

Outlook for 20Y JGB Auction

Take it as dip-buying opportunity

- ✓ Average to good primary sale of new 20Y JGBs expected
- ✓ We would like to think about bidding at JL167+1.0 to 1.2bp level (on compound yield basis)
- ✓ In terms of relative value, it would be worth considering switching out from 7Y or 10Y, if it is necessary.

Strategic Memorandum DSTE305
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Auction Details

Auction Date: April 16, 2019
Issue Date: April 17, 2019
Maturity Date: March 20, 2039
Offering Amount: About 900 billion yen

* New 20Y JGBs to be redeemed in March 2039, JL168, will likely carry a 0.4% coupon.

** On April 15, 20Y WI barely traded, and closed at 0.380% (+2.0bp v. previous day's close). JL167 traded at 0.370-0.375% (+2.0 - +2.5bp) and closed at 0.370% (+2.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Placing bids at JL167+1.0-1.2bp level

After the previous 20Y JGB auction went well at the 0.390-0.395% level on March 19, the bond markets firmed up around the globe on the back of diminished expectations of US rate hikes in 2019. In Japan, market sentiment for superlong JGBs remained favorable, supported by demand from investors heading to the end of the fiscal year. In such an environment, the 20Y JGB yield declined to 0.325% during intraday trading at one point. Amid the global trend of higher stock prices/lower bond prices after the start of the new fiscal year, the 20Y JGB yield has been moving mostly at the 0.340-0.375% range.

Let's look at the environment surrounding the JGB market. Amid persisting concerns about the global economy, the Fed and ECB have shifted to the dovish side. Recently, excessive worries about the global economy are diminishing, partly due to positive results of some economic indicators in China and Europe, in addition to the US. However, the Fed and ECB are unlikely to immediately shift to the hawkish side in view of those indicators on a single month basis. It would be still difficult to assume the emergence of strong upward pressure on JGB yields. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ New 20Y JGBs will be the first issuance of the March 2039 bonds (JL168) in new fiscal year;
 - As new 20Y JGBs are attractive in terms of carry (Appendix 5), strong worries would be unnecessary for demand from investors prior to the longest Golden Week holiday period in history.
- ✓ The BOJ is expected to conduct four purchase operations before the next 20Y JGB auction scheduled for May;
 - Two operations in April (BOJ's plan) and two in May (our expectation). Despite lingering caution about a cut in the offer amount, the possibility of the cut in the 10-25Y zone in April appears limited.
- ✓ After tomorrow's auction, there will be no big supply in the superlong zone until the 30Y JGB auction scheduled for May 14;
 - Given this and the aforementioned BOJ purchase schedule, the supply/demand balance is expected to remain favorable in the superlong zone.
- ✓ The 20Y sector is not expensive on the curve at the current level;
 - The sector appears rather undervalued vs. the 25-30Y and 40Y sectors. However, it would be difficult to think of switching out from those sectors into 20Y as we assume that flattening pressure will likely remain in the superlong zone.

All in all, tomorrow's auction is expected to have average to good results. We would like to think about bidding at the JL167+1.0 to 1.2bp level (on compound yield basis). In terms of the relative value, it would be worth considering switching out from the long-term sector, such as the 7Y or 10Y, if it is necessary. The 20Y sector is not undervalued vs. those sectors at the current level. However, amid the flattening trend of the superlong zone expected to continue on the back of favorable supply/demand balance, the 7Y/20Y or the 10Y/20Y flattening positions are less likely to be negatively affected by the market direction, whether it is bear or bull.

