1 Trends of JGB Market in FY2019

(1) Review

In FY2019, interest rates dropped globally as major central banks enhanced their monetary easing towards summer amid growing concerns that escalating protectionist trade policies would affect trade and production over a long term. Later towards the year-end, bond markets turned weak. As the Novel Coronavirus (COVID-19) outbreak expanded throughout the world from the turn of the year, however, interest rates wildly fluctuated, destabilizing bond markets. Although the JGB market followed European and U.S. market trends, interest rate fluctuations were relatively narrower under the BOJ's continued policy of "Quantitative and Qualitative Monetary Easing with Yield Curve Control."

In April, bond markets in Japan and other countries weakened in response to improvements in economic indicators in major countries. In May, however, buying pressure increased in bond markets as the U.S. government's offer to raise tariffs on Chinese and Mexican imports coincided with a growing fear of the United Kingdom's possible exit from the European Union without agreement. From early June, bond markets remained firm as speculation about U.S. interest rate cuts led market participants to grow conscious of potential additional monetary easing in Japan and Europe.

In July, bond markets leveled off as market participants enhanced a wait-and-see attitude ahead of month-end Japanese, U.S. and European monetary policy meetings. After the U.S. Federal Reserve Board at an attention-attracting meeting of the Federal Open Market Committee decided on interest rate cuts to insure against downside risks while leaving its economic assessment unchanged, U.S.-China trade disputes intensified from August to early September, leading bond markets in Japan and other countries to firm further. Then, the U.S. benchmark long-term interest rate slipped below 1.5% for the first time in 38 months and the 10-year JGB yield sank to minus 0.295%, close to the record low of minus 0.3% posted in July 2016. Interest rates rose back later as BOJ Governor KURODA Haruhiko checked any excessive drop of super long-term interest rates and the United States and China indicated their compromise at trade talks. Toward late September, however, bond buying outpaced selling again. Factors cited behind the dominant bond buying included market participants' consciousness of political uncertainties over the impeachment of U.S. President Donald Trump and speculation about the BOJ's additional monetary easing following the BOJ's plan to reexamine economic and price trends at its next monetary policy meeting.

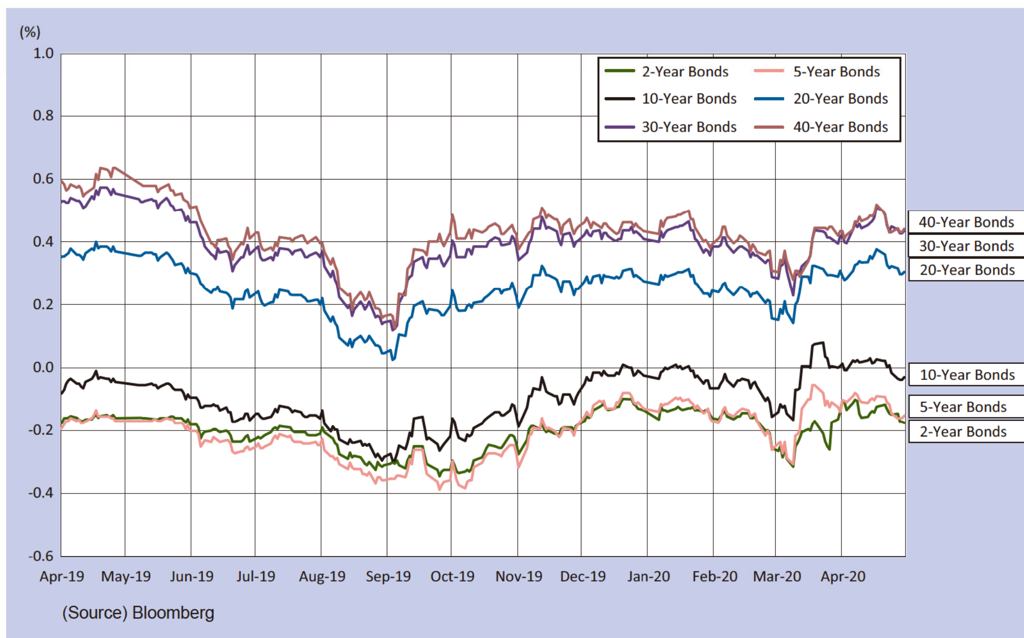
Later toward the year-end, a view that a low interest rate environment would be prolonged grew in response to the Federal Open Market Committee's indication of an end insurance rate cuts accompanied by a decision at its meeting in late October to cut interest rates for the third consecutive meeting. However, bond markets weakened as investors eased their risk-off attitude against the backdrop of expected progress in U.S.-China trade talks and the fading of uncertainties about the United Kingdom's exit from the European Union after the ruling party's landslide victory in a front-loaded general election. Then, the BOJ further reduced the size of JGB purchase operations in the super long-term zone and indicated a cut in the frequency of such operations, with early autumn speculation fading away about the BOJ's enhancement of its monetary easing through the strengthening of its negative interest rate policy, exerting upward pressure on long-term interest rates in Japan.

