1 Trends of JGB Market in FY2020

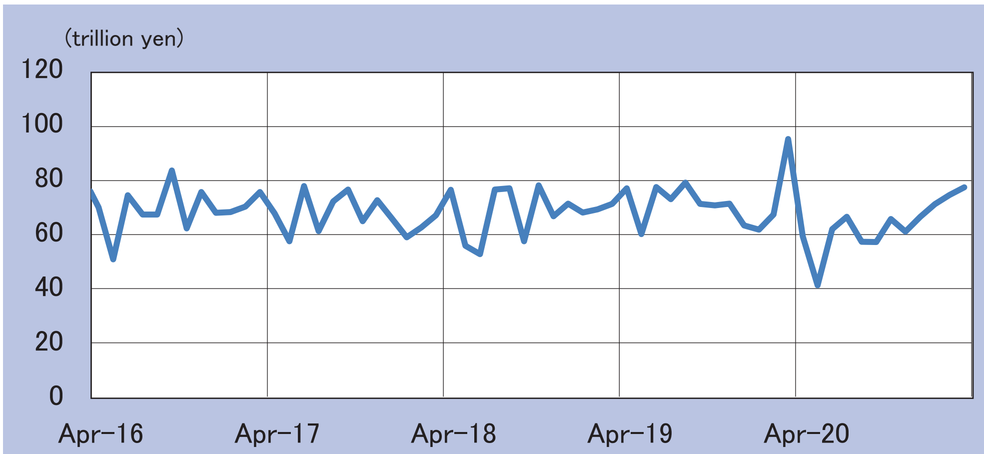
(1) Review

The JGB market entered FY2020 amid turmoil that started in March 2020 due to the global spread of COVID-19. In the April-June quarter, yields on super long-term JGBs among others rose slightly as the market turmoil from the COVID-19 pandemic calmed down and the government decided to increase JGB issuance under two supplementary budgets. From July through December, yields remained stuck in a narrow range. The JGB market trading volume plunged in April and May and failed to sufficiently rally from June through December. In early 2021, a sharp rise in US long-term interest rates and various expectations about the BOJ' monetary policy review put the upward pressure on the JGB yields. JGB trading volume increased substantially amid rising yields.

In March 2020, the COVID-19 epidemic developed into a global pandemic, rattling financial markets throughout the world. As the ask-bid spread substantially expanded on the U.S. Treasury market to affect market functions, Treasury prices fluctuated wildly. On the JGB market as well, liquidity declined, with volatility expanding rapidly. This might have been because investors and securities companies reduced risk tolerance in view of growing uncertainties amid the COVID-19 pandemic. Market participants' telework might have accelerated the liquidity decline. Under these situations, trading volume of coupon-bearing JGBs increased rapidly in March (Fig. 1-1).

In early FY2020, financial markets gradually restored stability as monetary policy actions by the BOJ and other central banks were successful. Liquidity improved on the JGB market as well. Trading volume of coupon-bearing JGBs plunged in April and May before starting to rise back gradually in June (Fig. 1-1).

Fig. 1-1 Monthly trading volume of interest-bearing JGBs



Note: Trading volume covers interest-bearing JGB trading between all investors, excluding "others," and bond dealers, and a half of interest-bearing JGB trading between bond dealers.
(Source) Japan Securities Dealers Association

