

## Outlook for 5Y JGB Auction

### Auction may tail with a higher probability than usual

- ✓ The 5Y JGB yield is moving at around -0.3%. Tomorrow's auction will be held at the lowest bidding yield level since the auction in July 2016. In terms of the absolute yield level, primary dealers may take a cautious bidding stance and, as a result, the auction may tail with a higher probability than usual.
- ✓ Paying close attention to demand from domestic investors, we would like to think about our bidding stance under the assumption that the 5Y JGB yield will move in the range around -0.3% over the next one month.
- ✓ In terms of the relative value, it would be worth considering switching out from the 7Y sector.

Strategic Memorandum DSTE326  
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### Auction Details

**Auction Date:** August 15, 2019  
**Issue Date:** August 16, 2019  
**Maturity Date:** June 20, 2024  
**Offering Amount:** About 1.9 trillion yen

\* New 5-year JGBs will likely be the first reopening of JS140 carrying a 0.1% coupon.

\*\* On August 14, JS140 traded at -0.310 - -0.300% (+1.0 - +2.0bp v. previous day's close) and closed at -0.305% (+1.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

**Tomorrow's auction will be held at the lowest bidding yield level since the auction on July 14, 2016**

After the previous 5Y JGB auction went smoothly at the -0.235 to -0.230% level on July 9 amid a pause on a yield downtrend, the 5Y JGB yield rose to -0.210% at one point on an intraday basis. Then, the yield temporarily fell to -0.315% on August 13, the lowest intraday level since July 2016. Tomorrow's auction will be held at the lowest bidding yield level since the auction on July 14, 2016. In terms of the absolute yield level, primary dealers may take a cautious bidding stance and, as a result, the auction may tail with a higher probability than usual.

**Monetary policies will head to a more accommodative direction in Japan, Europe, and the US**

Let's look at the environment surrounding the JGB market. 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. In such a situation, the ECB has decided to consider an additional rate cut and the resumption of quantitative easing policy. The BOJ also implied that it could conduct additional easing at the latest monetary policy meeting. At the latest FOMC meeting, the Fed decided to cut the interest rate by 25bp, as widely expected, but Chair Jerome Powell pointed at the post-meeting press conference that the cut was not the beginning of a long rate cut cycle. That temporarily led to the plunge in bond markets around the globe. However, monetary policies will go in a more accommodative direction in Japan, Europe, and the US anyway. Although we need to be careful about activities to unwind the recent risk-off moves, such activities are unlikely to trigger a big

yield uptrend. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **5Y cheapness on the curve:** The 5Y sector is substantially undervalued vs. around the 7Y sector and the superlong sectors (Appendix 3). The 5Y sector was excessively overvalued vs. the 2Y sector, but this has been corrected due to the latest steepening in the 2-5Y zone (Appendix 8).
- ✓ **Continuous support from neighboring sector:** There is a strong support especially from the 6Y sector, which appears constantly short due to the impact of the BOJ's JGB purchase policy in the 5-10Y zone.
- ✓ **Slim possibility of the BOJ's another purchase reduction in the 3-5Y zone:** In its JGB purchase operations offered on August 9, the BOJ trimmed the offer amount in the 3-5Y zone. The possibility of another trimming in this zone appears slim at least over the next one month.
- ✓ **Caution about the BOJ's JGB purchase operation in the 5-10Y zone on the day after the 5Y JGB auction:** While the 10Y JGB yield moves at around the lower end of the BOJ's current operational target range, "about double the range of between -0.1% and +0.1%," the central bank is scheduled to conduct a JGB purchase operation in the 5-10Y zone on August 16, the day after the 5Y JGB auction. The operation is garnering strong market attention in terms of (1) whether the offer amount will be reduced or not and (2) whether a floor will be set for bidding yield or not —if it is, how the BOJ will set the floor (on yield itself or yield spread to the previous day's close). The JGB market may become volatile on the day (incl. timing of the operation notice), depending on the details of the operation.
- ✓ **Demand from overseas investors is uncertain:** Expectations for demand from overseas investors appear strong 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 remain attractive on a XCCY basis and appear to be more attractive than 10Y UST or 10Y Bunds on a hedged basis. However, as their activities in August tend to be relatively low (Appendix 9), there is strong uncertainty about the level of demand from them at tomorrow's auction.

