%	0.13%	0.13%	0.13%		
	3	0.63%	0.30%	0.88%	0.38%		
	4	1.13%	0.51%	1.63%	0.69%		
	5	1.63%	<b>0.73%</b>	2.38%	1.03%		

Source: Bloomberg; compiled by Daiwa Securities.

**OIS by Rate-hike Scenario (2 rate hikes/year)**



Source: Bloomberg; compiled by Daiwa Securities.

The 5-year forward 5-year US Treasury yield (corresponding to the latter half of the 10-year yield) is currently at 2.24%. As this level is around the midpoint of the range (2-2.5%) projected by the longer-run federal funds rate outlook in the Fed's dot chart and New York Fed's surveys, it can generally be considered to be at a reasonable level. Of course, that is not to say that there is no room for a short-term decline. However, as we can say that the 5-year forward 5-year yield has also undergone a reasonable correction, extremely aggressive assumptions have not been observed in the market<sup>1</sup>. The chart below shows our new estimates for upward and downward yield scenarios<sup>2</sup> based on the 5-year OIS and the 5-year forward 5-year yield.

**US Treasury 5Y Yield, 5Y-forward 5Y Yield, 10Y Yield (by scenario, %)**

	UST	5Y	(5Y OIS)	5Y5Y	10Y
Current level		0.74	0.65	2.24	1.45
Upward scenario		<b>1.00</b>	0.81	2.50	<b>1.71</b>
Downward scenario		<b>0.50</b>	0.43	2.00	<b>1.21</b>

Source: Bloomberg; compiled by Daiwa Securities.

**10-year JGB yield unlikely to fall below 0% for now**

As US Treasury yields bounced back last Friday, the likelihood of the 10-year JGB yield falling below 0% appears to have diminished for now. That said, we should be aware of the possibility that 0.07%, which had been the lower limit of the range, has now become the upper limit of the range. If so, the dip-buying target in the new range would be 0.07% for the 10-year yield and 0.45% for the 20-year yield (10-year/20-year spread of 38bp).

<sup>1</sup> On 1 Apr 2021, the 5-year forward 5-year US Treasury yield rose to 2.63%.

<sup>2</sup> Note that these are not upper limit or lower limit scenarios.

**Forecasts for Target Federal Funds Rate in New York Fed Surveys (%)**

<b>Primary dealers</b>	Jun-22	Sep-22	Dec-22	Jun-23	Sep-23	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27
25%	0.13	0.13	0.13	0.13	0.13	0.13	0.63	1.38	1.88	2.13
Median	0.13	0.13	0.13	0.13	0.38	0.38	1.13	1.75	2	2.38
75%	0.13	0.13	0.13	0.38	0.38	0.63	1.63	2.38	2.5	2.63
<b>Market participants</b>	Jun-22	Sep-22	Dec-22	Jun-23	Sep-23	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27
25%	0.13	0.13	0.13	0.13	0.13	0.13	0.75	1.25	1.63	1.63
Median	0.13	0.13	0.13	0.13	0.25	0.38	0.88	1.63	2.13	2.13
75%	0.13	0.13	0.13	0.38	0.38	0.63	1.63	2.28	2.5	2.38

Source: New York Fed surveys; compiled by Daiwa Securities.

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### ■ Credit Rating Agencies

#### [Standard & Poor's]

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