

Outlook for 5Y JGB Auction

Smooth auction is expected

- ✓ An average result is expected at tomorrow's auction for new 5Y JGBs in new maturity basket (JS140 to be redeemed in June 2024). We would like to think about our bidding stance, assuming that the 5Y JGB yield will move in the range centered at -0.27 to -0.23% over the next one month.
- ✓ In terms of the relative value, it would be worth considering switching out from the 7-10Y sectors.

Strategic Memorandum DSTE318
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Auction Details

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

* New 5Y JGBs, JS140, will likely carry a 0.1% coupon.

** On July 8, WI barely traded, and closed at -0.240% (+1.5bp v. previous day's close).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

5Y JGB yield has been moving at -0.29 to -0.24% level since previous auction

After the previous 5Y JGB auction went fairly at the -0.230 to -0.225% level on June 18 amid the yield downtrend, the 5Y JGB yield continued to decline. On June 21, the yield temporarily fell to -0.290% on an intraday basis. Then, the markets mostly posted higher stock prices/lower bond prices toward the end of June, while Japanese investors paid attention to 1Q-FY portfolio (1H-end for overseas investors), keeping the 5Y JGB yield also in the uptrend. Entering July, the yield rose to -0.240% at one point on an intraday basis. For the past several days, the yield is mostly moving at the -0.265 to -0.245%.

Global low interest rate environment would be unchanged

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. While the ECB is poised to amplify easing (including a rate cut), speculation on the Fed's rate cuts before year-end appears strong (putting aside the degree of rate cut). Along with lingering speculations on the BOJ's further easing (such as revision to forward guidance) and additional easing (deepening of interest rate in negative territory), the global low interest rate environment would be unchanged. Reflecting the strong result of US jobs data, released at the end of the last week, the bond markets have been softening. However, we see that the yield uptrend is unlikely to gain momentum, prior to the congressional testimony by Fed chair Jerome Powell on July 10-11. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **New 5Y JGBs in new maturity basket to be redeemed in June 2024 (JS140):** Demand from Japanese investors could be stronger than that for reopened issues.
- ✓ **Relative-value advantages:** The 5Y sector is noticeably undervalued vs. the 7-10 sectors on the curve (Appendix 3). In addition, 5Y cash is undervalued against swaps (Appendix 4).
- ✓ **Constant support factor:** There is a strong support from sectors which appear constantly short, such as the 6Y sector, due to the impact of the BOJ's JGB purchase policy in the 5-10Y zone.
- ✓ **Limited possibility of the BOJ's further reduction in the offer amount:** In its first JGB purchase operations in July, the BOJ cut the offer amount in the 3-5Y zone. As this led to the further inversion of the 5-7Y zone of the yield curve, the possibility of further trimming appears limited especially in the near term.
- ✓ **Demand from overseas investors is uncertain:** There are strong expectations for demand from overseas investors because (1) the purchase amount of intermediate JGBs by overseas investors since the beginning of FY19 has been substantially higher than the average during FY13-18 (Appendix 9) and (2) 5Y JGBs still appear to be attractive on a cross currency basis (Appendix 10). However, there is also uncertainty about the level of demand as market participants are aware of rate cuts by the ECB and the Fed.

Thinking about our bidding stance, assuming the range centered at -0.27 to -0.23% / In terms of the relative value, it would be worth considering switching out from the 7-10Y sectors

All in all, needing to pay close attention to demand from both domestic and overseas investors, we expect tomorrow's auction to go smoothly. We would like to think about our bidding stance, assuming that the 5Y JGB yield will move in the range centered at -0.27 to -0.23% over the next one month. In terms of the relative value, it would be worth considering switching out from the 7-10Y sectors. The 5Y sector is noticeably undervalued vs. these sectors at the current level (Appendix 3). Especially regarding this week's schedule in the 5-10Y zone, the Auction for Enhanced Liquidity for JGBs (with remaining maturities of 5-15.5 years) worth around 60bn yen is to be held, while the BOJ has no plan to conduct purchase operation. This is likely to increase expectations for a short-term correction in the cheapness of the 5Y sector.

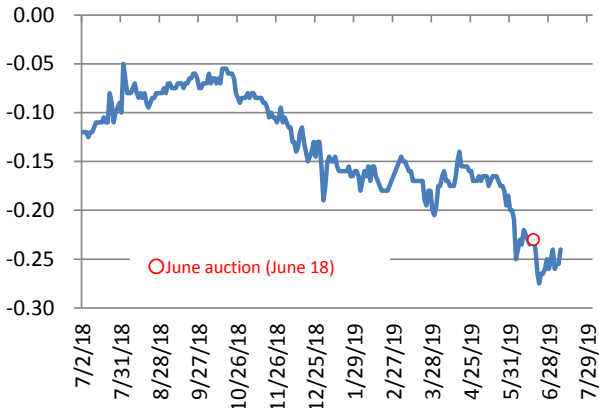
5Y JGB Auction Results

Auction Date	Issue #	Maturity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
7/9/19	140	6/20/24	0.1*	1.9**									
6/18/19	139R	3/20/24	0.1	2.1	4.51	101.58	101.57	0.01	-0.228	-0.226	0.002	97.7373	Avg
5/16/19	139R	3/20/24	0.1	2.1	4.94	101.32	101.31	0.01	-0.170	-0.168	0.002	16.6556	Good
4/9/19	139	3/20/24	0.1	1.9	5.31	101.32	101.31	0.01	-0.164	-0.162	0.002	5.2806	Good
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

