

## Outlook for 30Y JGB Auction

### Smooth auction expected at 0.915-0.920% level

- ✓ The 30Y JGB yield is at the 0.9% level, the highest under the BOJ's Yield Curve Control (YCC) policy. As recent yield uptrend may lose momentum in the near term, no hesitation will be needed to buy new 30Y JGBs maturing in September 2048. Low possibility of BOJ's reduction in JGB purchase amounts in the zone over 25Y will likely be supportive for primary sales of new 30Y JGB. We expect a smooth auction at 0.915-0.920% level.
- ✓ It will be worth considering switching out from the 20Y sector into the 30Y sector or buying 30Y JGB asset swaps.

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### Auction Details

**Auction Date:** October 11, 2018  
**Issue Date:** October 12, 2018  
**Maturity Date:** September 20, 2048  
**Offering Amount:** About 700 billion yen

\* New 30Y JGBs, JX60, will likely carry a 0.9% coupon.

\*\* On October 10, JX59 was traded at 0.935-0.940% (-1.0 - -0.5bp v. previous day's close) and closed at 0.940% (-0.5bp). WI was not traded and closed at 0.920% (-0.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### 30Y JGB yield back to the 0.9% level

Since the previous 30Y JGB auction went well at the 0.835-0.840% level on September 11, the 30Y JGB yield has been mostly in an uptrend to the 0.9% level. The US market has been softening on the back of higher stock prices and good economic data, pushing the 10Y Treasury yield to the 3.0% level. The uptrend in US Treasury yields has been helping the 30Y JGB yield up. In early October, the 30Y JGB yield temporarily rose to 0.950% on an intraday basis. Since then, the yield has been mostly moving at the 0.935-0.945% level.

### Bidding at the highest yield level under the YCC policy

The 30Y JGB yield is at the 0.9% level, the highest under the BOJ's Yield Curve Control (YCC) policy introduced in September 2016 (Appendix 1). At its monetary policy meeting in July, the Bank strengthened the framework for the YCC policy alongside a downward revision to its inflation outlook through FY2020. In the environment where the observed inflation rate is expected to stay at around 1%, the 10Y JGB yield has been edging up to 0.15-0.20% level, triggered by the uptrend of US Treasury yields under the tightening cycle, and the 30Y JGB yield has been also edging up. On the other hand, rate hike projections among FOMC participants as of September are unchanged from those as of June (four hikes in 2018 and three hikes in 2019). Partly because of this, the uptrend of US long-term interest rates (from the current levels) may lose momentum. In addition to concerns about cyclical slowdown in the global economy, caution about an economic setback due to US-China trade friction appears deep-rooted. Especially over the next one month, the recent yield uptrend may lose momentum partly due to the unwinding of existing positions

etc. amid strong uncertainty over the outlook of the US mid-term election to be held on November 6. No hesitation will be needed to buy new 30Y JGBs in new maturity basket at the highest yield level under the YCC policy.

**Offer amount in the zone over 25Y is unlikely to be reduced in the near term**

On September 28, the BOJ announced its JGB purchase schedule and guideline for October (Outright Purchases of Japanese Government Securities). Regarding the zone over 10Y, the Bank only lowered the offer range in the over 25Y zone from 50-150bn yen to 10-100bn yen. Under the current framework of JGB purchase operations, further downward revisions to the offer range are unlikely. In other words, there is no room to reduce the offer amounts in the zone of 25Y, and thereby the BOJ is unlikely to conduct a non-essential cut in the offer amounts. The possibility of reduction in the zone over 25Y appears slim especially in the near term.

**Demand from investors may be limited to only need-to-have amount**

Looking at the seasonality of superlong JGB trading trend by major investors, we find that both net and gross purchases in October, the first month in 2H, are the lowest in a fiscal year (Appendix 6). Although the yield level has been now substantially up, demand from investors may be limited to only need-to-have amount. In addition, as newly issued 30Y JGBs (JX60) are expected to carry higher coupon than JX59, duration will be shorter as well.

**Relative-value wise, cash 30Y sector is undervalued vs. 20Y sector and also swaps**

Measuring in the past three-month period, we find that the 30Y sector is noticeably undervalued at the current level especially vs. the 20Y sector (Appendix 3). Regarding asset swaps, the 30Y cash is currently undervalued against swaps (Appendix 4) partly because the 30Y JGB asset swap spread has recently been tightening. Relative values should not negatively impact primary sales of new 30Y JGBs.

**Smooth auction expected at 0.915-0.920% level**

Overall, we expect tomorrow's auction to go smoothly at the 0.915-0.920% level. Decent short-covering is expected for the 30Y sector. Relative-value wise, it will be worth considering switching out from the 20Y sector into the 30Y sector or buying 30Y JGB asset swaps. In addition to the fact that the 20Y/30Y spread is the widest level both in CY18 and FY18 (Appendix 7), new 20Y JGBs (to be redeemed in Sep 2038) are to be auctioned on Thursday, October 18. These factors may intensify the flattening trend especially over the short term. Asset swaps could attract purchases for undervaluation.

