

Outlook for 40Y JGB Auction

Good dip-buying opportunity

- ✓ Little caution will be needed for tomorrow's primary sales of new 40Y JGBs because: (1) the auction will be conducted in a yield-Dutch method; (2) it will be relatively small-lot issuance of about 500 billion yen; (3) there are strong expectations for demand from investors at around 1%; and (4) decent short-covering and inventory demand are expected from primary dealers. We need to be attentive to bidding-up activities in pre-auction trading, which could negatively impact the primary sales. Expecting the JU10 yield to decline to at least 0.95% some point in the Jan.-Mar. period, however, we would like to place our bids for new 40Y JGBs around 1.0% at the auction.

Strategic Memorandum DSTE208
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Auction Details

Auction Date:	January 12, 2018
Issue Date:	January 16, 2018
Maturity Date:	March 20, 2057
Offering Amount:	About 500 billion yen

* New 40Y JGBs will be the fourth reopening of JU10 carrying a 0.9% coupon.

** On January 11, JU10 traded at 1.010-1.015% (unch - +0.5bp v. previous day's close; 0.995-0.999% on a compound yield basis) and closed at 1.010% (unch; 0.995%).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

A good dip-buying opportunity

After the previous 40Y JGB auction went poorly on November 28, the JU10 yield declined from 1.020% to 0.950% toward the mid-December on an intraday basis. Subsequently, speculations on the BOJ's intention to reduce its JGB purchases grew in late December, and, in actual fact, the bank's trimming the purchase amounts for superlong JGBs surprised JGB market participants in terms of its timing on January 9. Those, combined with the JGB market softness, have led the JU10 yield to 1.015% (0.999% on compound yield) ahead of tomorrow's auction. Going forward, the BOJ is expected to continue to trim its JGB purchase amount in measured steps under the framework of the yield curve control policy. However, we think that such a move is unlikely to trigger a surge in JGB yields especially in the zone over 25Y, where the supply/demand balance has been too tight for a quite long time.

Little caution will be needed for tomorrow's primary sales of new 40Y JGBs because: (1) the auction will be conducted in a yield-Dutch method; (2) it will be relatively small-lot issuance of about 500 billion yen; (3) there are strong expectations for demand from investors at around 1%; and (4) decent short-covering and inventory demand are expected from primary dealers. We need to be attentive to bidding-up activities in pre-auction trading, which could negatively impact the primary sales. Expecting the JU10 yield to decline to at least 0.95%

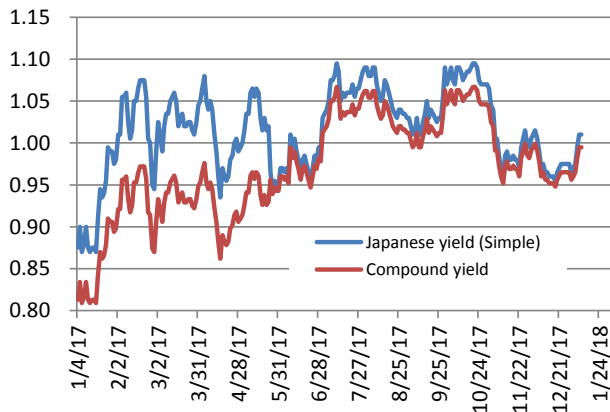
some point in the Jan.-Mar. period, however, we would like to place our bids for new 40Y JGBs around 1.0% at the auction.

