Daiwa Securities

Outlook for 10Y JGB Auction

Placing solid bids above 0%

- ✓ Significant increase in MOF borrowing expected from July, but the downside of 10Y JGBs should be well supported at the 0% level by the BOJ, which is expected to purchase more JGBs amid enhanced monetary easing via "further active purchases of JGBs" etc. under the YCC policy. Solid demand expected from investors in positive yield territory as well.
- ✓ Hedging by selling M0

[BOX] **June BOJ Purchase:** Slowly responding to MOF's significant borrowing expected from July, but no change in the 1- to 3-year zone so far. There is a strong possibility of the BOJ to increase purchases in the zone during this month

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Auction Details

Auction Date:	June 2, 2020
Issue Date:	June 3, 2020
Maturity Date:	March 20, 2030
Offering Amount:	About 2.1 trillion yen

* New 10Y JGBs will likely be the last reopening of JB358 carrying a 0.1% coupon.
** On June 1, JB358 traded at 0.000-0.005% (unch - +0.5bp v. previous day's close) and closed at 0.005% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

10Y JGBs having been tightly range-bound around 0%

The previous 10-year JGB auction went well at the 0.000-0.005% level (-0.5bp - unchanged vs. previous day's close) in May. Since then, the 10-year JGB yield (conventional yield of JB358) has been range-bound between -0.010% and 0.005% on an intraday basis, while the JGB market has moved in a narrow range with low volatility.

Despite significant increase in MOF borrowing expected from July, 10-year JGB yield is expected to remain stable at "around 0%" amid enhanced monetary easing under YCC policy

Let's check the environment surrounding the JGB market. After first lifting its state of emergency on 39 prefectures and later on three more prefectures in the Kinki region, the Japanese government did so for the five remaining prefectures, including Tokyo, on May 25. Following Europe and the US, Japan is also cautiously and quickly resuming those social and economic activities that had been shut down by the central and regional governments because of the COVID-19 pandemic. However, given that the second supplementary budget includes about Y10tn in discretionary reserves and that there are still over Y20tn in front-loaded JGBs, we think the likelihood of additional increases in calendar-based JGB market issuance from future supplementary budgets has declined substantially. Due to expansion of fiscal deficit to an unprecedented level, we are unable to ignore the possibility that caution about upward pressure on yields will easily increase in terms of fiscal soundness in the long term. Over the short/medium term, however, there is a quite strong possibility that the 10-year JGB yield will move under the control of the BOJ. The yield is thus expected to remain stable at "around 0%." In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Short-covering is expected to some extent:** Partly because the repo rate of JB358 is somewhat tight in comparison with neighboring issues, short-covering by primary dealers is expected to some extent;
- ✓ **Solid demand expected from investors in positive yield territory:** Demand from investors appears to be strong at 0.0% or higher. If bidding starts in positive yield territory, solid demand is expected from investors;
- ✓ **Not cheap in terms of relative value:** Our analysis based on data since the previous 10Y JGB auction shows that the 10Y sector is remarkably overvalued vs. the 15-year and 30-year sectors on the current yield curve. Meanwhile, it is neither noticeably overvalued nor undervalued against other sectors (Appendix 3). Since the April auction, the moving range of 10Y asset swaps has been quite narrow. We can say that 10Y cash is neither noticeably overvalued nor undervalued against swaps at the moment (Appendix 4);
- ✓ **BOJ expected to purchase more JGBs in June than in May:** It is highly likely that the BOJ will increase the offer amount in the over-5-year to 10-year zone by around Y30bn to Y400bn from the first operation in June vs. Y370bn in the last operation in May (refer to BOX section later in this report). In comparison with around Y2tn in the estimated total monthly purchase amount by the BOJ in June (= Y400bn x five times), the issuance amount in tomorrow's auction is around Y2.1tn. As the BOJ is strengthening monetary easing via measures such as "further active purchases of JGBs," there is also a possibility of an increase in the purchase amount during the month when the BOJ judges that it is necessary. Additionally, the downside of 10Y JGBs should be well supported because the central bank is adopting the YCC policy.

Placing solid bids above 0%

All in all, we would like to think of our bidding stance at tomorrow's auction, assuming that 10-year JGBs will be strongly supported at 0.00-0.005% especially in June. We would like to also keep in mind that positive carry and positive return are expected from 10-year JGBs on the current shape of the yield curve (Appendix 5). Recently, the range of leading JGB futures (June contract or M0) appears to be edging down amid a gradual increase in open interest. In the near term, the upside of the futures may be limited. It would be worth considering buying JB3588 tap and hedging by selling the JGB futures.

