Daiwa Securities

Daiwa's View

Money accumulating faster at deposit-taking institutions on larger corporate bond issuance

- Larger corporate bond issues slow total lending and exacerbate the deposit-loan gap

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp

Daiwa Securities Co. Ltd.

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Larger corporate bond issues slow total lending and exacerbate the deposit-loan gap

In contrast with the sharp swings in US yields, the JGB market has remained firm recently. It was certainly reassuring that the third supplementary budget and additional economic stimulus passed by the Cabinet Office yesterday was within the market's consensus expectation, but what has been remarkable about the JPY bond market recently is the strength of demand in the 20-year zone and the consequent heavy buildup of cash at deposit-taking institutions.

It was reported this week that NTT Finance plans to launch a Y1tn corporate bond issue. If it goes through, it would be the largest single bond launch by one company in history.

It would probably be a mistake to interpret this increase in the size of bond issues and expansion of the corporate bond market symbolized by NTT Finance's issuance as a shift of funds within the bond market from JGBs to corporate bonds (which would have an upward impact on yields). That would of course be true of the funds flow within the JPY bond market on a single day, but the bigger picture is that funds that would have been used for bank lending are being replaced by corporate bond issuance, which means a decline in bank lending and increase in the deposit-loan gap.

The conventional wisdom in Japan is that the size of Japan's corporate bond market is small at around Y10tn of annual issuance (the average annual issuance from 2010 to 2018 was Y9.1tn) as indirect financing has been a main tool. The BOJ's expansion of its corporate bond buying operations also has an impact, however. The corporate bond market has continued growing over the past few years, and launches in 2020 will total around Y15tn, making it impossible to ignore the shift in how companies raise funds, a way from taking out bank loans to toward issuing corporate bonds.

Especially in the case of the large companies that generally obtain an outside credit rating when issuing a corporate bond, the increase in the size of corporate bond issues seems to be having an impact on the deposit-loan gap at the megabanks that the large corporations are customers of. Assuming this investment demand from deposit-taking institutions is flowing into the 20-year zone of the JGB market, if the BOJ decides to extend its special covid-19 corporate bond buying operations at its December policy meeting, it should indirectly improve JGB supply-demand and cause a flattening of the JGB curve.

The last 20-year JGB auction of the year is scheduled for tomorrow. The 20-year zone has been strengthening since before the auction, with the 20-year yield settling in below 0.4%, and if the auction is a satisfactory one at below a 0.4% yield, we expect it will reduce the likelihood of yields climbing back above the 0.4% level.

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2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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■ Credit Rating Agencies

[Standard & Poor's]

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

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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.moodys.com/pages/default_ja.aspx)

Assumptions, Significance and Limitations of Credit Ratings

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[Fitch]

The Name of the Credit Rating Agencies group, etc

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Assumptions, Significance and Limitations of Credit Ratings

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IMPORTANT

Conflicts of Interest: Daiwa Securities Co. Ltd. may currently provide or may intend to provide investment banking services or other services to the company referred to in this report. In such cases, said services could give rise to conflicts of interest for Daiwa Securities Co. Ltd.

Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:
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.
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%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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 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.
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Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association