

Outlook for 10Y JGB Auction

Demand from investors at positive yield level should be carefully measured

- ✓ Demand from investors is uncertain at negative yield level. In addition, primary dealers seem to be rather long in the 10Y sector.
- ✓ We would like to carefully measure demand from investors at positive yield level. It would be much easier for primary dealers to place bids in the positive yield territory and also at JB352 yield + around 2.5bp level.
- ✓ In terms of the relative value, we think of short-term switching out from the 15Y or 30Y sector to the 10Y sector.

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Auction Details

Auction Date:	January 8, 2019
Issue Date:	January 9, 2019
Maturity Date:	December 20, 2028
Offering Amount:	About 2.2 trillion yen

* New 10Y JGBs, JB353, will likely carry a 0.1% coupon.

** On January 7, JB352 traded at -0.025 - -0.020% (+1.5 - +2.0bp v. previous day's close) and closed at -0.020% (+2.0bp). WI closed at 0.000% (+2.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Demand from investors should be carefully measured at positive yield level

Since the previous 10Y JGB auction went poorly at the 0.070-0.075% level on December 4, the bond markets have firmed up around the globe amid growing worries about the outlook of the global economy due to the continued downtrend of global equity and crude oil prices as well as deterioration in Chinese and European economic indicators. After the 10Y JGB yield fell into negative territory at end-2018 (Dec 28), it temporarily declined to -0.050%, the lowest level since November 2016, on January 4 (the first business day of the year).

At the end of last week, the US markets posted higher stock prices/lower bond prices because (1) the result of jobs report was strong, (2) Fed chairman Jerome Powell's remarks were taken by market participants as a sign of a pause in the interest-rate hiking cycle to bolster the economy, and (3) it was disclosed that the US and China will hold vice ministerial level trade talks on January 7-8. Reflecting the movements in the U.S. markets, JGBs declined today (Jan 7), pushing up the 10Y JGB yield temporarily to -0.020% on an intraday basis (as of 14:00 JST). As far as the near-term outlook is concerned, excessive risk-off activities thus far may let up. However, unless US-China trade friction improves drastically, concerns about the global economy will continue to linger. As crude oil prices are currently hovering at a low level, it is difficult for inflation expectations to rise sharply as well. We thus can say that JGB yields are still unlikely to face strong upward pressure. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ Short-covering by primary dealers appears to be weak;
- ✓ Demand from investors at the negative yield level is uncertain;
- ✓ At the current level, the 10Y sector is noticeably overvalued vs. the 2-5Y sectors, while it is undervalued vs. the 15Y sector (Appendix 3);
- ✓ There is uncertainty about the BOJ's JGB purchase operations
 - In JGB purchase operations in the 5-10Y zone offered on January 4, the BOJ kept the offer amount unchanged at 430bn yen, the same as the previous operation (Dec 27). Meanwhile, the central bank substantially reduced the purchase target issues. Specifically, only JB351 and JB352 were the targets among 10Y JGBs with over seven years left to maturity. If BOJ purchases of JGBs near the on-the-run issue increase, this would be supportive for the 10Y sector. At the moment, however, it is difficult to judge whether the latest measure is temporary (because the BOJ is facing difficulty in reducing the offer amount due to turbulence in the financial market) or continuous one. It is difficult to take the latest action as a factor conducive to purchases of new 10Y JGBs.

