

Outlook for 10Y JGB Auction

Investor demand will be the key for successful sale

- ✓ Although risk-on mode is worrisome in the near term, JGB yields may not have a strong uptrend in a longer-term perspective
- ✓ BOJ's new forward guidance seems to imply a cut in both short-term and long-term policy interest rates in the case of additional easing
- ✓ We would like to think about placing our bids to buy only necessary amount, testing demand from investors at around -0.15%
- ✓ In terms of relative value, it would be worth considering switching out from the 20Y sector, which is expected to continue to face BOJ's unforeseen trimming risk

Strategic Memorandum DSTE339
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Auction Details

Auction Date:	November 6, 2019
Issue Date:	November 7, 2019
Maturity Date:	September 20, 2029
Offering Amount:	About 2.1 trillion yen

* New 10Y JGBs will likely be the first reopening of JB356 carrying a 0.1% coupon.

** On November 5, WI barely traded, and closed at -0.140% (+4.5bp v. previous day's close). JB356 traded at -0.155 - -0.135% (+3.0 - +5.0bp) and closed at -0.140% (+4.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

10Y JGBs moving in a volatile way since previous auction

After the previous 10Y JGB auction went poorly on October 1, the 10Y JGB yield (conventional yield of on-the-run issue; the same hereinafter in this report) temporarily declined to -0.225% on an intraday basis on October 7 amid the firmness of the JGB market. Since then, the JGB market had softened due to many bond-unfriendly factors, such as a more optimistic outlook for US-China trade talks and Brexit, diminishing expectations for additional easing by the BOJ, and the emergence of speculations on an end to rate cuts by the Fed. The 10Y JGB yield then momentarily rose to -0.115% on an intraday basis on October 29. After the BOJ announced a new forward guidance at the Monetary Policy Meeting (MPM) held at the end of October, JGBs surged and the 10Y JGB yield declined to -0.190% at one point on November 1. Today (Nov 5), the 10Y JGB yield moves in the -0.155 to -0.145% level on an intraday basis as the JGB market softens in relation to the US market trend of higher stock prices/lower bond prices during Japan's long weekend with Monday off. Since the previous auction, it appears that 10Y JGBs have been moving in a volatile way.

Risk-on mode worried in the near term, but JGB yields may not have a strong uptrend in a longer-term perspective

Let's look at the environment surrounding the JGB market. Currently, a sense of caution is increasing about the risk-on mode in overseas markets. In the longer term, however, it would be difficult to fully eliminate worries about the global economy. In Europe and the US, a next step of monetary policies appears to be the status quo or additional easing (such as

rate cuts). As such, it is now difficult to expect a major yield uptrend in JGB yields. accommodative direction, although the degree somewhat differs by nation/region. As such, external factors are unlikely to give strong upward pressure to JGB yields.

BOJ's new forward guidance seems to imply a cut in both short-term and long-term policy interest rates in the case of additional easing

In Japan, the BOJ announced the new forward guidance—"As for the policy rates, the Bank expects short- and long-term interest rates to remain at their present or lower levels as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost" at the October MPM. This appears to imply a cut in the short-term and long-term policy interest rates (among the four options stated by the BOJ) in the case of additional easing. Regarding the long-term rate, the target under the framework of the yield curve control policy is "around 0%." Specifically, the BOJ is supposed to be conducting JGB purchase operations to move the rate "at about double the range of between -0.1% and +0.1%." It appears that the BOJ is not minding the technical difficulty in the case of additional easing via lowering of the long-term rate at the moment. The new forward guidance, which is very complicated, seems to have lengthened the time frame until additional easing. However, similar to Europe and the US, the BOJ's next move appears to either keep the current monetary easing or move for additional easing.

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

- ✓ **Primary dealers appear neutral, being neither long nor short in 10Y sector:** They are unlikely to bid in an aggressive stance;
- ✓ **Not too expensive in terms of relative value:** The 10Y sector is somewhat undervalued vs. the 15Y sector (Appendix 3). The asset swap spread indicates that 10Y cash has become more undervalued than that at the previous auction (Appendix 4);
- ✓ **The possibility of trimming in the 5-10Y zone appears low:** As the 10Y JGB yield is about to reach "about double the range of between -0.1% and +0.1%," the possibility of the BOJ trimming purchasing JGBs in the 5-10Y zone appears low in the near term. In addition, the on-the-run JB356 is unlikely to be excluded from the target list in the BOJ's purchase operations.

Pacing bids to take only necessary amount / switching out from 20Y

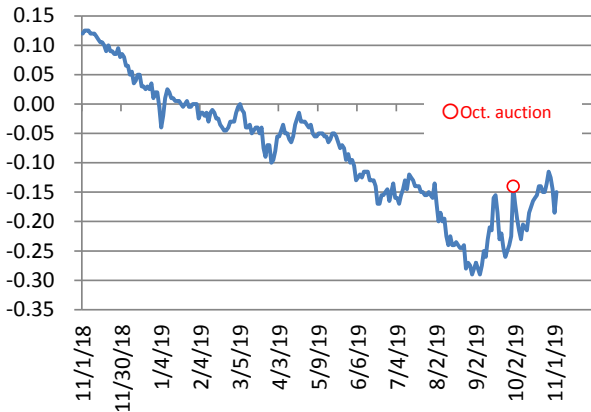
All in all, we would like to think about placing bids to buy only necessary amount, testing demand from investors at the current level (around -0.15%). In terms of the relative value, it is less motivated to build new positions at the current level. However, it would be worth considering switching out from the 20Y sector. In its JGB purchase operations conducted today (Nov 5), the BOJ reduced the offer amount in the 10-25Y zone by 20bn yen to 100bn yen from 120bn yen in the previous operation. Given that there was greater room to adjust the 1-5Y zone, in which the offer was placed at the same time, we think that today's trimming was a foreseen move by the BOJ. Amid increasing number of remarks on the level of superlong yields by the BOJ, we forecast that caution about trimming in the 10-25Y zone will linger, given the limited room to cut purchases in the zone over 25Y. In November, a concentrated supply is scheduled in the superlong zone from next week. Partly because of this, it may be difficult to see flattening of the long-superlong zone until index duration extension activities intensify at the end of the month.

