

Outlook for 10Y JGB Auction

Dip-buying 10Y JGBs at yield level 0% or above

- ✓ New 10Y JGBs will likely be sold smoothly only at 0% or higher yield level. The auction may tail to 0% when auction participants have to bid at the yield level below 0%.

Strategic Memorandum DSTE295
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Auction Details

Auction Date: March 5, 2019
Issue Date: March 6, 2019
Maturity Date: December 20, 2028
Offering Amount: About 2.2 trillion yen

* New 10Y JGBs will likely be the final reopening of JB353 carrying a 0.1% coupon.

** On March 4, JB353 traded at -0.005 - 0.000% (+1.0 - +1.5bp v. previous day's close) and closed at -0.005% (+1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

10Y JGB yield up to 0%

After the previous 10Y JGB auction went well at the -0.015 to -0.010% level on February 5, the JGB market firmed up amid intensifying caution about the global economic slowdown, pushing the 10Y JGB yield to -0.050%, the lowest level since January 4, at one point in late February. Since then, the JGB market has softened amid a clearer trend of higher stock prices/lower bond prices in the US market as well as the BOJ's reduction in the number of offers in the 5-10Y zone to four (from five until Feb.) in its March operation guideline, which surprised market participants. In such a situation, the 10Y JGB yield has risen to 0%.

Dip-buying at 0% or higher yield level

Recently, US stocks have been performing well as market participants are becoming more optimistic about US-China trade negotiations and also favor the Fed's patient stance for rate hikes. As witnessed by upside breakout of the 10Y Treasury yield from the recent range, US Treasuries have been softening as well. Those suggest possible change in the external environment. However, concerns about the global economic outlook are lingering, given recent weak US economic indicators in addition to sluggish European and Chinese data. The Fed's dovish shift is rather supportive for the bond markets as well. We think that taking a dip-buying stance will work for JGBs.

In such an environment, key points to think about placing bids at tomorrow's auction are as follows:

- ✓ Uncertainty about the level of primary dealers' short-covering
- ✓ Demand from investors is expected in positive yield territory;
 - ✓ As the 10Y sector is more attractive than the 20Y sector in terms of carry (Appendix 6), we are not worried about demand for 10Y JGBs with positive yields from investors;
- ✓ The 10Y sector is not attractive in terms of the relative value
 - The 10Y sector is not cheap on the curve at the current level (Appendix 3). On the contrary, the sector is noticeably overvalued vs. the 30Y sector (Appendix 3). 10Y cash is also expensive against swaps in comparison to the level at the previous auction (Appendix 4);
- ✓ Uncertainty about the BOJ's offer amounts in JGB purchase operations
 - In its JGB purchase guideline for March (Outline of Outright Purchases of Japanese Government Securities) announced on February 28, the BOJ reduced the number of offers in the 5-10Y zone from five until February to four. In line with the cut, the upper limit of the offer range was lifted from 600bn yen to 650bn yen. Reflecting this change, we expect that the offer amount in the 5-10Y zone in the first operation in March to be held on March 6 will likely increase to 480bn yen, up 50bn yen from the previous amount. This is because when the BOJ reduced the number of offers in the 1-5Y and 5-10Y zones alongside the rise in the upper limit of the offer ranges in its operations thus far, it increased the offer amount in the first operation of the month by 50bn yen each from the previous amount (regardless of the median of the new range). On a monthly basis, the purchase amount is expected to decline by 230bn yen compared to February. However, as there are various speculations about the first offer amount going around in the market, tomorrow's bidding stance may be influenced by those speculations.

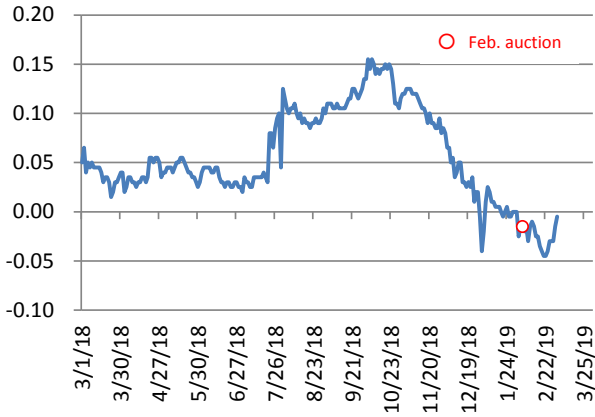
All in all, taking a dip-buying stance for 10Y JGBs at 0% or higher yield level, we would like to think about our bidding tomorrow. If we gain confidence that new 10Y JGBs will be sold at the level by the Ministry of Finance, we would like to place solid primary bids to take certain amount by selling the 7Y sector etc.

