

Outlook for 5Y JGB Auction

Unlikely to serve as negative market catalyst

- ✓ Bidding with a near-term range around -0.120 to -0.090% in mind
- ✓ In terms of relative value, it would be worth considering 2Y/5Y/7Y butterfly trade

Strategic Memorandum DSTE387
FICC Research Dept.

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Auction Details

Auction Date: June 18, 2020
Issue Date: June 19, 2020
Maturity Date: March 20, 2025
Offering Amount: About 1.9 trillion yen

* New 5Y JGBs will likely be the last reopening of JS143 carrying a 0.1% coupon.

** On June 17, JS143 traded at -0.110% (unch v. previous day's close) and closed at -0.110% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

5Y JGB yield range appears to have risen in June compared to late May

After the previous 5Y JGB auction went well at the -0.120 - -0.115% (unch - +0.5bp vs. previous day's close), the 5Y JGB yield (conventional yield of JS143) temporarily moved in the -0.145 - -0.120% range amid a range-bound movement of the JGB market. In early June, reacting to long-term UST yields and USD/JPY, which posted upside breakout from their ranges in April-May, the JGB market softened and the 5Y JGB yield also momentarily rose to -0.085% on an intraday basis. Amid growing caution about a second wave of coronavirus infections around the globe in mid-June, the 5Y JGB yield fell to -0.125% at one point partly due to lower stock prices/higher bond prices. This week, the yield is moving at around -0.110%. It appears that the range for the 5Y JGB yield has risen in June compared to late May (Chart 1). In such an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **The current yield level may fail to stimulate investor appetite for 5Y JGBs:** Given the fact that the 5Y JGB yield has been moving in the range at around -0.120 to -0.090% in June, investors may not have strong appetite for 5Y JGBs if tomorrow's auction is held at around -0.110%;
- ✓ **Not undervalued in terms of the relative value:** Our analysis based on data since the previous 5Y JGB auction and that in the past three months show that the 5Y sector is not cheap on the curve at the current level. Rather it is noticeably overvalued vs. the 20Y sector (Appendix 3). Since the previous auction, JS143 asset swap has been

range-bound around the LIBOR-9 to -7bp (Appendix 6). At the current level, 5Y cash is neither noticeably overvalued nor undervalued against swaps;

- ✓ **Good support is expected from the BOJ's purchase operations:** The next 5Y JGB auction is scheduled for July 9, at which the MOF will sell the June-2025 notes, JS144. The issuance amount will be increased by about 600bn yen from tomorrow's 1.9tn yen to around 2.5tn yen. In the period from tomorrow's auction to the next 5Y JGB auction, there is a possibility that the BOJ will conduct four purchase operations in the 3-5Y zone (twice in June and we expect twice in July). Ahead of a substantial issuance increase in 5Y JGBs from July, it is highly expected that the BOJ will increase its purchase in the 3-5Y zone from the current 320bn yen to around 380bn yen as a possibility. If so, we can estimate that buyers for tomorrow's 5Y JGBs will likely have certain exit up to about 1.4tn yen.
- ✓ **Collateral demand is expected to grow in association with the BOJ's special fund-supply operations in response to the COVID-19 pandemic:** At the Monetary Policy Meeting on June 16, the BOJ increased its estimated size of the special fund-supply program in response to the COVID-19 pandemic to 90tn yen. Although all the amount is not necessarily used, collateral demand for short- and intermediate-term JGBs is expected to grow going forward.