40Y JGB Auction Results

Offer Date	Issue#	Nominal Coupon (%)	Maturity Date	Issue Size (100M yen)	B/C	Highest Accepted Yield (%)	Allotment (%)	Issue Price (yen)	Yield on the previous day (%)**	30Y/40Y on the previous day (bp)**	Yield at close on the auction day (%)**	30Y/40Y at close on the auction day (bp)**	
1/12/18	10R	0.9	3/20/57	500.0*					0.995	15.9			
11/28/17	10R	0.9	3/20/57	534.1	3.00	1.005	63.8132	96.60	0.991	16.0	0.999	16.3	Poor
9/26/17	10R	0.9	3/20/57	556.2	3.24	1.015	1.4525	96.27	1.012	19.4	1.012	19.0	Good
7/25/17	10R	0.9	3/20/57	563.7	3.20	1.045	6.5217	95.30	1.046	18.8	1.033	18.8	Good
5/25/17	10	0.9	3/20/57	530.2	2.87	0.965	5.1671	97.86	0.945	14.5	0.956	14.7	Poor
3/22/17	9R	0.4	3/20/56	561.5	2.95	0.935	13.6363	82.55	0.941	10.0	0.929	10.7	Good
1/24/17	9R	0.4	3/20/56	509.9	2.99	0.865	15.3846	84.59	0.862	9.4	0.866	9.4	Avg
11/25/16	9R	0.4	3/20/56	573.8	2.98	0.725	26.5037	88.90	0.722	9.3	0.680	8.3	Good
9/27/16	9R	0.4	3/20/56	532.1	2.73	0.560	15.6657	94.34	0.554	6.9	0.563	6.3	Good
7/26/16	9R	0.4	3/20/56	458.3	2.89	0.345	31.7647	102.04	0.329	6.3	0.324	6.3	Good
5/26/16	9	0.4	3/20/56	451.6	3.07	0.400	36.7380	100.00	0.415	5.6	0.385	4.7	Good

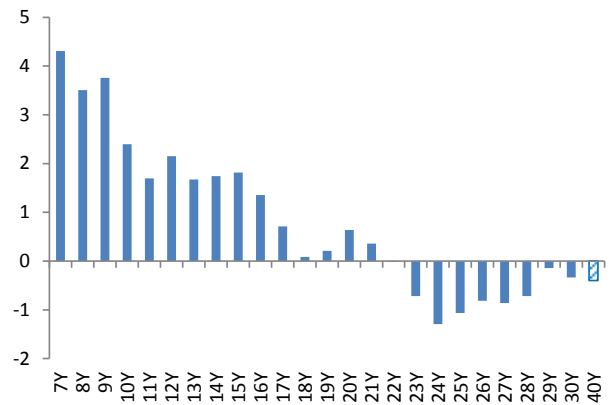
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



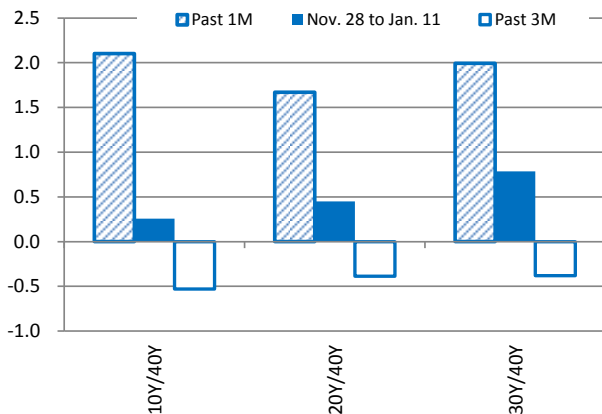
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Nov. 28 v. Jan. 11, bp)



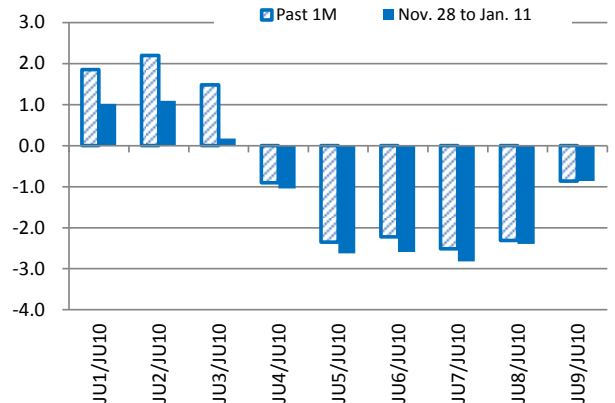
Source: Daiwa Securities.

