

Daiwa's Economic View

FICC Research Dept.

Banks' room to absorb JGBs: Deposit-loan gap and IRRBB regulation

- Deposit-loan gap continues to narrow
- IRRBB gives banks scope to purchase Y390tn in 2-year JGBs and Y80tn in 10-year JGBs

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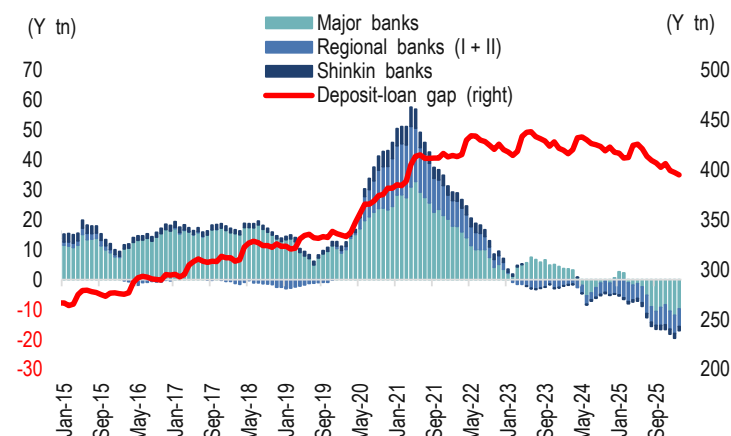

Daiwa Securities Co. Ltd.

Even before the Bank of Japan (BOJ) began quantitative tightening (QT), a central question in the JGB market was who would hold government bonds in place of the BOJ. A year and a half has now passed since the BOJ started QT, yet banks have increased their JGB holdings only modestly. Two factors explain why banks have not accumulated more JGBs: the narrowing deposit-loan gap, and constraints under interest rate risk in the banking book (IRRBB) regulation.

Deposit-loan gap continues to narrow

February loan and deposit data showed total outstanding loans at banks and *shinkin* banks rising 4.5% y/y (average balance basis), while deposits grew only 1.1%, extending the downtrend in the deposit-loan gap that has continued since April 2024. The gap has shrunk by around Y43tn from its peak of around Y439tn. Banks fund their securities investments from the deposit-loan gap, the portion of deposits not lent out. Accelerating capital flows and rising lending as the economy picks up are welcome developments, but from a bond and interest rate perspective, they represent a headwind.

Chart 1: Deposit-Loan Gap (y/y, original data)



Source: BOJ; compiled by Daiwa.

Note: Based on average amounts outstanding. The original data for the deposit-loan gap is the total for major banks, regional banks (I + II), and shinkin banks.

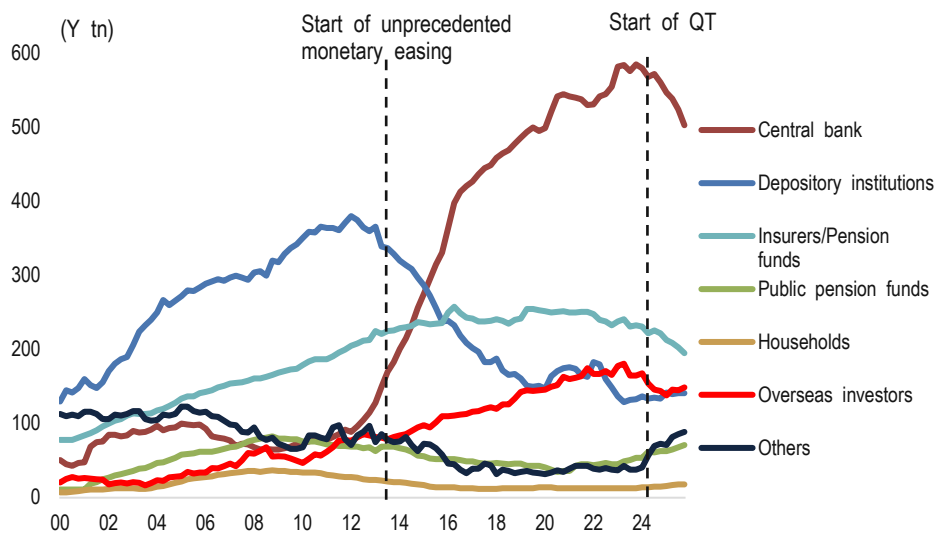
IRRBB and banks' capacity to purchase JGBs

Under the Basel framework's IRRBB rules, banks are required to quantify the interest rate risk in their banking books and keep it within prescribed limits.

Banks earn profits primarily by funding themselves with short-duration liabilities (deposits) and investing in longer-duration loans and securities, capturing the term spread. This inherently generates interest rate risk, which IRRBB constrains to prevent it from becoming excessive¹.

As noted, roughly a year and a half has passed since the BOJ started QT, and while its JGB holdings have declined as bonds mature, the entities that have most expanded their holdings are public pension funds and the "other" category. Depository institutions (including banks)² have seen only a modest increase. Banks were the largest holders of JGBs before quantitative and qualitative easing (QQE) began, and many observers cite both expectations of higher interest rates and regulatory constraints as reasons why banks have not accumulated more bonds under the current QT³.

Chart 2: JGB Holdings by Type



Source: BOJ; compiled by Daiwa.

Note: Figures are on a market value basis.

