

Daiwa's View

JGB yield outlook (as of 10 Aug)

- Anticipating 10-year JGB yield of 0.45% and 20-year yield of 1.10% at end-FY23

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◆ JGB yield outlook

In this report, we examine JGB yield outlook after YCC revisions, reflecting revisions to our outlook for the BOJ's monetary policy. We now anticipate a 10-year JGB yield of 0.45% and a 20-year yield of 1.10% at end-FY23, assuming a scenario of lower US yields. In the following sections, please refer to our Chief Market Economist Mari Iwashita's latest report regarding the outlook for the BOJ's monetary policy.

The 30-year JGB auction, which was conducted on 8 August, temporarily put a brake on a rise in yields in the market. While the amounts purchased in *Rinban* operations have been kept unchanged after YCC revisions, the superlong JGB auction results were strong. This calming down of the yield uptrend would have probably reassured the BOJ, which has conducted non-scheduled operations thus far. The 10-year JGB yield is currently at below 0.6%, which is the level when non-scheduled operations were implemented on 31 July right after YCC revisions. Thus, there is a possibility that investors have started to accept the current level after YCC revisions.

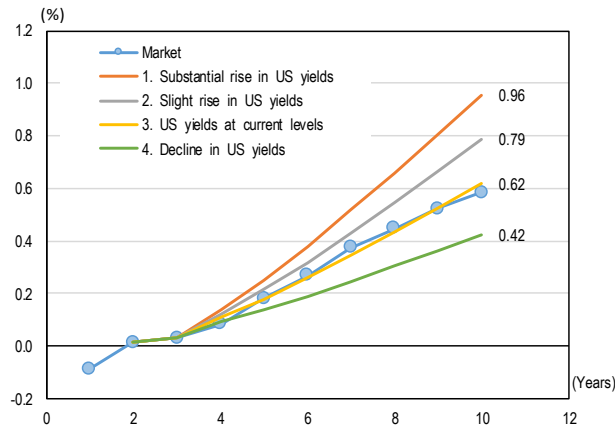
JGB Yield Outlook (%)

		FY23								
		Jul-Sep			Oct-Dec			Jan-Mar		
		Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end	Lower limit	Upper limit	Term-end
Japan	IOER	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	10Y	0.40	0.75	0.55	0.35	0.85	0.50	0.30	1.00	0.45
	20Y	1.00	1.45	1.20	0.95	1.60	1.15	0.90	1.80	1.10
	30Y	1.30	1.70	1.50	1.25	1.85	1.45	1.20	2.05	1.40

Source: Compiled by Daiwa Securities.

Daiwa assumes the 10-year yield's fair value at present is about 0.6%. This is largely consistent with an estimated yield curve based on our trial calculation. When compiling this estimated yield curve, "the outlook for the short-term yield" is important.

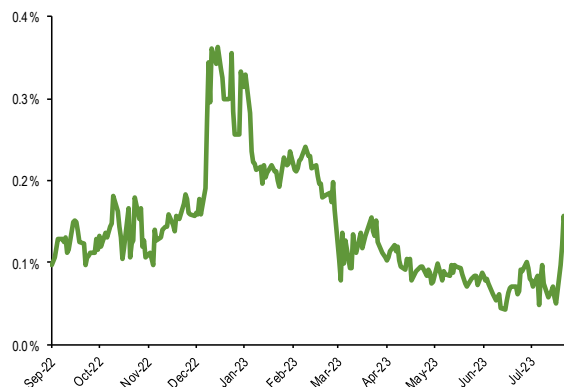
Estimated Yield Curve



Source: Bloomberg, compiled by Daiwa Securities.

When using the 1-month swap forward rate to observe market speculation on future rate hikes, a rise to about 0.15% was seen right after YCC revisions, but the rate is now at about 0.10% after hitting a peak. Compared to the rise to about 0.35% with the December 2022 revisions, pricing in of future rate hikes is limited this time.

1Y1M JPY OIS



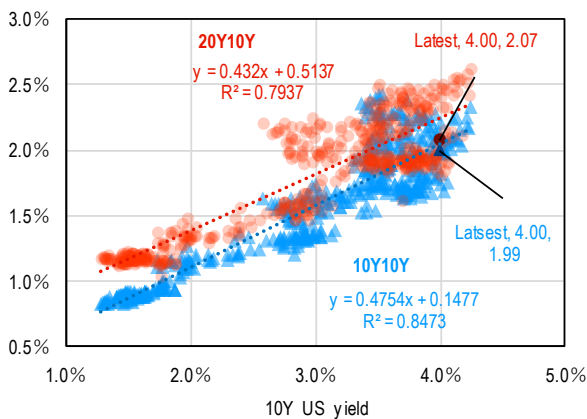
Source: Bloomberg, compiled by Daiwa Securities.

Regarding the termination of the negative interest rate policy, BOJ Deputy Governor Shinichi Uchida mentioned that "This decision will be made if the Bank assesses that it would be appropriate to prevent price rises by suppressing demand in the real economy" and "Given current developments in economic activity and prices in Japan, the Bank assesses that there is still a long way to go before such decisions are made" in his speech on 2 August (unusually announced a day in advance). This sort of communication by the BOJ is serving as a major factor in constraining excessive pricing in of rate hikes in the market.

