

Outlook for 10Y JGB Auction / Rinban in July

Key will be demand from investors at -0.15 to -0.10% level

- ✓ We would like to think about our bidding stance for new 10Y, JB355, assuming the 10Y JGB yield's range between 0.2% and -0.1% over the next one month, at the yield level with 1bp or wider spread to JB354.
- ✓ Switching out from 5Y into 10Y to look at

[BOX] BOJ's JGB purchases in July 2019

- ✓ A change on the 10-25Y zone purchase may be aimed at helping current steepening around the long end of the curve, but such a steepening would be short lived

Strategic Memorandum DSTE316
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Auction Details

Auction Date:	July 2, 2019
Issue Date:	July 3, 2019
Maturity Date:	June 20, 2029
Offering Amount:	About 2.1 trillion yen

* New 10Y JGBs, JB355, will likely carry a 0.1% coupon.

** On July 1, WI barely traded, and closed at -0.140% (+1.5bp v. previous day's close).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Tomorrow's auction to be held at the lowest bidding yield level since the auction in July 2016, which had an average result amid yield downtrend toward -0.3%

The previous 10Y JGB auction was held at the -0.110 to -0.105% level on June 4 and the result turned to be somewhat weak. After the auction, the 10Y JGB yield trended down and fell to -0.195% on June 21 on an intraday basis, the lowest level since July 2016. Subsequently, the market posted higher stock prices/lower bond prices, while Japanese investors paid attention to 1Q-FY portfolio (1H-end for overseas investors). The trend pushed up the 10Y JGB yield to -0.140% at one point on an intraday basis. Tomorrow's auction is to be held at the lowest bidding yield level since the auction in July 2016, which was conducted a few days before the 10Y JGB yield bottomed out at -0.3% and had an average result.

The -0.15 to -0.10% yield level would not discourage market participants from buying new 10Y JGBs in new maturity basket

Concerns about the global economy are lingering partly because of the existence of factors that warrant no optimism, such as Brexit and trade frictions vs. the US. As the ECB is poised to amplify easing (including a rate cut) and the Fed is almost certain to cut rates before year-end, speculations on the BOJ's further easing (such as revision to forward guidance) and the possibility of additional easing (deepening of interest rate in negative territory) are mounting. Market participants are thus aware of the global yield downtrend. On the other hand, the recent sharp yield downtrend has started to let up as excessive expectations for the Fed's rate cuts are currently diminishing. Tomorrow's auction is to be held in such a situation, but expectations for investor demand appear strong partly because (1) new 10Y JGBs (to be redeemed in Jun 2019) will belong to new maturity basket and (2) the 10Y sector is the most attractive in terms of carry on the short- to long-term zone of the

curve, where yields are falling in negative territory across the board (Appendix 5). As we expect speculation on the BOJ's additional easing to persist in the near term, the -0.15 to -0.10% yield level would not discourage market participants from buying new 10Y JGBs in new maturity basket.

Diminishing likelihood of BOJ reducing offer amounts in 5-10Y zone

A near-term concern is the BOJ's purchase operations. At his press conference in June, BOJ governor Haruhiko Kuroda stated that "doubling of the 0.1% trading band the central bank has set for the 10-year yield to allow more flexible moves." This implies that around -0.2% is not a strict floor. Partly due to this, the likelihood appears to have declined that the BOJ will reduce its offer amounts for JGB purchases in the 5-10Y zone in the immediate future.

We think about our bidding stance, assuming the 10Y JGB yield's range between -0.2% and -0.1%, at the yield level with 1bp or wider spread to JB354

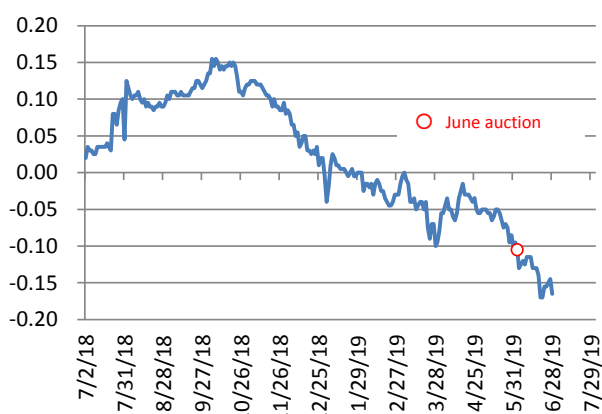
All in all, we think about our bidding stance, assuming that the 10Y JGB yield will likely move in a range between 0.2% and -0.1% over the next one month, at the yield level with 1bp or wider spread to JB354. The 10Y sector is not cheap on the curve at the current level. The sector is rather noticeably overvalued vs. the short-term sectors, such as 2-3Y sectors (Appendix 3). In addition, we are worried about the richness of 10Y cash against swaps (Appendix 4). In terms of the relative value, it is thus difficult to aggressively build new positions. However, it would be worth considering switching out from e.g. the 5Y sector, in which the BOJ is expected to trim its purchase amounts, given today's steepening.

