

Outlook for 20Y JGB Auction

Bidding above 0.2% to take minimum necessary amount

- ✓ 20Y JGB yield temporarily rose to 0.210%, the highest since July
- ✓ Lingering concerns about global economy and expected more accommodative monetary policies along with resurgence of geopolitical risk in the Middle East may ease upward pressure on 20Y JGB yield
- ✓ Auction participants may take cautious bidding stance at tomorrow's auction in the midst of closely-watched central bank events
- ✓ We need to carefully check potential demand from domestic investors, who are heading to end-1H FY19
- ✓ 20Y sector is not cheap in terms of relative value, but it would be worth considering building flattening positions in 7Y/20Y at 49-50bp level

Strategic Memorandum DSTE331
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Auction Details

Auction Date: September 18, 2019
Issue Date: September 19, 2019
Maturity Date: June 20, 2039
Offering Amount: About 900 billion yen

* New 20Y JGBs will be the final reopening of JL169 carrying a 0.3% coupon.

** On September 17, JL169 traded at 0.190-0.210% (-1.0 - +1.0bp v. previous day's close) and closed at 0.210% (+1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

20Y JGB yield rose to 0.210%, the highest since July

After the previous 20Y JGB auction went smoothly at the 0.110-0.115% level on August 20, the 20Y JGB yield temporarily declined to 0.015% on an intraday basis on September 4 on a sustainable uptrend in JGBs. Then, the bond markets softened around the globe, reflecting (1) speculations on the resumption of US-China trade talks, (2) eased caution about a no-deal Brexit, and (3) favorable US economic indicators. On September 6, we also saw a media report on remarks by BOJ Governor Haruhiko Kuroda—yields in the superlong zone have “fallen a bit too far.” This led to deterioration in market sentiment for superlong JGBs. Today (Sep 17) on an intraday basis, the 20Y JGB yield momentarily rose to 0.210%, the highest level since July 25 (as of 15:00 JST).

Upward pressure on 20Y JGB yields may be eased

Let's look at the environment surrounding the JGB market. Currently, the bond markets around the globe are entering the correction stage as excessive caution about Brexit and trade frictions vs. the US appears to be easing. That said, we think it difficult to fully eliminate worries about the global economy, given the persisting worries about the Chinese economy etc. The market is unlikely to substantially change its recognition that monetary policies will go in a more accommodative direction in Japan, Europe, and the US. Also given the resurgence of the geopolitical risk in the Middle East, we think that upward pressure on 20Y JGB yields from the current level may be limited. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows: In such an

environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Auction to be held in the midst of closely-watched central bank events:** The FOMC meeting and the BOJ's Monetary Policy Meeting are scheduled to announce their decisions on 18th and 19th, respectively. The market consensus for the former is a 25bp rate cut and that for the latter is no major change (such as further lowering of negative rates). If any, we may see surprises leaning to yield declines, such as a substantial rate cut and lowering of interest rates further into negative zone. Due to the recent yield uptrend, these events are unlikely to lead to further yield increases. However, we have to take a cautious stance at tomorrow's auction in the midst of central bank events.
- ✓ **Short-covering appears to be stronger this time than at the previous auction:** Amid the recent yield uptrend, investors have been seen to buy superlong JGBs such as 20Y JGBs. Short-covering at tomorrow's auction appears to be stronger than at the previous auction, which should serve as a support to some extent.
- ✓ **Potential demand from investors needs to be carefully checked:** At tomorrow's auction, potential demand for 20Y JGBs especially from Japanese investors seems strong because (1) tomorrow's auction is the last 20Y JGB auction in the first half of FY19 and (2) the absolute yield level of 20Y JGBs has been corrected up. The trading trends of major investors show that both net and gross purchases in September tend to increase especially in comparison with those in August and October (Appendix 7). That being said, we need to carefully check potential demand from investors in the midst of important central bank events.
- ✓ **Not cheap in terms of relative value:** The 20Y sector is neither noticeably rich nor cheap on the 5-20Y zone of the curve at the current level. On the other hand, the 20Y sector is expensive on the 20-40Y zone of the curve (Appendix 3). The expensiveness especially in the superlong zone can be also confirmed by the downtrend of the 10Y/20Y30Y curvature amid the recent steepening trend (Appendix 6). In addition, the data from the previous auction shows that 20Y cash is overvalued against swaps (Appendix 4). In terms of the relative value, further adjustments appear to be needed.

