

Outlook for 40Y JGB Auction

Primary sale should go smoothly at 0.4% level

- ✓ Tomorrow's auction is to be held at the lowest bidding yield level since the auction in July 2016
- ✓ In the current environment, the 40Y JGB yield may decline close to 0.3% in the medium/long term; therefore the 0.4% yield level would not discourage market participants from buying new 40Y JGBs
- ✓ Gauging demand from real-money investors at the current level, we would like to think of our bidding to take new 40Y JGBs, if needed, at the 0.4% level.
- ✓ It would be worth considering switching out from the 30Y sector

Strategic Memorandum DSTE320
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Auction Details

Auction Date: July 23, 2019
Issue Date: July 24, 2019
Maturity Date: March 20, 2059
Offering Amount: About 400 billion yen

* New 40Y JGBs will be the first reopening of JU12 carrying a 0.5% coupon.

** On July 22, JU12 traded at 0.410-0.415% (+0.5 - +1.0bp v. previous day's close: 0.415-0.420% on compound yield) and closed at 0.410% (+0.5bp; 0.415%).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Placing bids to take only minimum necessary amount

After the previous 40Y JGB auction went well at around 0.550% (on WI basis) on May 28, the 40Y JGB yield (on conventional) remained downward, temporarily falling to 0.335% in mid-June on an intraday basis. Then, the yield has mostly been in the 0.360-0.440% range and recently moving around 0.4%. Tomorrow's auction is to be held at the lowest bidding yield level since the auction in July 2016 when the 40Y JGB yield was in the process of bottoming-out after hitting a record low¹. In such a situation, key points to think about placing bids at tomorrow's auction are as follows:

- ✓ **Short-covering appears not so strong in 40Y:** Primary dealers seem to be rather long in superlong JGBs as a whole;
- ✓ **The 40Y sector is neither rich nor cheap on the curve** (Appendix 5): It is difficult to expect aggressive demand to build new curve positions at the current level;
- ✓ **The auction will be conducted in a yield-Dutch method with the small issuance amount of about 400bn yen:** 40Y JGB auctions tend to go smoothly, generally;
- ✓ **After tomorrow's auction, a series of noteworthy events are scheduled toward the end of the month:** It is difficult to take large positions in either direction;

¹ The yield temporarily logged 0.045% on July 6, 2016, on an intraday basis.

- ✓ **JGB yields are unlikely to face strong upward pressure in the current environment:** With the possibility that the 40Y JGB yield will decline close to 0.3% especially in the medium/long term, we think that market participants are unlikely to be discouraged from buying 40Y JGBs at the 0.4% level.

Thinking of our bidding, if needed, at the 0.4% level / It would be worth considering switching out from currently held 30Y sector

All in all, gauging demand from real-money investors at the current level, we would like to think of our bidding stance to take new 40Y JGBs, if needed, at the 0.4% level. As the 40Y sector is neither noticeably rich nor cheap on the curve, it is difficult to aggressively build new positions. However, we find a strong tendency of 20Y/40Y and 30Y/40Y spreads unlikely to face strong widening pressure after the 40Y JGB auction (Appendix 7). As new 30Y JGBs are to be auctioned in early August, it would be worth considering switching out from the currently held 30Y sector.

