

JGB Insight

Superlong JGBs: Stay bullish

- ✓ Some selling-off seen after the 30Y JGB auction, but superlong JGBs continue gaining and curve remains under flattening
- ✓ Upward pressure on superlong JGB yields unlikely to strengthen in the favorable environment
- ✓ Diminishing speculations on the BOJ's cut in JGB purchases
- ✓ Strong support expected in Jan-Mar period in terms of supply/demand
- ✓ Stay bullish on superlong JGBs with 30Y JGB yield falling below 0.55% and 10Y/30Y spread of 55-57bp in mind

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Some selling-off seen after the 30Y JGB auction, but superlong JGBs continue gaining and curve remains under flattening

On February 7, the Ministry of Finance reopened and sold 30Y JGBs, JX61, successfully at the lowest bidding yield level since November 2016. In the morning session, JX61 traded at 0.590 - 0.595% (-1.0 - -0.5bp vs. previous day's close), while the JGB futures softened. Although the auction was held at around 0.590% level (-0.5bp), it went well as bids were accepted at the expected level and the bid-to-cover ratio was the highest since July 2018. In the secondary market, however, some investors sold a large amount of superlong JGBs amid sluggish performance of JX61 at 0.590 - 0.595% (-1.0 - -0.5bp), which put the JGB yield curve in the long-term to superlong zone under strong steepening pressure. JX61 was temporarily sold to 0.615% (+2.5bp. vs. previous day's close) as well. However, superlong JGBs found some dip-buyers, rebounding in this morning session. JX61 traded up to 0.575% and the long end of the curve flattened to the level we saw before the 30Y JGB auction.

Upward pressure on superlong JGB yields unlikely to strengthen in the favorable environment

Let's check the environment surrounding superlong JGBs. This week, excessive concerns about a US economic slowdown have diminished due to a series of strong economic indicators, such as jobs report released at the end of last week. Meanwhile, worries about the global economy are intensifying, given downward revisions to growth rate projections by the ECB and the BoE. Also, the situation has been 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 has often triggered big reversals under major JGB downtrends and flattening trends of the yield curve in the long history, has just shifted to a dovish stance. Under the current environment, it is difficult to expect strong upward pressure on superlong JGB yields.

Diminishing speculations on the BOJ's cut in JGB purchases

As an internal factor, the BoJ has kept unchanged the offer amounts in all the target zones at the first operations in February from those in the final operations in January. Similar to the guideline of operations, the offer amounts at the first operation of the month appear to be easily adjustable for the BOJ, irrespective of the external environment. Given this, we think that the possibility of adjustments to the offer amounts in February is quite slim, unless an urgent matter arises. This is all the more so, if we consider the fact the USD/JPY rate was at the 112-114 level in September-December 2018 when the BOJ aggressively trimmed the purchase amount by reducing the number of offers. Under the current market environment, speculations on a pause in the BOJ's cut in JGB purchases may lead to a positive atmosphere in buying JGBs.

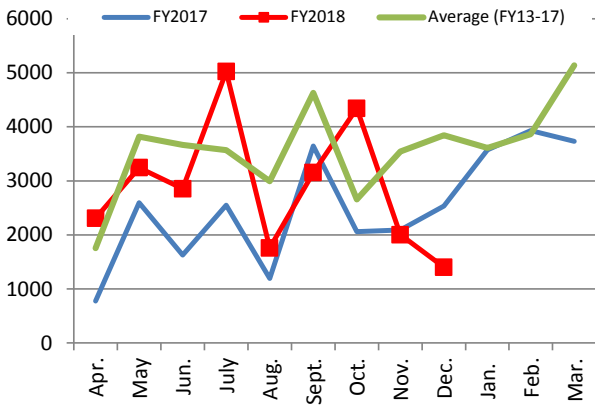
Strong support expected in Jan-Mar period in terms of supply/demand

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 (Chart 1). Although the 40Y JGB auction in January was held at the 0.7% level, the lowest level since November 2016, it went well backed by strong demand from investors. Since then, superlong JGB yields have remained on a downtrend. The developments of after the latest 30Y JGB auction are also implying strong demand.

