

JGB Insight

The March-June 2018 JGB Futures Roll

- ✓ Open interest is over Y12 trillion, which remains high among previous lead contracts at the same point in time to last trade day.
- ✓ JBH8/JBM roll has been proceeding at a pace much slower than average.
- ✓ We see JBH8/JBM8 spread to widen to about 35 ticks with strong support at 28 ticks.
- ✓ We expect the BOJ to keep the latest offer sizes unchanged at the planned JGB purchases next week.

Strategic Memorandum DSTE221
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Tuesday, March 13 is the last day of trading for the lead and most-active March 2018 JGB futures contract. In this report, we check the current progress in the March-June 2018 roll activities and think about near-term development in the calendar spread.

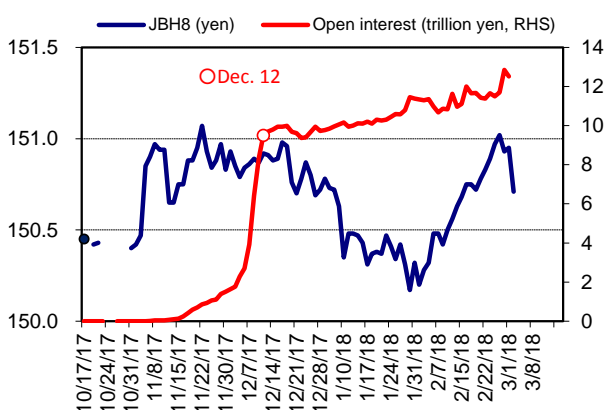
Open interest is over Y12 trillion, which remains high among previous lead contracts at the same point in time to last trade day

After effectively becoming the lead JGB futures contract on December 12, 2017, the March 2018 contract, or JBH8, declined until end-January but has been firm since February, and it set its own high today. Open interest in JBH8 has been in a rising trend during that time, reaching as high as just under Y13 trillion this week. It is the first time since the March 2015 contract that the open interest of the lead contract grows over Y12 trillion (as of March 1, Charts 1 & 2). Compared with previous contracts at the same point prior in time to the last trade day, this is the highest open interest since the March 2008 contract.

JBH8/JBM8 roll is proceeding at a pace much slower than average

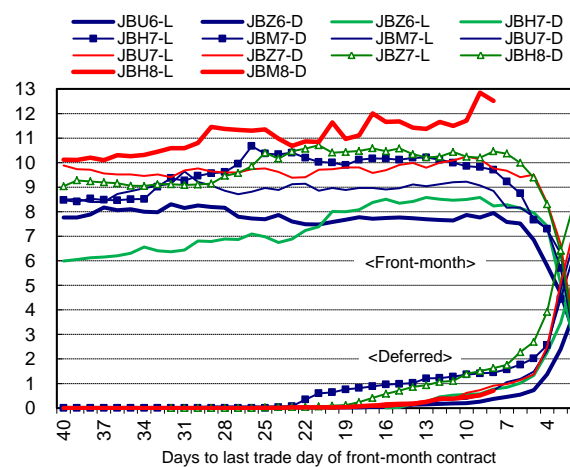
As of March 1, eight trading days before the last trade day of JBH8, just under 5.4% of JBH8 had been rolled over to the June 2018 contract or JBM8, less than the roughly 8% average for previous rollovers by that point since the introduction of negative interest rates (Chart 3). The JBH8/JBM8 roll appears to be proceeding at a pace much slower than average.

