

Outlook for 5Y JGB Auction

Demand from investors in the highest yield territory will be the key

- ✓ Although caution remains strong about downtrend in JGBs amid risk-on mode, fundamental factors prevent us from expecting a major uptrend in JGB yields in the longer term
- ✓ As short-covering by primary dealers is unlikely to be sufficiently strong, demand from investors for 5Y JGBs in the highest yield territory in FY19 will be the key for tomorrow's primary sale
- ✓ In terms of relative value, our eyes are on short-term switching out from 20Y sector prior to the 20Y JGB auction scheduled for next Wednesday or 15Y sector in anticipation of correction in 5Y cheapness to the sector

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Auction Details

Auction Date: November 14, 2019
Issue Date: November 15, 2019
Maturity Date: September 20, 2024
Offering Amount: About 1.9 trillion yen

* New 5Y JGBs will be the first reopening of JS141 carrying a 0.1% coupon.

** On November 13, JS141 traded at -0.180 - -0.170% (-1.5 - -0.5bp v. previous day's close) and closed at -0.180% (-1.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Demand from investors in the FY2019 highest yield territory will be the key

Since the previous 5Y JGB auction went poorly at around -0.280% on October 17 amid JGB downtrend, the 5Y JGB yield had been largely on an uptrend. Yesterday (Nov 12), the yield temporarily rose to -0.165% on an intraday basis, the highest level since May 2019. Given the fact that the highest 5Y yield level this year is -0.140% as on April 17, we can expect strong support at around -0.15%.

Let's look at the environment surrounding the JGB market. Currently, caution remains strong about downtrend in JGBs amid 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 to keep the current easing stance unchanged or move for additional easing (such as rate cuts). As such, fundamental factors prevent us from expecting a major uptrend in JGB yields. Here, we summarize the key points to think about the bidding stance at tomorrow's auction, which is expected to be held at the -0.20 to -0.15% level, the highest yield territory in FY19, as follows:

- ✓ **Not expensive in terms of relative value:** At the current level, the 5Y sector is especially undervalued vs. the 2-4Y and 15Y sectors on the curve (Appendix 3). Although 5Y cash was temporarily excessively overvalued against swaps, it is no longer in such a situation (Appendix 4);

- ✓ **Market sentiment in the 5Y sector has not been good:** As witnessed by the continued rise in the 5Y JGB yield led by the decline in JGB futures, market sentiment in the 5Y sector has not been good recently. As time is needed to discern the direction of JGB futures, it is difficult to buy 5Y JGBs in an aggressive stance;
- ✓ **Diminished caution about trimming by the BOJ:** We think that the probability of near-term trimming in BOJ purchases in the 3-5Y zone is low, given that (1) the 10Y JGB yield has been moving within “about double the range of between -0.1% and +0.1%” and (2) the supply/demand condition in the intermediate zone does not appear tight;
- ✓ **Short-covering by primary dealers does not seem to be strong;**
- ✓ **Difficult to expect demand from overseas investors:** 5Y JGBs currently lack strong attractiveness both on XCCY and hedged bases (Appendixes 10-11). Given the rise in overseas yields and the fact that the end of fiscal year is approaching, we are unable to expect demand for JGBs to strengthen under the circumstances.

Switching out from 20Y or 15Y sectors

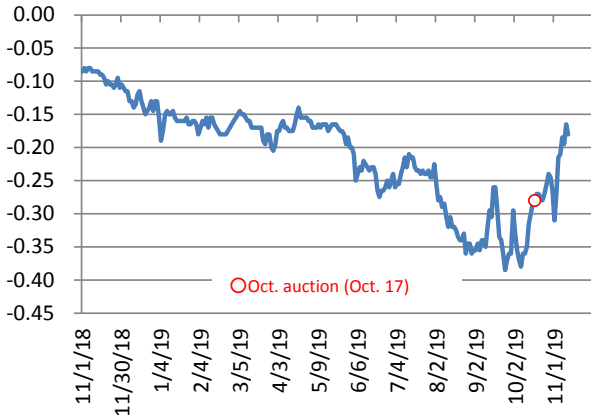
All in all, we would like to think of our bidding stance for tomorrow’s auction, checking Japanese investors’ demand for new 5Y JGBs at the cheapest price level in FY19. In terms of the relative value, 5Y JGBs do not appear expensive on the curve. In such a situation, our eyes are on short-term switching out from the 20Y sector as new 20Y JGBs are to be auctioned on November 20. In addition, as the 5Y sector is noticeably undervalued vs. the 15Y sector, it would be also worth considering short-term switching out from the 15Y sector in anticipation of correction in the cheapness.

