Mizuho Market Comment

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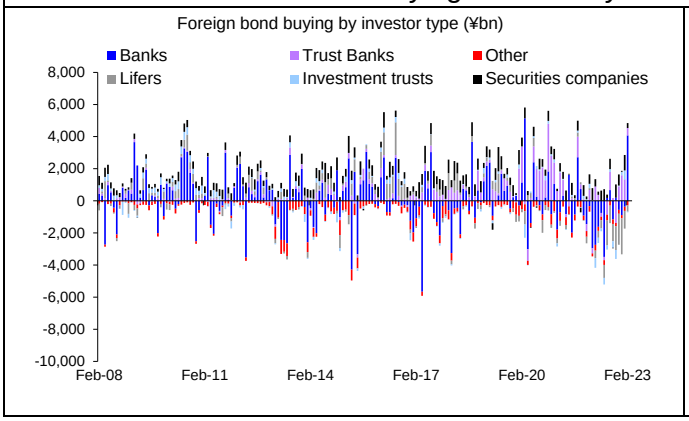
MIZUHO

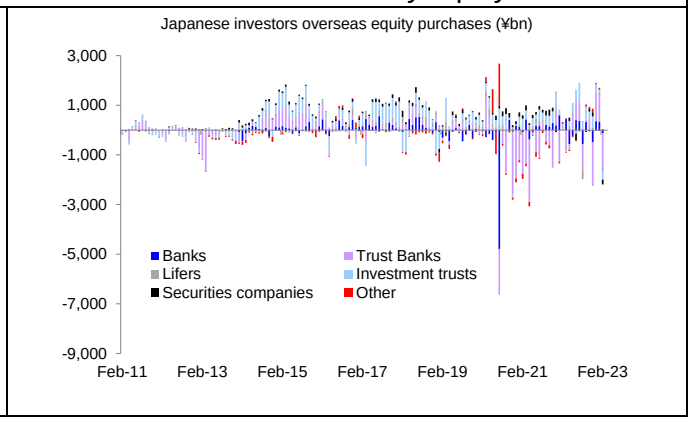
Japan flows set to slow into fiscal year end

- **MoF's monthly ITS data revealed that banks drove the heavy buying of foreign bonds in Feb…**
- **…while the selling on the equity side was driven by trust banks**
- **Japan flows into fiscal year end will likely be subdued. In early FY23 they seem likely to be choppy…**
- **…at least until yields overseas have more clearly peaked**

Banks drive the huge net buying of foreign bonds in Feb-23…
MoF's monthly International Transaction in Securities (ITS) data for February revealed that banks were the driver of the surge in Japanese foreign bond buying on the month, with net purchases of ¥4,075bn. This was the largest monthly figure for banks since Mar-20 and the 2nd largest monthly total for banks since 2005 when the data series begins. Mar-20 seems a logical buying point as investors moved to price in the impact of Covid. Feb-23 is a much less obvious buying point. The MoF report shows the bulk of the buying was in the first third of the month before 2yr UST yields pushed well above 4.5%. The fact that some banking accounts are sitting on a decent loss on the back of their recent activity likely means that they will be quieter in coming months. In addition, we are in the final weeks of the fiscal year – a period when activity usually eases off - and in the wake of the recent sell-off UST volatility is elevated, which also tends to breed hesitancy on the part of Japanese investors.

Banks dominated the bond buying in February… …while trust banks were heavy equity sellers

