

## JGB Insight

### JGBis: Best season to invest

- ✓ Good size of positive carry expected by investing in April-May

Strategic Memorandum DSTE230  
FICC Research Dept.

Senior JGB Strategist  
**Keiko Onogi**  
+813 5555 8788  
keiko.onogi@daiwa.co.jp  
Daiwa Securities Co. Ltd.

#### BEI has been in the 55-60bp range

Since the previous 10Y JGBi auction went smoothly on February 6, the breakeven inflation rate (BEI) of the on-the-run JBI22 has been mostly in the 55-60bp range (Chart 1). The U.S 10Y TIPS BEI remains flat around 2.1%, crude oil prices hovers in the high level (Chart 8a) and Japan's inflation keeps on uptrend (Chart 9) etc. In such an environment, JGBis are moving stably without facing strong selling pressure. On the other hand, the upside of the BEI from 60bp has been limited in the absence of new investors and as the long-term nominal yield has been staying in the 0.0-0.1% level under the BOJ yield curve policy.

#### JGBis have been mostly performing better than nominal JGBs

Let's review the performance of JGBis from the February auction up to today with the comparison to that of nominal JGBs on JBI22 and JB346 (Chart 6). JBI22 had performed better than JB346 until the end of March. In April, however, JB346 performs better than JBI22 as carry on JBI22 declines amid a downtrend in index ratio, when its closing price is mostly unchanged.

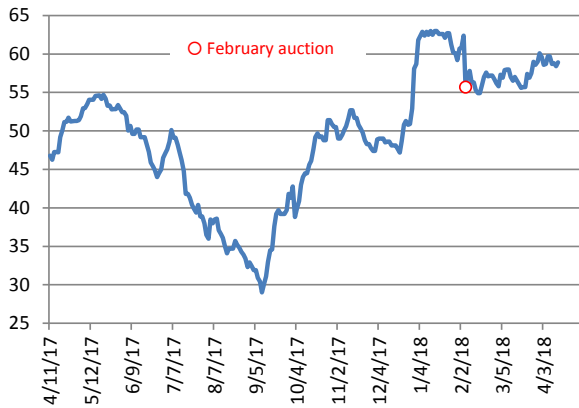
#### Inflation is warming up

We check the environment surrounding JGBis. The growth rate of the nationwide core CPI in February, announced on March 23, was 1.0% y/y, escaping from the 0% level. Stronger boosts from petroleum products, such as gasoline and kerosene, along with solid rise in general services, supported the year-on-year growth. But we don't take the recent uptrend in inflation as a rapid change in the long-term inflation trend as the impact from travel package fees and accommodation charges, which were influenced by Chinese New Year holidays, appear significant. We expect the growth rate of the nationwide core CPI to remain roughly flat at the 0.9-1.1% level toward July. According to the result of the latest wage hike negotiations, called Shunto, the base salary is expected to rise only slightly in FY18. Expecting the wage growth to stay sluggish, we think that the observed inflation is most likely to remain moderate. Also in the US, market participants seem to be building a consensus on inflation that it is warming up but not heating up (Chart 8a). Given the fact that crude oil prices hit 40-month high amid growing expectations on a tighter supply and demand balance, however, we think that pessimistic view on inflation is unlikely to emerge sharply. All in all, the environment surrounding JGBis is not that bad, we see.

#### April-May can be a good time to invest JGBis

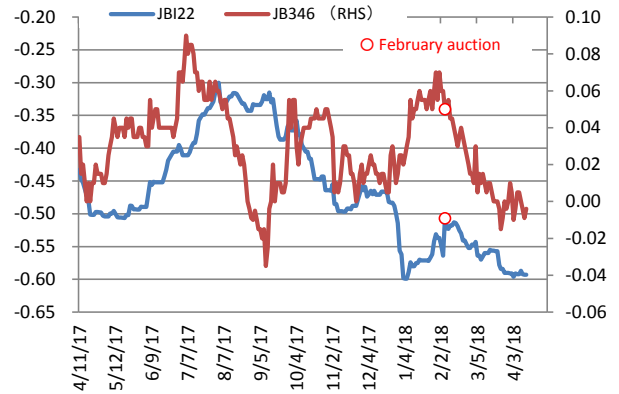
Our estimate of the index ratio on JBI22, based on our inflation forecasts, implies that it is highly likely to post an uptrend toward February 2019 (Chart 9). That means, if we invest in JGBis like JBI22 today, we could get a good size of positive carry or a positive return even if the JGBi price remains unchanged during the investment period (Chart 7). Although there are some persistent worrisome factors, such as small market, low liquidity and limited number of market participants etc., April-May can be a good time to invest JGBis.

