

## Outlook for 20Y JGB Auction

### Not perfect opportunity to buy though

- ✓ High probability that new 20Y JGBs will be excluded from the BOJ purchase list. Negative impact on tomorrow's primary sale, however, may be limited
- ✓ While short-covering seems to be not strong, decent demand from investors is expected for new 20Y JGBs to belong to new maturity basket
- ✓ 20Y sector appears more expensive on the current yield curve than it is on BOJ curve
- ✓ We would like to think of our bidding stance, assuming the 0.2-0.3% yield level over the next one month
- ✓ Considering buying 20Y cash against swaps or buying asset swaps

Strategic Memorandum DSTE338  
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### Auction Details

**Auction Date:** October 24, 2019  
**Issue Date:** October 25, 2019  
**Maturity Date:** September 20, 2039  
**Offering Amount:** About 900 billion yen

\* New 20Y JGBs, JL170, will likely carry a 0.3% coupon.

\*\* On October 23, WI barely traded, and closed at 0.260% (unch v. previous day's close). JL169 traded at 0.250-0.260% (unch - +1.0bp) and closed at 0.250% (unch).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### 20Y JGB yield at the highest level since June

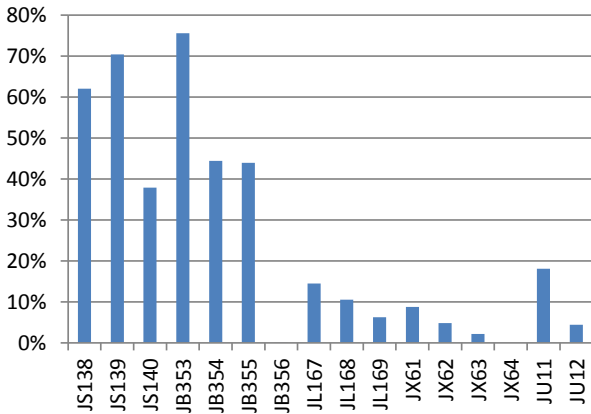
Since the previous 20Y JGB auction went well at the 0.205-0.210% level on September 18, JGBs have been volatile in a wide range without a clear direction. In such a situation, the yield of on-the-run 20Y JGBs (on conventional yield basis) has moved mostly in the 0.150-0.255% range on an intraday basis. For the past several days, the 20Y JGB yield rose amid the softness in the JGB market. As of 14:00 today, the yield momentarily rose to 0.260%, the highest level since June, on an intraday basis.

Let's look at the environment surrounding JGBs. Currently, the bond markets are entering the correction stage around the globe as excessive caution about the Brexit and US-China trade friction appears to be easing. Meanwhile, concerns about the global economy seem to be strengthening recently due to growing worries about a US economic slowdown, in addition to concerns about the European and Chinese economies. In Europe and the US, monetary policies are still expected to go in a more accommodative direction, although the degree somewhat differs by nation/region. Although we need to be attentive to risk-on activities, external factors are unlikely to give strong upward pressure to JGB yields. In such an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **The market is cautious about the possibility that new 20Y JGBs will be excluded from the target of BOJ's purchase operations, but BOJ holding ratios of on-the-run 20Y, 30Y, and 40Y JGBs and neighboring issues are already quite low:** In its JGB purchase operation for JGBs with over 25Y left to maturity on October 18, the BOJ excluded the on-the-run 30Y JGBs, JX64, auctioned on October 10, from the purchase list. That was the first operation in the over 10Y zone after the 30Y JGB auction. Amid growing uncertainty about the selection standard for issues the central bank buys, there is a strong possibility that new 20Y JGBs to be auctioned tomorrow will be excluded from the purchase list. However, the comparison of BOJ holding ratios of recently-issued several issues by maturity (5Y, 10Y, 20Y, 30Y and 40Y) shows that the ratios of 20Y, 30Y, and 40Y JGBs are quite low relative to 5Y and 10Y JGBs (Chart 1). This implies that investors have strong demand for superlong JGBs in the primary stage. Depending on demand from investors, negative impact by the BOJ's operation risk on tomorrow's primary sale of new 20Y JGBs may be limited;
- ✓ **Short-covering is unlikely to strongly support primary sale:** Short positions around the 20Y sector appear to have been already covered to some extent;
- ✓ **Demand from investors is expected to be stronger:** In addition to the attractiveness of 20Y JGBs in terms of carry and the broad base of investors, tomorrow's auction will issue new 20Y JGBs in new maturity basket to be redeemed in September 2039. We therefore expect decent demand from investors;
- ✓ **Lacking strong attractiveness on the curve, but cheapening vs. swaps:** According to data since the previous auction and over the past three months, the 20Y sector is neither noticeably overvalued nor undervalued vs. major sectors on the 5-20Y zone of the curve at the current level (Appendix 3a). On the other hand, 20Y cash has become more undervalued against swaps (Appendix 4);
- ✓ **20Y sector appears more expensive on the current yield curve than it is on BOJ curve:** Compared to (1) the BOJ curve, the yield curve shape desired by the BOJ at the time of introduction of yield curve control (YCC) policy and (2) the shape of the yield curve immediately before the introduction of the YCC policy, the 20Y sector still appears expensive on the 10-30Y zone of the current curve (Appendix 6). Amid growing uncertainty about the shape of the curve sought by the BOJ, the 20Y sector looks overvalued if we use the BOJ curve as a guideline;
- ✓ **Bidders may hesitate to place aggressive bids ahead of central bank events:** Starting from tomorrow's ECB Governing Council meeting, major central bank events are slated to be held (FOMC meeting on Oct. 29-30 and BOJ's monetary policy meeting on Oct. 30-31). As many market participants are paying attention especially to the Fed's rate cut stance beyond October and the BOJ's decision on additional easing, it would be difficult to place aggressive bids ahead of those events.