In early January, stock price falls, bond price hikes and the yen's appreciation came in response to growing tensions in the Middle East but were short-lived. As concerns about the COVID-19 infection expansion grew from late January to the end of FY2019, investors' risk-off attitude increased again. From late February, particularly, the financial environment rapidly deteriorated as inflationary expectations declined due to a rise in the number of market participants anticipating a global recession and a rapid decline in crude oil prices. Central banks then introduced monetary easing measures one after another, leading the U.S. benchmark long-term interest rate to fall to a record low close to 0.3% temporarily. In contrast, concerns about an increase in government bond issuance accompanying fiscal authorities' large-scale economic stimulus packages and asset sales to secure cash reserves worked to push up interest rates. In the meantime, the 10-Year JGB yield fell to minus 0.2% before rising to 0.095%, the highest level in about 16 months, posting wild fluctuations.

After Japan entered FY2020 on April 1, the government declared a state of emergency for seven major prefectures on April 7 and for the whole of Japan on April 16. As trading remained inactive due to a further fall in market participants' risk tolerance amid the spread of split operations and working remotely, the BOJ increased the frequency of JGB purchase operations, successfully leading the 10-Year JGB yield to remain around 0%.

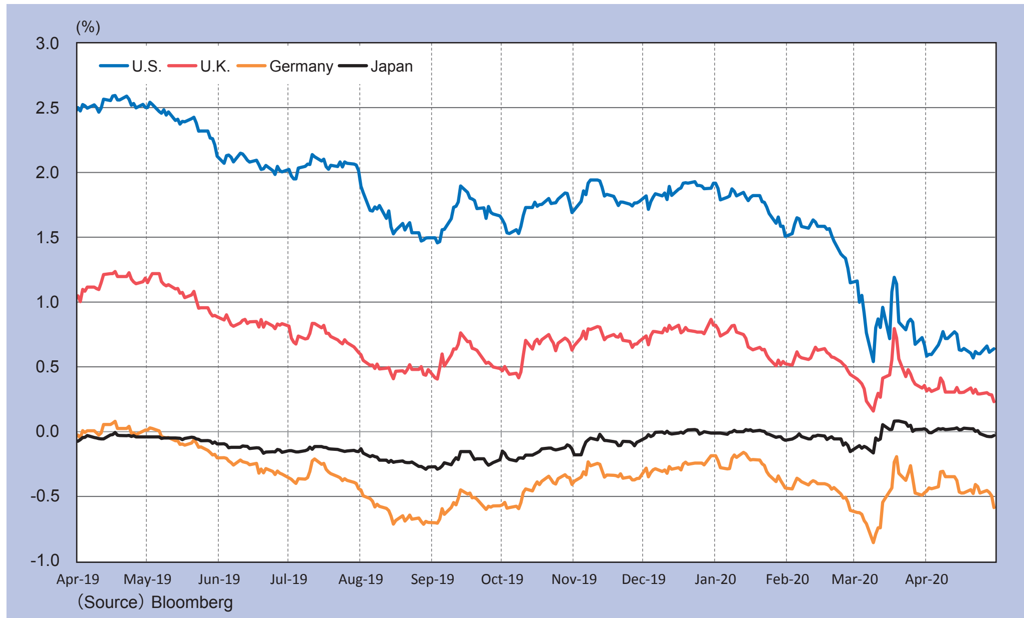
While each country has mobilized all possible policies in the face of the critical conditions, the external environment surrounding the JGB market contains various points to check, including whether policies could be normalized without turbulences after the end of the COVID-19 outbreak. The JGB market trend including these points should be closely watched.

