

Outlook for 5Y JGB Auction

Placing bids around JS138+0.5bp level

- ✓ We would like to think about placing our bids around the JS138+0.5bp level, assuming that the 5Y JGB yield will move in the -0.20 to -0.16% range until the next 5Y JGB auction in May.

Strategic Memorandum DSTE303
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Auction Details

Auction Date:	April 9, 2019
Issue Date:	April 10, 2019
Maturity Date:	March 20, 2024
Offering Amount:	About 1.9 trillion yen

* New 5Y JGBs to be redeemed in March 2024, JS139, will likely carry a 0.1% coupon.

** On April 8, 5Y WI barely traded, and closed at -0.165% (-1.0bp v. previous day's close). JS138, current on-the-run, traded at -0.170% (-1.0bp) and closed at -0.170% (-1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Placing bids around JS138+0.5bp level

After the previous 5Y JGB auction went smoothly at the -0.160 to -0.155% level on March 12, the bond markets firmed up around the globe on the back of diminished expectations of US rate hikes in 2019. In such a situation, the 5Y JGB yield temporarily declined to -0.200% on an intraday basis, the lowest level since October 2016. Amid the intensifying trend of higher stock prices/weaker yen/lower bond prices around the start of the new fiscal year, the 5Y JGB yield temporarily rose to -0.160% on an intraday basis on April 5. Today (Apr 8), the yield moves at -0.170% while the JGB market bounces.

Mixed by item, the results of March US jobs data released on Apr. 5 failed to make market participants more optimistic about the US economic outlook. That, combined with increasing political uncertainties on US-China trade talks and Brexit, etc. makes bond bulls cheering up around the globe. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ New 5Y JGBs, JS139, will be redeemed in March 2024, belonging to a new maturity basket;
 - Expectations on demand from Japanese investors may be slightly higher at tomorrow's auction than tap-issuance auctions.

- ✓ Currently, primary dealers do not seem to be short in the 5Y sector;
 - This is partly because the BOJ has conducted only three JGB purchase operations in the 3-5Y zone, totaling about 1.2 trillion yen, since the previous 5Y JGB auction in March.
- ✓ The 5Y sector is not expensive on the curve (Appendix 3);
 - Based on the data in the period from the previous 5Y JGB auction to today, the 5Y sector appears noticeably undervalued vs. the 2-3Y sectors.
- ✓ Market sentiment for the short-term zone is expected to improve in new reserve maintenance period to start next week;
 - Downside of 5Y JGBs may be limited.
- ✓ After tomorrow's auction, the BOJ is expected to conduct at least four purchase operations before the next 5Y JGB auction scheduled in May;
 - Three operations in April (BOJ's plan) and one in May (our expectation).
- ✓ Under the current environment, it is difficult to factor in additional easing by the BOJ;
 - The Fed and the ECB have just shifted to the dovish side. If they become more dovish, speculation on the BOJ's additional easing may emerge. However, the possibility on such an emergence appears slim as far as we see it in the limited period, for example, toward the 5Y JGB auction in May.

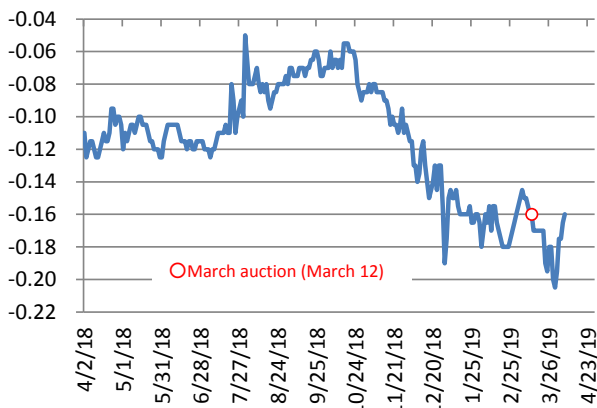
All in all, we would like to think about our bidding stance around the JS138+0.5bp level, assuming that the 5Y JGB yield will move in the -0.20 to -0.16% range by the next auction scheduled for May 16. At the level, positive return is expected from new 5Y JGBs (Appendix 7) and the inverted 2Y/5Y spread is likely to revert to 0bp or above (Appendix 10).