With the BOJ expected to continue with QT, we look next at how much capacity banks have to purchase JGBs. When assessing interest rate risk under IRRBB, both the volume of holdings and their maturity are key considerations. Short- and medium-term bonds with lower interest rate risk are easier for banks to hold, while super-long bonds are relatively more difficult. Chart 3 shows our rough estimates of banks' (major banks + regional banks) JGB purchasing capacity by maturity. The figures indicate that banks collectively have capacity to purchase around Y390tn in 2-year JGBs and roughly Y80tn in 10-year JGBs⁴.

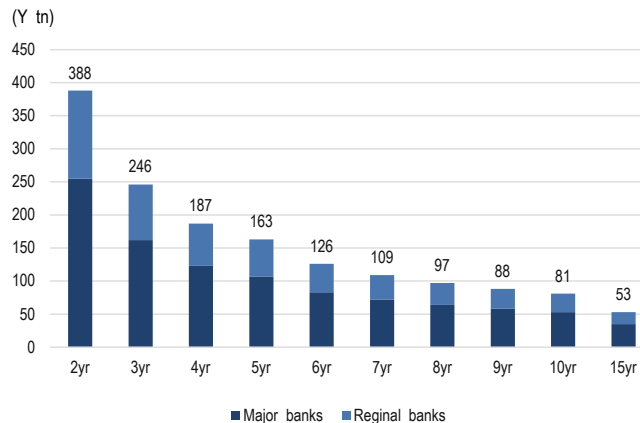
¹ Under IRRBB, banks are required to disclose their interest rate risk as measured by the decline in economic value of equity (Δ EVE) and the reduction in net interest income (Δ NI). In the context of debt management policy, Δ EVE tends to receive more attention; this report treats interest rate risk as equivalent to Δ EVE.

² "Others" is the total of "securities investment trusts," "other financial intermediaries," "financial auxiliaries," "public captive financial institutions," "non-financial corporations," "general government (excluding 'public pension funds')," and "private nonprofit institutions serving households." A closer look reveals that within the "others" category, holdings of T-bills (TDBs) by the "general government" and holdings of JGBs by "other financial intermediaries" have been increasing since the start of QT.

³ The summary of discussions from the "Study Group on Government Debt Management" on 21 June 2024 stated that "Since 2013, there have been constraints from regulations on capital and risk management frameworks, such as the phased implementation of Basel III."

⁴ Estimates based on the latest available data (Sep 2025).

Chart 3: Banks' JGB Purchasing Capacity Under IRRBB (by maturity)



Source: Disclosure materials; compiled by Daiwa.

The BOJ currently holds around Y500tn in JGBs. Our purely numerical simulation shows that if banks were to buy only 2-year JGBs, they could absorb roughly 80% of the BOJ's holdings. In 10-year bond equivalent terms, however, they could absorb only 16%. JGBs that banks cannot hold will need to be distributed to a diverse range of investors, including households, nonresident investors, and non-financial corporations. These investors could demand higher premiums in the process, implying higher refinancing costs.

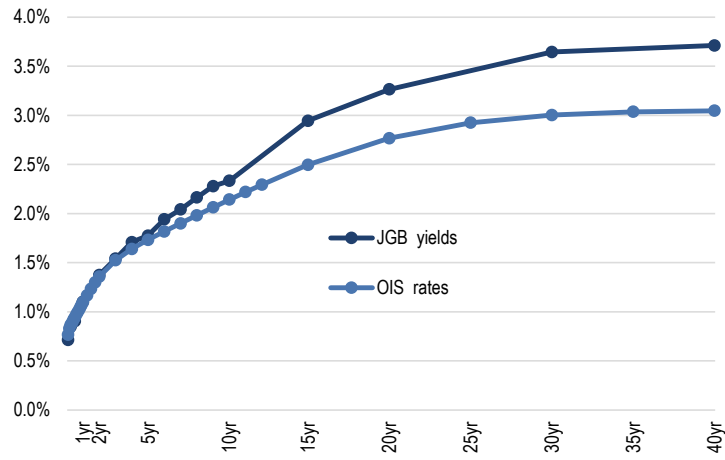
Naturally, a heavy concentration of new issuance in short- and medium-term maturities would also not be desirable from a debt management perspective. Shortening issuance maturities may ease near-term market absorption, but it increases the interest rate risk borne by the sovereign as issuer. That said, the Ministry of Finance (MOF) plans to introduce "mid-year hearing" from this fiscal year to increase flexibility in its JGB issuance plans. This indicates a growing move to flexibly adjust issuance maturities in response to changing market conditions.

The 2 April 10-year JGB auction, the first of the new fiscal year, produced a weak result with a tail of Y0.36, the largest since August 2024. With the narrowing deposit-loan gap and IRRBB compliance effectively capping banks' JGB purchasing capacity, we think the BOJ's interim review and MOF's mid-year hearing scheduled for June will be important forums for deepening the discussion on what JGB holdings should look like, including [where balance sheets ultimately settle](#).

(Appendix)

The maturity-specific purchasing capacity shown in Chart 3 also appears to have explanatory power for asset swap (ASW) spreads (JGB yield minus swap rate) across the maturity spectrum. JPY ASW spreads tend to widen, indicating relative cheapening of JGBs, from the 5-year point onward (Chart 4). One explanation is that the regulations described above make it increasingly difficult for banks to hold JGBs as duration lengthens.

Chart 4: JPY Yield Curves



Source: Bloomberg; compiled by Daiwa.
Note: Data as of 31 Mar.

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