Daiwa Securities

Daiwa's View

Additional easing's implications for the market

➢ Simple and clear for credit, and profound for JGBs

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Daiwa Securities Co. Ltd.

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After hearing about yesterday's additional easing by the BOJ, I was reminded of the term "Kuroda's bazooka" for the first time in a long time. I will focus on the following two implications the additional easing has for the market.

First implication: Time-limited measures vs. permanent measures

The latest additional easing involves skillful implementation of time-limited measures and permanent measures, which are seen favorably. Specifically, two time-limited measures lasting until the end of September 2020[1] are: 1) an increase in the purchase amount of CP and corporate bonds and (2) strengthening of the Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19).

The reason measures for smoothly facilitating financing are time-limited is clear. Amid the spread of the infectious disease and dwindling corporate activities due to a call to refrain from going outside and requests to suspend operations, cash burn at companies is very severe. Many major companies have moved to secure liquidity on hand at the same time in preparation for the possibility that this situation will be prolonged, which has led to a decline in fund liquidity[2] and less accommodative conditions in terms of corporate financing. The best prescription for this kind of problem, which is unprecedentedly severe but temporary, is to eliminate worries via massive supportive measures until the severe period has passed. In that sense, we think that the latest measures, which could be described as "Kuroda's credit bazooka," are sufficient to satisfy near-term needs in Japan. I welcome them with open arms.

Meanwhile, it cannot be missed that the third measure, that of "further active purchases of JGBs and T-Bills," is permanent. Here, the purchase guideline of Y80tn was removed and the phrasing changed to "a necessary amount of JGBs without setting an upper limit." Of course, the most straightforward interpretation of this measure would be additional easing (= yield declines) to address a tighter financial environment due to the COVID-19 pandemic. However, if this was the only purpose, the third measure would be time-limited. The reason this measure was set as permanent is probably because the BOJ intends to secure a free hand not only in the case of an increase in JGB purchases but also in the tapering stage in the future, with a view to the post-COVID-19 stage.

[1] Of course, the term may be extended or the amount increased, depending on the BOJ's judgement.
[2] A situation in which smooth financing is difficult, despite solvency being secured.

If so, the implications that this measure has for JGBs are complicated. Many people probably still remember that intermediate/long-term JGB yields surged as market expectations for deeper negative rates receded in October 2019 immediately after the BOJ introduced the wording "at their present or lower levels" in its statement. Although an upper limit is not set and permanent purchases are intended, (straightforwardly) interpreting this as "yield declines" entails a risk.

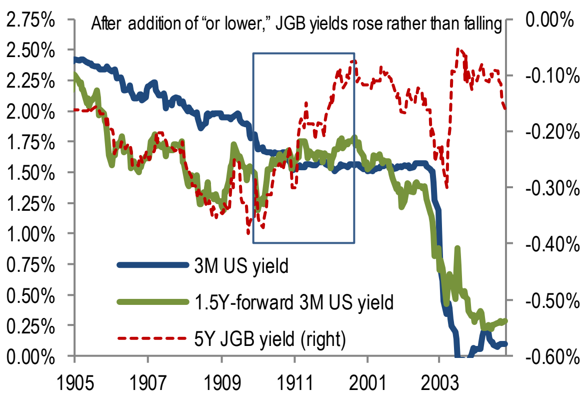
Given the aforementioned factors, in addition to the third measure's obvious aspect of involving "aggressive purchases," we should now also recognize a less obvious side to it---that it is a strategic move to increase discretion in the future, by removing wording that has become a hindrance to it as its role under the YCC policy comes to an end. There are two sides to every issue, and words can have hidden meanings. Of course, a straightforward interpretation is fine under the near-term circumstances in which the JGB issuance amount is expected to increase due to lower liquidity in the bond market and the COVID-19 crisis. I think that the hidden meaning of the third measure will emerge after the two aforementioned time-limited measures are withdrawn.

Second implication: Change to wording about superlong yields

Secondly, there are a change of attitude towards superlong yields and implications for the shape of the yield curve. Summarizing the fact, when asked about superlong JGBs in the yield curve at a Q&A session of the press conference, Governor Kuroda stated that "We haven't veered away from our stance that excessive flattening of the yield curve is undesirable." However, the typical answer up to now—that it would not be strange even if there were a further rise--was not included. In addition, Governor Kuroda said that it is difficult to assume a phase of yield declines, although this did not point only to the superlong zone. Moreover, in the BOJ's JGB monthly purchase schedule for May, which was announced after the MPM ahead of schedule, there were changes to the 1- to 3-year zone (clear increase in purchase amount similar to the previous month) as well as to the 3- to 5-year zone and the 5- to 10-year zone (upward revision in terms of the average offer amount). On the other hand, the offer amount and the number of offers were again unchanged in the superlong zone.

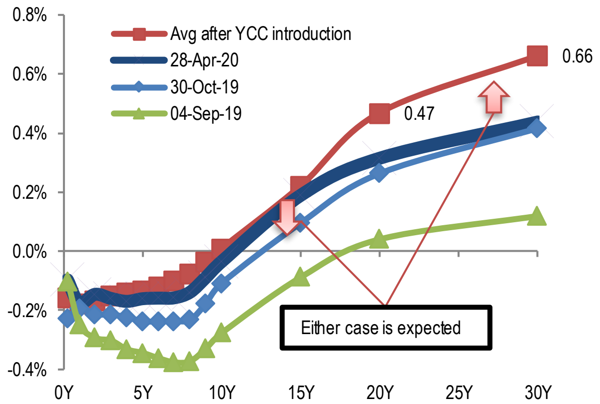
Overall, this gave us the strong impression that the BOJ has a sense of vigilance with regard to yield increases (represented by the Governor's remark that it is difficult to assume a phase of yield declines). The BOJ appears to recognize that steepening pressure will naturally emerge without its aggressive moves, if it properly implements the yield curve control policy. If so, as long as the yield curve is stable and in line with the controlled short-term and long-term yields, the BOJ probably no longer has a specific stance with regard to controlling superlong yields. The yield curve is likely to face natural steepening pressure going forward as greater upward pressure is placed across the yield curve.

Chart: 5Y JGB Yield and 1.5Y-forward 3M US Yield



Source: Bloomberg; compiled by Daiwa Securities.

Chart: JGB Yield Curve



Source: Bloomberg; compiled by Daiwa Securities.

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[Standard & Poor's]

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As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

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), Daiwa Securities Living Investment Corporation (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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- 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.
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- 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.
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