

Outlook for 10Y JGB Auction

BOJ goes “a step further,” but optimism unlikely to grow about tomorrow’s primary sale

- ✓ Tomorrow’s auction to be held at a lower bidding yield level than the previous auction as well as at the lowest level since the auction in July 2016.
- ✓ The BOJ goes “a step further,” forcing market participants to be aware of the global yield downtrend. That said, it is hard to factor in BOJ actions, such as modification of the YCC framework. 10Y JGBs, which lack strong relative-value attractiveness, are unlikely to find aggressive buyers at the -0.20 to -0.15% level.
- ✓ We would like to think about our bidding stance at tomorrow’s auction, assuming that 10Y JGBs will find better buyers at the -0.15 - -0.10% level.

Strategic Memorandum DSTE322
FICC Research Dept.

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Auction Details

Auction Date: August 1, 2019
Issue Date: August 2, 2019
Maturity Date: June 20, 2029
Offering Amount: About 2.1 trillion yen

* New 10Y JGBs will likely be the first reopening of JB355 carrying a 0.1% coupon.

** On July 31, JB355 traded at -0.160% (-0.5bp v. previous day's close) and closed at -0.160% (-0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Tomorrow’s auction is to be held at a lower bidding yield level than the previous auction as well as at the lowest level since the auction in July 2016

After the previous 10Y JGB auction went smoothly at the -0.140 to -0.135% level on July 2, the 10Y JGB yield has been moving in the -0.170 to -0.120% range on an intraday basis. For the past few days, the yield is moving at the -0.160 to -0.150% level, around the lower end of the recent range. Tomorrow’s auction is to be held at a lower bidding yield level than the previous auction as well as at the lowest 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.

BOJ also goes “a step further,” forcing market participants to be aware of the global yield downtrend

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. In such a situation, the ECB has decided to consider an additional rate cut and the resumption of quantitative easing policy. In the policy statement released yesterday (Jul 30), the BOJ also clearly stated that it “will not hesitate to take additional easing measures if there is a greater possibility that the momentum toward achieving the price stability target will be lost.” BOJ governor Haruhiko Kuroda also said that “we have become more positive about monetary easing,” implying possible implementation of additional easing. On the market-focused July FOMC meeting, market participants are almost certain for a rate cut and some anticipate a couple of rate cuts in 2019. In such an environment where we have to be aware of the global yield downtrend, key points to think about bidding at tomorrow’s auction are as follows:

That said, it is hard to factor in concrete actions such as modification of YCC framework, and therefore it would be difficult to buy aggressively at the -0.20 to -0.15% level

✓ **Absolute yield level:** Although the BOJ appears to have become more dovish at the July monetary policy meeting, post-meeting reactions show that the market has not factored into any actions possibly taken by the BOJ, such as a revision to the yield curve control policy. At the June press conference, Governor Kuroda said that “a doubling of the 0.1% trading band the central bank has set for the 10-year yield to allow more flexible moves,” suggesting that around -0.2% is not a strict BOJ floor. However, around -0.2% would continue to be recognized as the floor of the 10Y JGB yield in the market unless the central bank actually takes some measures to lead the policy rates down. If not, it would be difficult to buy 10Y JGBs aggressively at the -0.20 to -0.15% level.

Lack of strong attractiveness in terms of relative value

✓ **Relative value:** The 10Y sector is neither noticeably rich nor cheap on the curve (Appendix 4). Since the beginning of the year, the 10Y asset swap spread has been moving in a very narrow range (Appendix 5). As the current level is around the median of the range, 10Y cash is neither noticeably overvalued nor undervalued against swaps.

Persisting expectations on demand from investors

✓ **Demand:** At tomorrow's auction, short-covering from primary dealers does not appear strong at all. Regarding demand from investors, expectations on demand especially from duration-constrained investors are persisting partly because the 10Y sector has an advantage in terms of carry in the short- to long-term zone where all yields are falling below zero (Appendix 6).

Bidding on the view 10Y JGBs will find better buyers at -0.15 - -0.10% level

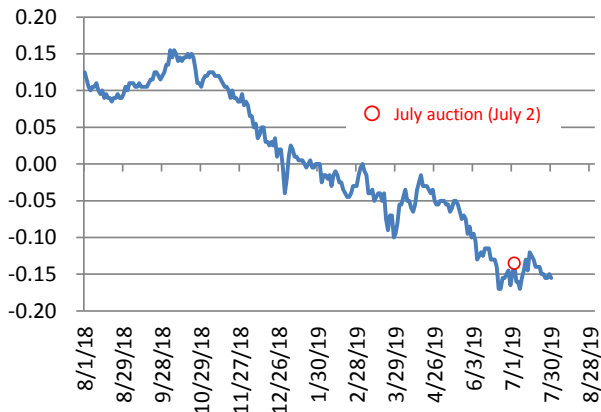
All in all, we would like to think about our bidding stance at tomorrow's auction, assuming that 10Y JGBs will find better buyers at the -0.15 - -0.10% level. In terms of the relative value, it is difficult to aggressively build new positions at the current level. If any on the curve, there may be activities to switch out from the short-term/intermediate sectors, rather than the superlong sector. Yesterday, BOJ governor Haruhiko Kuroda touched on the shape of the yield curve. However, under the current market environment, the BOJ flow-based reduction in purchases around the long end of the curve is unlikely to give the yield curve a substantial flattening correction. Unless “Outline of Outright Purchases of Japanese Government Securities” to be announced in the late afternoon today includes a surprising modification to JGBs with over ten years left to maturity, switching out from the superlong sector would not work well. Meanwhile, as mentioned, the 10Y sector has an advantage in terms of carry in the short- to long-term zone where all yields are falling below zero. From this viewpoint, it would be more worth considering switching out from the short- to long-term sectors.

