November 22, 2019
Japanese report: Nov. 21, 2019 (DSTR1240)

Daiwa Securities

JGB Insight

Ballooning actual stimulus with political developments

- ✓ This week, with signs of Prime Minister Abe's cherry blossom viewing party imploding, moves are afoot at the political party level to request Y10 trillion of real stimulus in the FY19 supplementary budget. Such a budget does not look realistic at this point, however.
- ✓ Even if it does materialize and lead to an increase in JGB issuance by the entire amount, additional market issuance on a calendar basis looks very unlikely within the fiscal year.
- ✓ The 20-year auction went well. Although we do not expect a big collapse in superlong JGBs anytime soon, it will be hard to aggressively purchase 20Y JGBs below 0.25%. We recommend taking a dip-buying stance with the possibility of the 20Y JGB yield trading back in the 0.25-0.30% range.

Strategic Memorandum DSTE344
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Amid signs of the cherry blossom viewing party imploding, real stimulus of Y10 trillion poping up

This week, with Prime Minister Abe's cherry blossom viewing party showing signs of imploding, the LDP and New Komeito Party leadership appear to have agreed to ask for real stimulus of Y10 trillion in the FY19 supplementary budget. As some media outlets have already reported, it would mark the first time that mark has been reached since FY12, when the Abe administration began, and only the fifth time since FY85 (Chart 1) if the supplementary budget includes spending of Y10 trillion. With the exception of FY12, this has occurred in response to a crisis, such as the 2011 earthquake & tsunami and the global financial crisis. Conditions do not appear to be at such crisis levels at this point. Additionally, with the initial budget for FY19 already having come in at a record high of Y100 trillion, we do not think it will be easy to cobble together a large supplementary budget with additional spending of Y10 trillion. Prime Minister Abe has been put on the defensive over his cherry blossom viewing party and is losing his edge, with some polls showing a sharp drop in the cabinet's approval ratings. The current situation makes us hard not to view talk of such a large stimulus as nothing but hot air arising out of political maneuverings with an eye on the possibility of the Diet being dissolved.

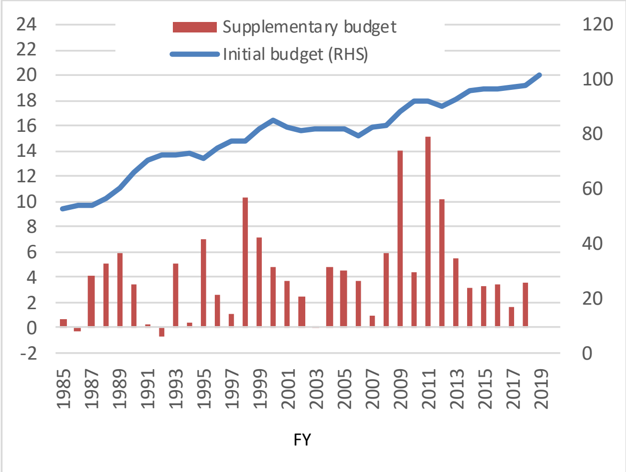
Although you can never say never in politics, it does not look very realistic at this point

Even if there is a supplementary budget with spending of Y10 trillion, we think it would have little impact on the supply-demand balance for JGBs in this fiscal year. For starters, it is unlikely that all Y10 trillion would be financed by public debt. And even if public debt were to increase by Y10 trillion relative to the initial budget, the issuance of financial resource JGBs increases by that entire amount, and total JGB issuance increases by Y10 trillion, that would unlikely cause an increase in market issuance on a calendar basis. This is because there is a strong probability that it could be handled by merely adjusting front-loaded issuance, which is at a record high of Y52 trillion (Chart 2). A large increase in the basic balance deficit is conceivable, however. It is also possible that a large stimulus package of over Y10 trillion will alleviate concerns over the economy. Longer term, there is a possibility that this will become a factor that pushes interest rates higher. Either way, although you can never say never in politics, real stimulus of Y10 trillion does not look very realistic at this point.

Calendar basis market issuance looks very unlikely to increase in FY19 unless the size of the supplementary budget exceeds Y20-30 trillion

Prior to the blowup over the cherry blossom viewing party, the size of the FY19 supplementary budget that was being considered within the LDP was apparently about Y5 trillion. It is conceivable that total JGB issuance will increase, depending on the size of economic stimulus projects and the scale of fiscal measures funded by the FILP program. Nevertheless, as already explained, given that front-loaded issuance is at a record-high level, we think the amount of calendar basis market issuance is very unlikely to increase in FY19. Calendar basis market issuance is very unlikely to increase in FY19 unless the size of the supplementary budget reaches Y20-30 trillion.

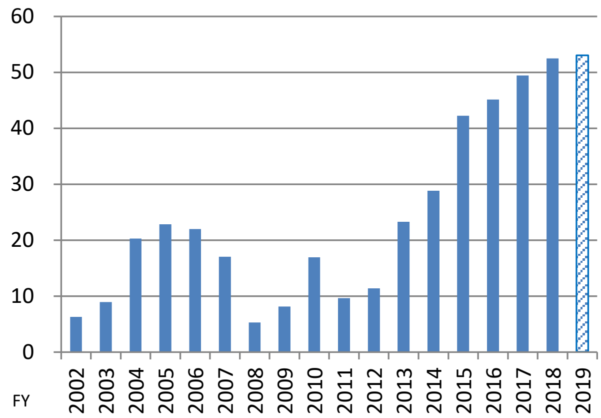
Chart 1: Initial and Supplementary Budgets (Yen trillions)



Note: Based on expenditure in general account; supplementary budget is the total amount of supplementary budgets billed in the fiscal year; initial budget in 2019 includes temporary and/or special treatments

Source: Ministry of Finance

Chart 2: Front-loaded JGB Issuance (Yen trillions)



Source: Ministry of Finance

20-year JGB auction went well

MOF's 20Y JGB auction on November 20 (for a reopening of JL170) went well. The auction was held at a lower yield than what prevailed in the pre-auction market on the day, and bidding was stronger than previously expected, driven primarily by demand from dealers for covering shorts. After the auction, with superlong JGBs remaining firm, the 20-year JGB yield dropped to as low as 0.235% during intraday trading today (November 21).

Let's check the conditions surrounding the bond market. The recent risk-on trend appears to be subsiding somewhat now. In future, however, as long as there is no heightening of expectations for easing, we think a lack of strong reasons to buy may make it difficult for JGBs to move higher. From a longer-term perspective, however, with as much uncertainty as there is now, it will be difficult to reach the point where concerns over the global economy can be completely brushed aside. The next monetary policy moves in Europe and the US will likely either be keeping policy on hold or additional easing measures (including rate cuts). Current fundamentals suggest a steep rise in yields is unlikely. Overall, we think a buy-on-dips stance can be effective at the current market level.

Although a 40-year JGB auction is scheduled for next week, expectations of support from the lengthening of index durations approaching end-November are likely to strengthen. We do not think there will be a major collapse in superlong JGBs, but it is difficult to chase prices higher with 20-year JGB yields trading below 0.25%. Over the period until the next 20-year JGB auction on December 17, we think there is a possibility of 20-year JGB yields moving back into a range of 0.25-0.30%. At current levels we recommend standing ready to find good opportunities to buy on dips

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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May 2018

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1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.
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2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (8986).

3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

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