

Outlook for 30Y JGB Auction

Expected to tail with a high probability

- ✓ 30Y JGBs have been volatile since the previous 30Y JGB auction, which went quite poorly
- ✓ Demand from both domestic and overseas investors appears strong in the global low interest rate environment
- ✓ Lack of relative-value attractiveness may keep primary dealers, who are losing appetite for new supplies, on the sidelines
- ✓ We would like to think about our bidding stance, assuming the range centered at 0.3-0.4%, with a long tail in mind
- ✓ Dip-buying target at the 0.38-0.40% level

Strategic Memorandum DSTE317
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Auction Details

Auction Date: July 4, 2019
Issue Date: July 5, 2019
Maturity Date: June 20, 2049
Offering Amount: About 700 billion

* New 30Y JGBs, JX63, will likely carry a 0.4% coupon.

** On July 3, WI barely traded, and closed at 0.355% (-3.5bp v. previous day's close).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

30Y JGBs have been volatile since the previous 30Y JGB auction, which went quite poorly

After the previous auction for 30Y JGBs, which was held at the 0.305-0.310% level, went quite poorly, the 30Y JGB yield temporarily rose to 0.395% on an intraday basis. Then, as the market was aware of an almost-certain rate cut by the Fed before year-end and the geopolitical risk, the bond markets firmed up around the globe, pushing the 30Y JGB yield down to 0.275% at one point. Toward the end of June, the markets posted higher stock prices/lower bond prices, while Japanese investors paid attention to 1Q-FY portfolio (1H-end for overseas investors). The 30Y JGB yield thus momentarily rose to 0.390%. Subsequently, the yield mostly remained range-bound between 0.355% and 0.385%. Today (Jul 3), the day before the auction, however, the yield declined to 0.345% at one point on an intraday basis. Since the previous auction, 30Y JGBs have been volatile.

Demand from both domestic and overseas investors appears strong in the global low interest rate environment

Concerns about the global economy are lingering partly because of the existence of factors that warrant no optimism, such as Brexit and trade frictions vs. the US. As the ECB is poised to amplify easing (including a rate cut) and the Fed is almost certain to cut rates before year-end, speculations on the BOJ's further easing (such as revision to forward guidance) and the possibility of additional easing (deepening of interest rate in negative territory) are mounting. Market participants are thus aware of the global yield downtrend. In such an environment, we think that superlong JGBs are attractive compared to foreign bonds on a hedging cost basis. Demand for superlong JGBs from both domestic and overseas investors thus appears to be strong.

Lack of relative-value attractiveness may keep primary dealers, who are losing appetite for new supplies, on the sidelines

On the other hand, tomorrow's auction seems to warrant caution. This is because (1) the result of the 10Y JGB auction, conducted on July 2, implied primary dealers' cautious stance to new supplies and (2) we still remember that the 30Y JGB auction in June had a quite weak result. Moreover, it appears difficult to build positions in terms of the relative value as (1) the 30Y sector is not cheap on the curve at the current level and (2) 30Y cash is not undervalued against swaps. It is thus highly possible that primary dealers will have a cautious bidding stance also at tomorrow's auction.

We would like to think about our bidding stance, assuming the range centered at 0.3-0.4%, with a long tail in mind

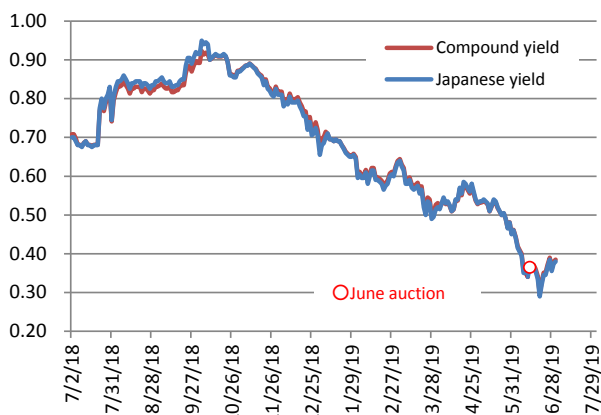
All in all, we would like to think about our bidding stance, assuming that the 30Y JGB yield will move in the range centered at 0.3-0.4% over the next one month. In particular, if tomorrow's auction is held at the current level (around 0.35%), we would keep in mind a high possibility of a long tail, setting dip-buying target at the 0.38-0.40% level.