Fig.1-1 JGB Yield Trends by Maturity



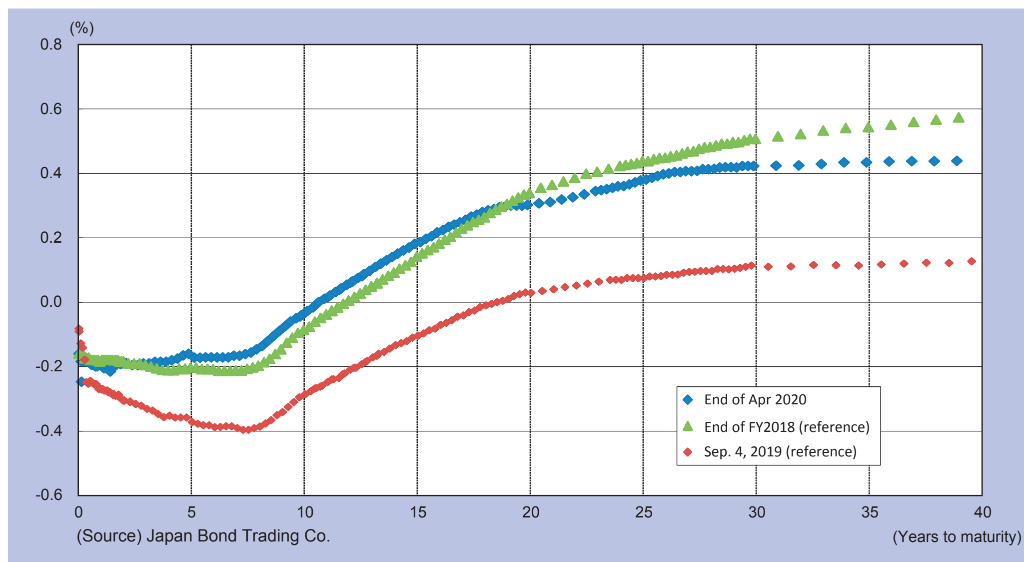
(Source) Bloomberg

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



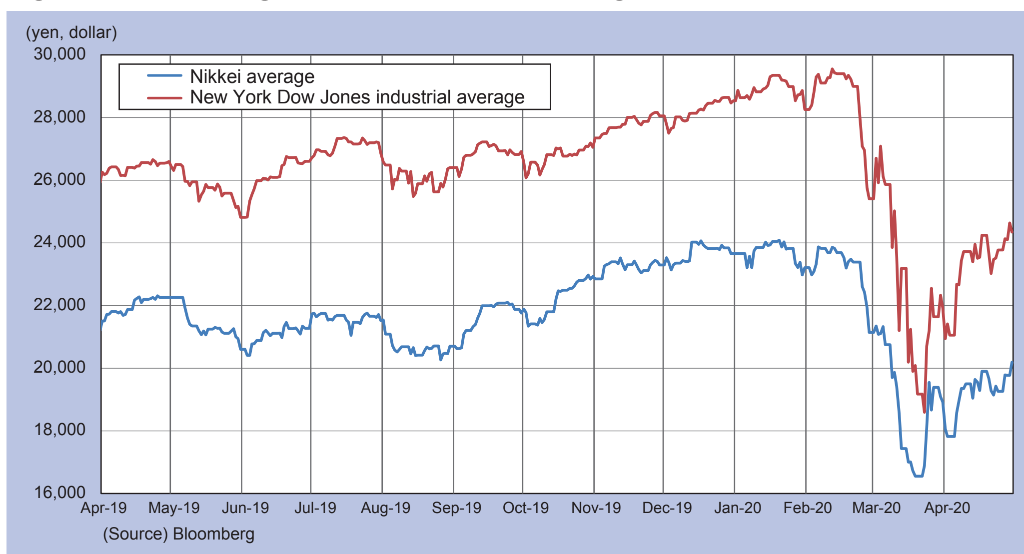
(Source) Bloomberg

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) Investor Trends

Under expectations that the BOJ's Quantitative and Qualitative Monetary Easing with Yield Curve Control policy would be prolonged, 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.

Japanese investors selected European and non-sovereign bonds among foreign bonds in a few years before increasing U.S. bond purchases again in FY2019. They saw U.S. bonds as attractive apparently because dollar fundraising costs declined thanks to the Federal Reserve Board's insurance rate cuts responding to growing uncertainties about the future world economy amid the escalating U.S.-China trade disputes and because U.S. interest rates had more room to fall amid expectations that the monetary environment would grow more accommodative globally.

Since the turn of the year, meanwhile, policy interest rates in major countries have fallen to record lows due to the growing risk of a global recession accompanying the expansion of the COVID-19 outbreak, while Japanese investors have been required to remain alert to potential credit market destabilization. The investment environment for Japanese investors has been growing severer.

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

(Source) Bloomberg