Daiwa Securities

Daiwa's View

US long-term yield declined to the 3.6% level

- The lower 3% level is a point of reference for the near-term lower limit; a 10-year US yield at the 2% level is still a little ways off for the moment

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Yesterday, the US long-term yield declined to the 3.6% level. The yield stood at 4.33% on 21 October, when St. Louis Fed President James Bullard and San Francisco Fed President Mary Daly simultaneously signaled a slowdown in the pace of rate hikes. Therefore, it is calculated that the yield dropped substantially by as much as 60-65bp in a little less than one month.

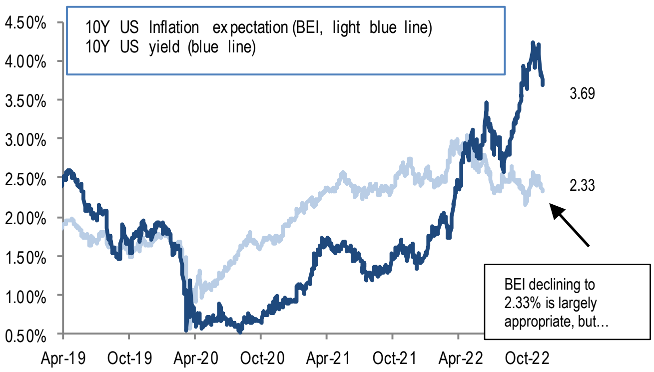
◆ <u>Appropriateness of 10-year BEI of 2.33% and real yield of 1.37%</u>

We compare this change from the standpoint of the breakeven inflation rate (BEI) and real yield. On 21 October, the BEI closed at around 2.55%, and the real yield was around 1.78%. As of yesterday, the BEI closed at 2.33% and the real yield was 1.37%, indicating a 22bp drop and a 41bp drop, respectively.

When interpreting this in terms of fundamentals, with stronger confidence in the Fed and a change in the US CPI stage (peaking out) observed, it wouldn't feel odd to see stabilization of a 10-year BEI that was equivalent to the average CPI over the next ten years cruising towards the 2.3% level (approximately equal to PCE of 2%) in line with regression to the mean.

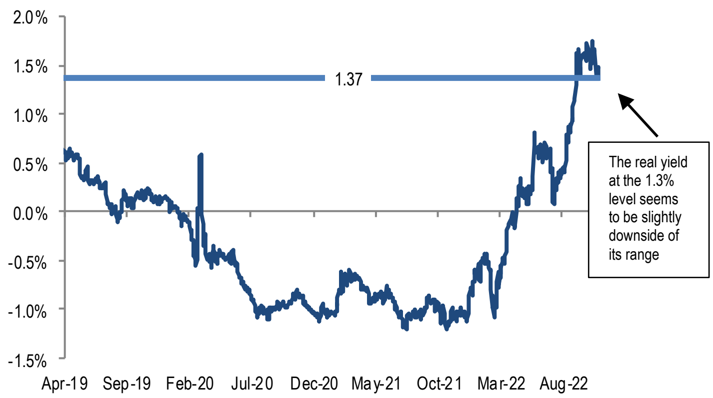
Meanwhile, it appears that the current real yield of 1.37% has moved to the downside of the near-term appropriate range. As we mentioned yesterday, a "sufficiently restrictive" real policy interest rate level (which the Fed is aiming for) is estimated at 1.5-2% (slightly above 1.5%). Although the real policy interest rate and the 10-year real yield are not equal, in her speech on 14 November, Fed Vice Chair Lael Brainard expressed a sense of satisfaction that "we've seen the entire curve from one to 10 years move above 1% in real terms." Given this, we expect the 10-year real yield to move centering around 1.5% in the near term, with 1% being a point of reference for the lower limit.

10Y US Treasury Yield, BEI



Source: Bloomberg; compiled by Daiwa Securities.

