

## Outlook for 10Y JGB Auction

### Bidding at -0.20 - -0.15% level

- ✓ New 10Y JGBs to be redeemed in September 2029, JB356, are expected to carry a 0.1% coupon
- ✓ External factors are unlikely to put JGB yields under strong upward pressure; once market confirms October BOJ operation policy and digests information included in it, factors related to BOJ's JGB purchases may play out
- ✓ In addition to strong advantage of 10Y JGBs in terms of carry in the short- to long-term zone, new 10Y JGBs to be sold at the first 10Y JGB auction in 2H FY19 will be in new maturity basket. Investor appetite may be strong
- ✓ It would be worth considering (1) selling 2Y/5-7Y/10Y butterfly or (2) switching out from 20Y JGBs with around 10 years left to maturity

Strategic Memorandum DSTE334  
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### Auction Details

**Auction Date:** October 1, 2019  
**Issue Date:** October 2, 2019  
**Maturity Date:** September 20, 2029  
**Offering Amount:** About 2.1 trillion yen

\* New 10Y JGBs, JB356, will likely carry a 0.1% coupon.

\*\* On September 30, WI barely traded, and closed at -0.210% (+1.5bp). JB355 traded at -0.230 - -0.220% (+1.0 - +2.0bp v. previous day's close) and closed at -0.225% (+1.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

**About 2bp premium expected v. JB355 may bring bids around -0.2% for new 10Y JGBs**

After the previous 10Y JGB auction went smoothly at around -0.265% on September 3, the 10Y JGB yield temporarily rose to -0.150% on an intraday basis on September 18 amid a correction stage of the JGB market. While the BOJ continued to trim the offer amounts of JGBs (incl. 5-10Y zone) in its purchase operations following the BOJ's Monetary Policy Meeting (MPM) on September 19, market sentiment for JGBs remained rather firm. The 10Y JGB yield thus declined to -0.265% at one point on September 25. Since then, the yield has slightly trended up partly because the market was aware of tomorrow's auction. As of 14:00 today (Sep 30), the on-the-run JB355 yield is moving at -0.230 to -0.225%. Expecting about 2bp premium v. JB355 on the current yield curve, we think that bids may be placed around -0.2%.

**External factors are unlikely to give strong upward pressure to JGB yields**

Let's look at the environment surrounding the JGB market. Recently, the outlook for US-China trade talks has again become more uncertain, alongside growing worries about the European economy. In the long term, it would be difficult to fully eliminate worries about the global economy. In Europe and the US, monetary policies will go in a more accommodative direction, although the degree somewhat differs by nation/region. As such, external factors are unlikely to give strong upward pressure to JGB yields.

**Once market confirms October BOJ operation policy and digests information included in it, factors related to BOJ JGB purchases may play out**

In Japan, the BOJ keeps trimming purchasing JGBs, while some are skeptical about the feasibility of additional easing by the central bank (putting aside its aggressive attitude). In the “Outline of Outright Purchases of Japanese Government Securities” to be released tonight, we expect revisions in the over 10Y zone (such as fewer offers). Meanwhile, the possibility appears high that the number of offers and the offer range will remain unchanged in the 5-10Y zone. As projections for the revisions seem to vary widely in the JGB market, we need to be cautious about market reactions. However, once the market confirms and digests information included in the operation guideline paper, factors related to JGB purchases may play out.

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

- ✓ **New 10Y JGBs to be redeemed in September 2029, JB356:** In addition to strong advantage of 10Y JGBs in terms of carry in the short- to long-term zone, new 10Y JGBs to be sold at the first 10Y JGB auction in 2H FY19 will be in new maturity basket. Investor appetite may be strong for such new notes.
- ✓ **Support confirmed at the -0.20 to -0.15% level:** Amid the BOJ’s trimming purchasing JGBs (incl. twice cuts in the 5-10Y zone), which started from BOJ governor Kuroda’s post-September MPM press conference, the 10Y JGB yield slid from -0.150% to -0.265%. Despite the BOJ tapering, the duration the 10Y JGB yield moved at the -0.20 to -0.15% level was quite short. Given the fact, we can somewhat expect support at that level under the environment where upward pressure on JGB yields is unlikely to increase, although trimming by the BOJ warrants caution.
- ✓ **Undervalued vs. the 6-9Y sectors:** The 10Y sector is noticeably undervalued vs. the 6-9Y sectors (Appendix 3).

**Thinking about dip-buying at -0.20 - -0.15% level**

All in all, we would like to think about bidding at the -0.20 to -0.15% level. In terms of the relative value, it would be worth considering (1) selling 2Y/5-7Y/10Y butterfly or (2) switching out from 20Y JGBs with around 10 years left to maturity etc. As 2H FY19 starts tomorrow, volatility is expected to remain high in the near term. It is therefore easy to think about building barbell positions. The 2Y/5Y/10Y and 2Y/7Y/10Y butterfly spreads are close at the reversal (or support) levels (Appendix 6) as well. In the 10Y sector, total return from 10Y JGBs (JBs) is expected to be higher than that from 20Y JGBs (JLs; Appendix 5). Therefore, switching into newly issued 10Y JGBs would be attractive if we hold 20Y JGBs with around 10 years left to maturity.

