Daiwa Securities

JGB Insight

Checkup on the environment surrounding superlong JGBs

- ✓ There can be a lull in bond yield rise
- ✓ The BOJ may not be in a rush to reduce its purchases in the zone over 10Y
- ✓ Investor demand may not go beyond their need-to-have
- ✓ With possibility of short-term flattening in mind, it will be interesting to see how the 20Y JGB auction goes.

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The 30-year JGB auction held by MOF on October 11 and the BOJ purchase operations the day after proceeded with no disruptions, and the market for superlong bonds remains firm. Within the recent context of global share price declines and bond price increases, the steady rise in yields that began in late August appears to have paused. With a 20-year JGB auction coming up on October 18, this report focuses on the environment surrounding superlong bonds.

There can be a lull in bond yield rise

During that period of rising interest rates from late August to early October, superlong JGB yields rose to level around their highest since the BOJ began its yield curve control (YCC) policy in September 2016 (Chart 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. Conditions over the past few days, marked by the global weakening of stocks and strengthening of bonds, have made it impossible to ignore the possibility of a lull in recent rise in bond yields.

The BOJ may not be in a rush to reduce its purchases in the zone over 10Y

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 over-25Y zone, and thereby the BOJ is unlikely to conduct a non-essential cut in the offer amounts. On the 10-25Y zone, although the BOJ currently manages purchase operations in a" flexible" way, market participants will likely keep cautious about the BOJ's trimming of buying JGBs in the zone to 150 billion yen, the bottom of the current range, eventually. That being said, while superlong JGB yields are around their highest level since the YCC policy began, the yield curve's current shape suggests that it has largely corrected from the excessive flattening that it underwent at one point. Unless the central bank needs to respond to tighter supply-demand etc., we think it is unlikely to be in a hurry to cut its purchases in the over-10-year sectors.

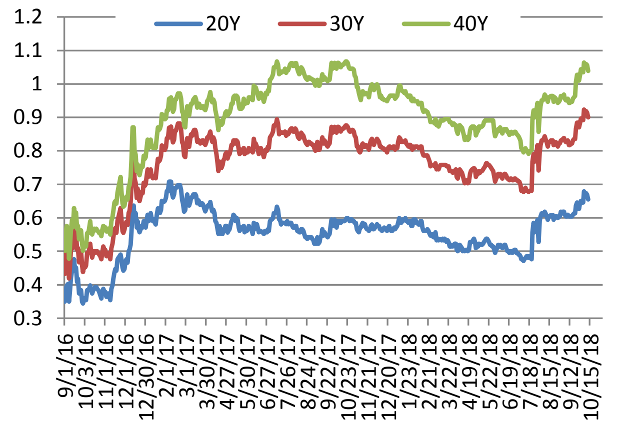
Investor demand may not go beyond their need-to-have

Data on the seasonality of superlong JGB trading activity by major investors shows that the month of October, the first one of the second fiscal half, tends to have the lowest level in both net and gross purchases (Chart 3). Although this time there has been a substantial increase in interest rate levels, there is still a possibility that demand from investors will be limited to only their need-to-have amount. Particularly when the increase in yields loses momentum, there is a possibility that this weakens investor interest in 30-year and 40-year JGBs.

With possibility of short-term flattening in mind

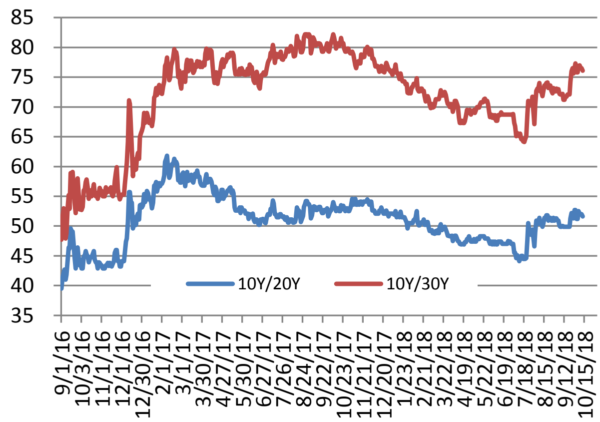
Overall, the environment for superlong JGBs does not appear to be that bad. Compared with 30-year and 40-year JGBs, 20-year JGBs have a particularly broad investor base and still offer much more attractive carry. With the above and possibility of short-term flattening around the long end of the curve in mind, it will be interesting to see how the 20Y JGB auction goes.

Chart 1: JGB 20Y. 30Y and 40Y Yields (%)



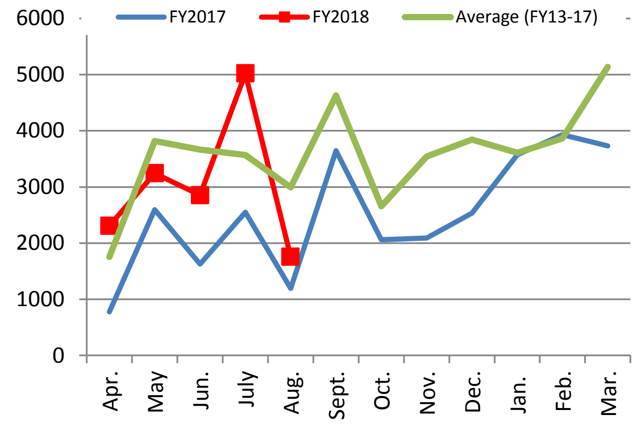
Note: On-the-run issue basis
Source: Daiwa Securities