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 (%)	
7/4/19	63	0.4*	6/20/49	700**									
6/13/19	62R	0.5	3/20/49	699.7	3.47	104.92	104.05	0.87	0.319	0.349	0.030	73.8028	Poor
5/14/19	62R	0.5	3/20/49	699.4	4.65	99.23	99.20	0.03	0.529	0.531	0.002	96.5889	Good
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

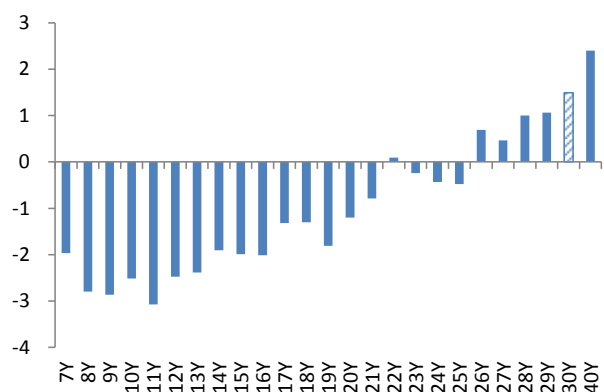
* Daiwa forecast as of July 2 ** Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



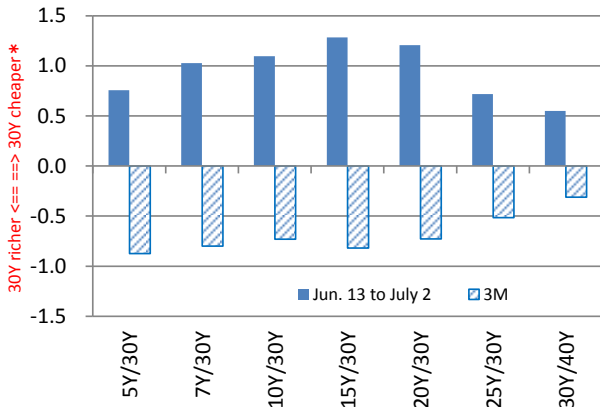
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Jun. 13 v. July 2)



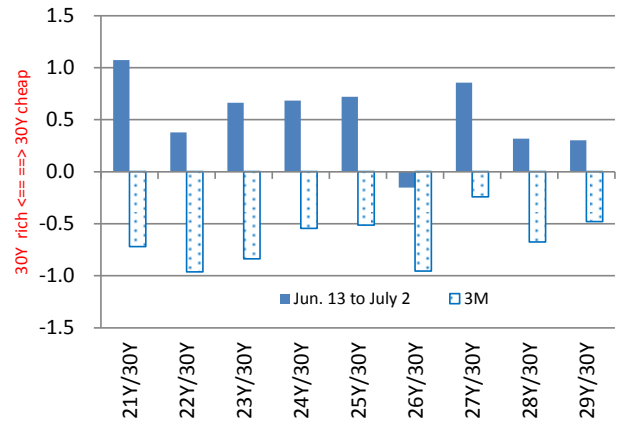
Source: Daiwa Securities.

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



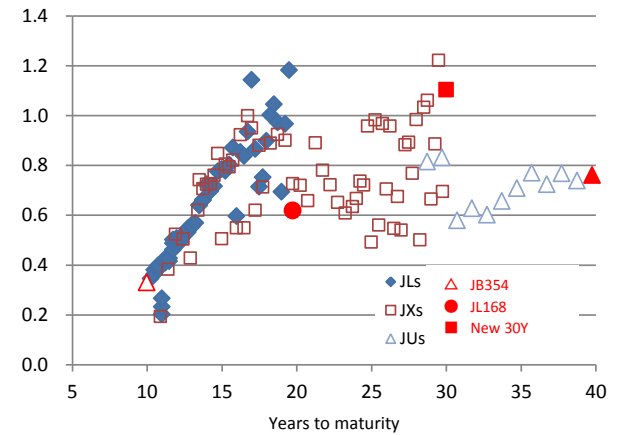
Source: Daiwa Securities.

Appendix 4: 30Y JGB Asset Swap Spread (bp)



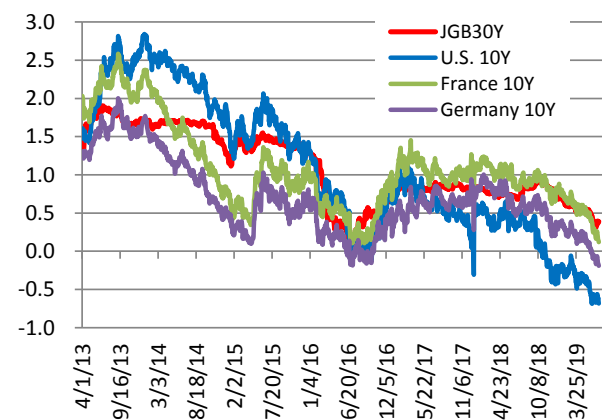
Note: 6M Yen LIBOR basis.
Source: Daiwa Securities.