10Y JGB Auction Results

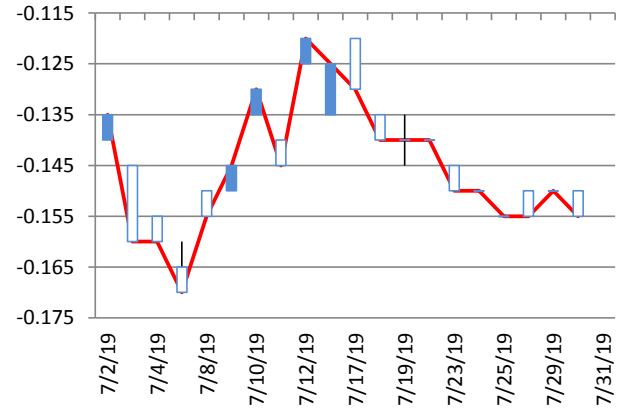
Auction Date	Issue#	Coupon %	Maturity Date	Issue Size (billion yen)	Bid/Cover	Average Accepted Price	Lowest Accepted Price	Tail (yen)	Average Accepted Yield	Highest Accepted Yield	Tail (%)	Allotment %	
8/1/19	355R*	0.1	6/20/29	2,100**									
7/2/19	355	0.1	6/20/29	2,099	3.92	102.42	102.40	0.02	-0.139	-0.137	0.002	93.8948	Avg
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

* Daiwa forecast as of July 31 ** Amount the MOF plans to issue

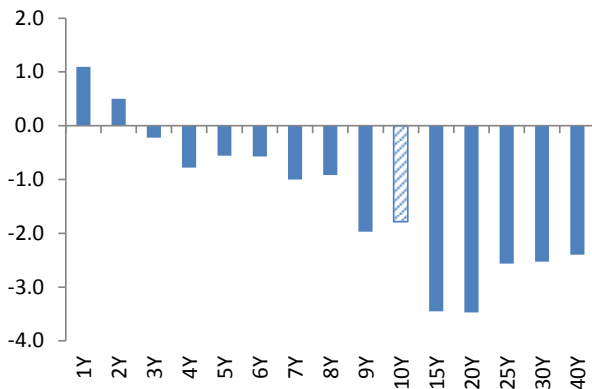
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)


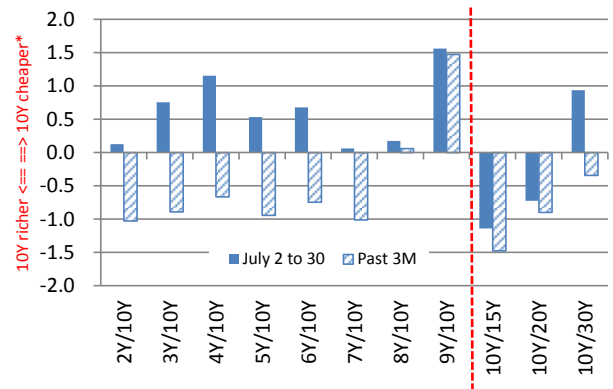
Source: Daiwa Securities.

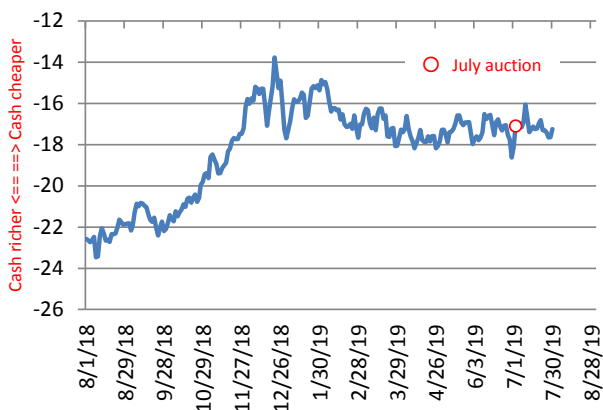
Appendix 2: JB335 Yield Open/High/Low/Close (%)


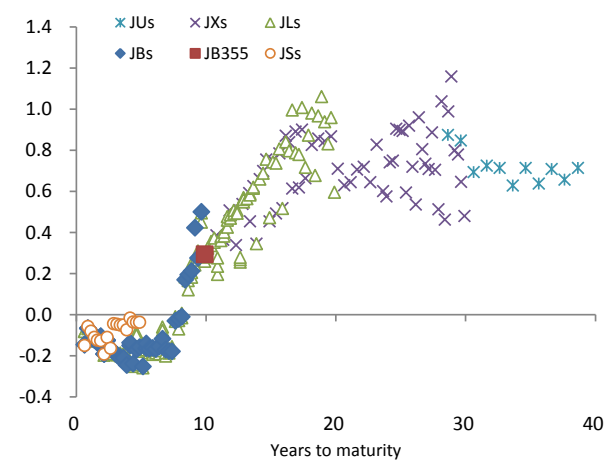
Source: Daiwa Securities.

Appendix 3: JGB Yield Change (July 2 v. July 30, bp)


Source: Daiwa Securities.

Appendix 4: Z-scores of JGB Yield Spreads

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

Appendix 5: 10Y JGB Asset Swap Spread (bp)

* Yen LIBOR basis
Source: Daiwa Securities.

Appendix 6: JGB Total Return Curve (3M, %)

Note: Based on JGB yield curve on July 30 ; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
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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- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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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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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- 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.
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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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