

## Outlook for 40Y JGB Auction

### Good primary sale expected

- ✓ In a favorable market environment for superlong JGBs, we expect the auction for 40Y JGBs to go well tomorrow, despite the low absolute yield level and the richness of 40Y JGBs on the curve. Some factors, such as a yield-Dutch method, expected decent short-covering, and small issuance amount of about 400bn yen, will be supportive for primary sale as well.
- ✓ We would like to think about our bidding stance to be able to take the amount we need to cover.

Strategic Memorandum DSTE288  
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### Auction Details

<b>Auction Date:</b>	January 29, 2019
<b>Issue Date:</b>	January 30, 2019
<b>Maturity Date:</b>	December 20, 2058
<b>Offering Amount:</b>	About 400 billion yen
<b>Auction Method:</b>	Dutch auction on a compound yield with the increment of 0.5bp

\* New 40Y JGBs will be the fourth reopening of JU11 carrying a 0.8% coupon.

\*\* On January 28, JU11 traded at 0.745% (unch v. previous day's close; 0.750% on compound yield) and closed at 0.740% (-0.5bp; 0.746%).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### 40Y JGB yield around 0.75%, the lowest level since December 2016

After the previous 40Y JGB auction went well at the 0.960-0.970% level (or 0.939-0.948% on compound yield basis) on November 27, 2018, the bond markets firmed up partly on lower crude oil prices and global equity prices amid heightening concerns about the global economy. From the beginning of this year, the financial markets appear to be getting out of risk-off mode. In the JGB market, however, superlong JGBs have been firm backed by demand from investors approaching the end of the fiscal year. On January 25, the 40Y JGB yield temporarily declined to 0.740% (or 0.746% on compound yield basis), the lowest level since December 2016 on an intraday basis (Appendix 1).

### Demand from investors is strongly expected amid favorable sentiment for superlong JGBs

Let's look at the environment surrounding superlong JGBs. Last week, some media reported 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 weaker 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 last week showed the Bank's strong caution about downside risks both to the economy and prices.

The report gave us an impression that monetary policy normalization has further receded. Although we need to closely watch this week's press conference by Fed chairman Jerome Powell and the subsequent moves in financial markets, market sentiment for superlong JGBs is unlikely to worsen substantially as demand from investors is expected amid a strong attention to the end of the fiscal year.

**We think about bidding stance to be able to take the amount we need to cover, expecting good auction**

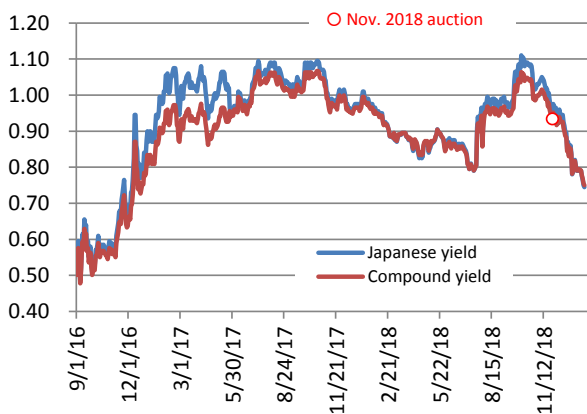
In such an environment, we expect the auction for 40Y JGBs to go well tomorrow, despite the low absolute yield level and the richness of 40Y JGBs on the curve (Appendix 5). There are some factors to support the primary sales as well, such as, (1) the auction will be conducted in a yield-Dutch method, (2) decent short-covering is expected, and (3) the issuance amount will be relatively small at about 400bn yen. We would like to think about our bidding stance to be able to take the amount we need to cover, assuming the high possibility that the 40Y JGB yield will decline to around 0.7% by the next auction scheduled for March 26.

