

JGB Insight

Yield curve with BOJ in difficult position to take policy action

- ✓ BOJ ended up emphasizing easing attitude at Sep MPM, leaving a strong impression on few policy measurements left in hands for immediate use
- ✓ Keeping current policy framework unchanged, BOJ appears to put all to modify current yield curve shape into daily operations
- ✓ In JGB purchase operations today (Sep 20), BOJ's trimming was more aggressive than usual, but we think, in current bond-friendly market, it will be impossible for BOJ to impact yield curve shape just only by trimming purchasing JGBs
- ✓ We would like to find a good timing to go in flattening with 10Y/20Y spread as a guideline

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Just emphasizing easing attitude just as at July MPM

At the monetary policy meeting (MPM) on September 19, the BOJ decided to keep its current monetary policy unchanged. This was largely in line with market expectations, although some market participants anticipated a move for additional easing, such as deepening the negative interest rate. In the policy statement, the central bank added a sentence implying that the BOJ may implement additional easing at the next MPM. However, it also shows a high chance that such an action may not be taken, if the economic condition on Japan remains favorable. While the ECB and the Fed adopted easing steps, the BOJ ended up emphasizing its easing attitude just as they did at the July MPM. This appears to have left a strong impression that the BOJ has few policy measurements available for immediate use in the market.

All to modify yield curve shape left to daily purchase operations

Reflecting the BOJ's policy decision, JGBs climbed substantially in the afternoon session on September 19, putting the JGB yield curve under bull-flattening pressure. Since BOJ Governor Haruhiko Kuroda touched on the level of superlong JGB yields in the interview with the Nikkei Newspaper, which was released on September 6, superlong JGBs have been softening amid growing caution about possible policy actions to lead the superlong zone of the curve to steepen. However, as the BOJ kept the current monetary policy unchanged, market participants rush in buying superlong JGBs. At the post-meeting regular press conference, Mr. Kuroda stated, "I think a steeper yield curve is favorable. ...Either way, we will make necessary adjustments for JGB purchases to keep an appropriate curve under the yield curve control (YCC) policy." That gave the market an impression that the policy board has put all to modify the yield curve shape into daily JGB purchase operations.

Post-MPM trimming was more aggressive than usual, but...

Give what the governor said at the press conference, the BOJ reduced the offer amounts in all zones (incl. sub zones) in its JGB purchase operations in the 5-10Y and over 10Y zones they offered today (Sep 20; Table 1). As the trimming was more aggressive than the BOJ usually does, the JGB futures plunged, putting the JGB yield curve under strong steepening pressure. Regarding the JGB purchase plan "Outline of Outright Purchases of Japanese Government Securities" to be announced on September 30, the possibility appears to have increased that the BOJ will make any changes, such as a cut in the number of offers per month or integration of sub zones (if more aggressive stance is taken) especially in the zone over 10Y. That being said, as long as the BOJ keeps the current policy framework unchanged, it may be difficult to expand the monetary base while the Bank keeps trimming JGB purchases (Chart 1). From this viewpoint, we forecast that the BOJ may increase the offer amounts in other target zones and/or TDB outright operations, looking at the market conditions at as-suitable-as-possible timings.

Controlling yield curve only via trimming purchases will not work effectively

Is it possible for the BOJ to continuously put steepening pressure on the superlong zone of the yield curve only by trimming purchases? Since the BOJ introduced the YCC policy and an annual pace of increase in the amount outstanding of its JGB holdings clearly fell below their "80tn yen" guideline, a positive relation has been observed between the 10Y/20Y spread and the estimated monthly purchase amount for JGBs with over 10-25Y to maturity, though with slight divergence (Chart 2). In other words, the more the BOJ cuts its offer amounts, the more the 10Y/20Y spread tightens. If we think of this tendency alongside the

stock effect (see [BOX]), it appears that controlling the yield curve only via trimming purchases will not work effectively.