Chart 1: Close Price and Open Interest of JBH8



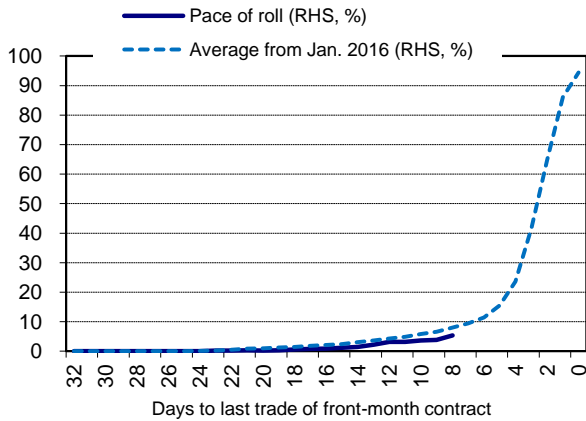
Source: Bloomberg

Chart 2: Open Interest (Yen trillions)



Source: Bloomberg

Chart 3: Progress in JBH8/JBM8 Roll

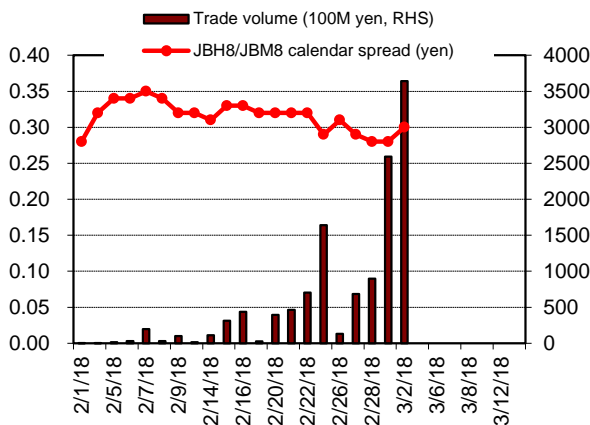


Source: Bloomberg, Daiwa Securities

We see JBH8/JBM8 spread to widen to about 35 ticks with strong support at 28 ticks

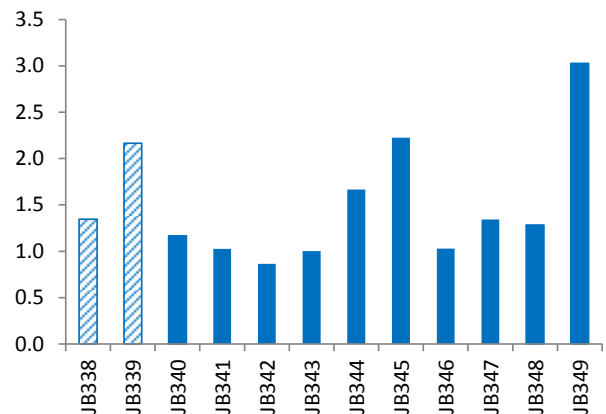
The March-June 2018 calendar spread, or JBH8/JBM8 spread, has widened from 28 to 35 ticks since February, amid extremely thin trading though. Once the roll started picking up, however, the spread steadily narrowed (amid still low trading volume), and it traded at 28-30 ticks today (March 2) (Chart 4). The outstanding balance of CTD for JBH8 (JB338) is fairly low at about Y1.3 trillion, or about 10% of open interest as of March 1. With the last trade day approaching, we think it likely that the market will see more buybacks in JBH8 and/or short rolls. In contrast, the outstanding balance of CTD for JBM8 (JB339) is about Y2.1 trillion, which is on the high side in the deliverable basket. The CTD spread has traded in a range of 1.0-1.5bp since January, and has recently been at the bottom of that range. Based on the supply-demand balance and the spread level in CTDs, we think the calendar spread is more likely to widen from its current level than it is to narrow. Although we need to pay close attention to other factors to impact the calendar spread, we think the JBH8/JBM8 spread has room to widen to about 35 ticks with strong support at 28 ticks.