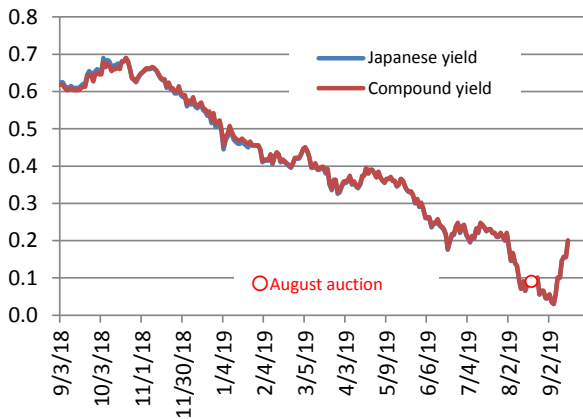
All in all, we would like to place our bids above 0.2% to be able to take new 20Y JGBs in minimum necessary amount. In terms of the relative value, it would be worth considering flattening positions if the 7Y/20Y spread widens to the 49-50bp level with the exit at the 45bp level in mind (Appendix 9).

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
9/18/19	169R	0.3	6/20/39	900*									
8/20/19	169R	0.3	6/20/39	1,019	3.81	103.67	103.60	0.07	0.110	0.114	0.004	32.8061	Avg
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

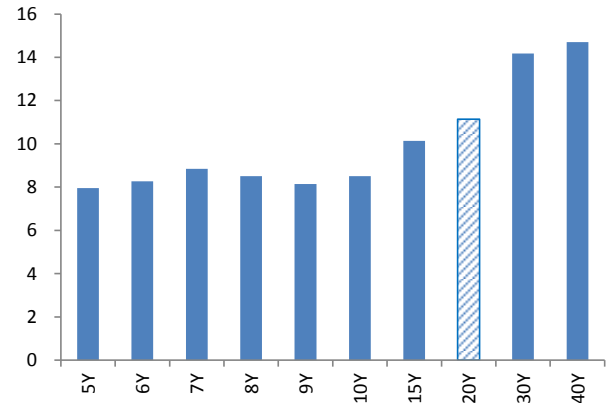
* Amount the Ministry of Finance plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



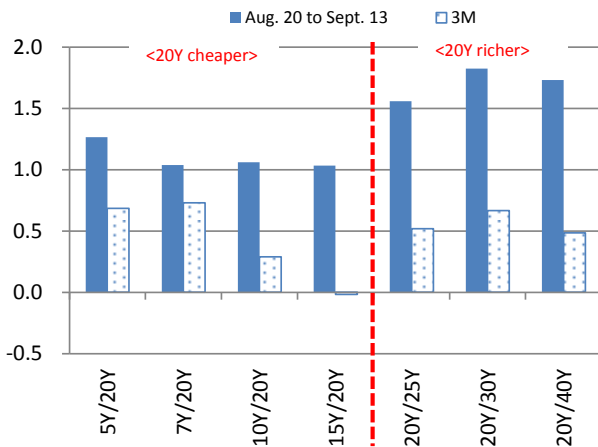
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Aug. 20 v. Sep. 13



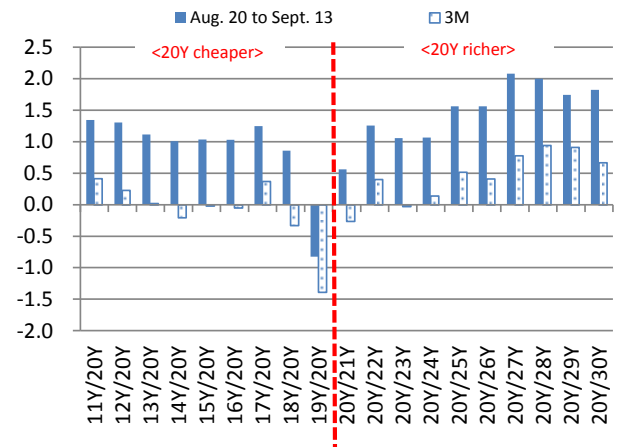
Source: Daiwa Securities.

