# Daiwa's View

## USD-denominated super-long JGB yields

- Super-long JGB yields rose significantly to around 3.0%, but generally valued as fair from global balance perspective
- Meanwhile, BOJ's low policy interest rate stands out globally, making carry + roll-down returns on super-long JGBs very attractive
- Once market volatility subsides, both domestic and foreign investors likely to focus more on this investment appeal

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The 10-year UST yield fell to 4.33% (down 7bp vs previous day) after a favorable result for the 9 July (US time) 10-year UST auction. Indeed, there has been strong buying of USTs on dips with the Fed expected to cut rates. Meanwhile, as of 9 July, the 30-year JGB compound yield remained high at around 3.0%, while the yield on the 30-year German bund remained elevated at around 3.16%, pointing to a disparity between these two yields and the UST yield.

### USD-denominated super-long government bond yields

If we convert the prices of super-long government bonds of major countries as of the morning of 10 July (Japan time) into US dollars, it appears that both super-long JGBs and European government bonds continue to be reasonably valued within the global balance. The USD-denominated asset swap spread on 30-year JGBs is currently around +132bp, widening by around +8bp compared to 6 June. Looking at European bonds, the spreads widened by 10bp in Germany and 11bp in France, indicating generally consistent movements within the global balance.

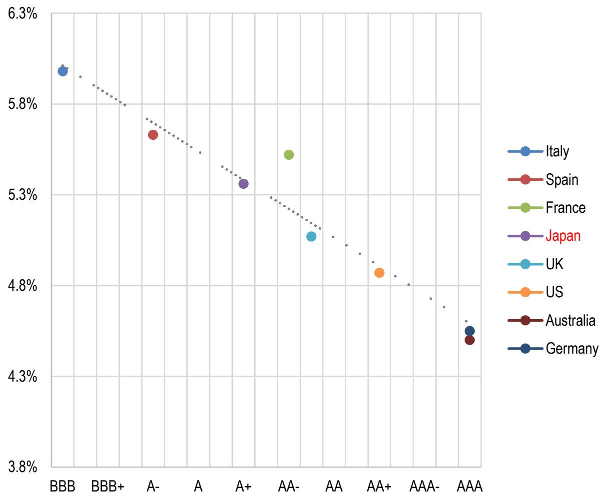
In other words, the recent rise for the 30-year JGB yield to around 3.0% is not necessarily driven solely by factors unique to Japan (at least not at this juncture), such as higher approval ratings for Sanseito ahead of the 20 July Upper House election leading to concerns about a possible downgrade of Japan's credit rating. Rather, it appears that this is a balanced movement within the context of expanding global term premiums.

**USD-denominated Super-long Yields in Major Nations**

| On-the-run 30yr government bonds | Maturity date | Local currency-denominated ASW (bp) | USD-denominated yield (%) | USD-denominated ASW (bp) |
|---|---|---|---|---|
| Germany | 8/15/2056 | 36 | 4.5 | 48 |
| Australia | 6/21/2054 | 60 | 4.55 | 51 |
| **US** | **5/15/2055** | **83** | **4.87** | **83** |
| UK | 7/31/54 | 81 | 5.07 | 102 |
| **Japan** | **6/20/2055** | **64** | **5.36** | **132** |
| France | 5/25/2055 | 118 | 5.52 | 148 |
| Spain | 10/31/2054 | 126 | 5.63 | 159 |
| Italy | 10/1/2054 | 155 | 5.98 | 193 |

*Source: Bloomberg; compiled by Daiwa.*

**USD-denominated Super-long Yields in Major Nations**




*Source: Bloomberg; compiled by Daiwa.*

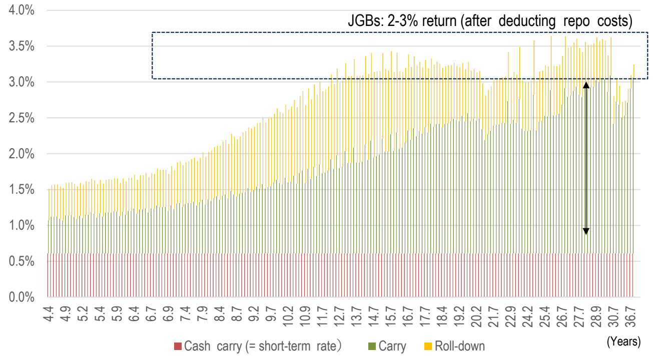
There does not appear to be widespread concern about a downgrade for Japan's credit rating at this juncture, which is certainly good news. That said, this also suggests that if new developments emerge in the future that raise concerns about a downgrade, super-long JGB yields would likely rise by +10~20bp from current levels (assuming other conditions remain unchanged). It is important to continue paying attention to the global balance and the risk of Japan's credit rating being downgraded.

## Carry + roll-down returns

While current super-long JGB yields are generally at fair levels from a global perspective, the BOJ's continued suppression of Japan's policy interest rate at low levels has created an unusually strong investment appeal for super-long JGBs due to their carry + roll-down returns. Actually, the current carry + roll-down for super-long JGBs is close to 3.0-3.5%. So, even after deducting the funding cost (repo cost) of 0.5-0.6%, we can calculate the yield at 2.5-3.0%. The appeal of this investment is clear when compared to the carry + roll down for super-long USTs (around 0.5-1.5%) after deducting repo costs, which have risen roughly 4.0% due to the Fed's high interest rate policy.

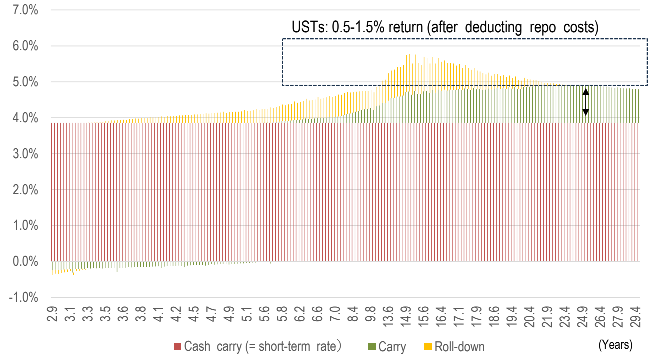
If BOJ interest rate hikes are further delayed and if confidence in the continued low stability of repo costs deepens, attention will likely focus even more on JGB investments that offer the advantage of this opportunity for carry + roll-down returns. Of course, currently there is a reluctance to invest due to the deterioration of JGB market functioning along with fragmentation of the JGB market (between maturities of less than 10 years and more than 10 years). However, once the sudden fluctuations settle down, the high investment appeal created by the combination of (1) super-long JGB yields that are generally at a fair level from a global perspective and (2) policy interest rates that are unusually low from a global perspective will begin to attract demand from both domestic and foreign investors.

**Carry and Roll-down Returns for JGBs**




*Source: Bloomberg; compiled by Daiwa.*

**Carry and Roll-down Returns for USTs**

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