

Outlook for 40Y JGB Auction

Taking a cautious bidding stance

- ✓ Although upward pressure on JGB yields is unlikely to increase, market sentiment for superlong JGBs currently appears unfavorable
- ✓ Caution is paid also to BOJ's tapering actions
- ✓ Bidding at the 0.4% level, if needed
- ✓ As we need to carefully watch the steepening trend in the near term, it would be difficult to aggressively build positions on the curve with 40Y JGBs; but it may be worth considering switching out from the 20Y sector in a short horizon

Strategic Memorandum DSTE333
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Auction Details

Auction Date: September 25, 2019
Issue Date: September 26, 2019
Maturity Date: March 20, 2059
Offering Amount: About 400 billion yen

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

** On September 24, JU12 traded at 0.375-0.395% (-2.0bp - unch v. previous day's close; 0.382-0.401% on compound yield) and closed at 0.395% (unch; 0.401%).

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

40Y JGB yield rising from 0.120% to 0.410%

After the previous 40Y JGB auction went poorly at the 0.405-0.410% level (0.411-0.416% on compound yield basis) on July 23, the 40Y JGB yield trended down amid the firmness of the JGB market. In early September, the yield temporarily declined to 0.120% on an intraday basis. Then, BOJ governor Haruhiko Kuroda touched on the level of superlong JGB yields amid the softness of the JGB market due to activities to unwind risk-off positions etc. Following the monetary policy meeting (MPM) on September 18-19, the BOJ aggressively cut the offer amounts in the over 10Y zone, which partially led to deterioration in market sentiment for superlong JGBs. The 40Y JGB yield momentarily rose to 0.410% at the end of last week (Sep 20). In such a situation, key points to think about placing bids at tomorrow's auction are as follows:

- ✓ **Dealers can be short in the 40Y sector, but...:** As they can be rather long in the 30Y sectors, total market shorts around the long end of the curve may be limited;
- ✓ **The superlong zone's expensiveness on the curve was corrected, but...:** For example, the 30Y40Y spread remains low at around 4bp;
- ✓ **The auction will be conducted in a yield-Dutch method in small lot of about 400bn yen:** Generally, primary sale of 40Y JGBs tends to go smoothly;

- ✓ **Caution needed for the BOJ's operation stance:** The BOJ may modify their purchase stance for JGBs with over 10 years left to maturity aggressively, such as by reducing the number of offers per month or intergrading sub-zones, in the October operation guideline released at the end of this month;
- ✓ **A series of supplies scheduled in the superlong zone:** By the next 30Y JGB auction in October, there is a high possibility that the BOJ will conduct only one purchase operation in the over 10Y zone. On the other hand, starting with the 40Y JGB auction tomorrow, a series of supplies is expected in the superlong zone, such as the auction for enhanced liquidity (400bn yen on October 3) etc.
- ✓ **A certain level of demand is expected from investors:** While Japanese major investors show a notable stance of buying superlong JGBs at a certain pace, both net and gross purchases in August appear to have been lower than the average levels (Appendix 7). As there is a tendency that both net and gross purchases in September are higher than those in July or August (Appendix 7), we can expect certain demand from investors.

Although upward pressure on JGB yields is unlikely to increase, market sentiment for superlong JGBs currently appears unfavorable

Let's look at the environment surrounding the JGB market. Recently, the outlook for US-China trade talks has again become more uncertain, alongside growing worries about the European economy. In the long term, it would be difficult to fully eliminate worries about the global economy. In Europe and the US, monetary policies will go in a more accommodative direction, although the degree somewhat differs by nation/region. Also given the resurgence of the geopolitical risk in the Middle East, we think that upward pressure on JGB yields are unlikely to increase due to external factors. Despite such an environment, recent market sentiment for superlong JGBs appears to remain unfavorable.

