

## Outlook for 10Y JGB Auction

### Taking it as a good dip-buying opportunity

- ✓ Tomorrow's 10Y JGB auction will likely be held at record-low bidding yield level
- ✓ Amid a yield downtrend, impact by BOJ's cut in purchase amounts roughly estimated at around 2.5bp.
- ✓ We think about our bidding stance at tomorrow's auction, taking the -0.270 to -0.250% level as a good dip-buying level for 10Y JGBs
- ✓ It would be worth switching out from 7Y or considering 5Y/7Y/10Y butterfly

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### Auction Details

**Auction Date:** September 3, 2019  
**Issue Date:** September 4, 2019  
**Maturity Date:** June 20, 2029  
**Offering Amount:** About 2.1 trillion yen

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

\*\* On September 2, JB355 traded at -0.275 - -0.265% (+0.5 - +1.5bp v. previous day's close) and closed at -0.270% (+1.0bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

#### Tomorrow's 10Y JGB auction likely to be held at record-low bidding yield level

After the previous 10Y JGB auction went acceptably at the -0.155 to -0.150% level on August 1, the 10Y JGB yield slid from -0.135% on August 6 to -0.290% on August 29 on an intraday basis amid a further advance in the bond markets around the globe. Since the end of last week, the 10Y JGB yield has been moving at the -0.280 to -0.265% level probably because of the BOJ's trimming in its JGB purchases. It is highly possible that tomorrow's 10Y JGB auction will be held at a record-low bidding yield level.

#### Long-term interest rate likely to remain on downtrend

Amid lingering caution about Brexit and trade frictions vs. the US, market participants have been strongly concerned about the global economic outlook. The market is unlikely to change its recognition that monetary policies will go in a more accommodative direction in Japan, Europe, and the US. The global yield downtrend is expected to continue going forward. Putting aside the degree of the BOJ's commitment to the YCC policy, we see that it has been becoming difficult for the central bank to control the long-term interest rate. Until this month's monetary policy meeting (MPM), the BOJ may conduct purchase operations in the 5-10Y zone twice at most. Therefore, the possibility of further trimming is left. However, there is a good possibility that the 10Y JGB yield will decline into the -0.35 to -0.30% level by the September MPM. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

**Impact by BOJ's cut in JGB purchase amount estimated at around 2.5bp**

- ✓ **Absolute yield level:** Despite the recent tapering by the BOJ through two operations in August, the 10Y JGB yield declined to -0.290% on August 29. However, the yield rose to -0.265% at one point following another tapering in the 5-10Y zone on August 30 (the second reduction of the month in the zone) and today's tapering in the 10-25Y zone. We thus can roughly estimate that the impact of around 80bn yen cut in the 5-10Y zone in total and 20bn yen reduction in another zone is around 2.5bp. Even if we assume that the BOJ will continue to cut the offer amounts by around 20-30bn yen each in two operations which are to be held before the MPM on September 18-19, factoring in an around 2.5bp rise in yields would be enough. Under the assumption that overseas yields would continue to decline following the ECB Governing Council meeting and the FOMC meeting, the current level can be a good level to buy 10Y JGBs.

**Lack of strong attractiveness in terms of relative value**

- ✓ **Relative value:** Relative value: Data from the previous auction shows that the 10Y sector is neither noticeably rich nor cheap on the curve (Appendix 3). In addition, 10Y asset swap spread is at the widest level since November 2018, reflecting the intensified trend since mid-August (Appendix 4). At the current level, 10Y cash is strongly overvalued against swaps.

**Demand from investors can be still expected**

- ✓ **Demand:** At tomorrow's auction, short-covering from primary dealers does not appear strong. Regarding demand from investors, we can still expect demand especially from duration-constrained investors 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 5).