Chart 1: BEI (bp)



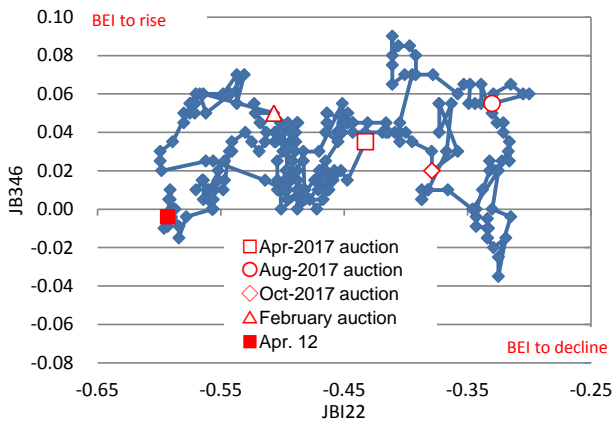
Source: Daiwa Securities

Chart 2: JBI22 and JB346 Yields (%)



Source: Daiwa Securities.

Chart 3: Correlation between JBI22 and JB346 (%)



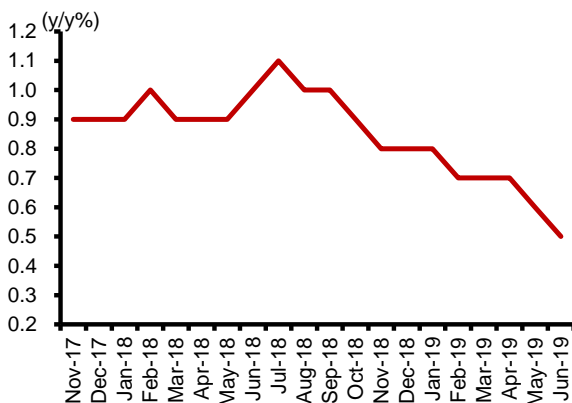
Source: Daiwa Securities

Table 1: BOJ Purchase and MOF Buyback Results

	Previous Day's Close (Yen)	Pro-rata Price Spread (Yen)	Average Successful Price Spread (Yen)	Allotment on Pro-rata (%)	B/C	Close Price (Yen)
1/9/18	106.60	-0.120	-0.159	86.7	5.92	106.50
1/29/18	106.20	-0.170	-0.198	80.6	6.80	106.00
2/7/18	105.65	0.090	0.028	4.3	5.22	105.80
2/13/18	105.75	-0.170	-0.211	80.8	5.77	105.75
2/26/18	106.00	-0.060	-0.101	28.2	7.02	106.05
3/2/18	106.00	0.040	0.028	89.8	6.18	105.95
3/23/18	106.25	0.000	-0.230	93.5	3.86	106.30
4/2/18	106.35	-0.060	-0.115	53.3	5.88	106.35
4/11/18	106.35	-0.060	-0.082	80.6	5.55	106.35

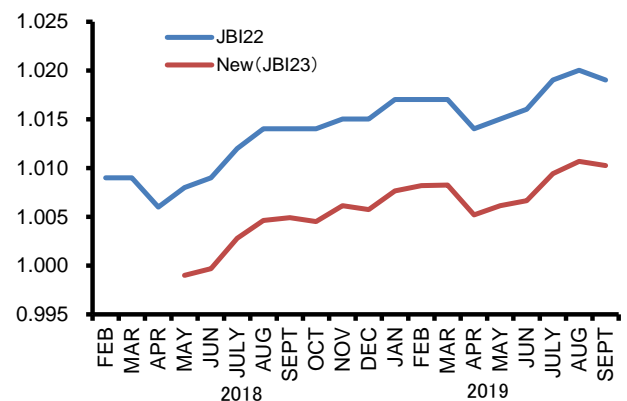
(Note) Previous Day's Close and Close Price are based on JBI22. Buybacks by the Ministry of Finance on February 13 and April 11, 2018  
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Chart 4: Nationwide Core-CPI Growth Outlook



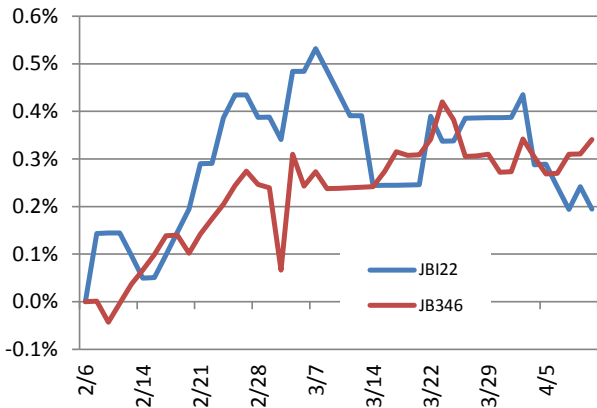
Note: actual for Nov. 2017 to February 2018  
Source: Daiwa Securities.