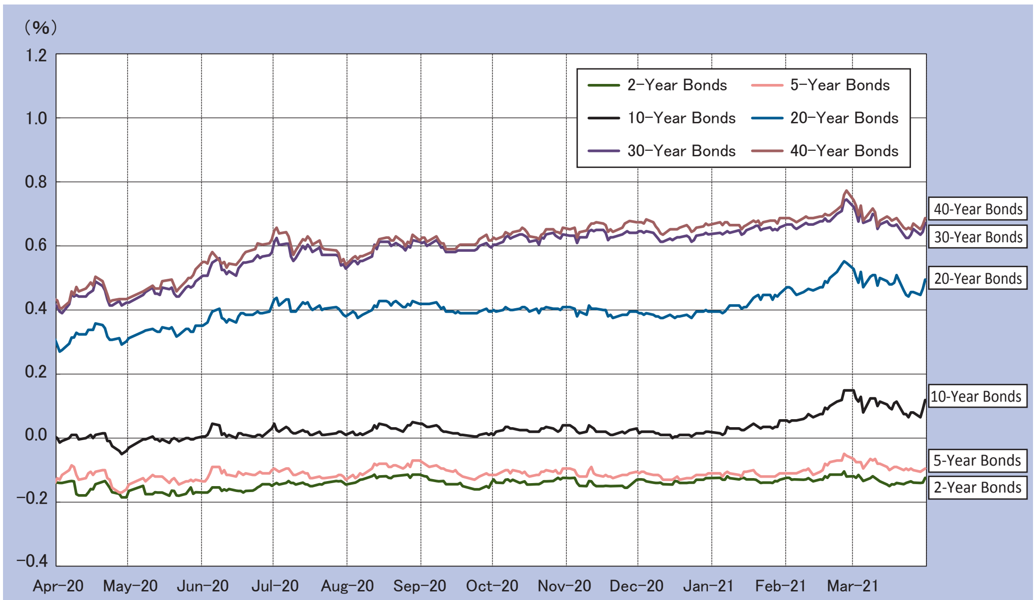
The 10-Year JGB yield stood at 0% on April 1 and at 0.03% on June 30, indicating little change in the three months. On the other hand, the 20-Year JGB yield rose slightly from 0.29% on April 1 to 0.415% on June 30 and the 30-Year JGB yield from 0.41% to 0.595% (Fig. 1-2). In line with two FY2020 supplementary budgets formulated in response to the COVID-19 infection expansion, the fiscal year's planned JGB issuance amount was increased by about 100 trillion yen. JGB issuance amounts for a wide range of maturities were raised, though the amount for Treasury Discount Bill was most notably increased. Nevertheless, the increased issuance was auctioned smoothly as investors' demand increased accordingly.

From summer, JGB yields stayed in a narrow range. The 10-Year JGB yield remained in a small range between 0% and 0.05%, while the 20-Year JGB yield leveled off around 0.4% (Fig. 1-2). The coupon-bearing JGB trading volume rose back from bottom levels seen from April to May but remained below the FY2019 average until December (Fig. 1-1). While the U.S. presidential election, the announced development of COVID-19 vaccines and other events exerted great impacts on financial markets in the world in November, the JGB market stayed range-bound.

In December, the BOJ announced that it was going to assess the effects and side-effects of the current monetary policy. In January 2021, U.S. long-term interest rates accelerated their rise (Fig. 1-3) in response to the Democratic Party's winning of a 50th seat in the Senate, leading the JGB yields to turn up. Speculation that the BOJ would consider expanding the allowable fluctuation range for the 10-Year JGB yield during its monetary policy assessment contributed to the yield's rise reportedly. In February, the 10-Year JGB yield rose to as high as 0.175% (Fig. 1-2). In line with the yield rise, the average trading volume of coupon-bearing JGBs in the January-March quarter exceeded the FY2019 average (Fig. 1-1).