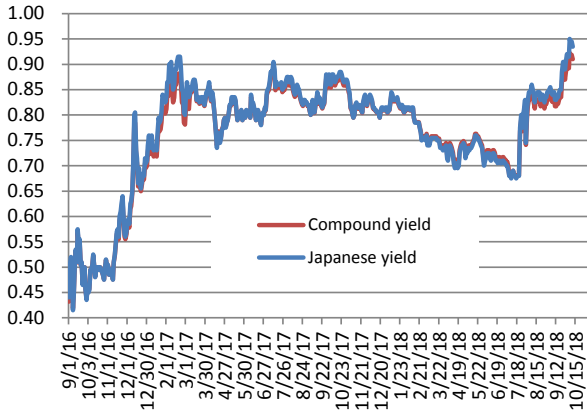
**30Y JGB Auction Results**

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 (%)	
10/11/18	60	0.9*	9/20/48	700**									
9/11/18	59R	0.7	6/20/48	797.0	4.23	96.71	96.70	0.01	0.838	0.838	0.000	81.5511	Good
8/9/18	59R	0.7	6/20/48	744.1	4.68	96.41	96.35	0.06	0.850	0.853	0.003	73.4502	Avg
7/5/18	59	0.7	6/20/48	780.6	5.01	99.90	99.85	0.05	0.704	0.706	0.002	31.2024	Good
6/19/18	58R	0.8	3/20/48	785.1	4.22	102.27	102.20	0.07	0.707	0.710	0.003	39.1509	Avg
5/15/18	58R	0.8	3/20/48	795.6	4.41	101.31	101.30	0.01	0.746	0.746	0.000	91.8088	Good
4/12/18	58R	0.8	3/20/48	802.5	4.34	102.11	102.05	0.06	0.714	0.716	0.002	19.1148	Good
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

\* Daiwa forecast \*\* Amount the Ministry of Finance plans to issue

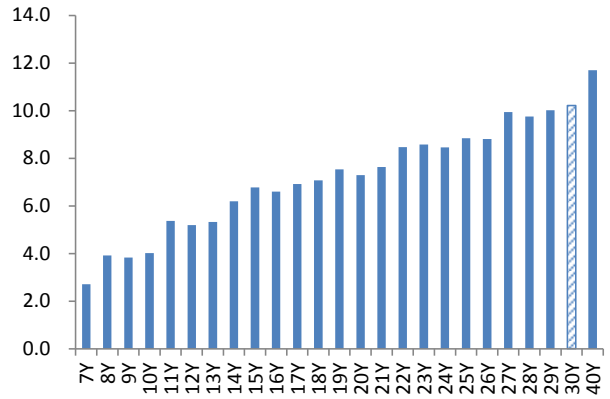
Source: Ministry of Finance (MOF), Daiwa Securities.

**Appendix 1: 30Y JGB Yield (%)**



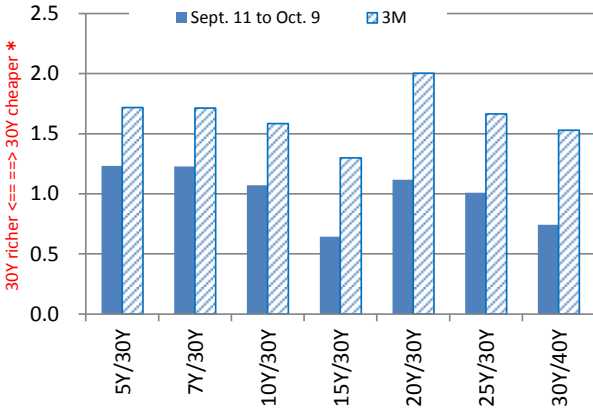
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp; Sept. 11 v. Oct. 9)**



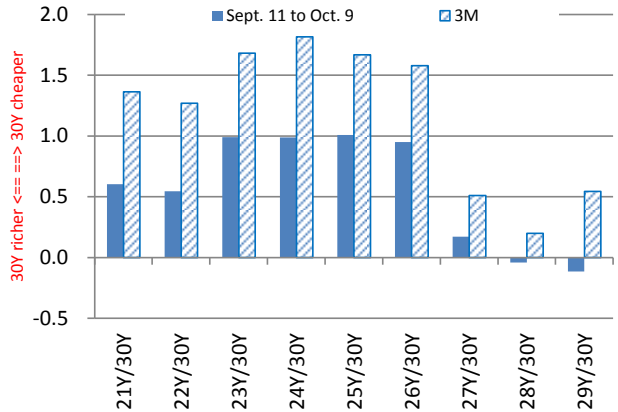
Source: Daiwa Securities.

