

# Daiwa's View

## Have JGBs started to outperform US Treasuries?

- Possibility of more active investment in bonds in Japan and Europe, where monetary policy stance differs from the Fed's

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Daiwa Securities Co. Ltd.

### Possibility of more active investment in bonds in Japan and Europe, where monetary policy stance differs from the Fed's

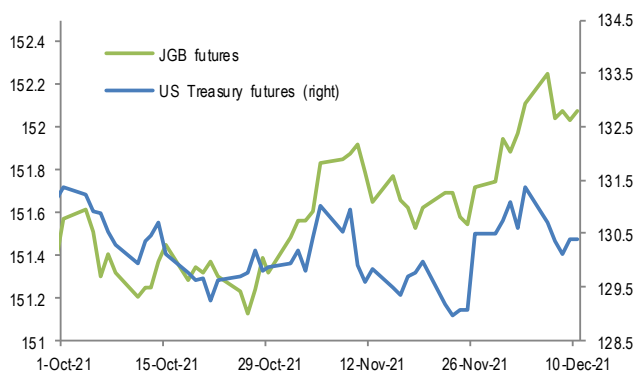
### Have JGBs started to outperform US Treasuries?

According to *International Transactions in Securities* (weekly; based on reports from designated major investors) released yesterday, it was revealed that Japanese investors took a flexible and contrarian approach, buying foreign stocks and selling bonds, during 28 November-4 December when panic in the market amid the turmoil caused by the Omicron variant led to bond purchases and a plunge in stock prices. It seems that they were able to solidly secure profit amid a drop in yields that was [difficult to justify in terms of fundamentals](#).

Meanwhile, yesterday's data also revealed that net buying of JGBs by overseas investors exceeded Y2tn during the same period. During this series of developments including the emergence of concerns about Omicron and the subsequent easing of such concerns, outperformance of JGB futures vs. US Treasury futures was somewhat noticeable (chart below). Growing investment by overseas investors was also seen in the cash bond market.

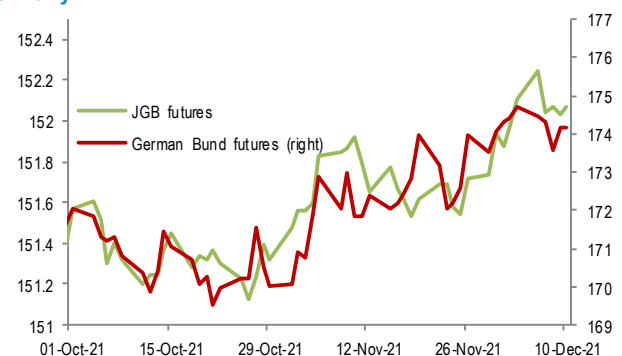
That said, comparing prices of JGB futures with their US and European counterparts, prices of JGB futures have mostly moved in parallel with those of German Bund futures. We thus do not have the impression that JGBs are the only target of speculative purchases by overseas investors. On the contrary, JGB and European bond futures started to outperform US Treasury futures after the November FOMC meeting. While the Fed is becoming more hawkish due to rising inflation, we suspect the possibility of increasing investment in bonds in Japan and Europe, where monetary policy stance is different from the Fed's stance.

Prices of Long-term Gov't Bond Futures in Japan and US



Source: Bloomberg; compiled by Daiwa Securities.

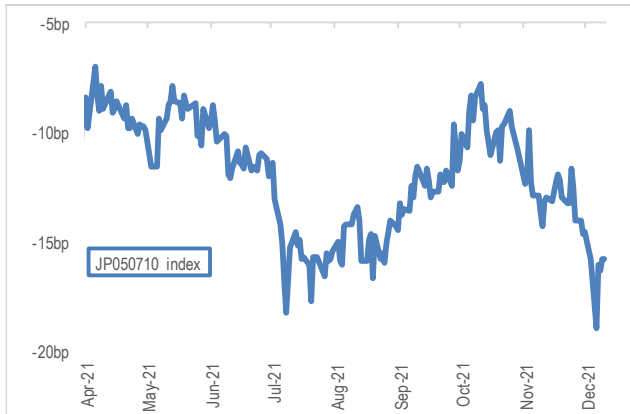
Prices of Long-term Gov't Bond Futures in Japan and Germany



Source: Bloomberg; compiled by Daiwa Securities.

