

Outlook for 20Y JGB Auction

Good auction expected

- ✓ Tomorrows' auction for JL167 is expected to go well at JL166 yield + around 1.0bp level on compound yield basis. At the level, JL167 will likely be born rich vs. the regression line for 20Y JGBs with over 10 years to left to maturity. However, we need to place our bids, factoring in the current good market sentiment for superlong JGBs.

Strategic Memorandum DSTE286
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Auction Details

Auction Date:	January 24, 2019
Issue Date:	January 25, 2019
Maturity Date:	December 20, 2038
Offering Amount:	About 1.0 trillion yen

* New 20Y JGBs, JL167, will likely carry a 0.5% coupon.

** On January 23, JL166 traded at 0.450-0.455% (-0.5bp - unch v. previous day's close) and closed at 0.450% (-0.5bp). WI closed at 0.470% (-0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Sale of new 20Y JGBs expected to go well at JL166 yield + around 1.0bp level

The previous 20Y JGB auction had a good result at the 0.545-0.550% level on December 18, though the bid-to-cover ratio was relatively low. After the auction, the bond markets firmed up around the globe amid intensifying risk-off activities. In such a situation, the 20Y JGB yield (on-the-run issue's conventional yield basis) was on a downward trend, and temporarily declined to 0.430%, the lowest level since November 2016, on an intraday basis at the beginning of the year. With the financial markets getting out of risk-off mode, the 20Y JGB yield went up to 0.5% at one point. While the JGB futures remains relatively firm and the market sentiment around the long end of the curve is kept good by dip-buyers, however, the 20Y JGB yield declines back to 0.450% this week.

Some reports, released this week, show a clear slowdown in the Chinese economy, reigniting concerns about the global economy. Partly due to the yen appreciation, which strengthened in December, a rebound in Japanese stocks has been less progressive than that, for example, in US stocks. In such an environment, it is still difficult for market participants to see JGB yields to rise strongly. The January *Outlook for Economic Activity and Prices* report the BOJ released today shows the Bank's strong caution about downside risks both to the economy and prices. The report gives us an impression that monetary policy normalization has further receded. Although we need to closely watch next week's FOMC meeting and the subsequent moves in financial markets, the JGB market is likely to

remain at a high price range for a while. By the next 20Y JGB auction to be held on February 19, the 20Y JGB yield may spend more time at the level below 0.45% than it has been for the past one month. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ Uncertainty about primary dealers' short-covering etc. as repo rates in the 20Y sector appear not tight;
- ✓ Degrees of investor demand for new 20Y JGBs, which will belong to a new maturity basket, at the current level (around 0.45%) in a situation where investors are paying attention to their end-FY portfolio;
 - According to Trends in Bond Transactions by Investor Type announced on January 21, both net and gross purchases for superlong JGBs by life and non-life insurers in December 2018 were much lower than those in December 2017 and also the December average from 2013 to 2017 (Appendix 7). Expectations for demand from investors are thus strong while they head to the fiscal year end.
- ✓ After tomorrow's auction, the BOJ plans to conduct JGB purchase operations in the 10-25Y zone on January 28. In addition, the BOJ is expected to conduct four purchase operations by the next 20Y JGB auction scheduled for February 19 (one this month and we now expect three operations in February);
- ✓ In the near term, the BOJ is unlikely to cut the purchase amount in the zone over 10Y;
 - In its JGB purchase policy for February (Outline of Outright Purchases of Japanese Government Securities), we expect the BOJ to keep the number of offers and the offer range in the 10-25Y zone unchanged from the figures in January.
- ✓ Measured in the period from the previous 20Y JGB auction (Dec. 18), the 20Y sector is currently not cheap on the curve (Appendix 3). Similarly measured, 20Y cash is overvalued against swaps (Appendix 4). It is thus difficult to strongly expect new demand in terms of the relative value.