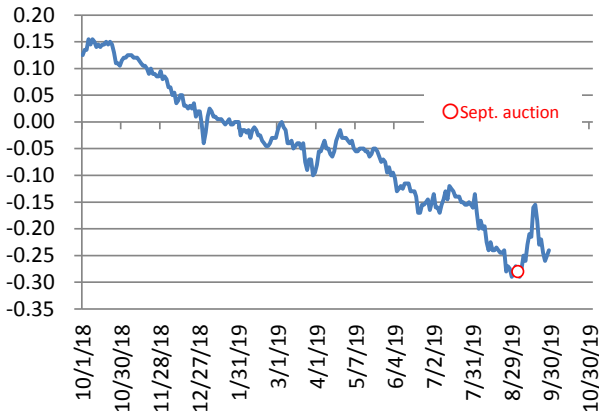
**10Y JGB Auction Results**

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 %	
10/1/19	356	0.1*	9/20/29	2,100**									
9/3/19	355R	0.1	6/20/29	2,412	3.60	103.68	103.66	0.02	-0.265	-0.264	0.001	99.4435	Avg
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

\* Daiwa forecast as of Sep. 30 \*\* Amount the MOF plans to issue

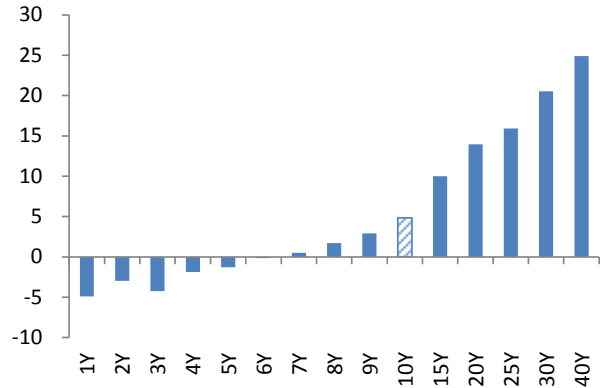
Source: Ministry of Finance (MOF), Daiwa Securities.

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



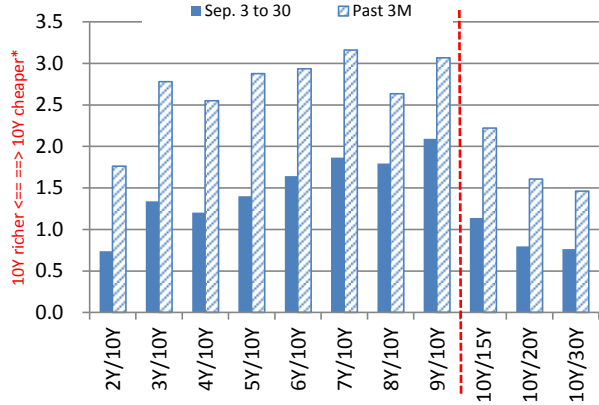
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (Sep. 3 v. Sep. 27, bp)**



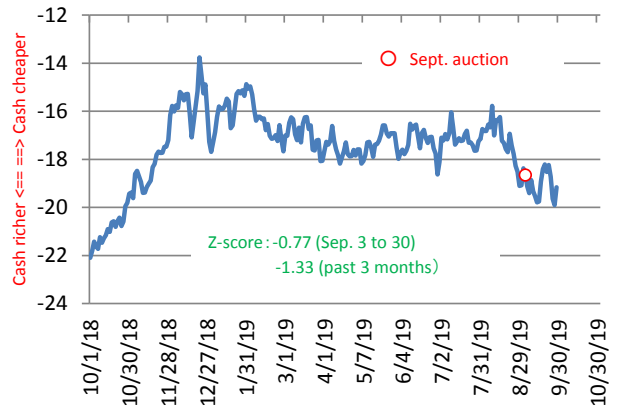
Source: Daiwa Securities.

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



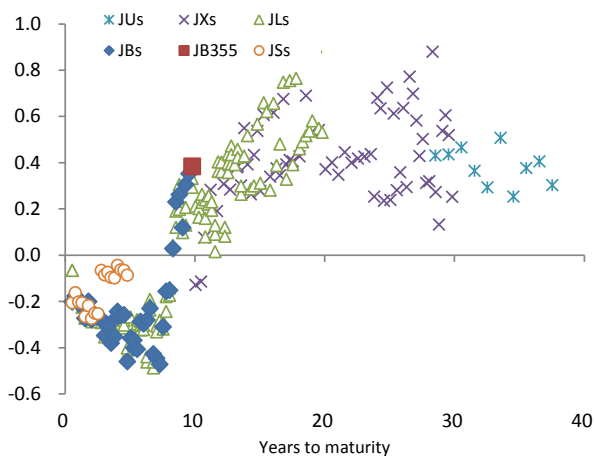
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y  
Source: Daiwa Securities.

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



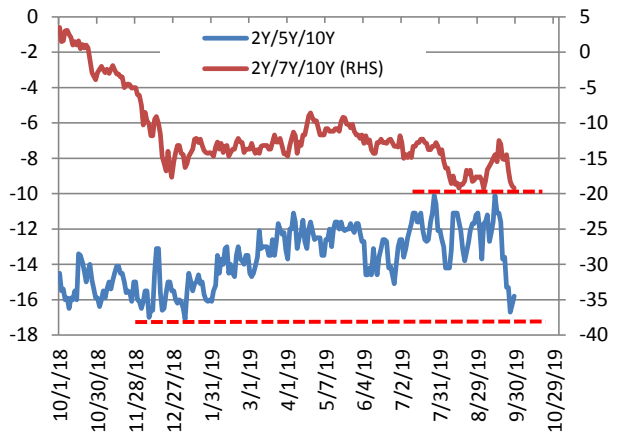
\* Yen LIBOR basis  
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on September 27; assuming that those yield curve shapes do not change and factoring roll-down effect etc. JB355 is supposed to carry a 0.1% coupon and 2bp spread to JB355.  
Source: Daiwa Securities

**Appendix 6: JGB 2Y/5Y/10Y and 2Y/7Y/10Y Butterfly Spreads (bp)**



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

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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.
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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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