* Daiwa forecast as of July 8 ** Amount the MOF plans to issue

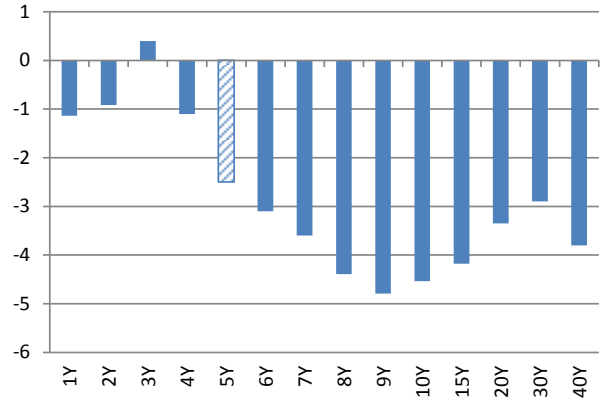
Source: Ministry of Finance, Daiwa Securities.

Appendix 1: 5Y JGB Yield (%)



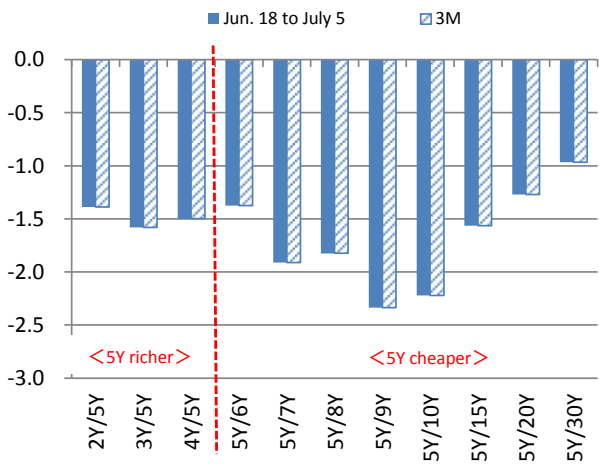
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): June 18 v. July 5



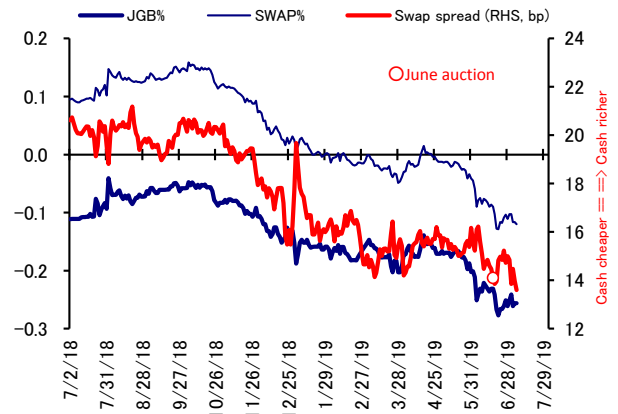
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



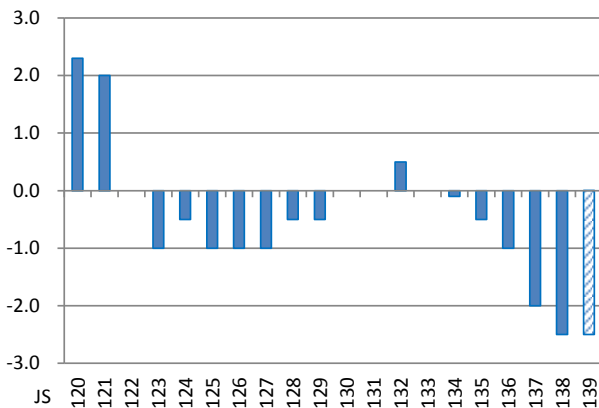
Source: Daiwa Securities.

Appendix 4: 5Y Swap Spread



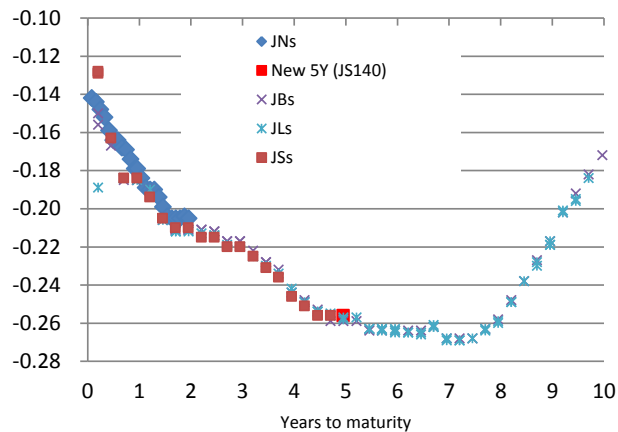
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): June 18 v. July 5



