

Outlook for 5Y JGB Auction

Bidding at JS137 yield + 0.5 to 1.0bp level

- ✓ Placing our bids to take the amount we need to cover at around JS137 yield + 0.5 to 1.0bp level

Strategic Memorandum DSTE285
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Auction Details

Auction Date: January 16, 2019
Issue Date: January 17, 2019
Maturity Date: December 20, 2023
Offering Amount: About 2.0 trillion yen

* New 5Y JGBs, JS138, will likely carry a 0.1% coupon.

** On January 15, JS137 traded at -0.150 - -0.145% (unch - +0.5bp v. previous day's close) and closed at -0.145% (+0.5bp). WI traded at -0.140% (+0.5bp) and closed at -0.140% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Placing bids to take the amount we need to cover at JS137 yield + 0.5 to 1.0bp level

Since the previous 5Y JGB auction went poorly at the -0.115 to -0.110% level on December 13, the JGB market has firmed up amid growing risk-off sentiment. In such an environment, the 5Y JGB yield (JS137 on conventional basis) temporarily declined to -0.190%, the lowest level since November 2016, on an intraday basis at the beginning of this year. Subsequently, 5Y JGBs softened as investors showed up to sell 5Y JGBs amid a pause in risk-off activities. The 5Y JGB yield thus rose to -0.140% at one point. For the past few days, the yield is mostly moving at the -0.155 to -0.145% level (as of 14:00 JST on Jan. 15).

Let's check the environment surrounding 5Y JGBs. As US-China trade friction is unlikely to improve dramatically, we think that concerns about the global economy will persist. Although the downtrend of crude oil prices appears to have taken a breather, the rebound is still lackluster. Inflation expectations are thus unlikely to rise sharply. Above all, the Fed has clarified its stance of suspending rate hikes, depending on economic conditions. Given all together, we can say that bond yields are unlikely to face strong upward pressure around the globe. Meanwhile, if we assume that it is premature to factor in the BOJ's additional easing, the downside appears limited for JGB yields especially in the short-term to intermediate zone from the current levels. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ From the viewpoint of the 5Y sector, the level of demand related to short-covering is uncertain partly because repo rates of already-launched issues are not tight at the moment;
- ✓ As the short-term to intermediate zone of the JGB yield curve is almost flat, the absolute 5Y JGB yield level is not attractive especially vs. the level in shorter sectors such as the 2Y sector (Appendix 9b).
- ✓ Although the 5-7Y zone of the curve has flattened near to 0bp, which implies that the 5Y sector is cheap vs. the 6-7Y sectors, it is more likely for the zone to remain under flattening pressure than to face strong steepening pressure in the current bond-friendly environment;
- ✓ Looking at the 1-5Y zone over around one week from tomorrow's auction, the BOJ's offer amount to purchase in the zone will be around 750bn yen (= 350bn yen in the 1-3Y zone + 400bn yen in the 3-5Y zone), while the JGB issuance by the Ministry of Finance will be worth around 2.4tn yen (= 5Y JGBs worth 2.0tn yen at tomorrow's auction + Auction for Enhanced Liquidity of 400bn yen in the 1-5Y zone).

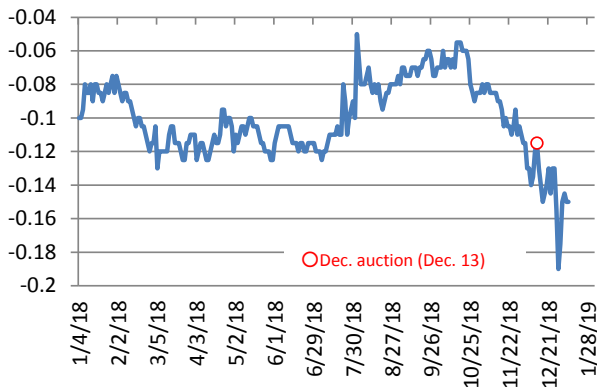
All in all, we would like to think about placing our bids to take the amount we need to cover tomorrow at around the JS137 yield + 0.5 to 1.0bp level.

