

## Outlook for 5Y JGB Auction

### Bidding at JS136 + 0.5 to 1.0bp level

- ✓ Relative-value wise, it would be worth considering switching out from 3Y sector into new 5Y JGBs

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### Auction Details

**Auction Date:** October 16, 2018  
**Issue Date:** October 17, 2018  
**Maturity Date:** September 20, 2023  
**Offering Amount:** About 2.0 trillion yen

\* New 5Y JGBs, JS137, will likely carry a 0.1% coupon.

\*\* On October 15, JS136 was traded at -0.065% (unch v. previous day's close) and closed at -0.070% (-0.5bp). WI was traded at -0.060% (-0.5bp) and closed at -0.060% (-0.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### Bidding at JS136 + 0.5 to 1.0bp level

We would like to check the environment surrounding 5Y JGBs. Since the previous 5Y JGB auction went well at the -0.070 to -0.065% level on September 13, the 5Y JGB yield (JS136 on conventional basis) has been mostly in the -0.070 to -0.065% range on an intraday basis. In the JGB market, many participants are paying attention to upward pressure on US Treasury yields under the tightening cycle. Give the latest plunge in global share prices, the yield uptrend since late August appears to be currently losing momentum especially prior to US mid-term election etc. In such an environment, the JGB market may reach a stalemate. We think that the 5Y JGB yield may thus remain range-bound at around -0.065% for a while.

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

- ✓ Decent short-covering is expected for the 5Y sector (incl. already-issued notes).
- ✓ 5Y JGBs have few active investors, which causes low liquidity.
- ✓ Incentive for the so-called "BOJ trade" has declined since a major broker changed the method to calculate closing prices.
- ✓ The JS (5Y JGB) curve has steepened compared to that as of the previous auction. On the current shape of the curve, we need to take into consideration certain level of spread for newly-issued 5Y JGBs in new maturity basket (JS137) vs. JS 136.

- ✓ The 5Y sector is noticeably undervalued especially vs. the 3Y sector at the current level (Appendix 3).

**Relative value suggests switching out from 3Y sector**

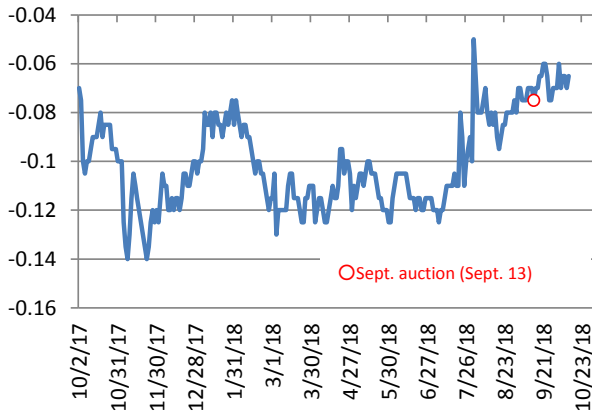
Overall, we would like to place our bids at the JS136 + 0.5 to 1.0bp level at tomorrow's auction. Relative-value wise, it would be worth considering switching out from the 3Y sector into new 5Y JGBs. As mentioned, the 5Y sector is noticeably undervalued vs. the 3Y sector at the current level (Appendix 3). In addition, as the 3Y/5Y spread is the widest level since November 2017 (Appendix 7), reversal moves can be easily expected. Moreover, if new 5Y JGBs are accepted at the aforementioned level, they would be more attractive than the 3Y sector in terms of total return (Appendix 7).

**5Y JGB Auction Results**

Auction Date	Issue #	Marurity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
10/16/18	137	9/20/23	0.1*	2.0**									
9/13/18	136R	6/20/23	0.1	2.0	5.53	100.82	100.81	0.01	-0.071	-0.069	0.002	10.5496	Good
8/16/18	136R	6/20/23	0.1	2.1	3.95	100.86	100.85	0.01	-0.076	-0.074	0.002	37.0117	Avg
7/10/18	136	6/20/23	0.1	2.0	4.87	101.03	101.02	0.01	-0.107	-0.105	0.002	39.4402	Avg
6/21/18	135R	3/20/23	0.1	2.0	3.88	101.02	101.00	0.02	-0.113	-0.109	0.004	61.1594	Poor
5/17/18	135R	3/20/23	0.1	2.0	4.22	100.99	100.98	0.01	-0.103	-0.101	0.002	33.7643	Avg
4/17/18	135R	3/20/23	0.1	2.0	4.40	101.09	101.08	0.01	-0.120	-0.118	0.002	95.5045	Good
3/13/18	135	3/20/23	0.1	2.2	4.18	101.05	101.04	0.01	-0.108	-0.106	0.002	67.4216	Avg
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

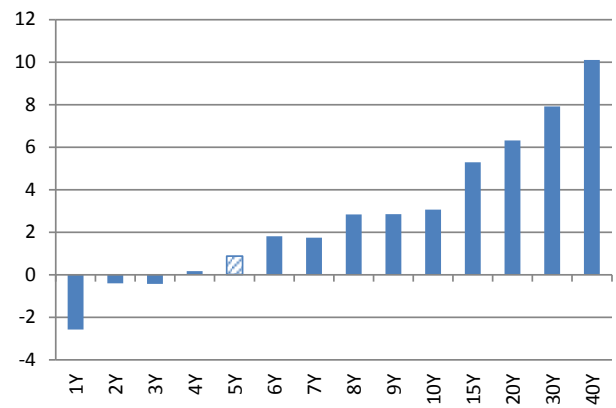
\* Daiwa forecast (as of Oct. 15) \*\* Amount the MOF plans to issue  
 Source: Ministry of Finance, Daiwa Securities.

