

JGB Insight

Tolerance against uptrend in overseas yields

- ✓ JGBs in the short- to long-term zone of the curve show certain degree of tolerance against the rise in overseas yields
- ✓ The yield curve shape in the zone is unlikely to change substantially under the YCC policy
- ✓ JSs with 5 years left to maturity including JS135 are expected to have a very small return, according to the total return analysis
- ✓ Buying 5Y on dips at -0.095 - -0.085% level

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Confirmed tolerance of JGBs against rise in overseas yields

This week, the JGB market appears to have gone through the 5Y JGB auction, conducted on May 17 by the Ministry of Finance (MOF), smoothly at the level around the top of the recent 5Y JGB yield range, amid growing caution about rising US long-term interest rates. On May 16, the 10Y US Treasury (UST) yield rose to 3.10% at one point for the first time in six years and ten months. On the other hand, the 10Y JGB yield has been quite stable at around 0.05% in comparison to the UST yield. As recently-announced economic indicators, including inflation readings, appear mixed, the outlook for US long-term interest rates seems to be divided—the pessimistic view (expecting further rise) and the optimistic view (projecting that rates will remain flat). In Japan, the Jan-Mar GDP, which was expected to post negative growth, was weaker than expected when announced on May 16. Regarding the GDP results as well, there are both pessimists (viewing that economic growth has paused) and optimists (expecting recovery in Apr-Jun). However, the GDP data are at least not something that could destabilize the BOJ's yield curve control (YCC) policy. In particular, the short-term to long-term zone of the JGB yield curve appears to be increasing the tolerance against the rise in overseas yields under the YCC policy, which sets the targets to control short-term and long-term interest rates. This is shown by, for example, the correlation between 10Y JGB and US Treasury yields during the two periods: (1) the BOJ's QQE expansion from October 2014 to September 2016 and (2) the YCC policy from September 2016 to date (Chart 1). As both yields were relatively highly correlated and the volatility of the 10Y JGB yield vs. the 10Y US Treasury yield was high under the BOJ's QQE expansion. Under the YCC policy, however, we can confirm a substantial decline in the correlation and the volatility, as witnessed by a plunge in both figures.

The yield curve shape in the short- to long-term zone is unlikely to change substantially under the YCC policy

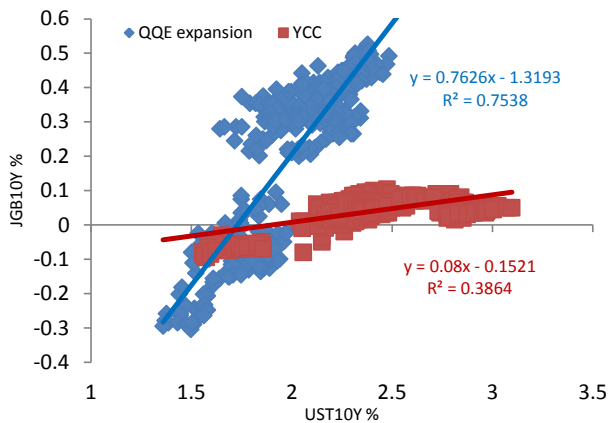
As we reported last week, the BOJ removed the wording on the timing for reaching the 2% inflation target, which was previously set in "around FY2019", in the April 2018 *Outlook for Economic Activity and Prices Report* released on April 27. Partly because of this, the *Summary of Opinions at the Monetary Policy Meeting on April 26-27*, announced on May 10, garnered attention by JGB market participants. Regarding the removal, their initial interpretation was divided into two—"duration of monetary easing extended" or "paving the way for normalization with more flexible measures." However, the Summary of Opinions did not show that the wording was removed based on the consensus among policy board members reflecting a clear policy direction. That, combined with BOJ Governor's remark on the inflation outlook in his speech on the same day, "If anything, risks are slanted to downside", makes us easier to get a hunch that the current monetary policy would last for long than to read and find a sign on normalization. Although we need to carefully watch the outlook of US long-term interest rates, the shape of the yield curve is unlikely to change substantially, especially in the short-term to long-term zone, over the medium/long term.

JSs with 5 years left to maturity including JS135 are expected to have a very small return

In such an environment, thinking of investment with better carry even slightly especially in the short- to intermediate-term zone, we find that 5Y JGBs with about 5 years left to maturity (including JS135) appear unattractive to (1) 10Y and 20Y JGBs with about 5 years left to

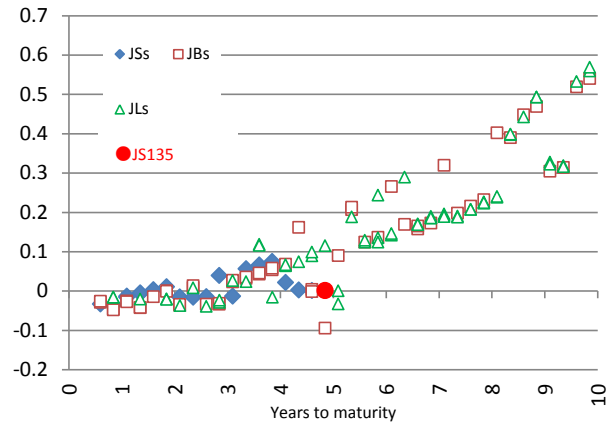
maturity and (2) 5Y JGBs with about 3-4 years left to maturity (Chart 2). With the start of the new reserve maintenance period, there are supportive factors for the 5Y sector on the JS curve, such that the money market has been stabilized as witnessed by a fall in the GC repo rate and expected subsequent decline in TDB yields. However, we would like to take an opportunity to buy 5Y JGBs with about 5 years left to maturity, like JS135, at the -0.095 - -0.085% level, rather than chase the upside from -0.100%.

Chart 1: Correlation between JGB and UST in 10Y



Source: Daiwa Securities

Chart 2: JGB Total Return Curve (3M, %)



Note: Based on JB, JS and JL yield curves on May 16, respectively; Assuming that those yield curve shapes do not change a

[BOX] May BOJ JGB Purchase Schedule (as of May 17)

(Yen billions)

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker
5/1/18	T 5/2/18	50.6			450.6			
5/2/18	W 5/7/18	AEL (2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years to maturity)						
5/3/18	TH -	Public Holiday (Constitution Memorial Day)						
5/4/18	F -	Public Holiday (Greenery Day)						
5/7/18	M 5/8/18		250.6	330.6		191.2	70.6	
5/8/18	T 5/9/18	10Y JGB Auction						
5/9/18	W 5/10/18		251.2	330.4	451.1			
5/10/18	TH 5/11/18	10Y JGBi Auction						
5/11/18	F 5/14/18					191.6	70.3	25.0
5/14/18	M 5/15/18		250.0	330.6	450.7			
5/15/18	T 5/16/18	30Y JGB Auction						
5/16/18	W 5/17/18	50.1				191.3	71.2	
5/17/18	TH 5/18/18	5Y JGB Auction						
5/18/18	F 5/21/18		◎	◎	◎			
5/21/18	M 5/22/18							
5/22/18	T 5/23/18	20Y JGB Auction						
5/23/18	W 5/24/18		◎	◎		◎	◎	
5/24/18	TH 5/25/18	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)						
5/25/18	F 5/28/18		◎	◎	◎			○
5/28/18	M 5/29/18							
5/29/18	T 5/30/18	40Y JGB Auction						
5/30/18	W 5/31/18				◎	◎	◎	
5/31/18	TH 6/1/18	2Y JGB Auction						

Note: ◎ Scheduled by the BOJ, ○ Daiwa forecast; figures for actual
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

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[Standard & Poor's]

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