

Outlook for 30Y JGB Auction

Not the best opportunity to buy though

- ✓ The highest yield level since mid-October may stimulate real-money investors' appetite for new 30Y JGBs.
- ✓ On the other, there are some worrisome factors—e.g., short-covering by primary dealers may not be strong enough.
- ✓ Building new curve positions on the current yield curve may not be profitable enough. Switching may be limited within the 30Y sector.
- ✓ Unless we see further adjustment in pre-auction trading tomorrow, we would like to think about placing our bids to take only minimum necessary amount.

Strategic Memorandum DSTE341
FICC Research Dept.

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Auction Details

Auction Date: November 12, 2019
Issue Date: November 13, 2019
Maturity Date: September 20, 2049
Offering Amount: About 700 billion yen

* New 30Y JGBs will be the first reopening of JX64 carrying a 0.4% coupon.

** On November 11, JX64 traded at 0.455% (+1.0bp v. previous day's close) and closed at 0.450% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

After the previous 30Y JGB auction went well at the 0.385-0.390% level on October 10, the JGB market softened. With market participants becoming more optimistic about US-China trade talks and Brexit, the market was weighed by many bond-unfriendly factors, such as diminishing expectations for additional easing by the BOJ and the emergence of speculations on an end to rate cuts by the Fed as well. During that period, the 30Y JGB yield had been range-bound around 0.4% as dip-buyers were seen above the level. At the end of last week, the yield momentarily rose to 0.445% on an intraday basis, the highest level since June amid intensifying risk-on activities and probably because investors started preparing for tomorrow's auction. The auction will likely be held at the highest bidding yield level since the auction held in May 2019 for a reopening of JX62.

Let's look at the environment surrounding the JGB market. Currently, a sense of caution is left about the risk-on mode in overseas markets. In the longer term, however, it would be difficult to fully eliminate worries about the global economy. In Europe and the US, a next step of monetary policies appears to be the status quo or additional easing (such as rate cuts). As such, fundamental factors prevent us from expecting a major yield uptrend in JGB yields. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Absolute yield level:** Tomorrow's auction will likely be held at the highest bidding yield level since the auction in May 2019 (reopened issues of JX62). In addition, new 30Y JGBs will be auctioned at the highest yield level amid the JGB decline stage since mid-October. Expectations will grow on decent demand from real-money accounts;
- ✓ **Relative value:** At the current level, the 30Y sector is not cheap on the intermediate to superlong zone of the curve (Appendix 3). The 30Y asset swap is in positive territory v. Yen LIBOR level, but it has overvalued since the previous auction (Appendix 4);
- ✓ **Supply/demand balance:** Starting from tomorrow's auction through the Auction for Enhanced Liquidity scheduled for December 12, we will have new supply of superlong JGBs in a relatively good size every week. During the period, the BOJ will buy only about 390bn yen of superlong JGBs, if the Bank keeps the current offer amounts unchanged, with a high probability. There are a couple of supportive factors. As a large amount of JGBs are redeemed in December, expectations for support from index duration extension activities are likely to strengthen at the end of the month. Regarding the FY20 JGB issuance plan, which is likely to garner attention going forward, the market may increase speculation on a cut in the superlong zone. However, worries about the supply/demand balance in the superlong zone are likely to persist in the near term.
- ✓ **Short-covering by primary dealers may not be strong enough for smooth sale.**

All in all, unless we see further adjustment in pre-auction trading, we would like to place our bids to take minimum necessary amount of new 30Y JGBs. In terms of the relative value, it is not a good timing to aggressively build new positions. Regarding the curve, bear flattening had intensified during the recent downtrend, but such a trend appears to be letting up. Switching is likely to be limited within the 30Y sector.