5Y JGB Auction Results

Auction Date	Issue #	Marutiry Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
1/16/19	138	12/20/23	0.1*	2.0**									
12/13/18	137R	9/20/23	0.1	2.2	3.84	101.02	101.00	0.02	-0.112	-0.108	0.004	13.0155	Poor
11/15/18	137R	9/20/23	0.1	2.3	3.89	100.91	100.91	0.00	-0.087	-0.087	0.000	68.1985	Good
10/16/18	137	9/20/23	0.1	2.0	4.88	100.77	100.76	0.01	-0.055	-0.053	0.002	40.2505	Avg
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

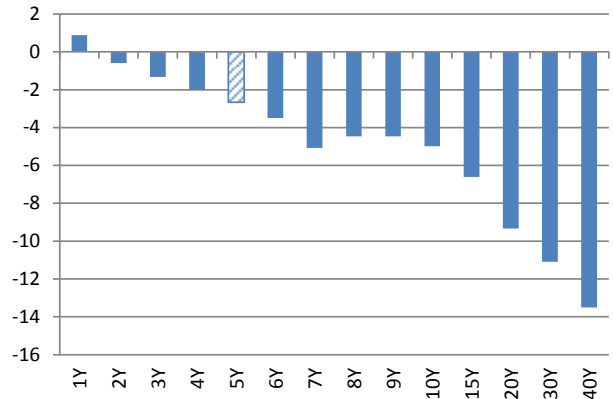
* Daiwa forecast (as of Jan. 15) ** Amount the MOF plans to issue
Source: Ministry of Finance, Daiwa Securities.

Appendix 1: 5Y JGB Yield (%)



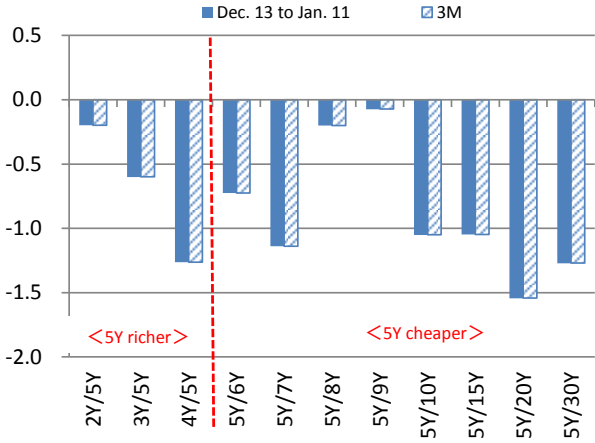
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Dec. 13 v. Jan. 11



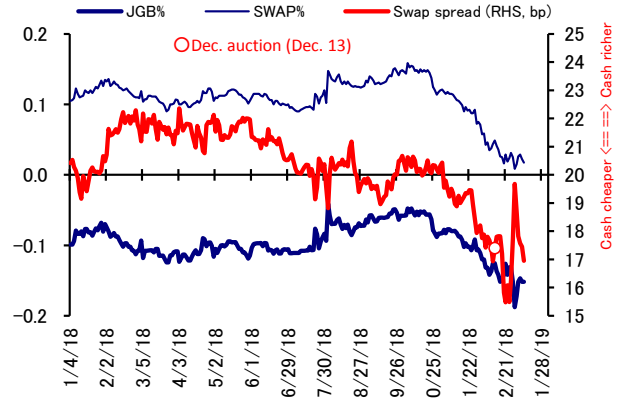
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



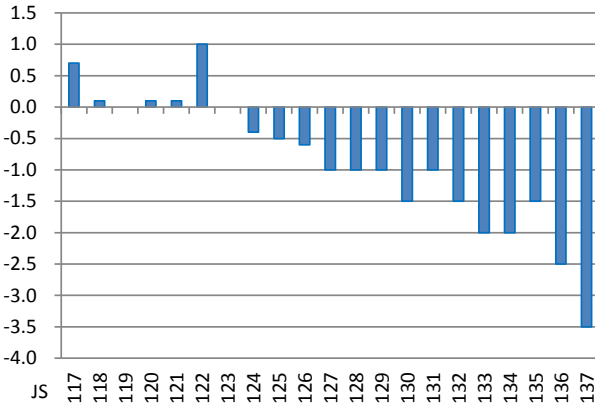
Source: Daiwa Securities.

Appendix 4: 5Y Swap Spread



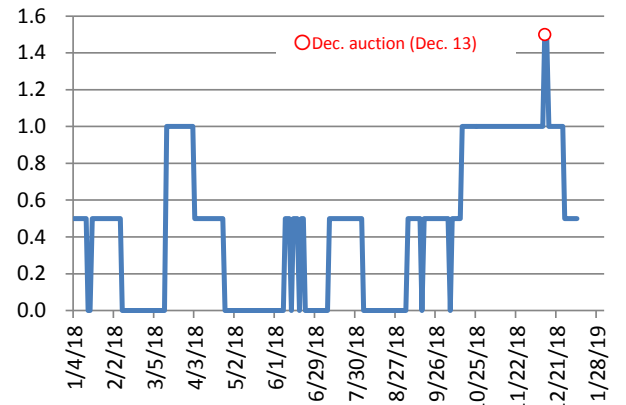
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): Dec. 13 v. Jan. 11