Chart 5: Index Ratio Forecast on JBI22



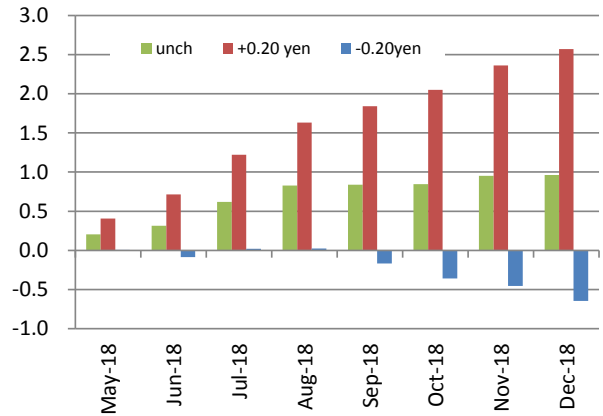
Note: based on Chart 4; actual for Feb. to May 2018; New (JBI23) is the issue to be auctioned on May 10.  
Source: Daiwa Securities

**Chart 6: Realized Return: JBI22 v. JB346**



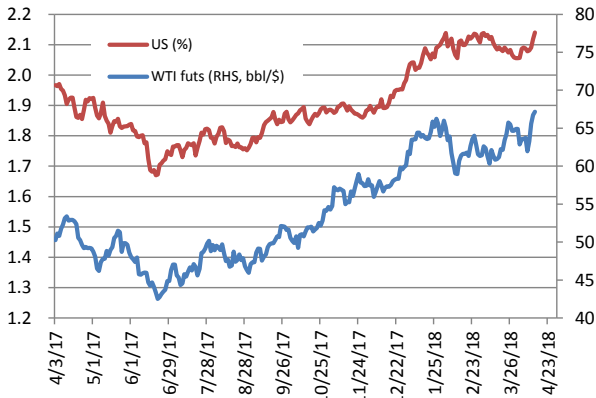
Notes: From Feb. 6 to each day  
Source: Daiwa Securities

**Chart 7: Holding Period Return on JBI22 (%)**



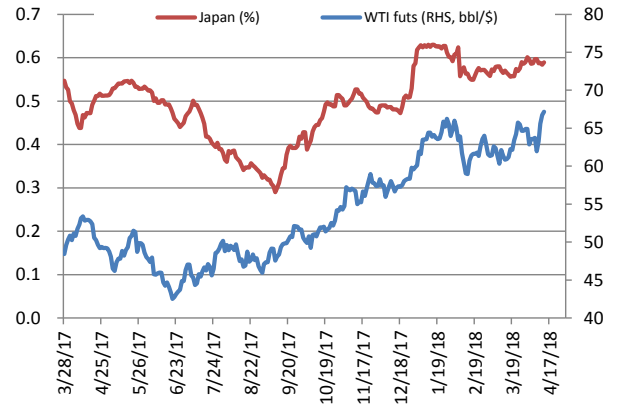
Notes: Return by scenario is estimated based on the index ratio in Chart 5. Price during each holding period from April 13 is unchanged under "the scenario 1", up 0.20 yen every month under "the scenario 2", and down 0.20 yen every month under "the scenario 3."  
Source: Daiwa Securities

**Chart 8a: US BEI and Oil Price**



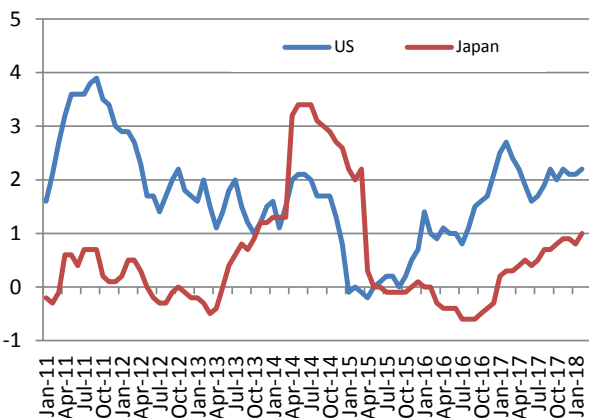
Source: Bloomberg

**Chart 8b: Japan BEI and Oil Price**



Source: Bloomberg, Daiwa Securities.

**Chart 9: US and Japan CPI Growth (y/y %)**



Source: Bloomberg

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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.

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