

Outlook for 40Y JGB Auction

Placing bids to take only minimum necessary amount

- ✓ Tomorrow's auction is expected to go well just as previous 40Y JGB auctions did. However, we would like to take a stance of placing bids to buy only minimum necessary amount, given the possibility of a limited upside after the auction.

Strategic Memorandum DSTE299
FICC Research Dept.

Senior JGB Strategist
Keiko Onogi
+813 5555 8788
keiko.onogi@daiwa.co.jp
Daiwa Securities Co. Ltd.

Auction Details

Auction Date: March 26, 2019
Issue Date: March 27, 2019
Maturity Date: March 20, 2058
Offering Amount: About 400 billion yen

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

** On March 25, JU11 traded at 0.565% (-2.0bp v. previous day's close: 0.584% on compound yield) and closed at 0.565% (-2.0bp: 0.584%).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Placing bids to take only minimum necessary amount

Since the previous 40Y JGB auction went well at the 0.730-0.735% level (or 0.737-0.742% on compound yield basis) on January 29, the bond markets have firmed up around the globe amid lingering worries about the global economy, reflecting a more dovish stance at the Fed and ECB. In the JGB market, superlong JGBs have been firm backed by demand from investors as they paid attention to end-FY portfolio. Today (Mar 25), the 40Y JGB yield temporarily declined to 0.565% (or 0.584% on compound yield basis) on an intraday basis (Appendix 1). Given the current level, we expect tomorrow's auction to be held at the lowest yield level since the auction on September 27, 2016 (second reopening of JU9)¹, immediately after the introduction of the BOJ's yield curve control (YCC) policy. In such a situation, key points to think about placing bids at tomorrow's auction are as follows:

- ✓ Short-covering demand appears to be relatively strong;
- ✓ Prior to the start of the new fiscal year, it is difficult to chase a yield downtrend from the current level;

¹ The auction was conducted at the 0.570-0.580% level (or 0.559-0.564% on compound yield basis), with the Bloomberg survey's estimate for the highest accepted yield ranging from 0.560 to 0.590% (mode: 0.570%). The result is shown in the red box of the table on the next page.

- Although upward pressure on JGB yields is unlikely to strengthen in the current environment, it is now difficult to aggressively factor in rate cuts or additional easing by the BOJ, Fed, and ECB.
- ✓ The 40Y sector is not cheap on the curve at the current level (Appendix 5);
 - It is difficult to build new positions in terms of the relative value.
- ✓ The auction will be conducted in a yield-Dutch method with the small issuance amount of about 400bn yen;
 - The auction may have a strong result.
- ✓ Demand from overseas investors should be carefully watched;
 - In February, the gross purchase amount of superlong JGBs by overseas investors exceeded 1.6tn yen, the highest level since September 2016. Their net purchase amount was also the highest level since November 2017.

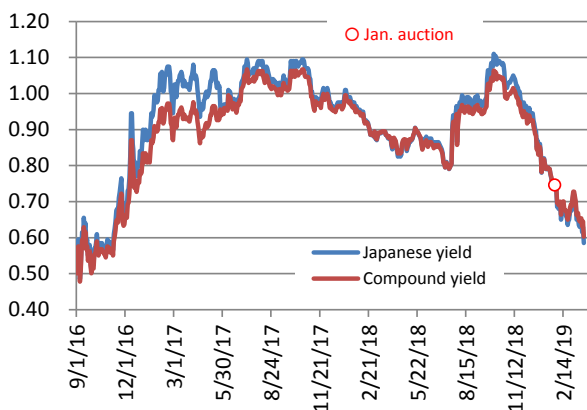
All in all, tomorrow's auction is also expected to go well. However, we would like to take a stance of placing bids to buy only the minimum necessary amount, given the possibility of a limited upside after the auction.