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 %	
11/6/19	356R*	0.1*	9/20/29	2,100**									
10/1/19	356	0.1	9/20/29	2,100	3.42	102.62	102.33	0.29	-0.158	-0.130	0.028	6.1227	Poor
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

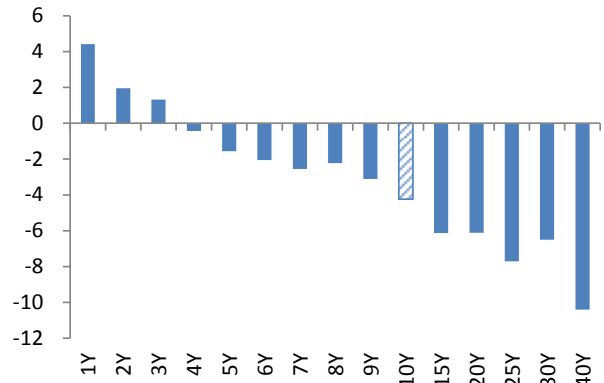
* Daiwa forecast as of Nov. 5 ** Amount the MOF plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



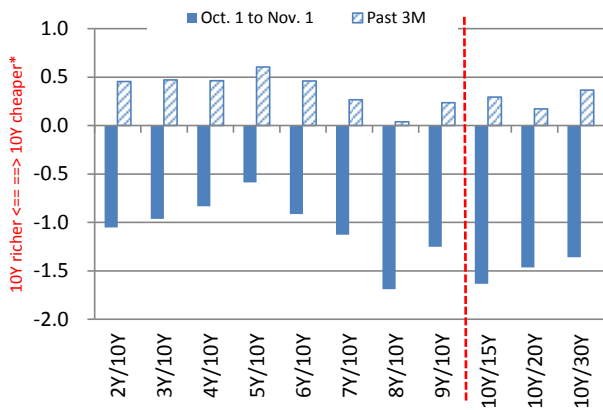
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Oct. 1 v. Nov. 1)



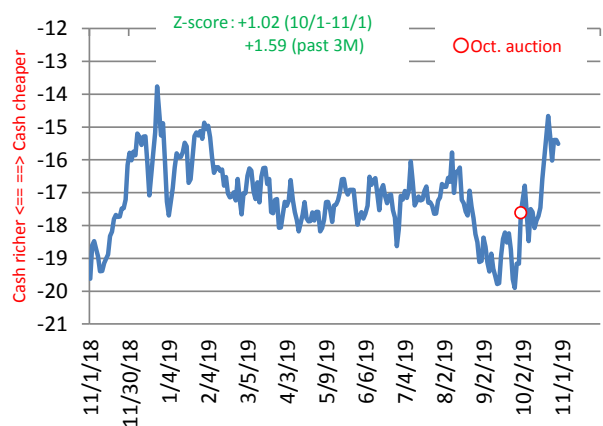
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



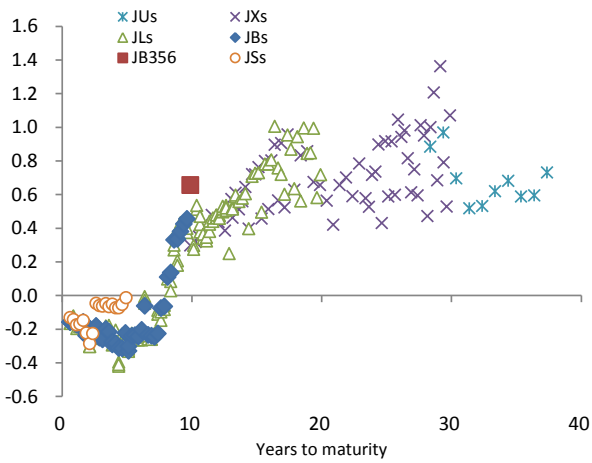
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
 Source: Daiwa Securities.

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



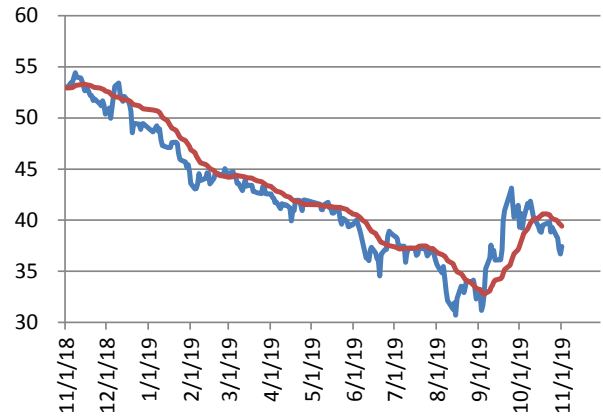
* Yen LIBOR basis
 Source: Daiwa Securities.

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



Note: Based on JGB yield curve on Nov. 1; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6: JGB 10Y/20Y Spread (bp)



Note: Generic compound yield basis
Source: Daiwa Securities

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[Standard & Poor's]

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[Moody's]

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