Difficult to expect substantial steepening of JGB yield curve amid flattening trend of yield curves in Europe and US

Let's look at the environment surrounding the JGB market. Since the beginning of September, excessive caution about Brexit and trade frictions vs. the US appears to be easing. However, we think it difficult to fully eliminate worries about the global economy, given the persisting worries about the Chinese economy etc. In Europe and the US, the recognition is unchanged that monetary policies will go in a more accommodative direction, although the degree somewhat differs by nation/region. Also given the resurgence of the geopolitical risk in the Middle East, we think that upward pressure on JGB yields are unlikely to strengthen due to external factors. Moreover, it is difficult to expect that the JGB yield curve will steepen substantially amid the flattening trend of yield curves in Europe and the US.

Finding a good timing to go in flattening with 10Y/20Y spread as a guideline

Regarding the near-term superlong zone of the yield curve, we would like to find a good timing to go in flattening, surfing the volatility safely. Table 2 shows the comparison of the 10Y/20Y and 10Y/30Y spread levels as of closing on September 4, the day before Mr. Kuroda's interview with Nikkei, as of closing on September 18, and as of around the introduction of the YCC (based on the curve for which the BOJ deemed appropriate). In comparison with the 10Y30Y spread, the 10Y/20Y spread appears to have room to widen.

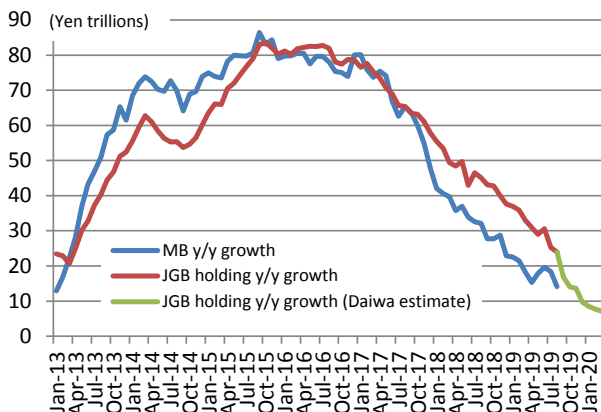
Table 1: BOJ JGB Purchases and MOF Issuance

(Yen billions)

	Offer size per operation	Mid	Number of Offers (per month)	Offer size as of Sep. 20	Change from previous operation	Monthly Total exp. in Sep. as of Sep. 20 (a)	MOF issuance per month in FY2019* (b)	(a)-(b)
Up to 1 year	About 10-100	55	2	50	-	100	-	-
Over 1 to 5 years	Over 1 to 3 years	About 250-500	375	4	400	1,600	2,000	-400
	Over 3 to 5 years	About 250-500	375					
Over 5 to 10 years	About 250-550	400	4	380	-200	1,520	2,100	-580
Over 10 years	Over 10 to 25 years	About 100-250	175	3	120	360	900	-540
	Over 25 years	About 10-100	55					
Linkers	About 25	-	2	25	-	50	400	-250**
Floaters (in even months)	About 100	-	1	100	-	100	-	-
TOTAL:						5,160 to 5,260	7,600 to 8,400	

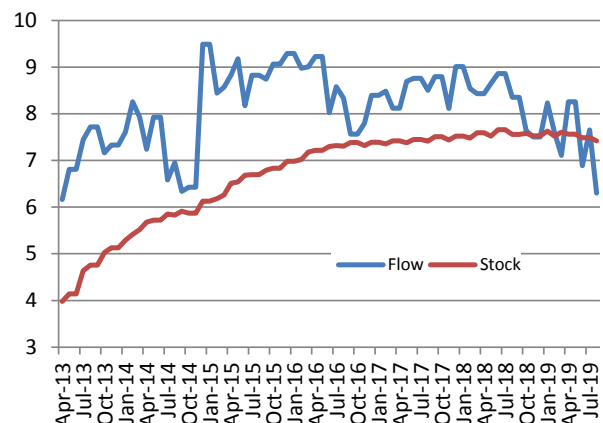
(Note) "Offer size per operation" and "Number of offers (per month)" are as released on August 30. * Excluding NPCA2 and AEL; JGB linkers issued 4 times per year ** Factoring in the BOJ purchase conducted every month and the MOF quarterly issuance
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Chart 1: Annual Increase in BOJ JGB Holding and Monetary Base