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)**	
3/26/19	11R	0.8	3/20/58	400*					0.603	7.2			
1/29/19	11R	0.8	3/20/58	399.5	3.79	0.740	10.2272	102.04	0.746	9.3	0.746	9.3	Good
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
9/27/16	9R	0.4	3/20/56	532.1	2.73	0.560	15.6657	94.34	0.554	6.9	0.563	6.3	Good

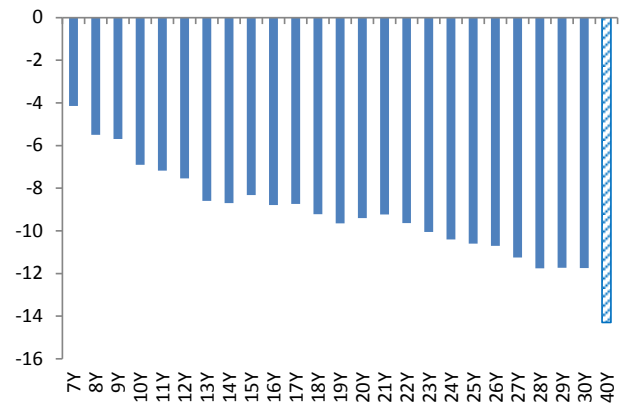
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Jan. 25 close for the Jan. 2019 auction
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



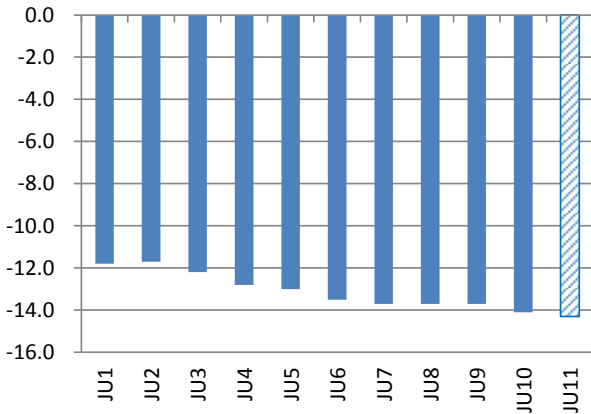
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Jan. 29 v. Mar. 22



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): Jan. 29 v. Mar. 22



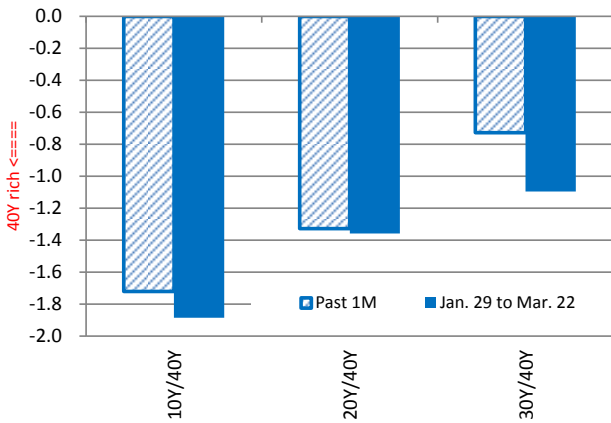
Source: Daiwa Securities.

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

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	975.5	194.8	20.0%	780.7
JU2	1,338	68	5.1%	1,270
JU3	1,356	194	14.3%	1,162
JU4	1,957	220	11.2%	1,738
JU5	1,919	133	6.9%	1,785
JU6	1,985	931	46.9%	1,054
JU7	2,153	1,057	49.1%	1,096
JU8	2,315	1,231	53.2%	1,084
JU9	3,354	1,490	44.4%	1,864
JU10	3,323	1,092	32.9%	2,230
JU11	2,104	407	19.3%	1,697

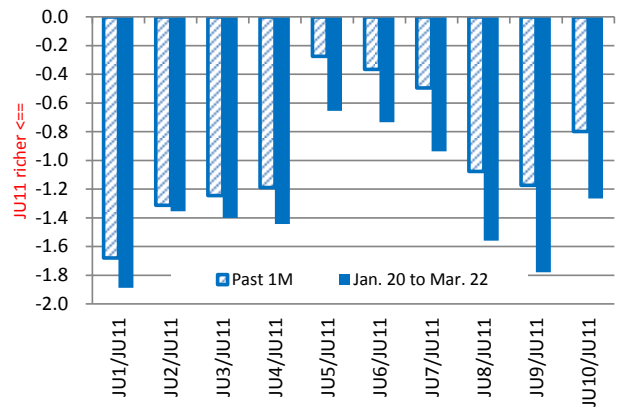
Note: as of March 8
Source: Daiwa Securities.