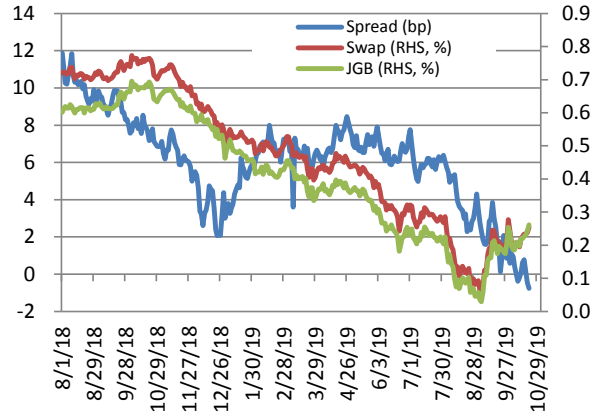
All in all, we would like to think of our bidding stance at tomorrow's auction, assuming that the JL170 yield will move in the 0.2-0.3% level over the next one month. In terms of the relative value, we would like to think of positioning against swaps. On the recent yield uptrend, the 20Y swap spread has tightened (Chart 2). It would be worth considering buying 20Y cash against swaps or buying asset swaps (Appendix 4) because (1) the 20Y swap spread tends to face widening pressure under the yield uptrend and (2) superlong cash appears to have substantially factored in the BOJ's operation risk.

Chart 1: BOJ Holding of JGBs to Issue Amount (%)



Note: as of Oct. 10 on the BOJ start day  
Source: Daiwa Securities.

Chart 2: 20Y JGB Yield, 20Y Swap Rate and Spread



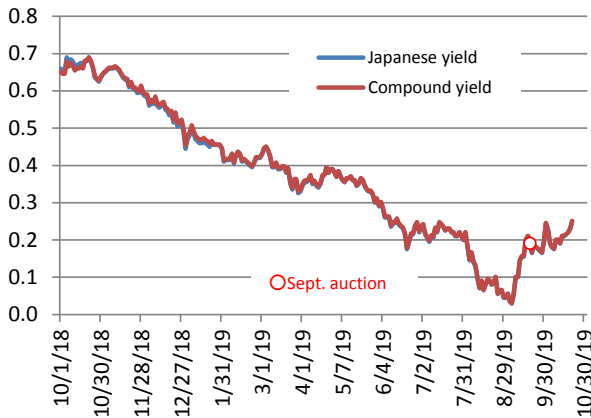
Source: Daiwa Securities.

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
10/24/19	170	0.3*	9/20/39	900**									
9/18/19	169R	0.3	6/20/39	949	3.48	101.79	101.70	0.09	0.205	0.210	0.005	20.3703	Good
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

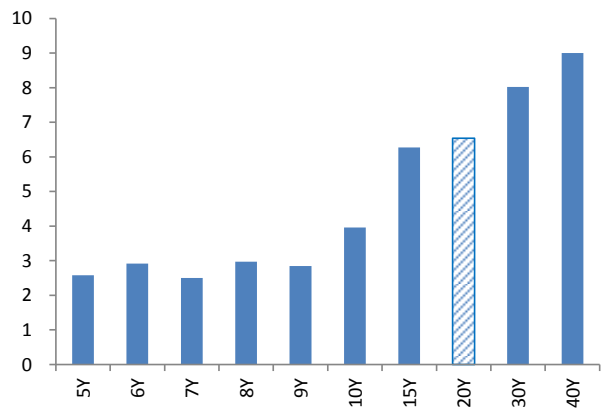
\* Daiwa forecast (as of Oct. 23) \*\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



