

Outlook for 10Y JGBi Auction

Hoping for Support at 0-10bp BEI level

- ✓ BEI is the lowest level since October 2013
- ✓ Remaining sluggish in the near term, Japan inflation is expected to start rising for the scheduled consumption tax hike in October
- ✓ With index ratio expected to decline toward October etc., it is not a good timing to buy JGBis in an aggressive stance
- ✓ There are some factors, which may discourage market participants from bidding JGBis in an aggressive stance, such as declining crude oil, yen appreciation and declining BEIs in the US and Europe
- ✓ Setting the 0-10bp level in BEI as a dip-buying point, we would like to think about out bidding stance

Strategic Memorandum DSTE324
FICC Research Dept.

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Auction Details

Auction Date:	August 8, 2019
Issue Date:	August 9, 2019
Maturity Date:	March 20, 2029
Offering Amount:	About 400 billion yen
Auction Method:	Dutch auction on an inflation-not-adjusted price with the increment of 0.05 yen
Base CPI:	101.40 (Nat'l core-CPI in Dec. 2018)
Ref. CPI:	101.800 (as on Aug. 9)
Index ratio:	1.00394 (as on Aug. 9)

* New 10Y JGBis will be the first reopening of JBI24 carrying a 0.1% coupon.

** On Aug. 7, JBI24 traded at 104.25 yen (+0.15 yen v. previous day's close) and closed at 104.25 yen (+0.15 yen). JBI24 BEI closed at 12.3bp.

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Positive return is sustained, although BEI is at the lowest level since October 2013

After the previous JGBi auction on May 10, the break-even inflation rate (or BEI) remained in the 20-25bp range for a while. However, the rate started to trend down in mid-June and recently declined to around 12bp, the lowest level since the Ministry of Finance remodeled and resumed JGBi issuance in October 2013 (Chart 1, Appendix on page 5). Concerns about the global economy are persisting partly because of the existence of factors that warrant no optimism, such as Brexit and trade frictions vs. the US. As inflation expectations tend to decline in Europe and the US, Japan's BEI is also likely to face downward pressure. On the other hand, JBI24 itself appears to be sustaining favorable performance, as witnessed by the continued positive return, although the BEI has been on a downtrend (Chart 3).

Remaining sluggish in the near term, inflation is expected to start picking up in October

In predicting the future developments, we are concerned about negative impact on JGBi investor sentiment from expected weakness in observed domestic inflation. The nationwide core-CPI growth rate has been consistently in positive territory for more than two years. However, it is expected to decline to around 0.5% toward September because positive contributions from energy prices are expected to start to contract. However, as the consumption tax rate hike is slated for October (from 8% to 10%), the CPI growth rate is expected to start picking up.

With index ratio expected to decline toward October etc., it is not a good timing to buy JGBis in an aggressive stance

Here, we check the index ratio path based on our CPI forecast. Going forward, it is likely to decline slightly toward October, then trend upward toward February 2020 (Chart 6). However, if we assume that the JGBi price will be unchanged after buying at tomorrow's auction, the expected return from JGBis would remain around 0% until around December (Chart 7). Unless a surge in JGBi prices is expected, it would not be a good timing for building new positions or adding positions at tomorrow's auction.

Setting the 0-10bp level in BEI as a dip-buying point

Amid persisting concerns about the global economy, there are some factors, which may discourage market participants from buying JGBis in an aggressive stance, such as crude oil prices, yen appreciation and the decline in European/US BEIs. In the low expected inflation environment, Japan's BEI may keep the downtrend in the near term. Setting the 0-10bp level in BEI as a dip-buying point, we would like to think about our bidding stance at tomorrow's auction (Table 3).