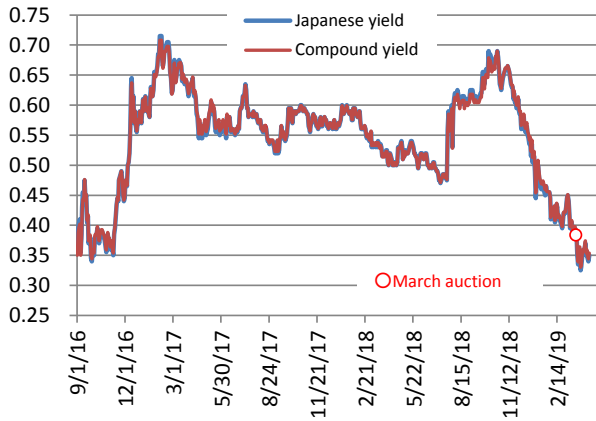
20Y JGB Auction Results

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
4/16/19	168	0.4*	3/20/39	900.0**									
3/19/19	167R	0.5	12/20/38	1,143	4.84	101.99	101.95	0.04	0.391	0.393	0.002	14.9462	Good
2/19/19	167R	0.5	12/20/38	1,118	4.67	101.47	101.40	0.07	0.419	0.423	0.004	29.3637	Good
1/24/19	167	0.5	12/20/38	1,133	4.57	100.59	100.55	0.04	0.467	0.469	0.002	24.2842	Good
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

* Daiwa forecast as of Apr. 15 ** Amount the Ministry of Finance plans to issue

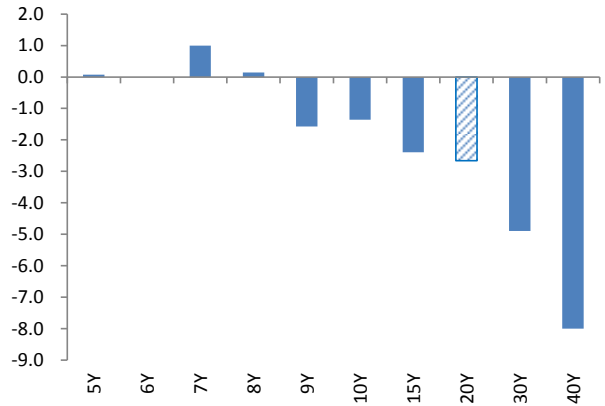
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



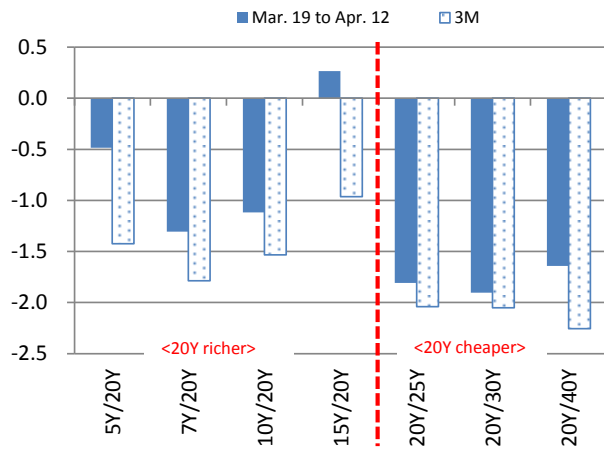
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Mar. 19 v. Apr. 12



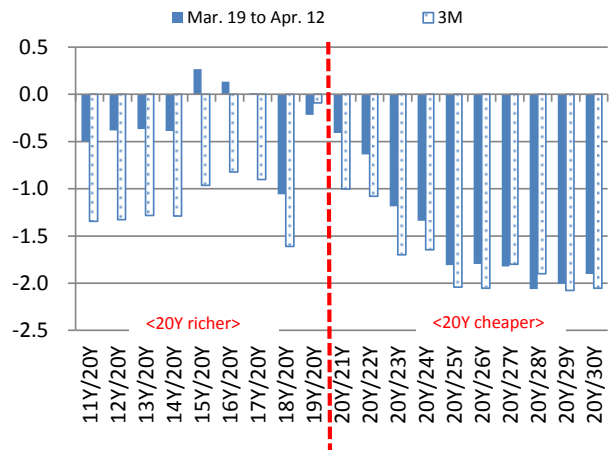
Source: Daiwa Securities.

