

Outlook for 30Y JGB Auction

Smooth auction expected

- ✓ A smooth auction is expected, but upside of 30Y JGBs may be limited in the secondary market.
- ✓ Paying close attention to investor demand at the current absolute yield level and also on the curve, we would like to place solid bids to be able to take necessary amount.
- ✓ Relative-value wise, caution remains about unwinding holding positions, such as flatteners.

Strategic Memorandum DSTE307
FICC Research Dept.

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Auction Details

Auction Date: May 14, 2019
Issue Date: May 15, 2019
Maturity Date: March 20, 2049
Offering Amount: About 700 billion yen

* New 30Y JGBs will be the first reopening of JX62 carrying a 0.5% coupon.

** On May 13, JX62 traded at 0.535-0.540% (unch - +0.5bp v. previous day's close) and closed at 0.540% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

30Y JGB yield has moved 0.510%→0.585% →0.525% since the April auction and tomorrow's auction is likely to be held around 0.540%

After the previous auction for the first issuance of JX62 went well at the 0.540-0.545% level on April 4, the 30Y JGB yield declined from 0.545% on April 5 to 0.510% on April 11-12 on an intraday basis. Subsequently, the bond markets firmed up around the globe amid signs of improvement in Chinese and European economic indicators alongside weakening excessive caution about US-China trade friction and Brexit. The 30Y JGB yield also rose to 0.585% at one point (on an intraday basis on April 19 and 22). Then, the yield temporarily declined to 0.555% before the Golden Week holiday, reflecting improvement in market sentiment for superlong JGBs. After the holiday, the US-China trade war was added to the risk-off mood in the markets as the US-China trade talks became more uncertain. In such a situation, the JGB market moved firmly. The 30Y JGB yield also declined to 0.525% at one point on an intraday basis. Ahead of tomorrow's auction, JX62 traded at 0.535-0.540% (unch - +0.5bp vs. previous day's close) as of 15:00 today.

In the environment where neither upward nor downward pressure would strengthen on JGB yields, 30Y JGB yield could stay in the existing range

Let's check the environment surrounding 30Y JGBs. As near-term improvement or resolution of US-China trade friction is unlikely, the issue would continue to serve as a major risk for the global economy. In addition, as the US and European central banks are dovish, we would not see strong upward pressure on JGB yields for the time being. On the other hand, if we assume sharp yield declines, such as the 30Y JGB yield falling below 0.5%, we would need to see new factors such as stronger expectations for the Fed's rate cut or the

emergence of speculations on additional easing by the BOJ. The 30Y JGB yield could stay in the existing range in the near term.

In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ The amount of short-covering from primary dealers is uncertain;
 - It seems that they are not as short as they were at the previous 30Y JGB auction.
- ✓ Expectations for demand from investors remains strong;
 - There appear to be strong expectations for demand from a wide range of investors, including life insurers (for need-to-have amount), co-operative financial institutions, and overseas investors (appendixes 7-9).
 - If we assume that the market will remain range-bound and the yield curve shape will barely change, JX62 appears undervalued from the viewpoint of total return (Appendix 6).
- ✓ Low possibility that the BOJ will reduce offer amounts in the zone over 25Y
 - On April 19, the BOJ trimmed the offer amount in the over 25Y zone (from 50bn yen to 40bn yen). The possibility of further reduction in the zone appears low especially in the near term.
- ✓ The 30Y sector is neither noticeably rich nor cheap on the curve (appendixes 3-4). Moreover, 30Y cash is neither noticeably overvalued nor undervalued against swaps (Appendix 5).
 - The lack of relative-value attractiveness could discourage market participants from buying new relative-value positions at the timing of this auction. We would rather be cautious about activities to unwind holding positions, such as flatteners.

We would like to place solid bids to be able to take necessary amount, checking investor demand at the current absolute yield level and also on the curve.

