

Outlook for 40Y JGB Auction

Bidding at 1.000-1.035% level

- ✓ Auction participants may take a cautious stance for primary sales of new 40Y JGBs before the release of the BOJ's JGB purchase schedule and guideline for October (*Outright Purchases of Japanese Government Securities*) scheduled for the end of this month. As there are some supportive factors, however, we would like to place our bids at the 1.000-1.035% level (on compound yield basis) only on a short-covering purpose.
- ✓ Switching out from JU1 or JU3-5 into JU11

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Auction Details

Auction Date:	September 26, 2018
Issue Date:	September 27, 2018
Maturity Date:	June 20, 2058
Offering Amount:	About 400 billion yen

* New 40Y JGBs will be a reopening of JU11 carrying a 0.8% coupon.

** On September 25, JU11 was traded at 1.050-1.070% (+1.0 - +3.0bp v. previous day's close; 1.014-1.031% on compound yield) and closed at 1.065% (+2.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Bidding at 1.000-1.035% level

After the previous 40Y JGB auction went well at the 0.895-0.900% level (or 0.883-0.888% on compound yield basis) on July 24, the JGB market softened amid growing speculations on the BOJ's policy shift. In such an environment, the 40Y JGB yield temporarily rose to 0.965%. Reflecting the result of the BOJ's July 2018 Monetary Policy Meeting (MPM), the yield plunged to 0.865%. Since then, the yield had mostly moved in the 0.950-0.995% level. Following the BOJ's trimming of the offer amount in the over 25Y zone in its JGB purchase operation on September 21, superlong JGBs decline significantly. As of 14:00 today (Sept. 25), one day before the auction, the 40Y JGB yield temporarily rose to 1.070% (or 1.032% on compound yield basis), the highest level since October 2017 and also close to the highest under the yield curve control (YCC) policy.

On September 21, the following day of the 20Y JGB auction, the BOJ trimmed the offer amount of JGBs in the over 25Y zone from the previous 60bn yen to 50bn yen at its regular operation. Partly because the BOJ adjusted the offer amount in the over 10Y zone in purchase operation on the following day of superlong JGB auction for the first time under the Kuroda regime, the reduction came as a surprise especially in terms of its timing. Consequently, the JGB market sharply declined and the JGB yield curve faced strong steepening pressure. Amid lingering caution about the BOJ's "flexible" purchase operations, market participants should factor in certain risk premiums for their position management or

investment. In addition, the 40Y JGB auction is to be held prior to the announcement of the BOJ's JGB purchase schedule and guideline for October (*Outright Purchases of Japanese Government Securities*). In such an environment, auction participants may take a cautious stance for primary sales of new 40Y JGBs.

Meanwhile, there are some supportive factors as well, such as —(1) the auction will be conducted in a yield-Dutch method, (2) the absolute yield level has risen to the highest level under the YCC policy, as mentioned above, (3) the 40Y sector is cheap on the curve (Appendix 3), (4) decent short-covering is expected, (5) the issuance amount will be relatively small at about 400bn yen, and (6) the next 40Y JGB auction is scheduled in November.

All in all, we would like to place our bids the 1.000-1.035% level (on compound yield basis) only on a short-covering purpose. Relative-value wise, it would be worth considering switching out from JU1 or JU3-5 into JU11 as JU11 is currently cheap vs. them (Appendix 3 and 6). The total return is expected higher in JU11 than JU1 and JU3-5 (Appendix 4).