Bidding at the 0.4% level, if needed

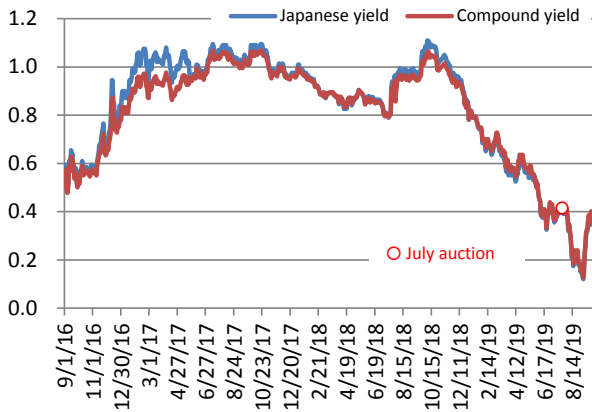
All in all, we would like to think about bidding at the 0.4% level, given the possibility that the 40Y JGB yield will move in the 0.35-0.45% level over the next one month. As we need to carefully watch the steepening trend in the near term, it would be difficult to aggressively build curve positions. However, it may be worth considering switching out from the 20Y sector in a short horizon. Comparing the steepening period since the beginning of September with the flattening period in August, we find that the 10Y/20Y spread has a stronger steepening momentum than the 10Y/30Y and 10Y/40Y spreads (Appendix 9). From the viewpoint of the BOJ's purchase operations as well, the BOJ is more likely to trim purchasing JGBs in the 10-25Y zone than those in the 25-40Y zone.

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)**	
9/25/19	12R	0.5	3/20/59	400*					0.358	4.0			
7/23/19	12R	0.5	3/20/59	399.6	3.02	0.425	25.1445	102.73	0.415	3.9	0.415	4.9	Poor
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

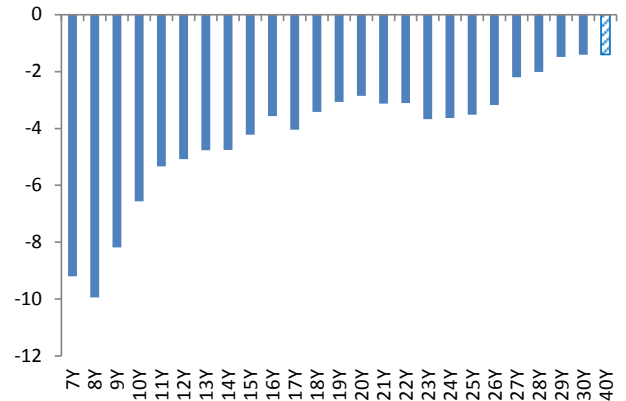
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Sept. 20 close for the Sept. 2019 auction
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



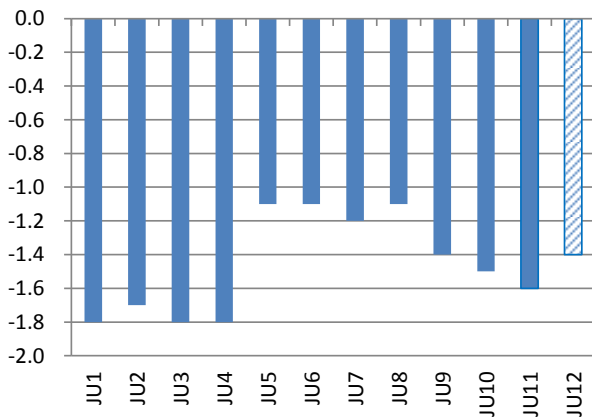
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): July 23 v. Sep. 20



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): July 23 v. Sep. 20



Source: Daiwa Securities.

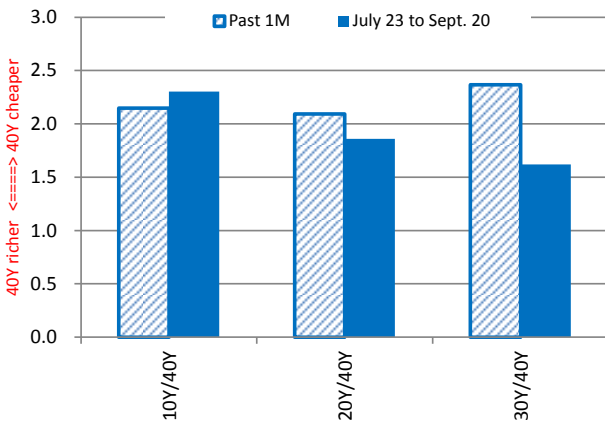
Appendix 4: 40Y JGBs held by BOJ (Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,051.7	248.9	23.7%	802.8
JU2	1,342	70	5.2%	1,272
JU3	1,362	195	14.3%	1,167
JU4	1,962	221	11.3%	1,742
JU5	1,960	136	6.9%	1,824
JU6	1,990	932	46.8%	1,058
JU7	2,167	1,066	49.2%	1,101
JU8	2,319	1,255	54.1%	1,064
JU9	3,383	1,521	45.0%	1,862
JU10	3,371	1,155	34.3%	2,216
JU11	2,562	469	18.3%	2,093
JU12	804	28	3.5%	776