Bidding with a near-term range around -0.120 to -0.090% in mind

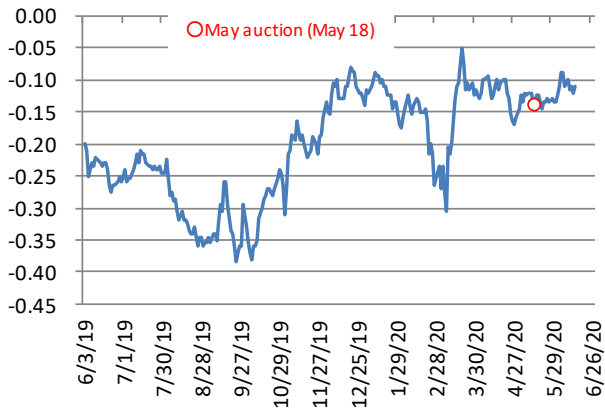
All in all, we would like to think about our bidding stance, assuming that the 5Y JGB yield will remain in the range centered at -0.120 to -0.090% until the next 5Y JGB auction in July. If there is a high chance of bids being placed at the -0.10 to -0.09% level, we could take an aggressive stance, including outright purchases. However, such a chance appears low at the moment. In terms of the relative value, it would be worth considering the 2Y/5Y/7Y butterfly trade (buying 5Y/selling 2Y and 7Y). Since April, the butterfly spread has been moving in a range of about 5bp, and it is now close to the upper limit of the range, which looks attractive (Appendix 8). In addition, positive carry is expected from the butterfly position even if the shape of the 2Y/5Y/7Y curve does not change in an investment horizon.

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 (%)	
6/18/20	143R	3/20/25	0.1	1.9*									
5/18/20	143R	3/20/25	0.1	2.0	4.49	101.07	101.05	0.02	-0.122	-0.119	0.003	49.2132	Good
4/9/20	143	3/20/25	0.1	2.1	4.98	100.97	100.96	0.01	-0.095	-0.093	0.002	43.4187	Good
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

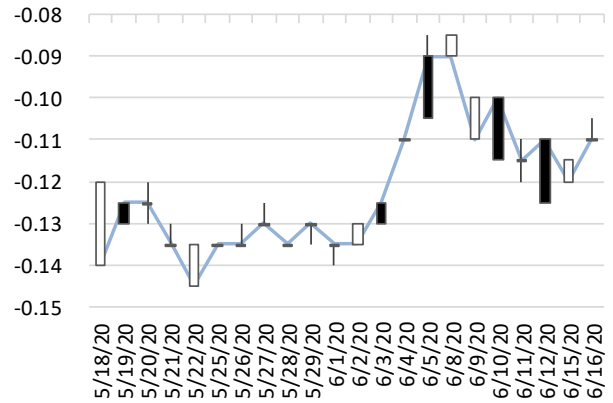
* Amount the MOF plans to issue
Source: Ministry of Finance, Daiwa Securities.

Appendix 1a: 5Y JGB Yield (%)



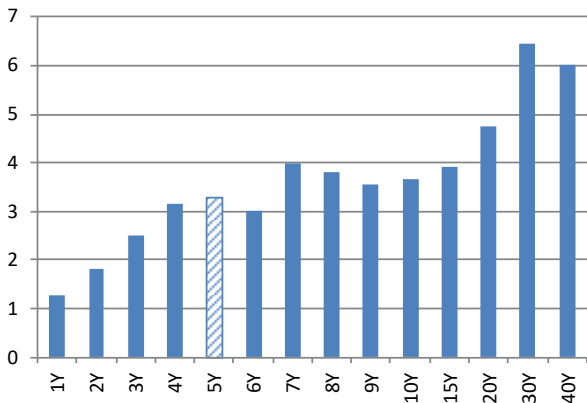
Source: Daiwa Securities.