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



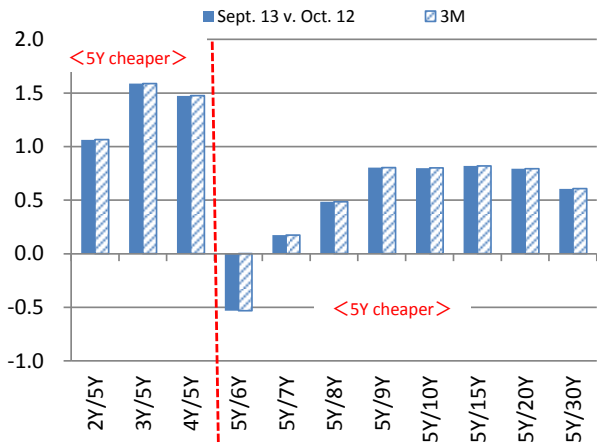
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp): Sept. 13 v. Oct. 12**



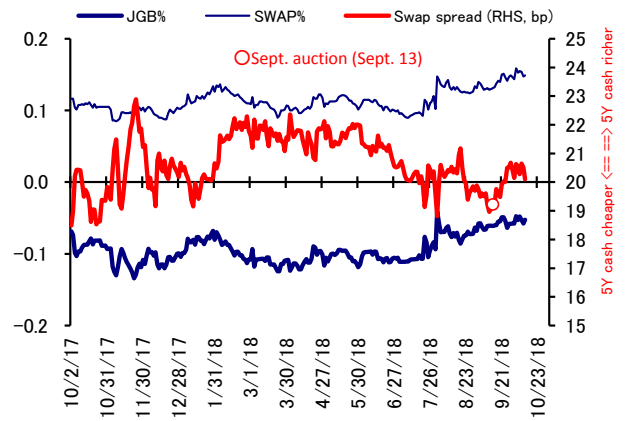
Source: Daiwa Securities.

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



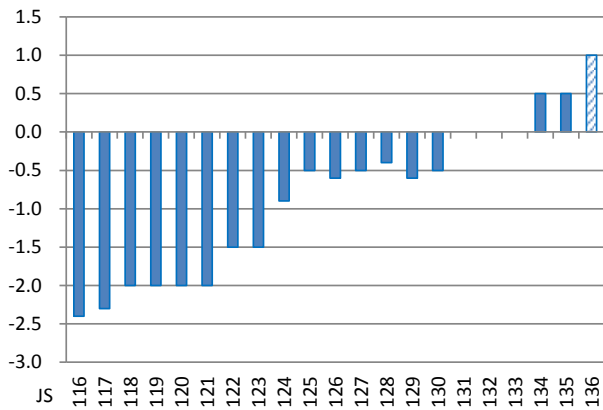
Source: Daiwa Securities.

### Appendix 4: 5Y Swap Spread



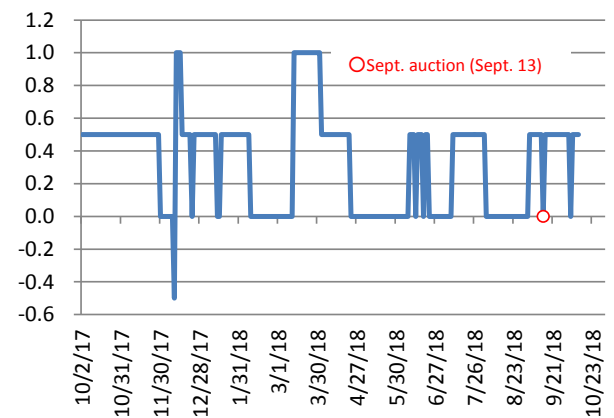
Source: Daiwa Securities.

### Appendix 5: JS Yield Change (bp): Sept. 13 v. Oct. 12



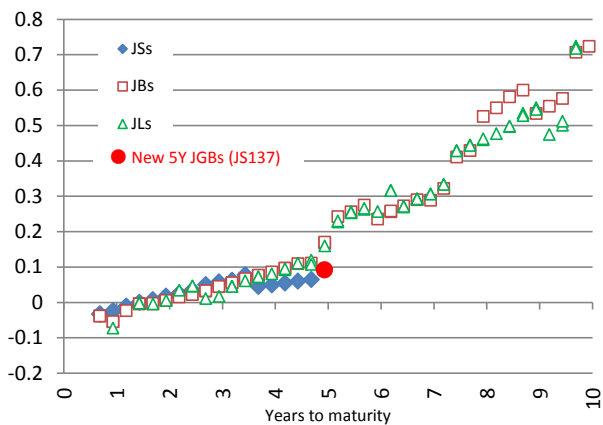
Source: Daiwa Securities.

