

## Outlook for 5Y JGB Auction

### Buy at -0.105 - -0.095% level

- ✓ Factoring in all, we would like to place our bids for new 5Y JGBs at the -0.105 - -0.095% at the auction.
- ✓ It will be worth considering building 5Y/10Y/20Y butterfly position.

Strategic Memorandum DSTE222  
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### Auction Details

**Auction Date:** March 13, 2018  
**Issue Date:** March 20, 2018  
**Maturity Date:** March 20, 2023  
**Offering Amount:** About 2.2 trillion yen

\* New 5Y JGBs, JS135, will likely carry a 0.1% coupon.

\*\* On March 12, WI barely traded, and closed at -0.105% (unch v. previous day's close).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### Placing bids at -0.105 - -0.095% level

After the previous 5Y JGB auction went well on February 14, the 5Y JGB yield declined from -0.090% on February 15 to -0.125% at one point in early March on an intraday basis. Over the past few days, the yield has been moving at the -0.120 - -0.115% level, around the lower end of the recent range.

Key points to think about the bidding level at tomorrow's auction are as follows:

- JS135 is expected to be a large amount of issuance over four auctions (incl. tomorrow's auction), totaling about 8.2 trillion yen;
- The 5Y sector is currently undervalued vs. the 8-10Y sectors on the JGB yield curve (Appendix 3);
- It is highly possible that the BOJ will conduct five to six purchase operations, in which new 5Y JGBs will be included in the purchase list, by the next 5Y JGB auction to be held on April 17 (three operations in March and two to three more operations expected in April);
- Given the result of today's TDB purchase operation by the BOJ, we think that (1) domestic investors' collateral-related demand has played out and (2) demand from foreign investors may weaken amid gradual tightening in USD/JPY basis swaps. We are thus cautious about the possibility that market sentiment for TDBs and 2Y JGBs will worsen toward the new fiscal year;

and so on.

Triggered by the revived Morimoto school scandal, concerns about the political situation rapidly grow. Regarding the matter that the Ministry of Finance altered the scandal-related documents, which included the name of Akie Abe, wife of Prime Minister Shinzo Abe, Minister of Finance Taro Aso clearly denied the possibility that he will step down at the press conference held this afternoon. The press conference gave us an impression that he has gone through questions from reporters without difficulty. However, it appears unavoidable to see a decline in the Abe administration’s approval rating and a rise in uncertainty about Prime Minister Abe’s grip on power. Toward the LDP’s presidential election in September, the political situation is likely to become more unstable. In the near term, we are worried about the impact on Diet approval of next BOJ governor and deputy governors. However, as the ruling parties are ascendant both in the lower and upper houses, the possibility that the Diet will not approve the already submitted nomination proposal (Governor Haruhiko Kuroda as well as deputy governors Masayoshi Amamiya and Masazumi Wakatabe) appears quite slim. We think that the BOJ will continue the current monetary policy in a matter-of-fact stance.

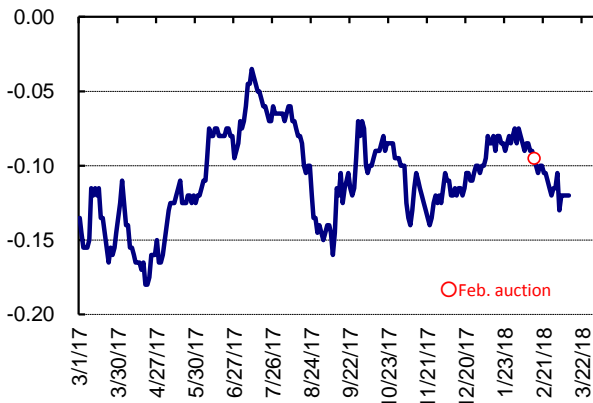
All in all, we would like to place our bids for new 5Y JGBs at the -0.105 - -0.095% level at tomorrow’s auction. At the -0.100 - -0.095% level, it will be worth considering taking some outright positions as well. Relative-value wise, we think of building a 5Y/10Y/20Y butterfly position (selling 10Y/buying 5Y and 20Y) with cash- and duration-neutral weighting. This is likely to work well with a further rise in yield volatility and flattening of the yield curve. Moreover, we expect a positive return from the position even if the shape of the yield curve is unchanged.

