

JGB Insight

BOJ trims again

- ✓ In JGB purchase operations offered on July 19, the BOJ trimmed buying of JGBs (1) in the 10-25Y zone from the previous 190 billion yen to 180 billion yen and (2) in the zone over 25Y from the previous 70 billion yen to 60 billion yen.
- ✓ The offer range in August purchase operations is attracting attention. If the current range is maintained especially in the zone over 25Y, speculations on an end to the reduction may gain momentum.
- ✓ With the offer amounts in all targeted zones assumed to be at their lower end of the current offer ranges, the BOJ's JGB holdings is estimated to increase just only about 20 trillion yen y/y from end-June 2018, a level before the introduction of the QQE.

Strategic Memorandum DSTE255
FICC Research Dept.

Senior JGB Strategist
Keiko Onogi
+813 5555 8788
keiko.onogi@daiwa.co.jp
Daiwa Securities Co. Ltd.

Trimming over 10Y

In JGB purchase operations offered on July 19, the BOJ trimmed buying of JGBs (1) in the 10-25Y zone from the previous 190 billion yen to 180 billion yen and (2) in the zone over 25Y from the previous 70 billion yen to 60 billion yen. This is the first adjustment to JGB purchase operations since the cut in the offer amount in the 5-10Y zone on June 29 (from 430 billion yen to 410 billion yen). By zone, this was the first reduction in the 10-25Y zone since January 9, and also the first cut in the zone over 25Y since February 28. In addition, this was the first simultaneous reduction in the both zones since January 9. We think that the background factors for the latest reduction are as follows:

- ✓ Since late June, the superlong zone of the yield curve has flattened at an accelerate pace;
- ✓ The buying operations on July 19 were regarded as the best timing to trim the offer amount in the zone over 10Y;
- ✓ As witnessed by a recent rebound of the USD/JPY rate to the 113 level last seen in January 2018, the yen has been weakening. In such an environment, a risk that the yen would become stronger than around the 110 level¹ (average exchange rate projected by companies) by the BOJ's reduction in the offer amount appeared limited.

Similar to the recent reduction cases, the forex and stock markets did not regard the BOJ action as a directional factor, having quite limited reactions. Regarding superlong JGBs, the market sentiment remains good especially for 20Y JGBs.

August offer rages attracting attention

Due to this cut, the offer amount in the zone over 25Y is now quite close to the lower end of the offer range set for July. This implies that there should a downward revision to the offer range for August operations. For example, if we assume the range centering on 60 billion yen, the offer range could be set as 10-110 billion yen, like the range in the zone up to one year. If the current range (50-150 billion yen) is maintained, on the other hand, speculations on an end to the reduction in the zone over 25Y may gain momentum, which may put the 20-40Y zone of the JGB yield curve under flattening pressure. This is especially so, as it appears difficult to adjust the frequency of purchases² (such as fewer purchase offers per month than now). At the moment, the emergence of such speculations must be undesirable also for the BOJ. If the BOJ does not change the guideline for its JGB purchases (by deleting/revising the aforementioned exceptional clause or integrating the offer ranges in Outline of Outright Purchases of Japanese Government Securities etc.) following the Monetary Policy Meeting on July 30-31, the offer range in the zone over 25Y for August operations will likely be revised downward with a high probability. For reference, the lowest offer amount in the 10-25Y zone and the zone over 25Y since the introduction of the QQE in April 2013 are 100 billion yen and 30 billion yen, respectively. At that time, the guideline for an annual pace of increase in the amount outstanding of the BOJ's JGB holdings was about 50 trillion yen. In Outline of Outright Purchases of Japanese Government Bonds back then