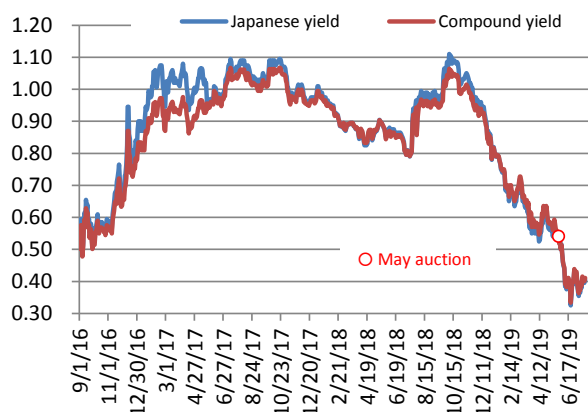
40Y JGB Auction Results

Offer Date	Issue#	Nominal Coupon (%)	Maturity Date	Issue Size (100M yen)	B/C	Highest Accepted Yield (%)	Allotment (%)	Issue Price (yen)	Yield on the previous day (%)***	30Y/40Y on the previous day (bp)**:	Yield at close on the auction day (%)**	30Y/40Y at close on the auction day (bp)**	
7/23/19	12R	0.5	3/20/59	400*					0.411	4.0			
5/28/19	12	0.5	3/20/59	404.5	3.87	0.535	84.4117	98.75	0.560	5.6	0.541	5.1	Good
3/26/19	11R	0.8	3/20/58	413.3	3.50	0.610	8.9655	106.58	0.584	7.2	0.617	7.2	Poor
1/29/19	11R	0.8	3/20/58	399.5	3.79	0.740	10.2272	102.04	0.746	9.3	0.746	9.3	Good
11/27/18	11R	0.8	3/20/58	449.2	3.85	0.940	57.2420	95.41	0.943	12.5	0.934	12.1	Good
9/26/18	11R	0.8	3/20/58	399.2	3.24	1.025	66.5584	92.71	1.027	14.3	1.027	14.3	Good
7/24/18	11R	0.8	3/20/58	399.5	3.30	0.880	36.6400	97.33	0.896	12.8	0.921	13.1	Good
5/29/18	11	0.8	3/20/58	456.7	3.92	0.865	52.4978	97.81	0.890	15.0	0.857	13.5	Good
3/27/18	10R	0.9	3/20/57	566.1	3.19	0.885	20.6239	100.49	0.886	14.6	0.882	14.2	Good

* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of July 19 close for the July 2019 auction

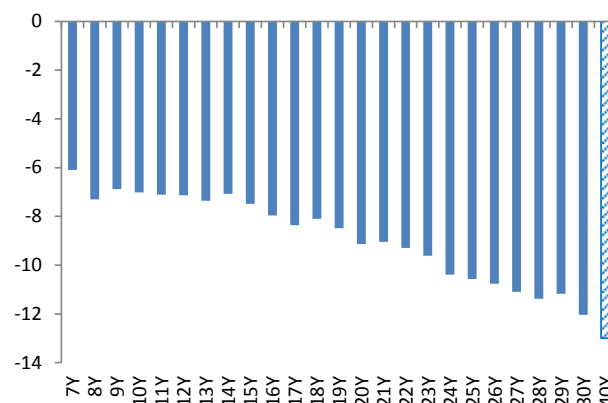
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)

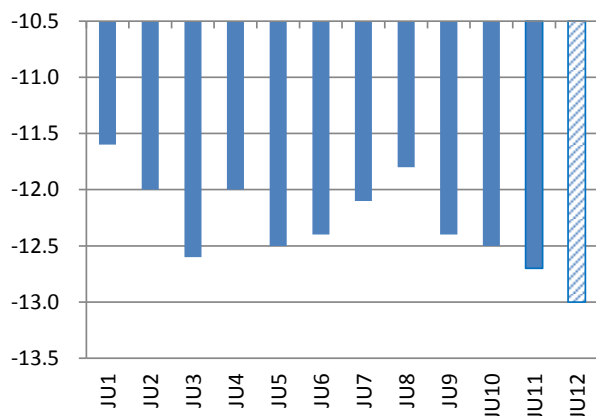


Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): May 28 v. July 19



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): May 28 v. July 19


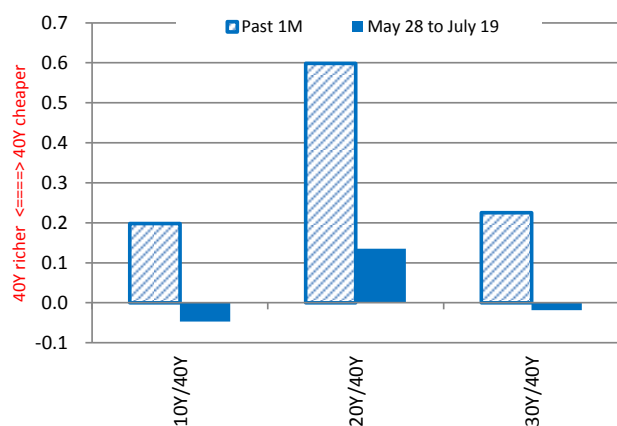
Source: Daiwa Securities.

