

Outlook for 30Y JGB Auction

Taking bullish stance

- ✓ Bidding expected at the 0.5% level for the first time since November 2016
- ✓ While strong upward pressure on JGB yields appears more unlikely, speculations on the BOJ's cut in JGB purchases have diminished sharply and strong support is expected in terms of supply/demand as well
- ✓ Expecting that the 30Y JGB yield will decline to the 0.50-0.55% level by the end of FY18, we would like to think about placing solid bids to build small-lot long positions
- ✓ The 10Y/30Y and 20Y/30Y spreads appear to have leeway to tighten by around 5bp

Strategic Memorandum DSTE291
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Auction Details

Auction Date: February 7, 2019
Issue Date: February 8, 2019
Maturity Date: December 20, 2048
Offering Amount: About 700 billion yen

* New 30Y JGBs will be the first reopening of JX61 carrying a 0.7% coupon.

** On February 6, JX61 traded at 0.585-0.595% (-1.0bp - unch v. previous day's close) and closed at 0.595% (unch).

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Tomorrow's auction expected to be held at the 0.5% level for the first time since November 2016

Since the previous 30Y JGB auction went well at around 0.72% in January, global bond markets have mostly firmed up partly because the January FOMC statement and Fed chairman's press conference showed a patient stance for rate hike and balance sheet run-off policies, while market participants have become more worried about the outlook for the global economy. Such worries were caused by a caution about weak economic indicators in China and the US as well as the impact of the prolonged US government partial shutdown. While investors are paying attention to end-FY portfolio, the market sentiment for superlong JGBs remains favorable. Since the beginning of February, we have thus been seeing the 30Y JGB yield (on-the-run issue on conventional yield basis) frequently moving at the level below 0.6%. As of 15:00 today (Feb 6), JX61 temporarily traded at 0.585 - 0.595% (-1.0bp - unchanged vs. previous day's close), indicating that tomorrow's auction will likely be held at the 0.5% level for the first time since November 2016 with a high probability.

Strong upward pressure on JGB yields is more unlikely

Let's check the environment surrounding 30Y JGBs. The US market staged higher stock prices/lower bond prices as (1) excessive concerns about a US economic slowdown have diminished due to a series of announcements of strong economic indicators (such as jobs data released at the end of last week) and (2) earnings results at major companies are largely solid. That being said, concerns about the global economy are lingering. The situation is unchanged that inflation expectations are unlikely to rise sharply partly because of crude oil prices hovering at a low level. Above all, the Fed, which triggered reversals under major JGB downtrends, has just shifted to a dovish stance. Strong upward pressure

on JGB yields appears more unlikely now than a month ago.

Strong support expected in terms of supply/demand

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, the 40Y JGB auction in January that was held at the 0.7% level, the lowest level since November 2016, went well backed by strong demand from investors. Since then, superlong JGB yields have remained on a downtrend. Also given that JX61 is expected to generate the highest return in the superlong zone (Appendix 5), there are no strong concerns about demand from investors.

placing solid bids to build small-lot long positions

As the 10Y JGB auction, which was held on February 5 in the negative yield territory for the first time since November 2016, posted a solid result, the 10Y JGB yield appears to be steadily taking hold in negative territory. If so, there is a good possibility that the 30Y JGB yield will decline to the 0.50-0.55% level by the end of FY18. We would like to think about placing solid bids to build small-lot long positions

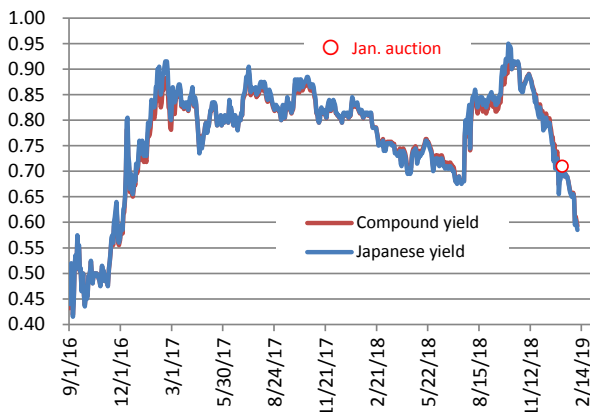
In terms of the relative value, 30Y JGBs are expensive both on the JGB yield curve and against swaps due to recent flattening of the curve and widening of the asset swap spread (appendixes 3-4). However, if we assume that the long-superlong zone of the yield curve will remain under flattening pressure, the 10Y/30Y and 20Y/30Y spreads appear to have leeway to tighten by around 5bp compared to, for example, those on the yield curve in early November 2016 when the 10Y JGB yield was hovering at around -0.05%.