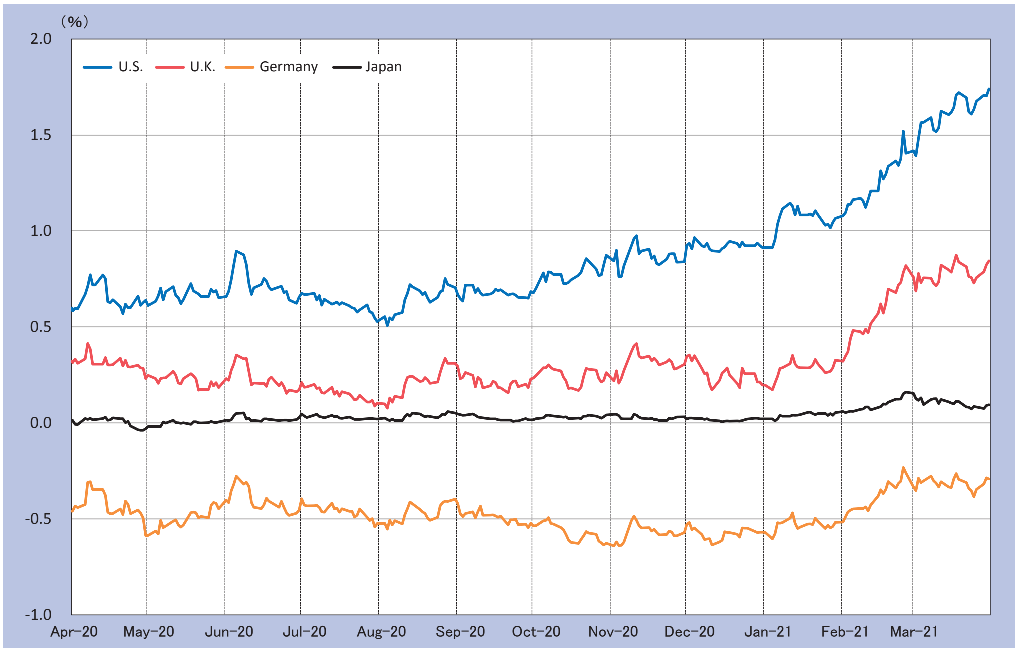
In March, the BOJ completed the policy assessment and clarified that the allowable range of 10-Year JGB yield fluctuations would be between plus and minus 0.25%. It then indicated that it would be desirable for the yield to fluctuate to some extent within that range. The central bank also emphasized that it would retain the policy of stabilizing long- and super long-term JGB yields at low levels as far as the impact of COVID-19 remains. Then, long- and super long-term JGB yields turned down. At the end of March, the 10-Year JGB yield came to 0.12%, the 20-Year JGB yield to 0.495% and the 30-Year JGB yield to 0.67% (Fig. 1-2).

Fig. 1-2 JGB Yield Trends by Maturity



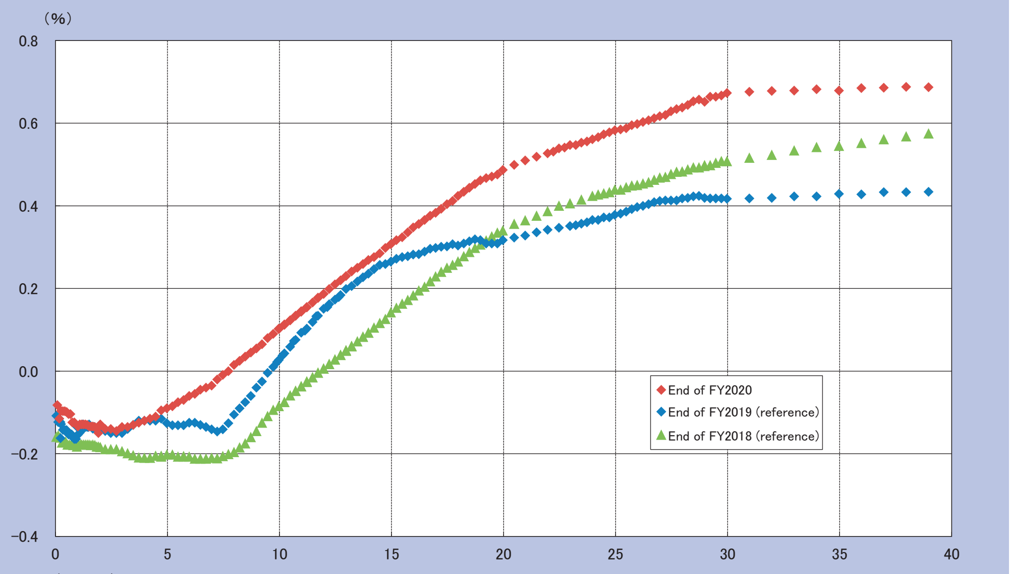
(Source) Nikkei QUICK

Fig. 1-3 10-Year Government Bond Yields (U.S., U.K., Germany, Japan)



(Source) Bloomberg

Fig. 1-4 Yield Curve Trends



(Source) Japan Bond Trading Co.

