

Outlook for 20Y JGB Auction

Smooth auction expected

- ✓ Tomorrow's auction is expected to go smoothly on expectations for demand from investors and support from BOJ purchases
- ✓ As neither upward nor downward pressure would strengthen on JGB yields, we would like to think about our bidding stance under the assumption that the 20Y JGB yield will remain in a narrow range centering at 0.350% over the next one month
- ✓ It would be worth considering (1) switching out from the 7Y sector or/and (2) buying the 5Y/20Y barbell vs. 10Y short

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Auction Details

Auction Date: May 22, 2019
Issue Date: May 23, 2019
Maturity Date: March 20, 2039
Offering Amount: About 900 billion yen

* New 20Y JGBs will be the first reopening of JL168 carrying a 0.4% coupon.

** On May 21, JL168 traded at 0.360-0.365% (-0.5bp - unch v. previous day's close) and closed at 0.360% (-0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Smooth auction expected

After the previous 20Y JGB auction went well at the 0.365-0.370% on April 16, the bond markets softened 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 20Y JGB yield also rose to 0.400% at one point on an intraday basis. Subsequently, US-China trade talks became more uncertain during the Golden Week, creating caution about risk-off mode. In such a situation, the 20Y JGB yield temporarily declined to 0.340%. Since last weekend, the JGB market has been softening amid mounting speculations on the postponement of the consumption tax hike. The 20Y JGB yield has also risen to 0.365%.

Let's look at the environment surrounding the JGB market. 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. In Japan, investors appear to be waiting for a dip-buying opportunity partly because of growing speculations on the delay in the consumption tax hike. Especially in the near term, it would be difficult to assume a substantial yield decline. In such an environment, key points to think about the bidding level at tomorrow's auction are as follows:

- ✓ Expectations for demand from investors remains strong;
 - While JGB yields up to the 10Y sector have been constantly negative, strong demand for 20Y JGBs is expected from a wide range of investors in terms of attractive carry (Appendix 5).
- ✓ It is highly possible that the BOJ will conduct five purchase operations in the 10-25Y zone before the next 20Y JGB auction scheduled for June 25;
 - Two operations in May (BOJ's plan) and three in June (our expectation). The total purchase amount is estimated at around 800bn yen (160bn yen x five times) on a current offer amount basis.
- ✓ Data from the previous auction indicates that the 20Y sector is neither noticeably rich nor cheap on the curve (Appendix 3). Meanwhile, the asset swap spreads show that 20Y cash is cheaper than it was at the previous auction, which is likely to increase demand (Appendix 4).

Bidding assumes continuous narrow range-bound moves centering at 0.350%

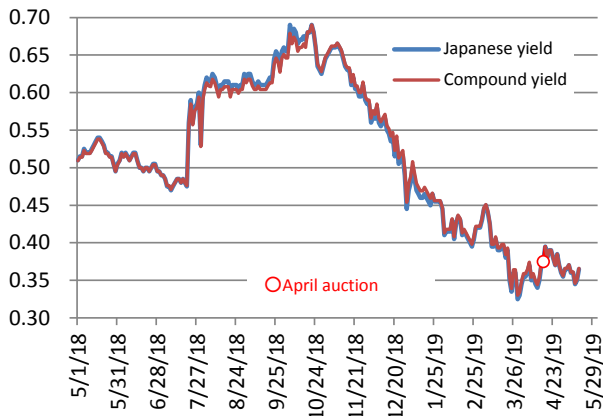
All in all, tomorrow's auction is expected to go smoothly. We would like to think about our bidding stance under the assumption that the 20Y JGB yield will remain in a narrow range centering at 0.350% over the next one month. In terms of the relative value, it would be worth considering (1) switching out from the 7Y sector or/and (2) buying the 5Y/20Y barbell vs. 10Y short, if any (Appendixes 6-7). Amid the flattening trend on the back of favorable supply/demand balance of the 20Y sector, these positions are less likely to be negatively affected by the market direction.