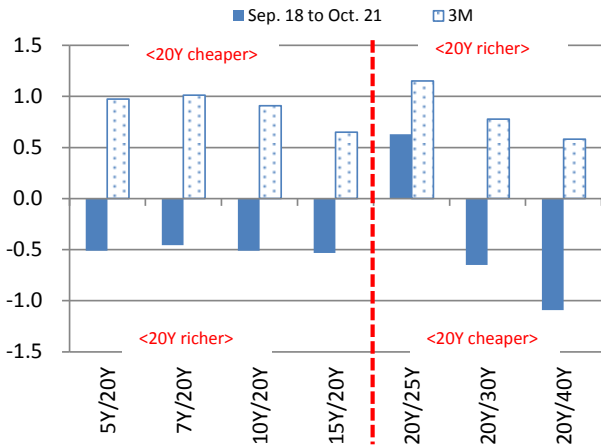
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Sep. 18 v. Oct. 21



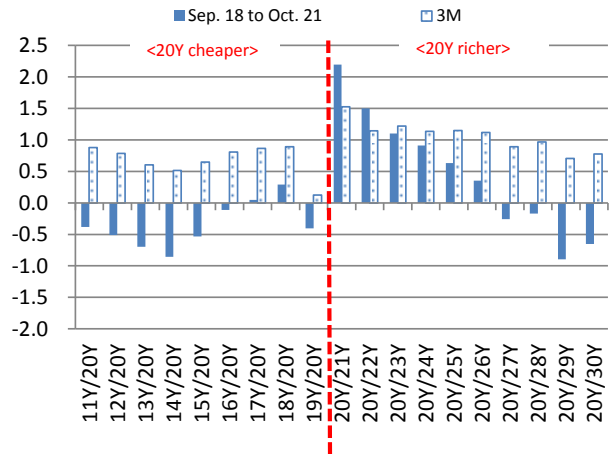
Source: Daiwa Securities.

**Appendix 3a: Z-score I**



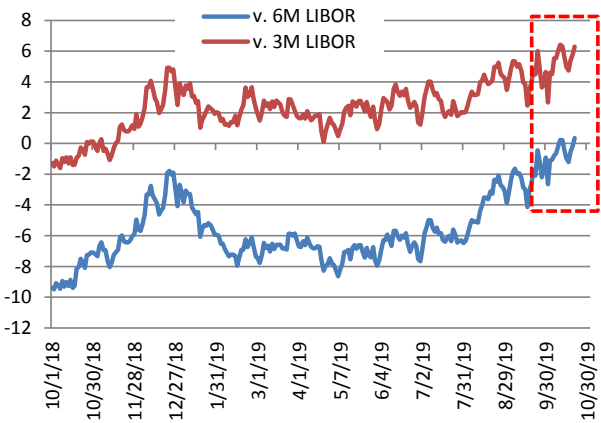
Source: Daiwa Securities.

**Appendix 3b: Z-score II**



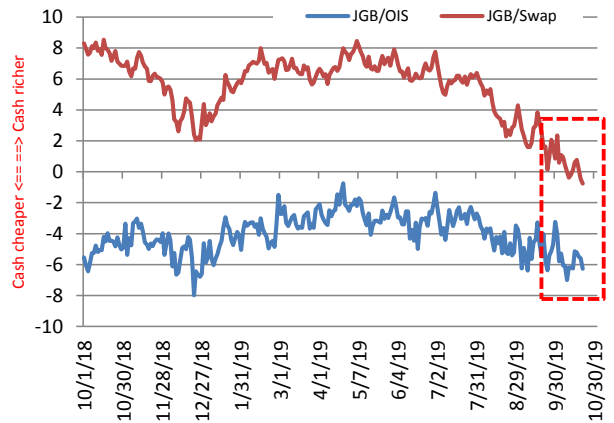
Source: Daiwa Securities.

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



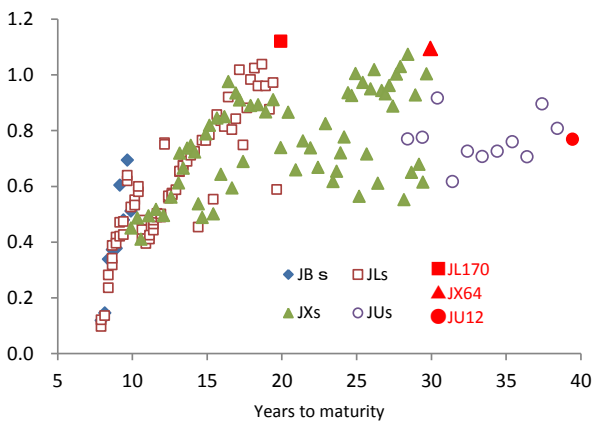
Note:   since the Sep. auction  
Source: Daiwa Securities.