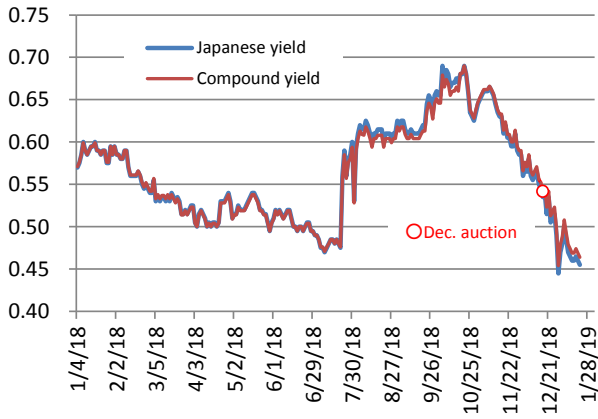
All in all, we expect tomorrow's auction for new 20Y JGBs, JL167, to go well at the JL166 yield + around 1.0bp level (compound yield basis). At the level, JL167 will likely be born rich vs. the regression line for 20Y JGBs with over 10 years to left to maturity. However, we need to place our bids, factoring in the current good market sentiment for superlong JGBs.

20Y JGB Auction Results

Auction Date	Issue #	Coupon (%)	Maturity Date	Issue Size (billion yen)	B/C	Average Accepted Price (Yen)	Lowest Accepted Price (Yen)	Tail (Yen)	Average Accepted Yield (%)	Highest Accepted Yield (%)	Tail (%)	Allotment (%)	Rating
1/24/19	167	0.5*	12/20/38	1,000**									
12/18/18	166R	0.7	9/20/38	1,121	3.44	102.80	102.75	0.05	0.543	0.545	0.002	65.7187	Good
11/20/18	166R	0.7	9/20/38	999	3.91	101.55	101.50	0.05	0.612	0.615	0.003	45.3947	Avg
10/18/18	166	0.7	9/20/38	1,075	4.23	100.29	100.25	0.04	0.683	0.685	0.002	41.8922	Avg
9/20/18	165R	0.5	6/20/38	999	4.03	97.91	97.85	0.06	0.618	0.622	0.004	13.0174	Good
8/21/18	165R	0.5	6/20/38	1,121	4.66	98.10	98.05	0.05	0.607	0.610	0.003	15.0048	Good
7/12/18	165	0.5	6/20/38	1,118	4.54	100.13	100.10	0.03	0.492	0.494	0.002	63.8373	Good
6/26/18	164R	0.5	3/20/38	999	4.23	99.93	99.85	0.08	0.503	0.508	0.005	5.5369	Poor
5/22/18	164R	0.5	3/20/38	999	4.12	99.42	99.40	0.02	0.532	0.533	0.001	87.1182	Avg
4/19/18	164R	0.5	3/20/38	999	3.69	100.00	99.90	0.10	0.500	0.505	0.005	3.4926	Poor
3/15/18	164	0.5	3/20/38	1,127	4.47	99.22	99.20	0.02	0.543	0.544	0.001	83.3690	Good
2/22/18	163R	0.6	12/20/37	1,146	4.44	100.68	100.65	0.03	0.561	0.563	0.002	56.8524	Avg
1/25/18	163R	0.6	12/20/37	1,069	4.17	100.14	100.10	0.04	0.592	0.594	0.002	55.9271	Avg
12/14/17	163	0.6	12/20/37	1,139	4.56	100.48	100.45	0.03	0.573	0.574	0.001	60.4234	Good

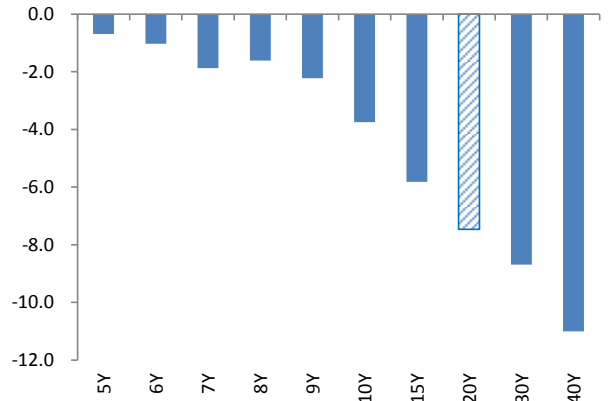
* Daiwa forecast as of Jan. 23 ** Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