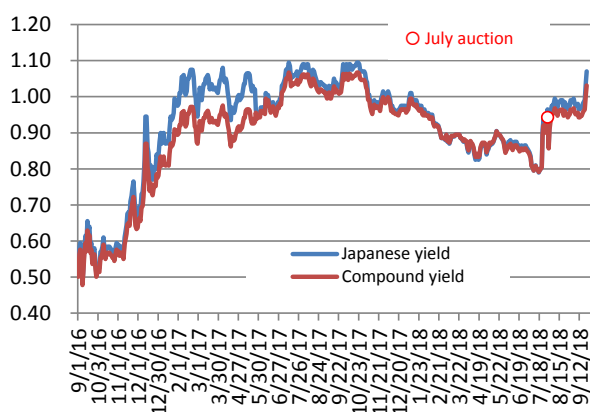
40Y JGB Auction Results

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)**	
9/26/18	11R	0.8	3/20/58						1.006				
7/25/18	11R	0.8	3/20/58	399.5	3.30	0.880	36.6400	97.33	0.896	12.8	0.921	13.1	Good
5/29/18	11	0.8	3/20/58	456.7	3.92	0.865	52.4978	97.81	0.890	15.0	0.857	13.5	Good
3/27/18	10R	0.9	3/20/57	566.1	3.19	0.885	20.6239	100.49	0.886	14.6	0.882	14.2	Good
1/12/18	10R	0.9	3/20/57	572.1	3.67	0.985	10.8072	97.24	0.995	15.9	0.982	15.5	Good
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

* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Sept. 21 close for Sept. 2018

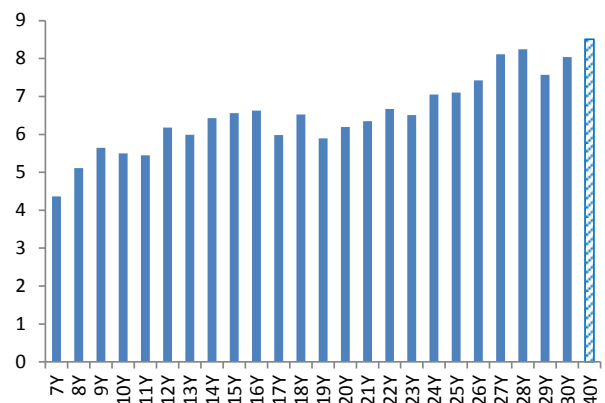
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



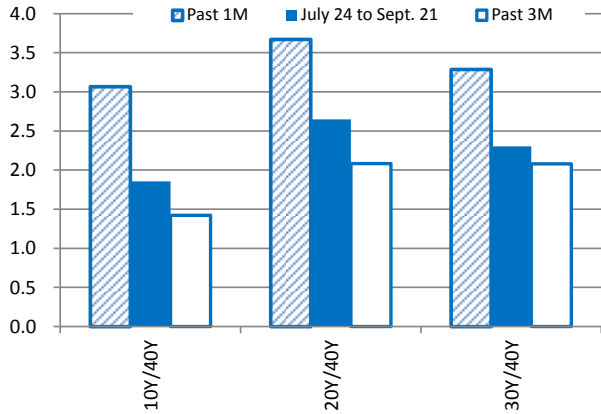
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (July 24 v. Sept. 21, bp)



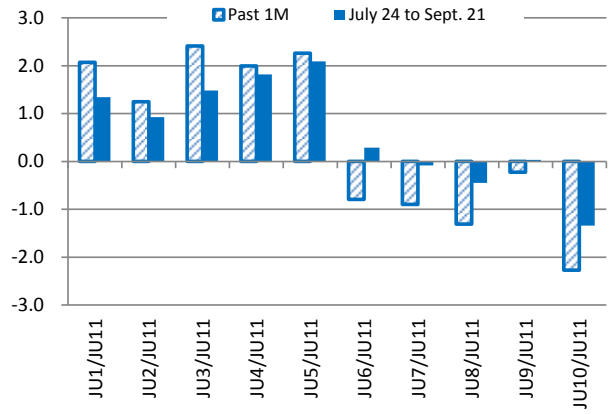
Source: Daiwa Securities.