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 %	
7/2/19	355	0.1*	6/20/29	21,000**									
6/4/19	354R	0.1	3/20/29	2,099	3.99	102.04	102.01	0.03	-0.106	-0.103	0.003	15.1237	Poor
5/8/19	354R	0.1	3/20/29	2,099	4.44	101.59	101.57	0.02	-0.060	-0.058	0.002	36.0139	Avg
4/2/19	354	0.1	3/20/29	2,412	5.07	101.61	101.60	0.01	-0.060	-0.059	0.001	37.4603	Good
3/5/19	353R	0.1	12/20/28	2,233	4.25	101.00	100.98	0.02	-0.002	0.000	0.002	74.5124	Poor
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

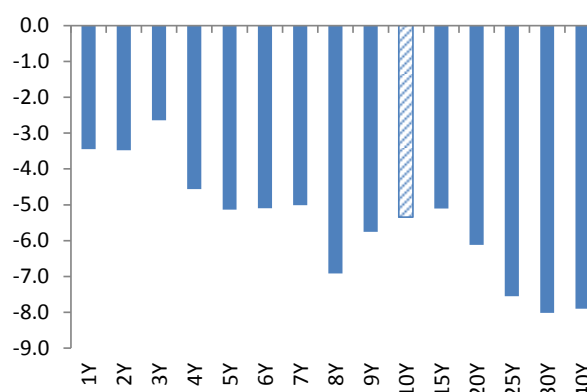
* Daiwa forecast as of July 1 ** Amount the MOF plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



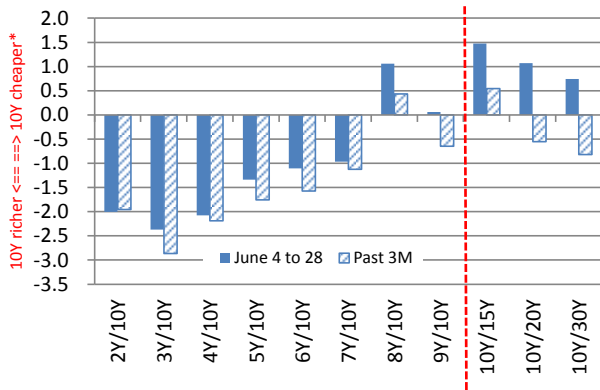
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (June 4 v. June 28, bp)



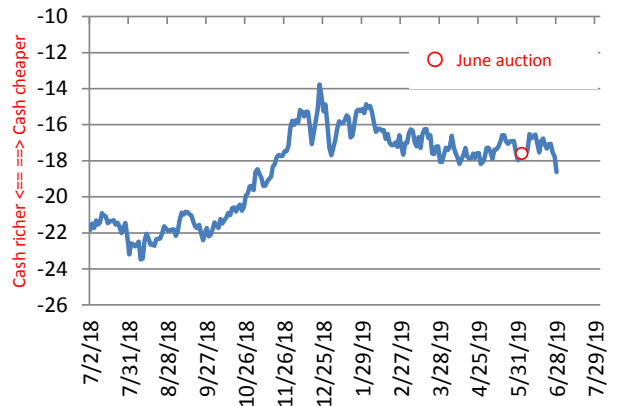
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



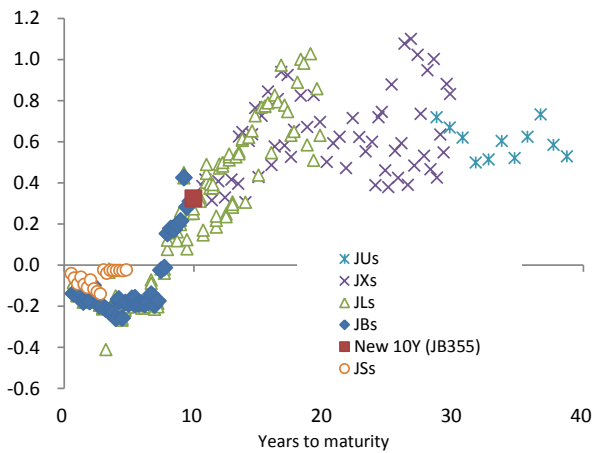
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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 June 28; assuming that those yield curve shapes do not change and factoring roll-down effect etc.; new 10Y (JB355) is supposed to have 0.1% coupon and 1bp spread to JB354.
Source: Daiwa Securities.

Appendix 6: JGB 5Y/10Y Spread (bp)



Note: On-the-run issue basis
Source: Daiwa Securities

[BOX] BOJ JGB Purchases in July 2019

The BOJ updated its “Outline of Outright Purchases of Japanese Government Securities” on June 28. The changes from the report it announced at the end of May are as follows:

- ✓ It raised the top of its range of offer amounts in the 1-3Y zone
- ✓ It lowered both the bottom and top of its range of offer amounts in the 3-5Y zone
- ✓ It lowered the top of its range of offer amounts in the 10-25Y zone

Since the BOJ announced it would be flexible with its operations, there has been (1) constant speculation on reduction in offer amounts in all zones other than the up-to-1Y, JGB linker, and floating-rate note zones or (2) speculation on some changes in the guideline for the following month (announced at end-month). Under these conditions, the market's initial reaction to this latest changes in the guideline was relatively limited.

