Daiwa Securities

Daiwa's View

JGB yield outlook (15 Sep Update)

➢ 10-year JGB yield is expected to be at about 0.80% at end-1H FY24

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◆ JGB yield outlook

In this report, we update our JGB yield outlook, reflecting revisions to our BOJ monetary policy outlook. This time, we forecast that the 10-year JGB yield will be at about 0.80% at end-1H FY24.

In this yield outlook, estimated yield levels differ greatly by scenario. In the yield outlook chart, there is a large difference between the upper limit and lower limit. This is because we compiled yield levels by using different scenarios as assumptions.

Our outlook for the BOJ Monetary Policy (Chart 3) assumes three scenarios with different probabilities. This time, our yield outlook also assumes three paths in line with the three policy scenarios. In the following sections, we explain the yield path of each scenario.

Chart 1: JGB Yield Outlook (%)

	FY23				FY24			
	Oct-Dec		Jan-Mar		Apr-Jun		Jul-Sep	
	Range	Term-end	Range	Term-end	Range	Term-end	Range	Term-end
IOER	-0.10 ～ 0.00	-0.10	-0.10 ～ 0.00	-0.10	-0.10 ～ 0.00	0.00	-0.10 ～ 0.00	0.00
2yr	-0.10 ～ 0.25	0.00	-0.10 ～ 0.25	0.05	-0.10 ～ 0.40	0.20	-0.10 ～ 0.40	0.15
5yr	0.20 ～ 0.60	0.25	0.05 ～ 0.60	0.25	0.05 ～ 0.80	0.45	0.05 ～ 0.95	0.40
10yr	0.55 ～ 1.15	0.70	0.35 ～ 1.15	0.70	0.35 ～ 1.30	0.90	0.35 ～ 1.40	0.80
20yr	1.20 ～ 1.70	1.40	0.95 ～ 1.70	1.40	0.95 ～ 1.80	1.45	0.95 ～ 1.85	1.30
30yr	1.45 ～ 1.90	1.65	1.20 ～ 1.90	1.65	1.15 ～ 1.95	1.65	1.15 ～ 2.00	1.50

Source: Compiled by Daiwa Securities.

◆ Main scenario

First, we explain the yield path in the main scenario. Here, the BOJ is expected to eliminate negative interest rates in April 2024 after declaring that the 2% price stability target has been achieved, under the assumption of a soft landing of the US economy. In this case, due to elimination of negative interest rates, we would see a rise in projections for the policy interest rate in the future. This is expected to lead to a rise in the short-term/intermediate JGB yields, which would serve as a starting point and lead to a rise in the 10-year JGB yields. In last week's simulation, we estimated that the 10-year JGB yield when negative interest rates are eliminated would be at 1.15%. However, note that this is calculated under the assumption of US yields at current levels. Currently, the market is factoring in elimination of negative interest rates in April 2024. As such, given that the start of US rate cuts is also projected at this timing, we forecast that the 10-year JGB yield will be slightly lower than the estimated value in the above-mentioned simulation. We forecast that the 10-year JGB yield will be at around 0.9% in April-Jun 2024, assuming a decline in US yields. Subsequently, JGB yields are likely to look for the possibility of further rate hikes, a move to follow elimination of negative interest rates. That said, this would also depend on the US yield trends. If the market continues to factor in rate cuts, the momentum for higher JGB yields is unlikely to gain under the assumption of lower US yields. In addition, as our main scenario assumes a moderate decline in US yields, we would see outperformance of superlong forward JGB yields, which are highly correlated with US yields. As a result, despite elimination of negative interest rates, superlong JGB yields would not be expected to rise so much in April-June compared to intermediate/long-term yields. The above is a yield path outlook reflecting our main scenario.