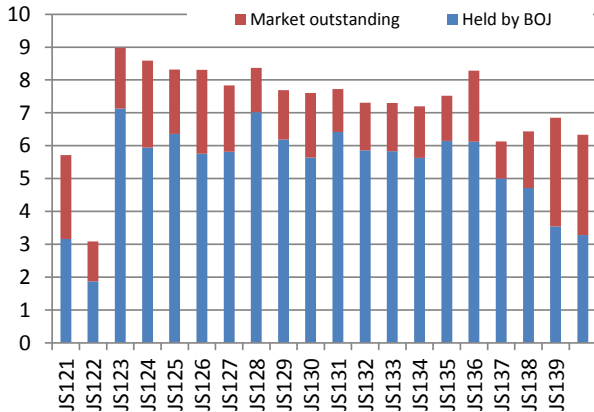
Source: Daiwa Securities.

Appendix 6: JGB Yield Curve (%), July 5



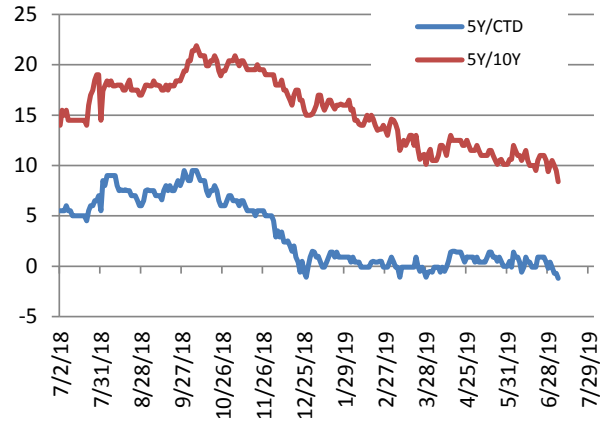
Source: Daiwa Securities.

Appendix 7: JS Market Outstanding and BOJ Holding Amount (exp. Yen trillions)



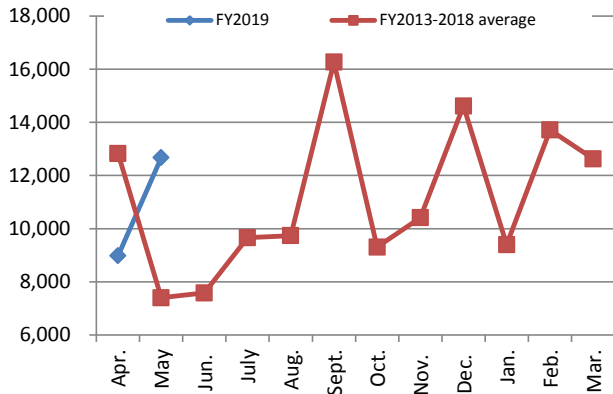
Note: as of June 28 on BOJ start basis
Source: Daiwa Securities.

Appendix 8: 5Y/CTD and 5Y/10Y Spreads (bp)



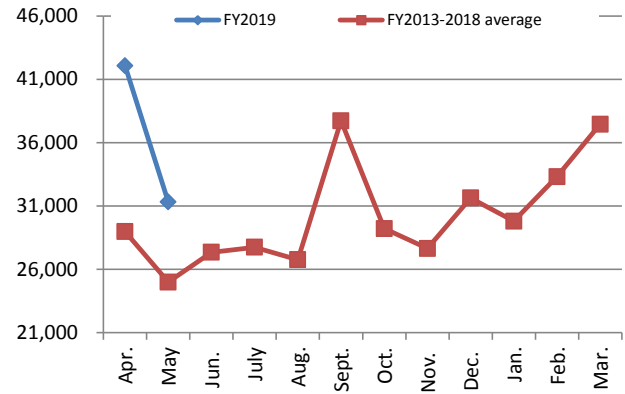
Note: On-the-run and CTD compound yields
Source: Daiwa Securities.

Appendix 9a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)



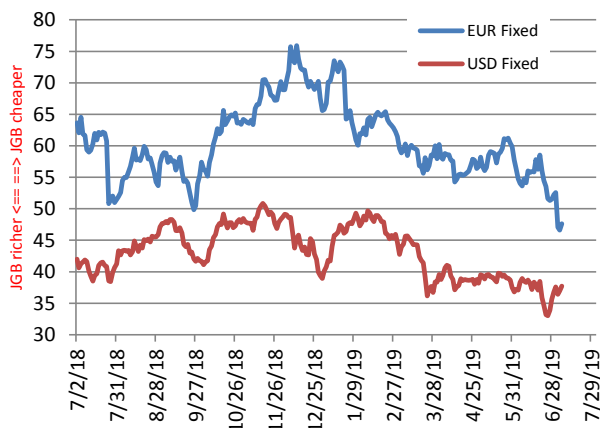
Source: JSDA

Appendix 9b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)



Source: JSDA

Appendix 10: Benchmark Spreads (bp)



Note: against 5Y UST and 5Y OBL
Source: Daiwa Securities

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[Standard & Poor's]

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May 2018

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