If a rise in yields in the short-term/intermediate zone is suppressed, the level of the 10-year yield, in the case of the lack of major change in Japanese fundamentals, would decline towards end-FY23 in line with a drop in US yields. During the stage of lower US yields, the point of reference for the 10-year JGB yield would be about 0.4%, which is suggested by the estimated yield curve (regarding US yield outlook, refer to our 22 Jun 2023 report [Daiwa's View](#)).

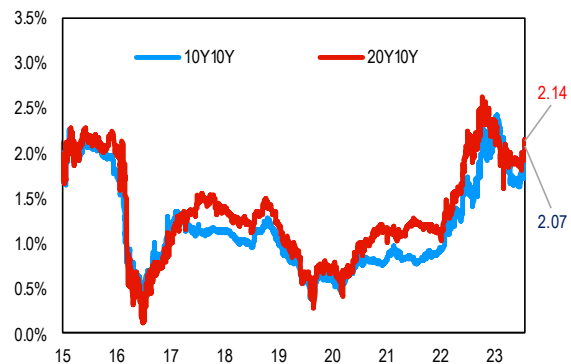
- ◆ Superlong yields: Correlating with overseas yields even after YCC revisions
 Superlong JGB yields are maintaining a close correlation with overseas yields even after YCC revisions. We assume that this point will not change substantially going forward. The 10-year forward 10-year JGB yield (10Y10Y yield), which is important when examining the 20-year JGB yield, is also expected to decline towards end-FY23 in line with US yields. Assuming that the 10Y10Y yield will decline from the current level of about 2.0%, we expect the 20-year yield to decline to about 1.1% towards end-FY23.

Scatter Chart of JGB 10yr Forward Yields and 10yr US Yield



Source: Bloomberg; compiled by Daiwa Securities.

JGB 10yr Forward Yields

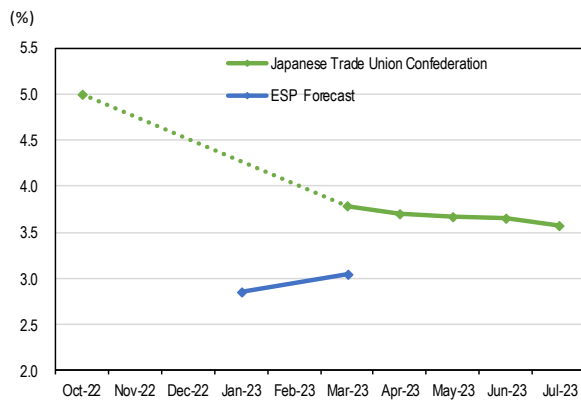


Source: Bloomberg; compiled by Daiwa Securities.

- ◆ Scenario of a rise in inflation expectations
 Meanwhile, if inflation expectations rise further in the future with a major change in Japanese fundamentals, we need to pay attention to the possibility that the 10-year yield will rise towards the upper limit of 1%. At this point, the possibility is not high. However, in the case of a rise in BEI to 2% in a situation where the real yield maintains the current level of about -0.5%, it can be calculated that the YCC's upper limit of 1% would be attacked by moves of the 10-year yield aiming for 1.5%. That said, we do not forecast that the market will fully price in inflation expectations of 2% at end-FY23. The first summary of 2024 spring annual labor-management wage negotiations, the biggest focal factor regarding an achievement of the price target, will be published mid-March if figures are released in line with the usual schedule.

In the case that the BOJ declares the achievement of the price stability target at time of the release of *Outlook for Economic Activity and Prices* report (*Outlook Report*), January 2024 would be the last opportunity within FY23. However, it is difficult to fix prior expectations for the result of spring wage negotiations. Looking at *ESP Forecast* survey conducted in the last fiscal year, we learn how difficult it is for forecasts as of January to become correct. Thus, until April 2024, we would not see the declaration of the achievement of the price stability target reflecting the results of spring wage negotiations. Meanwhile, the market may price in the achievement of the 2% price stability target, reflecting the results of spring wage negotiations in March. Looking at the 1-month swap forward rate, the level in March is high, although the release of *Outlook Report* is not scheduled. In that case, we forecast a rise to 1%, the upper limit of YCC, as a risk scenario.

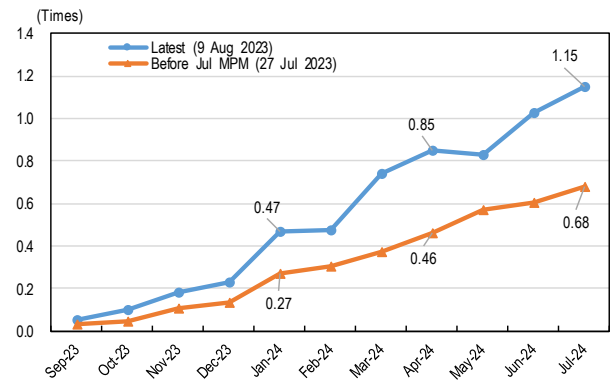
Rate of Wage Hikes in 2023 Spring Wage Negotiations



Source: Japanese Trade Union Confederation, JCER; compiled by Daiwa Securities.

Note: The Japanese Trade Union Confederation's figure as of Oct 2022 is based on request policy, ESP Forecast figures show forecasts as of then.

1-month Swap Rate's Pricing in of Rate Hikes



Source: Bloomberg; compiled by Daiwa Securities.

Note: Each hike assumes a 10bp rate hike.

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