

## Outlook for 30Y JGB Auction

### Placing bids around JX60 + 0.7bp level

- ✓ Although tomorrow's 30Y JGB auction will be held at the lowest yield level in FY18, expectations on demand from investors paying attention to end-FY portfolio appear strong in the current market environment where bond yields are unlikely to face strong upward pressure.
- ✓ We would like to place our bids to take the amount we need to cover around JX60 yield + 0.7bp level (on compound yield basis).
- ✓ In terms of the relative value, we think of purchasing vs. around the 7Y sector or swaps.

Strategic Memorandum DSTE284  
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### Auction Details

**Auction Date:** January 10, 2019  
**Issue Date:** January 11, 2019  
**Maturity Date:** December 20, 2048  
**Offering Amount:** About 700 billion yen

\* New 30Y JGBs, JX61, will likely carry a 0.7% coupon.

\*\* On January 9, JX60 traded at 0.690 - 0.705% (+0.5 - +2.0bp v. previous day's close) and closed at 0.700% (+1.5bp). WI closed at 0.725% (+1.5bp).

### Exp. Rating on Auction Results

|        |      |         |      |             |
|--------|------|---------|------|-------------|
| 1      | 2    | 3       | 4    | 5           |
| Failed | Poor | Average | Good | Outstanding |

**Tomorrow's auction will be held at the lowest yield level in FY18, but...**

Since the previous 30Y JGB auction went well at around 0.795% on December 11, the bond markets have firmed up around the globe amid growing worries about the outlook of the global economy due to the continued downtrend of global equity and crude oil prices as well as deterioration in Chinese and European economic indicators. In such an environment, investors showed up for buying superlong JGBs, pushing down the 30Y JGB yield (on-the-run issue on conventional yield basis) to 0.650% in early January on an intraday basis for the first time since July 2018. Although the yield rose to 0.695% this week on an intraday basis amid a pause in risk-off activities which have continued since last autumn, tomorrow's 30Y JGB auction will be held at the lowest yield level in FY18.

**Under the current environment, yields are unlikely to face strong upward pressure**

Let's check the environment surrounding 30Y JGBs. We have been seeing higher stock prices/lower bond prices in the U.S. and Japan since the last weekend because (1) the result of US jobs report was strong, (2) Fed chairman Jerome Powell's remarks were taken by market participants as a sign of a pause in the interest-rate hiking cycle to bolster the economy, and (3) excessive caution about US-China trade friction is diminishing due to progress of this week's trade talks. As far as the near-term outlook is concerned, excessive risk-off activities since last autumn may let up, as witnessed by the fact that crude oil prices appear to be testing a rebound. However, as US-China trade friction is unlikely to improve drastically, concerns about the global economy will persist, we think. Although the downtrend of crude oil prices appears to have taken a breather, prices are still hovering at a

low level. Inflation expectations are thus unlikely to rise sharply. Above all, the Fed has clarified its stance of suspending rate hikes, depending on economic conditions. Partly because of this, we can say that bond yields are unlikely to face strong upward pressure around the globe.

**Expectations for demand from investors appear strong while investors paying attention to end-FY portfolio**

In such an environment, we expect strong support for superlong JGBs in terms of supply/demand, as witnessed by the clear tendency that major investors increase purchases of superlong JGBs in the Jan-Mar quarter (Appendix 6). Although the absolute yield level is low, we are not worried so much about investor demand for new 30Y JGBs, which will belong to new maturity basket (to be redeemed in Dec 2048) and will be highly likely sold under par at the auction.