Note: as of March 8

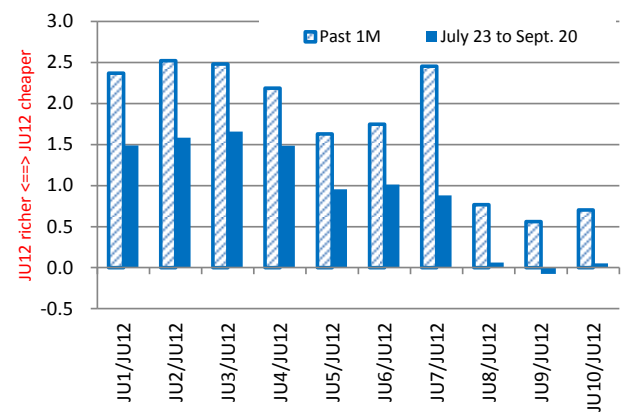
Source: Daiwa Securities.

Appendix 5a: Z-score I



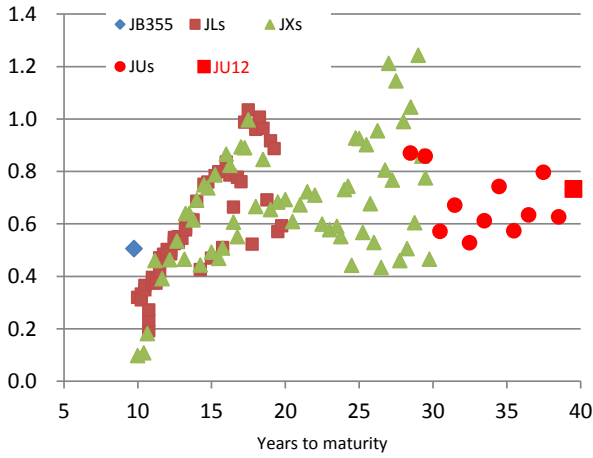
Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 5b: Z-score II



Source: Daiwa Securities.

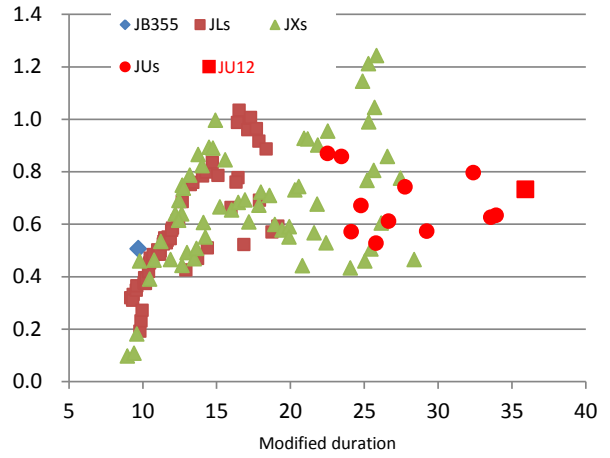
Appendix 6a: 3M Total Return Curve on Years to Maturity (%)



Note: Assuming that the yield curve shape as on Sept. 20 is unchanged and factoring in roll-down effect etc.

Source: Daiwa Securities

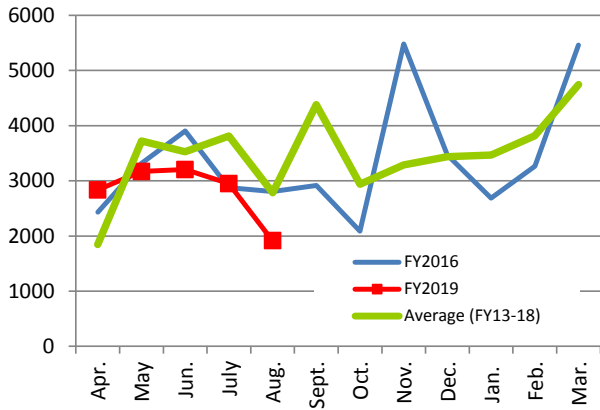
Appendix 6b: 3M Total Return Curve on Modified Duration (%)



Note: Assuming that the yield curve shape as on Sept. 20 is unchanged and factoring in roll-down effect etc.

