1 Trends of JGB Market in FY2017

(1) Review

In FY2017, bond market participants grew conscious of U.S. political developments, European political trends and geopolitical risks involving North Korea and other problems. The bond market environment then posted great changes including stock market hikes amid global economic expansion and European and U.S. monetary policy normalization moves. In the JGB market, however, long-term interest rates subject to control by the Bank of Japan moved in a narrow, stable range under the BOJ's Quantitative and Qualitative Monetary Easing with Yield Curve Control introduced in September 2016.

As bond yields declined globally in April on growing geopolitical risks involving Syria and North Korea and political turmoil over May's French presidential election, Japan's 10-year JGB yield fell to 0% temporarily. In response to the French presidential election results in May, market participants' risk-off attitude receded globally, leading JGB yields to moderately rise. Later, the JGB market remained stagnant.

Toward early July, the 10-year JGB yield rose to 0.105% temporarily as European and U.S. bond yields soared amid speculations about the European Central Bank's tapering of monetary easing. As the BOJ implemented a fixed-rate JGB-purchase operation for the long-term zone (with no bids made) and other measures on July 7, however, the yield dropped and stayed below 0.10% later.

As geopolitical risks grew on North Korea's ballistic missile firing and hydrogen bomb tests from August to September, the 10-year JGB yield plunged into a negative zone in early September for the first time since November 2016. However, the risk-off situation was short-lived. As North Korea refrained from conducting ballistic missile firing or nuclear tests on its National Foundation Day (September 9), the market became risk-on, with the 10-year JGB yield rising back into a positive zone.

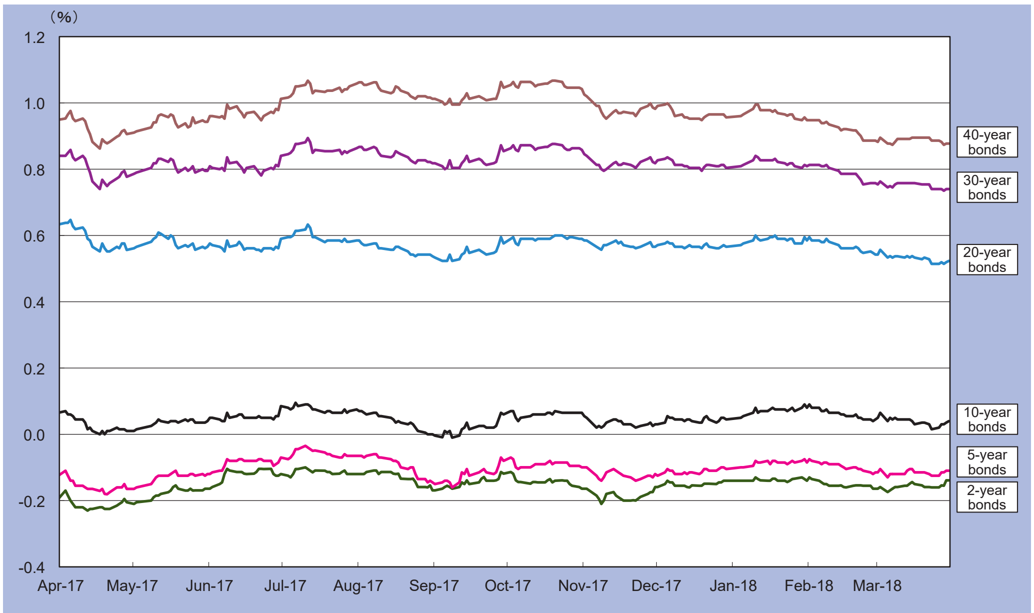
Later, foreign bond market yields wildly fluctuated amid speculations about the next U.S. Federal Reserve Board chair and U.S. tax reform-related developments. However, JGB yields stayed in a narrow range under the BOJ's Quantitative and Qualitative Monetary Easing with Yield Curve Control.

From the second half of December, U.S. and other stock indexes rose to record highs, with European and U.S. bond yields rising, as the enactment of the U.S. Tax Cuts and Jobs Act was expected to trigger an economic pickup. In the JGB market, yields mainly in the super-long-term zone increased as speculations about Japan's monetary policy normalization grew mainly among foreign investors on the BOJ's cut in JGB purchase operations for the zone in early January. As the 10-year JGB yield rose to 0.095% following foreign bond yield hike, the BOJ conducted a fixed-rate JGB-purchase operation for the long-term zone (with no bids made) on February 2, leading JGB yields to turn down.