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 (%)	
4/9/19	139	3/20/24	0.1*	1.9**									
3/12/19	138R	12/20/23	0.1	2.3	4.71	101.24	101.23	0.01	-0.157	-0.156	0.001	29.8196	Avg
2/13/19	138R	12/20/23	0.1	2.3	4.84	101.23	101.22	0.01	-0.151	-0.149	0.002	15.4016	Avg
1/16/19	138	12/20/23	0.1	2.3	5.15	101.21	101.21	0.00	-0.144	-0.144	0.000	85.4629	Good
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

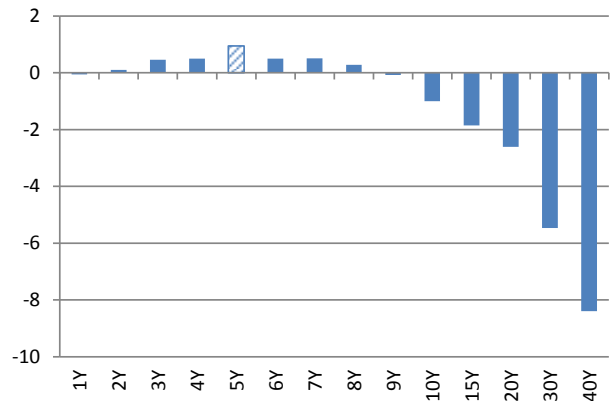
* Daiwa forecast (as of Apr. 8) ** Amount the MOF plans to issue
 Source: Ministry of Finance, Daiwa Securities.

Appendix 1: 5Y JGB Yield (%)



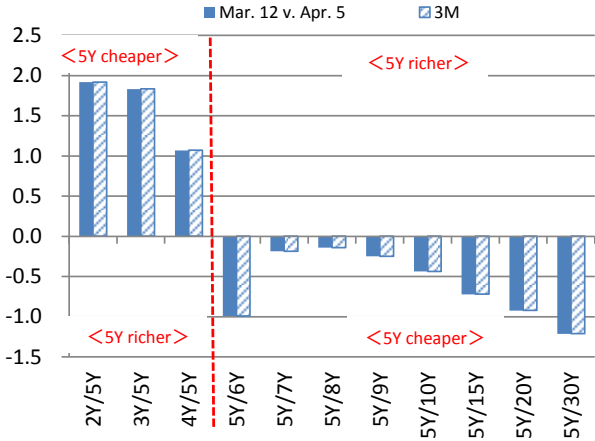
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Mar. 12 v. Apr. 5



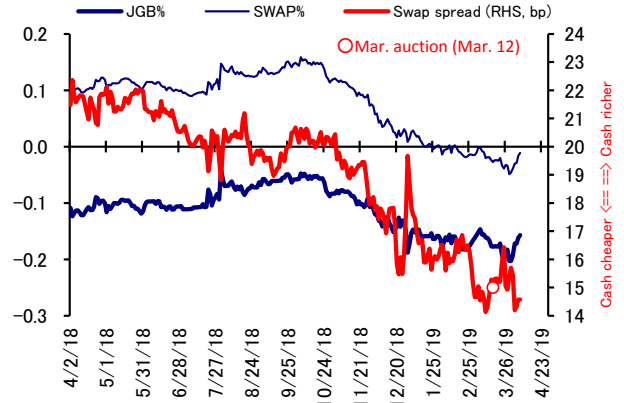
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



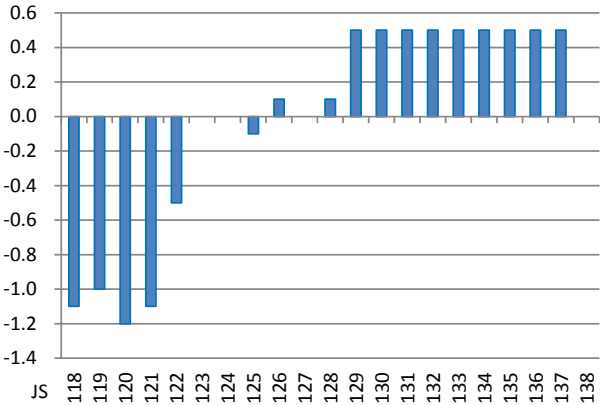
Source: Daiwa Securities.