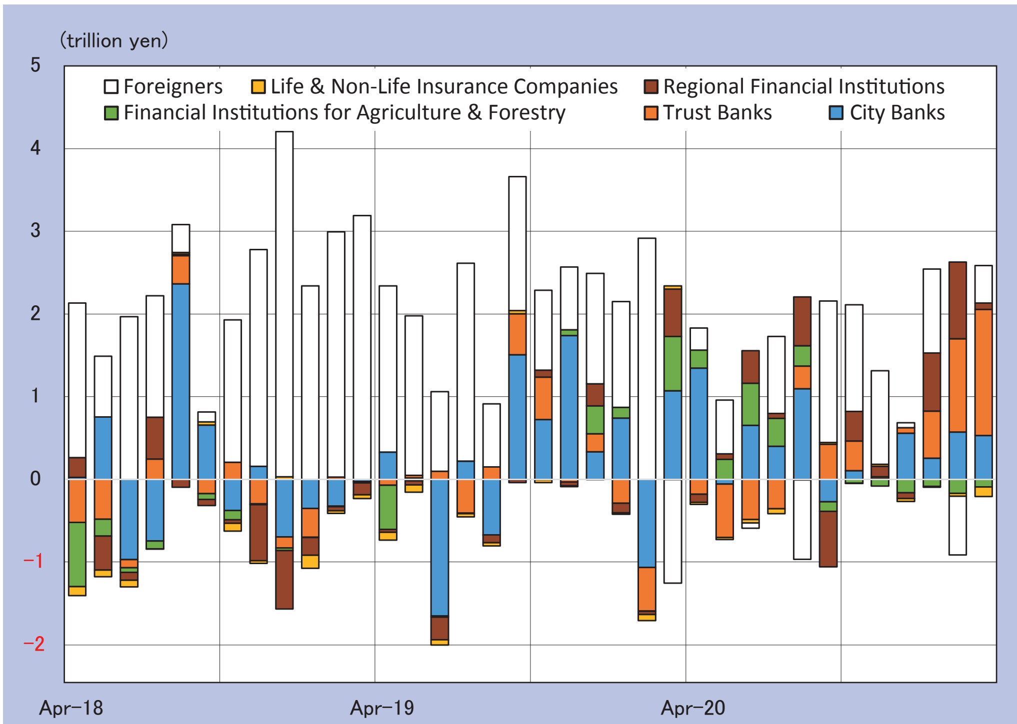
(2) Investor Trends

The total JGB issuance amount in FY2020 substantially increased as the government formulated three supplementary budgets to prevent COVID-19 infection from expanding, develop healthcare arrangements, support household finances, employment and businesses, promote economic restructuring after the COVID-19 pandemic and implement other measures. Investor trends regarding coupon-bearing JGBs indicated that city banks, foreign investors and some others posted net buying of medium to long-term JGBs maturing in 2, 5 and 10 years (Fig. 1-5). Life insurance companies, pension funds, regional financial institutions and some others increased their net buying of super long-term JGBs maturing in 20, 30 and 40 years from the previous year (Fig. 1-6).

Life insurance companies apparently enhanced their buying of super long-term JGBs due to unattractive yields on foreign bonds after currency hedging and the need for responding to new international capital regulations. Pension funds might have implemented operations to sell stocks and buy bonds to adjust their investment portfolios in view of a substantial stock market upsurge. Regional financial institutions might have expanded investment in longer-than-10-year JGBs with positive yields. Foreign investors' trading in medium to long-term and super long-term JGBs slackened in the first half of FY2020 but picked up in the second half (Figs. 1-5 and 1-6).

On the short-term JGB (Treasury Discount Bill) market, city banks and pension funds became relatively large net buyers in FY2020, joining foreign investors that have traditionally been net buyers (Fig. 1-7). Although dollar premiums for short-term dollar-yen basis swaps slackened (Fig. 1-8), short-term dollar interest rate falls helped to keep JGBs after currency hedging attractive for foreign investors. As a result, foreign investors' demand for short-term JGBs remained at high levels throughout FY2020. City banks also maintained their short-term JGB investment at high levels throughout the year. They might have invested increased deposits in short-term JGBs and bought short-term JGBs for collateral for lending from the BOJ. Pension funds also activated investment in short-term JGBs.

