

Daiwa's View

Divergence of Japanese and US forward yields

- Risk premium = investment attractiveness

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Daiwa Securities Co. Ltd.

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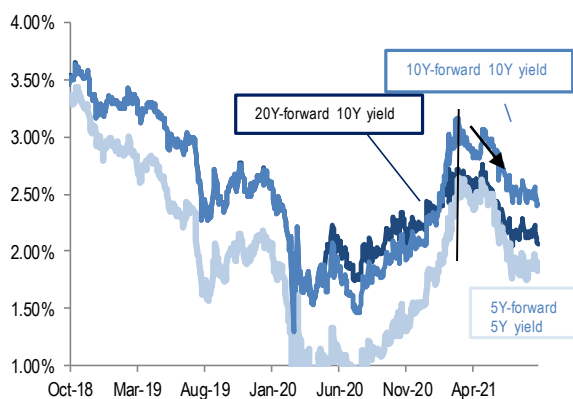
Yesterday, the 20-year forward 10-year US Treasury yield fell to 2.06%. Since the Fed pointed out a decline in far-forward rates in the minutes of the July FOMC meeting, the rise in yields has been contained.

Will Japanese and US forward yields show a correlation? In the right-hand chart below, which compares developments in the 20-year forward 10-year US Treasury yield and the 10-year forward 10-year JGB yield, a relatively strong correlation is observed between the Japanese and US forward yields. A large divergence occurred during March-April, but this was probably a somewhat irregular case caused by [BOJ Governor Haruhiko Kuroda's remarks denying widening of the trading band under the yield curve control policy](#). Due to the subsequent decline in global yields, Japanese and US forward yields had recovered the previous balance.

Now, a slight divergence has again been observed between the 10-year forward 10-year JGB yield and the 20-year forward 10-year US Treasury yield (an upward divergence by JGB yields in this case). This is probably reflecting an increasing wait-and-see stance among investors amid political instability and a surge in Japanese stock prices since the announcement of Prime Minister Yoshihide Suga's decision to leave office, as well as worries about the new prime minister's stance on the BOJ.

Of course, we won't know the political situation until all votes are counted, and, therefore, it is natural to require a certain amount of premium. On the other hand, if the current divergence were the result of an increased wait-and-see stance among many investors, it would be a term premium, which may become a source of additional return in the future (in terms of the average value). If we believe the superlong zone will eventually reflect fundamentals, buying on dips at an even pace would be recommended for the currently observed divergence.

US Treasury Forward Yields



Source: Bloomberg; compiled by Daiwa Securities.

20Y-forward 10Y US Treasury Yield, 10Y-forward 10Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

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