Appendix 1b: Candle of JS143 Yield (bp):



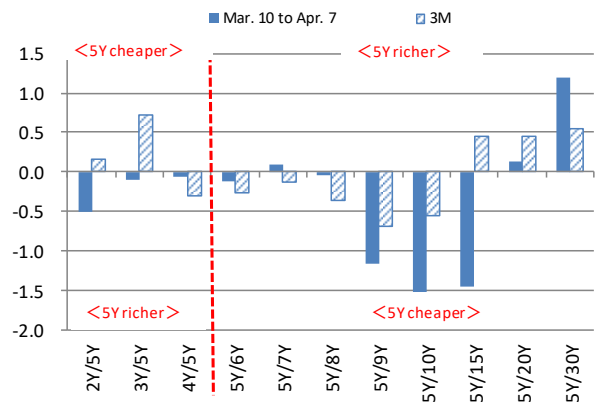
Note: Japanese conventional yield
Source: Quick

Appendix 2: JGB Yield Change (bp): May 18 v. June 16



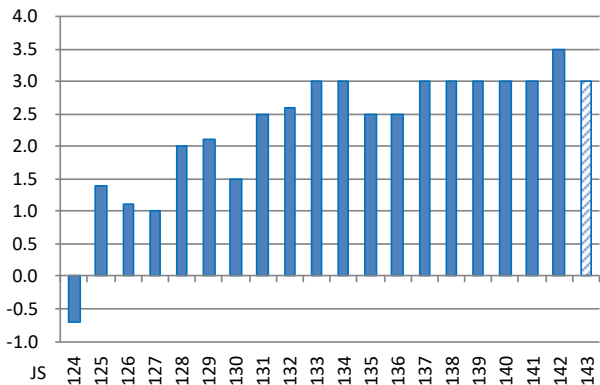
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



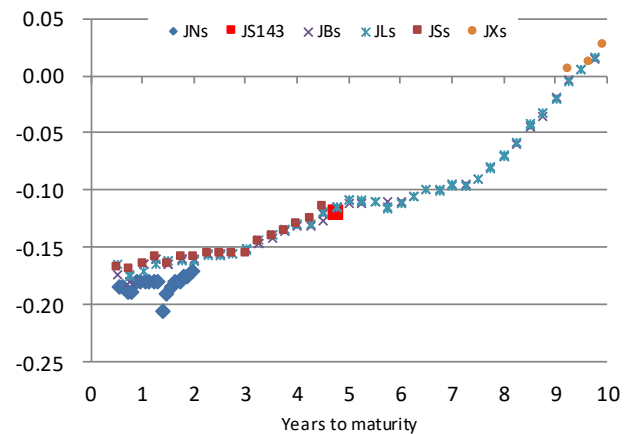
Source: Daiwa Securities.

Appendix 4: JS Yield Change (bp): May 18 v. June 16



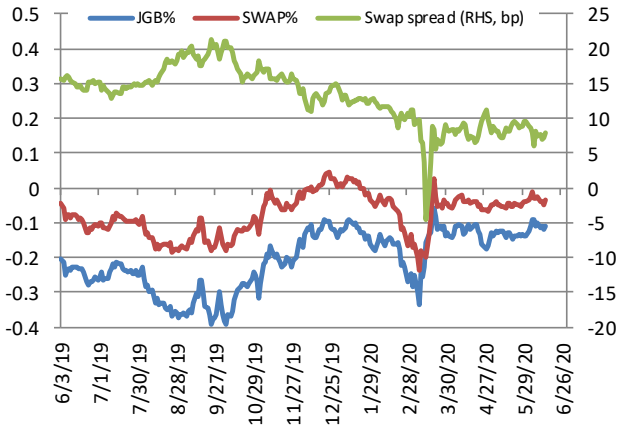
Source: Daiwa Securities.

Appendix 5: JGB Yield Curve (%), as on June 16



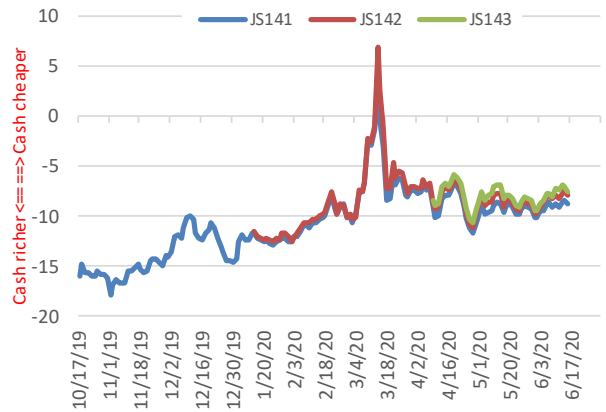
Source: Daiwa Securities.