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
5/22/19	168R	0.4	3/20/39	900*									
4/16/19	168	0.4	3/20/39	989	5.10	100.63	100.60	0.03	0.366	0.367	0.001	47.1709	Good
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

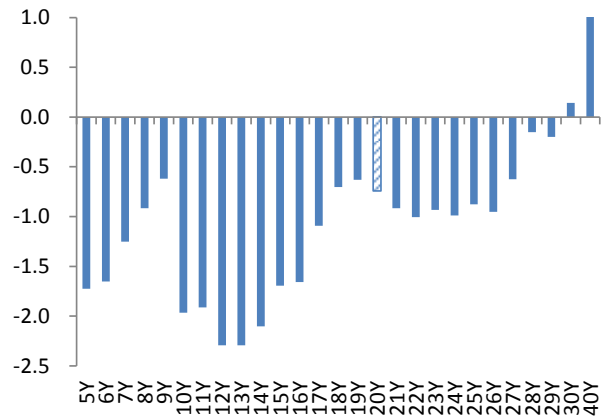
* Amount the Ministry of Finance plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



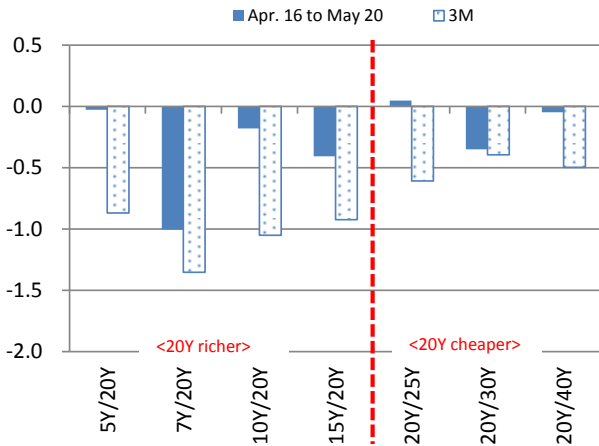
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Apr. 16 v. May 20



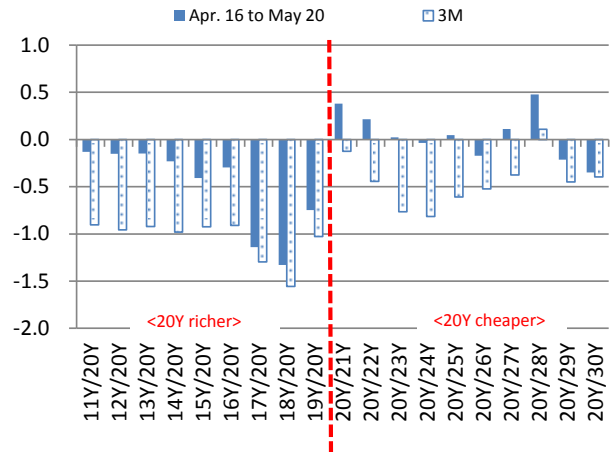
Source: Daiwa Securities.

Appendix 3a: Z-score I



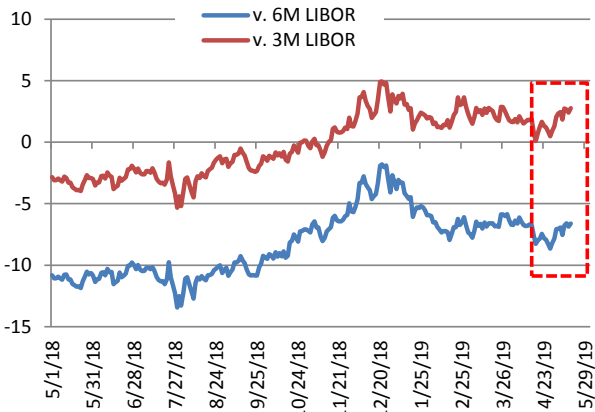
Source: Daiwa Securities.