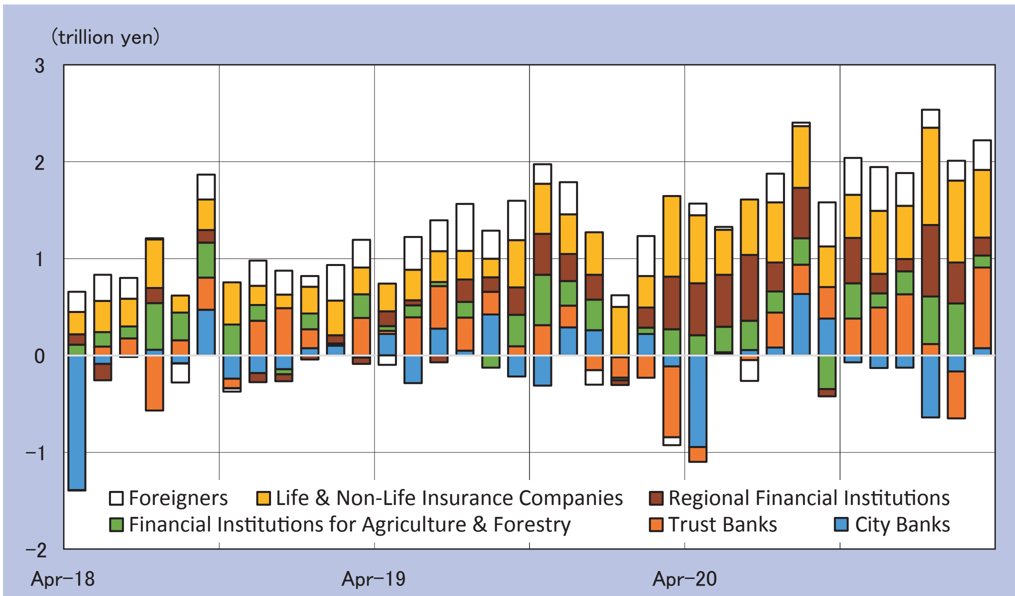
Fig. 1-5 Net buying/selling of medium to long-term JGBs by investor category



Note: Investors' direct purchases through auctions are excluded. Trust banks' trading covers their proprietary trading as well as transactions on behalf of pension funds, etc.

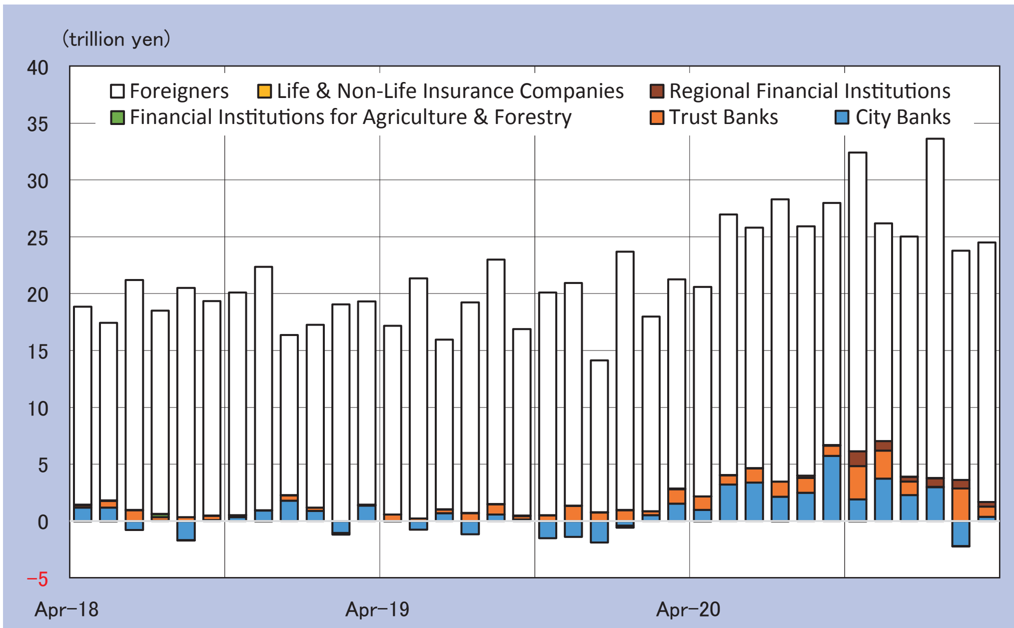
(Source) Japan Securities Dealers Association

