

Daiwa's View

JGB yields have started to outperform US yields

- Are stock effects greater than initially projected?

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Daiwa Securities Co. Ltd.

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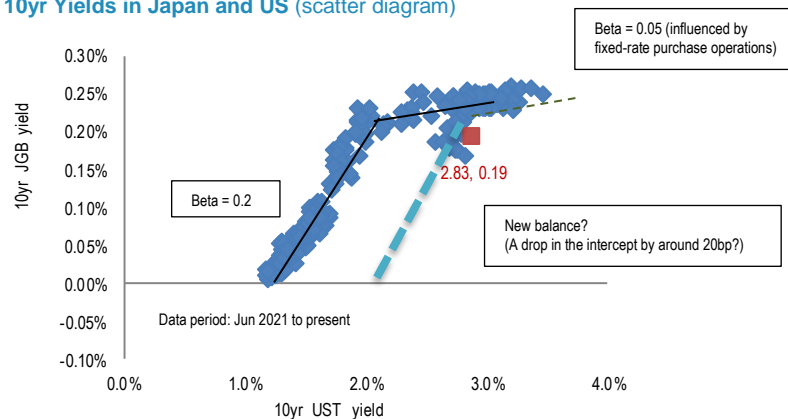
◆ JGB yields have started to outperform US yields

Recently, downward pressure on JGB yields has been strong. Compared to the balance in the past, JGB yields tend to outperform US yields. It has been frequently pointed out that the factors behind this include the unwinding of the attack by overseas speculators on the yield curve control (YCC) policy and the rise in hedging costs for investment from the yen (the yield of hedged 10-year US Treasuries falling into negative territory). These are also important factors in [the yield outlooks](#) in *Daiwa's View* reports, and they actually appear to be contributing to the decline.

That said, we get the impression that JGB yields are remarkably strong even considering the above-mentioned factors. Of note is that the beta of the 10-year JGB yield against the 10-year US yield seems to be recovering 0.2 (currently, when the US yield is still at 2.8%). Confirming the 10-year US and JGB yields since June 2021 (chart below), the 10-year JGB yield was around 0.24% when the 10-year US yield was at the 2.8% level. However, movements under the new balance appear to have begun since the July Monetary Policy Meeting.

If we assume that the 10-year JGB yield will follow the decline in the 10-year US yield from this position in line with a beta of 0.2, it is calculated that (1) the 10-year JGB yield will decline to the lower 0.1% level as the 10-year US yield returns to the neutral level and (2) the JGB yield will decline to around 0% when the US yield declines to 2%. (Note: In the case of a rise, the beta declines due to the existence of fixed-rate purchase operations.) Of course, it is too early to draw conclusions, so we need to verify this going forward using data. However, if this tendency is true, it can be said to be a major change for JGB market participants.

10yr Yields in Japan and US (scatter diagram)



Source: Bloomberg; compiled by Daiwa Securities.

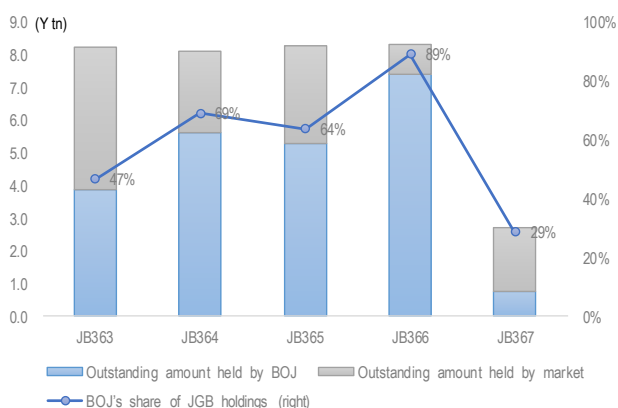
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Assuming this change happened around the time of the attack on the YCC policy, we surmise that one factor was “stock effects” (the impact of the total amount of bonds taken away from the private sectors by the BOJ). In the first half of the year, the BOJ bought JGBs worth around Y14tn in the 7- to 10-year zones via unscheduled operations to cope with the attack on the YCC policy by overseas speculators (of which, slightly more than Y11tn worth of JGBs were bought in fixed-rate purchase operations). Y14tn is equivalent to about 1-2% of the total amount of JGBs issued. In *Daiwa's View* reports, we estimated that this change in the BOJ's share of JGBs had the effect of lowering the 10-year JGB yield by around 3bp (1.5% x beta of 0.02). Regarding the beta, we used the BOJ's estimated results in the September 2016 Comprehensive Assessment and the March 2021 Assessment, in which the beta vs. the BOJ's share of JGB holdings (%) was 0.02 in both cases.

However, the above-mentioned data suggests the possibility that yields have declined much more than this estimate. We, therefore, need to reconfirm the premise. While the existing projection for the beta against the BOJ's share of JGB holdings is 0.02, we point out the following factors that could possibly lead to the beta rising above the existing projection.

1. **Marginal beta:** In the September 2016 Comprehensive Assessment and the March 2021 Assessment, the beta of 0.02 was calculated in the process of the BOJ's share of JGB holdings increasing towards 50%. However, if we assume that stock effects will strengthen linearly against the BOJ's share of JGB holdings, there is a possibility that the marginal beta is around 0.04 (double the existing projection). Marginal stock effects may be stronger than the past average.
2. **Average residual maturity:** The average residual maturity of JGBs held by the BOJ as stocks is about 6.5 years. Meanwhile, the average maturity of JGBs that were bought via fixed-rate purchase operations during the attack by overseas speculators on the YCC policy is about 9.3 years. Accordingly, there is a possibility that the average residual maturity will have a stronger effect than the amount purchased.
3. **Concentration on the 10-year sector:** The BOJ's share of JB364-366, which were the targets of fixed-rate purchase operations as of June, is 74%. The BOJ's share of JB366 is particularly high at about 90% (chart below). This share may be increasing stock effects in the 10-year sector in a slightly distorting manner. (However, this effect is expected to diminish over time.)

10yr JGBs by Maturity Basket: Outstanding Amounts Held by BOJ and by Market



Source: BOJ; compiled by Daiwa Securities.

Accepted Amounts in Fixed-rate Purchase Operations in 2022 (Y bn)

	Accepted amount	Neighboring issues of on-the-run 10yr JGB	Cheapest (JB356)
Feb	0	0	0
Mar	593.1	593.1	0.0
Apr	2,883.4	2,883.4	0.0
May	0	0	0
Jun	7,830.4	7,030.9	799.5
Jul	0	0	0
Total	11,306.9	10,507.4	799.5

Source: BOJ; compiled by Daiwa Securities.

Considering these factors, even if we presume that the 20bp drop assumed on the previous page is temporary, we still need to brace for stock effects of greater than -10bp in the near term. It could be that JGB yields may be more inclined to fall than before the attack by overseas speculators on the YCC policy. Therefore, it may be wise to wrap up minimal purchases before other investors return to full-scale investment in JGBs.

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