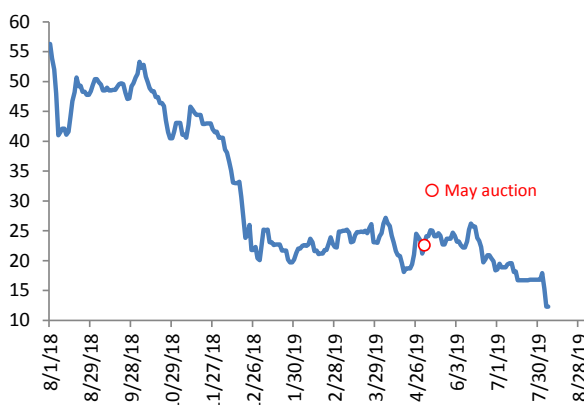
10Y JGBi Auction Results

Auction Date	Issue #	Coupon (%)	Maturity Date	Issue Size (billion yen)	B/C	Lowest Accepted Price/Issue Price (Yen) (Note 1)	Highest Accepted Yield (%)	Allotment (%)	BEI Before Auction (Note 2)	BEI on Auction Day (bp) (Note 2)	Change from p.d. (bp) (Note 2)	Market Expectation of Lowest Accepted Price (Yen) (Note3)	Expected range	
8/8/19	24R	0.1	3/10/29	400*					12.3					
5/10/19	24	0.1	3/10/29	430.2	3.72	103.70	-0.266	94.4029	21.5	22.6	1.1	103.50	103.30-103.60	Good
2/15/19	23R	0.1	3/10/28	421.8	3.34	103.60	-0.287	16.3120	21.6	21.7	0.1	103.50	103.40-103.50	Good
11/6/18	23R	0.1	3/10/28	435.4	3.70	103.90	-0.305	43.0272	41.1	41.1	0.0	103.85	103.75-103.90	Avg
8/7/18	23R	0.1	3/10/28	418.4	3.12	104.05	-0.309	6.3636	48.0	41.0	-7.0	104.00	103.75-104.30	Avg
5/10/18	23	0.1	3/10/28	447.1	4.02	106.35	-0.513	32.0441	56.5	58.7	2.2	106.20	106.10-106.30	Good
2/6/18	22R	0.1	3/10/27	440.8	3.38	105.35	-0.464	5.0000	62.4	55.7	-6.7	106.25	106.00-106.30	Poor
10/5/17	22R	0.1	3/10/27	446.4	3.10	104.50	-0.361	55.6088	38.8	39.9	1.1	104.40	104.30-104.50	Good
8/3/17	22R	0.1	3/10/27	419.3	3.19	104.55	-0.358	69.4877	36.0	38.5	2.5	104.45	103.70-104.50	Good
4/11/17	22	0.1	3/10/27	453.9	3.64	105.00	-0.385	50.5643	44.0	46.7	2.7	104.80	104.65-105.00	Good
2/7/17	21R	0.1	3/10/26	412.2	2.61	105.10	0.439	25.7142	62.9	58.2	-4.7	105.30	105.00-105.50	Poor
10/6/16	21R	0.1	3/10/26	425.1	3.21	104.80	-0.391	40.0537	30.9	37.1	6.2	104.75	104.50-104.90	Good
8/4/16	21R	0.1	3/10/26	454.3	2.85	104.20	-0.324	72.0520	30.0	31.0	1.0	103.80	103.40-104.05	Good
4/12/16	21	0.1	3/10/26	435.6	2.84	104.90	-0.376	80.0000	35.0	36.7	1.7	104.70	104.30-105.40	Good

* Planned by MoF (Note 1) Inflation adjusted price until August 2017 and inflation unadjusted price from October 2017 (Note2) Closing price; WI basis for new issues; as of Aug. 6 for the Aug. 2019 auction (Note 3) Bloomberg

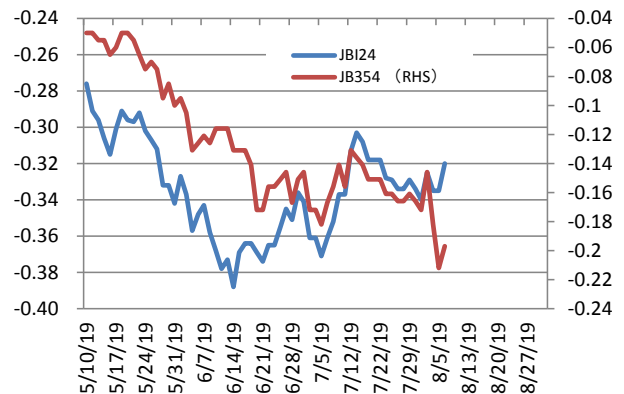
Source: Ministry of Finance, Daiwa Securities

Chart 1: BEI (bp)



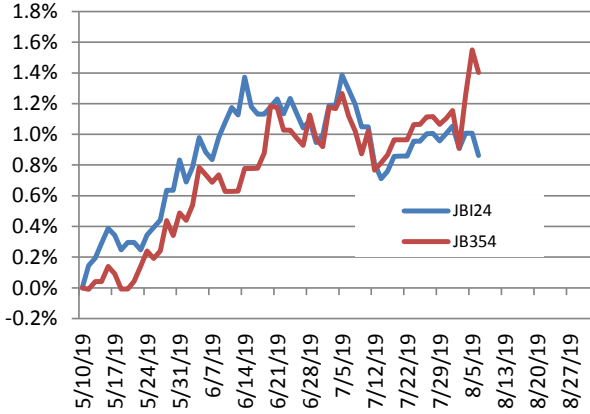
Note: On-the-run issues basis
Source: Daiwa Securities