Appendix 6a: 5Y Swap Spread (bp)



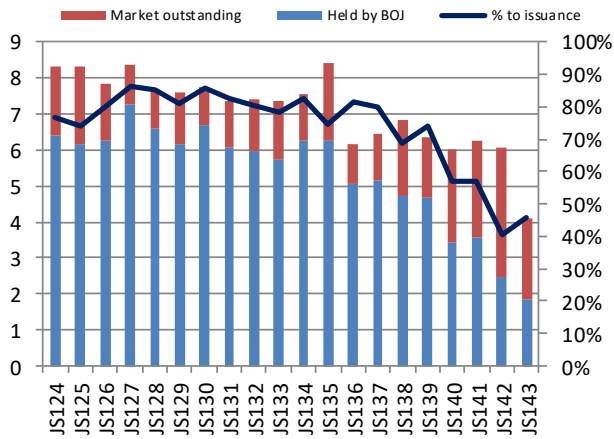
Source: Daiwa Securities.

Appendix 6b: JS Asset Swap (bp)



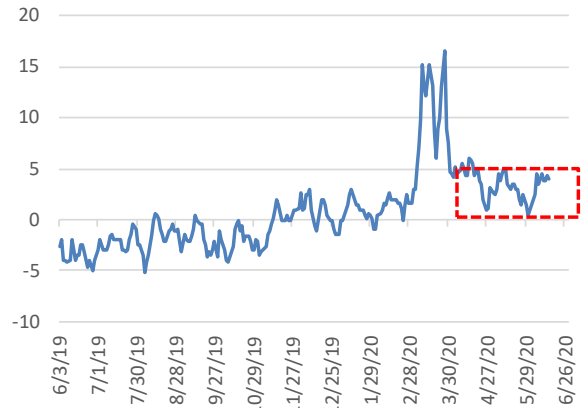
Note: Yen-Libor basis
Source: Daiwa Securities.

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



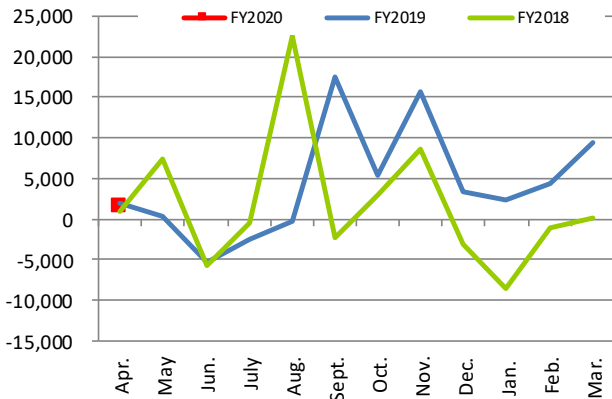
Note: as of June 10 on BOJ start basis
Source: Daiwa Securities.

Appendix 8: JGB 2Y/5Y/7Y Butterfly Spread (bp)



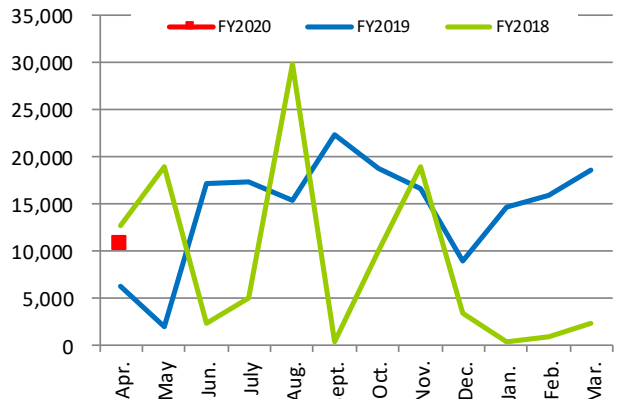
Note: On-the-run and CTD compound yield basis
Source: Daiwa Securities.

