

## Outlook for 5Y JGB Auction

### Generally, no hesitation in buying 5Y JGBs at the -0.10 - -0.05% level

- ✓ With near-term support expected around -0.05%, the -0.10 - -0.05% level should not discourage market participants from buying new 5Y notes
- ✓ In this particular situation, demand from domestic investors would be the key for tomorrow's auction.
- ✓ We think about our bidding stance with the possibility of a longer tail in mind
- ✓ Although it is difficult to sell the 10Y sector, it may be worth considering switching out from the 10Y sector because of the recent tightening of the 5Y/10Y spread

Strategic Memorandum DSTE373  
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### Auction Details

**Auction Date:** April 9, 2020  
**Issue Date:** April 10, 2020  
**Maturity Date:** March 20, 2025  
**Offering Amount:** About 1.9 trillion yen

\* New 5Y JGBs, JS143, will likely carry a 0.1% coupon.

\*\* On April 8, WI barely traded, and closed at -0.090% (+0.5bp v. previous day's close). JS142 traded at -0.095 - -0.085% (+0.5 - +1.5bp) and closed at -0.095% (+0.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

After the previous 5Y JGB auction went poorly at the -0.255 - -0.250% level (+5.0 - +5.5bp vs. previous day's close), the 5Y JGB yield temporarily rose to -0.040% on an intraday basis on March 19 amid a strong downturn in the JGB market. Once the market firmed up, the yield declined to -0.145% at one point on Apr. 1. Since the end of last week, the 5Y JGB yield has been inching up. Today (Apr. 8), it momentarily rose to -0.085% on an intraday basis.

Let's check the environment surrounding the JGB market. While the COVID-19 virus has been rampant globally with strong uncertainty on when the pandemic will come under control, caution about the economic downtrend remains strong partly as the Japanese government has declared a state of emergency. In Europe and the US, the authorities have started to announce aggressive policies also in the fiscal front, in addition to strengthening of monetary easing policy amid the aggravation of the pandemic. Under the trend of global fiscal expansion, Japan has also decided to expand fiscal spending (via a substantial increase in issuance amount of deficit JGBs). Along with this, JGB market issuance on a calendar basis is set to increase substantially. However, upward pressure on JGB yields is unlikely to rapidly strengthen as the increase in issuance is expected to start in July and the BOJ has increased its JGB purchases in the April plan. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **No hesitation in buying at the current yield level:** 5Y JGBs have been solidly supported around -0.05% since the BOJ started the negative interest rate policy (Appendix 8). If 5Y JGBs are supported around -0.05%, no hesitation is needed in buying 5Y JGBs at the -0.10 - -0.05% level.
- ✓ **Not overvalued in terms of the relative value:** Our analysis based on data since the previous 5Y JGB auction shows that the 5Y sector is not rich on the curve at the current level. Rather it is noticeably undervalued vs. the 10Y sector (Appendix 3). As the volatility of asset swaps has recently let up, 5Y cash is neither excessively overvalued nor undervalued against swaps at the current level (Appendix 4).
- ✓ **The increase in the number of offers per month in BOJ's purchase operations:** In order to "supply ample liquidity through aggressive JGB purchases etc.," the BOJ has increased the number of operations targeting notes in the over-3-year to 5-year zone in April to six times (from four in Mar.). If we assume that the number of offers will be maintained at six times in May---i.e., at least six operations will be conducted by the next 5Y JGB auction (May 18) with no change in the offer amount at 280bn yen---, the purchase amount is estimated at around 1.68tn yen. We can expect good support from BOJ's purchases.
- ✓ **The increase in the issuance amount related to the first supplementary budget turns out to be smaller than expected:** On April 7, the government has decided its first supplementary budget for FY20 at a cabinet meeting to procure fund for an economic stimulus package. From July, the issuance amount of JGBs is to be increased in most maturity zones. While the Ministry of Finance considered an increase in the issuance amount in the short-term/intermediate zone, a sense of caution mounted about how much the issuance amount of 5Y JGBs will be increased. Eventually, the increase has turned out to be 100bn yen vs. the initial plan (per auction).

As mentioned, there are many supportive factors for tomorrow's auction, for which worries would be unnecessary if in ordinary times. Under the state of emergency, however, many market participants are into more-intensified BCP mode (split system or teleworking, etc.), leading market liquidity further low. Primary dealers appear to be unprepared for tomorrow's auction as well. In addition, partly because of a rise in the USD/JPY basis swap into positive territory, demand from overseas investors is uncertain.