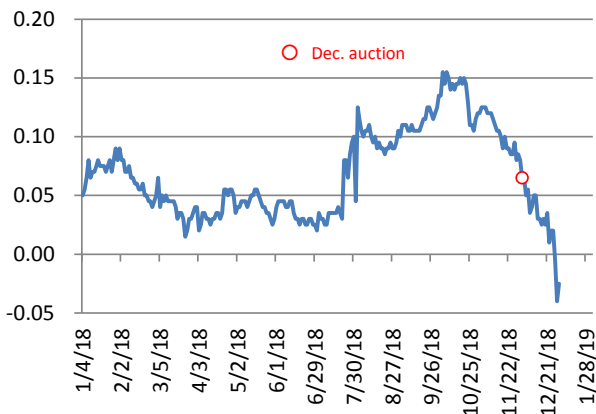
All in all, we would like to keep an eye on demand from investors at the positive yield level. It would be much easier for primary dealers to place bids in positive territory, for example, at around the JB352 yield + 2.5bp level as well. In terms of the relative value, we think of short-term switching out from the 15Y sector or the 30Y sector (where auction is to be held on Jan 10) to the 10Y sector.

10Y JGB Auction Results

Auction Date	Issue#	Coupon %	Maturity Date	Issue Size (billion yen)	Bid/Cover	Average Accepted Price	Lowest Accepted Price	Tail (yen)	Average Accepted Yield	Highest Accepted Yield	Tail (%)	Allotment %	
1/8/19	353	0.1*	12/20/28	2,200**									
12/4/18	352R	0.1	9/20/28	2,526	3.82	100.25	100.22	0.03	0.074	0.077	0.003	8.7628	Poor
11/1/18	352R	0.1	9/20/28	2,513	4.33	99.95	99.93	0.02	0.135	0.137	0.002	12.9543	Avg
10/2/18	352	0.1	9/20/28	2,436	4.21	99.59	99.58	0.01	0.141	0.142	0.001	47.4678	Good
9/5/18	351R	0.1	6/20/28	2,506	4.55	99.87	99.86	0.01	0.113	0.115	0.002	57.5664	Avg
8/2/18	351R	0.1	6/20/28	2,485	4.17	99.74	99.62	0.12	0.126	0.138	0.012	48.9994	Poor
7/3/18	351	0.1	6/20/28	2,478	4.37	100.62	100.60	0.02	0.037	0.039	0.002	38.2288	Good
6/5/18	350R	0.1	3/20/28	2,255	4.38	100.50	100.49	0.01	0.048	0.049	0.001	94.4896	Good
5/8/18	350R	0.1	3/20/28	2,432	4.20	100.53	100.52	0.01	0.046	0.047	0.001	91.9407	Good
4/3/18	350R	0.1	3/20/28	2,528	4.16	100.67	100.66	0.01	0.032	0.033	0.001	4.0302	Good
3/1/18	350	0.1	3/20/28	2,639	4.53	100.38	100.37	0.01	0.061	0.062	0.001	41.7549	Good
2/1/18	349R	0.1	12/20/27	2,456	4.58	100.11	100.09	0.02	0.088	0.090	0.002	72.9297	Avg
1/10/18	349R	0.1	12/20/27	2,467	3.74	100.21	100.20	0.01	0.078	0.079	0.001	65.5523	Avg
12/5/17	349	0.1	12/20/27	2,459	3.70	100.40	100.35	0.05	0.059	0.064	0.005	88.8083	Poor

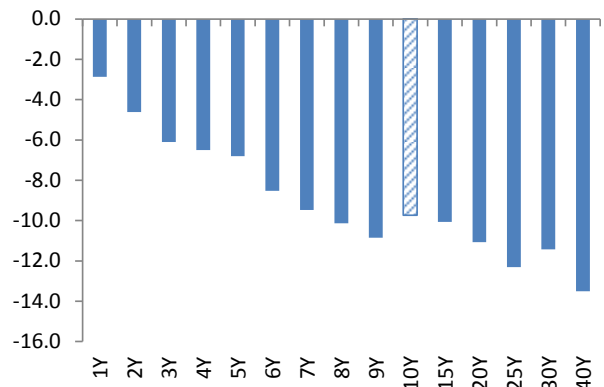
* Daiwa forecast as of Jan. 7 ** Amount the MOF plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