**5Y JGB Auction Results**

Auction Date	Issue #	Marutiry Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
3/13/18	135	3/20/23	0.1*	2.2**									
2/14/18	134R	12/20/22	0.1	2.5	4.67	100.94	100.94	0.00	-0.093	-0.093	0.000	91.9530	Good
1/16/18	134R	12/20/22	0.1	2.4	5.24	100.91	100.90	0.01	-0.084	-0.082	0.002	8.9750	Good
12/12/17	134	12/20/22	0.1	2.5	4.38	101.03	101.02	0.01	-0.104	-0.102	0.002	83.4736	Good
11/14/17	133R	9/20/22	0.1	2.5	4.19	101.01	101.00	0.01	-0.107	-0.105	0.002	53.5278	Avg
10/19/17	133R	9/20/22	0.1	2.5	4.24	100.90	100.90	0.00	-0.082	-0.082	0.000	88.7951	Good
9/12/17	133	9/20/22	0.1	2.2	4.07	101.06	101.03	0.03	-0.110	-0.104	0.006	47.7913	Poor
8/17/17	132R	6/20/22	0.1	2.3	4.46	100.89	100.88	0.01	-0.083	-0.081	0.002	69.6951	Avg
7/11/17	132R	6/20/22	0.1	2.5	4.85	100.67	100.66	0.01	-0.035	-0.033	0.002	81.8127	Avg
6/8/17	132	6/20/22	0.1	2.4	4.71	100.83	100.82	0.01	-0.065	-0.063	0.002	83.4769	Good
5/16/17	131R	3/20/22	0.1	2.3	3.59	101.06	101.04	0.02	-0.117	-0.113	0.004	41.5877	Avg
4/18/17	131R	3/20/22	0.1	2.3	3.28	101.29	101.25	0.04	-0.160	-0.152	0.008	50.9655	Poor
3/9/17	131	3/20/22	0.1	2.4	2.86	101.10	101.06	0.04	-0.118	-0.110	0.008	83.8513	Poor
2/14/17	130R	12/20/21	0.1	2.8	4.26	100.92	100.90	0.02	-0.089	-0.085	0.004	26.2248	Avg
1/19/17	130R	12/20/21	0.1	2.4	3.66	101.07	101.01	0.06	-0.116	-0.104	0.012	84.3630	Poor

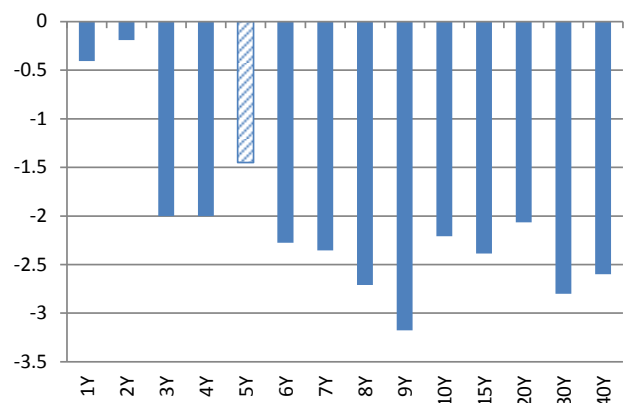
\* Daiwa forecast (as of Mar. 12) \*\* Amount the MOF plans to issue  
 Source: Ministry of Finance (MOF), Daiwa Securities.