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 (%)	
2/7/19	61R	0.7	12/20/48	700*									
1/10/19	61	0.7	12/20/48	762.2	4.03	99.62	99.60	0.02	0.715	0.716	0.001	87.3552	Good
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

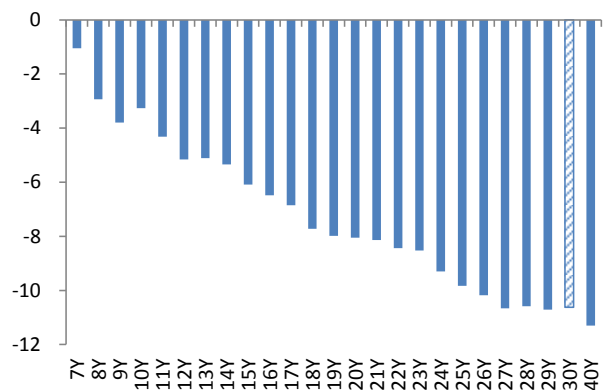
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



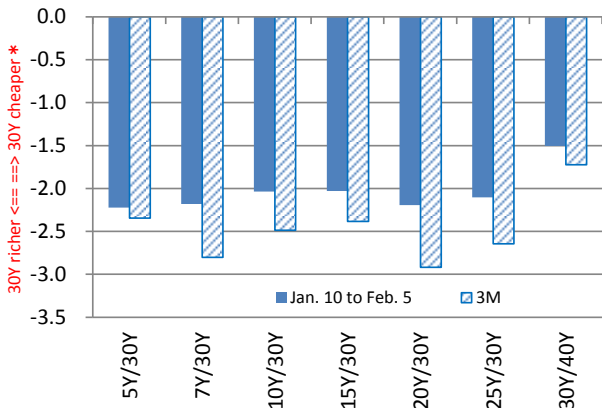
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Jan. 10 v. Feb. 6, bp)



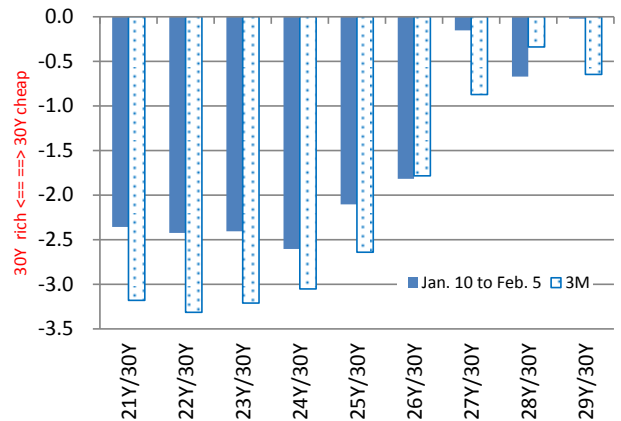
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



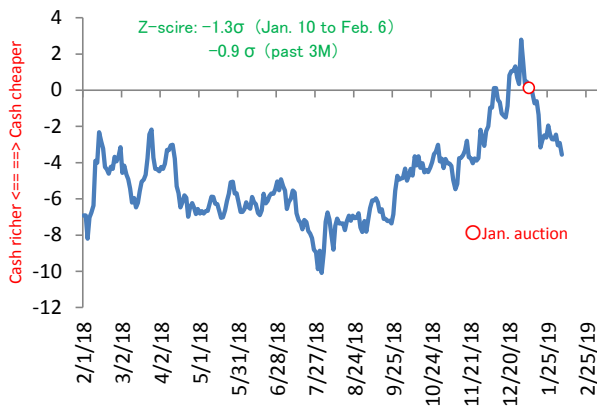
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
 Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



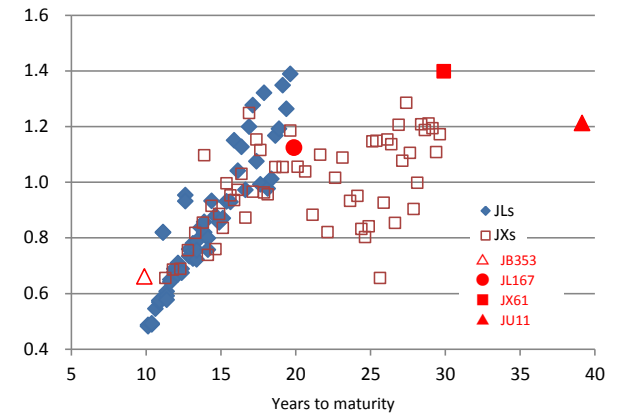
Source: Daiwa Securities.

