

Outlook for 30Y JGB Auction

Good for short-covering, but not for going long

- ✓ Solid short-covering is expected to support tomorrow's primary sales of new 30Y JGBs, but upside may be limited in the secondary market. Considering that the comfortable level to go long can be around 0.74%, which is the average cost for the latest 5 BOJ purchase operations, we don't expect aggressive primary bidding beyond short-covering around 0.72%.
- ✓ In relative-value wise, we think of switching out from the 10Y sector or buying 30Y JGB asset swaps.

Strategic Memorandum DSTE229
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Auction Details

Auction Date:	April 12, 2018
Issue Date:	April 16, 2018
Maturity Date:	March 20, 2048
Offering Amount:	About 700 billion yen

* New 30Y JGBs will be the first reopening of JX58 carrying a 0.8% coupon.

** On April 11, JX58 traded at 0.720-0.725% (-1.0 - -0.5bp v. previous day's close) and closed at 0.720% (-1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Good for short-covering, but not for going long

Since the previous 30Y JGB auction on March 6 went in a trouble-free manner at around 0.75%, the 30Y JGB yield has been edging down amid favorable market sentiment for superlong JGBs. After the start of the new fiscal year, it temporarily declined to 0.710% on an intraday basis. Once the result of the auction for enhanced liquidity (for JGBs with over 15.5 to less than 39 years left on April 5) turned out to be somewhat weak, the yield rose to 0.740% at one point. Subsequently, however, brisk dip-buying activities led it down to 0.720% ahead of tomorrow's auction. We think the key factors that will affect bidding at this auction will be:

- ✓ Decent short-covering is expected from primary dealers;
- ✓ With the beginning of the new fiscal year, demand for superlong JGBs appears to spark partly because of a trend of returning to yen-denominated bonds from foreign bonds;
- ✓ The 30Y sector is currently not expensive on the long to superlong zone of the JGB yield curve (Appendix 3);
- ✓ While the issuance amount is reduced (800 billion yen to 700 billion yen per auction), the BOJ's offer amount per operation in the zone over 25Y would be unchanged amid lingering cautions to the downtrend of the USD/JPY (see BOX);
- ✓ There are strong expectations that the supply/demand balance around the long end of the curve will remain favorable because, after the 20Y JGB auction scheduled for April

19, issuance of new superlong JGBs is not scheduled until the next 30Y JGB auction on May 15, which will follow the Golden Week holidays in Japan.

Given these factors, we think that strong caution will be unnecessary for tomorrow's auction. Meanwhile, new 30Y JGBs will be sold at the lowest bidding yield since the December 2016 auction. Moreover, upside may be limited as we find few factors except the tight supply/demand balance to support 30Y JGBs to the level below 0.7% at the moment. All in all, we would like to place solid bids only for short-covering, if JX58 trades at and below 0.72% in the pre-auction market. In terms of relative value, we think of switching out from the 10Y sector, which is at around the lower end of the BOJ range (0.0-0.1%) or buying 30Y JGB asset swaps, whose spread is currently close to the reversal point (Appendix 4).

[BOX] BOJ's JGB purchases

We see slim possibility that the BOJ will cut the offer amount in the zone over 10Y (especially over 25Y) by the end of April. Since late November 2017, the BOJ has occasionally reduced the offer amount in the zone over 25Y through three operations (100 billion yen → 90 billion yen → 80 billion yen → 70 billion yen). Nevertheless, the 30Y and 40Y JGB yields have trended down, and the yield curve in the superlong zone has kept flattening. In the current environment where the USD/JPY easily swings down, the BOJ would hesitate to cut the offer amount if the auction has only limited impact on the shape of the yield curve especially ahead of the Japan-US summit meeting scheduled for April 17-18, which could raise the tension amid growing caution about trade frictions.

