

Outlook for 10Y JGB Auction

Uneventful

- ✓ Backed by short-covering by primary dealers and demand from investors, tomorrow's auction is expected to be trouble-free.
- ✓ Expecting the 10Y JGB yield to move around a -0.030 – 0.001% range in the near term, we would like to think about our bidding stance.
- ✓ In terms of relative value, it would be worth considering switching out from 4-5Y sectors.

Strategic Memorandum DSTE378
FICC Research Dept.

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Auction Details

Auction Date: May 12, 2020
Issue Date: May 13, 2020
Maturity Date: March 20, 2030
Offering Amount: About 2.1 trillion yen

* New 10Y JGBs will likely be the first reopening of JB358 carrying a 0.1% coupon.

** On May 11, JB358 traded at 0.000-0.005% (+0.5 - +1.0bp v. previous day's close) and closed at 0.005% (+1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

10-year JGB yield appears to be getting away from negative territory

After the previous 10-year JGB auction went well at the 0.025 - 0.030% level (vs. WI closed at 0.015% on the previous day) in April, the 10-year JGB yield (conventional yield of on-the-run issue) remained range-bound between -0.010 - 0.020% on an intraday basis while the JGB market moved in a tight range. In late April, the JGB market firmed up partly because the BOJ decided to take additional monetary easing steps via measures such as "further active purchases of JGBs." The 10-year JGB yield also declined to -0.055% at one point on an intraday basis. While the US market has posted higher stock price/lower bond price trends during Japan's Golden Week holidays, the JGB market has also softened and the 10Y JGB yield has headed up. As of 14:00 today (May 11), the yield temporarily rose to 0.005%.

Caution lingers about additional issuance along with the second supplementary budget, but it is too early to factor in

Let's check the environment surrounding the JGB market. Europe and the US are getting ready to take gradual steps to reopen social/economic activities, which have been suspended by the spread of new coronavirus. However, as cautions remain deep-rooted about the second and third waves of the Covid-19 spreading, it is difficult to become completely optimistic about a V-shaped economic recovery. In Japan, the state of emergency, which was initially set to be end on May 6, was extended to May 31, but the government considers an early lifting by region. At the same time, the government appears to rush to compile the second supplementary budget in the current Diet session at the earliest. This is likely to lead to stronger caution about an additional increase in

calendar-based JGB market issuance. As the first supplementary budget entailed a substantial increase in the issuance amount in the short-term/intermediate zone, the market would be aware of additional issuance of 10Y JGBs in the second supplementary budget. However, as we need to take a little more time to discern the realistic size of the second supplementary budget, it is difficult for participants at tomorrow's auction to factor in a possible increase in the issuance amount. In addition, the 10-year JGB yield has been controlled by the BOJ. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Short-covering by primary dealers would serve as good support to some extent:** Partly because the repo rate of JB358 remains quite tight, short-covering can be expected to some extent;
- ✓ **Solid demand from investors expected in positive yield territory:** Demand from investors appears to be strong at 0.0% or higher. If bidding starts in positive yield territory, worries would be unnecessary for investor demand;
- ✓ **Not expensive in terms of relative value:** Our analysis based on data since the previous 10Y JGB auction shows that the 10Y sector is not rich on the curve at the current level and it is rather undervalued vs. the 9Y, 4-5Y, and 2Y sectors (Appendix 3, 6) on the current yield curve. Since the previous 10Y JGB auction, 10Y asset swaps have remained range-bound. We can say that 10Y cash is neither noticeably overvalued nor undervalued against swaps at the moment (Appendix 4);
- ✓ **BOJ expected to purchase more in May than in April:** Even if the BOJ does not change the current offer amount in the 5-10Y zone, its monthly purchase amount in May is expected to increase by nearly 100bn yen vs. the amount in April. As the BOJ is strengthening monetary easing further via measures such as "further active purchases of JGBs," the possibility remains for an increase in the purchase amount during the month when the BOJ judges that it is necessary. Additionally, it is now under the yield curve control policy. The downside of 10Y JGBs should be supported well.

Bidding with a near-term range around -0.030 – 0.010% in mind

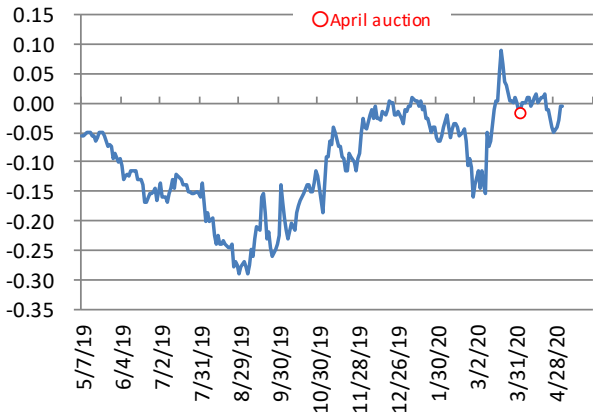
All in all, we think that the auction will go smoothly tomorrow. We would like to think of our bidding stance, assuming that the 10-year JGB yield will move in a range centered at -0.030 - 0.010% in the near term. In terms of the relative value, we think about switching out from the 4-5Y sectors. The 4-5Y sectors have recently been supported by the firmness around the 2Y sector, while the JGB market has been facing upside resistance. Therefore, the 10Y sector has been becoming more undervalued vs. the 4-5Y sectors (appendixes 3 and 6). Regarding the BOJ's monthly purchase amount in May, the amount in the 3-5Y zone is expected to be unchanged from that in April, but the amount in the 5-10Y zone is projected to increase by nearly 100bn yen. In terms of the BOJ's purchases, the recent steepening in the 4-5Y to 10Y zone may let up. Although it may be difficult to sell the 4-5Y sectors, it would be worth considering switching out from those sectors to new 10Y JGBs.

