

Outlook for 30Y JGB Auction

Moderate bidding around 0.71%

- ✓ If primary sales for new 30Y JGBs, which will be for the third and final reopening of JX58, take place around 0.71%, moderate bidding is expected for covering some short positions.
- ✓ Although the 30Y sector lacks relative-value attractiveness, we would like to pay attention to activities to switch out from the 20Y sector or 40Y JGBs with about 30 years left to the maturity.

Strategic Memorandum DSTE246
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Auction Details

| | |
|-------------------------|-----------------------|
| Auction Date: | June 19, 2018 |
| Issue Date: | June 20, 2018 |
| Maturity Date: | March 20, 2048 |
| Offering Amount: | About 700 billion yen |

* New 30Y JGBs will be the third (and final) reopening of JX58 carrying a 0.8% coupon.

** On June 18, JX58 barely traded and closed at 0.710% (unch v. previous day's close).

Exp. Rating on Auction Results

| | | | | |
|--------|------|---------|------|-------------|
| 1 | 2 | 3 | 4 | 5 |
| Failed | Poor | Average | Good | Outstanding |

Moderate bidding around 0.71%

After the previous 30Y JGB auction went well at around 0.75% on May 15, the JX58 yield (conventional) temporarily rose to 0.770% on an intraday basis. In late May, the bond markets in major nations moved firmly, as witnessed by the 10Y US Treasury yield falling below 2.8%, amid growing risk-off sentiment caused by the emergence of worries about the political situation in South Europe. In such an environment, the JGB market also performed well, pushing down the 30Y JGB yield to 0.695% at one point. However, as the momentum to buy 30Y JGBs appears to have diminished at the level below 0.7%, the 30Y JGB yield has been mostly moving at the 0.710-0.735% range since the beginning of June (Appendix 1).

We think the key factors that will affect bidding at this auction are as follows. We expect decent short covering as (1) new 30Y JGBs will be the last reopening of JX58 and (2) the repo rate recently started to ease. Regarding investor demand as well, strong caution would be unnecessary amid strong expectations on demand from investors, who have been losing their appetite for overseas bonds, although the absolute 30Y JGB yield level is low. On the other hand, a worrisome factor is the issuance schedule for superlong JGBs. The next auction for 30Y JGBs, which will belong to new maturity basket to be redeemed in June 2048, will be held on July 5, only slightly more than two weeks after tomorrow's auction. During that period, the BOJ is expected to conduct only two to three purchase operations in the zone over 10Y (two scheduled for June and another may be conducted on July 2). In

addition, the market has strong speculations on a reduction in the BOJ's offer amount in the zone¹.

Going through last week's central bank events (US FOMC meeting, ECB Governing Council meeting, and BOJ Monetary Policy meeting) which garnered a lot of attention, the JGB market is unlikely to face upward pressure in the near term. However, we are unable to become completely optimistic on the upside of 30Y JGBs from the current level (around 0.710%) as the 10Y and 20Y JGB yields remain in the existing ranges. All in all, if primary sales for new 30Y JGBs, which will be for the third and final reopening of JX58, take place around 0.71%, moderate bidding is expected only for covering some short positions and the upside of 30Y JGBs in the secondary market is likely to be limited.

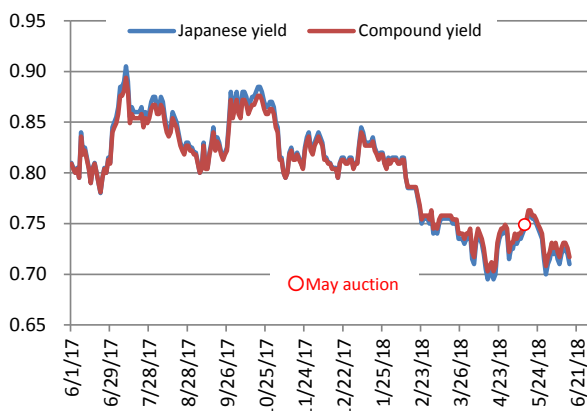
Currently, the 30Y sector is not noticeably cheap on the curve (Appendix 3). In addition, 30Y JGB asset swap is neither overvalued nor undervalued at the current level (Appendix 4). Those indicate that the 30Y sector in JGBs lacks relative-value attractiveness at the moment. However, we would like to pay attention to activities to switch out from the 20Y sector, in which new supply is scheduled on June 26, or 40Y JGBs with about 30 years left to maturity partly because JX58 carries longer duration and higher return than those 40Y JGBs (Appendix 5).