5Y JGB Auction Results

Auction Date	Issue #	Marurity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
11/14/19	141R*	9/20/24	0.1*	1.9**									
10/17/19	141	9/20/24	0.1	1.9	3.69	101.90	101.87	0.03	-0.280	-0.274	0.006	45.4644	Poor
9/11/19	140R	6/20/24	0.1	1.9	3.61	100.98	100.95	0.03	-0.308	-0.302	0.006	47.6063	Poor
8/15/19	140R	6/20/24	0.1	2.2	4.68	102.04	102.02	0.02	-0.314	-0.310	0.004	37.9896	Avg
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

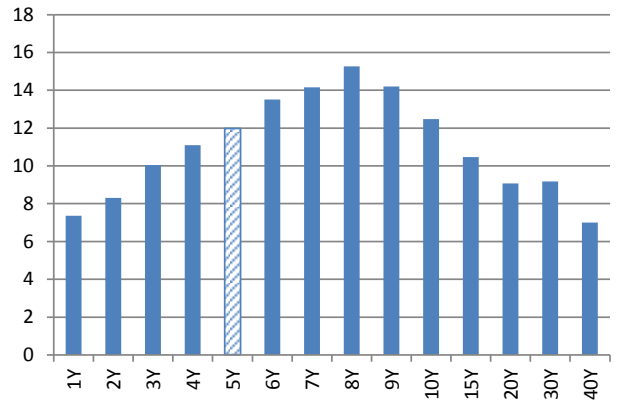
* Daiwa forecast as of Nov. 13 ** Amount the MOF plans to issue
Source: Ministry of Finance, Daiwa Securities.

Appendix 1: 5Y JGB Yield (%)



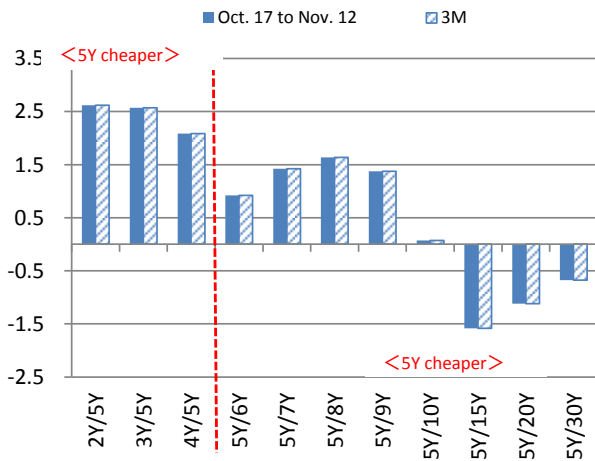
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Oct. 17 v. Nov. 12



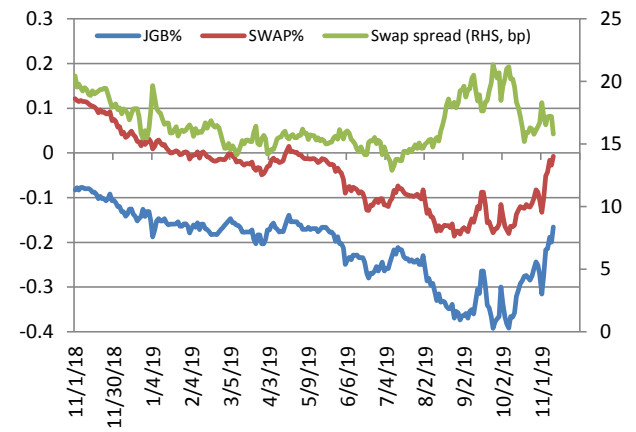
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