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 %	
5/12/20	358R	0.1*	3/20/30	2,100**									
4/2/20	358	0.1	3/20/30	2,306	4.19	100.76	100.75	0.01	0.023	0.024	0.001	83.0105	Good
3/3/20	357R	0.1	12/20/29	2,309	3.20	101.98	101.84	0.14	-0.100	-0.086	0.014	28.9846	Poor
2/4/20	357R	0.1	12/20/29	2,271	3.63	101.50	101.48	0.02	-0.051	-0.049	0.002	77.1508	Avg
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

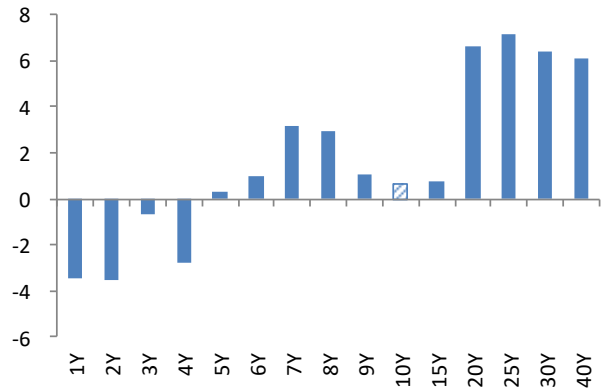
* Daiwa forecast as of May 11 ** Amount the MOF plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



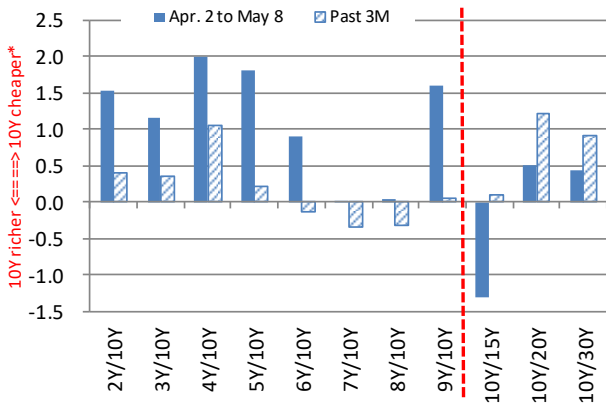
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Apr. 2 v. May 8)



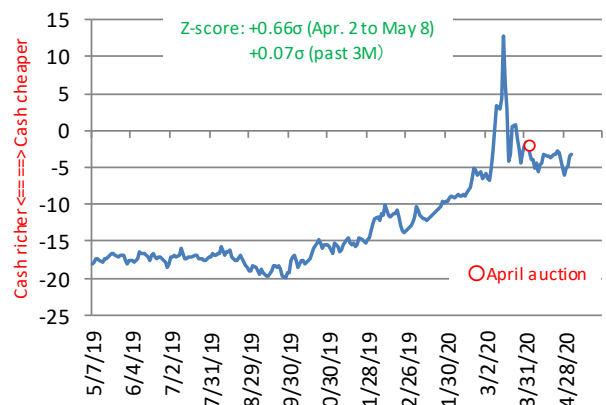
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



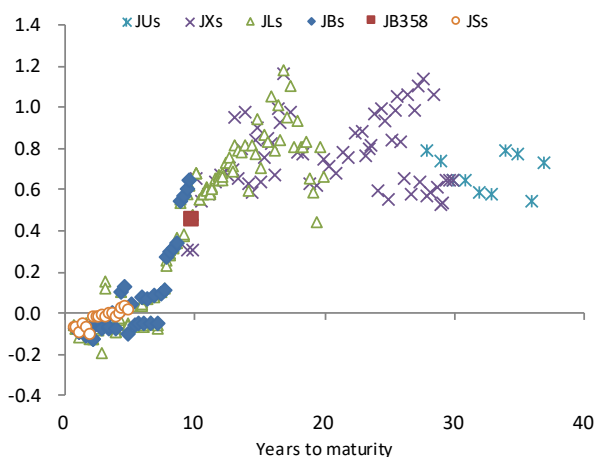
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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



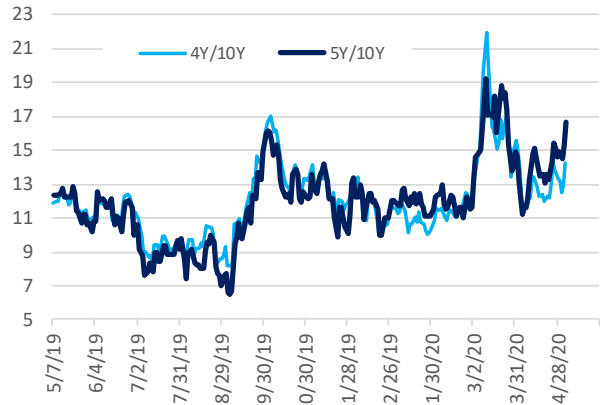
* Yen LIBOR basis
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on May 8; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6: JGB 4Y/10Y and 5Y/10Y Spreads (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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February 2020

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