

## Outlook for 10Y JGB Auction

### A longer tail expected

- ✓ Tomorrow's auction will likely be held at the lowest bidding yield level since the auction in November 2019
- ✓ Expecting the 10Y JGB yield to move mainly in the -0.10 to -0.05% level over the next one month
- ✓ A wider gap between lowest and average accepted prices (or a longer tail) expected than in January
- ✓ It would be worth considering short-term switching out from 7-8Y sectors

**[BOX] BOJ JGB Purchases in February 2020:** Steepening could be short-lived, despite drastic cut in the over 10Y zone

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### Auction Details

**Auction Date:** February 4, 2020  
**Issue Date:** February 5, 2020  
**Maturity Date:** December 20, 2029  
**Offering Amount:** About 2.1 trillion yen

\* New 10Y JGBs will likely be the first reopening of the December 2029 notes carrying a 0.1% coupon, JB357.

\*\* On Feb. 3, JB357 traded at -0.080 - -0.065% (-1.5bp - unch v. previous day's close) and closed at -0.065% (unch).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

**Tomorrow's auction will likely be held at the lowest bidding yield level since the Nov. 2019 auction**

After the previous 10Y JGB auction went well at the -0.005% to 0.000% level (vs. previous day's WI closing at -0.025%) on January 7 amid an downtrend in JGBs, the 10Y JGB yield temporarily rose into positive territory, to 0.010%, on an intraday basis, for the first time since December 20-24, 2019. Since then, the yield had moved in a tight range around 0% for a while. In the risk-off mood, set in late January by growing caution about the spread of new coronavirus, the fact that the FOMC gave us a somewhat dovish impression also has been playing a good role to lead JGBs up. Today, the 10Y JGB yield declines to -0.080% at one point on an intraday basis (as of 14:00). As tomorrow's auction will likely be held at the lowest bidding yield level since the Nov-2019 auction, we are concerned about negative impact on auction participants' bidding stance.

**Expecting a range-bound movement around -0.10 - -0.05% over the next one month**

We would like to check the environment surrounding JGBs. Over the next one month, the spread of the coronavirus may fuel worries about the global economy. In the global low inflation environment, we think that the US, Europe and Japan will likely keep their current easing policies. From the viewpoint of fundamentals, JGB yields are apt to decline in the current environment. Regarding external factors, strong caution will be needed on a possible correction in US stocks, which appear overheated. Given those factors together, we see that the 10Y JGB yield will likely to be range bound around the -0.10 - -0.05% level. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Primary dealers appear to be not deeply short:** Demand from investors would be the key for smooth sale of 2.1 trillion yen of reopened 10Y JGBs tomorrow;
- ✓ **Demand from investors is uncertain:** At the moment, it is hard to forecast how the coronavirus outbreak evolves and its impact on fundamentals. In such a situation, the level of investor demand for reopened 10Y JGBs is uncertain at the current level;
- ✓ **Undervalued vs. 7-8Y sectors:** Data from the previous auction suggests that the 10Y sector is noticeably undervalued vs. the 7-8Y sectors at the current level (Appendix 3). Against the superlong sector, the 10Y sector is neither noticeably overvalued nor undervalued;
- ✓ **The possibility of trimming in the 5-10Y zone appears low:** The 10Y JGB yield has been moving within “about double the range of between -0.1% and +0.1%.” Even under the flexible operation management, the possibility appears low that the BOJ will trim the offer amounts in the 5-10Y zone in the near term partly because this month’s offer amount in the over 10Y zone is set to be cut substantially (vs. previous month)..

**A wider gap between lowest and average accepted prices expected than in January**

All in all, we expect a wider gap between the lowest and the average accepted prices at tomorrow’s auction than that at the previous 10Y JGB auction in January, although we need to carefully watch demand from investors. We would like to think about our bidding stance to take minimum necessary amount around the lowest accepted price. In terms of relative value, it would be worth considering short-term switching out from the 7-8Y sectors as the 10Y sector is currently undervalued vs. those sectors. In particular, such a switching will gain attractiveness when the 7Y/10Y spread widens to 12bp. Assuming that steepening in the long to superlong zone triggered by the BOJ’s trimming plan will be short-lived (see [BOX]), on the other hand, we think that support on primary sale from activities to build new steepening positions will likely be limited.

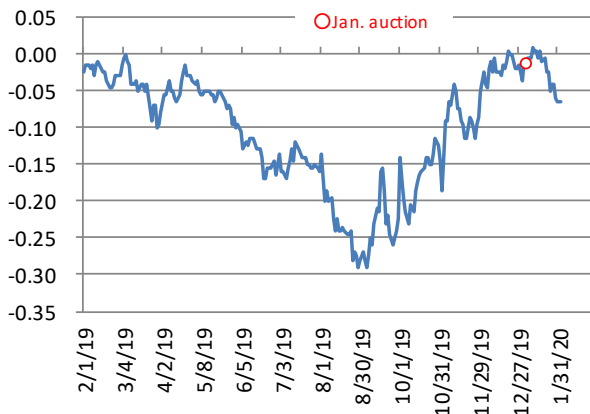
**10Y JGB Auction Results**

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 %	
2/4/20	357R*	0.1*	12/20/29	2,100**									
1/7/20	357	0.1	12/20/29	2,171	3.70	101.05	101.03	0.02	-0.005	-0.003	0.002	78.8770	Good
12/3/19	356R	0.1	9/20/29	2,100	3.28	101.40	101.24	0.16	-0.042	-0.026	0.016	95.7891	Poor
11/6/19	356R	0.1	9/20/29	2,100	3.62	101.99	101.94	0.05	-0.099	-0.094	0.005	80.6774	Avg
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