All in all, demand from domestic investors would be the key for tomorrow's auction. We think about our bidding stance to be able to purchase certain-lot of new 5Y notes at the lowest accepted price with the possibility of a longer tail. Although it is difficult to keep big positions in terms of the relative value, it would be worth considering switching out from the 10Y sector. Due to recent strength of the on-the-run 10Y JGB and its neighboring issues, it may be difficult to sell the 10Y sector. However, we anticipate a reversal in the 5Y/10Y spread because of its recent tightening development (Appendix 9).

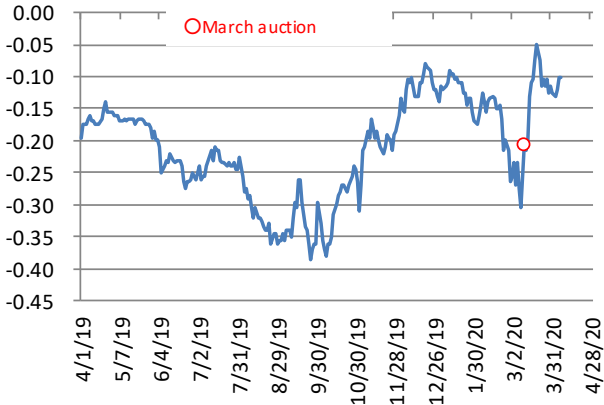
## 5Y JGB Auction Results

Auction Date	Issue #	Maturity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
4/9/20	143	3/20/25	0.1*	1.9**									
3/10/20	142R	12/20/24	0.1	1.9	2.73	101.55	101.37	0.18	-0.220	-0.184	0.036	21.4893	Poor
2/18/20	142R	12/20/24	0.1	2.1	4.49	101.19	101.18	0.01	-0.144	-0.142	0.002	13.8811	Good
1/15/20	142	12/20/24	0.1	2.1	4.48	100.93	100.93	0.00	-0.087	-0.087	0.000	90.2740	Good
12/10/19	141R	9/20/24	0.1	2.2	4.02	100.88	100.80	0.08	-0.083	-0.066	0.017	43.9215	Poor
11/14/19	141R	9/20/24	0.1	2.2	4.03	101.42	101.41	0.01	-0.190	-0.188	0.002	76.6232	Good
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

\* Daiwa forecast as of Apr. 8 \*\* Amount the MOF plans to issue

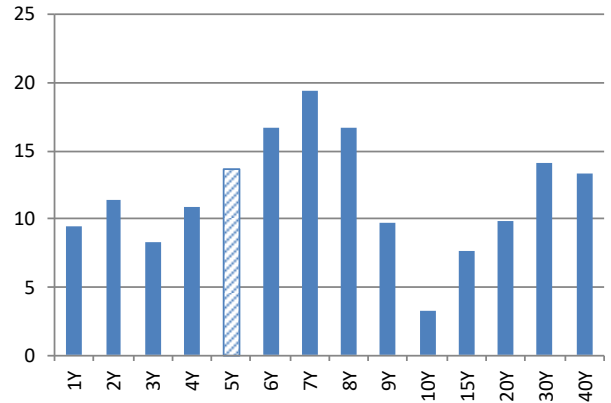
Source: Ministry of Finance, Daiwa Securities.

Appendix 1: 5Y JGB Yield (%)



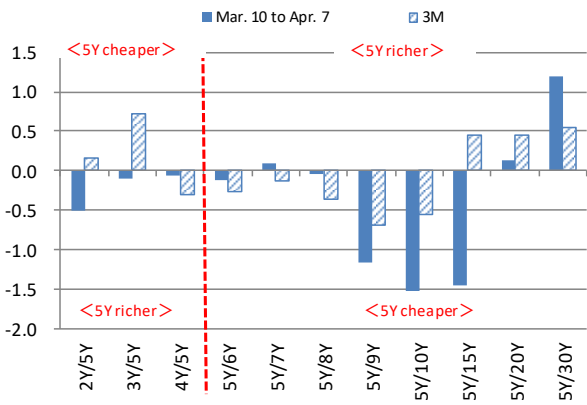
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Mar. 10 vs. Apr. 7



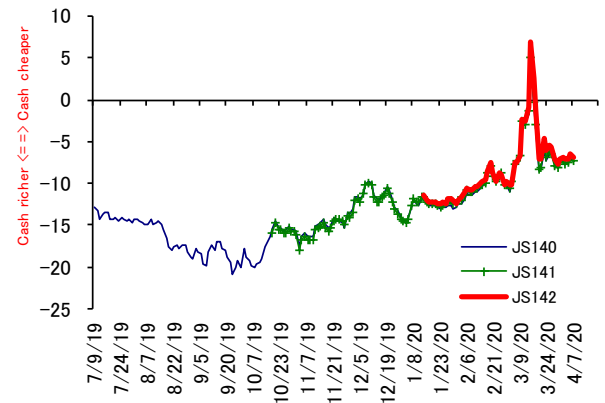
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