Chart 2: JBI24 and JB354 Yields (%)



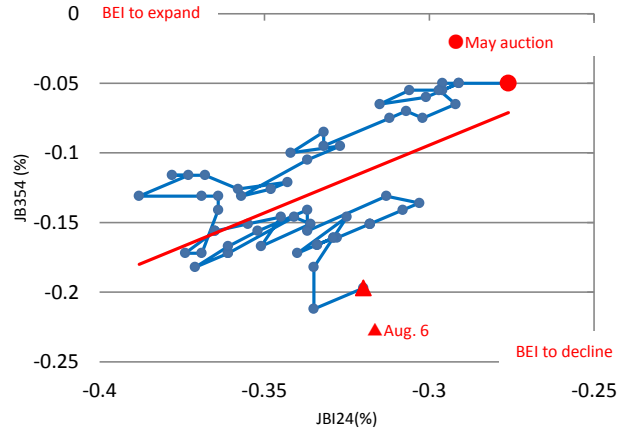
Source: Daiwa Securities

Chart 3: Realized Return of JBI24 (%)



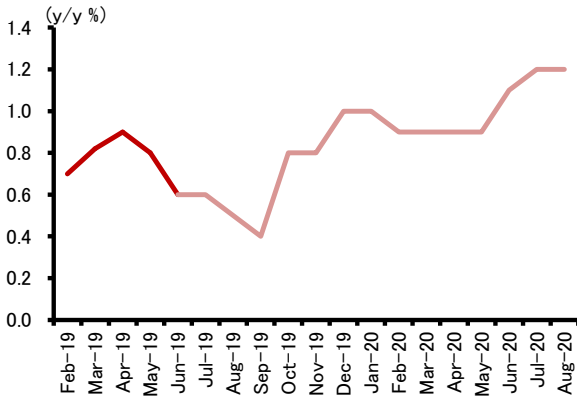
Note: HPR from May auction to each day
Source: Daiwa Securities

Chart 4: Correlation between JBI24 and JB354



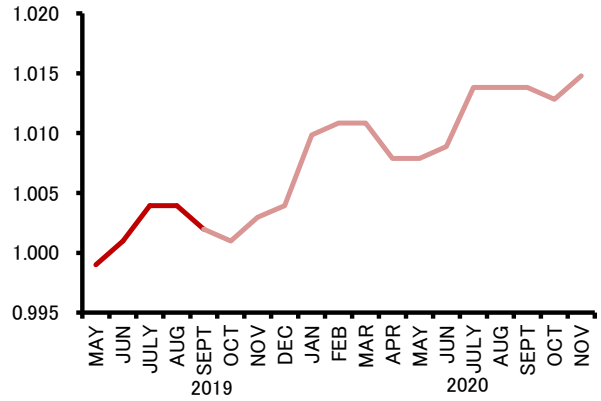
Source: Daiwa Securities

Chart 5: Nationwide Core-CPI Growth Outlook (y/y %)



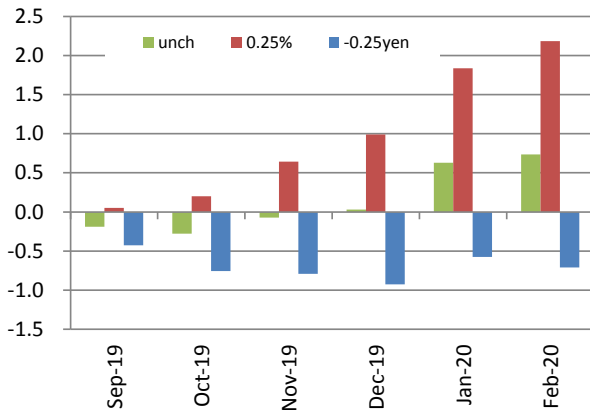
Note: Actual for Feb-Jun. 2019
Source: Daiwa Securities