\* Daiwa forecast as of Feb. 3 \*\* Amount the MOF plans to issue

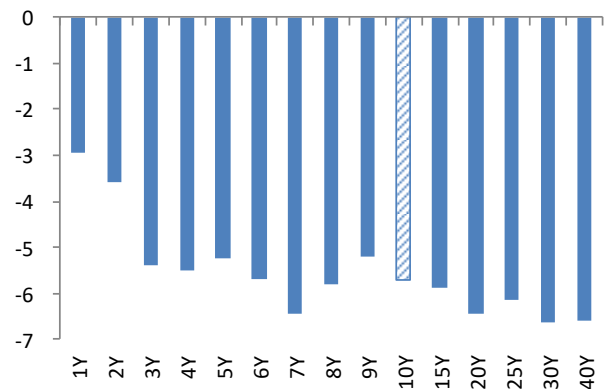
Source: Ministry of Finance (MOF), Daiwa Securities.

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



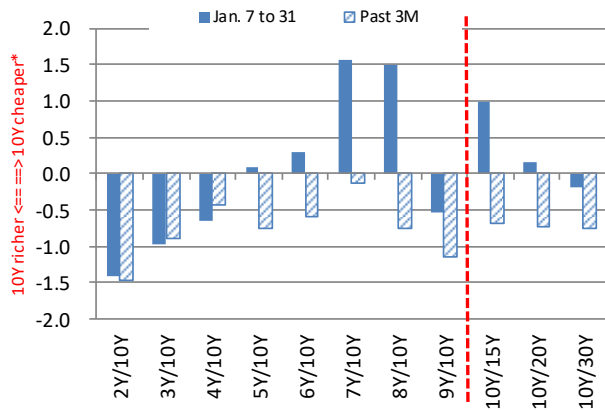
Note: as of 15.00 on Feb. 3  
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp, Jan. 7 v. Jan. 31)**



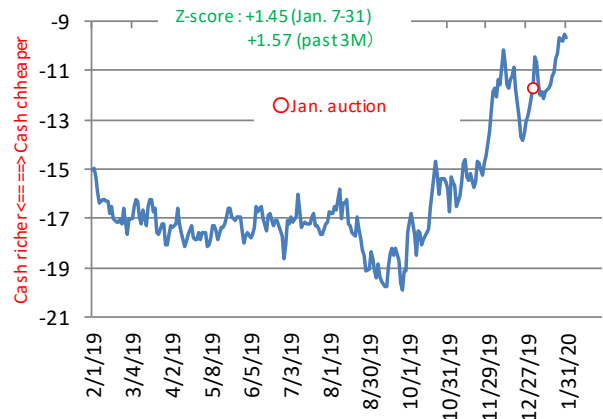
Source: Daiwa Securities.

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



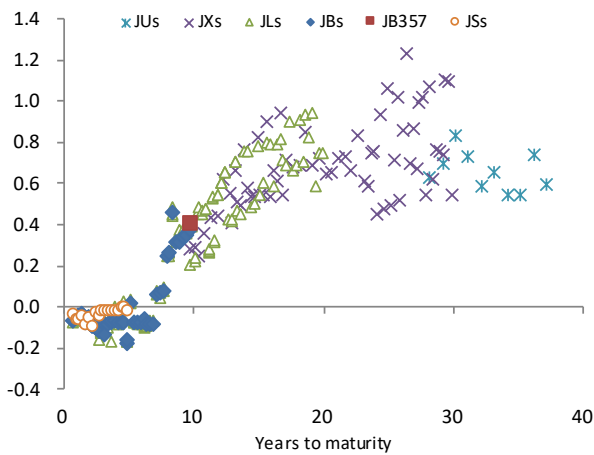
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y  
Source: Daiwa Securities.

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



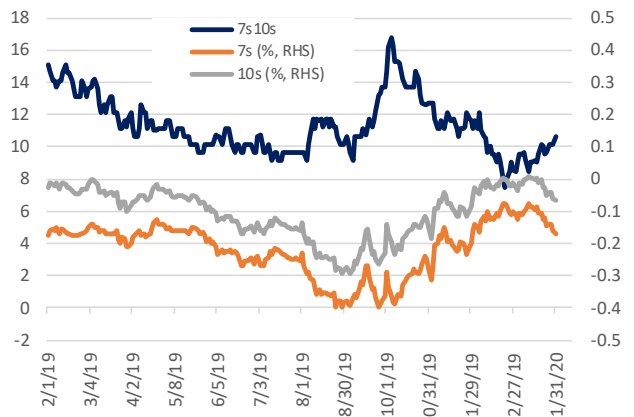
\* Yen LIBOR basis  
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on Jan. 31; assuming that those yield curve shapes do not change and factoring roll-down effect etc.  
Source: Daiwa Securities