Appendix 3a: Z-score I



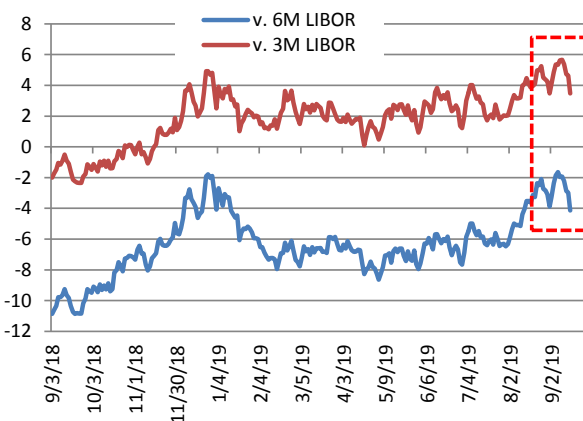
Source: Daiwa Securities.

Appendix 3b: Z-score II



Source: Daiwa Securities.

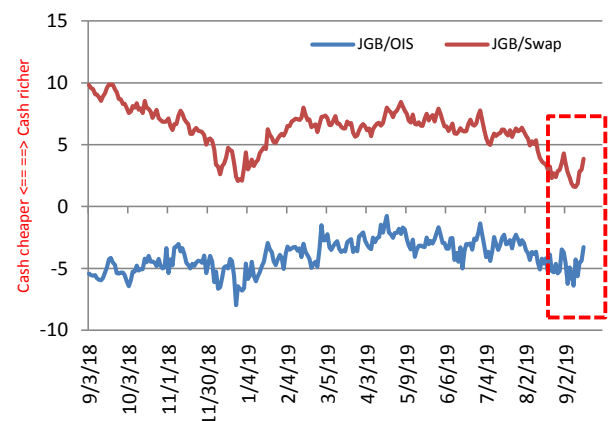
Appendix 4a: 20Y JGB Asset Swap Spread (bp)



Note: since the August auction

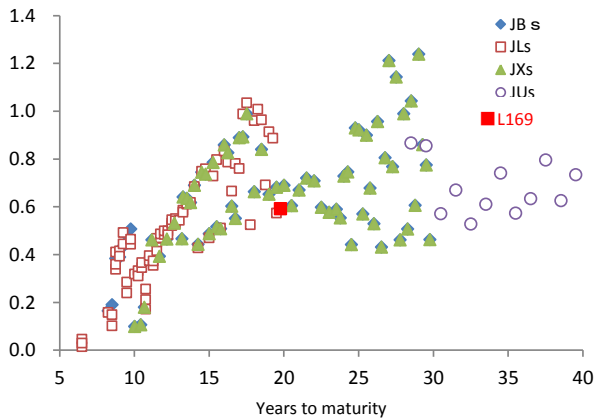
Source: Daiwa Securities.

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

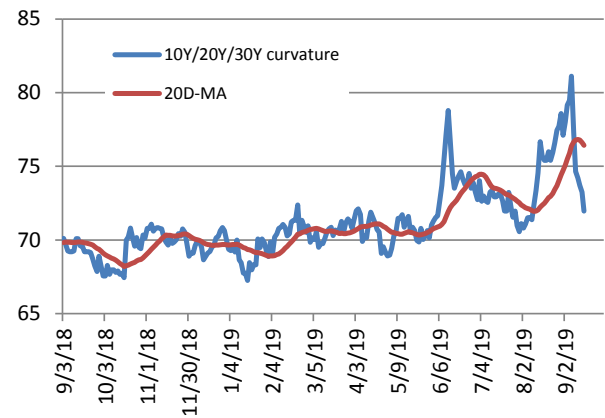


Note: since the August auction

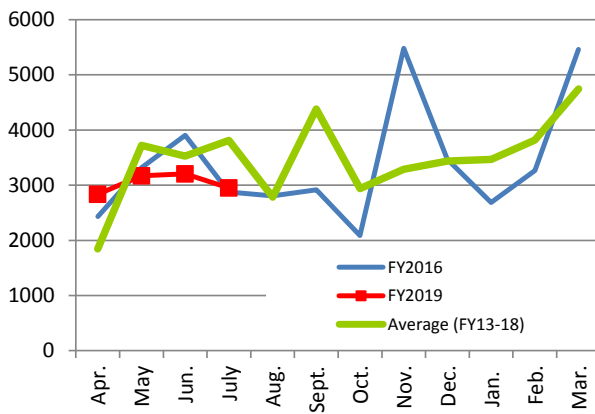
Source: Daiwa Securities.

