

Daiwa's View

10-year JGB yield of 0%

- Reduction in Sep operation schedule deserves attention

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp



Daiwa Securities Co. Ltd.

Reduction in Sep operation schedule deserves attention

10-year JGB yield of 0%

The yield curve in the US Treasury market flattened yesterday (the 5-year yield edged up from 0.65% to 0.67%, but the over 10-year zone was unchanged).

When the news was released that the ADP report substantially undershot the market estimate, the 5-year yield and the 10-year yield declined to exactly 0.6% and the 1.12% level, respectively. However, when Fed Vice Chair Richard Clarida expressed his opinion that tapering would start later this year and rate hikes would occur in 2023, the 5-year yield rose sharply from 0.6% to 0.69%. The fact that short-term/intermediate yields advanced sharply in response to the vice chair's comment, which was consistent with existing messages, means that slightly excessive speculation on a delay in rate hikes is growing in the market, and such speculation has been suppressed.

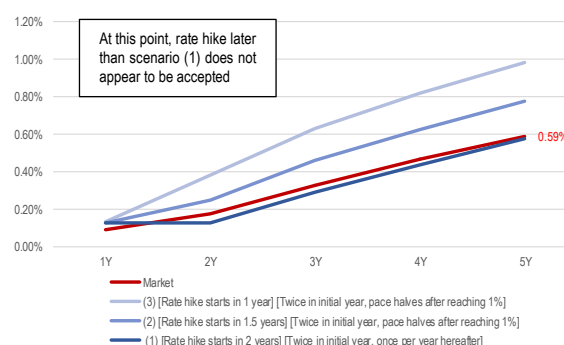
If Vice Chair Clarida's comment is the consensus of the chair and vice chairs (which is likely), last night's 5-year yield of 0.6%, which reflects rate-hike expectations, will be the near-term bottom. Meanwhile, if the Fed's stance is more hawkish than the market estimate—i.e., it doesn't put emphasis on an economic peak or the spread of the Delta variant—this will diminish expectations of reflation via high-pressure economic policies, which could easily lead to the resurgence of a flattening bias.

US Treasury 5-year Yield



Source: Bloomberg; compiled by Daiwa Securities.

US OIS Yield Curve by Rate-hike Scenario (timing, pace)



Source: Bloomberg; compiled by Daiwa Securities.

Yesterday, [the details](#) of quarterly refunding were announced. (The total amount was disclosed on 2 Aug.) For August, the scheduled auction size of coupon-bearing bonds was unchanged, as expected, while that of TIPS was increased by \$1bn. In addition, in the previous May documents, the advisory committee proposed cutting the issuance of

Treasuries in the future. This time, the Treasury Department stated that it “will continue to monitor the fiscal outlook while considering potential ways to reduce auction sizes in a manner that is aligned with borrowing and liquidity needs. ... with an expectation of announcing an initial set of auction size reductions as soon as the November refunding announcement.” The issuance of Treasuries is likely to decrease, although this is in line with our forecasts and the market consensus. If the reduction starts in November, the Treasury issuance amount will decrease at almost the same time as tapering. Therefore, positive and negative factors regarding supply/demand conditions for Treasuries are likely to offset each other.

◆ 10-year JGB yield reached 0%

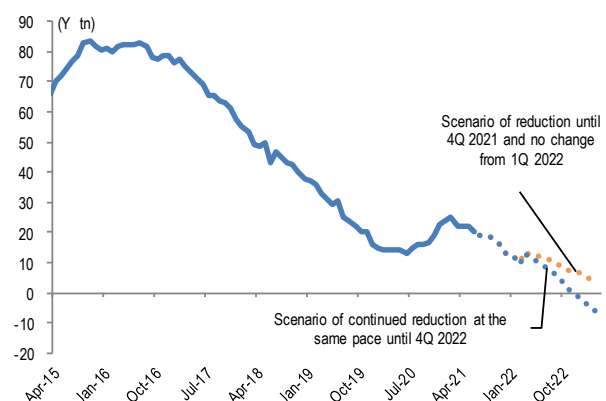
Yesterday, the yield of on-the-run 10-year JGBs finally reached 0%. The 10-year German Bund yield also fell to a threshold of -0.50%, with the 30-year yield also falling into negative territory. As such, falling yields are a global phenomenon. JGB yields are also unable to resist this trend, facing downward pressure. Up to the 10-year sector, yields are no longer positive, which is creating downward pressure in the superlong zone as well, with the 20-year yield declining to around 0.37%. In light of the absolute value, we have not seen this level for a while. However, a 10-year/20-year spread of 37bp is the median of our estimate range (30-45bp), and the 10-year forward 10-year yield is at 0.76%. This is not a situation like with US yields, in which one would need to point out a sense of overheating. If the 10-year JGB yield remains 0%, flattening is likely to intensify towards a 10-year/20-year spread at the mid-30bp level.

Moreover, the medium/long-term impact of a 10-year JGB yield of 0% at this stage is strong. If the threat of a 10-year JGB yield of 0% continues, the market will inevitably sense a cut in JGB purchase amounts in the operation schedule to be announced in September. However, in the operation schedules released in March and June, the purchase amount was decreased by Y250bn each time for two consecutive quarters. If the BOJ reduces the amount again in September, the issue of consistency with the current policy framework of expanding the monetary base will attract attention ([Second fork in the road is approaching](#)). In this regard, the Summary of Opinions from the Monetary Policy Meeting on 15-16 July included the opinion that “it is important not to tighten monetary policy prematurely,” which may have been a warning from a reflationist board member regarding the policy of expanding the monetary base. The cornerstone of the yield curve control policy is the balance between quantity and interest rates. If this warning heightens the hurdle for cutting purchase amounts in the schedule to be released in September, JGB yields are likely to face downward pressure similar to that in the global market.

Summary of Opinions at Monetary Policy Meeting on 15-16 July 2021 (28 Jul 2021)

- Even though the year-on-year rate of change in the CPI excluding fresh food is likely to increase on the back of a rise in commodity prices, there is a long way to go to achieve the price stability target of 2 percent and maintain that level in a stable manner. Thus, it is important not to tighten monetary policy prematurely.

Increase in Amount Outstanding of JGB Holdings at BOJ (y/y)



Source: Bloomberg; compiled by Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

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

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- 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

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association