**Appendix 1: 5Y JGB Yield (%)**



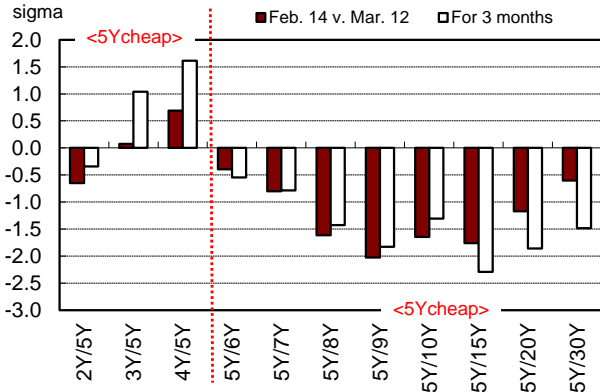
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (Feb. 14 v. Mar. 12; bp)**



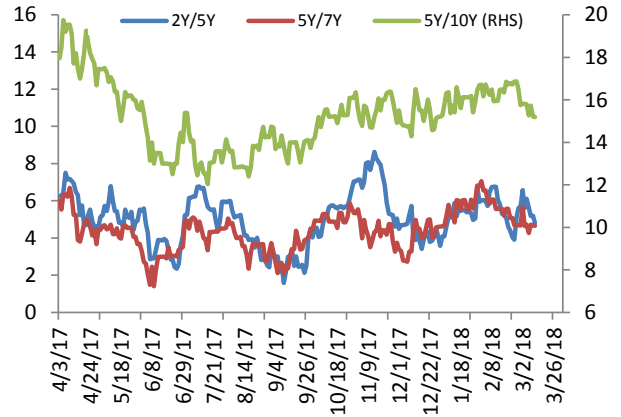
Source: Daiwa Securities.

### Appendix 3: Z-scores of JGB Yield Spreads



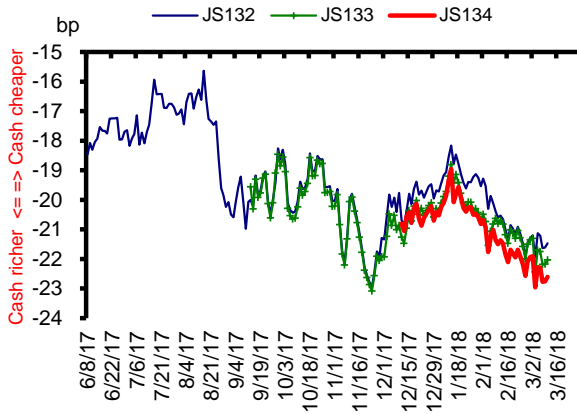
Source: Daiwa Securities.

### Appendix 4: JGB Yield Spreads (bp)



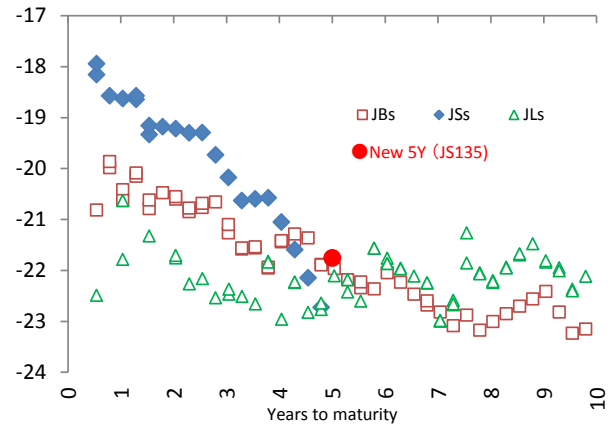
Source: Daiwa Securities.

### Appendix 5a: 5Y JGB Asset Swap Spreads



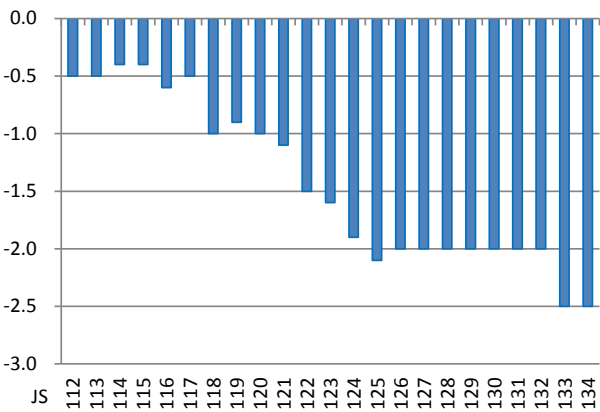
Note: against Yen LIBOR  
Source: Daiwa Securities.