Stay bullish on superlong JGBs with 30Y JGB yield falling below 0.55% and 10Y/30Y spread of 55-57bp in mind

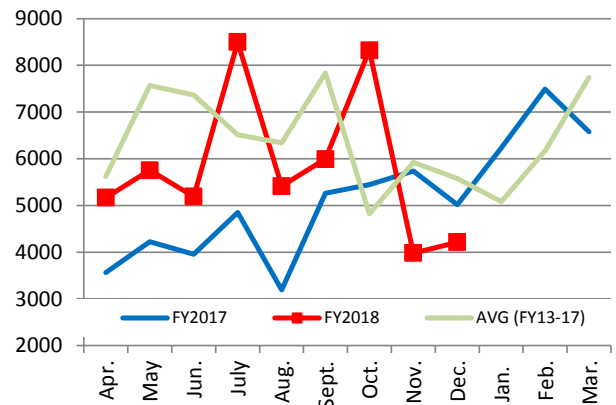
As the 10Y JGB auction, which was also held this week (February 5) in the negative yield territory for the first time since November 2016, posted a solid result, the 10Y JGB yield appears to be steadily taking hold in negative territory. Accordingly, the possibility appears high that the 30Y JGB yield will take hold at the level below 0.6% (Chart 2) under the assumption that the BOJ will continue with the yield curve control policy for the time being. Amid the favorable environment for superlong JGBs, there is a good possibility that the 30Y JGB yield will decline to the 0.50-0.55% level by the end of FY18. As the long-superlong zone of the yield curve has been flattening, we need to pay close attention to activities to unwind existing positions. 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 to their levels, for example, seen in early November 2016 when the 10Y JGB yield was hovering at around -0.05% (Chart 3). We expect the 10Y/30Y and the 20Y/30Y spreads to narrow to around 55-57bp and around 13-15bp, respectively, on an on-the-run compound yield basis.

Chart 1a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



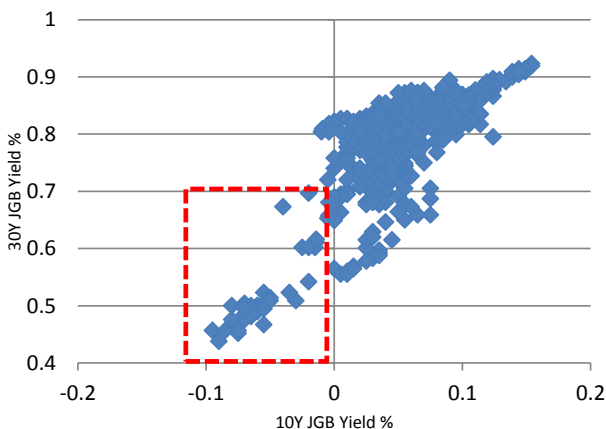
Source: JSDA

Chart 1b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



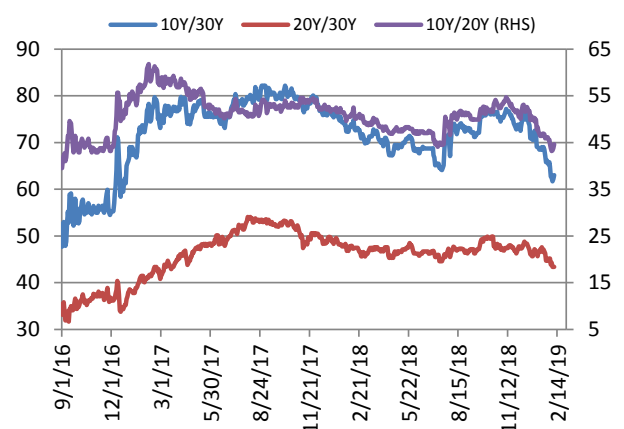
Source: JSDA

Chart 2: Correlation between 10Y and 30Y JGB Yields under BOJ's YCC Policy



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

Chart 3: JGB10Y/20Y, 10Y/30Y and 20Y/30Y Spreads (bp)



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

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[Standard & Poor's]

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[Fitch]

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