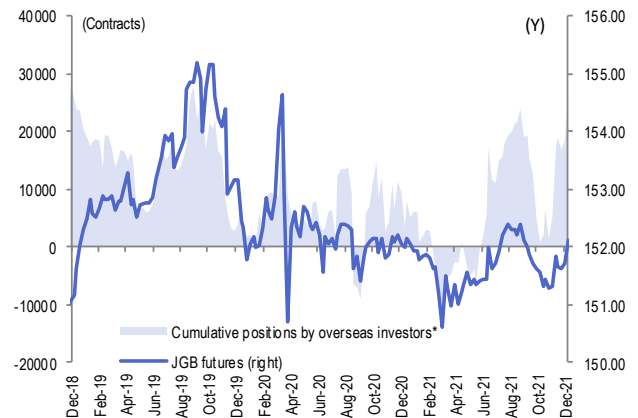
In the recent JGB market, overseas investors' net buying of JGB futures (purchases increased by more than 8,000 contracts since the emergence of the Omicron variant) and the richness of the 7-year zone (decline in the 5-year/7-year/10-year butterfly spread) garnered attention. In the case that this is not speculative moves but front-loaded investment, then even if we see a decline in the futures' investment balance going forward, this may lead only to moves to resolve distortion of the yield curve, instead of an upward shift of JGB yield levels overall."

JGB 5-yr/7-yr/10-yr Butterfly Spread



Source: Bloomberg; compiled by Daiwa Securities.

JGB Futures Price, Cumulative Positions by Overseas Investors

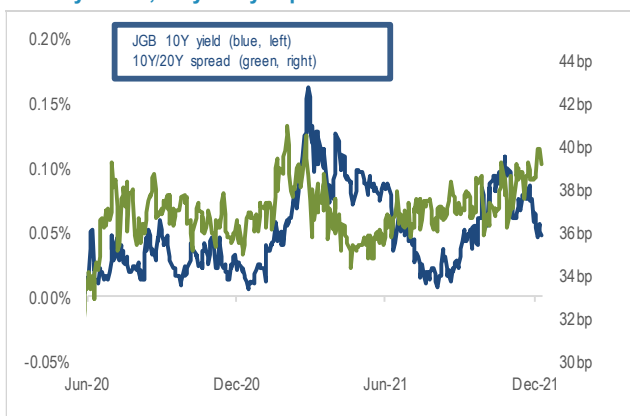


Source: Bloomberg, JPX; compiled by Daiwa Securities.  
\*Positions immediately after introduction of YCC regarded as 0.

Over the past several days, we have finally seen signs of outperformance of the 20-year JGB yield, which had been consistently underperforming. This can be also regarded as a move toward resolving underperformance, albeit slightly, while the 20-year sector has cheapened the most in the past two-year span in light of the balance with the 10-year absolute yield level as the 10-year/20-year spread temporarily widened to above 40bp.

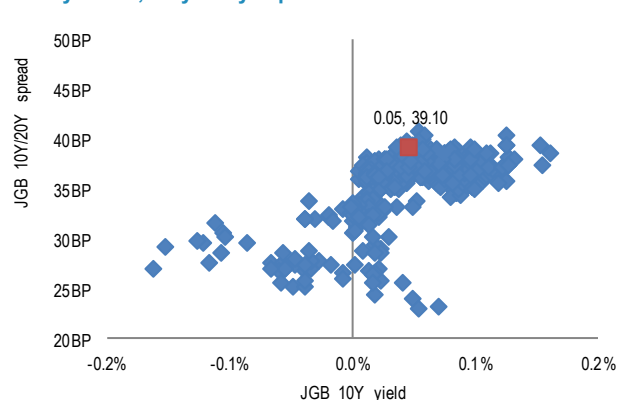
In [a recent Daiwa's View report](#), we pointed out the possibility that the JGB yield curve is prone to regressive steepening pressure in the initial stage of full-scale flattening of US Treasuries<sup>1</sup>. Increased investment in JGBs by overseas investors, which was confirmed in the latest *International Transactions in Securities*, and improved performance of JGB futures vs. US Treasuries may imply that the underperformance of JGBs is finally approaching its end.

JGB 10-yr Yield, 10-yr/20-yr Spread



Source: Bloomberg; compiled by Daiwa Securities.

JGB 10-yr Yield, 10-yr/20-yr Spread



Source: Bloomberg; compiled by Daiwa Securities.

<sup>1</sup> Daiwa's View [Will flattening spread to JGBs?](#) (11 Nov 2021).

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