Daiwa Securities

JGB Insight

BOJ’s assessment of monetary easing: Hoping the Bank finds good measures to improve market functionality II

- ✓ Including a ±0.2% band in the policy statement may fix the 10Y JGB yield at just under 0.2%. On the other hand, if the BOJ does it with less exact language, we think it could possibly allow the yield to rise above 0.2%.
- ✓ Without widening of the allowable trading band, there may not be any significant change in how the BOJ conducts its operations. However, this still leaves open the possibility of ceasing to publish its purchase operation schedule or reorganizing the targeted purchase zones.
- ✓ Paying close attention to 2s5s and 5s7s, which have steepened, and 20s30s and 30s40s, which have flattened, in the chaos on the assessment

Strategic Memorandum DSTE435
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Once the content and results of the assessment finally come out, the BOJ's actions and response will become clear

The BOJ is scheduled to hold a policy meeting on March 18-19. Once the content and results of the assessment of monetary easing come out at the meeting, the BOJ's actions and response will become clear. So far, the points that underline the assessment posited by the media and by direct statements by BOJ officials as being up include:

1. Widening the allowable trading band for the 10-year JGB yield, which is the long-term rate target used for the yield curve control (evening on January 15 to morning on January 16)
2. Clarification of the potential for deepening negative interest rates (February 10-11)
   - ➢ More recently, "clarification of the room for lowering short- and long-term rates" (March 11)
3. Using a shorter maturity for the long-term rate target (late February)
4. BOJ Governor Kuroda's clear denial on widening the 10-year JGB yield trading band (March 5)
5. Statement from Deputy BOJ governor Masayoshi Amamiya that walked back the governor's denial (March 8)
6. Modification of the three-layer structure of the current account (March 11)
7. Quantify the current trading band by changing "roughly about double ±0.1%" to something like "roughly about ±0.2%" and include it in the policy statement (March 12)

Watch closely how ±0.2% is expressed in the policy statement

These many speculative media articles etc. quoting both BOJ insiders and outsiders as well as remarks made by BOJ officials have increased uncertainty on the assessment in the JGB market and over how the BOJ will conduct its operations after the assessment. That has significantly reduced both the functionality and liquidity of the market. It is particularly difficult to gauge how the market might react if the BOJ quantifies the current trading band ("roughly about double ±0.1%") and expresses it in the policy statement as something like "roughly about ±0.2%." If on top of its "about 0%" target for the 10-year JGB yield it also clarifies an allowable trading band of ±0.2% (regardless of whether it includes modifiers "roughly" or "about"), it is easy to imagine the 10-year JGB yield settling in at just under 0.2%. On the other, the BOJ has a history to consider here. Back when its written statement described its long-term JGB purchases with the phrase "so that their amount outstanding will increase at an annual pace of about Y80 trillion," it wound up allowing the annual increase to drop below Y20 trillion, thereby rendering the guideline in its policy statement toothless (Chart 1). In light of this history, if the BOJ uses a phrase like "aim for roughly about ±0.2%" or other language with the same wiggle room, we think it could possibly allow the 10Y JGB yield to rise even above 0.2% in reaction to a rise in US long-term rates, for example.

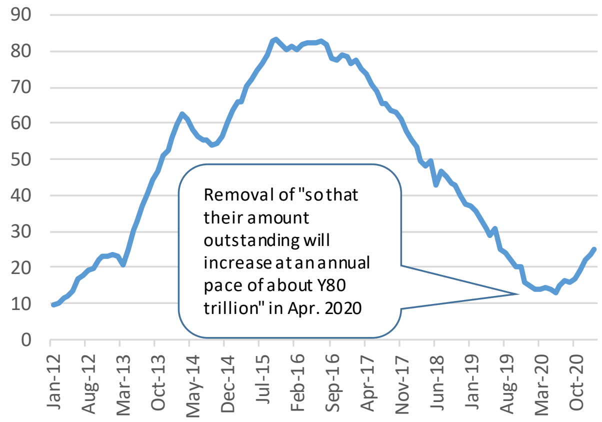
There is still the possibility of the BOJ ceasing to publish its operation schedule or reorganizing the targeted purchase zones

Next, we consider how the BOJ may conduct its JGB outright purchases after the assessment. Consider first this excerpt from the latest speech by Deputy Governor Amamiya: "In conducting yield curve control in a sustainable manner, it is important to strike an appropriate balance between maintaining market functioning and controlling interest rates. The Bank believes that it can find more ways to achieve this balance, because, although significant fluctuations in interest rates could lead to undesirable consequences, fluctuations within a certain range could have positive effects on the functioning of JGB markets without losing the effects of monetary easing." But he also emphasized that "with the economy hit by the impact of COVID-19, what is important now is to maintain the stability in the bond market and stabilize the entire yield curve at a low level, and it is necessary for the Bank to bear this in mind in conducting yield curve control for the time being." This suggests the possibility that there will not be any major change in the BOJ's outright JGB purchasing operations after the assessment. This is especially true if it does not change the allowable trading band for the 10-year JGB yield. However, this still leaves open the possibility of it ceasing to publish its purchase operation schedule (or possibly stopping only for the over-10-year zone) or reorganizing the targeted purchase zones, both of which could be done without adjusting (monthly) purchase amounts.

The 2-year/5-year and 5-year/7-year spreads steepened, and the 20-year/30-year and 30-year/40-year spreads flattened, in the chaos on the assessment

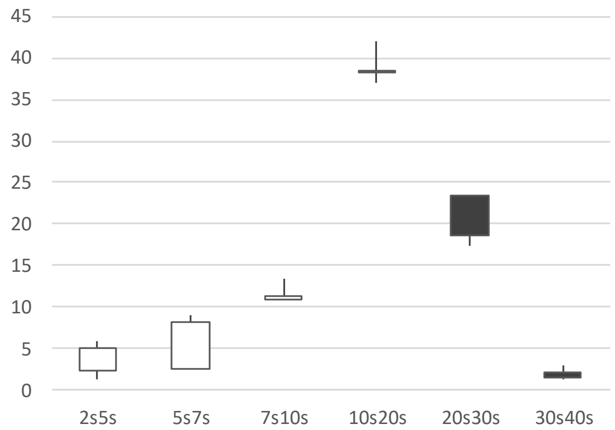
It is difficult to forecast the market reaction trend following the assessment, in part because of the still considerable uncertainty over the results of the assessment and how policy will change afterward. However, amid confusion over the assessment following news articles in mid-January discussing a widening of the 10-year JGB yield trading band, the JGB yield curve has experienced a steepening of the 2-year/5-year and 5-year/7-year spreads and a flattening of the 20-year/30-year and 30-year/40-year spreads (Chart 2). We would like to pay close attention to a possible reversal of those moves.

Chart 1: Annual Increase of BOJ's JGB Holding (Yen trillions)



Source: Bank of Japan, complied by Daiwa Securities.

Chart 2: JGB Yield Spread Moving Range (bp)



Note: On-the-run and CTD
Source: Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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February 2020

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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.
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), 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%.

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).

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- 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.

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