### Appendix 6: JS On-the-run and Off-the-run Spread (bp)



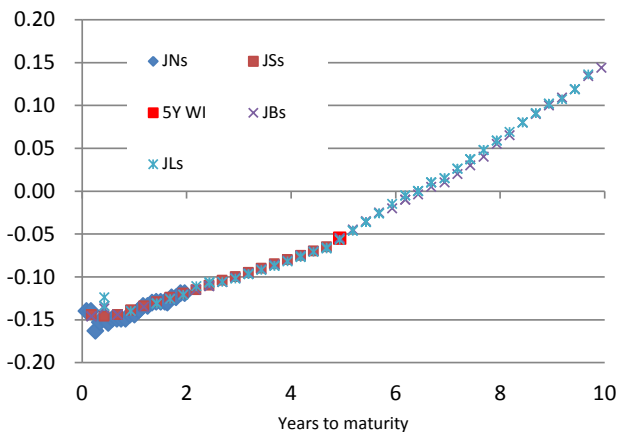
Source: Daiwa Securities.

### Appendix 7: 6M Total Returns of JSs, JBs and JJs (%)



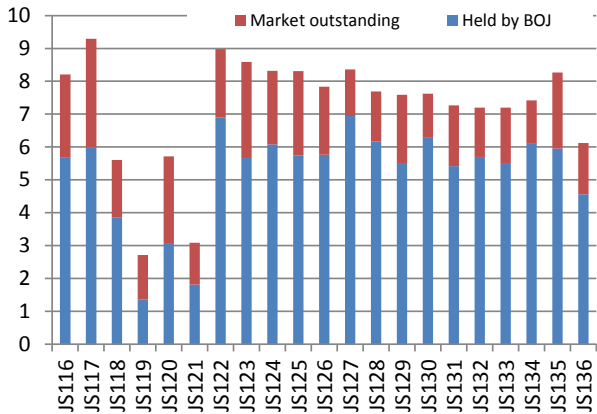
Note: Based on JB, JS and JJ yield curves on Oct. 12, respectively; Assuming that those yield curve shapes do not change and factoring roll-down effect est. ; For new 5Y JGBs (JS137), it is assumed that the coupon is 0.1% and the spread to JS136 is 1.0bp.  
Source: Daiwa Securities.

### Appendix 8: JGB Yield Curve (%)



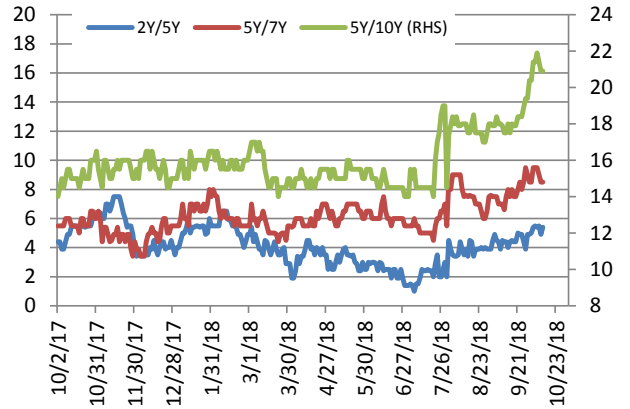
Note: as of Oct. 12  
Source: Daiwa Securities.

**Appendix 9: BOJ and Market Outstanding of JSs (Yen trillions)**



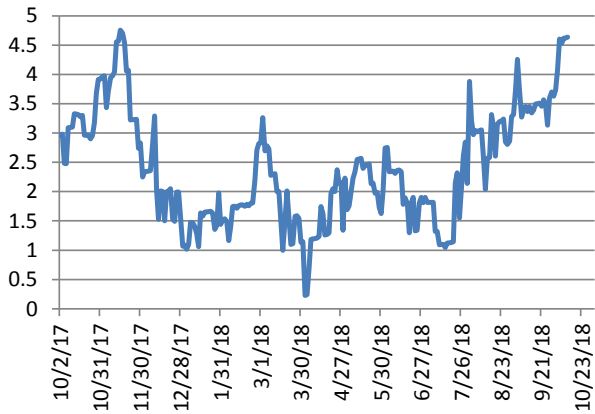
Source: Ministry of Finance, Bank of Japan, Daiwa Securities.

**Appendix 10: JGB Yield Spreads (bp)**



Source: Daiwa Securities.

**Appendix 11: 3Y/5Y Spread (bp)**



Source: Daiwa Securities.

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- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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May 2018

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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.
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- 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.
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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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