Fig. 1-6 Net buying/selling of super long-term JGBs by investor category



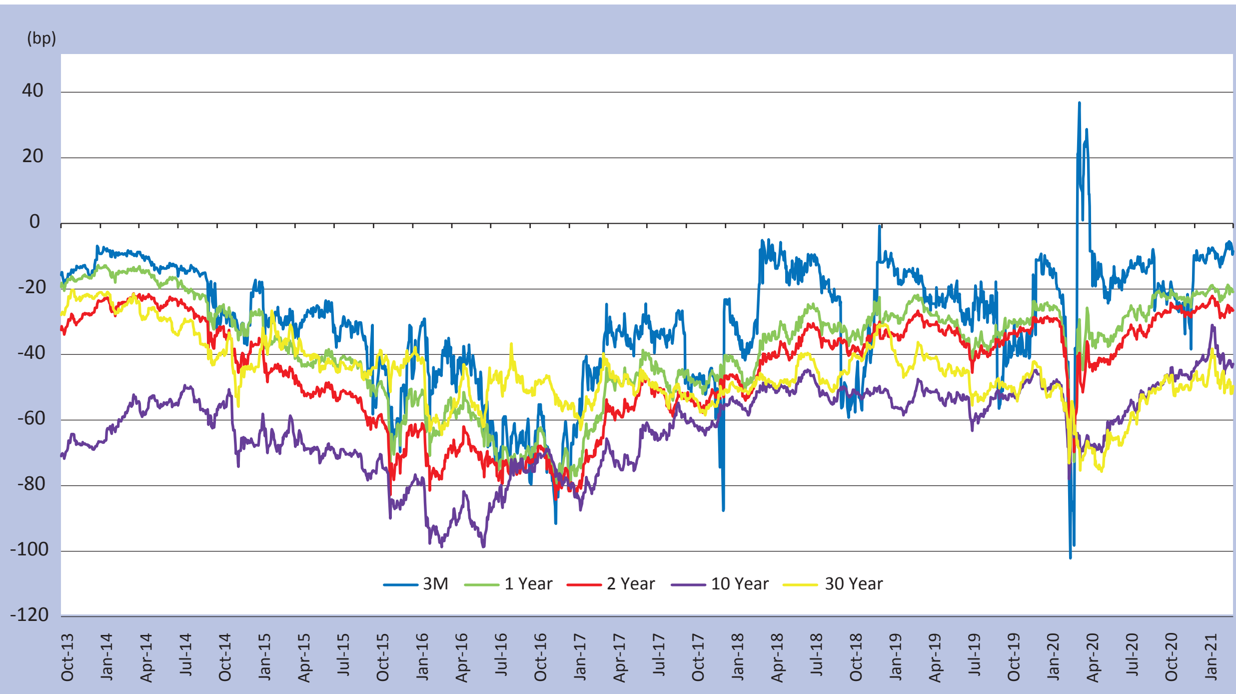
Note: Investors' direct purchases through auctions are excluded. Trust banks' trading covers their proprietary trading as well as transactions on behalf of pension funds, etc.
(Source) Japan Securities Dealers Association

Fig. 1-7 Net buying/selling of short-term JGBs by investor category



Note: Investors' direct purchases through auctions are excluded. Trust banks' trading covers their proprietary trading as well as transactions on behalf of pension funds, etc.
(Source) Japan Securities Dealers Association

Fig. 1-8 Dollar-Yen Basis Swap Spread



(Source) Bloomberg