

Daiwa's View

Have yields risen a bit too far?

- Using the average JGB yield since introduction of YCC policy as the centerline, the yield curve is currently the opposite of what it was in Sep 2019

Fixed Income Research Section
FICC Research Dept.

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



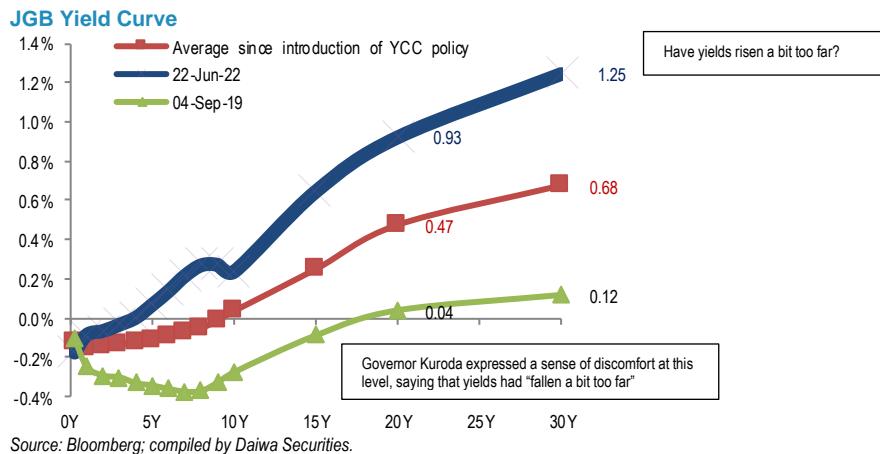
Daiwa Securities Co. Ltd.

Using the average JGB yield since introduction of YCC policy as the centerline, the yield curve is currently the opposite of what it was in Sep 2019

Have yields risen a bit too far?

Yesterday's 5-year JGB auction managed to go smoothly, as expected. However, caution about tomorrow's 20-year JGB auction is growing in the JGB market, in which the hedging function of futures is declining due to speculation about policy revisions by the BOJ amid further depreciation of the yen. Yesterday, the 20-year JGB yield closed at 0.92%.

On 6 September 2019, BOJ Governor Haruhiko Kuroda warned against an excessive decline in the yield curve, saying that yields had "fallen a bit too far." The BOJ started to induce the yield curve to steepen via a substantial cut in the scale of *Rinban* operations in the superlong zone when the 20-year JGB yield was about to fall into negative territory. Here, we compare the yield curve as of 4 September 2019, when yields had "fallen a bit too far," with the yield curve yesterday, and the average yield since the introduction of the yield curve control (YCC) policy. On 4 September 2019, the 20-year yield stood at 0.04% (-43bp vs. the average of 0.47%), and it is now at 0.93% (+46bp). The 30-year yield stood at 0.12% then (-56bp vs. the average of 0.68%), and is now at 1.25% (+57bp). As shown by this balance, using the average since the introduction of the YCC policy as the centerline, the yield curve is currently almost the opposite of what it was in September 2019.



This implies that the yield curve has currently reached a position at which yields can be judged to have risen a bit too far from an objective viewpoint. If the situation is unchanged or worsens after tomorrow's 20-year JGB auction, there could be a substantial increase in the amount of superlong JGBs expected to be purchased in the *Quarterly Schedule of Outright Purchases of Japanese Government Bonds* for Jul-Sep 2022 to be released at end-June.

◆BOJ Governor Kuroda's interview with *Nikkei* (6 Sep 2019)

- (Superlong JGB yields) have fallen a bit too far. Returns for life insurers and pension funds have declined significantly, and it has a negative impact on consumer sentiment. Of course, we'll adjust the volume and timing of our superlong bond market operations as necessary.

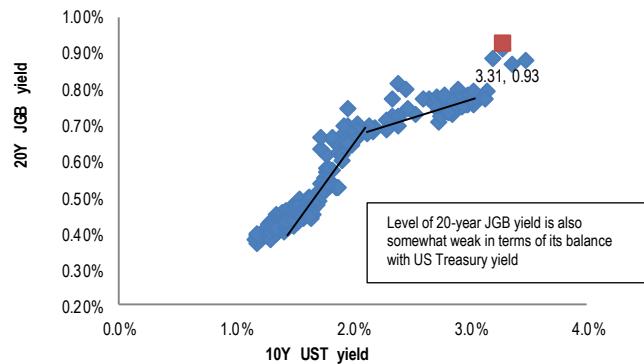
Viewing the current JGB yield curve from a broader perspective, we found that it is distorted, with a concave shape in the 10-year zone due to fixed-rate purchase operations for 10-year JGBs at 0.25%. In addition, the fact that the 7-year yield is approaching 0.25% is one factor behind the decline in the functioning of bond futures. It can be said that this situation indicates that the YCC policy is approaching a critical stage in which the BOJ will be forced to choose between one of two options—either revise the level of YCC (or withdraw from the policy) or substantially increase the scale of *Rinban* operations across the entire curve.

Of course, if the scale of *Rinban* operations were to be substantially increased, it would change an unspoken agreement between the BOJ and the market. That said, thinking about Governor Kuroda's comments, which were the trigger for the creation of this agreement, we found that it was the adjustments to the volume and timing, as needed, in response to the yield curve that had "fallen a bit too far." Of course, it is a well-known fact that Governor Kuroda was keeping in mind the possibility that a decline in investment returns for life insurers and pension funds might have a negative impact on economic activity due to psychologic reasons.

Therefore, it would be logical to think that the volume and timing of operations could be adjusted as needed if the situation changes to one with an excessive rise in yields and people are more concerned about a negative impact on economic activity because of psychologic reasons due to less confidence in the YCC policy (caused by an excessive rise in yields).

Also, while it is not a very decisive factor, the 20-year JGB yield has recently diverged upwards with regard to the balance it has had with the 10-year US yield (chart below). In particular, a surge over the past several days shows strong underperformance against swaps. This situation may also highlight weak demand for superlong JGBs—i.e., a need to increase the scale of *Rinban* operations. In any case, tomorrow's 20-year JGB auction and the subsequent shape of the yield curve will be the most noteworthy items in forecasting the quarterly *Rinban* operations to be released at end-June and future YCC operations.

10Y US Yield, 20Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

20Y JGB Yield, Swap Rate, Swap Rate Spread



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, Japan Security Token Offering Association