Daiwa's View

Factors Behind UST yield drop and key role of real yields

- Yield decline driven by real yields
- Global real yields declining amid growth rate outlook changes
- Rising yield risks declining, even in Japan

FICC Research Dept.

Shun Otani
81-3-5555-8764
shun.otani@daiwa.co.jp

Daiwa Securities Co. Ltd.

Declining 10yr UST yield and its factors: Driven by real yields

The 10-year UST yield has continued to decline. Since last September, this yield generally moved within a very narrow range, specifically an upper limit of 4.20% and a lower limit of 4.00%. However, since the start of 2026, the 10-year US Treasury yield rose to around 4.30% due to debasement trading triggered by geopolitical concerns originating from the US (such as Greenland issue) and the "JGB shock" on 20 January. However, it has been on a downward trend since the start of February, declining to 4.05% as of the end of last week, approaching the key 4.0% level.

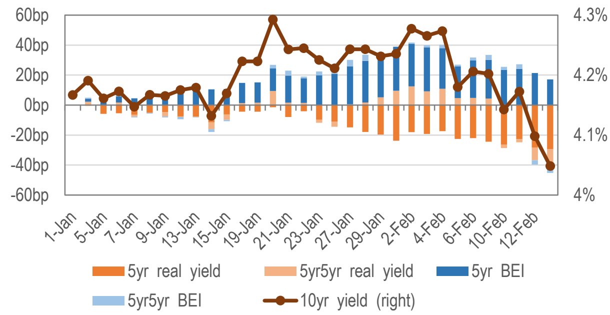
During the week of 9 February, several key economic indicators were released one after another, partly due to the impact of the government shutdown. Turning to retail sales figures released on 10 February (TUE), both the headline figure (market forecast: +0.4% → actual: +0.0% m/m) and the control group data (+0.4% → -0.1% m/m), which forms the basis for GDP statistics, were weaker than expected. This contributed to the UST yield decline. Meanwhile, employment statistics released on 11 February indicated that the nonfarm payrolls (+65,000 → +130,000) significantly exceeded the prior forecast, and the unemployment rate (4.4% → 4.3%) was lower than expected. Also, the headline CPI released on 13 February (+0.3% → +0.2%) landed slightly below expectations. However, as our chief economist Kenji Yamamoto and economist Shota Inoue indicated, there has been strong growth for US super-core inflation (core services excluding rent). As such, it is difficult to say this content dispels inflation concerns. At the very least, the employment statistics and CPI data released later in the week did not suggest a further decline for the 10-year UST yield.

We analyzed movements for the 10-year UST yield since January using four factors. First, we broke these factors down into inflation expectations (BEI) and real yields. Then we added the 5-year yield and 5-year forward 5-year yield (forward rate). In mid-January, after the 5-year BEI led yields higher, the 5-year real yield declined from the latter half of the month. Furthermore, the current decline for the 5-year forward 5-year real yield is also a factor pushing down the overall 10-year UST yield.

Chart 1: 10yr US Yield

Source: Bloomberg; compiled by Daiwa.

Chart 2: Factor Breakdown of 10yr US Yield (change since beginning of Jan)

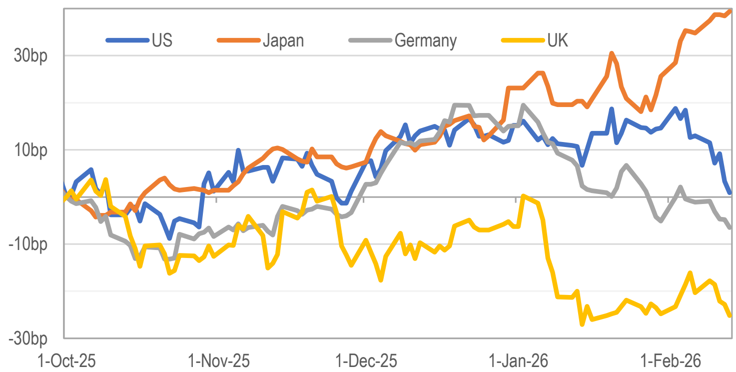


Source: Bloomberg; compiled by Daiwa.

Real yield declines can be observed in other countries as well. Looking at the changes for 10-year real yields as of last October for the US, Japan, Germany, and the UK, a significant decline in real yields occurred in the UK in early January, followed by a downward trend in Germany and the US. What this global decline for real yields indicates is that while various interpretations are possible, real yields, particularly long-term real yields, serve as a proxy variable for the economic growth rate.

The US stock market has seen underperformance for software-related and big tech stocks, partly due to the impact of the "Anthropic shock" in late January. Within that context, defensive stocks such as energy, materials, and public utilities are now supporting the overall index. We can also note that the downward revision for the high growth expectations held for the information-related industries, centered on AI expectations, is reflected in the decline for real yields.