Based on the first two changes noted above, relative to its final offer amounts in June its purchases in the 1-3Y zone will increase, its purchases in the 3-5Y zone will decrease, and, in certain cases, its purchases of 1-3Y JGBs may exceed its purchases of 3-5Y JGBs.

With any significant corrections having been seen for the excessive distortions around the belly of the curve, this looks like a new approach to curb those distortions driven by supply-demand imbalance around the 5Y sector with its total purchase amounts in the 1-5Y zone unchanged. This approach will likely be also used when the BOJ needs to think about additional easing, for example.

As the BOJ has lowered the top of its offer range in the 10-25Y zone, the likelihood has increased that the offer amount in that zone will be lower than its final offer amount in June. We trace the change back to BOJ Governor Kuroda's comments at his press conference following the June policy meeting. He said back then that the current flattening of the yield curve was a concern and that the BOJ would respond appropriately if necessary. We also think the change may be aimed at helping along the current steepening of the superlong zone, which started in late June. With the market being well aware of the stock effects from the BOJ's massive purchases of JGBs, the BOJ reductions in offer amounts for the zone over 10Y have failed to curb flattening when the yield curve trends flattening. If the BOJ reduces offer amounts when the curve faces steepening pressure, however, it may keep the yield curve under steepening pressure. As we just explained, however, the stock affects are also strong. We expect that even such a steepening trend will be short lived.

Given the latest changes in the operation guideline, we expect the initial offer amounts in July to be about 400bn yen in the 1-3Y zone (up 50bn yen from the final amount in June), 350bn yen in the 3-5Y zone (down 50bn yen), and 180bn yen in the 10-25Y zone (down 20bn yen), with the rest of the offer amounts unchanged (see Chart below).

Based on these changes and the amount of reductions, we recommend positioning for a flattening of the JGB yield curve around the time of the 30Y JGB auction.

BOJ JGB Purchases in July 2019 (Yen billions)

		Offer size per operation*		Number of Offers (per month)*	Offer size exp. for the first offer in July	Offer size as of June 28	Monthly Total exp.	MOF issuance per month in FY2019**
			Mid					
JGBs ex Linkers and Floaters								
Up to 1 year		About 10-100	55	2	50	50	100	-
Over 1 to 5 years	Over 1 to 3 years	About 250-500	375	4	400	350	1,600	2,000
	Over 3 to 5 years	About 250-500	375		350	400	1,400	1,900
Over 5 to 10 years		About 300-650	475	4	480	450	1,800	2,100
Over 10 years	Over 10 to 25 years	About 100-250	175	3	180	180	540	900
	Over 25 years	About 10-100	55		400	50	120	700 - 1,100
Linkers		About 25	-	2	25	25	50	400
Floaters (in even months)		About 100	-	1	100	100	100	-

(Note) Increased from June in blue and decreased in red * Excluding NPC1 and AEL; JGB linkers issued 4 times per year
Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

BOJ JGB Purchase Schedule in July 2019

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	TDBs	
7/1/19	M 7/2/19									
7/2/19	T 7/3/19	10Y JGB Auction								○
7/3/19	W 7/4/19		◎	◎		◎	◎			
7/4/19	TH 7/5/19	30Y JGB Auction								
7/5/19	F 7/8/19	○			◎			○	3M	
7/8/19	M 7/9/19	5Y JGB Auction								6M
7/9/19	T 7/10/19	5Y JGB Auction								
7/10/19	W 7/11/19	5Y JGB Auction								
7/11/19	TH 7/12/19	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)								○
7/12/19	F 7/16/19		◎	◎		◎	◎		3M	
7/15/19	M -	Public Holiday (Marine Day)								
7/16/19	T 7/17/19				◎			○	○	
7/17/19	W 7/18/19	20Y JGB Auction								
7/18/19	TH 7/19/19	20Y JGB Auction								1Y
7/19/19	F 7/22/19	AEL (2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years to maturity)								3M
7/22/19	M 7/23/19		◎	◎	◎					
7/23/19	T 7/24/19	40Y JGB Auction								○
7/24/19	W 7/25/19	40Y JGB Auction								
7/25/19	TH 8/1/19	2Y JGB Auction								
7/26/19	F 7/29/19	○				◎	◎		3M	
7/29/19	M 7/30/19									
7/30/19	T 7/31/19									
7/31/19	W 8/1/19		◎	◎	◎					

Note: ◎ Planned by the BOJ, ○ Daiwa forecast as of July 1
Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

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[Standard & Poor's]

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May 2018

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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.
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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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