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


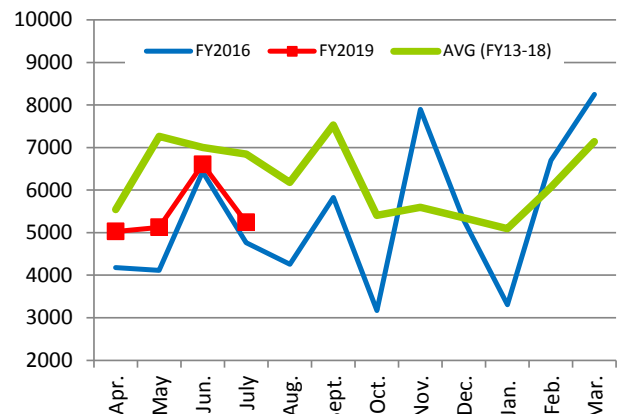
Note: Based on the Sept-13 JGB yield curve; factoring in roll-down effect etc.
 Source: Daiwa Securities.

Appendix 6: JGB10Y/20Y/30Y Curvature (%)


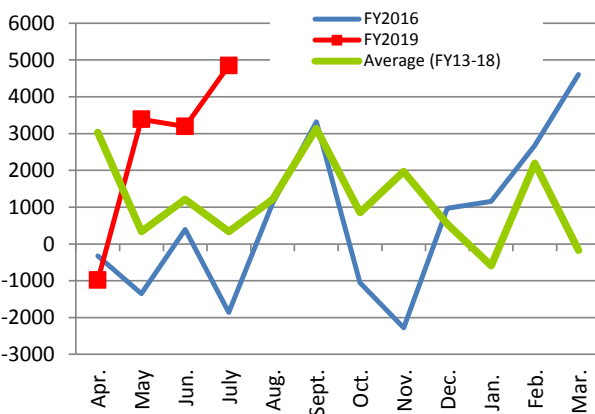
Note: On-the-run issue basis
 Source: Daiwa Securities

Appendix 7a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)


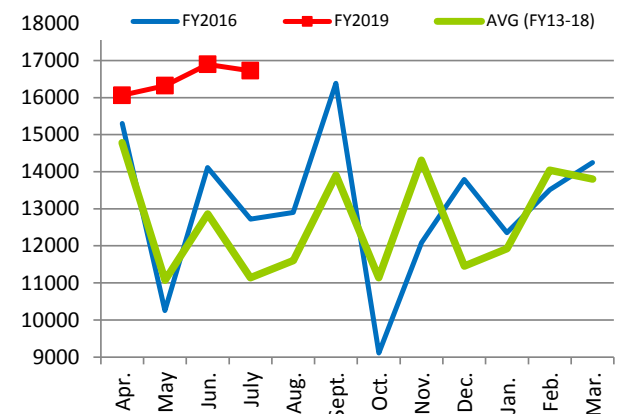
Source: JSDA

Appendix 7b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

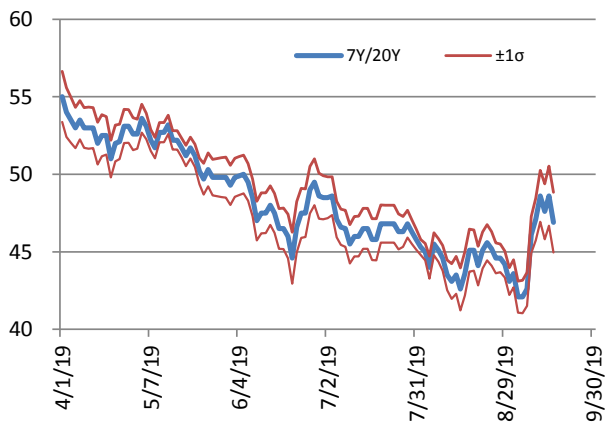
Appendix 8a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

Appendix 8b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

Appendix 9: JGB 7Y/20Y Spread (bp)



Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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[Standard & Poor's]

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[Moody's]

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May 2018

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