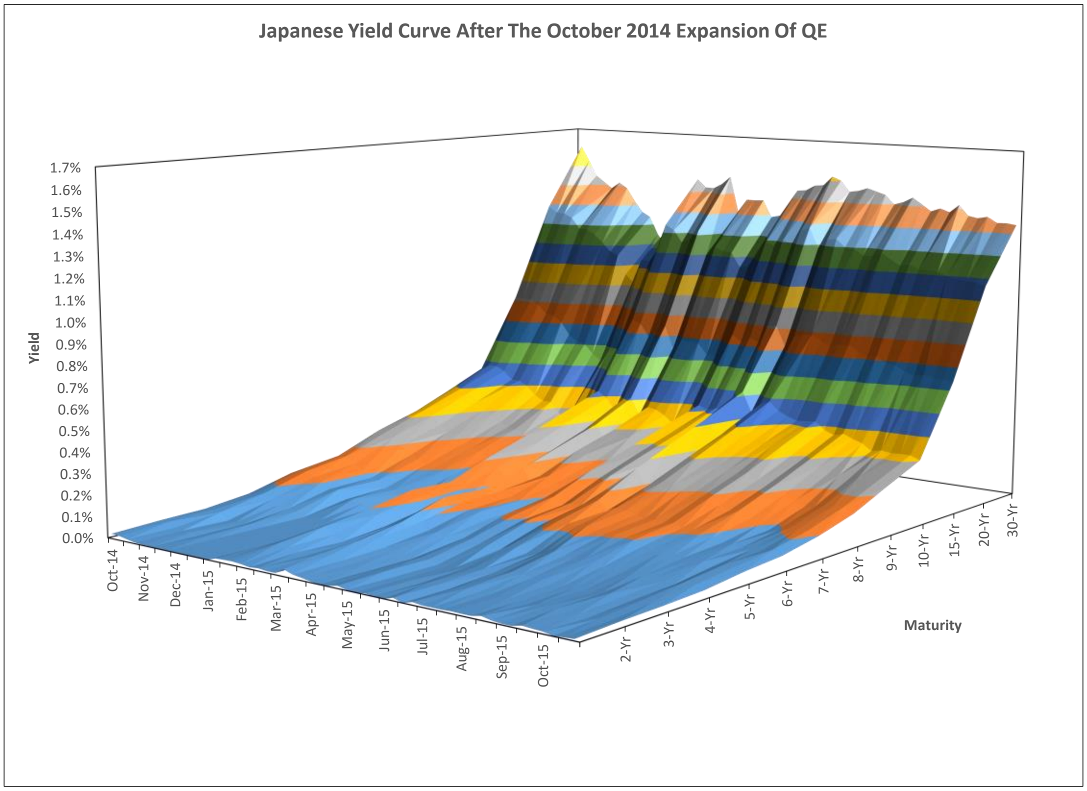
Update On Japanese Swap Spreads And Volatility

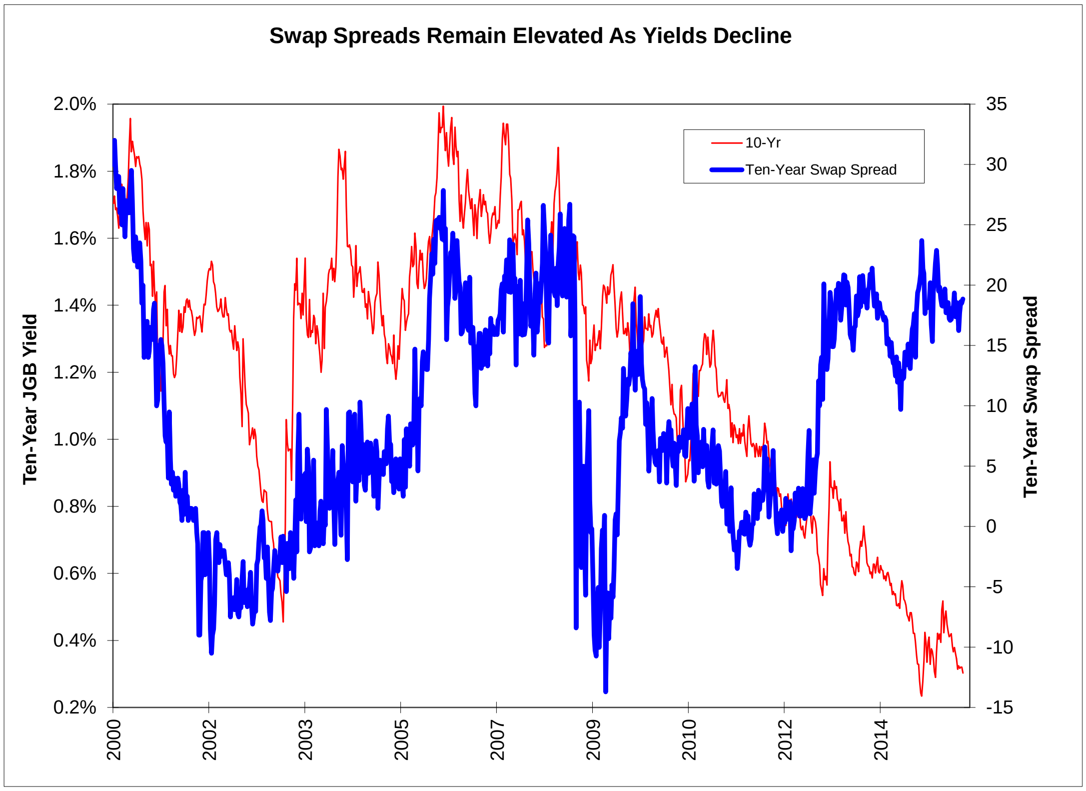
Ten-year Japanese government bond yields stand 8.9 basis points over their all-time low reached in January 2015 and are in a clear downtrend. While swap spread and volatility markets are somewhat defensive in their outlook, they best can be characterized as accepting lower yields.