### Appendix 6: JGB 7Y/10Y Spread



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

## [BOX] BOJ JGB Purchase in February 2020

At 17:00 on January 31, the BOJ announced its JGB purchase plan for February by updating the Outline of Outright Purchases of Japanese Government Securities. Changes from the January plan are as follows:

- ✓ Reduction in the number of monthly offers in the over 10Y zone to two times
- ✓ Lifting the upper limit of the offer range in the 10-25Y zone (150bn yen to 200bn yen)

The number of monthly offers is cut from seven times in January to six times. We attribute these changes to the following factors:

- ✓ Last week, the 10Y/20Y spread flattened very close to its historical tightest level;
- ✓ The BOJ is likely to have taken preventive measures against expected excessive flattening amid growing caution about negative impacts on the economy due to the spread of the new coronavirus.

Due to the latest plan, it is highly possible that the offer amount in February's first operation in the 10-25Y zone will increase by 30bn yen from 100bn yen at the January's last operation to 130bn yen and offer amounts in other zones will be kept unchanged, we think. Based on these projections, the monthly purchase amount in the over 10Y zone is expected to decrease from 390bn yen in January to 320bn yen in February.

### Initial reaction was steepening, but it could be short-lived

As most market participants expected the February plan to be unchanged from the January one, the drastic cut in the over 10Y zone was a surprise. On the evening session after the announcement, superlong JGBs plunged, putting the long to superlong zone of the yield curve under strong steepening pressure. Today (Feb 3), the JGB market is extending up, keeping the zone of the curve under bull—flattening pressure. As strong demand for superlong JGBs is expected in the Jan-Mar quarter, the last quarter in FY2019, more market participants are recently viewing that the BOJ's JGB purchases in the over 10Y zone are unnecessary. Thus far, the BOJ's cuts in JGB purchases in the over 10Y zone, especially in an yield downtrend, mostly have failed to rein in the flattening trend. The steepening caused by the latest trimming, therefore, could be short-lived.

### Balance of BOJ Purchase and MOF Issuance

(Yen billions)

	Offer size per operation	Mid	Number of Offers (per month)	Offer size expected at the first operation in Feb.	Offer size at the last operation in Jan.	Monthly Total exp. in Feb. (a)	MOF issuance per month in FY2019** (b)	(a)-(b)
<b>JGBs ex Linkers and Floaters</b>								
Up to 1 year	About 10-100	55	2	50	50	100	-	-
Over 1 to 5 years	Over 1 to 3 years	About 300-550	425	4	420	420	2,000	-320
	Over 3 to 5 years	About 200-450	325		340	340	1,360	1,900
Over 5 to 10 years	About 200-500	350	4	350	350	1,400	2,100	-700
Over 10 years	Over 10 to 25 years	About 50-200	125	2	130	100	900	-640
	Over 25 years	About 0-50	25		30	30	60	700 - 1,100
Linkers	About 30	-	2	30	30	60	400	-280**
Floaters (in even months)	About 100	-	1	100	100	100	-	-
<b>TOTAL:</b>						<b>4,920 to 5,020</b>	7,600 to 8,400	<b>-2,680 to -3,380</b>

(Note) "Offer size per operation" and "Number of offers (per month)" are as released by the BOJ on Jan. 31 and "Offer size at the first operation in Feb." is expected by Daiwa Securities as on Jan. 31 \* Excluding NPC1 and AEL; JGB linkers issued 4 times per year

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

### BOJ Purchase etc. Schedule for February 2020

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	JGB Floater	TDBs	MOF Buyback	
2/3/20 M	2/4/20											
2/4/20 T	2/5/20	10Y JGB Auction									○	
2/5/20 W	2/6/20	30Y JGB Auction									6M	
2/6/20 TH	2/7/20		◎	◎	◎			○		3M		
2/7/20 F	2/10/20	○				◎	◎		○			
2/10/20 M	2/12/20	Public Holiday (National Foundation Day)										
2/11/20 T	-	10Y JGB Linker Auction									○	
2/12/20 W	2/13/20		◎	◎	◎						○	
2/13/20 TH	2/14/20	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)									3M	
2/14/20 F	2/17/20	5Y JGB Auction									○	
2/17/20 M	2/18/20	20Y JGB Auction									1Y	
2/18/20 T	2/19/20		◎	◎	◎					3M		
2/19/20 W	2/20/20	Public Holiday (Emperor's Birthday obs.)										
2/20/20 TH	2/21/20	○				◎	◎	○				
2/21/20 F	2/25/20	AEL (20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years to maturity)									○	
2/24/20 M	-		◎	◎	◎							
2/25/20 T	2/26/20	2Y JGB Auction									3M	
2/26/20 W	2/27/20											
2/27/20 TH	2/28/20		◎	◎	◎							
2/28/20 F	3/2/20											

Note: ◎ Announced by the BOJ on Jan. 31, ○ Daiwa forecast as of Jan. 31

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

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