30Y JGB Auction Results

| Auction Date | Issue # | Coupon (%) | Maturity | Amt Issued (billion yen) | B/C | Average Accepted Price (Yen) | Lowest Accepted Price (Yen) | Tail (Yen) | Average Accepted Yield (%) | Highest Accepted Yield (%) | Tail (%) | Allotment (%) | |
|--------------|---------|------------|----------|--------------------------|------|------------------------------|-----------------------------|------------|----------------------------|----------------------------|----------|---------------|------|
| 6/19/18 | 58R | 0.8 | 3/20/48 | 700* | | | | | | | | | |
| 5/15/18 | 58R | 0.8 | 3/20/48 | 795.6 | 4.41 | 101.31 | 101.30 | 0.01 | 0.746 | 0.746 | 0.000 | 91.8088 | Good |
| 4/12/18 | 58R | 0.8 | 3/20/48 | 802.5 | 4.34 | 102.11 | 102.05 | 0.06 | 0.714 | 0.716 | 0.002 | 19.1148 | Good |
| 3/6/18 | 58 | 0.8 | 3/20/48 | 887.3 | 4.24 | 101.21 | 101.15 | 0.06 | 0.750 | 0.753 | 0.003 | 68.4310 | Avg |
| 2/8/18 | 57R | 0.8 | 12/20/47 | 911.9 | 4.27 | 99.50 | 99.45 | 0.05 | 0.820 | 0.822 | 0.002 | 92.6464 | Avg |
| 1/18/18 | 57R | 0.8 | 12/20/47 | 799.1 | 3.77 | 99.23 | 99.10 | 0.13 | 0.832 | 0.837 | 0.005 | 25.8603 | Poor |
| 12/7/17 | 57 | 0.8 | 12/20/47 | 917.5 | 4.38 | 98.84 | 98.80 | 0.04 | 0.848 | 0.850 | 0.002 | 75.8059 | Good |
| 11/9/17 | 56R | 0.8 | 9/20/47 | 862.5 | 3.43 | 100.26 | 100.00 | 0.26 | 0.789 | 0.800 | 0.011 | 7.3651 | Poor |
| 10/11/17 | 56R | 0.8 | 9/20/47 | 868.0 | 3.98 | 98.07 | 98.00 | 0.07 | 0.881 | 0.884 | 0.003 | 55.0218 | Good |
| 9/7/17 | 56 | 0.8 | 9/20/47 | 803.1 | 3.67 | 99.21 | 99.00 | 0.21 | 0.832 | 0.841 | 0.009 | 66.9438 | Poor |
| 8/8/17 | 55R | 0.8 | 6/20/47 | 829.8 | 3.90 | 98.20 | 98.10 | 0.10 | 0.876 | 0.880 | 0.004 | 12.8466 | Avg |
| 7/6/17 | 55R | 0.8 | 6/20/47 | 831.4 | 3.62 | 98.14 | 98.05 | 0.09 | 0.878 | 0.882 | 0.004 | 57.2512 | Avg |
| 6/6/17 | 55 | 0.8 | 6/20/47 | 804.7 | 3.63 | 99.58 | 99.45 | 0.13 | 0.817 | 0.822 | 0.005 | 12.0441 | Avg |
| 5/11/17 | 54R | 0.8 | 3/20/47 | 799.0 | 3.35 | 99.54 | 99.45 | 0.09 | 0.819 | 0.822 | 0.003 | 79.0333 | Good |

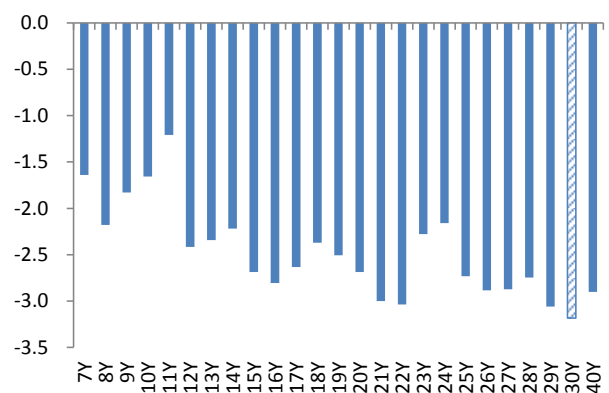
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



Source: Daiwa Securities.

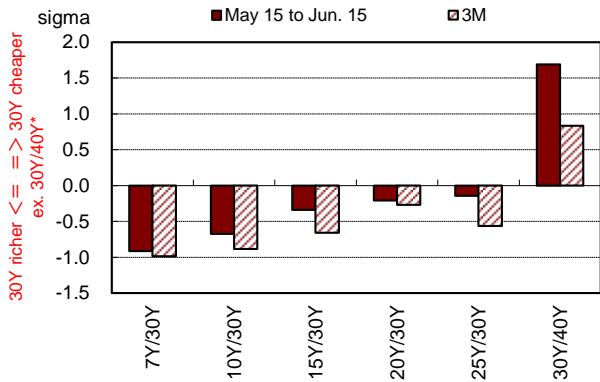
Appendix 2: JGB Yield Change (bp; May 15 v. June 15)



Source: Daiwa Securities.