Appendix 5a: Z-score I



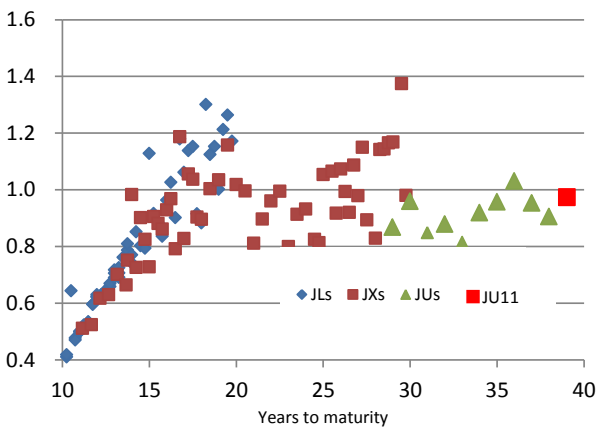
Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 5b: Z-score II



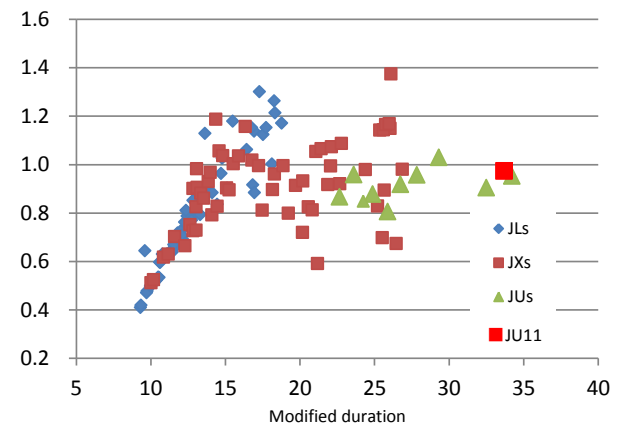
Source: Daiwa Securities.

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



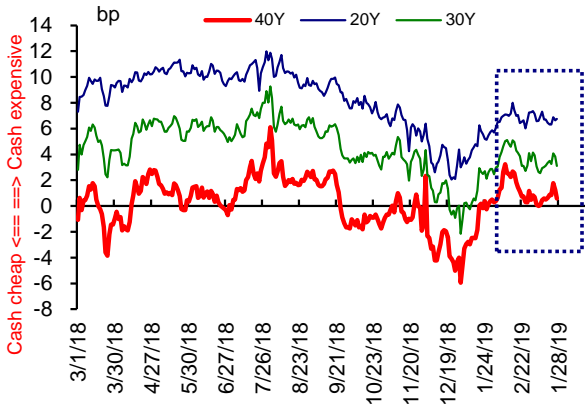
Note: Assuming that the yield curve shape as on Mar. 22 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities.

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



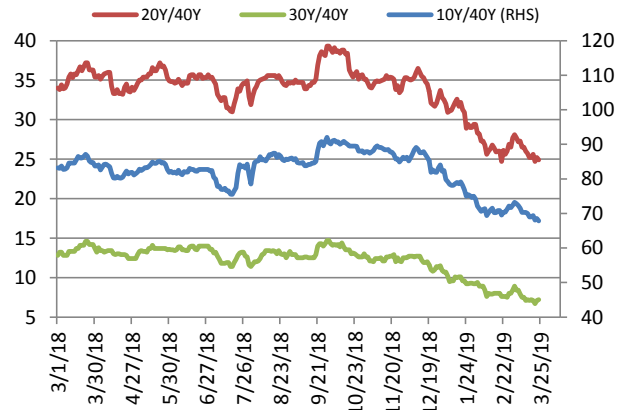
Note: Assuming that the yield curve shape as on Mar. 22 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 7: Swap Spreads



