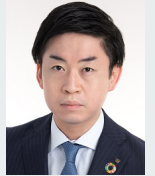


Daiwa's View

Very weak GDP growth rate in Japan

- Weak GDP growth rate in Japan affecting likelihood of additional rate hike from 0.25% to 0.5%

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Yesterday, the US long-term yield declined to 4.24% in response to weak retail statistics and solid data on unemployment compensation. The 10-year real yield, which surged after the CPI shock, declined to 1.94%, temporarily falling from the 2% threshold. Adding a breakeven inflation rate of 2.3% to a real yield of 2% (which is used as a point of reference) gives an estimated 10-year yield of 4.3%. Assuming the term premium does not post another surge, it is probably OK to say that dip-buying of 10-year USTs at around 4.5% would prove beneficial.

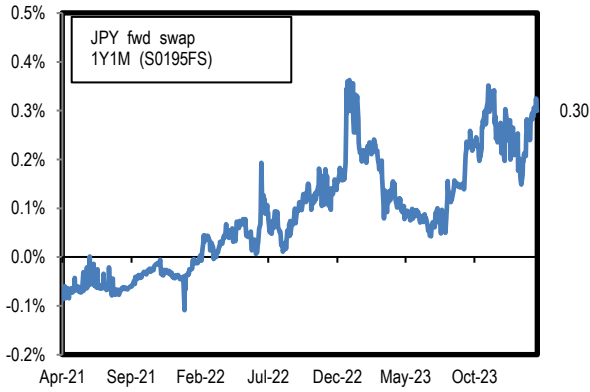
Sluggish GDP growth rate in Japan cannot be ignored

Meanwhile, what attracted attention yesterday were Japan's economic statistics. Specifically, Oct-Dec 2023 real GDP shrank by 0.4% q/q annualized, weaker than the market consensus of +1.1% and our Chief Economist Toru Suehiro's estimate of -0.3%. These statistics, which were largely in line with our economist's estimate, which was the only negative growth projection in the Bloomberg survey, show how the latest GDP data was a negative surprise. Looking at contributions from domestic and foreign demand revealed a discouraging situation, with domestic demand, such as private consumption, remaining weak (-0.3%pt q/q), but foreign demand lending support (+0.2%pt). After the data was released, the 10-year JPY OIS rate declined substantially from 0.94% to 0.91%.

As everyone knows, the BOJ signaled that the end of the negative interest rate policy was approaching by raising its FY24 growth rate projection from 1.0% to 1.2% in the January *Outlook for Economic Activity and Prices* report, adding that "the likelihood of realizing this outlook has continued to gradually rise." Of course, there is unlikely to be a change to the fixed course of eliminating negative rates, even after the release of the GDP data. That said, while the FY24 growth rate consensus is +0.8%, the projection of our Chief Economist Suehiro, whose estimate for the Oct-Dec 2023 growth rate was almost spot on, is +0.5%. If the growth rate were to fall below the BOJ's projections after "the first force" has waned, the likelihood of getting an additional rate hike from 0.25% to 0.5% may decline. In his speech on 8 February, BOJ Deputy Governor Shinichi Uchida stated "it is hard to imagine a path in which it would then keep raising the interest rate rapidly," given the current outlook. Therefore, if the outlook were to worsen, the upside for the JPY rate would likely be limited for a short time.

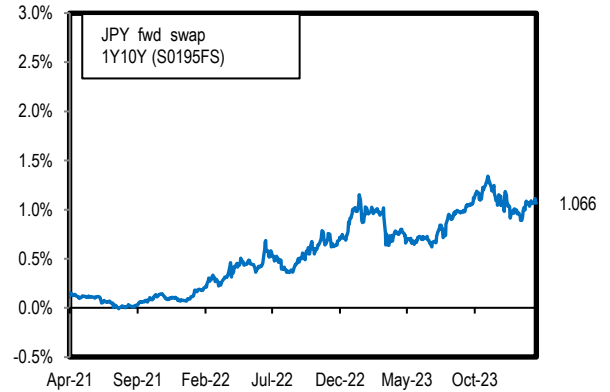
Comparing the current situation with the beginning of November 2023, when the 10-year JGB yield hit 0.97% at one point, we find that the 1-year forward 1-month OIS rate is approaching the level it was at in early November, rising to the 0.3% level, reflecting mounting speculation about the elimination of negative interest rates. However, the 1-year forward 10-year OIS rate is sluggish at 1.07%, far below the 1.28% it was at in the beginning of last November.

1yr1mo JPY Swap Rate



Source: Bloomberg; compiled by Daiwa.

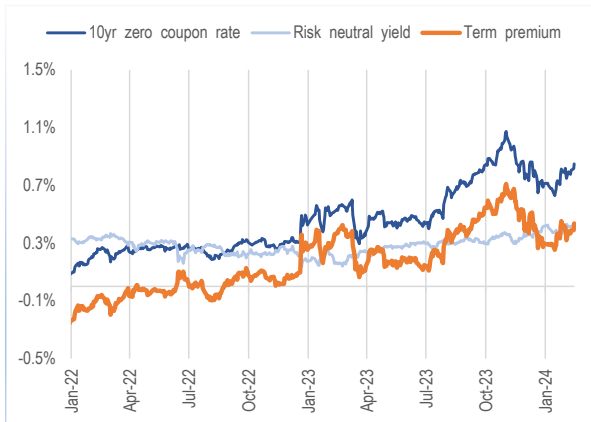
1yr10yr JPY Swap Rate



Source: Bloomberg; compiled by Daiwa.

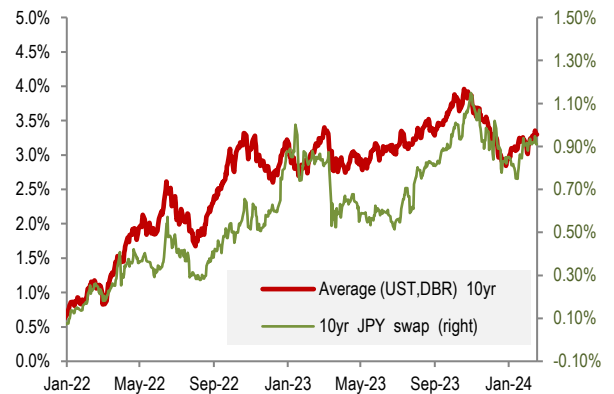
It has been found that the rise in JGB yields at the beginning of November was led by the term premium in response to the effects of a surge in UST term premiums. However, projections for the terminal rate have not risen substantially at this point, although elimination of negative interest rates now appears imminent. Deducting the recent OIS/JGB spread of 20bp provides a point of reference for the 10-year JGB yield one year from now at the upper 0.8% level. If US yields one year from now are lower than current levels, this estimate will likely decline slightly.

10yr JGB Term Premium



Source: MOF; compiled by Daiwa.

10yr JPY Swap Rate, Overseas Yields



Source: Bloomberg; compiled by Daiwa.

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