Chart 3: Long-term Real Yields in Four Major Nations (change since Oct 2025)



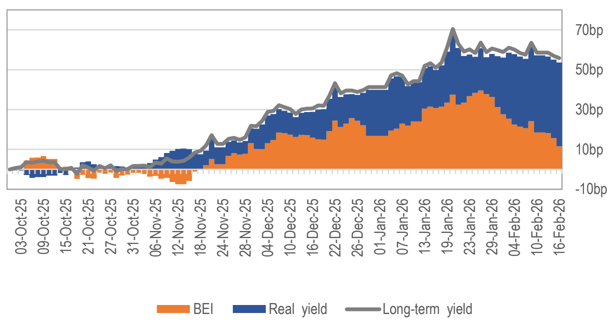
Source: Bloomberg; compiled by Daiwa.

Japan real yields

Among the long-term real yields for major economies, Japan is the only case in which their long-term real yield is still rising. Since the launch of the administration of Prime Minister Sanae Takaichi in October, the 10-year JGB yield has continued to rise due to fiscal concerns and fears of falling behind the curve. From a macroeconomic perspective, fiscal expansion at a stage where the output gap has disappeared carries the risk of accelerating inflation due to excess demand. Concerns about falling behind the curve also entail the risk that a delay in rate hikes could lead to future inflation. Each factor impacts the 10-year JGB yield by raising inflation expectations. Accordingly, the fact that real yields are rising amid a pause in the rise for inflation expectations, coupled with (1) the stabilization of the Takaichi administration following the Lower House election and (2) the subsequent rise in Japanese stocks driven by growth expectations, all suggest a shift from an "unfavorable yield rise" to a "favorable yield rise."

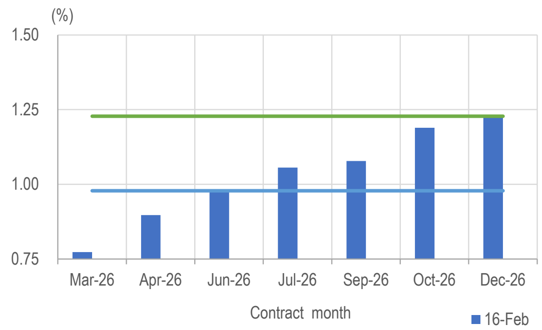
On 16 February, the second meeting between Takaichi and BOJ Governor Kazuo Ueda since 18 November of last year took place. After the meeting, Ueda said, "There were no particular requests regarding policy." The upward revision to the economic and price outlook in the BOJ's January *Outlook Report* has led the market to anticipate an early rate hike[1]. Market expectations for a rate hike by the April Monetary Policy Meeting had risen to nearly 80%, but following the weaker-than-expected GDP data on 16 February, expectations fell below 70%. That said, up until the June meeting, the market had priced in roughly one rate hike (25bp). The last rate hike occurred in December 2025 and it remains uncertain whether the next rate hike will follow the usual pace of once every six months (in June) or be brought forward slightly. Recent BOJ communications in the Summary of Opinions and *Outlook Report* increasingly express concern about the path toward inflation driven by yen depreciation. However, the exchange rate has not leaned toward yen depreciation after the Lower House election, as was widely feared. So, this means that the urgency of a March rate hike has not heightened. As for the next rate hike, April or June seem like reasonable options, falling around the start of the new fiscal year. Also, the government's acceptance of rate hikes, despite being perceived as opposing them, should contribute to lowering inflation expectations by easing concerns about falling behind the curve.

Chart 4: Change in 10yr BEI and Real Yield Since Oct 2025



Source: Bloomberg; compiled by Daiwa.

Chart 5: Market-implied Policy Interest Rate in Japan



Source: Bloomberg; compiled by Daiwa.

Future outlook

16 February (MON) was a US market holiday and there are now a few major economic indicators due out this week. For the 10-year UST yield to drop below the 4% threshold, new catalysts such as a bearish turn for the stock market would likely be needed. That said, in such a case, the real yield decline could potentially spread to Japan as well. While concerns remain about fiscal management under the second Takaichi administration, which is expected to be launched this week, the fate of the consumption tax cut (key market focus) will be debated at the national council. This means it will take some time for a clearer picture to emerge. From the perspective of this fiscal year, it seems reasonable to conclude that the initially feared rising yield risk has significantly diminished.

[1] Kento Minami & Kenji Yamamoto (23 Jan 2026). Daiwa's Economic View: January MPM: BOJ hints at faster pace of rate hikes.

IMPORTANT DISCLOSURES

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association