Given all together, with close attention to demand from domestic investors, we would like to think about our bidding stance under the assumption that the 5Y JGB yield will move in the range centered at -0.3% over the next one month. In terms of the relative value, it would be worth considering switching out from the 7Y sector (Appendix 8). The 5Y sector is substantially undervalued vs. this sector at the current level (Appendix 3). As the U.S. Trade Representative's Office announced today that the US will delay imposing the fourth round of punitive tariffs on certain of the Chinese products, a pause in the recent risk-off moves may correct the cheapness of the 5Y sector to the 7Y sector. Moreover, there is strong caution about the current high level of JGB futures as they continued to hit its highest of the leading contract on almost all days from last week through yesterday. The 5Y/7Y spread appears to have scope to ease the inversion by around 3bp.

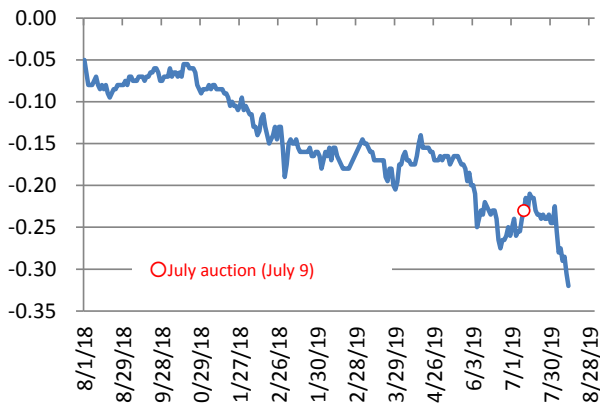
### 5Y JGB Auction Results

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 (%)	
8/15/19	140R*	6/20/24	0.1*	1.9**									
7/9/19	140	6/20/24	0.1	1.9	4.34	101.67	101.66	0.01	-0.233	-0.231	0.002	89.1730	Avg
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 August 14 \*\* Amount the MOF plans to issue

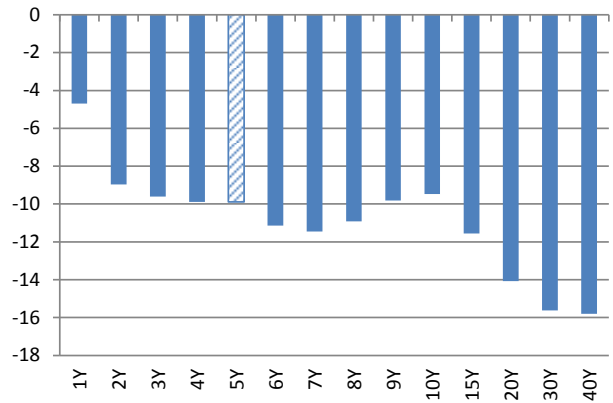
Source: Ministry of Finance, Daiwa Securities.

### Appendix 1: 5Y JGB Yield (%)



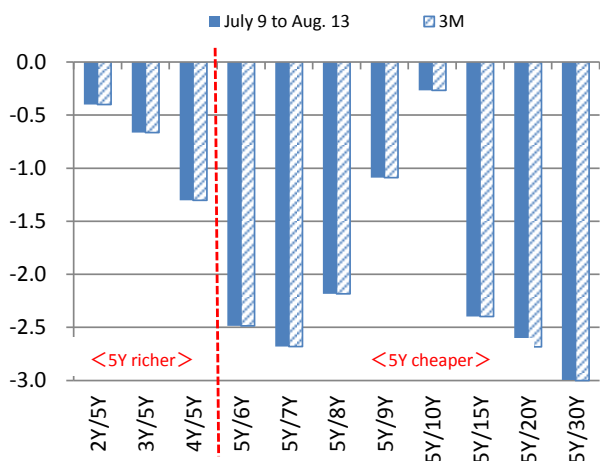
Source: Daiwa Securities.