Appendix 4: 40Y JGBs held by BOJ (Yen billions)

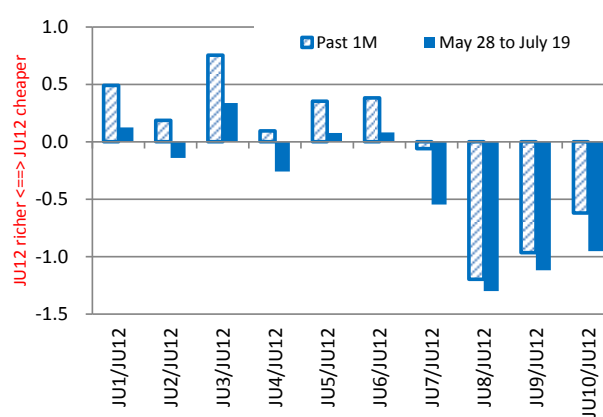
	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,022.3	205.4	20.1%	816.9
JU2	1,342	70	5.2%	1,272
JU3	1,356	195	14.4%	1,161
JU4	1,962	221	11.3%	1,742
JU5	1,946	136	7.0%	1,810
JU6	1,987	932	46.9%	1,055
JU7	2,166	1,065	49.2%	1,101
JU8	2,319	1,252	54.0%	1,067
JU9	3,377	1,521	45.0%	1,856
JU10	3,364	1,136	33.8%	2,229
JU11	2,546	469	18.4%	2,077
JU12	405	4	0.9%	401

Note: as of March 8

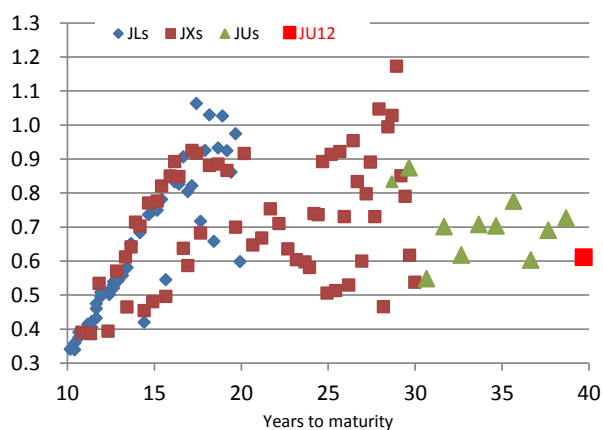
Source: Daiwa Securities.

Appendix 5a: Z-score I


Source: Daiwa Securities. Note: Based on on-the-run issues

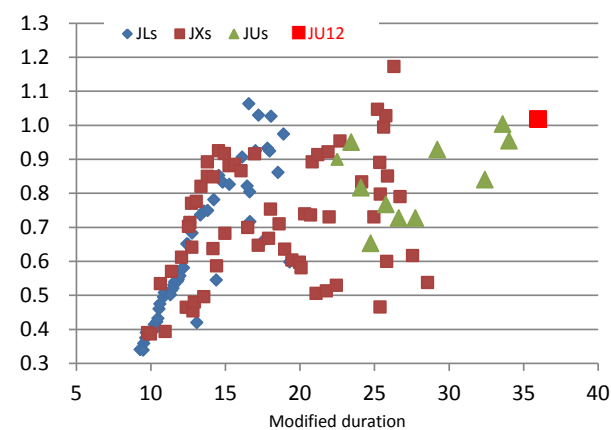
Appendix 5b: Z-score II


Source: Daiwa Securities.

Appendix 6a: 3M Total Return Curve on Years to Maturity (%)


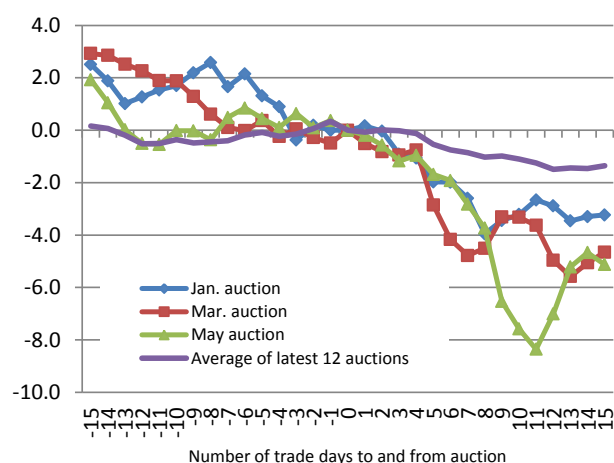
Note: Assuming that the yield curve shape as on July 19 is unchanged and factoring in roll-down effect etc.