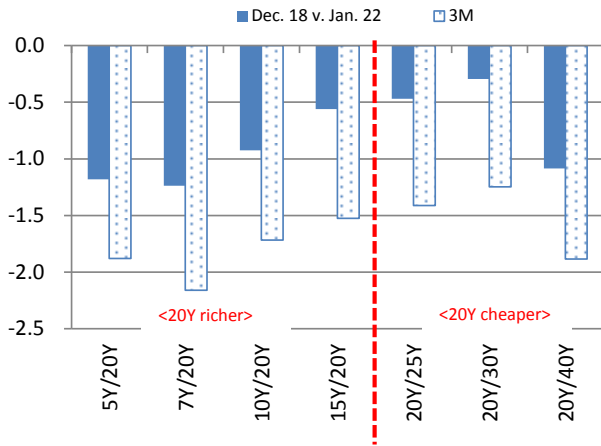
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Dec. 18 v. Jan. 22



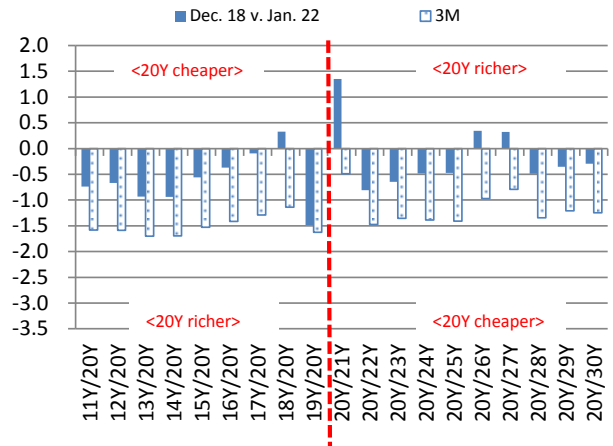
Source: Daiwa Securities.

Appendix 3a: Z-score I



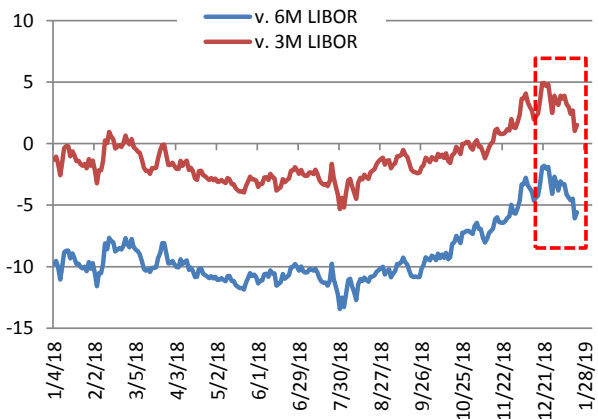
Source: Daiwa Securities.

Appendix 3b: Z-score II



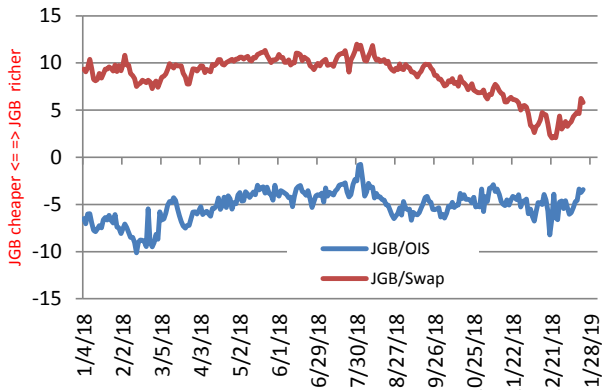
Source: Daiwa Securities.