Appendix 4: 5Y Swap Spread



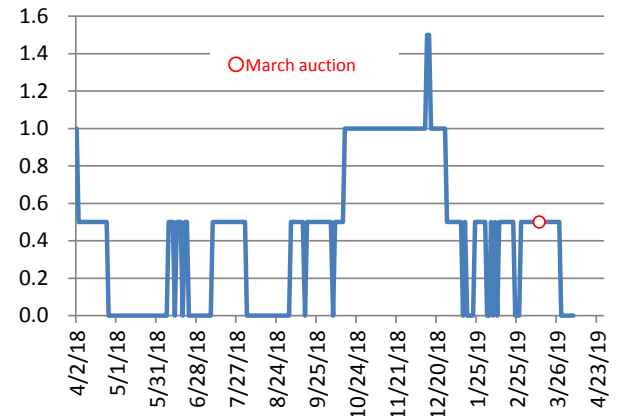
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): Mar. 12 v. Apr. 5



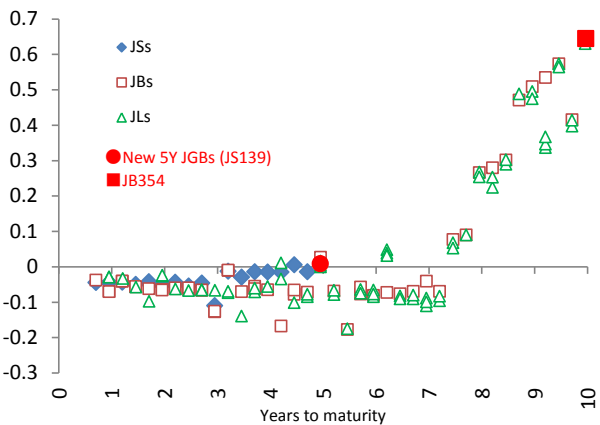
Source: Daiwa Securities.

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



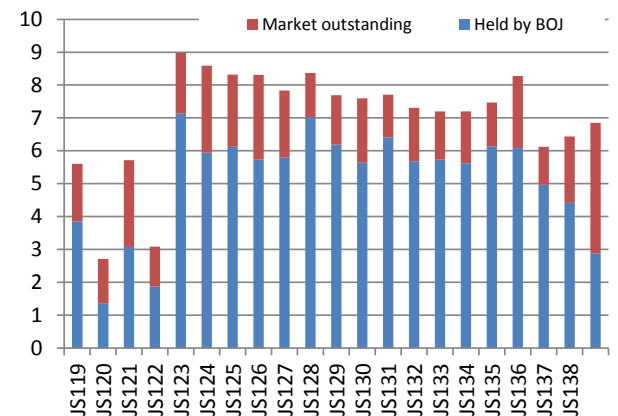
Source: Daiwa Securities.

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



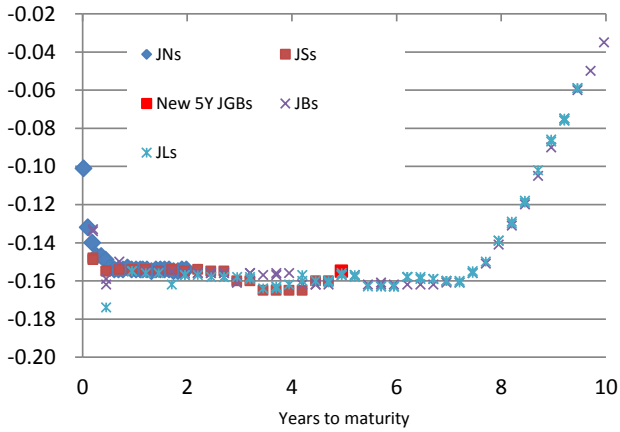
Note: Based on JB, JS and JL yield curves on Mar. 8, respectively; Assuming that those yield curve shapes do not change and factoring roll-down effect etc.; New 5Y JGBs, JS139, are assumed to have a 0.1% coupon and 0.5bp spread to JS138.
Source: Daiwa Securities.