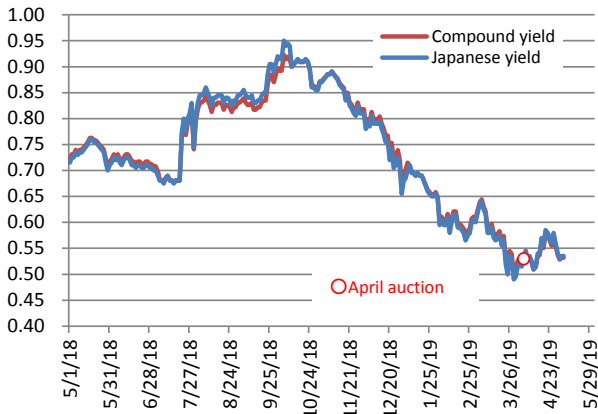
30Y JGB Auction Results

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 (%)	
5/14/19	62R	0.5	3/20/49	700**									
4/4/19	62	0.5	3/20/49	747.3	4.55	98.96	98.90	0.06	0.540	0.542	0.002	18.8092	Good
3/7/19	61R	0.7	12/20/48	739.7	4.56	101.97	101.90	0.07	0.621	0.624	0.003	4.7619	Good
2/7/19	61R	0.7	12/20/48	699.1	4.72	102.85	102.80	0.05	0.587	0.589	0.002	63.1931	Good
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

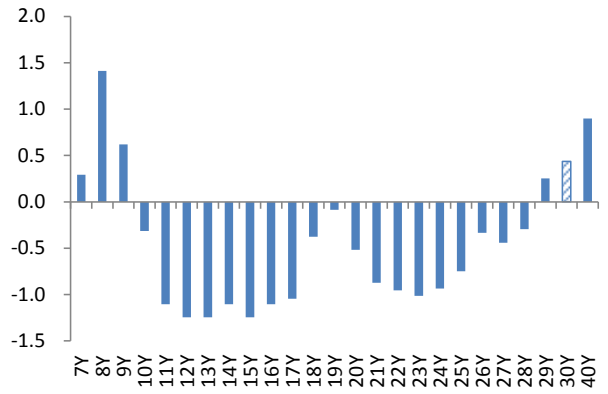
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)

Appendix 2: JGB Yield Change (Apr. 4 v. May 10, bp)

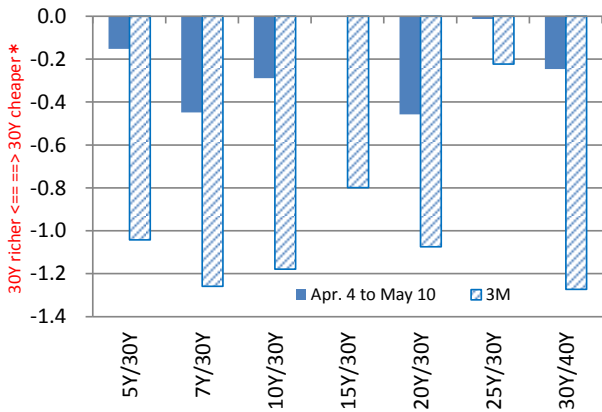


Source: Daiwa Securities.



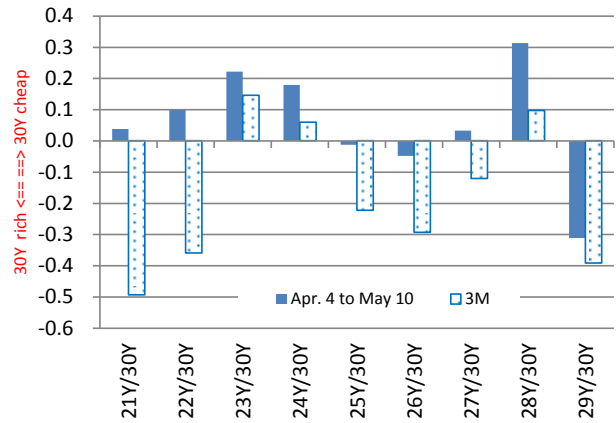
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



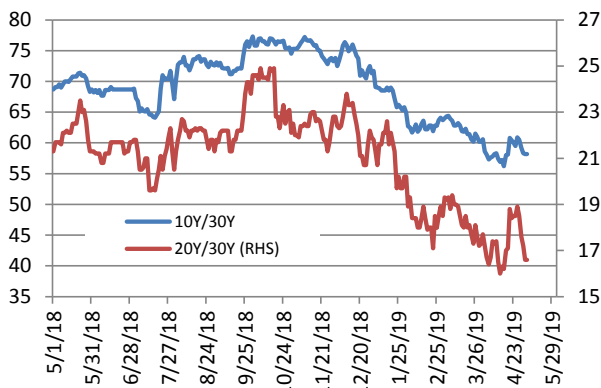
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