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



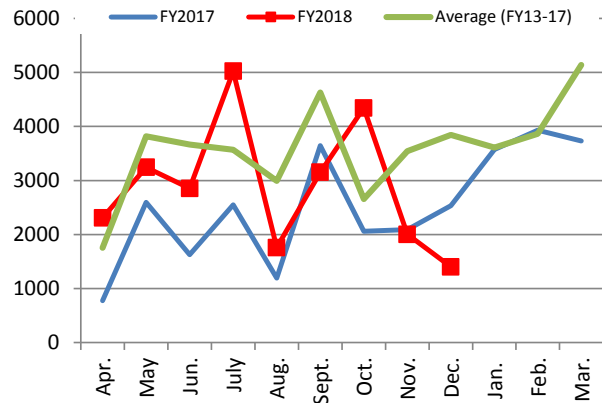
Note: 6M Yen LIBOR basis.
 Source: Daiwa Securities.

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



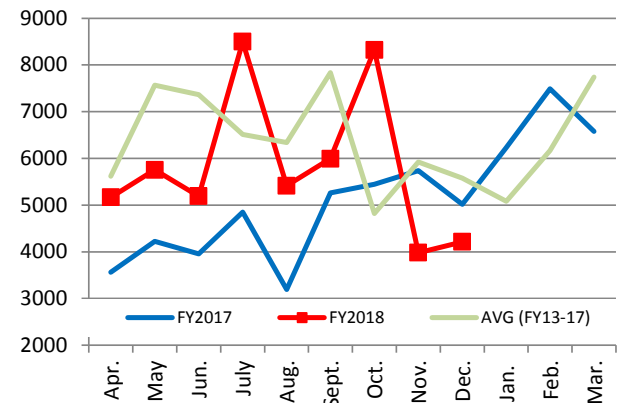
Note: Based on JGB yield curve on Feb. 5; assuming that the yield curve shape does not change and factoring roll-down effect etc.
 Source: Daiwa Securities

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



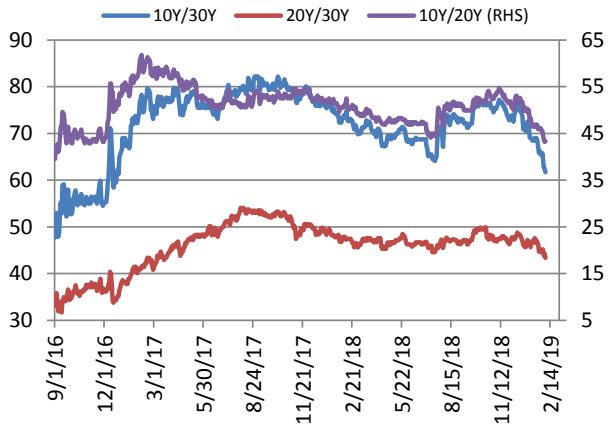
Source: JSDA

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



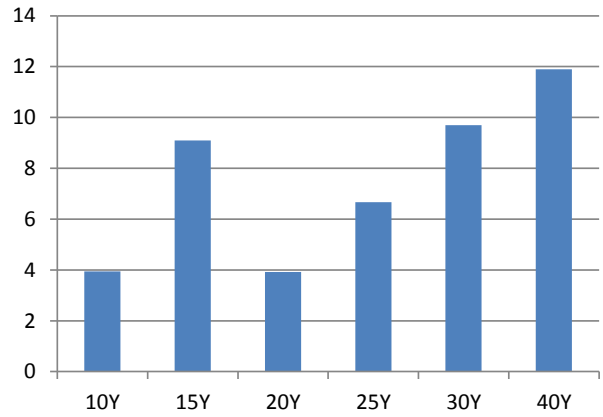
Source: JSDA

Appendix 7: JGB 10Y/20Y, 20Y/30Y and 10Y/30Y Spreads (bp)



Source: Daiwa Securities

Appendix 8: JGB Yield Change (bp): Nov. 1, 2016 v. Feb. 5, 2019



Source: Daiwa Securities

Explanatory Document of Unregistered Credit Ratings

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[Standard & Poor's]

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[Moody'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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* 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.

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