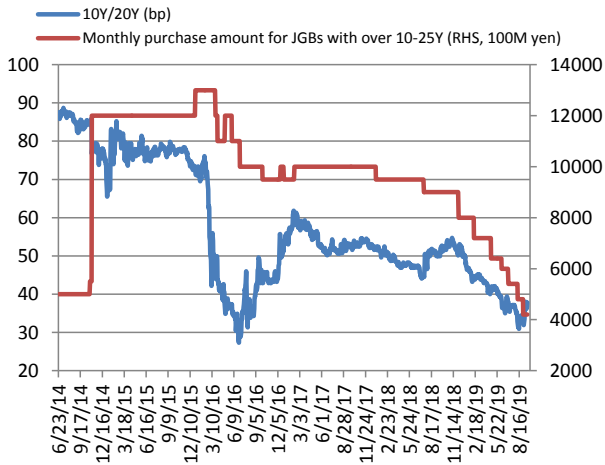
Source: Bank of Japan, Daiwa Securities.

[BOX] Average Maturities of BOJ JGB Holding (Stock) and Purchase (Flow) in Years



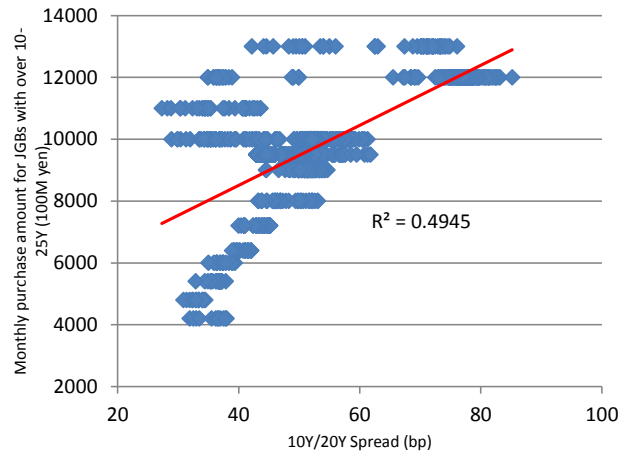
Source: Daiwa Securities.

Chart 2a: 10Y/20Y Spread and BOJ Monthly Purchase Amount for JGBs with over 10 -25Y to Maturity



Source: Daiwa Securities.

Chart 2b: 10Y/20Y Spread and BOJ Monthly Purchase Amount for JGBs with over 10 -25Y to Maturity



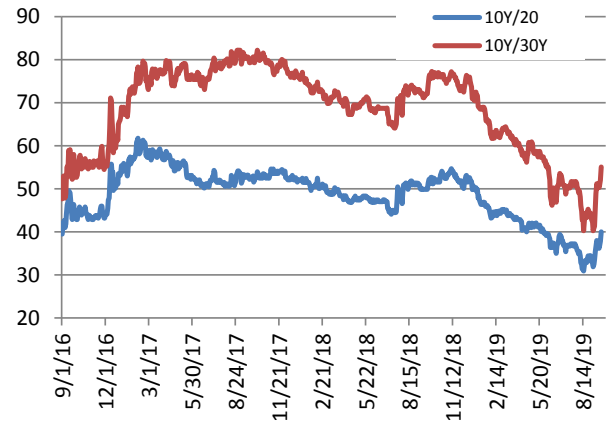
Source: Daiwa Securities.

Table 2: Levels of 10Y/20Y and 10Y/30Y Spreads (bp)

	10Y/20Y	10Y/30Y
YCC Introduction	42.2	53.0
9/5/19	33.5	41.3
9/18/19	37.8	52.0

Note: On-the-run issue basis
Source: Daiwa Securities

Chart 3: 10Y/20Y and 10Y/30Y Spreads (bp)



Note: On-the-run issue basis
Source: Daiwa Securities.

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[Standard & Poor's]

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[Fitch]

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