10Y US Treasury Real Yield



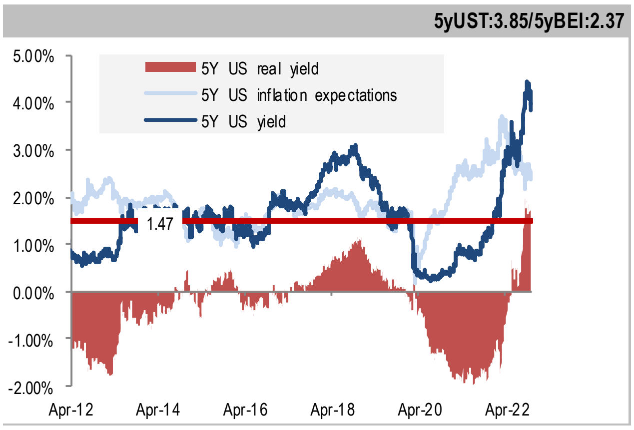
Source: Bloomberg; compiled by Daiwa Securities.

◆ <u>5-year yield and 5-year forward 5-year yield do not feel particularly unusual, but leeway for decline is lessening</u>

Next, we divided the 10-year US Treasury yield into the 5-year yield (5Y yield: first half) and the 5-year forward 5-year yield (5Y5Y yield: latter half). Then, we broke them down into two elements—BEI and real yield (charts below). Seen divided into the first half and the latter half, as well, the respective BEIs are at the lower 2% level and real yields are slightly below 1.5%, which does not feel particularly unusual. That said, we admit that we get the impression that real yields are moving towards the downside of the range of the "sufficiently restrictive" level that the Fed is aiming for.

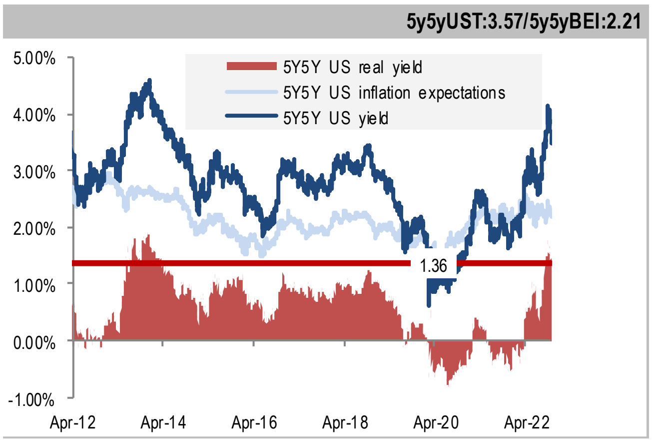
With regard to the 5Y5Y yield in particular, the BEI stands at 2.21% (slightly below the point of reference of 2.3%) and the real yield is 1.36% (slightly below the point of reference of 1.5%, and around 30bp higher than the lower limit of 1%). Therefore, we get the impression that the upside is quite limited in the near term. The nominal yield level has declined to 3.57%, approaching the lower 3% level. This may imply that leeway for bull flattening (deepening of yield-curve inversion, which entails outperformance of the 5Y5Y yield) is temporarily lessening.

5Y US Treasury Nominal Yield, BEI, Real Yield



Source: Bloomberg; compiled by Daiwa Securities.

5Y5Y US Treasury Nominal Yield, BEI, Real Yield



Source: Bloomberg; compiled by Daiwa Securities.

◆ <u>Point of reference for the near-term lower limit is the lower 3% level</u>

Of course, if inflation dies down and the Fed pivots, we would expect to see the real yield fall below 1% and the BEI remain low and stable. Accordingly, it is highly likely that the nominal yield would plunge to the 2% level (neutral regression). However, in the current circumstances in which the BEI is stable at the lower 2% level and Fed Vice Chair Lael Brainard is satisfied with a real yield above 1% in the entire curve, a 10-year US yield at the 2% level is still a little ways off for the moment, and the lower 3% level is a point of reference for the near-term lower limit.

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