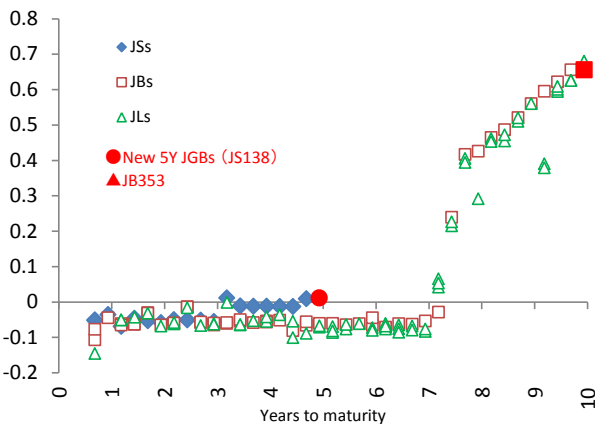
Source: Daiwa Securities.

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



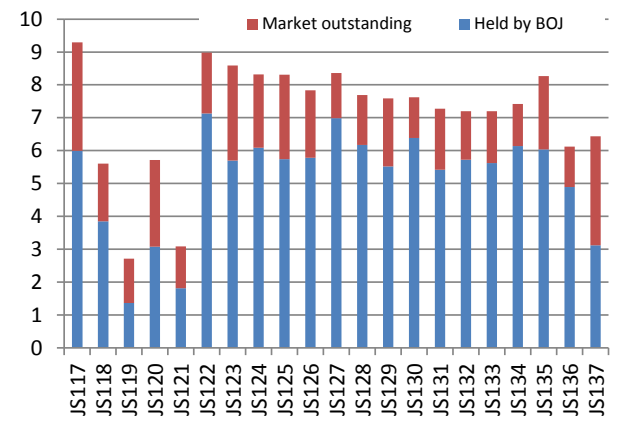
Source: Daiwa Securities.

Appendix 7: 3M Total Returns of JSs, JBs and JLs (%)



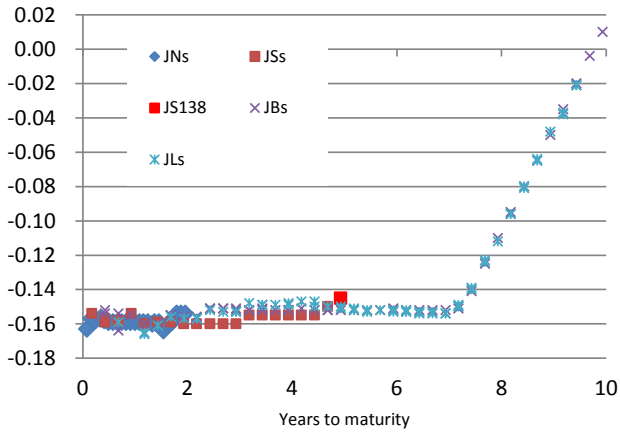
Note: Based on JB, JS and JL yield curves on Jan. 11, respectively; Assuming that those yield curve shapes do not change and factoring roll-down effect est.; New 5Y JGBs, JS138, are assumed to have a 0.1% coupon with 0.5bp spread to JS137.
Source: Daiwa Securities.

Appendix 8: BOJ and Market Outstanding of JSs (Yen trillions)



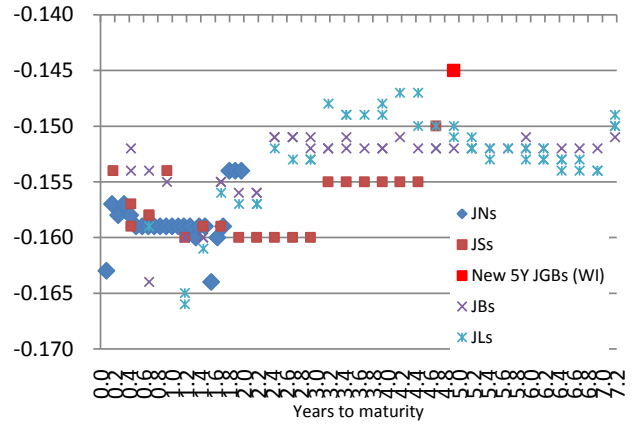
Note: as of Dec. 28
Source: Bank of Japan, Ministry of Finance, Daiwa Securities.

Appendix 9a: JGB Yield Curve (%)



Note: 0-10Y zone excluding 10Y and 20Y JGBs maturing in March 2019
Source: Daiwa Securities.

Appendix 9b: JGB Yield Curve (%)



Note: 0-7.2Y zone excluding 10Y and 20Y JGBs maturing in March 2019
Source: Daiwa Securities.

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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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[Standard & Poor's]

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[Moody's]

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[Fitch]

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May 2018

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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.
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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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