

Daiwa's View

FICC Research Dept.

Factors behind the rise in US yields and the importance of Japan's rate hike expectations

- US yields rose sharply by nearly 20bp in one week
- Factors behind high price of resources have greater impact than factors behind uncertainty; labor market should be monitored in the long term
- In Japan, rate hike expectations bring stability to the market and macroeconomy

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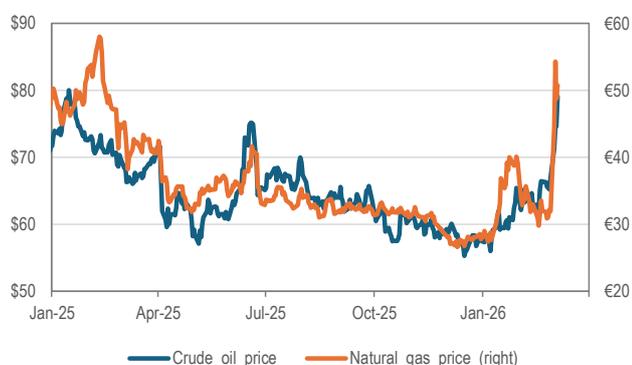
Daiwa Securities Co. Ltd.

In a report written before the opening of the session on Monday, we anticipated that the latest military conflict in the Middle East surrounding Iran would likely have a slight downward impact on US long-term yields. However, long-term yields ended up rising significantly by approximately 20bp in one week. In this report, we analyze the reasons why the forecast was off, and point out key factors for the future. In the latter half of this report, we consider the impact of the latest Middle East shock on the JGB market, drawing on a BOJ report as well as a media report based on information from those in the know publicized in the news on 5 March. Based on our analysis, we think that maintaining high expectations for a rate hike will lead to stability in the market, particularly for superlong bonds.

Factors behind the rise in US yields and key points for the future

Of the components making up long-term yields, there are upward (cost-push) factors that arise from high resource prices under the price mechanism of inflation expectations (BEI), but there are also downward factors (the opposite of demand-pull) that suggest an economic slowdown, caused by greater uncertainty reflected in the VIX Index and credit spreads. Our initial forecast was that these would offset each other, but, with the surge in the price of both crude oil and natural gas and other commodities, cost-push factors due to a de facto closure of the Strait of Hormuz, and other issues, have become the focus of attention. Meanwhile, the rise in the VIX Index and the widening of credit spreads have been limited so far compared to the rise in resource prices. With WTI futures prices continuing to rise in the NY market on the 5th, it would be better to assume stronger upward pressure on yields in the short term. However, irregularities in the credit market have also been pointed out. We would like to carefully assess both the upward and downward factors in a balanced manner.

Chart 1: Resource Prices (crude oil and natural gas futures)



Source: Bloomberg; compiled by Daiwa.

Chart 2: VIX Index, High-yield Credit Spread



Source: Bloomberg; compiled by Daiwa.

Long-term issues: The labor market is at a turning point

Considering the situation from a more long-term perspective, it is not yet clear whether the current shock will ripple into a substantial yield uptrend accompanied by the fading of rate cut expectations or a shift towards rate hike expectations. As our Economists Shota Inoue and Kenji Yamamoto pointed out in their report on the 4th, the pass-through of high crude oil prices to core inflation is influenced by the labor market. In Blanchard and Bernanke (2023)¹, which examined the mechanism by which the Covid-19 shock developed into significant inflation, they also point to the tightening of the labor market, such as the rise in the vacancy-to-unemployment ratio, as a factor that prolonged the initial inflation in the goods market. In the current US labor market, the unemployment rate is showing some signs of improvement, but wage growth has subsided. Therefore, while we do not currently anticipate a need for a major revision to our yield outlook², it will be necessary to carefully monitor the US labor market, including the jobs report to be released today, as there are concerns about a tighter labor market caused by a reduction in the inflow of immigrants due to the policies of the Trump administration.

Rate hike expectations in Japan and the impact on the bond market

In the midst of mounting concerns about energy prices in Japan, as well, Bloomberg published a report citing BOJ officials on the 5th with the headline "BOJ Is Said to Keep April Hike on Table With Eyes on Iran Crisis." We get the impression that the central bank would like to maintain rate hike expectations, despite the fact that the market is no longer pricing in a rate hike in April or June as much as it had before, due to the impact of BOJ policy board member appointments that were perceived as more dovish than expected, as well as worsening geopolitical risks and falling stock prices.

The Bank of Japan Working Paper by Ito et al. (2026) published on 27 February performs measurements using a policy reaction function based on interest rate and inflation forecasts in the QUICK Monthly Survey, which is a questionnaire survey of bond market participants. This function measures the extent to which market participants change their policy rate forecasts in response to changes in inflation expectations. The results show that the sensitivity (β) to inflation expectations has increased since the normalization of monetary policy in 2023.

When market participants forecast that the central bank will take appropriate policy action in response to prices, that serves as an automatic stabilizer that brings about a desirable outcome for the central bank. When inflation occurs, the expectation among private economic agents that the BOJ will respond to inflation with monetary tightening leads to a mechanism whereby long-term inflation expectations stabilize, the risk of accelerating inflation decreases, and economic fluctuations are suppressed. Conversely, if expectations that inflation will be left unchecked grow, it becomes a destabilizing factor for the market and the economy.

Implications for the JGB Market

In other words, convincing the market that the central bank will respond correctly to price shocks (such as those from resources) with rate hikes will lead to stabilization of long-term inflation expectations and the macroeconomy. It will also contribute to the stability of superlong yields by reducing the risk of falling behind the curve. Our department continues to see a rate hike in the Apr-Jun period as being the main scenario. However, on 24 February, the *Mainichi Shimbun* reported that Prime Minister Sanae Takaichi expressed reluctance about a rate hike in a meeting she held with BOJ Governor Kazuo Ueda on 16 February. In one respect, it would be hard to see politics as having a superficial influence on monetary policy. Moreover, if stock prices continue to decline, political pressure is expected to intensify. It would be prudent to keep in mind that a delay in the implementation of rate hikes due to political pressure would likely be accompanied by the destabilization of superlong yields.

¹ Olivier J. Blanchard and Ben S. Bernanke (2023). "[WHAT CAUSED THE US PANDEMIC-ERA INFLATION?](#)" NBER WORKING PAPER SERIES.

² FICC Research Dept. [Yield / Economic Outlook: Mar 2026](#).

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