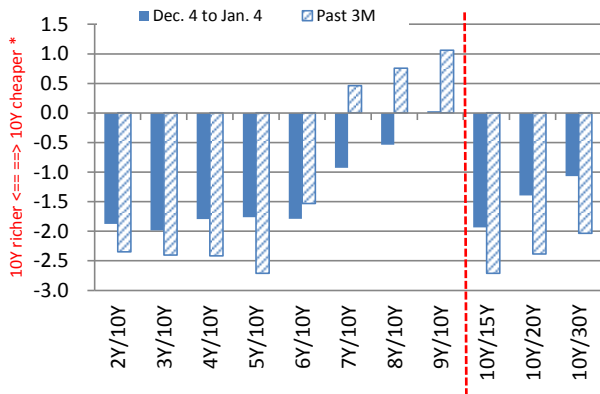
Note: as of 14:00 JST on Jan. 7
 Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Dec. 4 v. Jan. 4, bp)



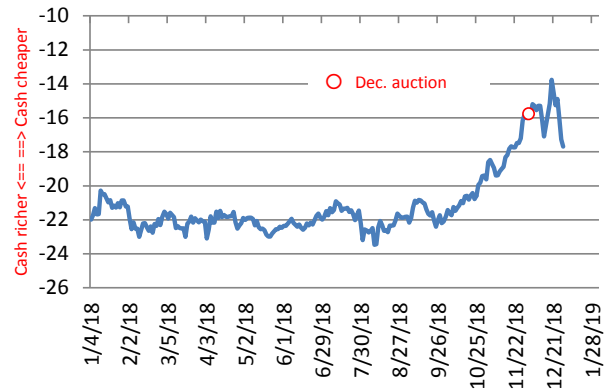
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



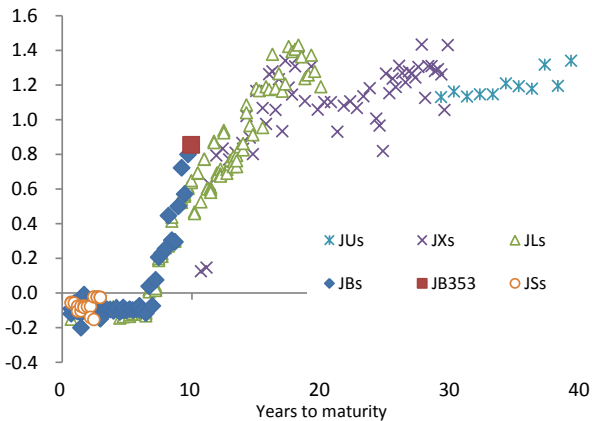
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

Appendix 4: 10Y JGB Asset Swap Spread (bp)



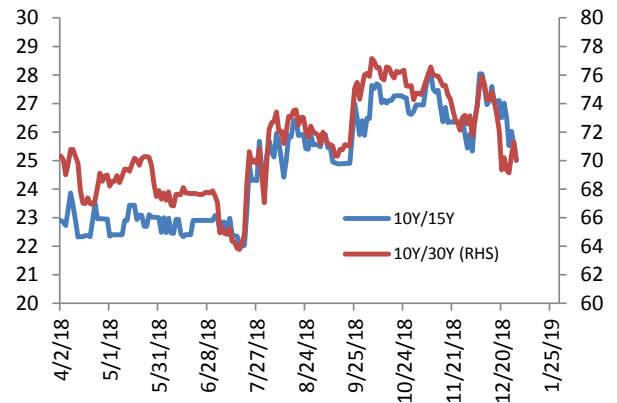
* Yen LIBOR basis
Source: Daiwa Securities.

Appendix 5: JGB Total Return Curve (3M, %)



Note: Based on JGB yield curve on Jan. 4; assuming that those yield curve shapes do not change and factoring roll-down effect etc; New 10Y notes (JB353) is supported to carry a 0.1% coupon and have 2bp spread to JB352.
Source: Daiwa Securities.

Appendix 6: JGB Yield Spread (bp)



Note: Generic yield basis
Source: Daiwa Securities

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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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.
- 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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