

## 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

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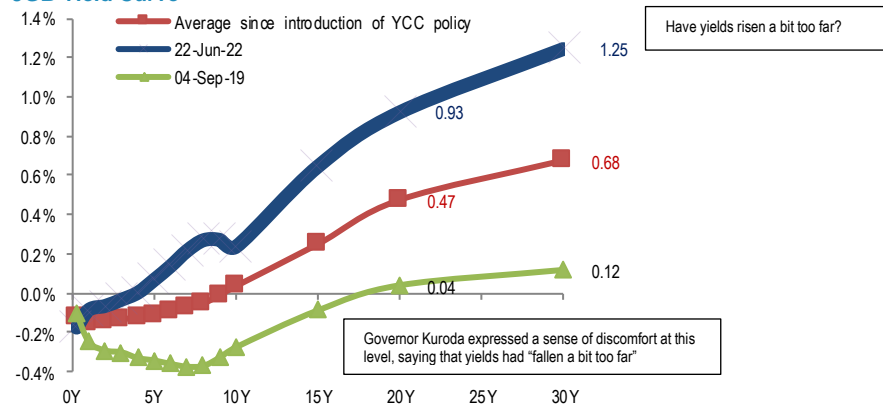
**Using the average JGB yield since introduction of YCC policy as the centerline, the yield curve is currently the opposite of what it was in Sep 2019**

**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.

**JGB Yield Curve**



Source: Bloomberg; compiled by Daiwa Securities.

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.

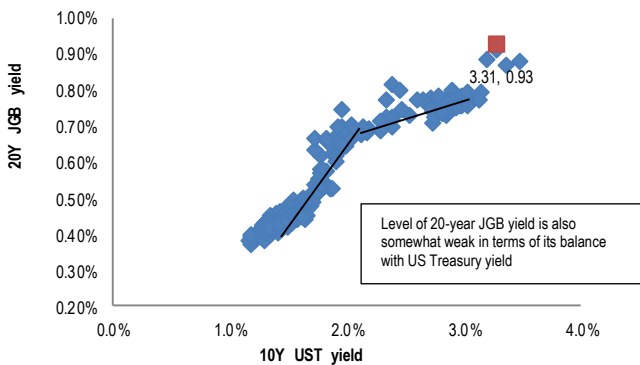
Viewing the current JGB yield curve from a broader perspective, we found that it is distorted, with a concave shape in the 10-year zone due to fixed-rate purchase operations for 10-year JGBs at 0.25%. In addition, the fact that the 7-year yield is approaching 0.25% is one factor behind the decline in 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).

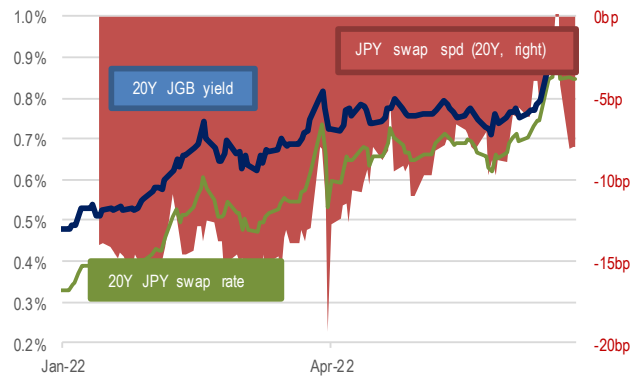
Also, while it is not a very decisive factor, the 20-year JGB yield has recently diverged upwards with regard to the balance it has had with the 10-year US yield (chart below). In particular, a surge over the past several days shows strong underperformance against swaps. This situation may also highlight 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.

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