

## Outlook for 20Y JGB Auction

### Solid primary sale expected

- ✓ New 20Y JGBs to be redeemed in June 2039, JL169, are expected to carry 0.3% or 0.2% coupon
- ✓ Auction will likely be conducted around the upper end of the 20Y JGB yield range since the previous auction
- ✓ While market participants appear to refocus on the global yield downtrend, expectations on demand for new 20Y JGBs from a wide range of investors linger strongly
- ✓ We think about our bidding stance, assuming that the yield will remain around the 0.20-0.25% range; it may be worth considering switching out from the 30Y sector

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### Auction Details

<b>Auction Date:</b>	July 17, 2019
<b>Issue Date:</b>	July 18, 2019
<b>Maturity Date:</b>	June 20, 2039
<b>Offering Amount:</b>	About 900 billion yen

\* New 20Y JGBs, JL169, will likely carry a 0.3% or 0.2% coupon.

\*\* On July 16, WI barely traded, and closed at -0.250% (-0.5bp v. previous day's close).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### Auction will likely be conducted around the upper end of the 20Y JGB yield range since the previous auction

After the previous 20Y JGB auction went smoothly at the 0.205-0.210% level on June 25, the 20Y JGB yield temporarily rose to 0.255% on an intraday basis amid the softness of the JGB market. Entering July, the US and European bond markets gained in positive reaction to the nomination of the next ECB president and U.S. President Trump's Fed appointees with dovish sense. As the JGB market followed suit, the 20Y JGB yield declined to 0.190% at one point. Once the stronger-than-expected US jobs data diminished excessive speculation on the US rate cut, the bond markets faced downward pressure around the globe. In such a situation, the 20Y JGB yield temporarily rose to 0.245% on July 12 on an intraday basis. The possibility is increasing that primary dealers will bid new 20Y JGBs around the upper end of the yield range since the previous auction.

### Market participants appear to refocus on the global yield downtrend

The last week's congressional testimony by Fed chair Jerome Powell implies that the central bank's rate cut in July is almost certain and reignites speculations on a couple of rate cuts in 2019. Amid lingering concerns about the global economy, the ECB is also poised to amplify easing (including a rate cut). In Japan, chain-reacted 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) will likely mount again. In the environment that market participants refocus on the global yield downtrend, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Fresh 20Y JGBs redeemed in June 2039 (JL169):** If the coupon is set at 0.2%, the issue will be sold under par at the auction.
- ✓ **Strong expectations on demand from investors:** In the global low interest rate environment, yields of JGBs with remaining maturities of nearly up to 13 years are below zero. Partly because of this, expectations on demand for new 20Y JGBs from a wide range of investors linger strongly in light of positive yields and the attractiveness in carry.
- ✓ **Uncertainty remains about demand in terms of relative value:** Data since the previous auction and that over the past three months show that the 20Y sector is neither cheap nor rich on the curve at the current level (Appendix 3). On the other hand, 20Y cash is at the cheaper level now than the previous auction (Appendix 4).

**We think about our bidding stance, assuming that the yield will remain at the 0.20-0.25% range / It may be worth considering switching out from the 30Y sector**

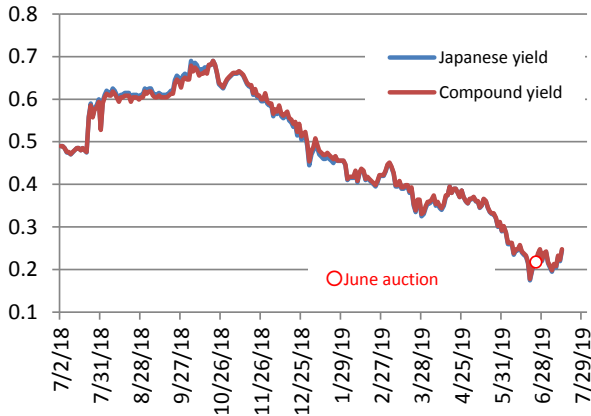
All in all, we think about our bidding stance, assuming that the 20Y JGB yield will move in the range between 0.20% and 0.25% until the next 20Y JGB auction (Aug 20). In terms of the relative value, switching out from the 30Y sector may become active in the market. The 20Y sector is neither noticeably overvalued nor undervalued vs. the 30Y sector at the current level (Appendix 3). Since the previous auction, the range of the 20Y/30Y spread has been very narrow, about 1bp (Appendix 6). Those may discourage curve players from building new positions on the spread aggressively. However, the flattening of the 20-30Y zone may not proceed if we consider (1) the expected spread between new 20Y JGBs, JL169, and JL168 and (2) the balance between the MOF's issuance and the BOJ's purchases until the next 30Y JGB auction (Aug 6). In addition, positive return is expected by holding new 20Y JGBs over the next one month v. the 30Y sector even if the shape of the 20-30Y zone curve (or 20Y/30Y spread level) remains unchanged. It would be worth considering switching out from the 30Y sector into the 20Y sector.