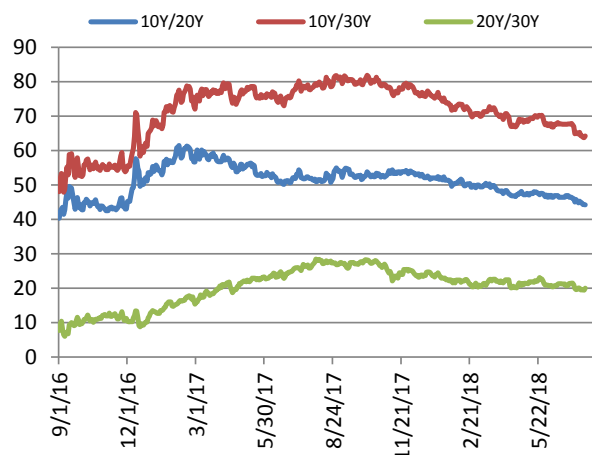
¹ Average of exchange rates expected by large manufacturing enterprises in the BOJ Tankan (June 2018)

² In Outline of Outright Purchases of Japanese Government Securities, it is said that "the Bank may increase the frequency as needed" as an exceptional clause of "Frequency of purchases," meaning that the decrease in the frequency is not assumed.

(dated on June 18, 2014, for example,) the offer range (in the combined zone for both zones—i.e., the zone over 10Y) was 130-350 billion yen.

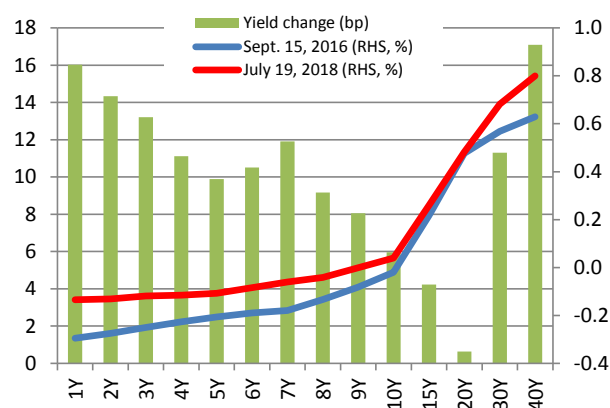
Amid weak inflation, the BOJ is expected to revise down its inflation outlook in the Outlook for Economic Activity and Prices report to be released at the end of July. In such an environment, it seems difficult for the BOJ to change or revise the monetary policy in the near term. For now, the BOJ has only a quite limited number of feasible measures. While the financial market's reactions to the BOJ's trimming buying JGBs have been diminishing, the BOJ is likely to continue to trim it in a matter-of-fact stance, carefully watching the market conditions. As an extreme example, if we assume that the offer amounts in all purchase target zones from August will be the lower end of the current offer ranges, the annual increase in the amount outstanding of the BOJ's JGB holdings from end-June 2018 is estimated at around 20 trillion yen (Table 2). If we assume the lower end of the offer range in the zone over 25Y at 10 billion, the annual increase is estimated at around 18 trillion yen. These figures are approximately the same as the average pace of annual increase before the QQE introduction (average around 19 trillion yen during the April 2012-March 2013 period).

JGB Yield Spreads (bp)



Source: Daiwa Securities

JGB Yield Change: Before and After YCC



Source: Daiwa Securities

Table 1: BOJ JGB Purchase and MOF Issuance

(Yen billions)

		Offer size per operation*		Number of Offers (per month)	Offer size**	Monthly Total exp.	MOF issuance per month in FY2018***
			Mid				
JGBs ex Linkers and Floaters							
Up to 1 year		About 10-100	55	2	50	100	-
Over 1 to 5 years	Over 1 to 3 years	About 200-300	250	6	250	1,500	2,247-2,647
	Over 3 to 5 years	About 250-350	300		300	1,800	2,140
Over 5 to 10 years		About 300-500	400	6	410	2,460	2,954
Over 10 years	Over 10 to 25 years	About 150-250	200	5	180	900	1,070-1,320
	Over 25 years	About 50-150	100		60	300	999 - 1,177**
Linkers		About 25	-	2	25	50	428***
Floaters (in even months)		About 100	-	1	100	100	-

* Scheduled by BOJ as of end-June 2018 ** As of July 19 *** Including the 2nd Non-competitive (est.) and AELs (est.). Per-issuance size for Linkers, which are issued quarterly

Source: Bank of Japan, Ministry of Finance, compiled by Daiwa Securities

Table 2: BOJ's JGB Outstanding (exp.)