**Placing bids to take the amount we need to cover buy the necessary amount JX60 yield + 0.7bp level**

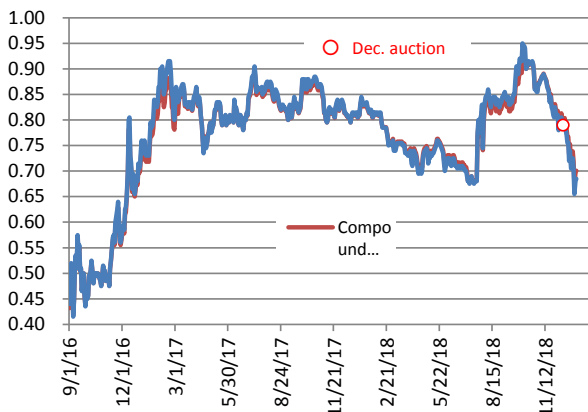
Overall, we would like to place our bids to take the amount we need to cover tomorrow around JX60 yield + 0.7bp level (on compound yield basis). In terms of the relative value, we think of purchases vs. around the 7Y sector or swaps. The 30Y sector is not cheap on the curve at the current level (Appendix 3). However, if the JGB market loses upward momentum amid a pause in risk-off mode, the long-superlong zone of the yield curve would easily face flattening bias. Since the previous auction, the 30Y JGB asset swap spread vs. the Yen LIBOR has been mostly in positive territory (Appendix 4). Given the trend under the BOJ's yield curve control (YCC) policy, we think that the spread is unlikely to tighten substantially in the territory (i.e., cash is unlikely to cheapen; Appendix 4). It thus would be worth considering purchases of asset swaps in the range where the spread is positive vs. the Yen LIBOR.

**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 (%) |      |
|--------------|---------|------------|----------|--------------------------|------|------------------------------|-----------------------------|------------|----------------------------|----------------------------|----------|---------------|------|
| 1/10/19      | 61      | 0.7*       | 12/20/48 | 700**                    |      |                              |                             |            |                            |                            |          |               |      |
| 12/11/18     | 60R     | 0.9        | 9/20/48  | 769.2                    | 3.78 | 102.55                       | 102.50                      | 0.05       | 0.794                      | 0.796                      | 0.002    | 82.4455       | Good |
| 11/12/18     | 60R     | 0.9        | 9/20/48  | 758.3                    | 3.99 | 100.60                       | 100.55                      | 0.05       | 0.874                      | 0.876                      | 0.002    | 64.4188       | Good |
| 10/11/18     | 60      | 0.9        | 9/20/48  | 706.4                    | 3.92 | 100.04                       | 100.00                      | 0.04       | 0.898                      | 0.900                      | 0.002    | 69.4027       | Good |
| 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 |

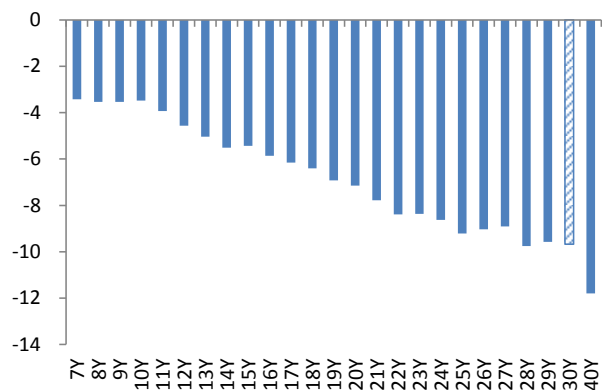
\* Daiwa forecast as of Jan. 10 \*\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

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



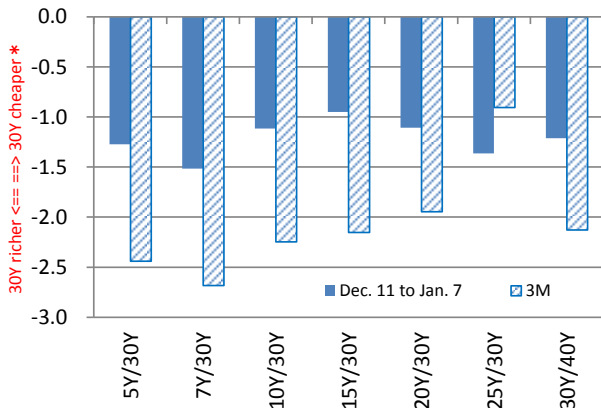
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (Dec. 11 v. Jan. 9, bp)**



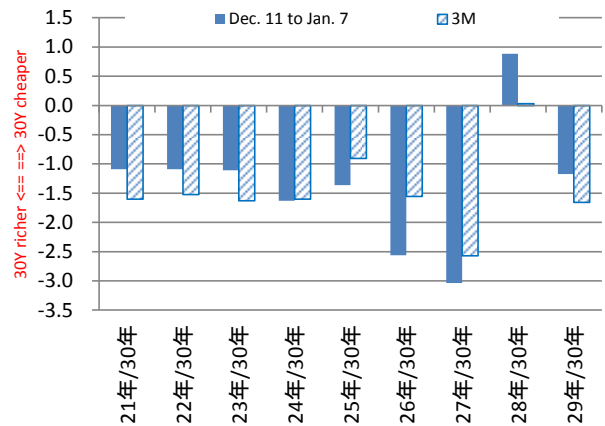
Source: Daiwa Securities.