**We think about our bidding stance at tomorrow's auction, taking the -0.270 to -0.250% level as a good dip-buying level for 10Y JGBs**

All in all, we would like to think about our bidding stance at tomorrow's auction by taking the -0.270 to -0.250% level as dip-buying level for 10Y JGBs. As mentioned above, it is difficult to build new positions in terms of the relative value. However, we think that excessive distortion of the curve in around the 7Y sector may be eased, given recent trimming of the BOJ purchase amounts in the 5-10Y zone. It would be worth considering building positions in anticipation of tightening of the 7Y/10Y spread and a continuous rise in the 5Y/7Y/10Y butterfly.

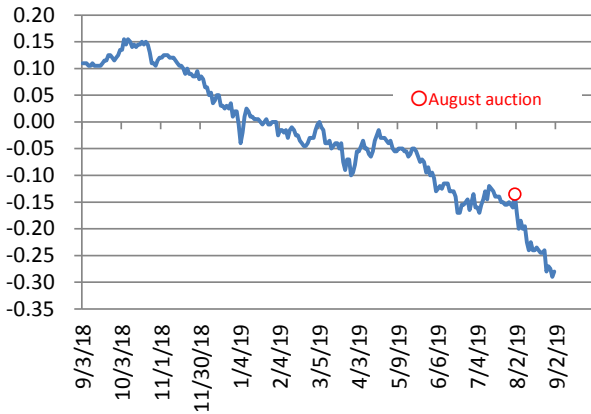
**10Y JGB Auction Results**

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 %	
9/3/19	355R*	0.1*	6/20/29	2,100*									
8/1/19	355R	0.1	6/20/29	2,099	3.76	102.53	102.51	0.02	-0.152	-0.150	0.002	1.7771	Avg
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

\* Daiwa forecast as of Sept. 2 \*\* Amount the MOF plans to issue

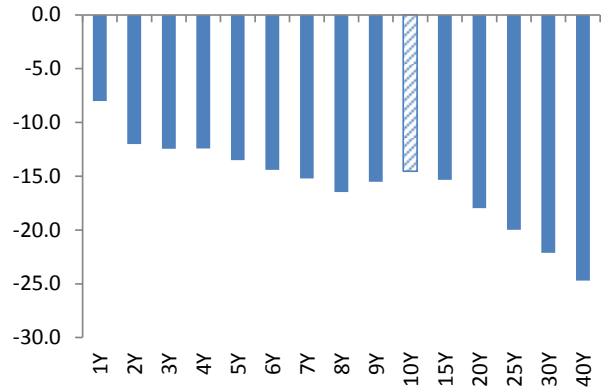
Source: Ministry of Finance (MOF), Daiwa Securities.

### Appendix 1: 10Y JGB Yield (%)



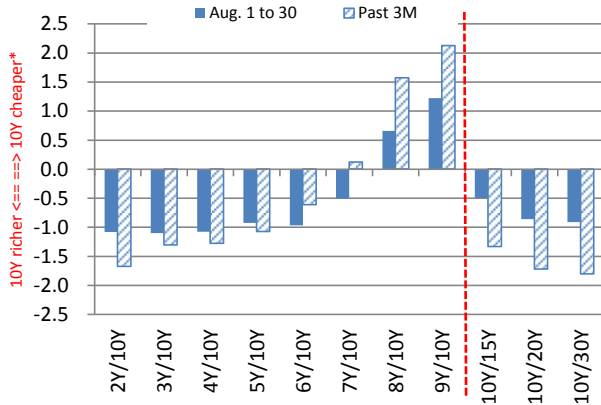
Source: Daiwa Securities.

### Appendix 2: JGB Yield Change (Aug. 1 v. Aug. 30, bp)



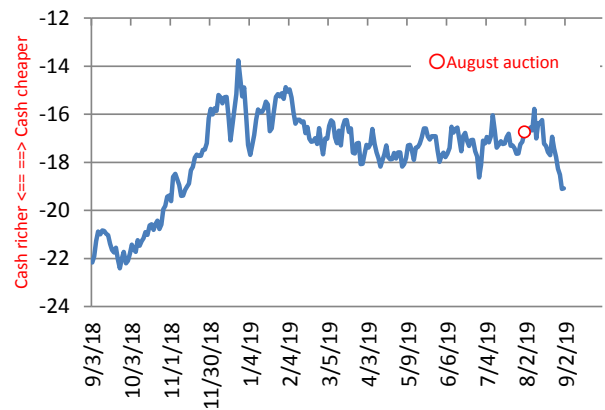
Source: Daiwa Securities.