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 %	
3/5/19	353R	0.1*	12/20/28	2,100**									
2/5/19	353R	0.1	12/20/28	2,528	4.80	101.12	101.11	0.01	-0.013	-0.012	0.001	61.9168	Good
1/8/19	353	0.1	12/20/28	2,235	4.04	100.84	100.83	0.01	0.015	0.016	0.001	39.9871	Good
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

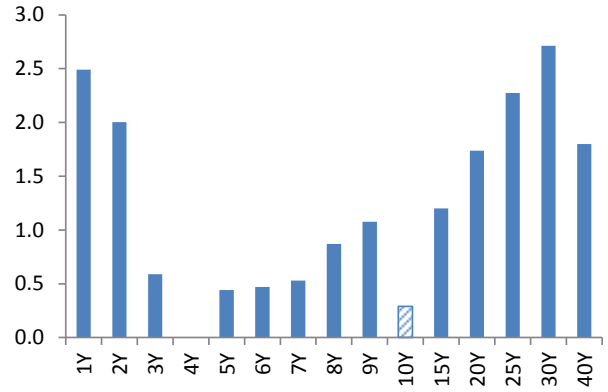
* Daiwa forecast as of Mar. 4 ** Amount the MOF plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



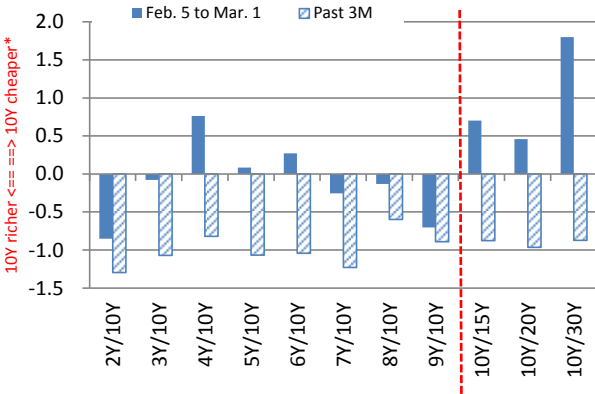
Note: as of 14:00 JST on Mar. 4
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Feb. 5 v. Mar. 4, bp)



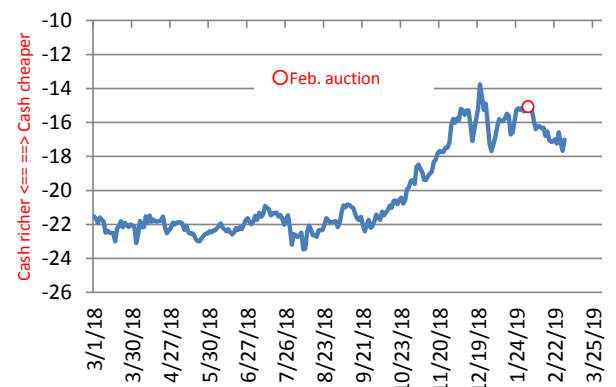
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



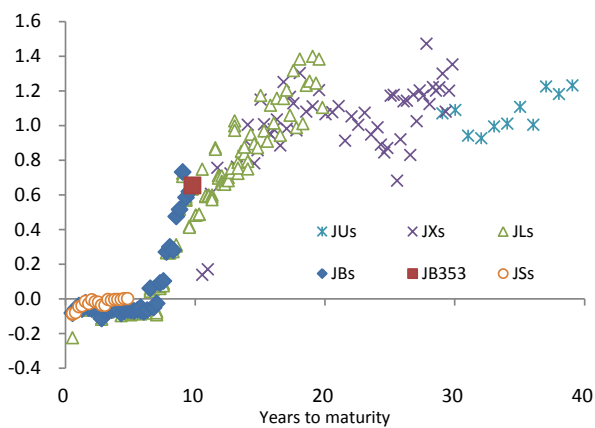
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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



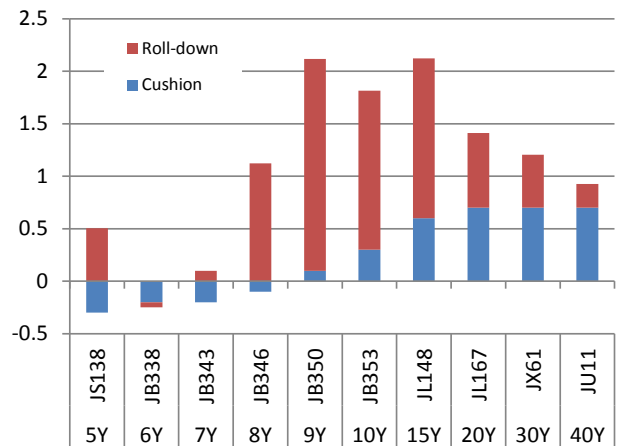
* Yen LIBOR basis
Source: Daiwa Securities.

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



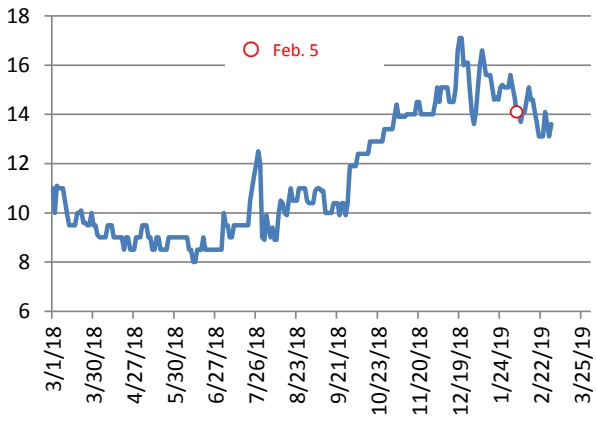
Note: Based on JGB yield curve on Mar. 1; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities.

Appendix 6: JGB Cushion and Roll-down (3M, bp)



Source: Daiwa Securities

Appendix 7: JGB 7Y/10Y Spread (bp)



Note: On-the-run 10Y and CTD basis
Source: Daiwa Securities.

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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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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.
- 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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