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



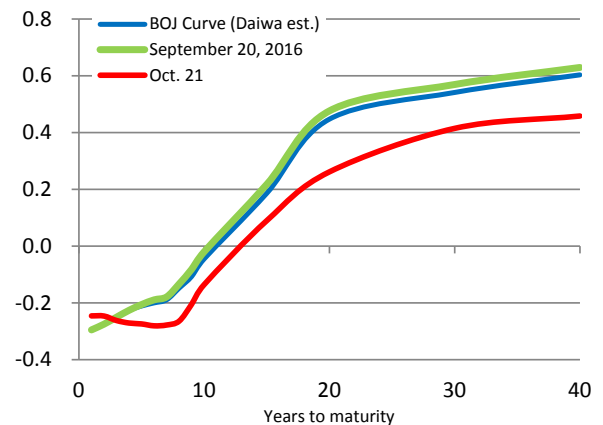
Note:   since the Sep. auction  
Source: Daiwa Securities.

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



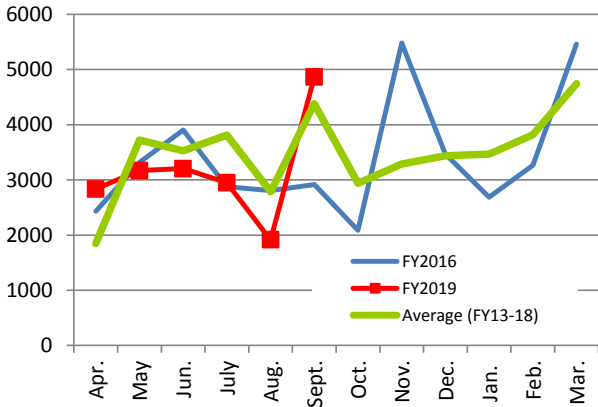
Note: Based on the Oct-21 JGB yield curve; factoring in roll-down effect etc.; JL170 is supposed to have a 0.3% coupon and about 1bp spread to JL169.  
Source: Daiwa Securities.

**Appendix 6: JGB Yield Curve Comparison (%)**



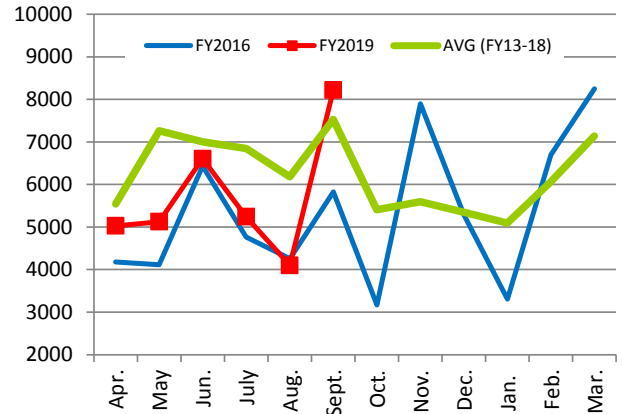
Note: "BOJ Curve" is estimated by Daiwa Securities, based on a chart in "Visualized Comprehensive Assessment and QE with YCC", which was released on Sep. 21, 2016 only in Japanese.  
Source: Daiwa Securities

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



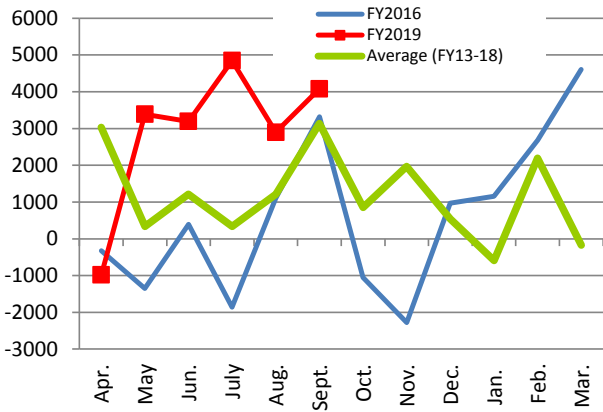
Source: JSDA

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



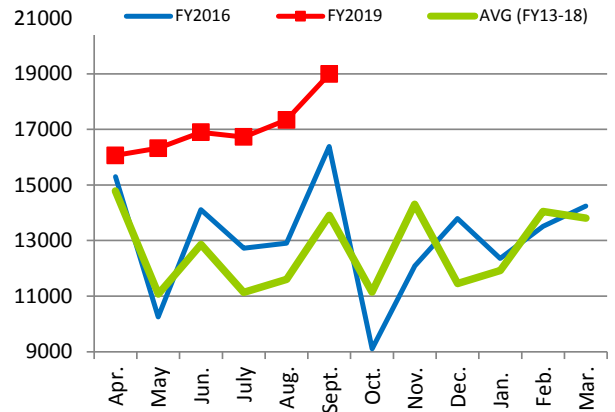
Source: JSDA

**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

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- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
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- 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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