Appendix 3a: Z-score I



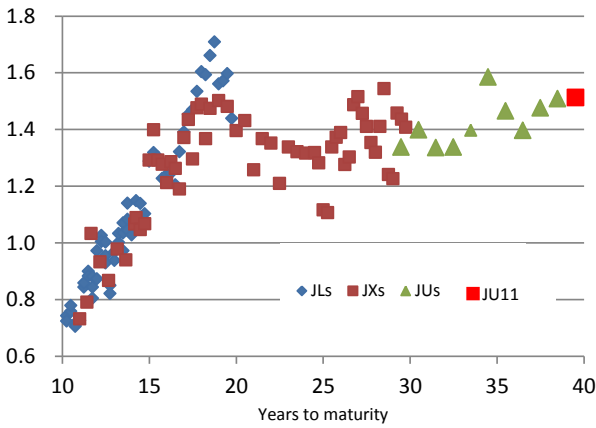
Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 3b: Z-score II



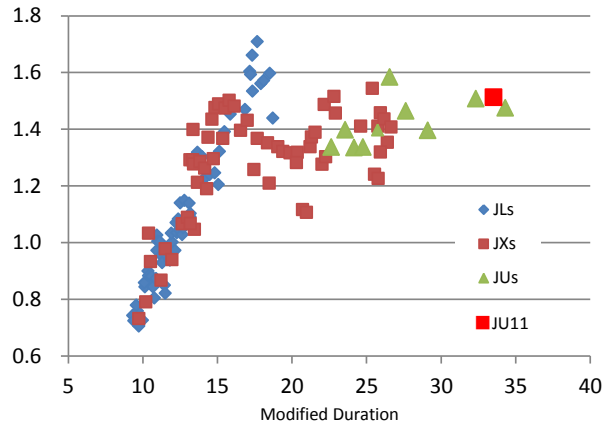
Source: Daiwa Securities.

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



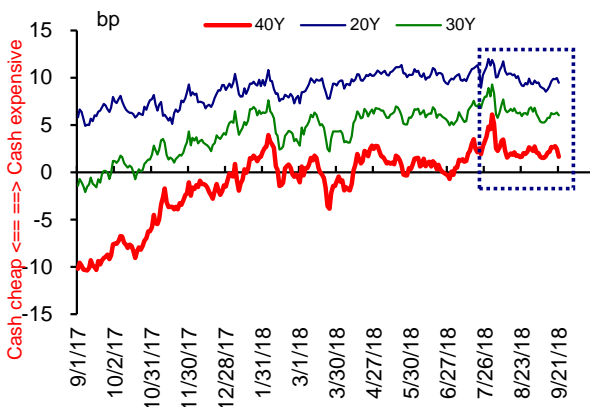
Note: Assuming that the yield curve shape as on Sept. 21 is unchanged and factoring in roll-down effect etc.; JU10/JU11 spread assumed to be 1.8bp
Source: Daiwa Securities.

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



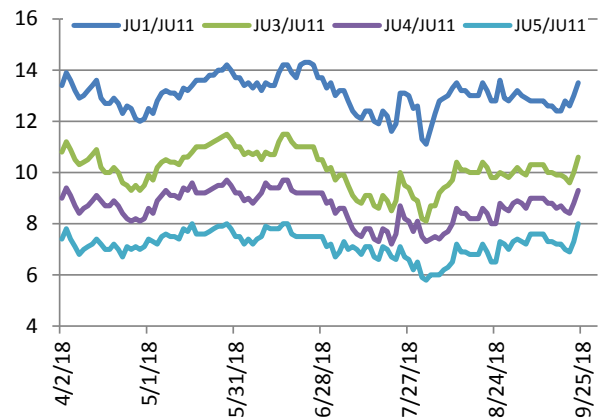
Note: Assuming that the yield curve shape as on Sept. 21 is unchanged and factoring in roll-down effect etc.; JU10/JU11 spread assumed to be 1.8bp
Source: Daiwa Securities.

Appendix 5: Swap Spreads



Source: Daiwa Securities.

Appendix 6: 40Y JGB Yield Spread (bp)



Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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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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[Fitch]

The Name of the Credit Rating Agencies group, etc

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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.

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