From early February, global bond yield hikes paused as Japanese and other stock markets plunged with volatility increasing. As concerns have grown on expanding government debt issues accompanying fiscal expansion in the United States and other countries, with monetary policy normalization becoming a global theme, government bond yields have been unstable.

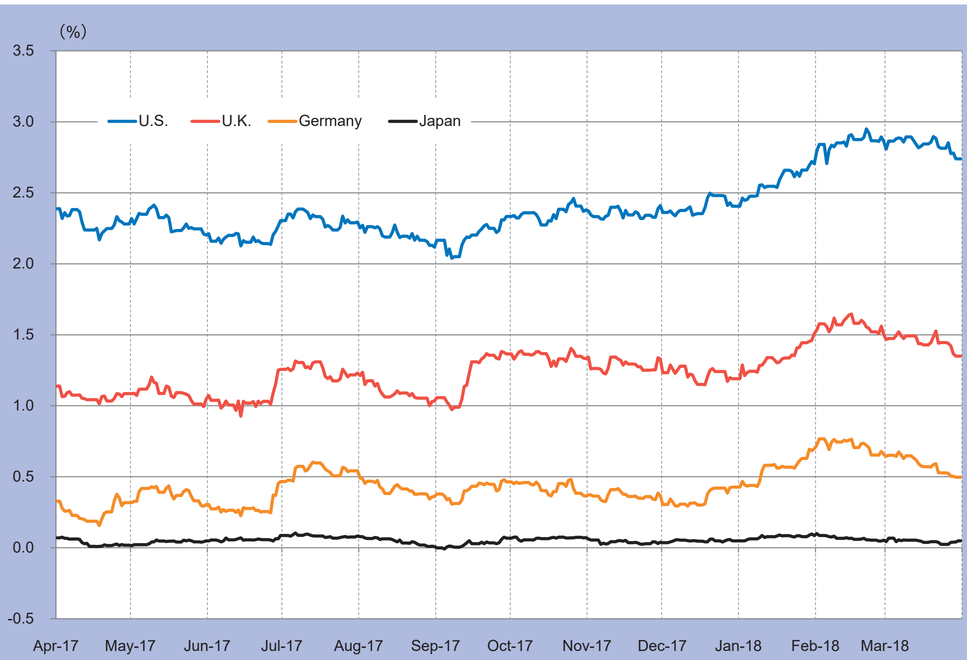
The external environment for the JGB market is plagued with numerous fluctuation factors including global monetary policy normalization moves and political developments in each country.

Fig.1-1 JGB Yield Trends by Maturity



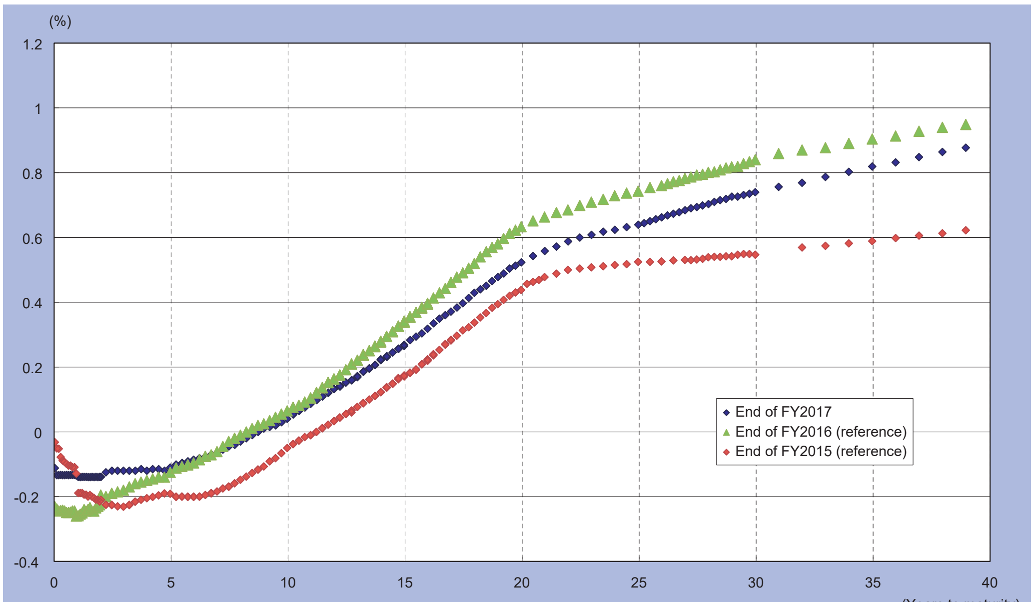
(Source: Japan Bond Trading Co.)

Fig.1-2 10-Year Government Bond Yields (U.S., Germany, Japan, U.K.)