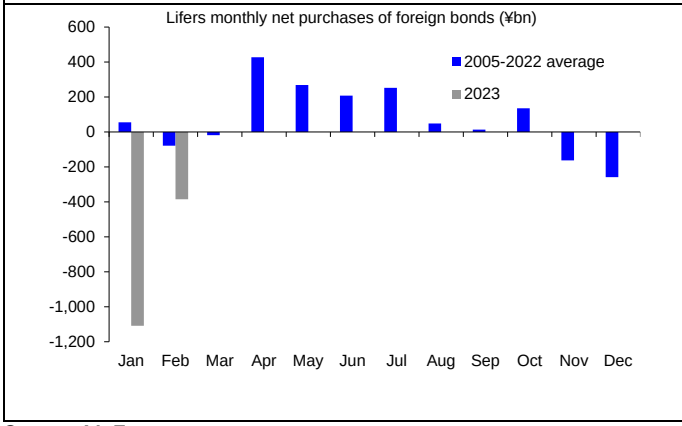
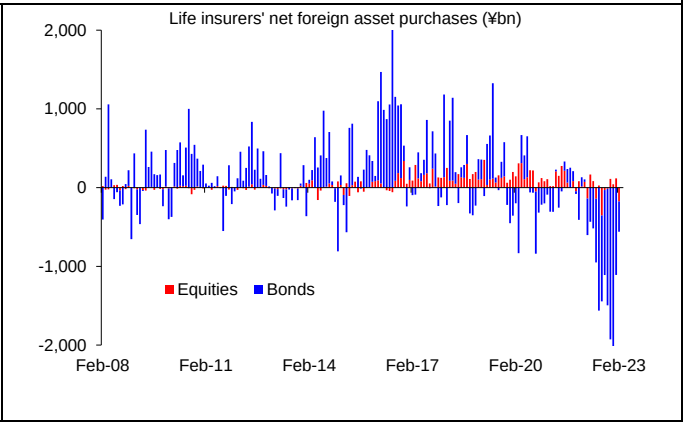




Source: MoF

..with trust banks and securities companies also net buyers
Other purchasers of foreign bonds on the month included trust banks (¥461bn) and securities companies (¥306bn). Trust bank activity in foreign bond markets was muted compared to recent months. Trust bank activity is mainly driven by rebalancing between asset classes and tends to be reactive rather than proactive.

Lifer selling in February much more muted. Hedging still deeply unattractive given costs
Not all investor groups were net buyers of foreign bonds in February. Lifers remained sellers (¥385bn). They have been record sellers in recent months but the degree of selling in February eased off sharply. We see this as largely driven by the approaching fiscal year end. Lifer flows in foreign bond markets tend to most closely reflect the stereo-typical seasonal pattern of buying at the start of the new fiscal half in April and September and selling as the fiscal year end approaches. We expect lifers to remain sellers in H1 FY23, although the scale of the selling seems unlikely to reach the levels seen in FY22. The fate of the BoJ's YCC policy will likely have a bearing on lifer activity in coming months, with any surge in longer-end Japanese rates likely to draw some funds back from overseas. Unhedged foreign bonds look attractive but we think lifers will be more comfortable when yields have more clearly peaked and volatility is lower. Hedging remains deeply unattractive given the on-going rise in hedging costs alongside the rise in overseas short-term interest rates, which has only accelerated in recent sessions.

Lifer flows have a strong seasonal flavour	Lifers' selling eases in February
	

Source: MoF,

Trust banks lead the net sales of overseas equities/funds…
The equity/fund side of the flows equation saw net selling on the month, led by trust banks. The monthly net selling figure at ¥2150bn was the 4th largest since 2005. We assume profit taking by trust banks after the jump in US equity markets in January, with the resulting funds mainly allocated into foreign bonds. The report shows the bulk of the selling of overseas taking place in the first third of the month and tailing off as the S&P dipped. Trust bank activity has been very choppy in recent months, especially on the equity side. Perhaps this is because risk assets have been volatile but trendless. The S&P is almost at the same level as it was in June-22, while trust bank net purchases of overseas equities/funds over that period are almost flat.

..with investment trusts also sellers on the month.
Trust banks were not the only sellers of equites/funds. Investment trusts (¥336bn), securities companies (¥194bn), lifers (¥175bn) and banks (¥125bn) were all sellers. For investment trusts, this was the first month of net sales since Mar-22. It bears watching.

Geographical breakdown shows funds flowing into the US – mainly on the equity side
Alongside MoF's ITS data the current account report also contains data on the geographical distribution of the investor flows albeit with a one-month lag. Today's ITS data cover February, which the current account data cover January. Japanese investors were modest net buyers of foreign bonds in January, with the bulk of the buying in US (¥357bn - first net purchases since August) and UK bonds (¥266bn - for a third consecutive month). In the eurozone the bulk of the funds flowed into German (¥251bn) and Italian (¥112bn) bonds. On the equity/fund side, the US absorbed the bulk of the buying for a second consecutive month.

We continue to see USD/JPY edging lower through most of 2023, with the primary driver a modest decline in UST yields, mainly in H2. We also expect that BoJ policy change will play a role too. Lifer selling of foreign bonds seemed to have limited impact in 2022 and we see this remaining the case the coming quarter. We expect to see a modest improvement in Japan's trade balance too in coming months, which should also lift JPY.