### Appendix 2: JGB Yield Change (bp): July 9 v. Aug. 13



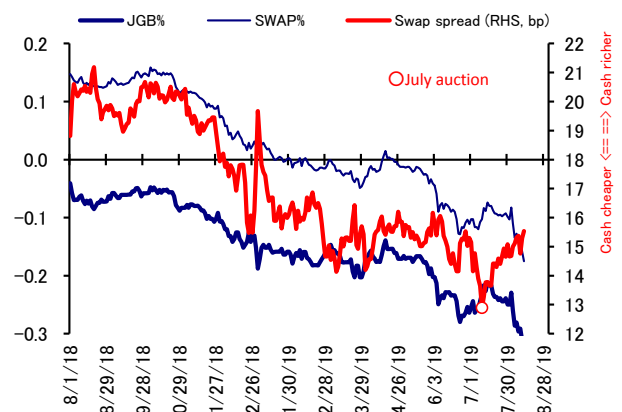
Source: Daiwa Securities.

### Appendix 3: Z-scores of JGB Yield Spreads

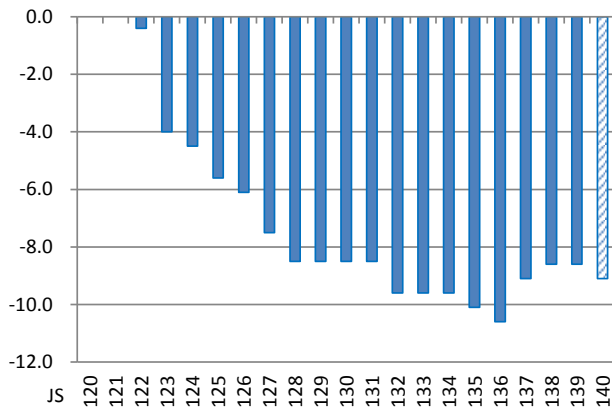


Source: Daiwa Securities.

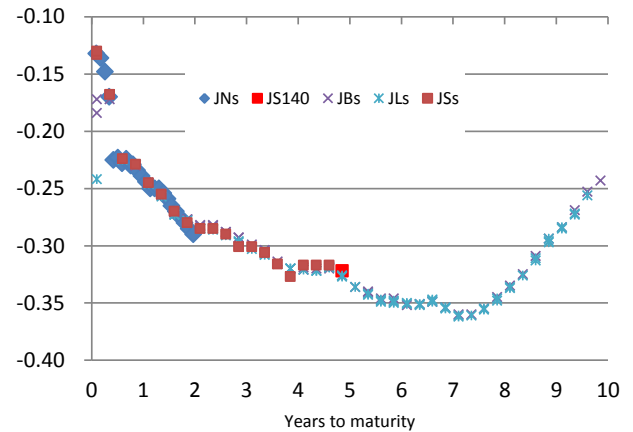
### Appendix 4: 5Y Swap Spread



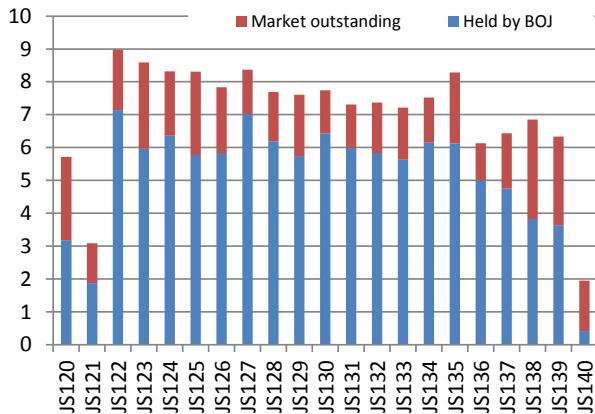
Source: Daiwa Securities.