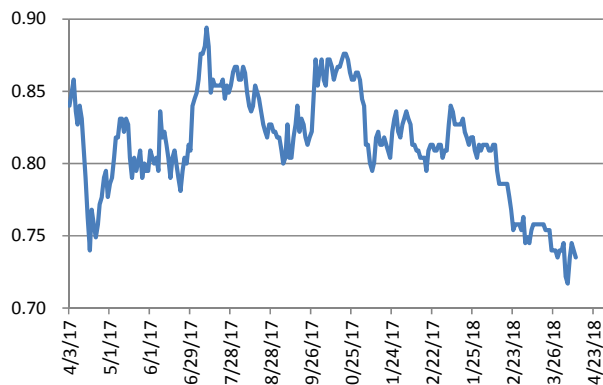
30Y JGB Auction Results

Auction Date	Issue #	Coupon (%)	Maturity	Amt Issued (billion yen)	B/C	Average Accepted Price (Yen)	Lowest Accepted Price (Yen)	Tail (Yen)	Average Accepted Yield (%)	Highest Accepted Yield (%)	Tail (%)	Allotment (%)	
4/12/18	58R	0.8	3/20/48	800*									
3/6/18	58	0.8	3/20/48	887.3	4.24	101.21	101.15	0.06	0.750	0.753	0.003	68.4310	Avg
2/8/18	57R	0.8	12/20/47	911.9	4.27	99.50	99.45	0.05	0.820	0.822	0.002	92.6464	Avg
1/18/18	57R	0.8	12/20/47	799.1	3.77	99.23	99.10	0.13	0.832	0.837	0.005	25.8603	Poor
12/7/17	57	0.8	12/20/47	917.5	4.38	98.84	98.80	0.04	0.848	0.850	0.002	75.8059	Good
11/9/17	56R	0.8	9/20/47	862.5	3.43	100.26	100.00	0.26	0.789	0.800	0.011	7.3651	Poor
10/11/17	56R	0.8	9/20/47	868.0	3.98	98.07	98.00	0.07	0.881	0.884	0.003	55.0218	Good
9/7/17	56	0.8	9/20/47	803.1	3.67	99.21	99.00	0.21	0.832	0.841	0.009	66.9438	Poor
8/8/17	55R	0.8	6/20/47	829.8	3.90	98.20	98.10	0.10	0.876	0.880	0.004	12.8466	Avg
7/6/17	55R	0.8	6/20/47	831.4	3.62	98.14	98.05	0.09	0.878	0.882	0.004	57.2512	Avg
6/6/17	55	0.8	6/20/47	804.7	3.63	99.58	99.45	0.13	0.817	0.822	0.005	12.0441	Avg
5/11/17	54R	0.8	3/20/47	799.0	3.35	99.54	99.45	0.09	0.819	0.822	0.003	79.0333	Good
4/13/17	54R	0.8	3/20/47	914.9	3.08	100.12	100.05	0.07	0.795	0.797	0.002	98.5832	Good
3/7/17	54	0.8	3/20/47	848.9	3.14	99.49	99.30	0.19	0.821	0.829	0.008	97.5395	Poor

* Amount the Ministry of Finance plans to issue

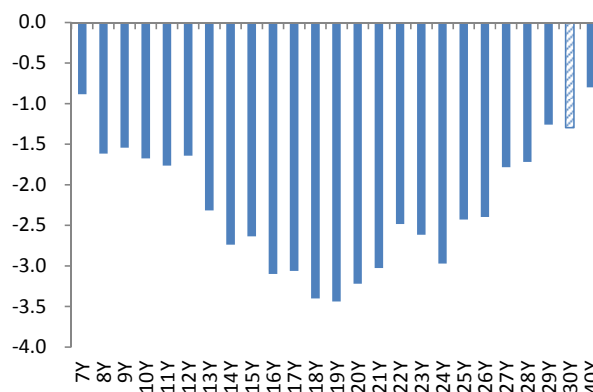
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



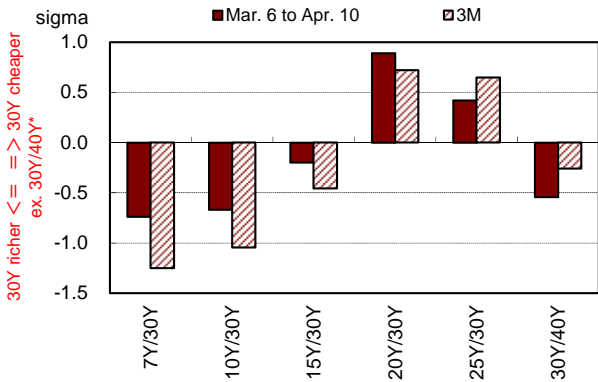
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Mar. 6 v. Apr. 10)



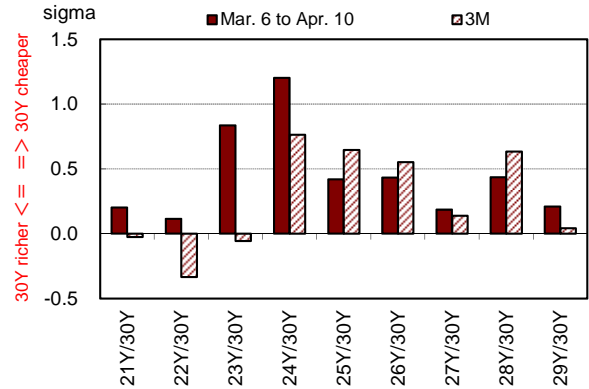
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