Appendix 4a: 20Y JGB Asset Swap Spread (bp)



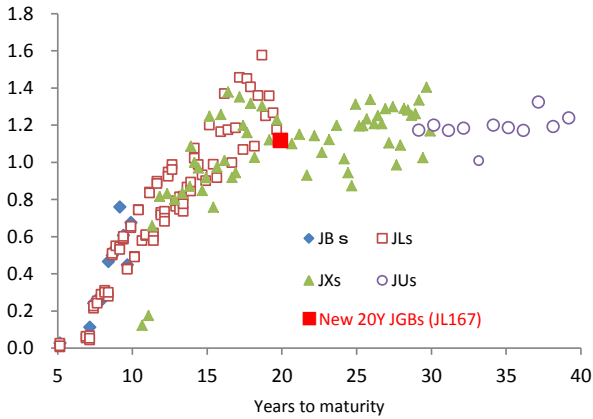
Note: since the Dec. auction
Source: Daiwa Securities.

Appendix 4b: 20Y JGB/Swap and JGB/OIS Spreads (bp)



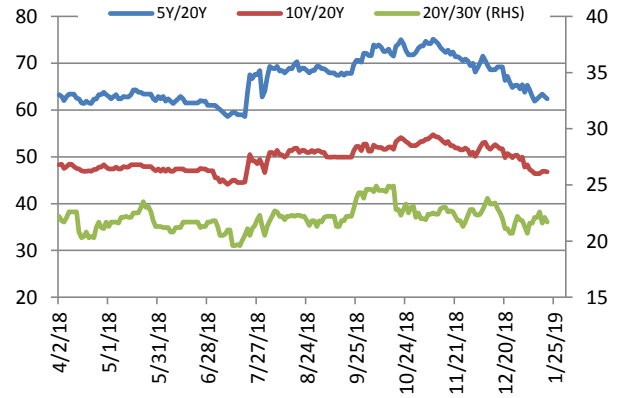
Source: Daiwa Securities.

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



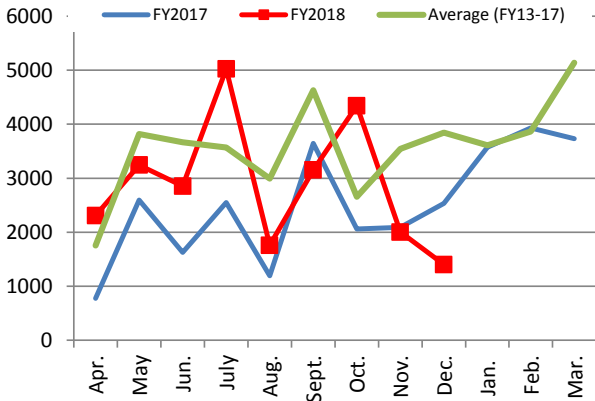
Note: Based on the Jan. 22 JGB yield curve; factoring in roll-down effect etc.; New 20Y JGBs (JL167) are assumed to have a 0.5% coupon and a 0.7bp spread to JL166 compound yield 1.5bp spread to JL166 Japanese yield).
Source: Daiwa Securities.

Appendix 6: JGB Yield Spreads (bp)



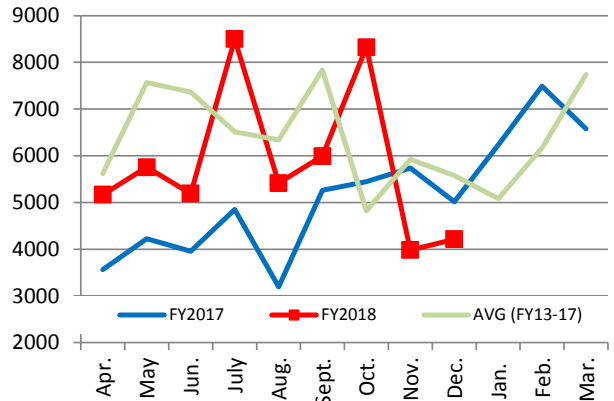
Note: CTD and on-the-run issues
Source: Daiwa Securities.

Appendix 7a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 7b: Trend of Life and Non-life Insurers' Goss Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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[Standard & Poor's]

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[Fitch]

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May 2018

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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.
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