

Daiwa's View

YCC to play role in the market

- Reducing upsize in 5-year JGB issuance and promoting increase in superlong JGB issuance desirable

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Daiwa Securities Co. Ltd.

Reducing upsize in 5-year JGB issuance and promoting further issuance of superlong JGBs desirable

YCC to play role in the market

The Liberal Democratic Party's Policy Research Council posted a "proposal for the third round of an emergency economic package" on its website, aiming to protect the public's lives and daily life from the unprecedented national difficulty of the COVID-19 pandemic. It proposed to secure at least a "Y60tn stimulus package, partly financed by Y20tn of fiscal spending" which is higher than that at the time of the global financial crisis, alongside the expression that "additional measures should be considered depending on the situation."

While a plunge in tax income is almost certain, the size of the economic package is expected to be larger than that at the time of the global financial crisis. Therefore, the package should be mainly financed by an increase in JGB issuance in the near term. The market consensus on the size of the further JGB issuance is around Y16.9tn (vs. initial budget), almost the same amount as that at the time of the Lehman crisis, and the increased issuance is expected to start in July 2020. If the issuance is increased by Y16.9tn during the nine months from July 2020 to March 2021 in line with the consensus, the monthly JGB market issuance (calendar base) is likely to increase by just under Y1.9tn¹.

The above-mentioned LDP proposal clearly states that "additional measures should be considered depending on the situation." Given the current condition that the spread of the new coronavirus is increasing with a time lag with the US/Europe, the size of further issuance is likely to expand. We have to say that a large uncertain factor (upward pressure on yields) has appeared regarding the JGB supply/demand conditions.

Given the above-mentioned situation, I would like to offer two opinions.

First, promotion of a further issuance of superlong JGBs is desirable if only to maximize the YCC's easing effects. Currently, the issuance of 30-year and 20-year JGBs is reportedly to be upped by around Y100bn each. I do not disagree with the basic stance that a "well-balanced increase in issuance in a wide range of maturity zones is desirable." However, if the increase in 20-year JGBs is limited to Y100bn as reported, it would be somewhat disappointing. As BOJ governor Haruhiko Kuroda has repeated, an excessive decline in superlong yields is one challenge at the BOJ. If the sustainability of monetary easing is secured by a revision to the excessive decline in superlong yields via stronger supply pressure on the superlong zone, the effect to boost Japan's economy, which is struggling with the unprecedented national difficulty, would be maximized. Given the size of the increased issuance, the demand level in the private sector, and the effectiveness of the policy mix, we think that a Y200bn or Y300bn increase in 20-year JGBs would be ideal.

¹ Y16.9tn/9 months = Y1.87778tn/month

Second, it would be recommended to avoid a substantial increase in the issuance in the 5-year zone. The aforementioned Reuters article said that some were cautious about the increase in 5-year JGBs, with which I agree. As the need for 5-year JGBs carrying negative yields is not strong, it is difficult to anticipate stable demand to absorb the increased issuance. Of course, if the 5-year JGB yield rises to positive territory, there would be strong demand from domestic investors. However, if so, this would cause confusion in terms of the consistency with the BOJ's zero percent target for the 10-year yield². Under the current YCC policy, the short-term and long-term interest rates are pegged at -0.1% and 0%, respectively, the positioning of the intermediate 5-year yield is thus somewhat incomplete. Therefore, a substantial increase in this zone may highlight such a challenge. If the issuer side aims to substantially increase the issuance of 5-year JGBs and this destabilizes the zone, it would be desirable for the BOJ to clarify the positioning of the zone under the YCC (addition of YCC target maturity).

In the Monthly Schedule of Outright Purchases of JGBs (competitive auction method) for April, announced by the BOJ at the end of March, the number of offers increased in the 1- to 3-year zone and the 3- to 5-year zone, while the number in the superlong zone was unchanged from the previous month. This implies the intention to steepen the yield curve. In addition, the comparison of the monthly purchase amount (median x no. of offers) in major zones between March and April shows about a Y1tn increase in the monthly purchase amount in operations (see charts below). We think that only this is a considerable increase. However, if we multiply the number of offers by the upper limit of the offer range per operation, the increase in the monthly purchase amount is calculated at around Y1.7tn (Y6.7tn/month → Y8.4tn/month). It is possible to interpret that this figure can absorb the annual amount to be increased in JGB issuance.

Chart: Monthly Schedule of JGB Outright Purchases (Apr 2020)

Residual maturity (year)	No. of offers (times)	Lower end (Y bn)	Upper end (Y bn)	Average (Y bn)
0-1	3	50	100	75
1-3	6	200	450	325
3-5	6	150	400	275
5-10	5	200	500	350
10-25	2	50	200	125
25-40	2	0	50	25
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Residual maturity (year)		Lower end x No. of offers (Y bn)	Upper end x No. of offers (Y bn)	Average x No. of offers (Y bn)
0-1		150	300	225
1-3		1,200	2,700	1,950
3-5		900	2,400	1,650
5-10		1,000	2,500	1,750
10-25		100	400	250
25-40		0	100	50
Total		3,350	8,400	5,875

Source: BOJ; compiled by Daiwa Securities.

Chart: Monthly Schedule of JGB Outright Purchases (Mar 2020)

Residual maturity (year)	No. of offers (times)	Lower end (Y bn)	Upper end (Y bn)	Average (Y bn)
0-1	2	10	100	55
1-3	4	300	550	425
3-5	4	200	450	325
5-10	4	200	500	350
10-25	2	50	200	125
25-40	2	0	50	25
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Residual maturity (year)		Lower end x No. of offers (Y bn)	Upper end x No. of offers (Y bn)	Average x No. of offers (Y bn)
0-1		20	200	110
1-3		1,200	2,200	1,700
3-5		800	1,800	1,300
5-10		800	2,000	1,400
10-25		100	400	250
25-40		0	100	50
Total		2,920	6,700	4,810

Source: BOJ; compiled by Daiwa Securities.

Either way, I have no doubt that the upcoming fiscal spending will make the YCC more effective in terms of the policy mix. Of course, upward yield pressure will be caused by the negative factor (increase in JGB issuance). However, the fact is unchanged that the YCC's easing effects will increase in the "phase of a yield uptrend." We look for a JGB issuance plan that can maximize the effect in the context of the policy mix with the YCC.

² As BOJ conducted fixed-rate operations for 5-year JGB yield at absolute yield level of -0.04% when it surged in the past, 5-year JGB's rise to positive territory would not be welcomed at the moment in terms of policy.

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■ Credit Rating Agencies

[Standard & Poor's]

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