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



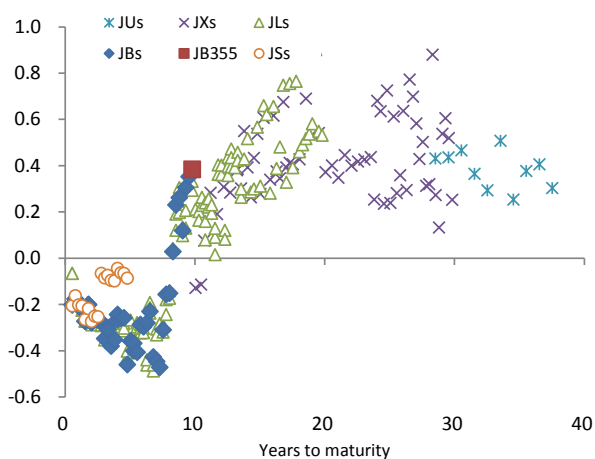
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y  
Source: Daiwa Securities.

### Appendix 4: 10Y JGB Asset Swap Spread (bp)



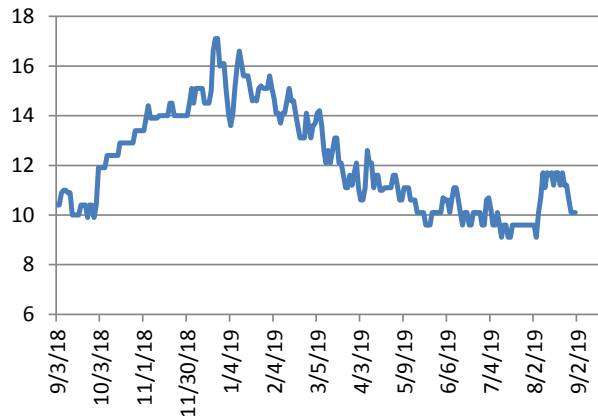
\* Yen LIBOR basis  
Source: Daiwa Securities.

### Appendix 5: JGB Total Return Curve (3M, %)



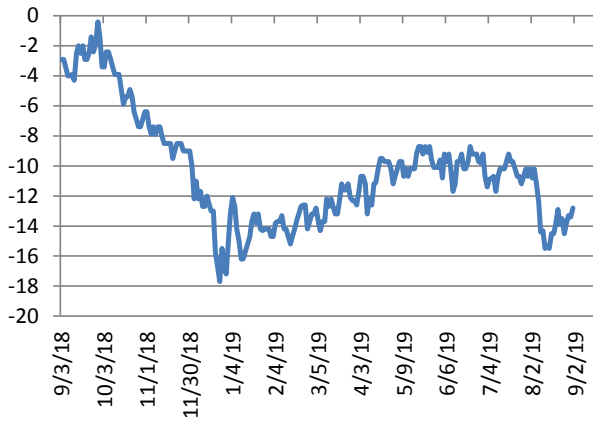
Note: Based on JGB yield curve on August 30 ; assuming that those yield curve shapes do not change and factoring roll-down effect etc.  
Source: Daiwa Securities

### Appendix 6: JGB 7Y/10Y Spread (bp)



Note: On-the-run and CTD basis  
Source: Daiwa Securities

**Appendix 7: JGB 5Y/7Y/10Y Butterfly Spread (bp)**



Note: On-the-run and CTD basis  
Source: Daiwa Securities

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- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 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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#### [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.
- 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.

\*\* 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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