	Purchase amount (face value) <A>	Redemption (face value) 	Redemption of JGBs purchased from July 2018 to June 2019 (face value) <C>	Net purchase (face value) <A-B-C>	Outstanding (face value)	Outstanding (BOJ B/S)
Jun-2018					424.6	435.4
July	8.14	1.2		6.9	431.6	
Aug	5.67	0.9		4.7	436.3	
Sept	5.57	9.6		-4.0	432.3	
Oct	5.67	0.9		4.7	437.0	
Nov	5.57	1.7		3.9	440.8	
Dec	5.67	9.5		-3.9	437.0	
Jan-2019	5.57	1.9		3.7	440.6	
Feb	5.67	1.3	0.10	4.2	444.8	
Mar	5.57	10.0	0.02	-4.5	440.4	
April	5.67	1.4	0.02	4.2	444.6	
May	5.57	1.6	0.02	3.9	448.5	
Jun	5.67	8.9	0.02	-3.3	445.2	455.7
Total redemption:			49.4	Annual increase:	20.6	20.4

Notes: actual for June 2018; "Purchase amount (face value)" in July is tentative under assumption that the purchase pace the BOJ announced on June 19 will be maintained for the rest of the month; "Redemption amount (face value)" is based on the amount outstanding of BOJ's JGB holdings by issue as of July 10 (start-day basis); "Redemption amount of JGBs purchased from July 2018 to June 2019 (face value)" is tentative, based on average purchase term to maturity in 0-1Y zone during June 2017 to June 2018 of around 7 months; regarding "Outstanding (face value)," figures are actual for June 2018 and estimates for July 2018 to June 2019; with respect to "Outstanding (BOJ B/S)," the figure on June 2018 is actual and that on June 2019 is estimated by adding gap between outstanding (face value) and outstanding (BOJ B/S) (around 10.5 trillion yen) to outstanding (face value) as of June 2019. "Total redemption" indicates the total of "Redemption (face value)" and "Redemption amount of JGBs purchased from July 2018 to June 2019."

Source: Daiwa Securities

[BOX] July BOJ JGB Purchase Schedule (as of July 20)

(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
7/2/18 M	7/3/18	50.0				190.7	70.7	25.2
7/3/18 T	7/4/18	10Y JGB Auction						
7/4/18 W	7/5/18		250.5	300.5	411.5			
7/5/18 TH	7/6/18	30Y JGB Auction						
7/6/18 F	7/9/18		250.5	300.4		191.0	70.2	
7/9/18 M	7/10/18	5Y JGB Auction						
7/10/18 T	7/11/18		250.8	300.5	410.8			
7/11/18 W	7/12/18	20Y JGB Auction						
7/12/18 TH	7/13/18				410.6	190.6	70.2	
7/13/18 F	7/17/18	Public Holiday (Marine Day)						
7/16/18 M	-		250	301				25
7/17/18 T	7/18/18	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)						
7/18/18 W	7/19/18				410.9	180.4	60.3	
7/19/18 TH	7/20/18	AEL (2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years to maturity)						
7/20/18 F	7/23/18	○	◎	◎				
7/23/18 M	7/24/18	40Y JGB Auction						
7/24/18 T	7/25/18				◎	◎	◎	
7/25/18 W	7/26/18	2Y JGB Auction						
7/26/18 TH	8/1/18		◎	◎	◎			
7/27/18 F	7/30/18	BOJ MPM (Day 1)						
7/30/18 M	-	BOJ MPM (Day 2)						
7/31/18 T	-							

Note: ◎ Scheduled by the BOJ, ○ Daiwa forecast; reduction from previous operation in red

Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:

- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moody.com/pages/default_ja.aspx)

[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.co.jp/web/>) May 2018

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.

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 (including tax) 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