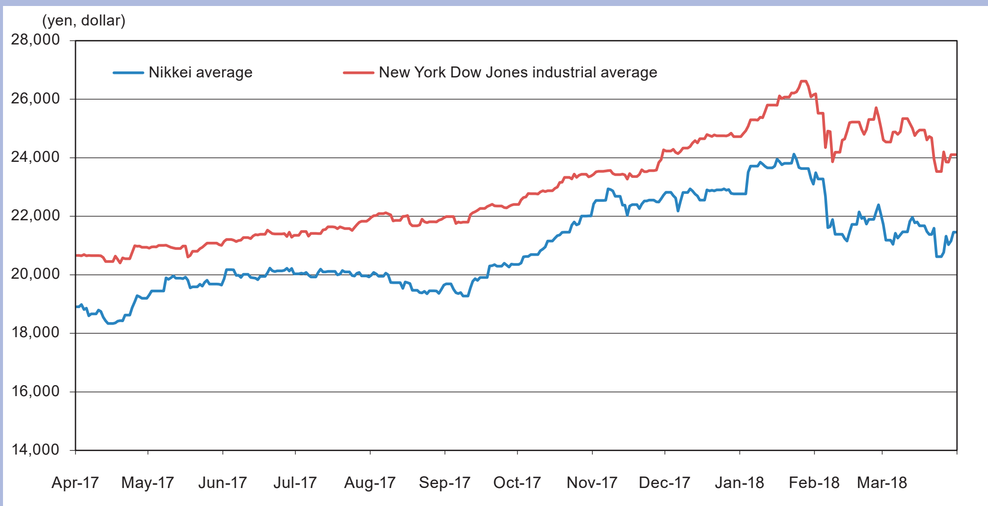
(Source: Bloomberg)

Fig.1-3 Yield Curve Trends



(Source: Japan Bond Trading Co.)

Fig.1-4 Nikkei Average and NY Dow Jones Average Trends

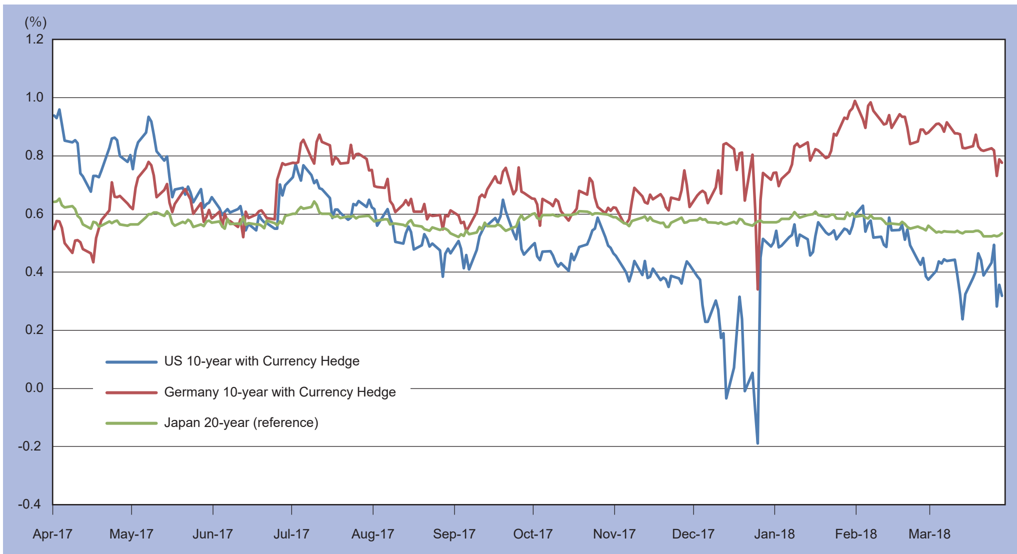


(Source: Bloomberg)

(2) Yen Bond Market Environment Changes

Under the BOJ's Quantitative and Qualitative Monetary Easing with Yield Curve Control, investors have shifted their funds not only to longer-term JGBs but also to local government bond, FILP agency bond, corporate bond and other credit markets, as well as foreign bond markets. As for the U.S. market, U.S. government securities' attractiveness for Japanese investors has declined relatively as the cost of raising dollar funds has risen amid the normalization of monetary policy. Meanwhile, the European market has had relatively higher attractiveness for Japanese investors, with the fundraising cost kept low. At present, therefore, Japanese investors are more interested in European bonds.

Fig.1-5 10-Year U.S. and German Government Bond Yield Trends with Hedge Cost Considered



(Source: Bloomberg)