Chart 6: JBI24 Index Ratio Forecast



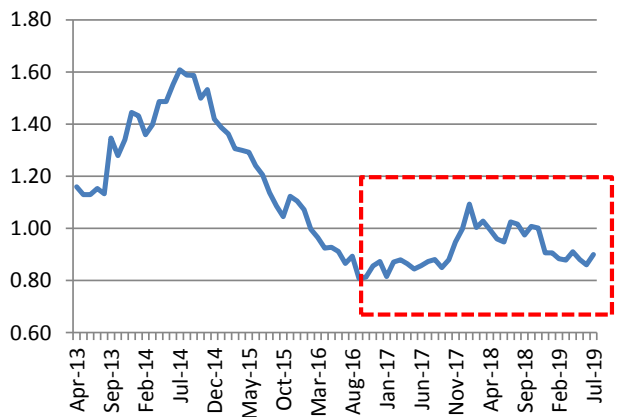
Note: Based on Chart 5, actual for May to Sept. 2019
Source: Daiwa Securities

Chart 7: JBI24 HPR Analysis (%)



Note: From the issuance day (Aug. 9) to the 10th of each month; factoring in index ratio in Chart 6; price at the end of period is assumed to be (1) unchanged, (2) increased by 0.25 yen each month and (3) decreased by 0.25 yen each month from the issuance day
Source: Daiwa Securities

Chart 8: CPI Core Change Forecast: 10Y average (%)



Source: QUICK

Table 1: Results of BOJ Purchase and MOF Buyback

	Previous Day's Close (Yen)	Pro-rata Price Spread (Yen)	Average Successful Price Spread (Yen)	Allotment on Pro-rata (%)	B/C	Close Price (Yen)
5/15/19	103.95	0.050	0.014	7.5	4.34	104.05
5/21/19	103.90	-0.010	-0.042	55.6	4.46	103.95
6/10/19	104.40	0.130	0.105	100.0	4.68	104.55
6/17/19	104.85	-0.110	-0.110	100.0000	5.61	104.65
6/26/19	104.60	-0.160	-0.210	100.0	6.29	104.50
7/5/19	104.55	-0.180	-0.180	100.0	5.12	104.65
7/22/19	104.10	-0.010	-0.054	53.3	4.36	104.10
8/2/19	104.15	0.080	0.055	64.8	5.05	104.25

Note: Previous Day's Close and Close Price are based on JBI24 ; Buyback by the Ministry of Finance for June 17

Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Table 2: Market Outstanding of JBIs (Yen billions)

	Issue Size	MoF Buyback	BoJ Outright Purchase	Market Outstanding
JBI17	646.7	26.7	252.7	367.3
JBI18	821.7	24.4	205.5	591.8
JBI19	1,091.8	15.5	156.0	920.3
JBI20	2,139.4	64.8	351.0	1,723.6
JBI21	1,727.2	106.7	364.7	1,255.8
JBI22	1,760.4	121.6	593.6	1,045.2
JBI23	1,722.7	61.6	167.6	1,493.5
JBI24	430.2	0.0	60.6	369.6
TOTAL	10,340.1	421.3	2,151.7	7,767.1
%	100.0%	4.1%	20.8%	75.1%

