

Daiwa's View

'True value'

- Around 0.1% is upper limit of 10-year JGB yield even after re-widening of the trading band?

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Daiwa Securities Co. Ltd.

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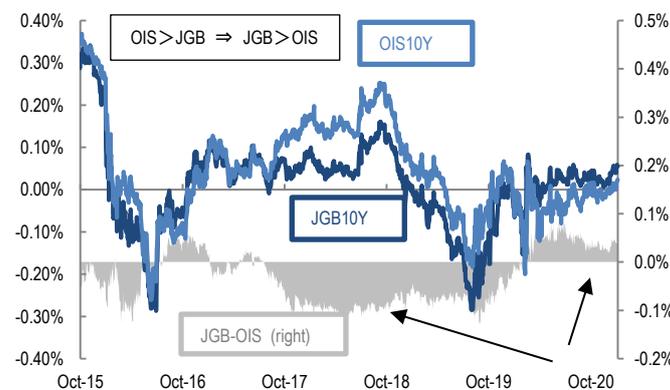
'True value'

At yesterday's 10-year JGB auction, the lowest accepted price was Y100.45 (0.054%) in line with the upper limit of the market consensus. With the average price being Y100.46 (0.053%), the tail was quite short. At the Non-price Competitive Auction II, as well, additional bids of Y241.3bn were [accepted](#). We can, therefore, say that the result was favorable overall, despite unstable market sentiment prior to the March assessment meeting.

Of course, one reason is probably the fact that the progress of the correction was viewed positively—around 0.05% was a stable trading level during the period from the introduction of yield curve control (YCC) in September 2016 to July 2018. However, it is true that the 10-year JGB yield climbed close to 0.15% at one point after the July 2018 assessment meeting decided to widen the trading band. I wonder if this sense of caution will increase.

Market participants are probably thinking that there is a difference in the 'true value' between then and now. One notable point has been a change in the ranking of JGBs and the OIS. From mid-2018 to October 2019, balance had been established regarding a relationship of JGBs < OIS. In other words, the 'true value' of JGBs at that time were forced down significantly compared to their usual value due to easing effects. However, now, with the 10-year OIS and 10-year JGB yields at 0.02% and 0.05%, respectively, it has shifted to a relationship of JGBs > OIS. This implies that the degree of monetary policy's restraining power against yields has changed between then and now (due to a decline in the 'true value,' the restraining power has weakened, although yields look the same). If so, when the re-widening of the trading band provides 'leeway' to yield fluctuations, the impact now will be different from what it was before.

10Y JGB Yield, OIS, JGB/OIS Spread



Source: Bloomberg; compiled by Daiwa Securities.

Since the introduction of YCC in September 2016, the JGB/OIS spread has mostly ranged between -0.12% and 0.10% . If we assume that the OIS moves at around 0% (no rate hikes beyond the removal of negative interest rates), the upper limit of the 10-year JGB yield is calculated at around 0.1% when using the upper limit of the aforementioned JGB/OIS spread. In other words, if the BOJ again decides to double the trading band at the upcoming March assessment meeting, the 10-year JGB yield level is expected to be as high as around 0.1% , unless policy rate projections change substantially (unless the OIS factors in rate hikes beyond the removal of negative rates). This appears to correspond to the projection level among many market participants.

At the time of the July 2018 assessment meeting, this policy action was regarded as a series of measures under the global exit strategy. Therefore, the 5-year yield also posted a clear uptrend (the emergence of premature rate-hike expectations). However, the situation now is different from then—central banks are fretting about decoupling rate-hike expectations, although they are heading toward tapering. Compared to the situation in July 2018, it has become difficult for rate-hike expectations to increase, which is likely to restrain a rise in the OIS and also the upper limit of JGB yields.



Source: Bloomberg; compiled by Daiwa Securities.

If we apply these considerations to the supply/demand factor, cash burning by Japanese depository institutions, which are holding an enormous amount of deposits at zero cost, will play a major role at the 10-year JGB yield level of above 0.1% , unless the policy rate is raised substantially (\rightarrow a hike in deposit rates). Amid increasing stock effects due to QE that has been conducted thus far¹, full-scale rate-hike expectations would probably be needed for the 10-year JGB yield to exceed 0.1% in a stable manner.

¹ As of 31 Jan 2021, the outstanding amount of JGBs held by the BOJ expanded to Y536.6tn.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

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Other Disclosures Concerning Individual Issues:

- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITs: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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- 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

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