### Appendix 5b: JGB Asset Swap Spread Curve (bp)



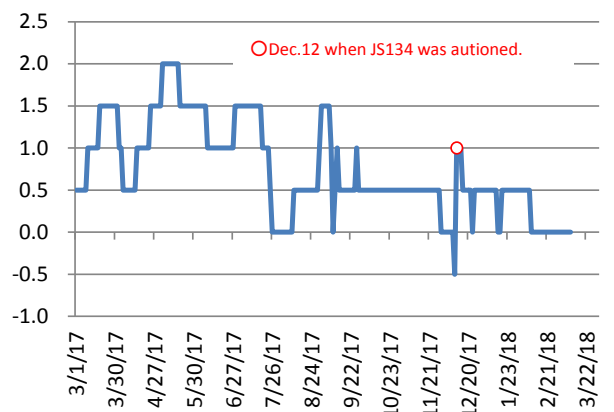
Note: against Yen LIBOR as of Mar. 9; JS135 is based on WI.  
Source: Daiwa Securities.

### Appendix 6: JS Yield Change (bp): Feb. 14 v. Mar. 12



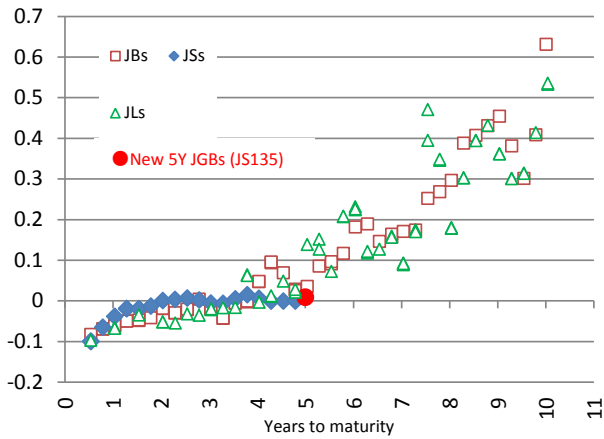
Source: Daiwa Securities.

### Appendix 7: JS On-the-run and Off-the-run Spread (bp)



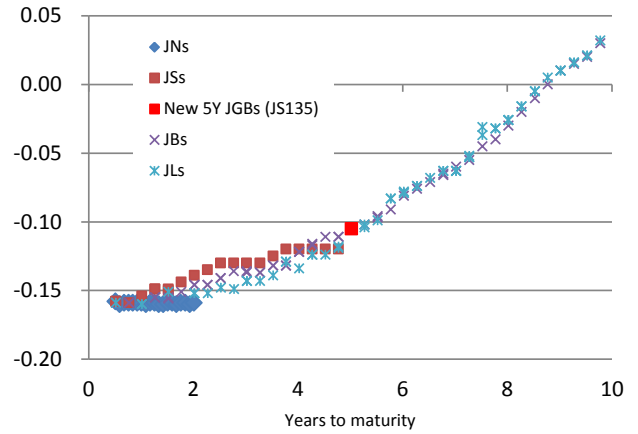
Source: Daiwa Securities.

**Appendix 8: 6M Total Returns of JSs, JBs and JJs (%)**



Note: Based on JB, JS and JJ yield curves on Feb. 9, respectively; Assuming that those yield curve shapes do not change and factoring roll-down effect etc.; Assuming the yield spread between JS135 and JS134 as 1bp.  
Source: Daiwa Securities.

**Appendix 9: JGB Yield Curve (%)**



Note: as of Mar. 9; JS135 is based on WI  
Source: Daiwa Securities.

**IMPORTANT**

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- 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.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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