Chart 4: JBH8/JBU8 Calendar Spread



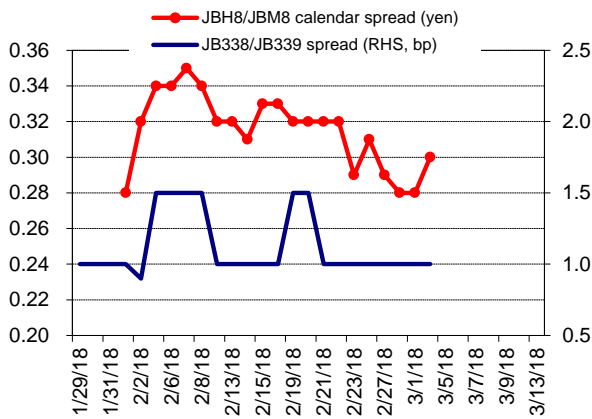
Source: Bloomberg

Chart 5: Market Outstanding of Deliverable JGBs (Yen trillions)



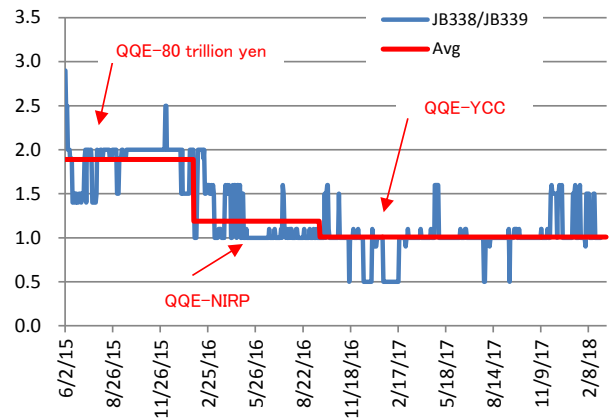
Note: as of Feb. 20 on a BOJ start day basis
Source: Daiwa Securities

Chart 6: Calendar Spread and CTD Spread



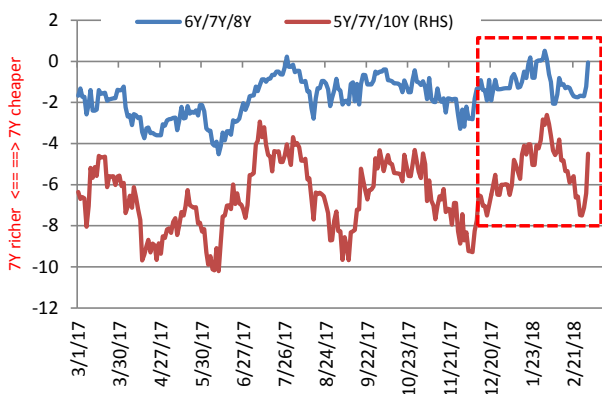
Source: JSDA.

Chart 7: JB338/JB339 Spread (bp)



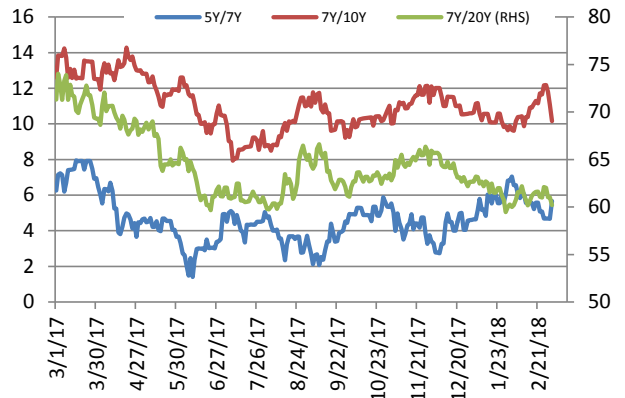
Source: Daiwa Securities

Appendix 1: JGB Butterfly Spread (bp)