Note: as of July 31

Source: Ministry of Finance, Bank of Japan, Daiwa Securities

Table 3: Image of Bidding Price at Auction and BEI

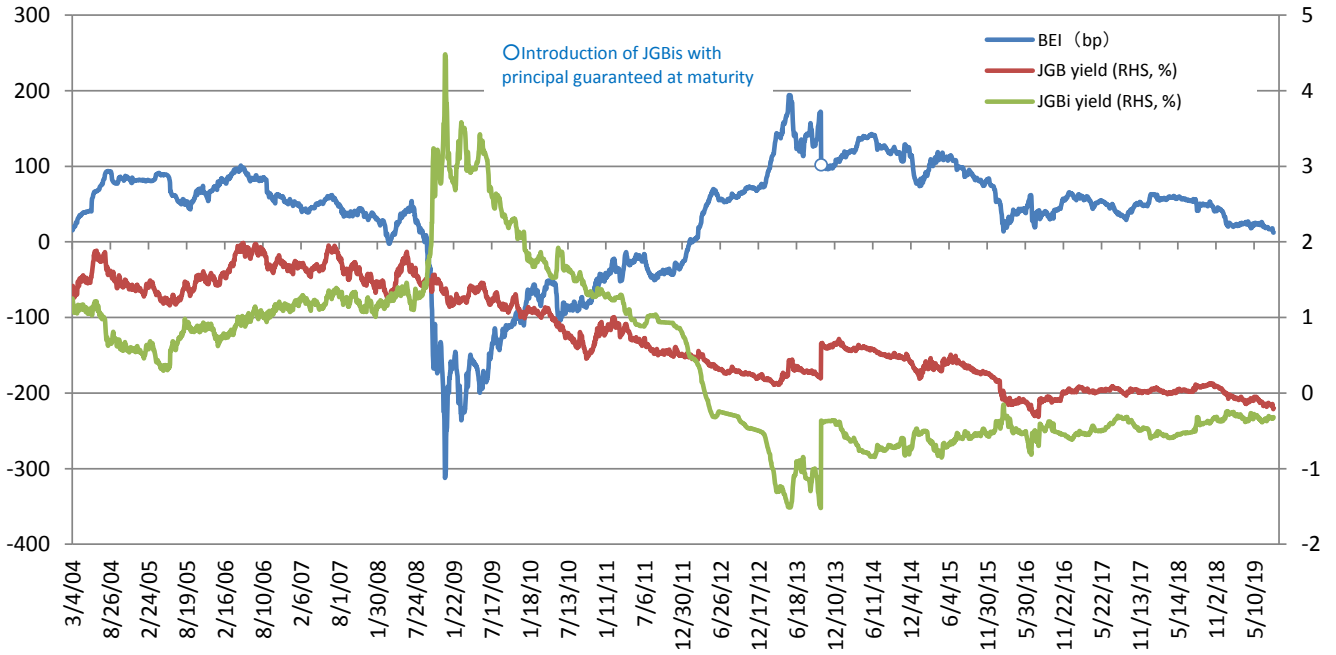
(Unit: bp)

		Nominal Yield (% JB354)									
		-0.230	-0.225	-0.220	-0.215	-0.210	-0.205	-0.200	-0.195	-0.190	-0.185
Bidding Price (Yen)	104.85	16.6	17.1	17.6	18.1	18.6	19.1	19.6	20.1	20.6	21.1
	104.80	16.1	16.6	17.1	17.6	18.1	18.6	19.1	19.6	20.1	20.6
	104.75	15.6	16.1	16.6	17.1	17.6	18.1	18.6	19.1	19.6	20.1
	104.70	15.1	15.6	16.1	16.6	17.1	17.6	18.1	18.6	19.1	19.6
	104.65	14.6	15.1	15.6	16.1	16.6	17.1	17.6	18.1	18.6	19.1
	104.60	14.1	14.6	15.1	15.6	16.1	16.6	17.1	17.6	18.1	18.6
	104.55	13.6	14.1	14.6	15.1	15.6	16.1	16.6	17.1	17.6	18.1
	104.50	13.1	13.6	14.1	14.6	15.1	15.6	16.1	16.6	17.1	17.6
	104.45	12.6	13.1	13.6	14.1	14.6	15.1	15.6	16.1	16.6	17.1
	104.40	12.1	12.6	13.1	13.6	14.1	14.6	15.1	15.6	16.1	16.6
	104.35	11.6	12.1	12.6	13.1	13.6	14.1	14.6	15.1	15.6	16.1
	104.30	11.1	11.6	12.1	12.6	13.1	13.6	14.1	14.6	15.1	15.6
	104.25	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1	14.6	15.1
	104.20	10.1	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1	14.6
	104.15	9.6	10.1	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1
	104.10	9.1	9.6	10.1	10.6	11.1	11.6	12.1	12.6	13.1	13.6
	104.05	8.6	9.1	9.6	10.1	10.6	11.1	11.6	12.1	12.6	13.1
	104.00	8.1	8.6	9.1	9.6	10.1	10.6	11.1	11.6	12.1	12.6
103.95	7.6	8.1	8.6	9.1	9.6	10.1	10.6	11.1	11.6	12.1	
103.90	7.1	7.6	8.1	8.6	9.1	9.6	10.1	10.6	11.1	11.6	
103.85	6.6	7.1	7.6	8.1	8.6	9.1	9.6	10.1	10.6	11.1	
103.80	6.1	6.6	7.1	7.6	8.1	8.6	9.1	9.6	10.1	10.6	
103.75	5.6	6.1	6.6	7.1	7.6	8.1	8.6	9.1	9.6	10.1	
103.70	5.1	5.6	6.1	6.6	7.1	7.6	8.1	8.6	9.1	9.6	
103.65	4.6	5.1	5.6	6.1	6.6	7.1	7.6	8.1	8.6	9.1	

Note: Based on the settlement day of Aug. 9

Source: Daiwa Securities

Appendix: BEI (March 2004 to present)



Note: on-the-run issue basis
 Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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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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[Standard & Poor's]

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[Fitch]

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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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