Appendix 3a: Z-score I



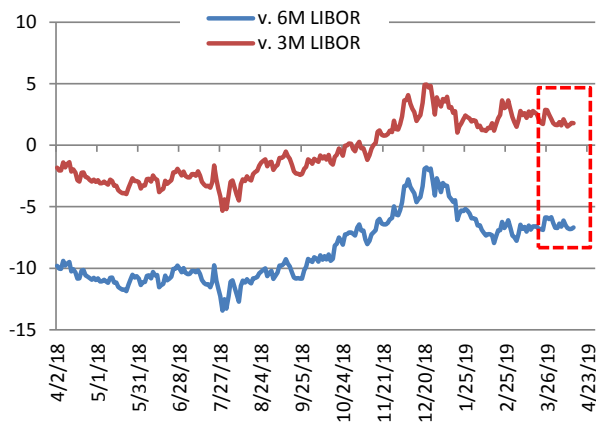
Source: Daiwa Securities.

Appendix 3b: Z-score II



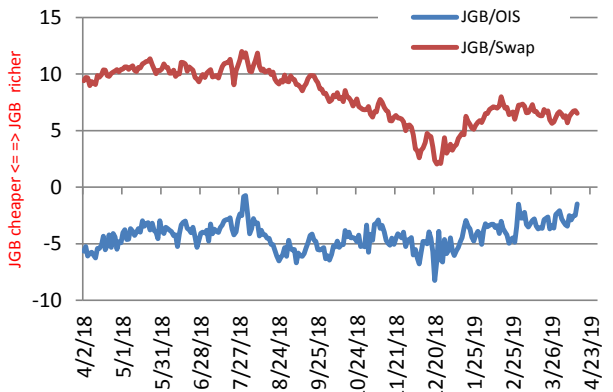
Source: Daiwa Securities.

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



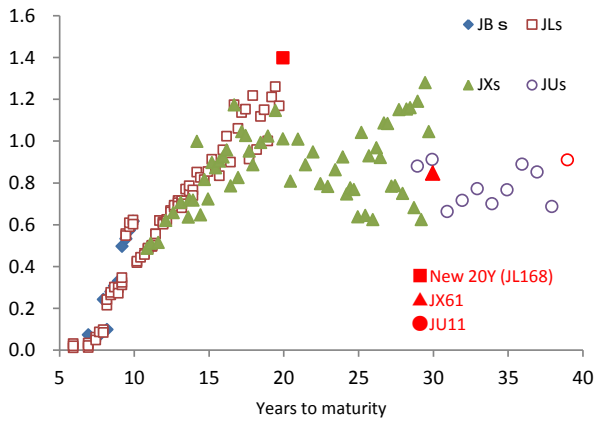
Note: since the March auction
Source: Daiwa Securities.

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



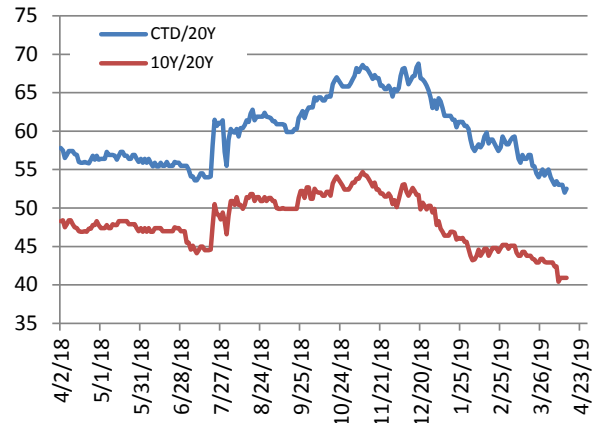
Source: Daiwa Securities.

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



Note: Based on the Apr. 12 JGB yield curve; factoring in roll-down effect etc.; New 20Y JGBs (JL168) is supposed to have a 0.4% coupon and +1.1bp spread (on compound yield) to JL167, Source: Daiwa Securities.

Appendix 6: JGB Yield Spreads (bp)



Note: On-the-run and CTD basis
Source: Daiwa Securities

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■ Credit Rating Agencies

[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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