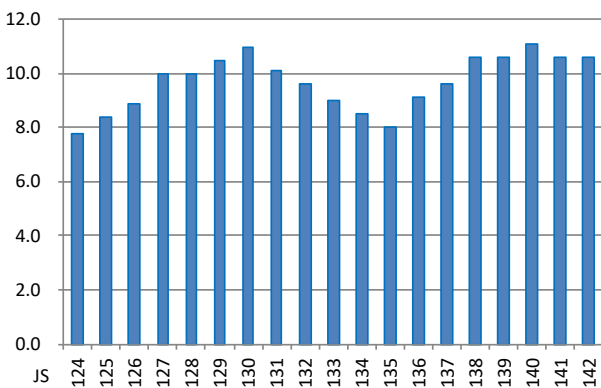
Source: Daiwa Securities.

Appendix 4: 5Y JGB Asset Swap Spread (bp)



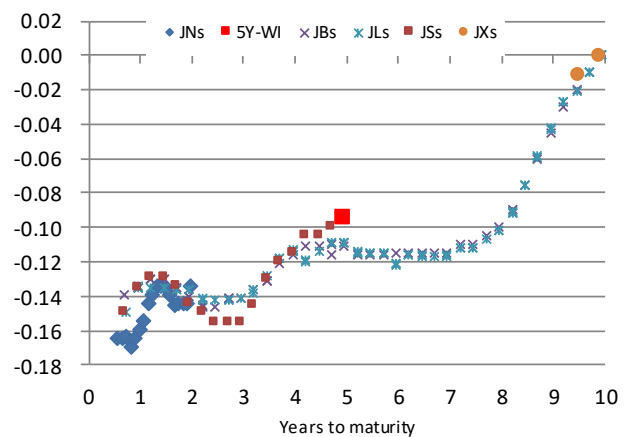
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): Mar. 10 vs. Apr. 7



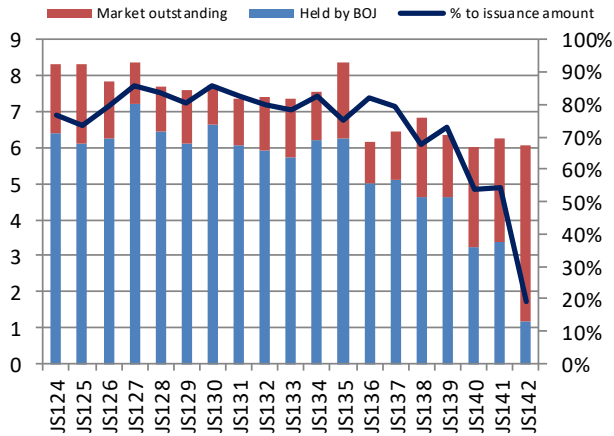
Source: Daiwa Securities.

Appendix 6: JGB Yield Curve (% as on Mar6)



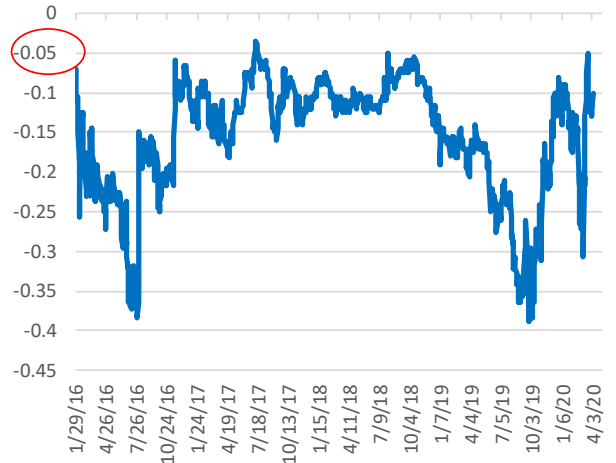
Source: Daiwa Securities.

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



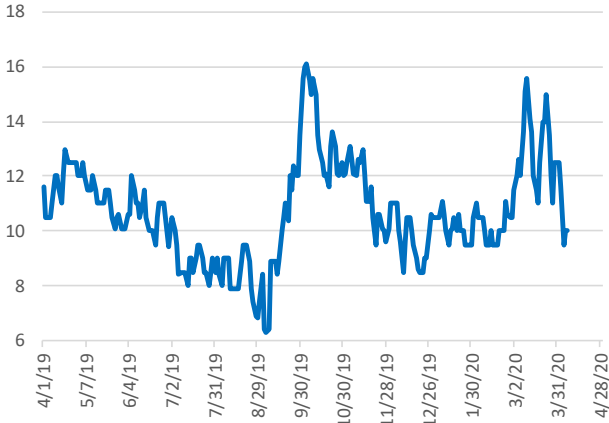
Note: as of Mar. 31 on BOJ start basis  
Source: Daiwa Securities.