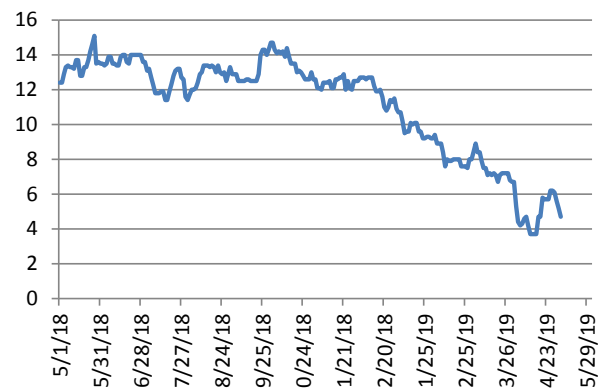
Source: Daiwa Securities.

Appendix 4a: 10Y/30Y and 20Y/30Y Spreads (bp)



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

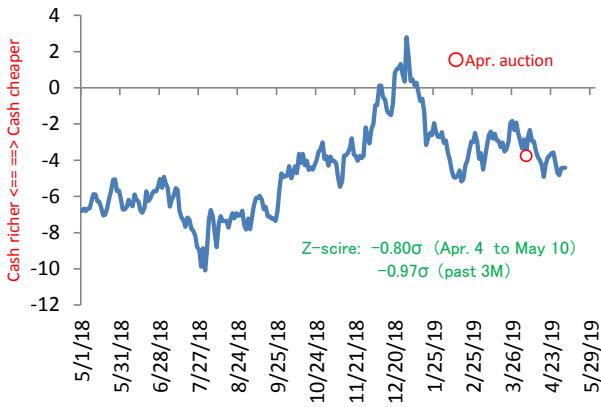
Appendix 4b: 30Y/40Y Spread (bp)



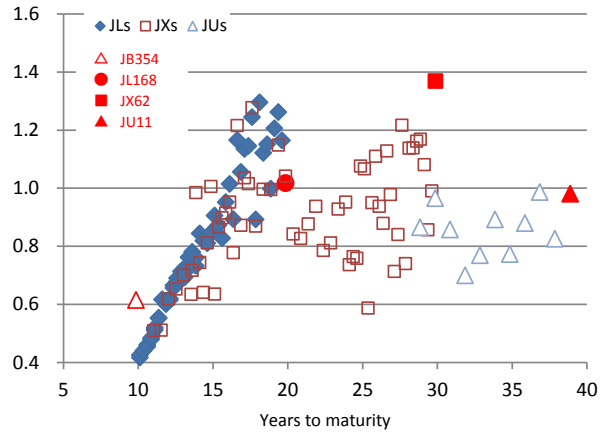
Note: On-the-run issue basis
Source: Daiwa Securities.

Appendix 5: 30Y JGB Asset Swap Spread (bp)

Appendix 6: JGB 3M Total Return Curve (%)

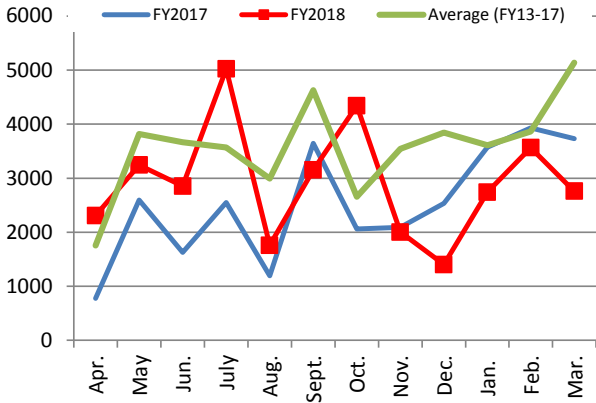


Note: 6M Yen LIBOR basis .
Source: Daiwa Securities.