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



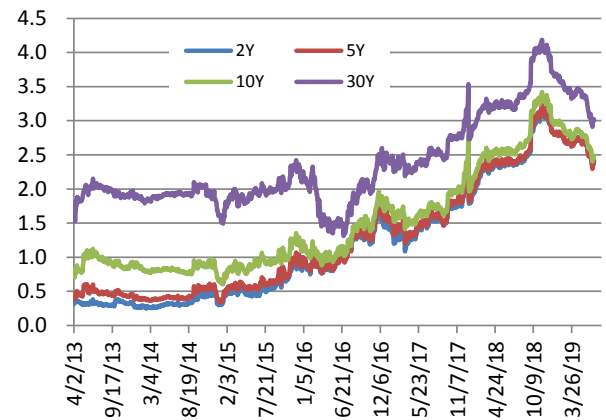
Note: Based on JGB yield curve on June 11, assuming that the yield curve shape does not change and factoring roll-down effect etc.; New 30Y, JX63, is assumed to carry a 0.4% coupon and about 0.5bp spread to JX62 on a compound yield basis.
Source: Daiwa Securities

Appendix 6: 30Y JGB Yield and Hedged Foreign Bond Returns (%)



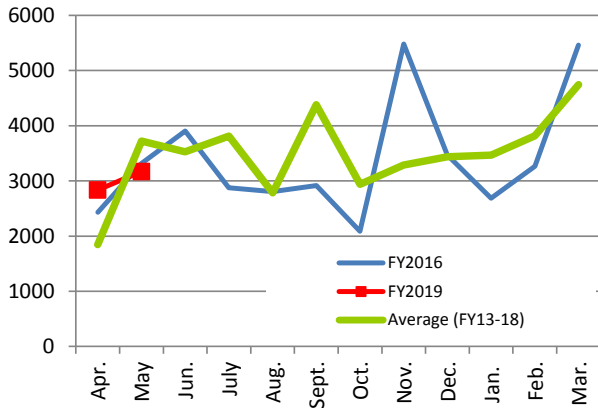
Source: Bloomberg, Daiwa Securities

Appendix 7: Hedged JGB Return (%)



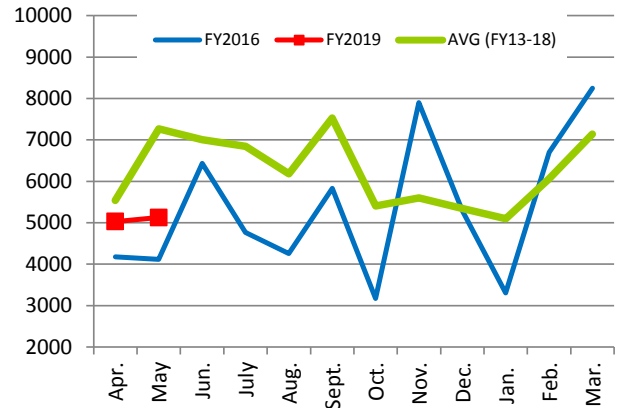
Note: USD basis
Source: Bloomberg, Daiwa Securities

Appendix 8a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



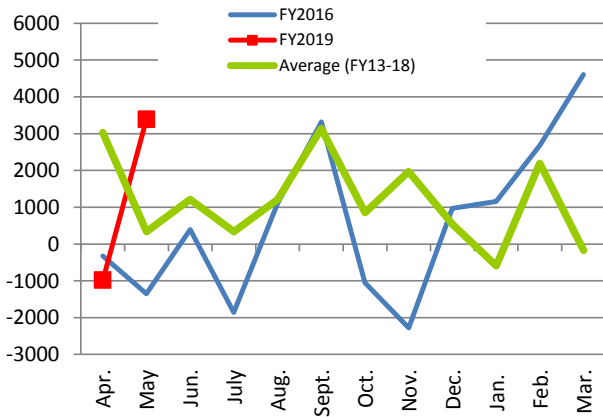
Source: JSDA

Appendix 8b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



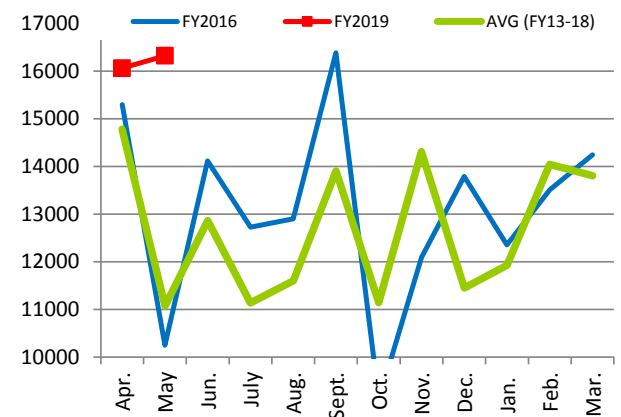
Source: JSDA

Appendix 9a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 9b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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[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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* 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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