**Appendix 8: 5Y JGB Yield under BOJ NIRP (%)**



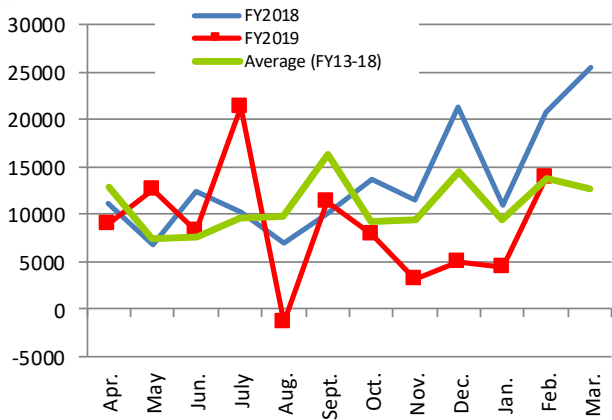
Note: On-the-run compound yield basis  
Source: Daiwa Securities.

**Appendix 9: JGB 5Y/10Y Spread (bp)**



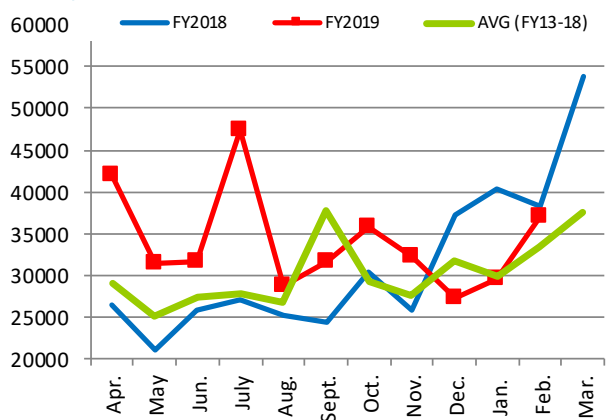
Note: as of Mar. 31 on BOJ start basis  
Source: Daiwa Securities.

**Appendix 10a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



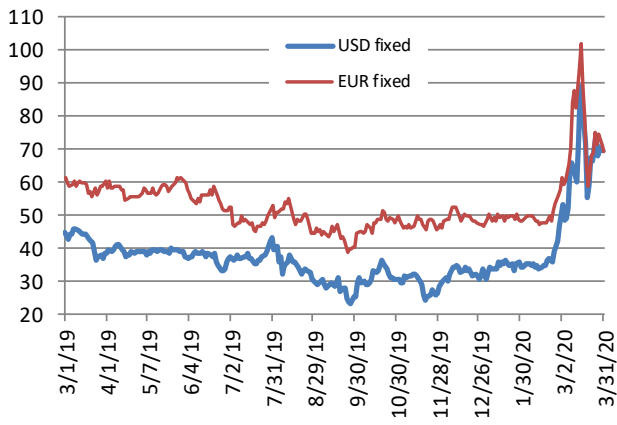
Source: JSDA

**Appendix 10b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



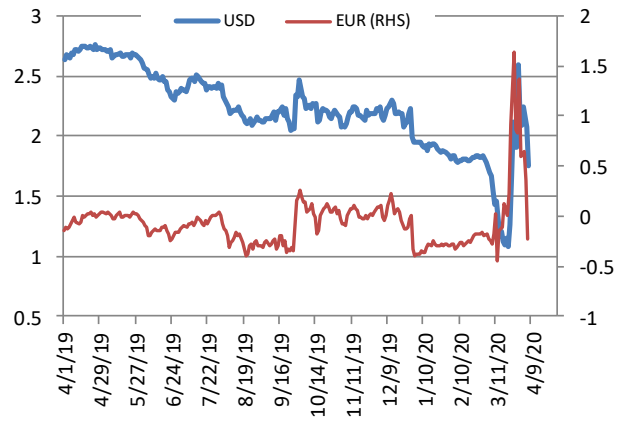
Source: JSDA

**Appendix 11a: 5Y JGB Benchmark Spreads (bp)**



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

**Appendix 11b: 5Y Hedged JGB Return (%)**



Source: Daiwa Securities

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February 2020

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- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
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- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* 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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