**40Y JGB Auction Results**

Offer Date	Issue#	Nominal Coupon (%)	Maturity Date	Issue Size (100M yen)	B/C	Highest Accepted Yield (%)	Allotment (%)	Issue Price (yen)	Yield on the previous day (%)**	30Y/40Y on the previous day (bp)**	Yield at close on the auction day (%)**	30Y/40Y at close on the auction day (bp)**	
1/29/19	11R	0.8	3/20/58	400*					0.750	9.2			
11/27/18	11R	0.8	3/20/58	449.2	3.85	0.940	57.2420	95.41	0.943	12.5	0.934	12.1	Good
9/26/18	11R	0.8	3/20/58	399.2	3.24	1.025	66.5584	92.71	1.027	14.3	1.027	14.3	Good
7/24/18	11R	0.8	3/20/58	399.5	3.30	0.880	36.6400	97.33	0.896	12.8	0.921	13.1	Good
5/29/18	11	0.8	3/20/58	456.7	3.92	0.865	52.4978	97.81	0.890	15.0	0.857	13.5	Good
3/27/18	10R	0.9	3/20/57	566.1	3.19	0.885	20.6239	100.49	0.886	14.6	0.882	14.2	Good
1/12/18	10R	0.9	3/20/57	572.1	3.67	0.985	10.8072	97.24	0.995	15.9	0.982	15.5	Good
11/28/17	10R	0.9	3/20/57	534.1	3.00	1.005	63.8132	96.60	0.991	16.0	0.999	16.3	Poor
9/26/17	10R	0.9	3/20/57	556.2	3.24	1.015	1.4525	96.27	1.012	19.4	1.012	19.0	Good
7/25/17	10R	0.9	3/20/57	563.7	3.20	1.045	6.5217	95.30	1.046	18.8	1.033	18.8	Good
5/25/17	10	0.9	3/20/57	530.2	2.87	0.965	5.1671	97.86	0.945	14.5	0.956	14.7	Poor

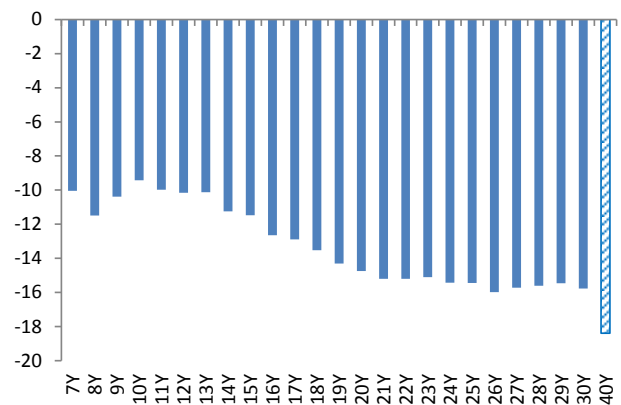
\* Issue amount planned by Ministry of Finance \*\* Based on WI for new JU series; as of Jan. 25 close for the Jan. 2019 auction  
Source: Ministry of Finance (MOF), Daiwa Securities.

**Appendix 1: 40Y JGB Yield (%)**



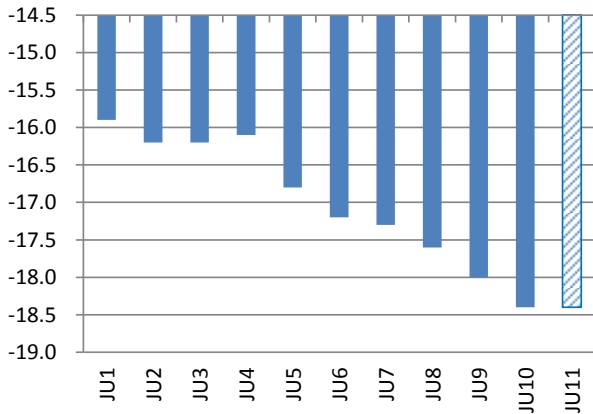
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp): Nov. 27 v. Jan. 25**



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): Nov. 27 v. Jan. 25



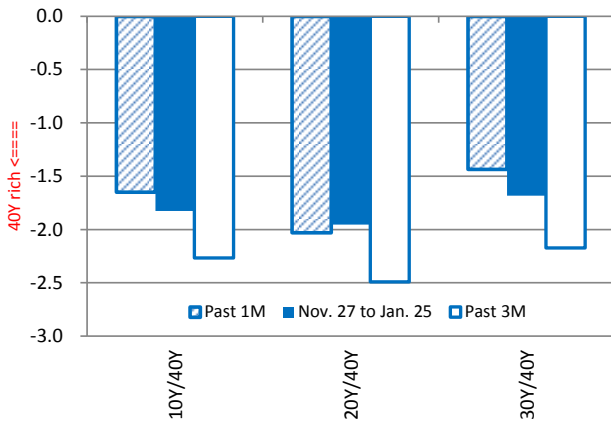
Source: Daiwa Securities.