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



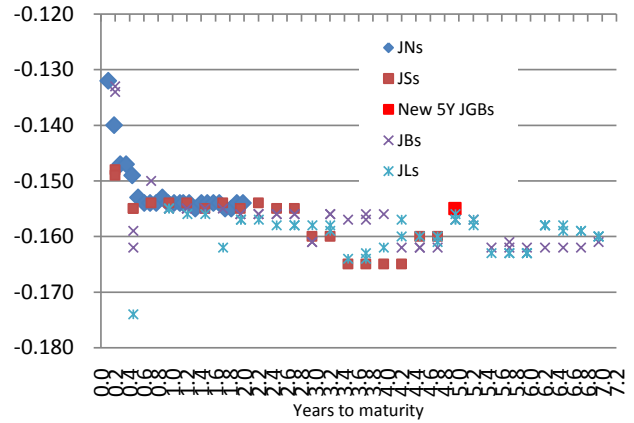
Note: as of Mar. 29
Source: Bank of Japan, Ministry of Finance, Daiwa Securities.

Appendix 9a: JGB Yield Curve (%): Apr. 5



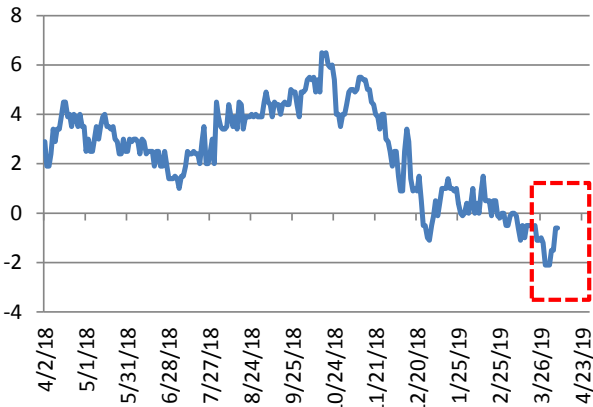
Note: 0-10Y zone; The spread between JS138 and new 5Y JGBs, JS139, is assumed to be 0.5bp.
Source: Daiwa Securities.

Appendix 9b: JGB Yield Curve (%): Apr. 5



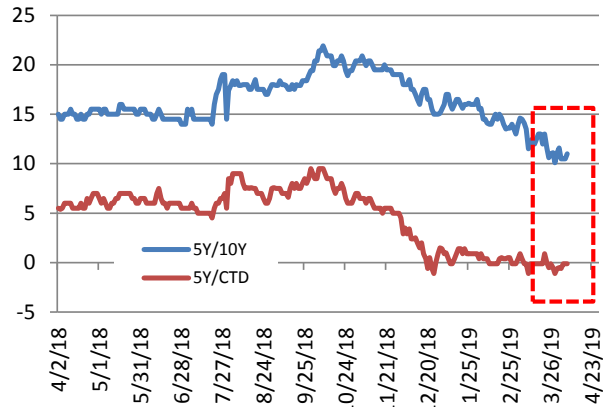
Note: 0-7.2Y zone; The spread between JS138 and new 5Y JGBs, JS139, is assumed to be 0.5bp.
Source: Daiwa Securities.

Appendix 10: JGB 2Y/5Y Spread (bp)



Note: On-the-run basis; the part squared in red is since the March auction.
Source: Daiwa Securities.

Appendix 11: JGB 5Y/CTD and 5Y/10Y Spreads (bp)



Note: On-the-run and CTD basis; the part squared in red is since the March auction.
Source: Daiwa Securities.

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[Standard & Poor's]

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May 2018

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