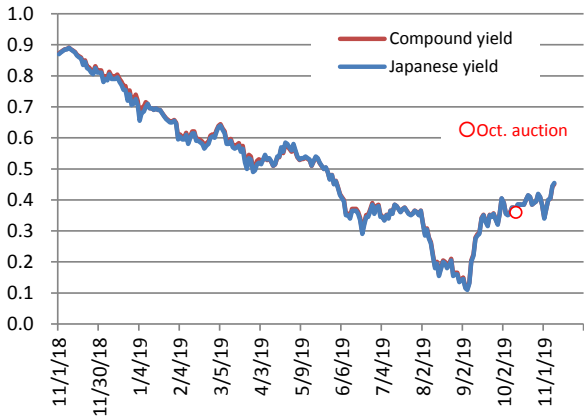
30Y JGB Auction Results

Auction Date	Issue #	Coupon (%)	Maturity	Amt Issued (billion yen)	B/C	Average Accepted Price (Yen)	Lowest Accepted Price (Yen)	Tail (Yen)	Average Accepted Yield (%)	Highest Accepted Yield (%)	Tail (%)	Allotment (%)	Rating	Close on Auction Day (%)
11/12/19	64R	0.4	9/20/49	700*										
10/10/19	64	0.4	9/20/49	795.1	3.87	100.46	100.40	0.06	0.382	0.385	0.003	17.7786	Good	0.360
9/5/19	63R	0.4	6/20/49	797.6	3.45	107.41	107.30	0.11	0.140	0.144	0.004	53.1585	Avg	0.134
8/6/19	63R	0.4	6/20/49	699.3	3.50	102.95	102.75	0.20	0.292	0.299	0.007	81.5080	Avg	0.305
7/4/19	63	0.4	6/20/49	799.4	4.01	101.15	101.00	0.15	0.357	0.362	0.005	13.0239	Avg	0.345
6/13/19	62R	0.5	3/20/49	699.7	3.47	104.92	104.05	0.87	0.319	0.349	0.030	73.8028	Poor	0.365
5/14/19	62R	0.5	3/20/49	699.4	4.65	99.23	99.20	0.03	0.529	0.531	0.002	96.5889	Good	0.535
4/4/19	62	0.5	3/20/49	747.3	4.55	98.96	98.90	0.06	0.540	0.542	0.002	18.8092	Good	0.530
3/7/19	61R	0.7	12/20/48	739.7	4.56	101.97	101.90	0.07	0.621	0.624	0.003	4.7619	Good	0.615
2/7/19	61R	0.7	12/20/48	699.1	4.72	102.85	102.80	0.05	0.587	0.589	0.002	63.1931	Good	0.610
1/10/19	61	0.7	12/20/48	762.2	4.03	99.62	99.60	0.02	0.715	0.716	0.001	87.3552	Good	0.710
12/11/18	60R	0.9	9/20/48	769.2	3.78	102.55	102.50	0.05	0.794	0.796	0.002	82.4455	Good	0.790
11/12/18	60R	0.9	9/20/48	758.3	3.99	100.60	100.55	0.05	0.874	0.876	0.002	64.4188	Good	0.875
10/11/18	60	0.9	9/20/48	706.4	3.92	100.04	100.00	0.04	0.898	0.900	0.002	69.4027	Good	0.900

* Amount the Ministry of Finance plans to issue

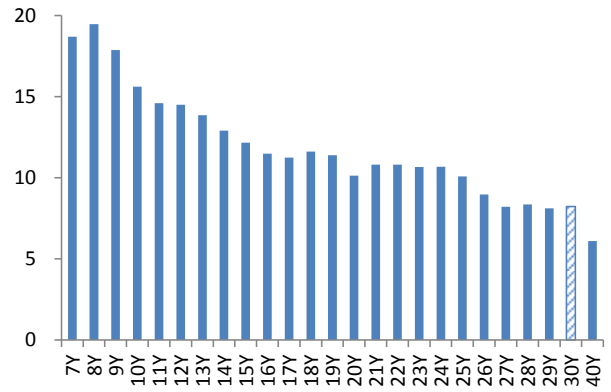
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