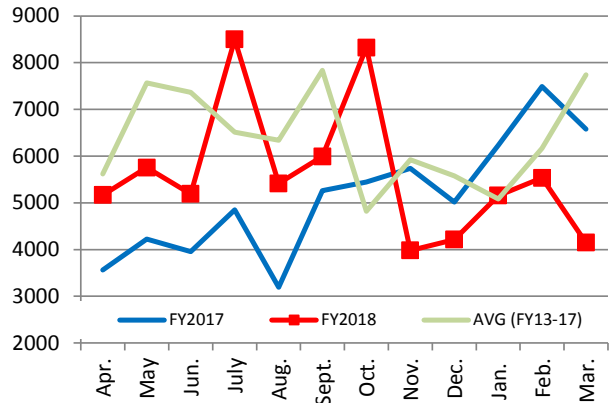
Note: Based on JGB yield curve on May 10; assuming that the yield curve shape does not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 7a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



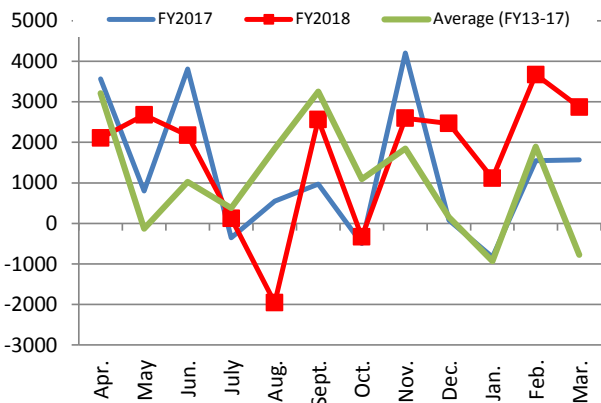
Source: JSDA

Appendix 7b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



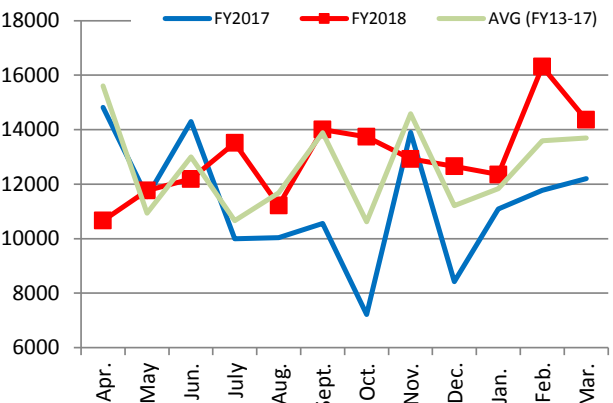
Source: JSDA

Appendix 8a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 8b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)

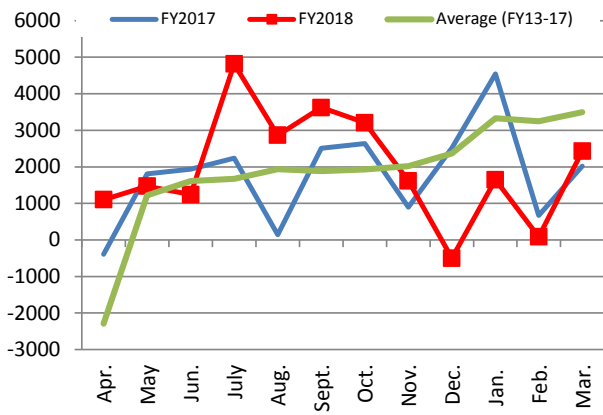


Source: JSDA

Appendix 9a: Trend of Agris' Net Purchase of Superlong

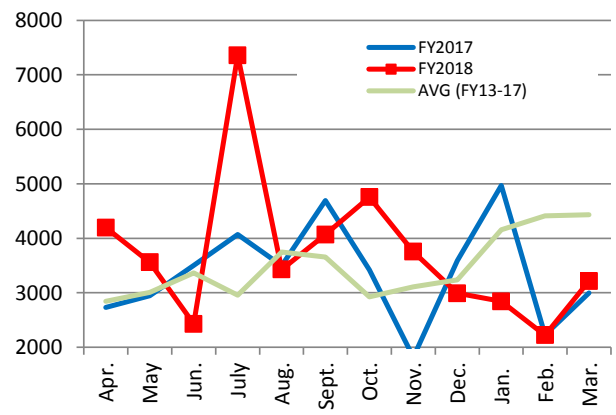
Appendix 9b: Trend of Overseas Agris' Gross Purchase

JGBs (Yen 100M)



Source: JSDA

of Superlong JGBs (Yen 100M)



Source: JSDA

Explanatory Document of Unregistered Credit Ratings

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[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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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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