

## Outlook for 20Y JGB Auction

### Bidding at the 0.1% level

- ✓ The auction is to be held at the record-low bidding yield
- ✓ Global yield downtrend may be refocused again
- ✓ Potential demand appears to remain strong, but we may not see aggressive purchases below 0.1%
- ✓ We think about our bidding stance, assuming that 20Y JGBs will be supported well by dip-buyers at the 0.1% level
- ✓ It would be worth considering buying the 10Y/20Y/30Y butterfly, going long in asset swap or trading the 7Y/20Y box

Strategic Memorandum DSTE328  
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### Auction Details

**Auction Date:** August 20, 2019  
**Issue Date:** August 21, 2019  
**Maturity Date:** June 20, 2039  
**Offering Amount:** About 900 billion yen

\* New 20-year JGBs will likely be the first reopening of JL169 carrying a 0.3% coupon.

\*\* On August 19, JL169 traded at 0.095-0.105% (+1.5 - +2.5bp v. previous day's close) and closed at 0.095% (+1.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### Expected to be sold at the record-low bidding yield level

After the previous 20Y JGB auction went well at the 0.250-0.255% level on July 17, the 20Y JGB yield trended down amid the firmness of the JGB market. The yield thus temporarily fell to 0.050% on an intraday basis. Since the end of last week, market sentiment for superlong JGBs has been bad, putting the yield curve under steepening pressure. In such a situation, the 20Y JGB yield briefly rose to 0.105% on an intraday basis today (up 2.5bp vs. previous day's close). Tomorrow's 20Y JGB auction is likely to be held at a record-low bidding yield level with a high probability.

### Global yield downtrend may be refocused again

Let's look at the environment surrounding the JGB market. Currently, excessive worries about a slowdown in the global economy appear to be easing, reflecting the news on considerations for economic stimulus measures in China and Germany. However, concerns about the global economy are likely to persist partly because of the existence of factors that warrant no optimism, such as Brexit and trade frictions vs. the US. The market is unlikely to immediately change its Recognition that monetary policies will go in a more accommodative direction in Japan, Europe, and the US in the market is unlikely to change immediately. Speculations on additional easing by the Fed are growing ahead of this weekend's economic symposium in Jackson Hole, The global yield downtrend may be refocused again. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **The level of short-covering is uncertain:** Primary dealers seem to be not deeply short in the 20Y sector, or rather long in superlong JGBs as a whole.
- ✓ **Strong expectations on demand from investors:** While yields of JGBs with remaining maturities of around up to 16 years are below zero, a wide range of investors appear to have strong demand for the 20Y sector in light of positive yields and the attractiveness in carry. However, if the yield falls below 0.1%, 20Y JGBs may fail to meet aggressive buyers.
- ✓ **Not expensive in terms of relative value:** The 20Y sector is neither noticeably rich nor cheap on the curve as of today's close. In addition, 20Y asset swap is at the cheapest level since December 2018 (Appendix 4).

**We think about our bidding stance, assuming that 20Y JGBs will be supported well by dip-buyers at the 0.1% level**

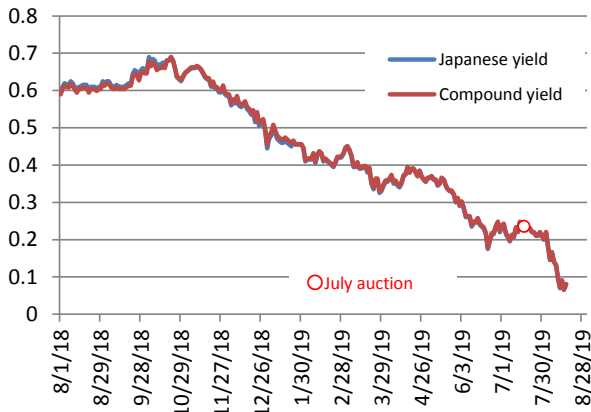
All in all, we think about our bidding stance, assuming that 20Y JGBs will be supported well by dip-buyers at the 0.1% level. In terms of the relative value, it would be worth considering buying the 10Y/20Y/30Y butterfly, going long in asset swaps or trading the 7Y/20Y box. Regarding the 10Y/20Y/30Y butterfly, the 20Y sector has become cheap because the 20Y curvature rose in the 10-30Y zone as the flattening in the 10/20Y lagged behind that in the 10/30Y (Appendix 6). We attribute the lag to the fact that (1) the 20Y JGB yield fell below 0.1% and (2) the BOJ trimmed the offer amount in the JGB purchase operation in the 10-25Y zone. With the downtrend of the 10Y/20Y/30Y butterfly, we find it worth considering buying the butterfly if the 20Y JGB yield is at the 0.1% level. The 20Y asset swap spread is approaching the 6M Yen LIBOR flat level (Appendix 4a). Also on a 3M Yen LIBOR basis, the reversal level has now come in sight (Appendix 4a). The 7Y/20Y box has been declining driven by the flattening of the 7Y/20Y swap spread (Appendix 7). We need to pay attention to receiving pressure by Japanese investors. However, with respect to steepening pressure triggered by overseas news on fiscal expansion, swaps may show more sensitive reactions than JGBs.