**Appendix 5: JS Yield Change (bp): July 9 v. Aug. 13**


Source: Daiwa Securities.

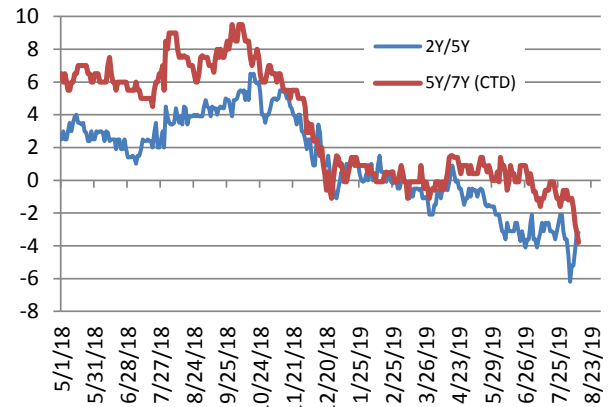
**Appendix 6: JGB Yield Curve (% , Aug. 13)**


Source: Daiwa Securities.

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


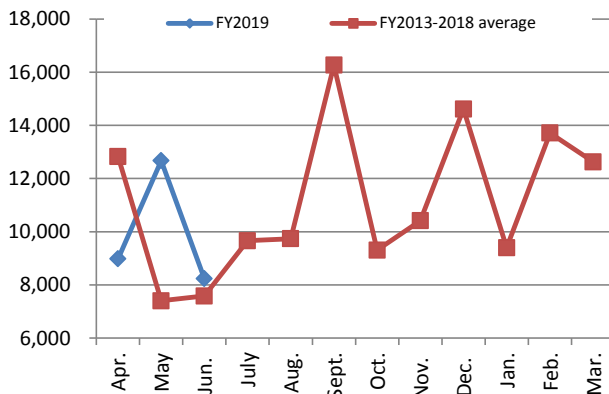
Note: as of July 31 on BOJ start basis

Source: Daiwa Securities.

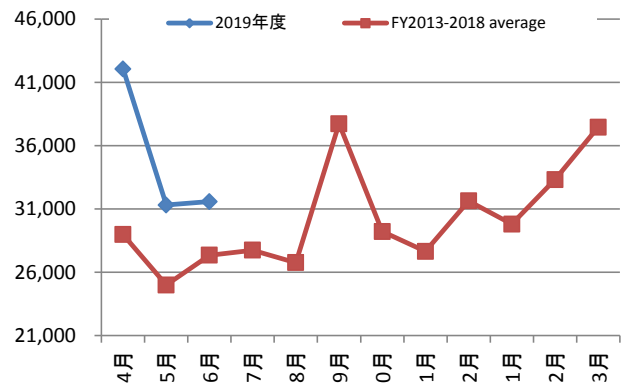
**Appendix 8: JGB 2Y/5Y, 5Y/7Y(CTD) Spreads (bp)**


Note: On-the-run and CTD compound yields

Source: Daiwa Securities.

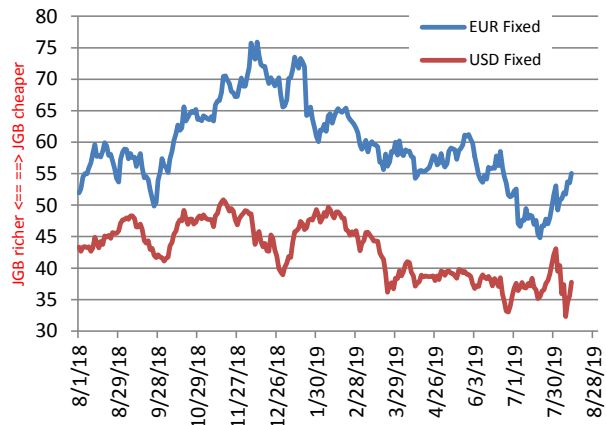
**Appendix 9a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**


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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- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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#### [Moody's]

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#### [Fitch]

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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.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* 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.

\*\* The ratio of margin requirements etc. to the amount of the transaction 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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