Appendix 3b: Z-score II



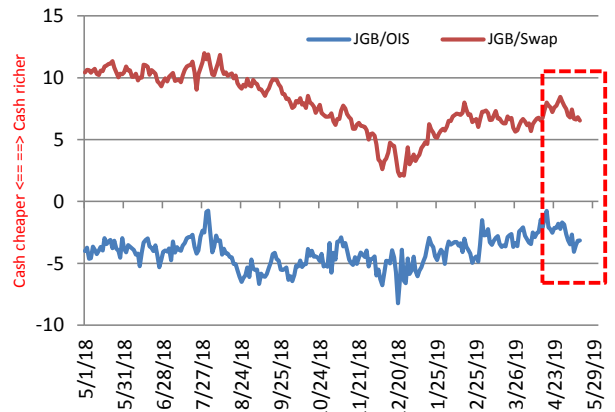
Source: Daiwa Securities.

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



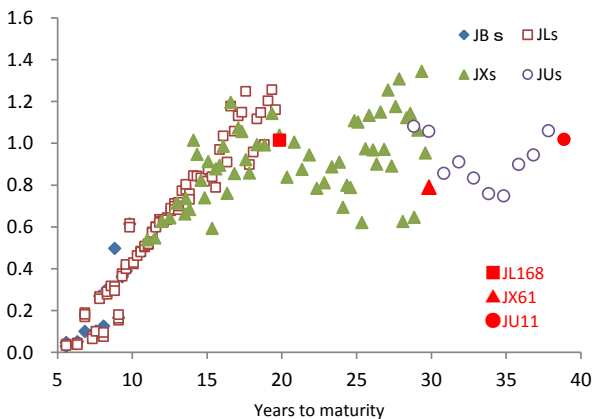
Note: since the April auction
Source: Daiwa Securities.

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



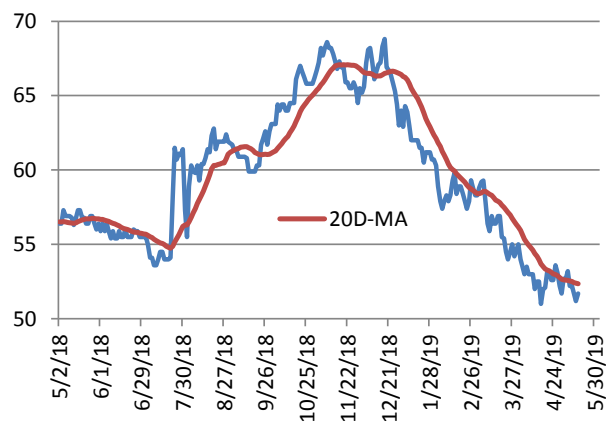
Note: since the April auction
Source: Daiwa Securities.

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



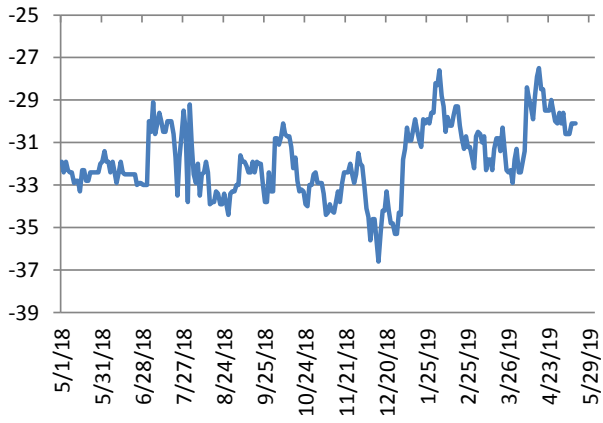
Note: Based on the Apr. 12 JGB yield curve; factoring in roll-down effect etc.; New 20Y JGBs (JL168) is supposed to have a 0.4% coupon and +1.1bp spread (on compound yield) to JL167,
Source: Daiwa Securities.

Appendix 6: JGB 7Y/20Y Spread (bp)



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

Appendix 7: JGB 5Y/10Y/20Y Butterfly Spread (bp)



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

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[Standard & Poor's]

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[Moody's]

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May 2018

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- 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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