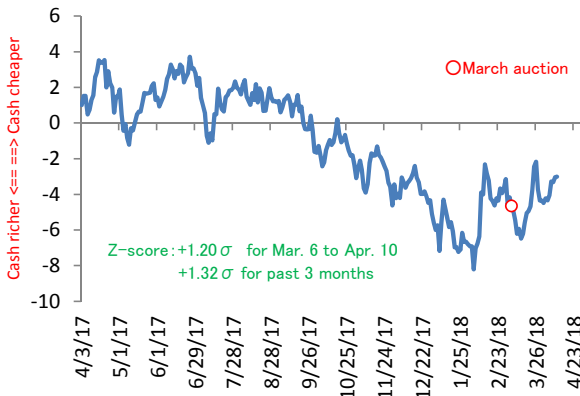
Source: Daiwa Securities. Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y

Appendix 3b: Z-scores of JGB Yield Spreads



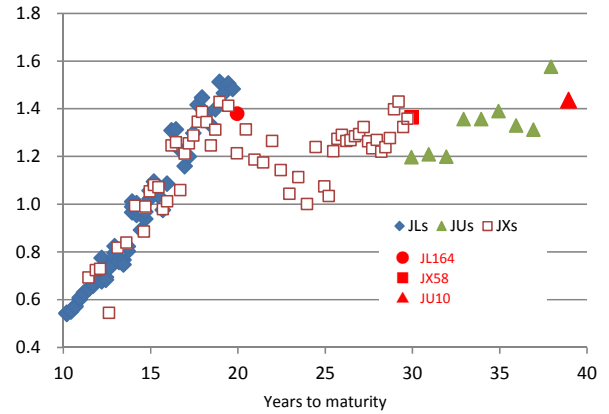
Source: Daiwa Securities.

Appendix 4: 30Y JGB Asset Swap Spread (bp)



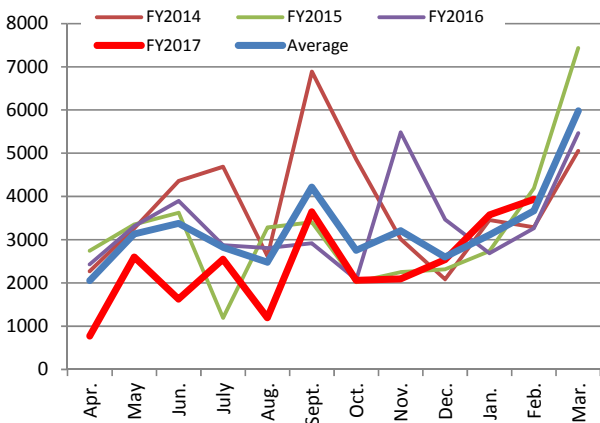
Note: 6M Yen LIBOR basis. Source: Daiwa Securities.

Appendix 5: JGB 6M Total Return Curve (%)



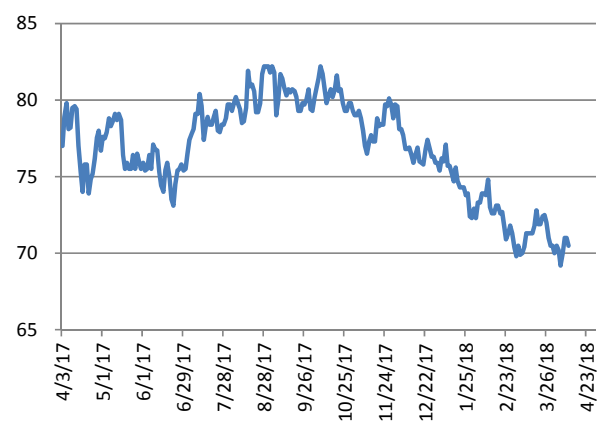
Note: Based on JGB yield curve on Apr. 10; assuming that the yield curve shape does not change and factoring roll-down effect etc. Source: Daiwa Securities.

Appendix 6: Life- and Non-life Insurers' Net Purchase of Superlongs by Fiscal Year (100M yen)



Source: JSDA

Appendix 7: JGB 10Y/30Y Spread (bp)



Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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