Swap Spreads And Yields

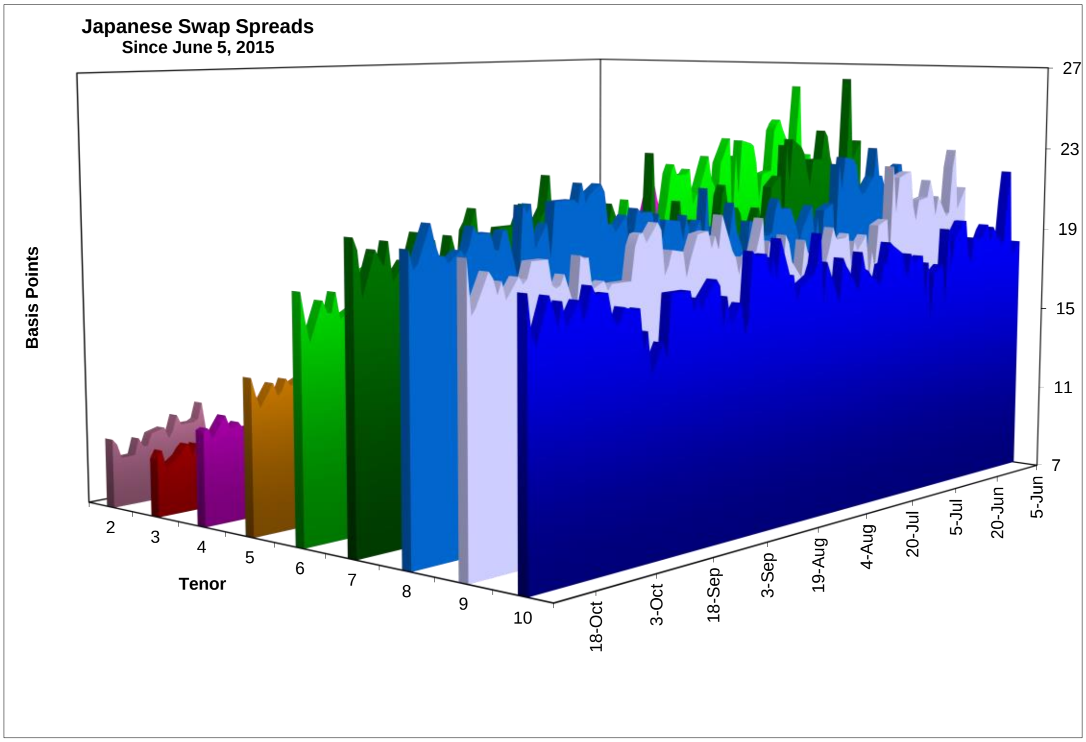
Ten-year swap spreads have remained within the range established with the April 2013 expansion of Japanese QE. Floating-rate payors in this market appear to be “top-pickers” willing to lock in historic lows in the belief they will not go lower still. As reversals in the JGB market tend to be short, sharp affairs, this trade does afford short-lived moments of self-congratulation.

Pseudo-real Japanese yields remain negative out to ten years and are well below their U.S. counterparts. The ten-year JGB has a real yield of -0.543%, compared to 0.620% for the ten-year UST. One-year real yields in Japan are an almost meaningless -5.431%. These negative implied real yields have not been successful in any macroeconomic sense, but the Japanese policymakers continue to believe they are necessary to forestall further deflationary pressures. They have yet to reignite a global yen carry trade in the face of monetary accommodation elsewhere with the result the JPY has traded in a narrow range since March 2015.



Term Structure Of Swap Spreads

If we map swap spreads across tenors from 2 to 10 years since the June 2015 Bank of Japan signal yen depreciation had gone far enough, we see almost no directional movement. This is not a market complacent about ever-lower yields.



Volatility

Implied volatility readings for zero-coupon Japanese government bonds have increased sharply since September. This is an expected response to lower yields. It also is an expected response to a steeper yield curve as measured by the forward rate ratio between two and ten years.