**Appendix 3a: Z-scores of JGB Yield Spreads**



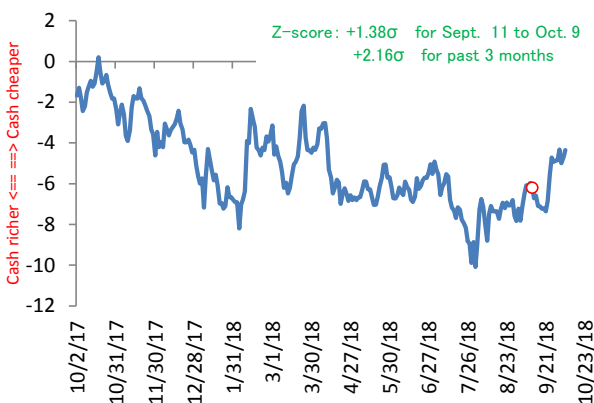
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y  
Source: Daiwa Securities.

**Appendix 3b: Z-scores of JGB Yield Spreads**



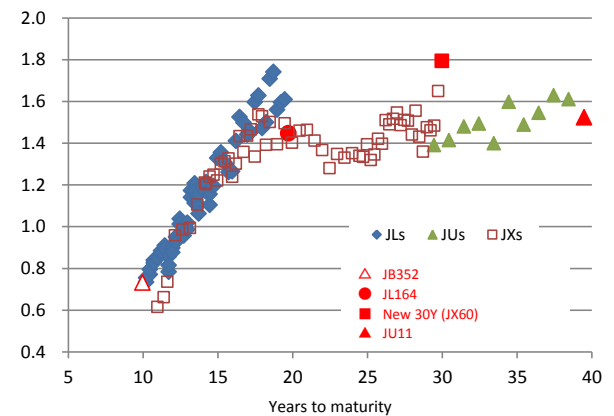
Source: Daiwa Securities.

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



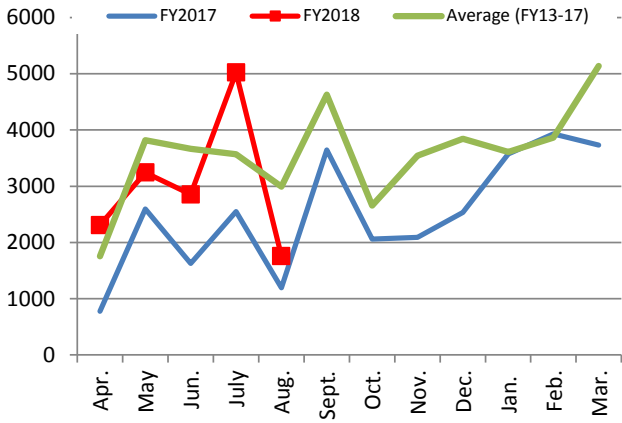
Note: 6M Yen LIBOR basis.  
Source: Daiwa Securities.

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



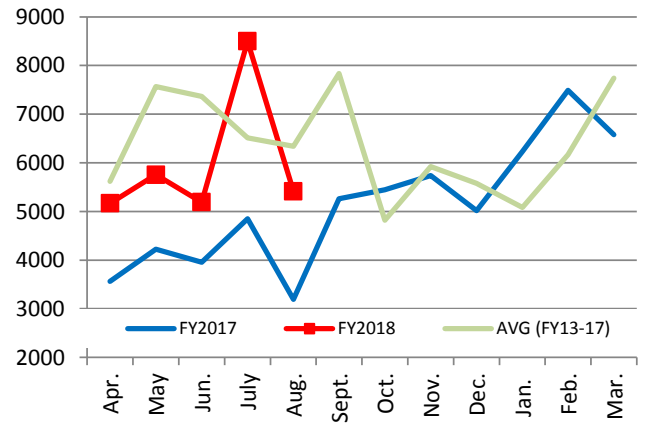
Note: Based on JGB yield curve on Sept. 7; assuming that the yield curve shape does not change and factoring roll-down effect etc.; New 30Y (JX60) is estimated on the assumption that the coupon is 0.9% and the spread to JX59 is 0.7bp.  
Source: Daiwa Securities

**Appendix 6a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)**



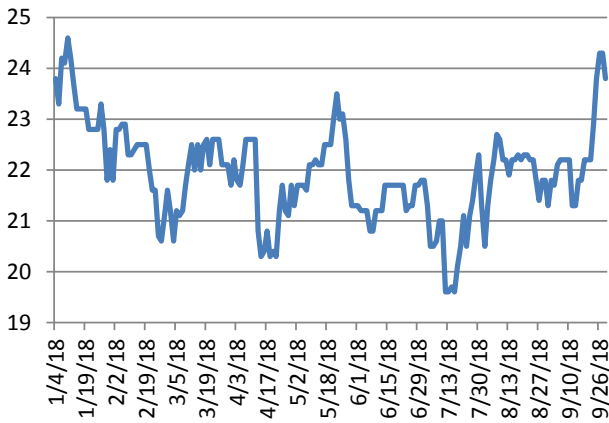
Source: JSDA

**Appendix 6b: Trend of Life and Non-life Insurers' Goss Purchase of Superlong JGBs (Yen 100M)**



Source: JSDA

**Appendix 7: JGB 20Y/30Y Spread (bp)**



Note: On-the-run issue basis  
Source: Daiwa Securities

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May 2018

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
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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.

\*\* 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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