Appendix 4: 40Y JGBs held by BOJ (Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	975.4	194.8	20.0%	780.6
JU2	1,335	62	4.7%	1,273
JU3	1,356	194	14.3%	1,162
JU4	1,957	220	11.2%	1,738
JU5	1,918	133	6.9%	1,786
JU6	1,985	926	46.6%	1,059
JU7	2,153	1,057	49.1%	1,096
JU8	2,315	1,225	52.9%	1,090
JU9	3,352	1,472	43.9%	1,880
JU10	3,323	1,069	32.2%	2,253
JU11	1,705	372	21.8%	1,333

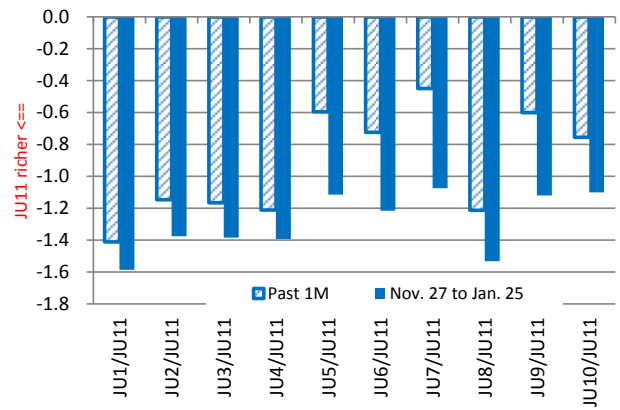
Note: as of Jan. 18 on the BOJ start day  
Source: Daiwa Securities

Appendix 5a: Z-score I



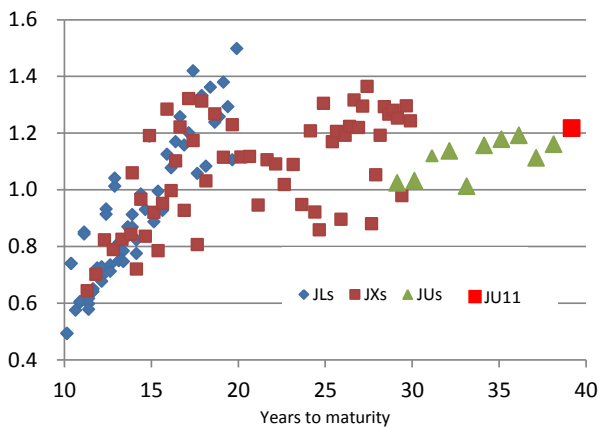
Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 5b: Z-score II



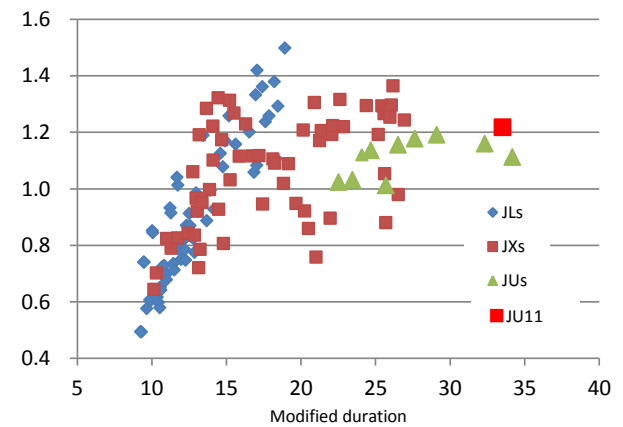
Source: Daiwa Securities.

Appendix 6a: 3M Total Return Curve on Years to Maturity (%)



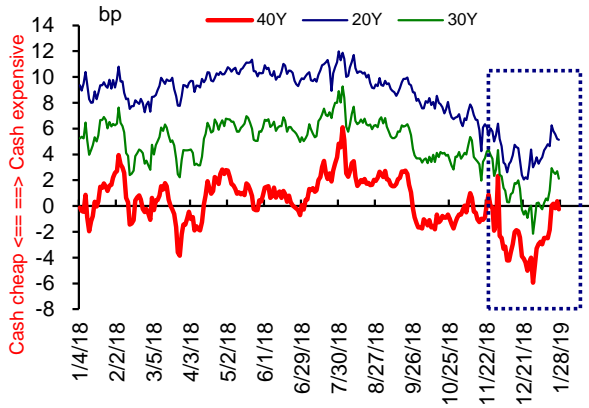
Note: Assuming that the yield curve shape as on Jan. 25 is unchanged and factoring in roll-down effect etc.  
Source: Daiwa Securities.