#### 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
8/20/19	169R	0.3	6/20/39	900*									
7/17/19	169	0.3	6/20/39	1,018	4.89	100.96	100.95	0.01	0.249	0.249	0.000	84.8219	Good
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

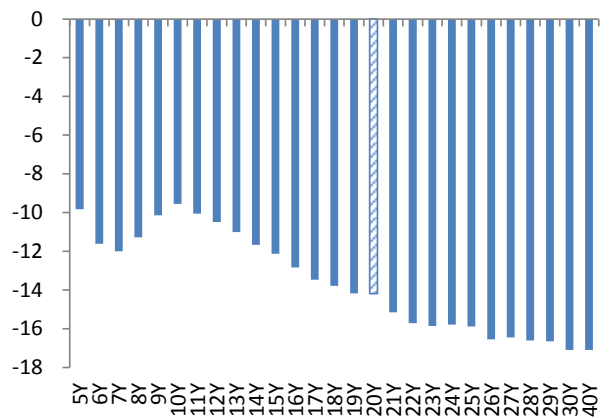
\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



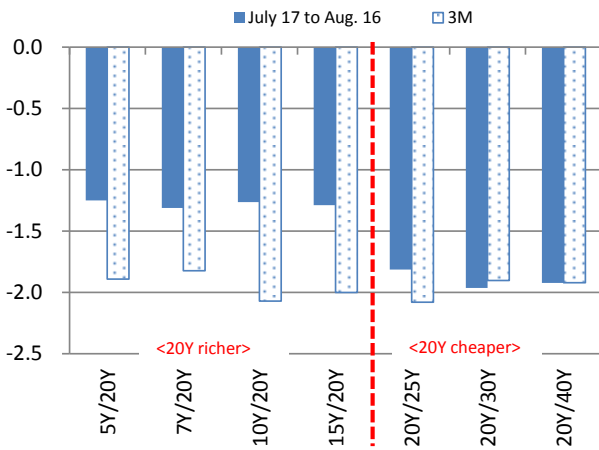
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): July 17 v. Aug. 16



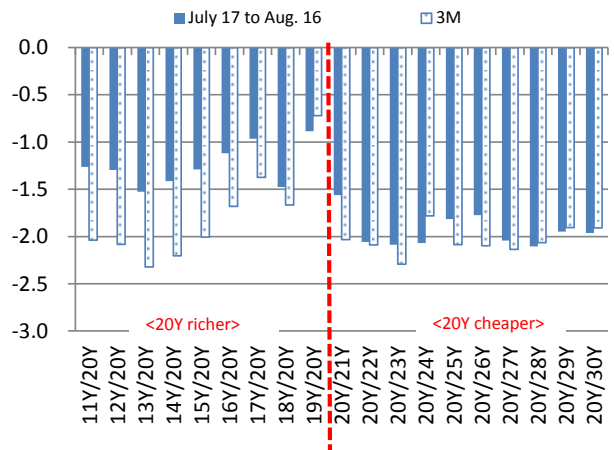
Source: Daiwa Securities.