Appendix 3a: Z-score I



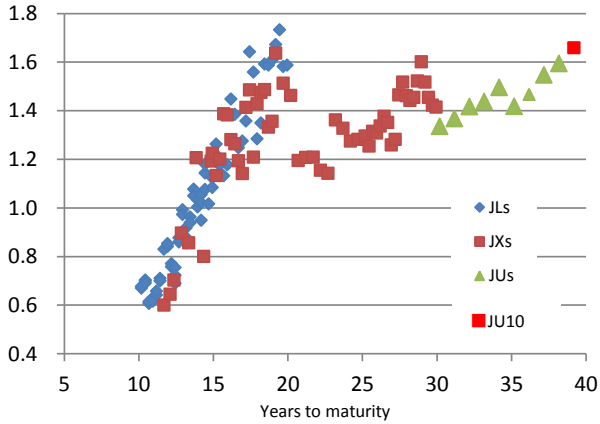
Note: Based on on-the-run issues
Source: Daiwa Securities.

Appendix 3b: Z-score II



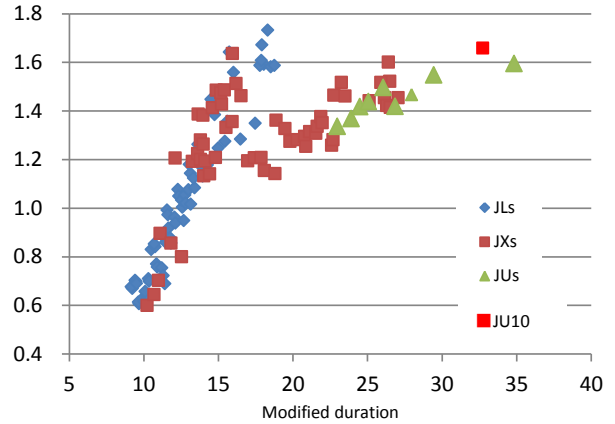
Source: Daiwa Securities.

Appendix 4a: 6M Total Return Curve on Years to Maturity (%)



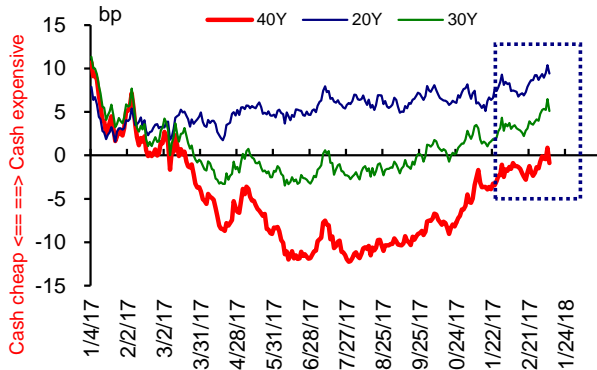
Note: Assuming that the yield curve shape as on January 11 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 4b: 6M Total Return Curve on Modified Duration (%)



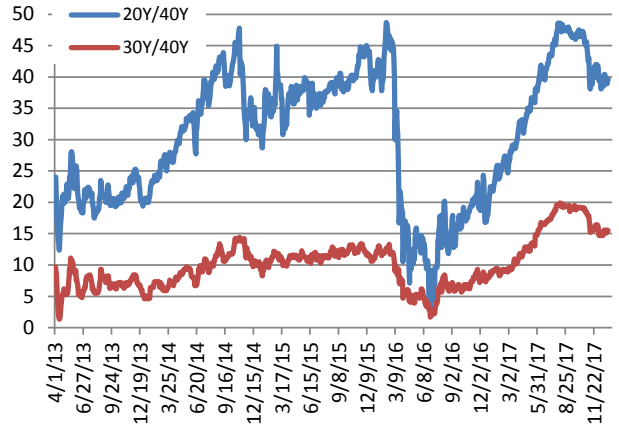
Note: Assuming that the yield curve shape as on January 11 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 5: Swap Spreads



Source: Daiwa Securities.

Appendix 6: JGB 20Y/40Y and 30Y/40Y Spreads (bp)



Source: Daiwa Securities.

IMPORTANT

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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.
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* 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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