Appendix 6b: 3M Total Return Curve on Modified Duration (%)



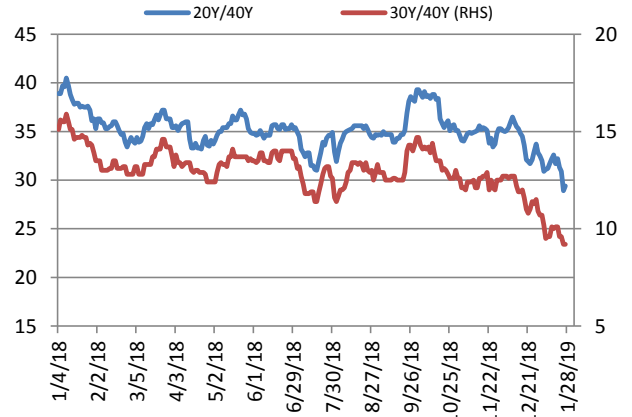
Note: Assuming that the yield curve shape as on Jan. 25 is unchanged and factoring in roll-down effect etc.  
Source: Daiwa Securities.

**Appendix 7: Swap Spreads**



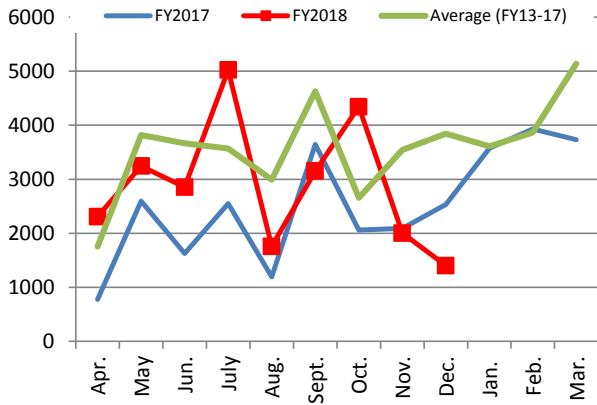
Source: Daiwa Securities.

**Appendix 8: JGB 20Y/40Y and 30Y/40Y Spreads (bp)**



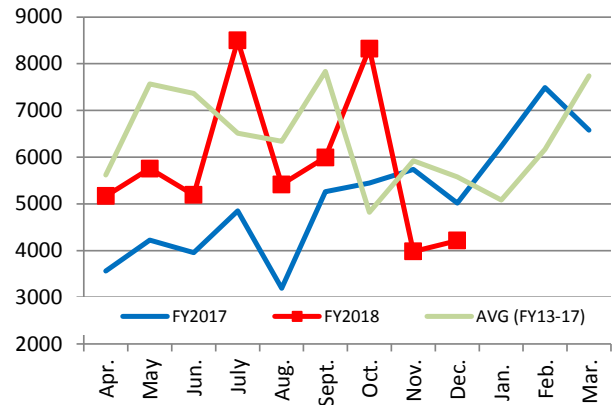
Note: On-the-run issue basis  
Source: Daiwa Securities.

**Appendix 9a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)**



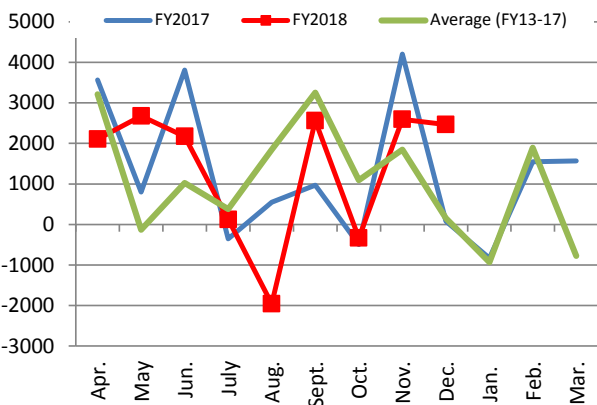
Source: JSDA

**Appendix 9b: Trend of Life and Non-life Insurers' Goss Purchase of Superlong JGBs (Yen 100M)**



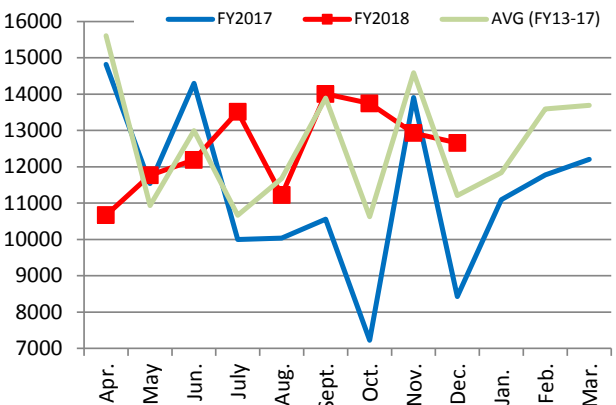
Source: JSDA

**Appendix 10a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)**



Source: JSDA

**Appendix 10b: Trend of Overseas Accounts' Goss Purchase of Superlong JGBs (Yen 100M)**



Source: JSDA

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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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