#### 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
7/17/19	169	0.3 or 0.2*	6/20/39	900**									
6/25/19	168R	0.4	3/20/39	1,017	4.08	103.63	103.55	0.08	0.208	0.212	0.004	25.6662	Avg
5/22/19	168R	0.4	3/20/39	1,007	5.47	100.75	100.70	0.05	0.359	0.362	0.003	23.4032	Good
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

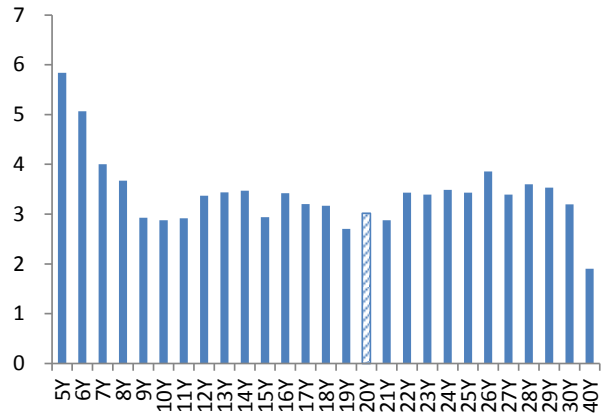
\* Daiwa forecast as of July 16 \*\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



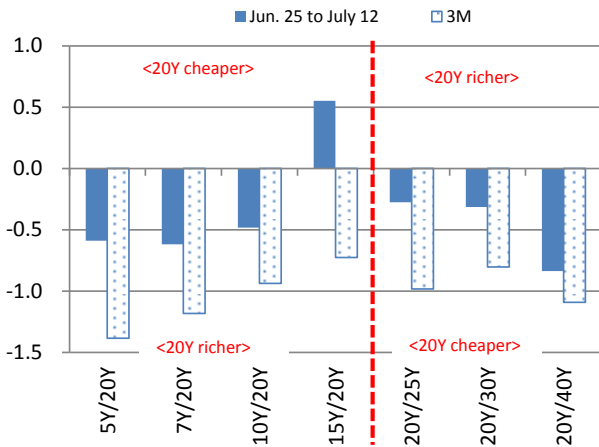
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Jun. 25 v. July 12



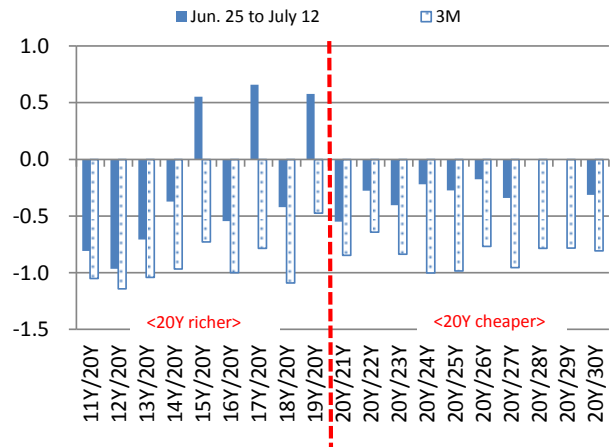
Source: Daiwa Securities.

Appendix 3a: Z-score I



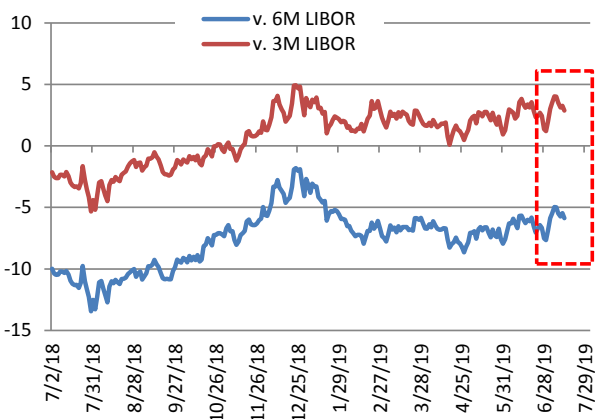
Source: Daiwa Securities.

Appendix 3b: Z-score II



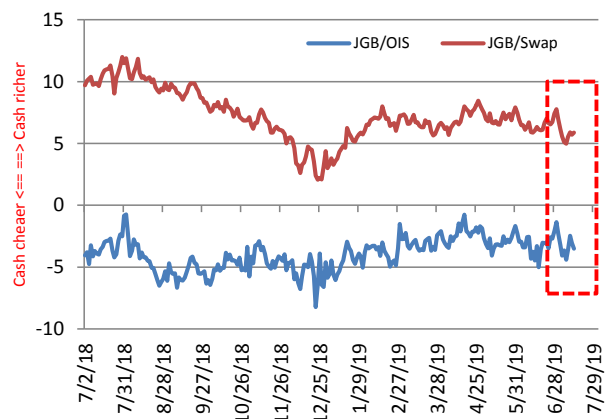
Source: Daiwa Securities.

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



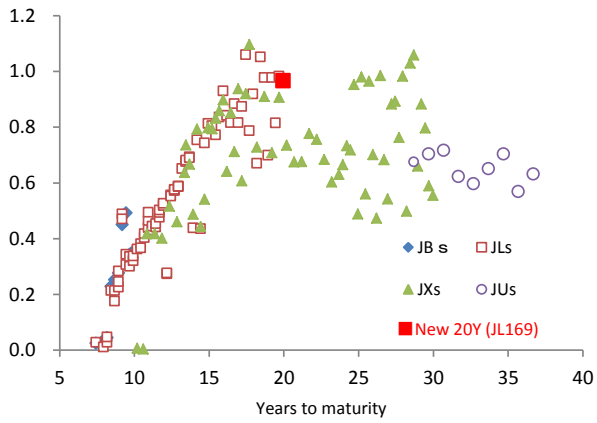
Note:   since the June auction  
Source: Daiwa Securities.

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



Note:   since the June auction  
Source: Daiwa Securities.

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



Note: Based on the July 12 JGB yield curve; factoring in roll-down effect etc.; JL169 is assumed to have a 0.3% coupon and about 0.8bp spread to JL168 on a compound yield basis., Source: Daiwa Securities.

**Appendix 6: JGB20Y/30Y Spread (bp)**



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

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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May 2018

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
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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.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
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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.

\*\* The ratio of margin requirements etc. to the amount of the transaction 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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