Source: Daiwa Securities

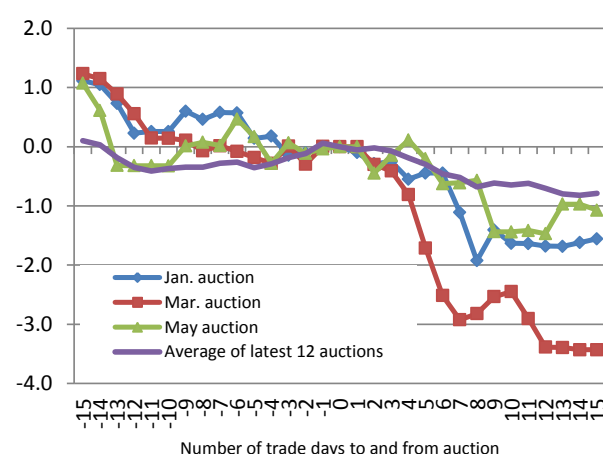
Appendix 6b: 3M Total Return Curve on Modified Duration (%)


Note: Assuming that the yield curve shape as on July 19 is unchanged and factoring in roll-down effect etc.

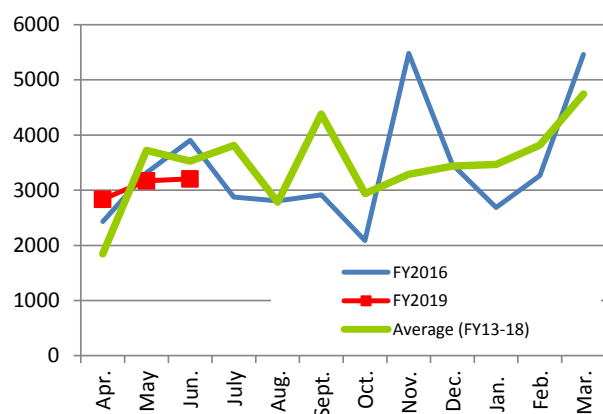
Source: Daiwa Securities

Appendix 7a: 20Y/40Y Spread (bp, before and after 40Y JGB auction)


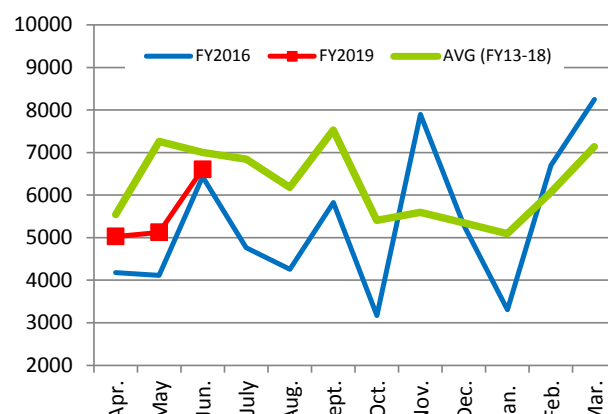
Source: JSDA

Appendix 7b: 30Y/40Y Spread (bp, before and after 40Y JGB auction)


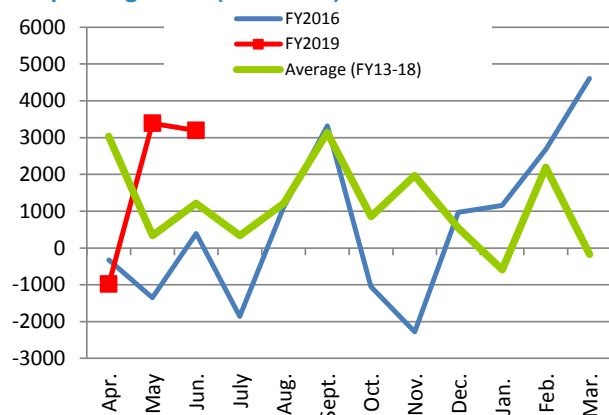
Source: JSDA

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


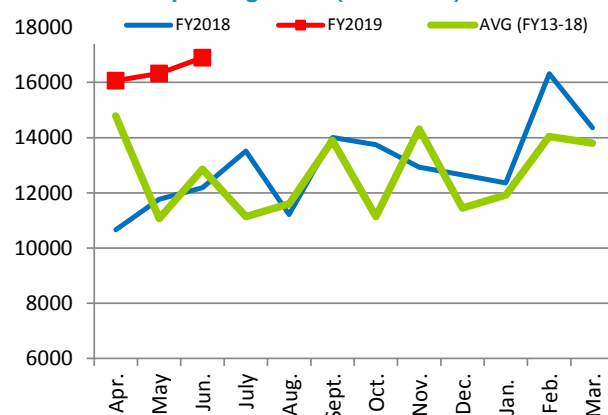
Source: JSDA

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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[Fitch]

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