Daiwa's View

Rise in US yield led by term premium, and weak yen

- Correction to excessive decline in forward yield levels
- Yen bond market also needs to carefully watch yen weakening lower than Y116/$

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Correction to excessive decline in forward yield levels

Yesterday, the 10-year US Treasury yield rose to 1.68% at one point (1.51% at end-2021 → 1.65% on 4 Jan). During this period, the 5-year yield moved from 1.26% to 1.36% (up 10bp) and the 5-year forward 5-year (5Y5Y) yield rose from 1.80% to 1.99% (up 19bp), leading to steepening of the yield curve led by forward yields.

That said, the 5Y5Y yield now standing at 1.99% is not at all a level that makes us particularly nervous in terms of the absolute level. In fact, while it occurred somewhat quickly, we interpret the rise to this level as a correction from the excessive decline seen at the end of last year.

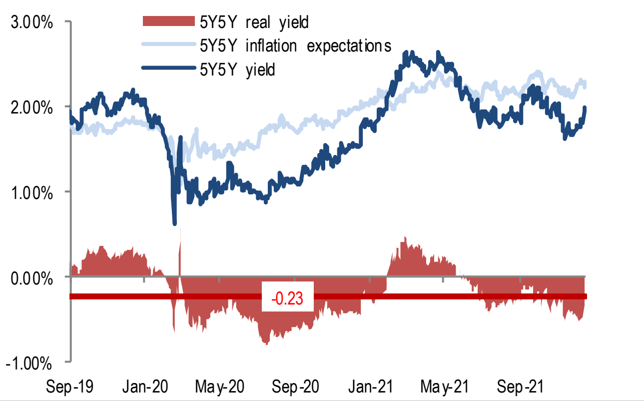
Observing the 5Y5Y yield via inflation expectations and the real yield, inflation expectations remained flat, while the 5Y5Y real yield rose substantially from –0.47% to 0.23%. This implies that the rise in the 10-year yield over the past two days was led by the term premium.

In short, this means that demand was weaker than supply. This year's 'yield uptrend' consensus trade was probably implemented intensively when (1) there was a concentrated issuance of corporate bonds at the beginning of the year and (2) buyers tended to take a cautious stance ahead of the release of the December FOMC meeting minutes (which include discussion about QT) and the jobs report at the end of week.

10Y US Treasury Yield

Source: Bloomberg; compiled by Daiwa Securities.

5Y5Y US Yield (nominal, real, inflation expectations)



Source: Bloomberg; compiled by Daiwa Securities.

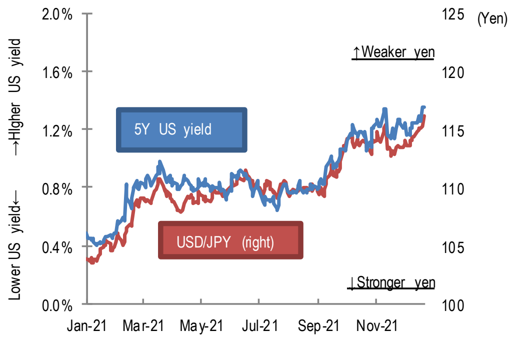
Looking back on the 5Y5Y real yield over the past several years shows that it stayed in the –0.5 to 0.25% range for a long time. Based on this, one can conclude that demand grows easily during times of excess money on the assumption that the 5Y5Y yield fully covers inflation. If the 5Y5Y yield moves beyond a rise from 1.75% to 2.00%, which can be positioned as a correction for an excessive decline, and continues to rise from 2.00% towards 2.25% (meaning a rise in the 5Y5Y real yield to positive territory), a buying opportunity will come in the Jan-Mar period, similar to last year.

◆ USD/JPY rate at the Y116 level

Yen bond market also needs to carefully watch USD/JPY rate

Yesterday, the USD/JPY rate exceeded Y116. That said, this depreciation of the yen can be fully explained by the 5-year yield difference between Japan and the US, as shown in the chart below. In essence, the yield curve control (YCC) policy has the effect of amplifying economic cycles amid the recovery of overseas economies by artificially reining in natural yield fluctuations. Accordingly, the widening of the relative yield difference during rising US yields and the weaker yen are totally expected circumstances.

5Y US Yield, USD/JPY



Source: Bloomberg; compiled by Daiwa Securities.

However, if the government/BOJ were to regard this depreciation of the yen as a threat, the impact on yen bonds would become extremely complex. As we mentioned in yesterday's report, based on recent information from the BOJ, it is strengthening the tone of its admission that there are fewer merits and more demerits to the weaker yen.

Going forward, if the government/BOJ send out more messages expressing disfavor regarding further depreciation of the yen, it will be more likely that market speculation will emerge that the BOJ will adjust interest rate target levels (although the removal of YCC rumored among some market participants appears to be excessive). As previously stated, a hawkish pivot by the BOJ is a topic that cannot be ignored in 2022.

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