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



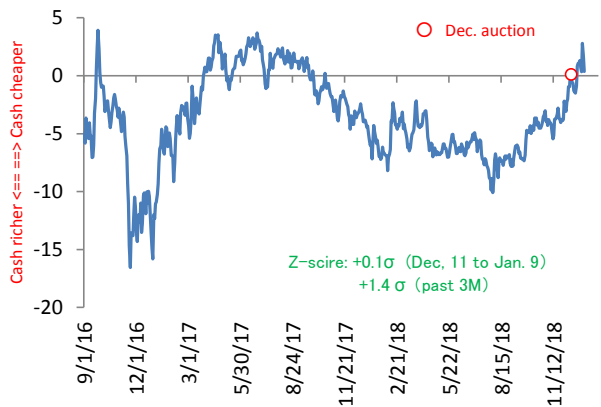
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y  
Source: Daiwa Securities.

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



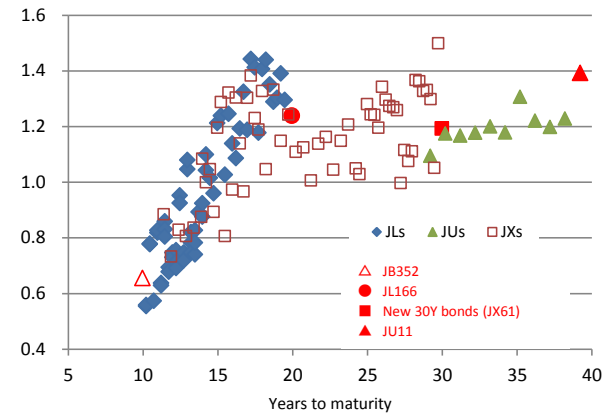
Source: Daiwa Securities.

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



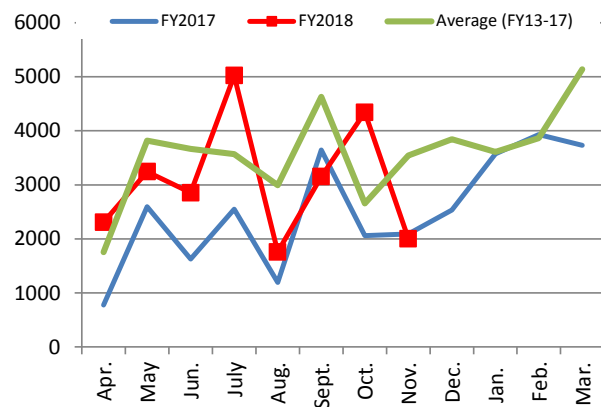
Note: 6M Yen LIBOR basis.  
Source: Daiwa Securities.

### Appendix 5: JGB 3M Total Return Curve (%)



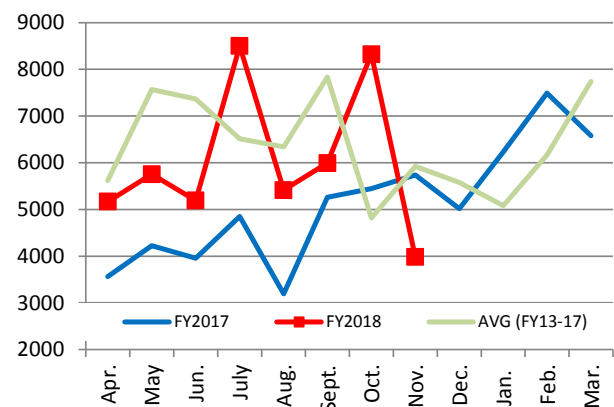
Note: Based on JGB yield curve on Jan. 8; assuming that the yield curve shape does not change and factoring roll-down effect etc.; New 30Y bonds (JX61) is assumed to have a 0.7% coupon and 2.0bp spread to JX60 yield (Japanese yield).  
Source: Daiwa Securities

### 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

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May 2018

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- 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.
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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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|                 |  |
|-----------------|--|
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