Implications of *Nikkei* interview with Mitsui O.S.K. Lines president

- Yields will not rise unless they decline

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Yields will not rise unless they decline

As is well known, containership rates are currently surging, boosting earnings at the three major Japanese shipping firms. Under the circumstances, the *Nikkei* on 31 May ran an article of an interview with Mitsui O.S.K. Lines president Takeshi Hashimoto. As this appears to have implications also for stagnant volatility in the JGB market, we introduce it today. Firstly, we state the conclusion—both prices and yields will "not rise unless they decline."

The factors behind the current tight conditions for container transport are (1) a decline in efficiency at ports and inland transportation since the surge of COVID-19 infections in Europe and the US (= supply constraints) and (2) a recovery of cargo movement due to the US government's benefits and rising vaccination rate (= demand recovery). That said, these facts are well known, and I thought that the next sentence has implications for the bond market. President Hashimoto stated that "overly expensive rates would increase the building of new ships and make reactionary moves significant," regarding this extraordinary hike in rates. He probably forecasts that a collapse of the supply/demand balance caused by expansion of lagging supply will create a large reaction in rates in the future.

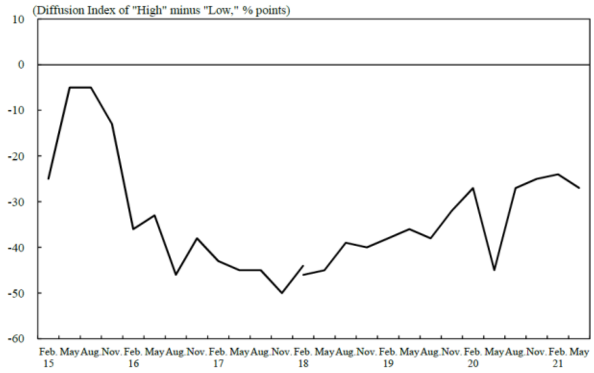
Mitsui O.S.K. Lines President Takeshi Hashimoto (31 May 2021)

Regarding containers bound for North America, rates of around $2,000 enable firms to secure profits in the container business. The current rate (author's note: more than $4,000) is an extraordinary level. Overly expensive rates would increase the building of new ships and make reactionary moves significant. Unless the high rates ease, this would have negative impact on the marine transportation business, not limited to the global economy.

I recognize that similar price dynamism impacted recent US yields. After the US long-term yield declined to around 0.5% toward July 2020, it rose to a level slightly below 1.8% in February and March 2021. The rise was directly triggered by President Joe Biden's fiscal policy (American Rescue Plan). One background factor of the decision for fiscal expansion (to excessive level, about which former Treasury Secretary Larry Summers was concerned) was a big-picture political judgment that "fiscal spending should be implemented by utilizing this low interest rate environment." If we express the series of phenomena by using an analogy from the phrase of the Mitsui O.S.K. Lines' president, we could say that "overly low yields increased the supply of bonds and enlarged reactionary moves."

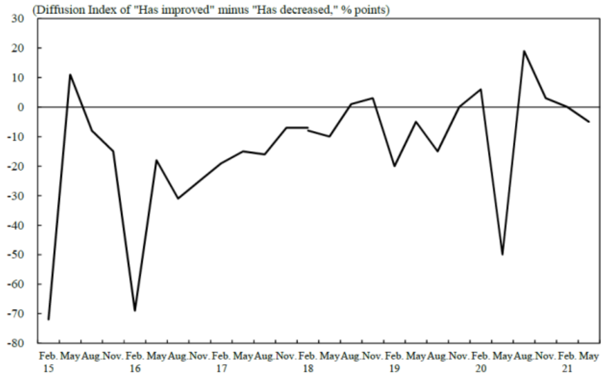
How is the JGB market? In *Bond Market Survey* (May 2021) released yesterday by the BOJ, data showed a slight decline in the DI for bond market functioning even after the March assessment meeting. At the JGB Market Special Participants meeting to be held this week, we will probably hear a flurry of direct language against the current severe conditions. There may be an opinion that the offer amounts should have been reduced in the monthly schedule of JGB purchase operations for June (released 31 May), in which the figures were unchanged from those for the previous month.

DI for Bond Market Functioning (current situation)



Source: Extracted from BOJ materials.

DI for Bond Market Functioning (change from three months ago)



Source: Extracted from BOJ materials.

However, I think that the BOJ should not avoid the main issue via short-sighted measures. The aforementioned cases of container rates and US yields show that such measures will not create a true change. Such measures even entail the risk of preventing a change in "supply," which plays a part in price changes by clouding macro dynamism and distorting decision-making (resource allocation) at economic agents.

Under the operations by the New York Fed, which purchases Treasury bonds that are neutral to the curve, a marked decline in yields is regarded as a market signal against a fiscal shortage. This enables the authorities to steer toward fiscal expansion. In the case of Japan, on the other hand, QE has been implemented by the distorted maturity composition (leaning on short term) aimed at steepening the yield curve. Therefore, the bond market tends to send a stronger alarm than necessary, which enables the authorities to easily catch signals related to the need to curve expenditures (tax hikes). In other words, short-sighted adjustments to JGB purchase operations (reduction) may be creating the causes for "the lack of yield increases" and low volatility from a longer viewpoint by reducing "supply" that should have been generated under ordinary circumstances, although they can raise yields in the short term.

In essence, I think that both yields and container rates "will not decline unless they rise" and "will not rise unless they decline." While the speed of change in demand is fast, that in supply is slower. This leads to a shift of the equilibrium to a point where demand matches supply, and the price converges to the new equilibrium. Market prices fluctuate amid these processes.

Of course, the central bank should cope with extraordinarily enormous price fluctuations that could cause a macro crisis. However, if it artificially creates low volatility and restrains a decline in yields in ordinary times via short-sighted changes in operations, adverse effects could arise. We should not regard this as improvement in market function. If we are afraid of a decline, supply will not change and thus yields (as equilibrium) will not rise either. The JGB market should get this implication from the *Nikkei* interview with Mitsui O.S.K. Lines' president, in our view.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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February 2020

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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 Y10bn. 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).

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- 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.
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