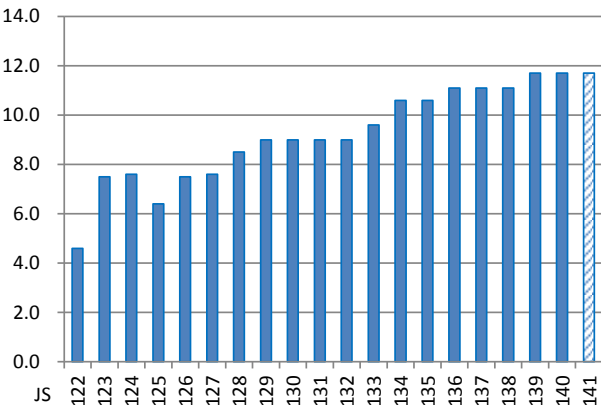
Source: Daiwa Securities.

Appendix 4: 5Y Swap Spread



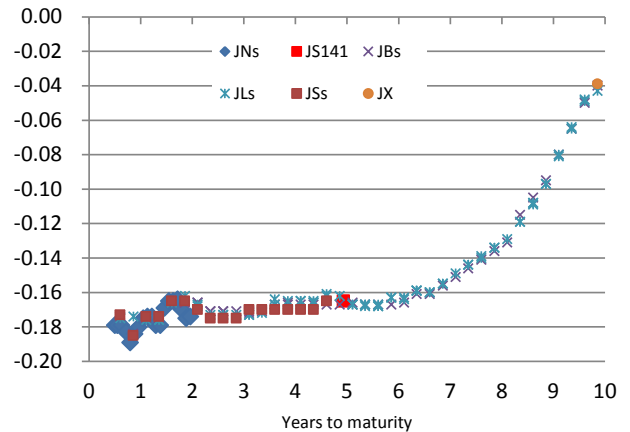
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): Oct. 17 v. Nov. 12



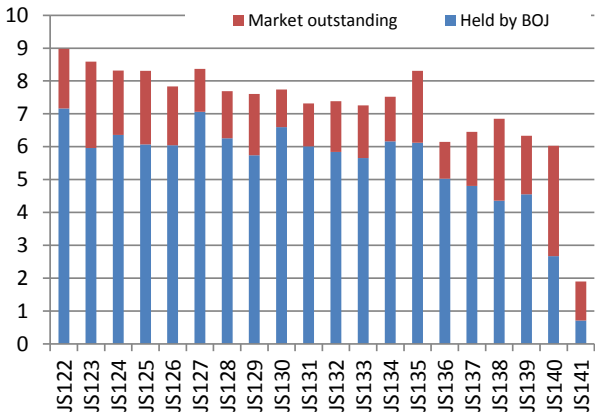
Source: Daiwa Securities.

Appendix 6: JGB Yield Curve (%), Nov. 12



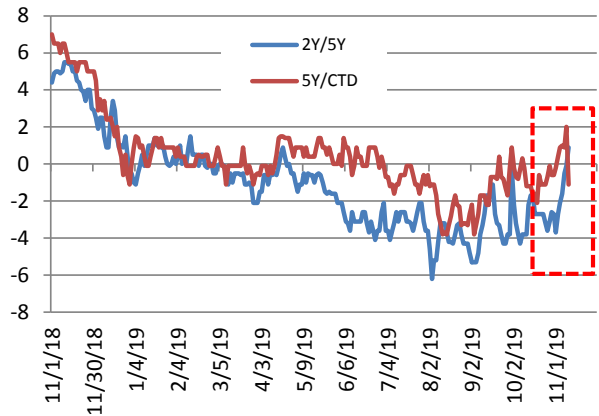
Source: Daiwa Securities.