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



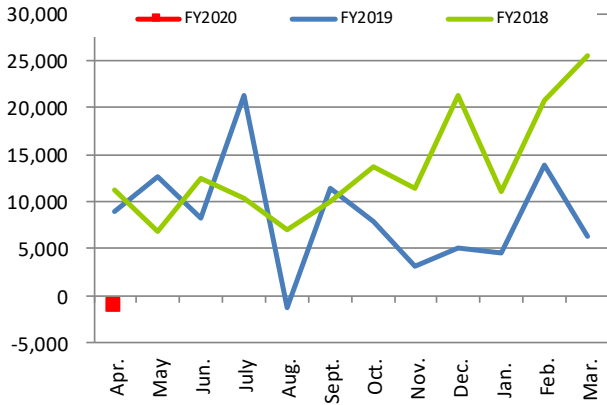
Source: JSDA

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



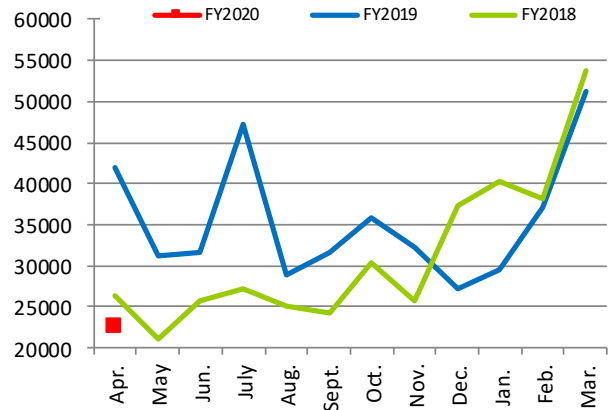
Source: JSDA

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



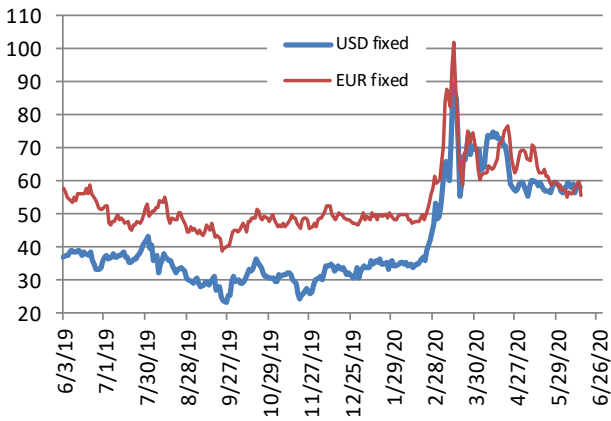
Source: JSDA

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



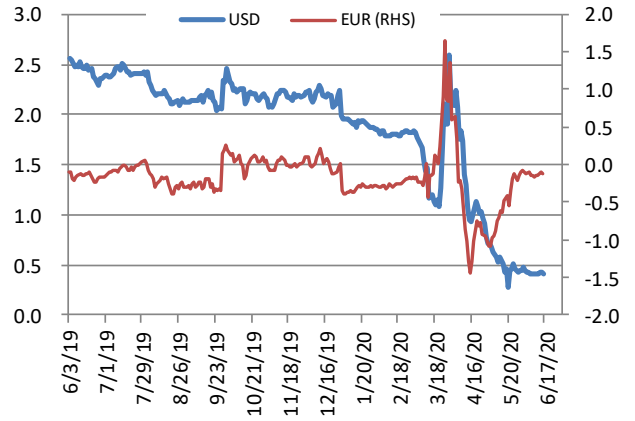
Source: JSDA

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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[Standard & Poor's]

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February 2020

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* 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.

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