◆ Sub-scenario ①

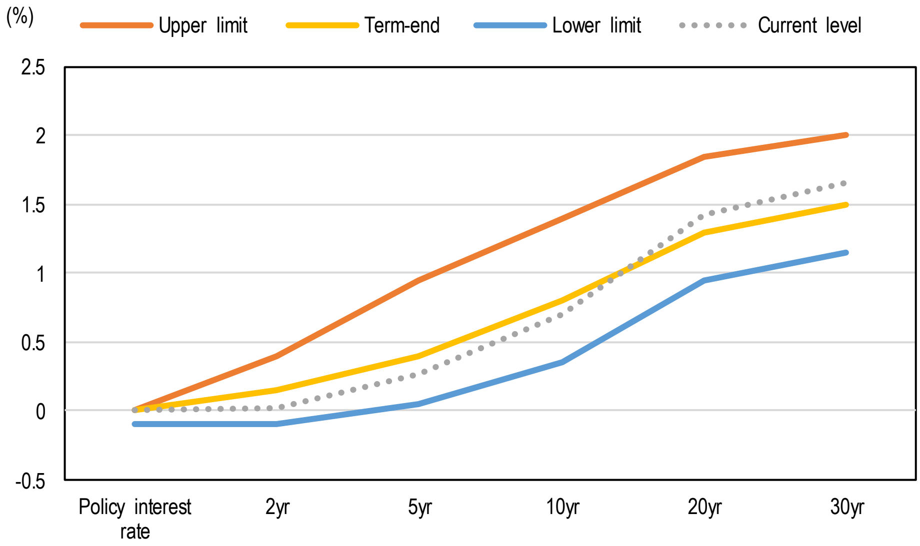
Next, we explain the yield path in our sub-scenario ①. Here, we forecast that yen depreciation will accelerate due to the interest rate differential, assuming that the federal funds rate will remain high due to a less-than-expected slowdown in inflation, even in 2H FY23 on the back of the firmness of the US economy. We assume that the BOJ will be forced to eliminate negative interest rates in order to contain a future rise in prices. Of course, the upper limit of YCC is expected to be raised like the main scenario. In this case, US yields when negative interest rates are eliminated are expected to remain high, similar to current levels. Thus, we forecast that the 10-year JGB yield level when negative interest rates are eliminated will be at around 1.15%. As the BOJ is expected to eliminate negative interest rates amid the lack of confidence in the economic outlook, it would be cautious about subsequent additional rate hikes. In the case that the market perceives this background to elimination of negative interest rates, yields are likely to continue to rise while the market continues to price in additional rate hikes as long as US yields and inflation remain high. Our upper limit projections in FY24 (i.e., 1.3% and 1.4%) show the 10-year JGB levels, which assume such rate-hike pricing in the market. The above is a yield path outlook reflecting our sub-scenario ①.

◆ Sub-scenario ②

Finally, we explain the yield path in our sub-scenario ②. Here, we assume that the BOJ will maintain the current monetary policy without achieving the price target due to slowdown in inflation amid a stall in the US economy. It appears that the market is not currently aware of this scenario, but this cannot be ignored by any means. In this case, as the achievement of the BOJ's price stability target will be postponed to the stage after the rate cut cycle in the US ends, JGB yields are likely to decline together with US yields for the time being. We would expect the 10-year JGB yield to decline to about 0.3%, assuming a decline in US yields to the neutral level. The above is a yield path outlook reflecting our sub-scenario ②.

In the above sections, we explained details of our yield outlook, which reflects three scenarios for the BOJ's monetary policy. It can be said that the market is currently in a difficult situation, in which estimated yield levels differ greatly by scenario. Consequently, it is not easy to accurately forecast a main scenario. However, as we are in such a situation, it may be helpful to think of yield levels under multiple scenarios. Of course, it is highly possible that the market will encounter changes beyond our expectations. That said, we consider that this report could serve as a useful reference when thinking of the outlook.

Chart 2: Estimated Yield Curves at End-1H 2024 by Scenario



Source: Compiled by Daiwa Securities.

Chart 3: BOJ Monetary Policy Outlook (Chief Market Economist Mari Iwashita: as of 11 Sep 2023)

Main Scenario		The BOJ conducts a series of discussions on whether achieving the 2% price stability target is in sight each time it releases *Outlook Report* (Jan and Apr 2024 reports are particularly important). With the probability of a soft landing with the US economy increasing, overseas yields remain high. Due to higher crude oil prices and the yen remaining weak, prices in 2H FY23 are higher than currently projected levels. Therefore, momentum for wage hikes continues.
Probability	**60%**	In Apr 2024, the BOJ eliminates negative interest rates, issuing declaration that the 2% price stability target has been achieved. The framework for the YCC remains. Provisions remain for a reference range for the long-term interest rate target (for example, in the case of a hike to 0.25%, ±0.50% band = -0.25% to +0.75%). With achieving the 2% price stability target appearing imminent, it becomes desirable to provide a road map for monetary policy normalization to avoid market confusion.
Sub-scenario ①		Amid global complex inflation, policy interest rates remain high despite the end of monetary tightening in US and Europe. With the US economy being strong, appreciation pressure on the dollar and deprecation pressure on the yen does not stop. With Japan's economy continuing to recover steadily, 2% price growth is maintained even in 2H FY23. Sustainable wage hikes come into view. The BOJ is forced to eliminate negative interest rates earlier than planned.
Probability	**20%**	When negative interest rates are eliminated, a sharp rise in interest rates is curbed by messages indicating that rates will not be raised anytime soon. However, the market could press for the next round of rate hikes.
Sub-scenario ②		The BOJ proceeds with debate carefully while keeping an eye on the external environment. It remains wedded to continuing easing, and misses an opportune chance to make new changes until review is completed.
Probability	**20%**	With US economy losing momentum unexpectedly, rate cuts seem imminent. This and prolonged sluggishness of China's economy increase downward pressure on Japan's economy. Due to lower US yields, situation with strong dollar/weak yen is corrected. Inflation drops to the 1% level from 2H 2023, making it impossible for BOJ to make a move. BOJ is the only major central bank unable to normalize following crisis response.

Source: Compiled by Daiwa Securities.

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