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



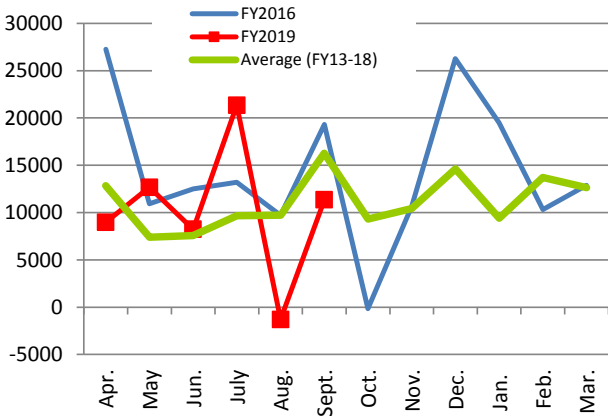
Note: as of Nov. 8 on BOJ start basis
Source: Daiwa Securities.

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



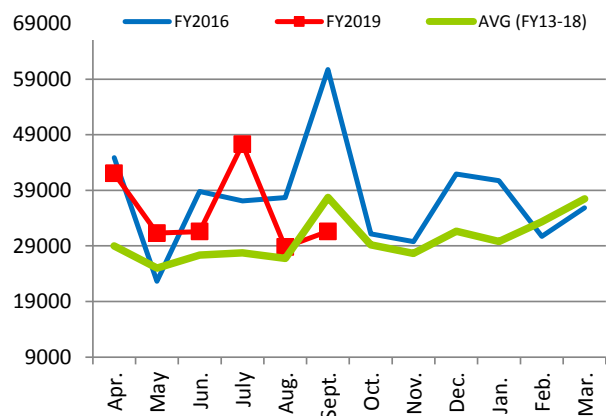
Note: On-the-run and CTD compound yields
Source: Daiwa Securities.

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



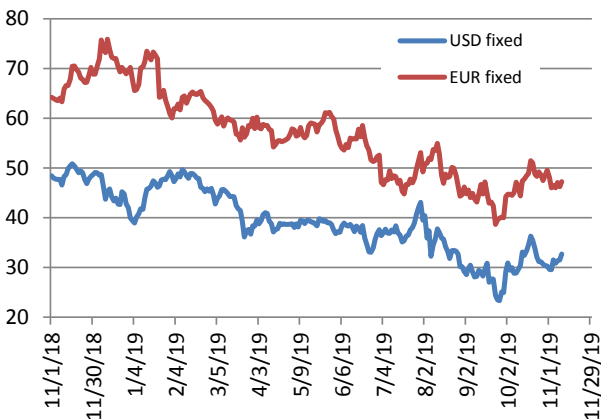
Source: JSDA

Appendix 9b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)



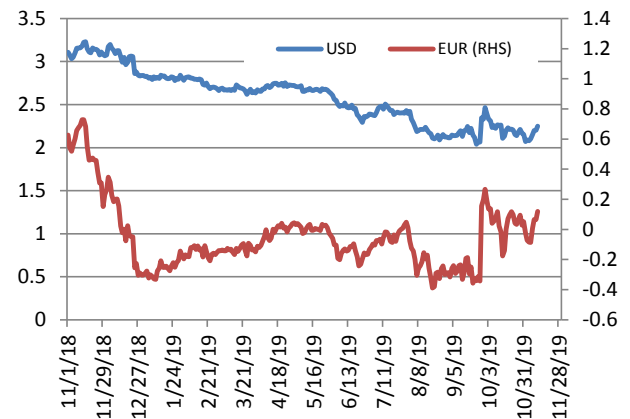
Source: JSDA

Appendix 10: 5Y JGB Benchmark Spreads (bp)



Note: against 5Y UST and 5Y OBL
Source: Daiwa Securities

Appendix 10: 5Y Hedged JGB Return (%)



Source: Daiwa Securities

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[Standard & Poor's]

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