Chart 2: JGB 10Y/20Y and 10Y/30Y Spreads (bp)



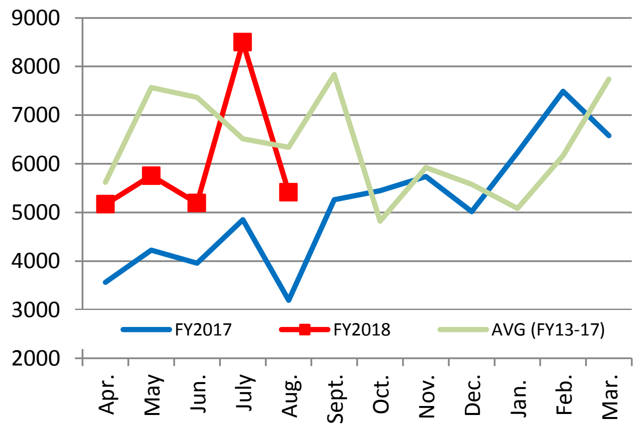
Note: On-the-run issue basis
Source: Daiwa Securities

Chart 3a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



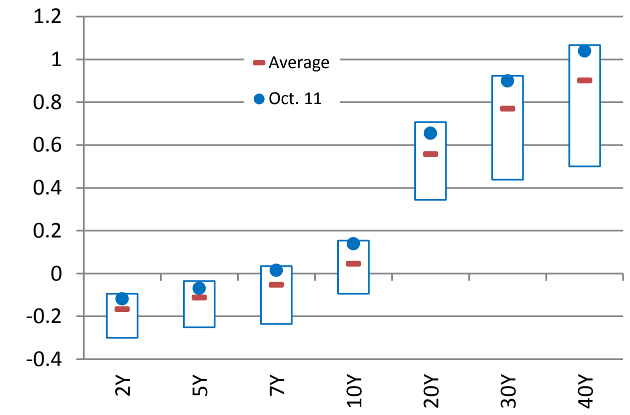
Source: JSDA

Chart 3b: Trend of Life and Non-life Insurers' Goss Purchase of Superlong JGBs (Yen 100M)



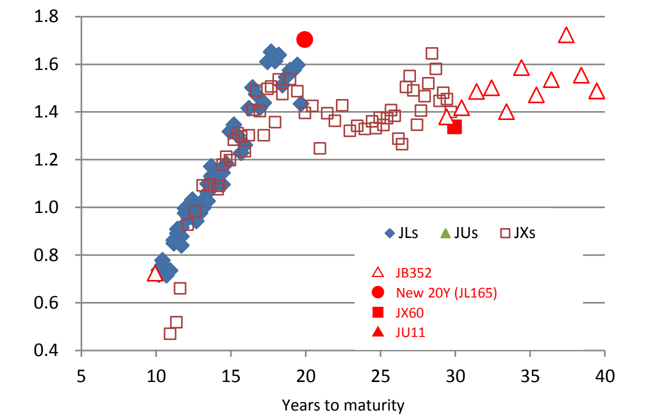
Source: JSDA

Appendix 1: JGB Yield Range under YCC (%)



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

Appendix 2: JGB 6M Total Return Curve (%)



Note: Based on JGB yield curve on Oct. 12; assuming that the yield curve shape does not change and factoring roll-down effect etc.; New 20Y (JL165) is estimated under the assumption that the coupon is 0.7% and the spread to JL165 compound yield is 1.5bp.
Source: Daiwa Securities

[BOX] October BOJ JGB Purchase Schedule (as of Oct. 12)

(Yen billions)

BOJ offer day / JGB auction day		(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	JGB Floater
10/1/18	M	10/2/18								
10/2/18	T	10/3/18	10Y JGB Auction							
10/3/18	W	10/4/18		300.8	350.6	450.7				
10/4/18	TH	10/5/18	AEL (for 20Y, 30Y and 40Y JGBs with over 15.5 to less than 39 years to maturity)							
10/5/18	F	10/9/18					180.8	50.4	25.1	
10/8/18	M	-	Public Holiday (Health-sports Day)							
10/9/18	T	10/10/18								
10/10/18	W	10/11/18	50.0			451.0				
10/11/18	TH	10/12/18	30Y JGB Auction							
10/12/18	F	10/15/18		301.2	351.4		181.4	50.2		
10/15/18	M	10/16/18								
10/16/18	T	10/17/18	5Y JGB Auction							
10/17/18	W	10/18/18		◎	◎	◎				
10/18/18	TH	10/19/18	20Y JGB Auction							
10/19/18	F	10/22/18	○				◎	◎		○
10/22/18	TH	10/23/18								
10/23/18	F	10/24/18	AEL (for 10Y and 20Y JGBs with over 5 to 15.5 years or less to maturity)							
10/24/18	M	10/25/18				◎	◎	◎	○	
10/25/18	T	11/1/18	2Y JGB Auction							
10/26/18	F	10/29/18		◎	◎	◎				
10/29/18	M	10/30/18								
10/30/18	T	-		◎	◎		◎	◎		
10/31/18	W	-	BOJ MPM (Day 2)							

Note: ◎ Scheduled by BOJ, ○ Daiwa forecast
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

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3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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IMPORTANT

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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.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- 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.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* 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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	The Financial Futures Association of Japan
	Japan Investment Advisers Association
	Type II Financial Instruments Firms Association