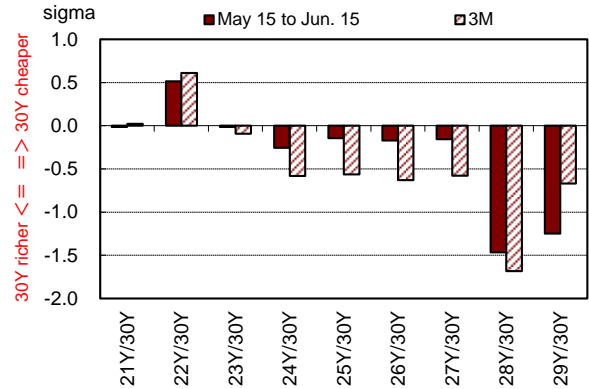
¹ Regarding the zone over 10Y, we expect the BOJ to lower the offer range in Outline of Outright Purchases of Japanese Government Securities to be announced on June 29 (e.g., from current about 50-150 billion yen to around 10-100 billion yen), and then trim the offer amount in July (from current about 70 billion yen to around 50 billion yen).

Appendix 3a: Z-scores of JGB Yield Spreads



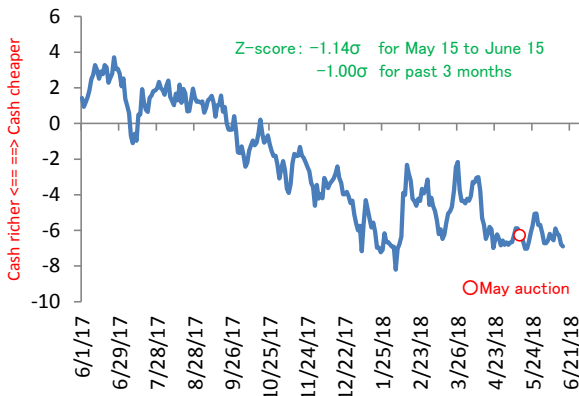
Source: Daiwa Securities. Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y

Appendix 3b: Z-scores of JGB Yield Spreads



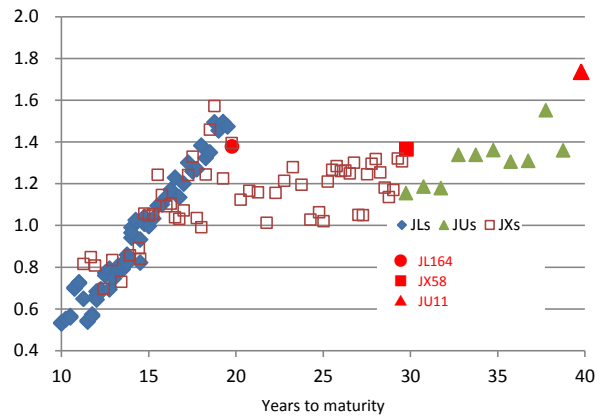
Source: Daiwa Securities.

Appendix 4: 30Y JGB Asset Swap Spread (bp)



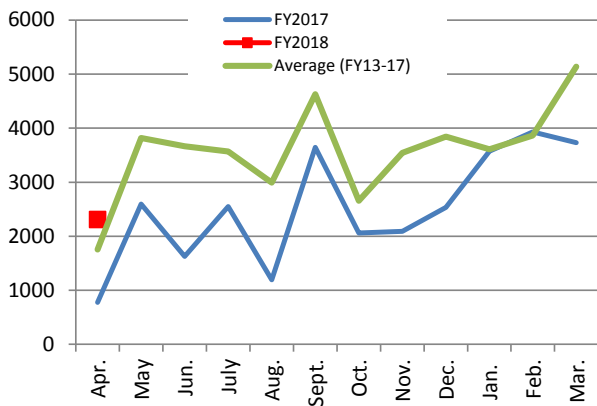
Note: 6M Yen LIBOR basis. Source: Daiwa Securities.

Appendix 5: JGB 6M Total Return Curve (%)



Note: Based on JGB yield curve on June 15; assuming that the yield curve shape does not change and factoring roll-down effect etc. Source: Daiwa Securities.

Appendix 6: Life- and Non-life Insurers' Net Purchase of Superlongs by Fiscal Year (100M yen)



Source: JSDA

Explanatory Document of Unregistered Credit Ratings

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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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.
- 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.

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