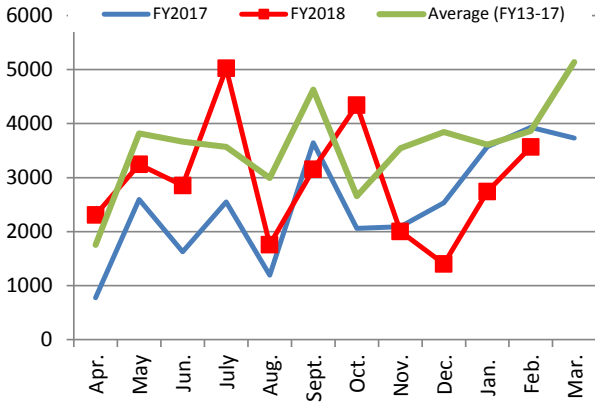
Source: Daiwa Securities.

Appendix 8: JGB Yield Spreads (bp)



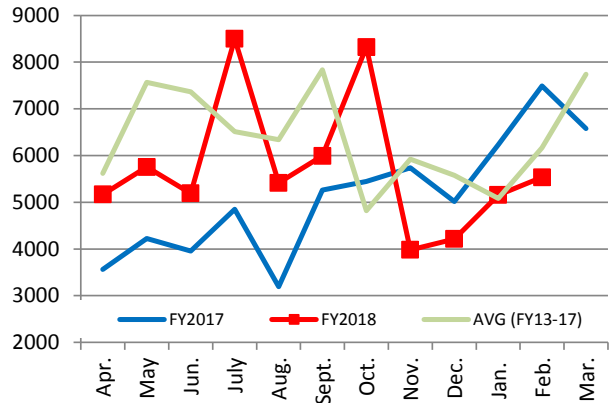
Note: On-the-run issue basis
Source: Daiwa Securities.

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



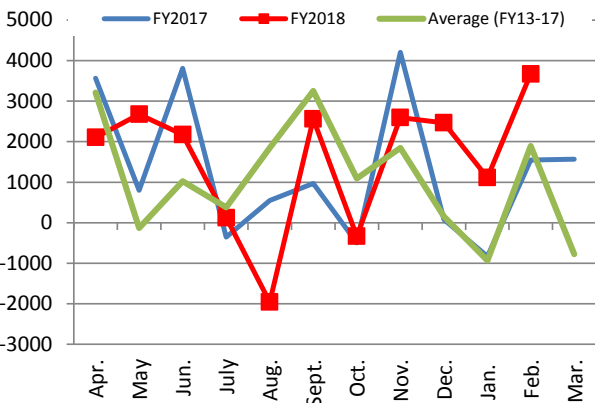
Source: JSDA

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



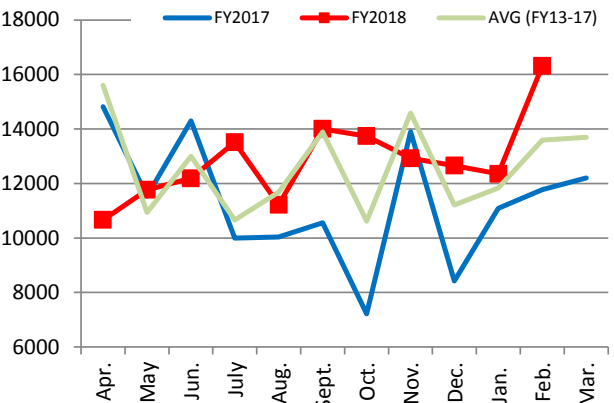
Source: JSDA

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



Source: JSDA

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



Source: JSDA

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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[Standard & Poor's]

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[Fitch]

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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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