

Daiwa's View

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

- Will downtrend let up soon?

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Daiwa Securities Co. Ltd.

Will downtrend let up soon?

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

As bond purchases did not stop again yesterday, the 10-year US Treasury yield slid to 1.43% and hit another record low since the outset of the fiscal year. Although it rose from 1.50% to 1.53% immediately after the announcement of [the CPI](#), the rise was again short-lived. The market likely did not change its view that the rise in prices led by specific items was transitory. The ECB Governing Council meeting showed a cautious stance for policy operations, which also put downward pressure on yields.

However, there are signs that the yield downtrend may let up soon. While the nominal yield continued to slide yesterday, 10-year inflation expectations (BEI) rebounded from 2.33% to 2.37% following a similar downtrend. As a result, the real yield declined to -0.94%. If we assume that the drop in inflation expectations lets up, room for a further decline would be limited in light of the current real yield level.

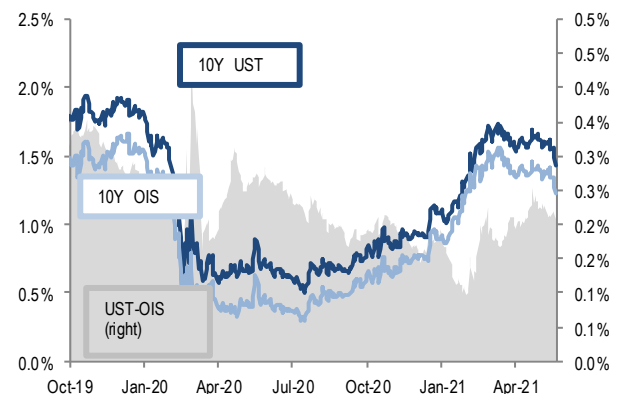
There is another factor. For example, in the New York Fed's survey, market participants forecast that the average federal funds rate over the next ten years (nearly equal to 10-year OIS) will be 1.28%. By adding 20bp (UST-OIS spread) to this, we presume that the appropriate value of the 10-year US Treasury yield based on the market participants' forecast is around 1.48%¹. If the yield reached this estimate, whose path is relatively stable, instead of the primary dealers' estimate, which tends to be fanned by market trends, commensurate correction in the yield level may have been completed (as upward momentum strong, we may see slight overshoot).

New York Fed's Survey (market participants)

	Longer Run	10-yr Average FF Rate
25th Pctl	1.75%	0.95%
Median	2.00%	1.28%
75th Pctl	2.50%	1.50%

Source: NY Fed; compiled by Daiwa Securities.

10Y US Treasury Yield, OIS, UST-OIS Spread



Source: Bloomberg; compiled by Daiwa Securities.

¹ Based on primary dealers' forecasts, they are 1.63% and 1.83%, respectively.

However, expectations for higher and higher yields are not so strong either. For example, the 5-year forward 5-year yield is currently at 2.25%, which is 25bp lower than the longer-run projection (median) of 2.5%, but 25bp higher than the longer-run projection among market participants in the New York Fed's survey. Even compared with the primary dealers' estimate (median: 2.31%), the difference is just -6bp. In other words, we can say that yields are currently at substantially comfortable levels, providing no evidence to say that yields "declined excessively and unsustainably." Although the yield downtrend is expected to let up, a strong rebound cannot be anticipated. This is likely to lead to lower volatility and moves to pursue carry and roll-down return.

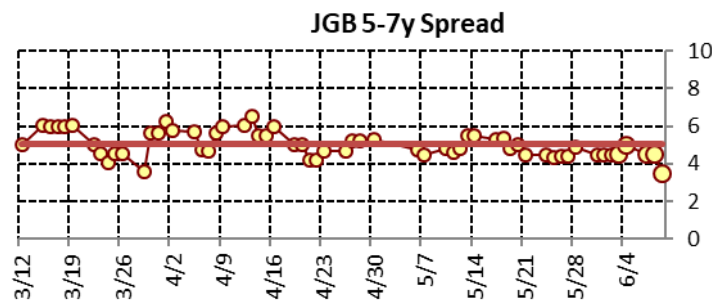
US Treasury Yields (%)

UST	5Y	(5Y OIS)	5Y5Y	(5Y5Y OIS)	10Y	UST	10Y	10Y10Y	20Y	20Y10Y	30Y
Current level	0.71	0.62	2.25	1.86	1.43	Current level	1.43	2.83	2.04	2.39	2.13

Source: Bloomberg; compiled by Daiwa Securities.

Yesterday, the 10-year JGB yield finally fell below 0.05%. Thus far, the yield tended to stop falling at the absolute level of 0.07%, which was regarded as a resistance line. However, the yield posted a downside breakout amid the continued sharp decline in US yields. Here, the drop may be influenced by the eligible zone, whose yield is now approaching -0.1%, amid an ongoing rise in JGB futures prices. If the yield downtrend in the eligible zone slows down at the threshold of around -0.1%, this would call attention to a flattening bias for the 7-year/10-year spread. As mentioned above, I forecast that the drop in the 10-year US Treasury yield will let up soon. However, if the yield declines to the 1.3-1.2% level (incl. overshoot), this would highlight "0%" for the 10-year JGB yield, alongside flattening of the 7- to 10-year zone.

JGB 5Y/7Y Spread (bp)



Source: Bloomberg; compiled by Daiwa Securities.

The contents of the Corporate Goods Price Index in Japan (released yesterday) may not have been that helpful. Corporate good prices substantially rose led by cost-push factors of higher material prices and yen depreciation. Although the figures exceeded the market estimates and our forecasts, the structure is becoming clear in which corporate profits are compressed due to the inability to pass on higher costs to downstream industries. China is in a similar situation—the PPI jumped as much as 9%, close to its peak in 2008 under the commodity super cycle, while the downstream CPI rose only 1.3%, raising concerns about erosion of corporate profits (some measures appear necessary at this level). In both cases, the rise in commodity prices is calling attention to stagflationary developments, instead of a sustainable rise in the CPI.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

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[Fitch]

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Other Disclosures Concerning Individual Issues:

- 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.

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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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