Appendix 3a: Z-score I



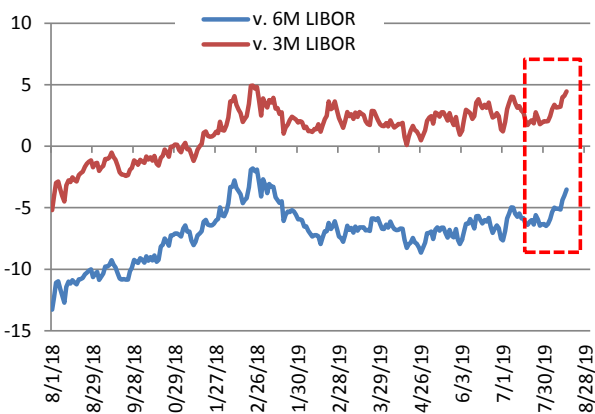
Source: Daiwa Securities.

Appendix 3b: Z-score II



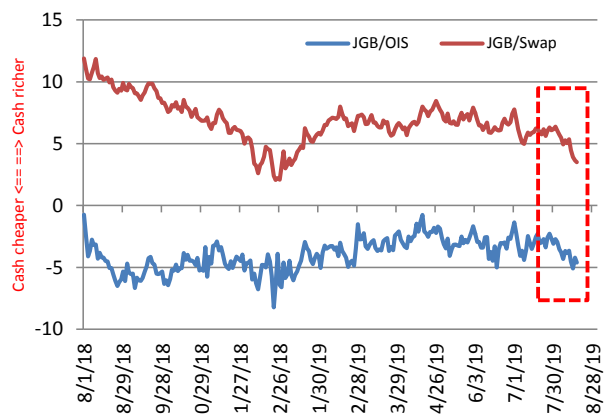
Source: Daiwa Securities.

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



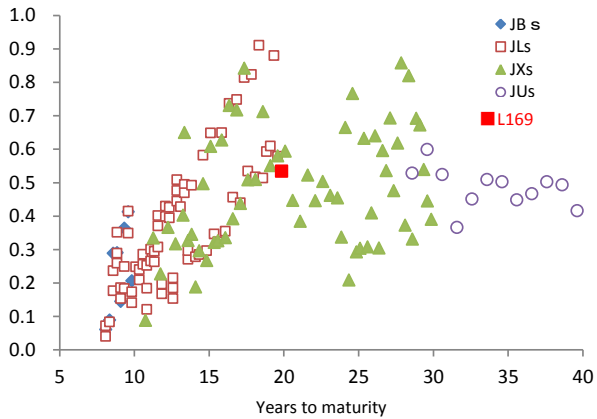
Note:   since the July auction  
Source: Daiwa Securities.

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



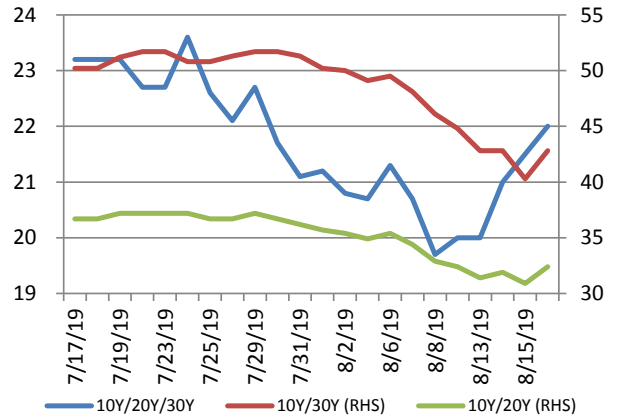
Note:   since the July auction  
Source: Daiwa Securities.

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



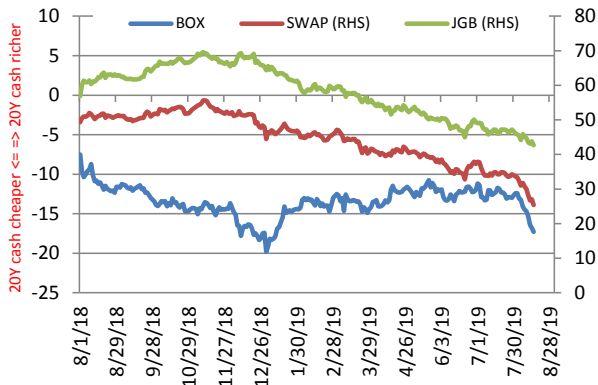
Note: Based on the August 16 JGB yield curve; factoring in roll-down effect etc.  
Source: Daiwa Securities.

**Appendix 6: JGB10Y/20Y/30Y Butterfly (bp)**



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

**Appendix 7: 7Y/20Y Box Spread (bp)**



Source: Daiwa Securities.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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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.

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