Daiwa Securities

Daiwa's View

Change in BOJ's operation schedule is in line with main objectives of policy assessment

- Impact of reductions is neutral
- Disclosure of quarterly schedule is an excellent move

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US Treasury yields fell by 1bp almost in parallel across the curve. On the other hand, the JGB futures price declined by Y0.07 to Y151.62 in the night market, marking a different move from US Treasuries. The reason for this is the "Quarterly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method)" for July-September 2021 announced at 17:00 yesterday.

The highlights this time are (1) reductions in the monthly offer amounts in three zones (the 1- to 3-year zone, 5- to 10-year zone, and 10- to 25-year zone, with no change to the 3- to 5-year zone or over-25-year zone), and (2) a change in the scheduled time frame from monthly to quarterly.

It was not the consensus to cut the offer amounts. However, the total amount of the reductions is only Y250bn/month and Y750bn for three months (Y250bn x 3). While the loan-deposit gap at major banks and regional banks increased by Y28.1tn over the past three months (Feb-May), their macro add-on balance increased by Y27.3tn in line with QE. Based on rough estimations, about Y0.8tn was allocated to investment. Given that these two factors were almost offset, the impact of this cut in the offer amounts on the market appears to be basically neutral.

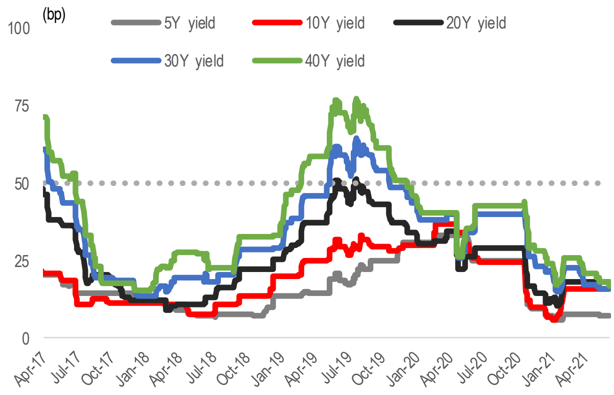
Comparison of Monthly Offer Amounts (Y bn)

	Jun			Jul-Sep		Change
Zone up to 1 year	150	(=150*1)	→	150	(=150*1)	0
1- to 3-year zone	1,900	(=475*4)		1,800	(=450*4)	-100
3- to 5-year zone	1,800	(=450*4)		1,800	(=450*4)	0
5- to 10-year zone	1,800	(=450*4)		1,700	(=425*4)	-100
10- to 25-year zone	200	(=200*1)		150	(=200*1)	-50
Over-25-year zone	50	(=50*1)		50	(=50*1)	0
Total	**5,900**			5,650		-250

Source: BOJ; compiled by Daiwa Securities.

The 3- to 5-year zone and over-25-year zone were not the target of reductions this time. Of note is whether this was determined based on a feel for the level (divergence from the theoretical value calculated by the BOJ) or the yield fluctuation range. We presume the following are factors with regard to the over-25-year zone: (1) a certain degree of price fluctuation that has been observed recently, (2) the yield currently being at the highest level in the short term, and (3) the fact that room for reductions is limited. Meanwhile, the 5-year JGB yield has recently been low without striking fluctuations. Nevertheless, this zone was not the target of reductions. With the 10-year yield being fixed by the yield curve control (YCC) policy, it may be possible to think that slightly different criteria is being used for the zones up to 10 years and those over 10 years.

Fluctuation Range of JGB Yields



Source: BOJ; compiled by Daiwa Securities.
Note: Difference between the maximum and minimum values in JGB yields in the preceding six months.

Room for reductions in the future is likely to depend on the policy for expanding the monetary base, which is associated with the inflation-overshooting commitment. In the current environment in which risk asset prices are largely stable, there is no opportunity for the BOJ to buy ETFs. Therefore, JGB purchases are a major tool for expansion of the monetary base. As long as the link between forward guidance and the monetary balance expansion policy is maintained, a substantial cut is unlikely.

◆ Change from monthly schedule to quarterly schedule is an excellent move

Meanwhile, the second change, in the scheduled time frame from monthly to quarterly, is a new attempt. According to the minutes of the "Bond Market Group" meeting released a day before the announcement of the quarterly schedule, there were many opinions that were concerned about a decline in market functioning. There was also a comment about operations for market adjustments (see below). It appears that the BOJ decided to change the scheduled time frame, giving consideration to these opinions from market participants.

Minutes of the 13th round of the "Bond Market Group" meetings (released on 28 Jun 2021)
The reduction in the size and the frequency of outright purchases of JGBs in April was appropriate in terms of maintaining market functioning. However, frequent changes in the purchase size would rather draw attention to the Bank's market operations. Hence, we believed it might be better to make changes to the purchase size about once every three months.

We think that this is an excellent move. This is because adjustments to the offer amounts are indispensable in terms of the YCC policy (adjustments have never been abandoned). When the BOJ changes the offer amounts frequently, its purchase operations (which have strong influence on the market) inevitably become the biggest point of focus in the daily market. In other words, an unavoidable demerit of the YCC is a decline in market functioning. Amid the prolongation of monetary easing, how to control the decline was an important issue.

In the monthly schedules thus far, the BOJ's adjustments to market changes over the past month (from the previous release to the latest release) tended to attract excessive attention. Due to the change to a quarterly schedule, we interpret it from a broader perspective, including considerations regarding the loan-deposit gap and an increase in the macro add-on balance. The divergence between the BOJ's long-term macro policy and the market's time frame, which is partially influenced by short-term speculation, creates unnecessary confusion (expectations for interpretation), but that is expected to decrease.

Due to fixation on the offer amounts in the quarterly schedule, fine-tuning cannot be made for daily operations, which is a bottleneck. However, this will not be a major demerit as confidence in the YCC has now increased. A quarterly schedule is very compatible with the new policy of aggressive allowance of market fluctuations since the assessment meeting as well as the introduction of tools to cope with remote possibilities (such as fixed-rate purchase operations for consecutive days). The BOJ has already established a framework for nimbly implementing powerful adjustments if needed, while continuing to minimize the level of market intervention. The latest change in the operation schedule is in line with the main objectives since the assessment meeting, giving us the impression that the details have finally been determined.

Going forward, if the accumulation of forced savings on a macro basis turns into consumption and fiscal spending expands via a supplementary budget, a premium is likely to appear more directly than before due to fiscal deterioration and a rise in economic/inflation expectations (if expectations are disappointed, yields are likely to retreat). If market fluctuations triggered by a change in the macro economy increase the possibility for investor earnings opportunities and losses, one could say that JGB market participants who have become accustomed to the YCC policy have finally started rehabilitation after a long stint in the hospital.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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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 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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- 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.

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