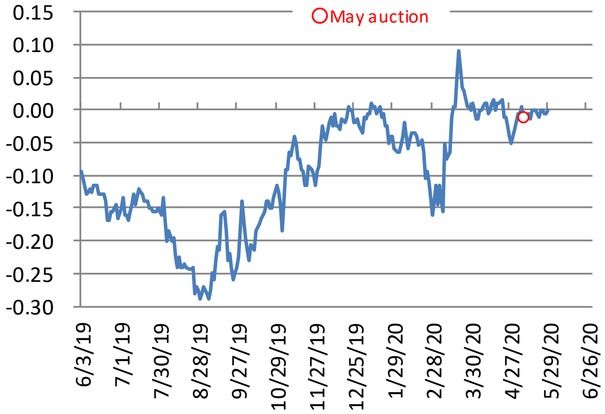
10Y JGB Auction Results

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 %	
6/2/20	**358R**	**0.1**	**3/20/30**	**2,100***									
5/12/20	358R	0.1	3/20/30	2,308	4.09	101.00	100.99	0.01	-0.001	0.000	0.001	72.6710	Good
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

* Amount the MOF plans to issue

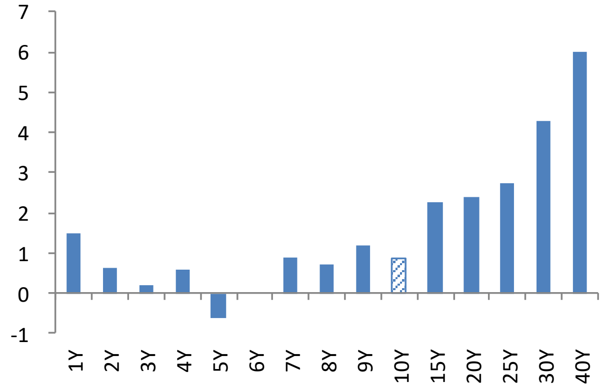
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



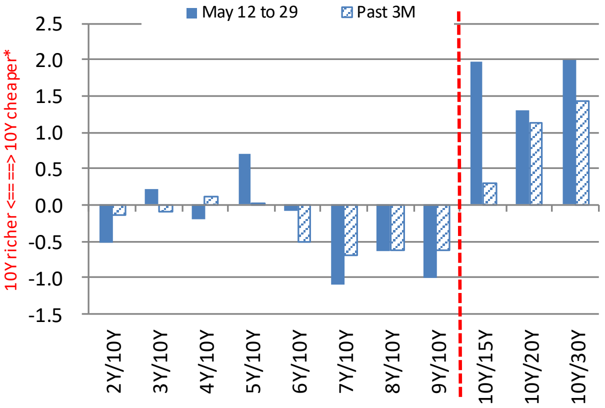
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, May 12 v. May 29)



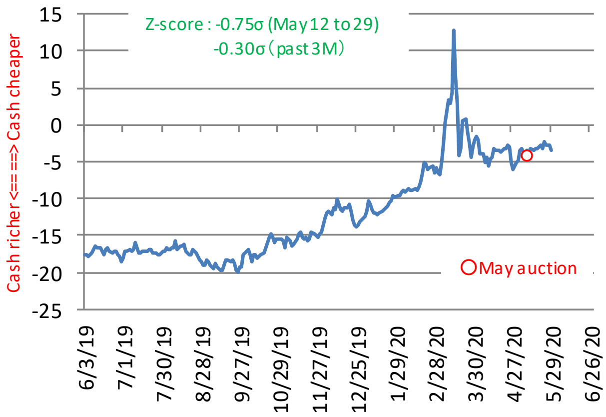
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads



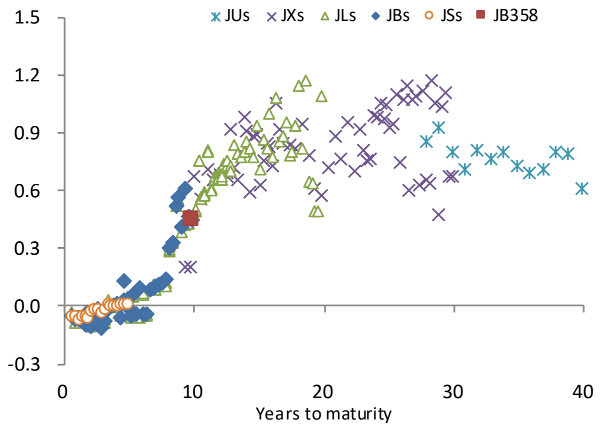
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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 29; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities

[BOX] BOJ's JGB purchases in June: Slowly responding to substantial increase in MOF borrowing expected from July

At 17:00 on May 29, the BOJ announced the Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for June 2020. The changes from the previous release for May are as follows:

- ✓ The downward revision to the upper limit of the offer range (Y500bn to Y450bn) and an increase in the number of offers (from five times to six) in the over-3-year to 5-year zone
- ✓ The upward revision to the lower limit of the offer range (Y200bn to Y250bn) in the over-5-year to 10-year zone

The number of monthly offers was increased from eight times in May to nine times. The latest changes appear to have been made to enhance the effects of the policy mix, prior to the substantial increase in JGB issuance expected from July, while the BOJ is strengthening monetary easing via measures such as “further active purchases of JGBs.” This time, the BOJ did not release the Outline of Outright Purchases of Japanese Government Securities, but it appears that the outline announced on April 27 will be effective until it is revised. Accordingly, the offer amount of Treasury Discount Bills is expected to be maintained at “about Y500bn to Y3.0tn” per operation.

In the BOJ’s JGB purchase operations in the over-1-year to 3-year zone, the over-25Y zone, and the JGBi category conducted today (June 1), the offer amounts were unchanged from the last operations in May at Y340bn, Y30bn, and Y30bn, respectively. The offer amounts in the first operations in June in other zones are expected as follows: Y80bn in the up to 1-year zone (unchanged from amount in last operation in May), Y350bn in the over-3-year to 5-year zone (unchanged), Y400bn in the over-5-year to 10-year zone (up Y30bn), Y120bn in the over-10-year to 25-year zone (unchanged), and Y100bn for floaters (unchanged from April). Based on the actual results as of today and these forecasts, we estimate that the total purchase amount in June (excl. floaters) will increase to around Y6.74tn from about Y6.25tn in May (start-day basis).

The BOJ will increase the offer amount in 1-3Y zone sometime during this month by carefully watching the market trends and the timing

We strongly feel it unsuitable that the BOJ keeps the offer amount unchanged in the over-1-year to 3-year zone from that in May through the June Monthly Schedule and the first operation of this month in that zone, which was offered today (June 1). The issuance amount of 2-year JGBs, which are to be auctioned on June 30 and to be issued on July 1, is slated to be increased by Y1tn from that in the previous month to Y3tn. If we assume no increase in the offer amount in the 1-3Y zone throughout June, the offer amount needs to be raised by around Y160bn from the first operation in July in order to maintain the balance between the MOF’s issuance and the BOJ’s purchases in June. The possibility remains high that the BOJ will start to increase the offer amount sometime during this month by carefully watching the market trends and the timing.

BOJ’s JGB Purchase etc.

(Yen billions)

	Offer size per operation	Mid	Number of Offers (per month)	Offer size exp. in June	*Offer size at the last operation in May*	Monthly Total exp. in June (a)	MOF issuance in June* (b)	MOF issuance in July* (c)	(b)-(a)	(c)-(a)
JGBs ex Linkers and Floaters										
1 year and less	50 - 100	75	3	80	*80*	240	-	-	-	
Over 1 to 3 years	200 - 500	350	6	340	*340*	2,040	2,000	3,000	-40	960
Over 3 to 5 years	200 - 450	325	6	350	*300*	2,100	1,900	2,500	-200	400
Over 5 to 10 years	250 - 550	400	5	400	*370*	2,000	2,100	2,600	100	600
Over 10 to 25 years	50 - 200	125	2	120	*120*	240	900	1,200	660	960
Over 25 years	0 - 50	25	2	30	*30*	60	700	1,300	640	1,240
Linkers	30	-	2	30	*30*	60	-	-	-	-
Floaters (in even month	100	-	1	-	-	100	-	-	-	-
					TOTAL**:	6,740	7,600	10,600	860	3,860

*(Note) "Offer size per operation" and "Number of offers (per month)" are as released by the BOJ on May 29. On "Offer size exp. in June," actual for 1-3Y and over 25Y and Daiwa forecast for other target zones. Change exp. v. May is in red. * Excluding auction II and AEL. 1-3Y is based on the MOF issue day. ** Excluding JGB floaters*

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

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■ Credit Rating Agencies

[Standard & Poor's]

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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 Y10bn. 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 is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
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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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