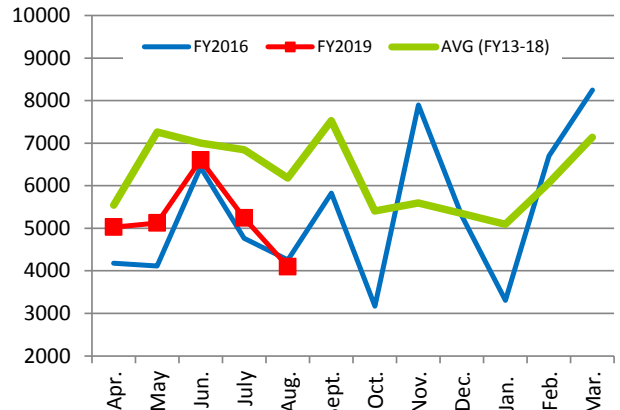
Source: Daiwa Securities

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



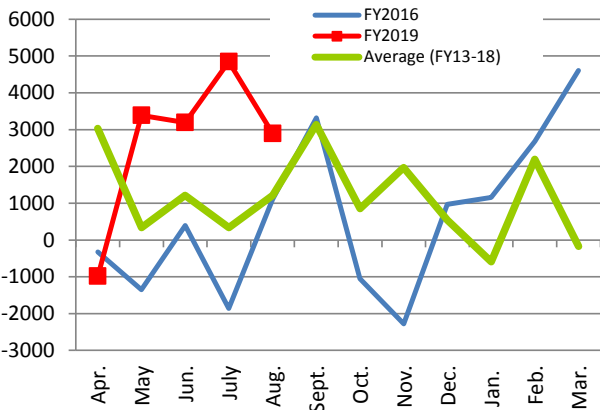
Source: JSDA

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



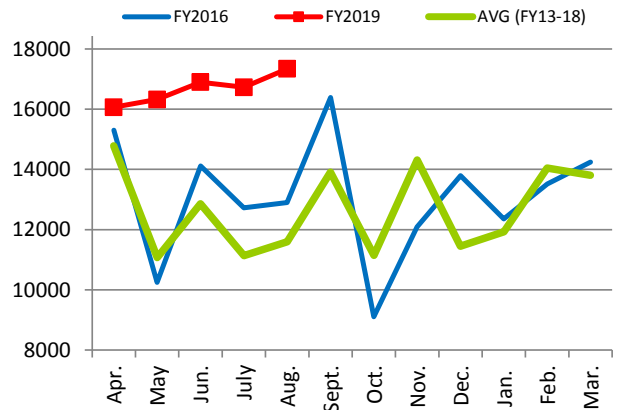
Source: JSDA

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



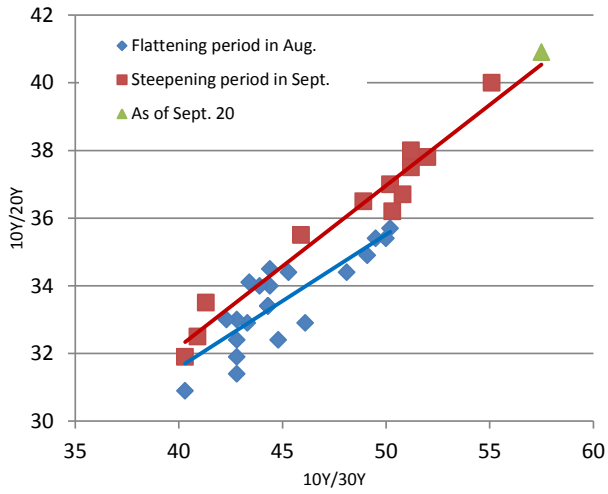
Source: JSDA

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



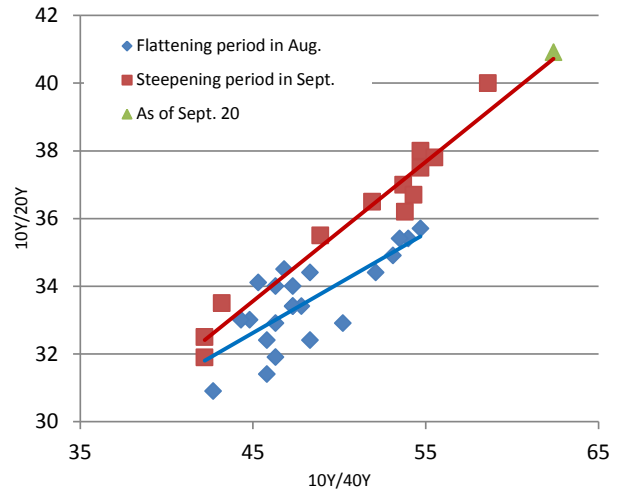
Source: JSDA

Appendix 9a: 10Y/20Y v. 10Y/30Y (bp)



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

Appendix 9b: 10Y/20Y v. 10Y/40Y (bp)



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

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[Standard & Poor's]

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