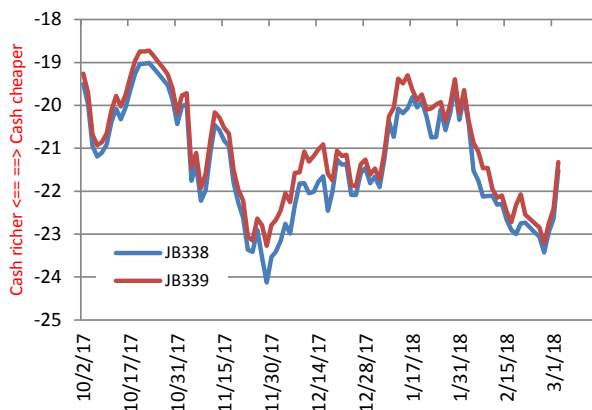
Source: Daiwa Securities

Appendix 2: JGB Yield Spread (bp)



Source: Daiwa Securities

Appendix 3: CTD Asset Swap Spread (bp)



Source: Daiwa Securities

No change in offer sizes for next week's operations

BOJ JGB Purchases

The BOJ lowered the offered amount in its over-25Y JGB buying operation this week (on February 28) to Y70 billion, from Y80 billion for the previous operation. Meanwhile, its "Outline of Outright Purchases of Japanese Government Securities" released at 17:00 on the same day noted that it will keep its range of offer amounts for all zones the same in March as they were in February.

We think the BOJ reduced the purchase this week as a response to the recent decline

in JGB yields and the flattening of the curve in the zone over 10 years. Superlong JGB yields, however, continued declining and the curve continued flattening for the rest of the week. More unfortunately, the yen strengthened (the USD/JPY dropped below 105, its lowest level since November 2016) and Japanese stocks weakened.

Next week, the BOJ will offer JGB purchase operations targeting JGBs in the over-1Y to 5Y and over-10Y zones on Wednesday, March 7. Given the downward pressure on yields in the superlong zone and the shape of the yield curve, the market may very well start expecting the BOJ to reduce its purchase amounts in next week's over-10Y purchase operations. Because a 30Y JGB auction is scheduled on March 6, however, we think it is unlikely for the central bank to reduce its purchases in the over-25Y zone, but a reduction of purchases in the over-10Y to 25Y zone may remain as a possibility. Considering the special circumstance of demand at the fiscal year-end, however, we think it likely that a purchase reduction of about Y10-Y20 billion would not be enough to push either superlong yields or the shape of the yield curve in the direction favored by the BOJ. We think, expecting to see some stock effects from the recent reductions, the BOJ is likely to leave its offer amounts for next week's purchase operations unchanged.

[BOX] Image of March BOJ JGB Purchase Schedule

(Yen billions)

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker
3/1/18	TH 3/20/18	10Y JGB Auction						
3/2/18	F 3/6/18		250.9	330.6	450.6			25.3
3/5/18	M 3/7/18							
3/6/18	T 3/20/18	30Y JGB Auction						
3/7/18	W 1/10/18		◎	◎		◎	◎	
3/8/18	TH 3/12/18	AEL (2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years to maturity)						
3/9/18	F -	BOJ MPM (Day 2)						
3/12/18	M 3/14/18				◎	◎	◎	
3/13/18	T 3/20/18	5Y JGB Auction						
3/14/18	W 3/16/18		◎	◎	◎			
3/15/18	TH 3/20/18	20Y JGB Auction						
3/16/18	F 3/20/18	○				◎	◎	
3/19/18	M 3/23/18		◎	◎	◎			
3/20/18	T 3/23/18	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)						
3/21/18	W -	Public Holiday (Vernal Equinox Day)						
3/22/18	TH 3/26/18				◎	◎	◎	
3/23/18	F 3/27/18		◎	◎				○
3/26/18	M 3/28/18							
3/27/18	T 3/20/18	40Y JGB Auction						
3/28/18	W 3/30/18	○				◎	◎	
3/29/18	TH 4/15/18	2Y JGB Auction						
3/30/18	F 4/3/18		◎	◎	◎			

Note: ◎ Scheduled by the BOJ, ○ Daiwa forecast; BOJ MPM (Day 1 on Mar. 8) in blue

Source: Bank of Japan, Ministry of Finance, 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.
- 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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