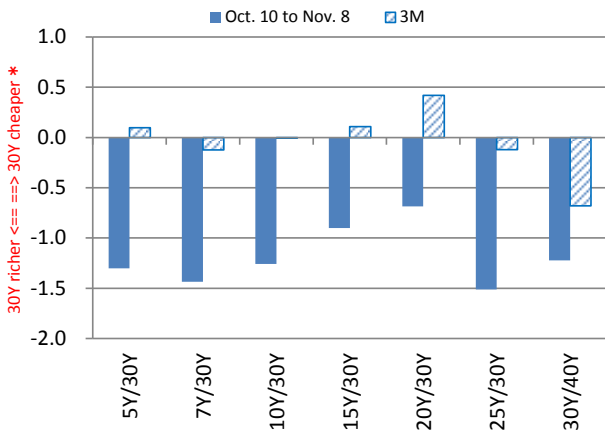
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Oct. 10 v. Nov. 8)



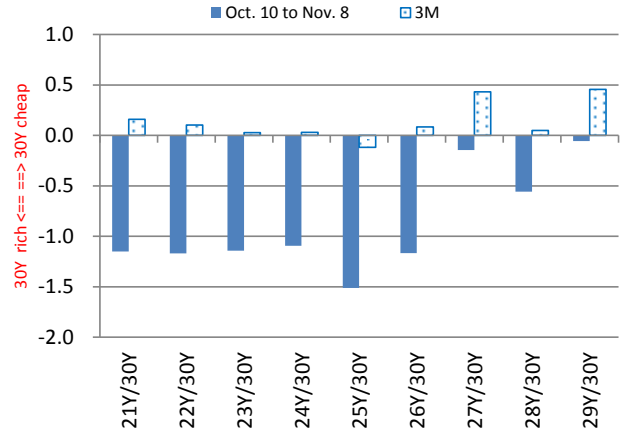
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



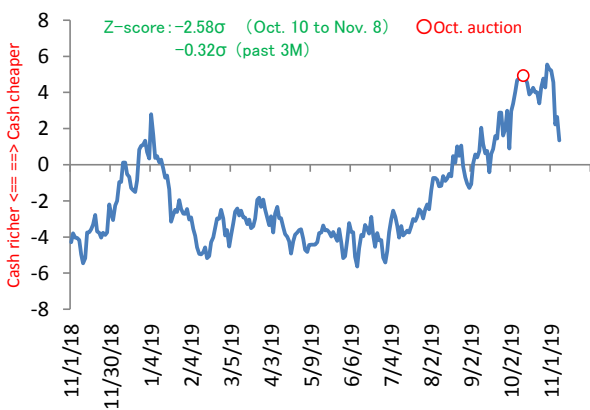
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



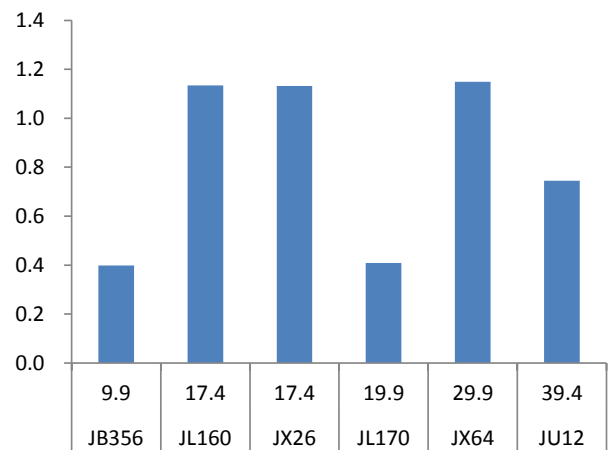
Source: Daiwa Securities.

Appendix 4: 30Y JGB Asset Swap Spread (bp)



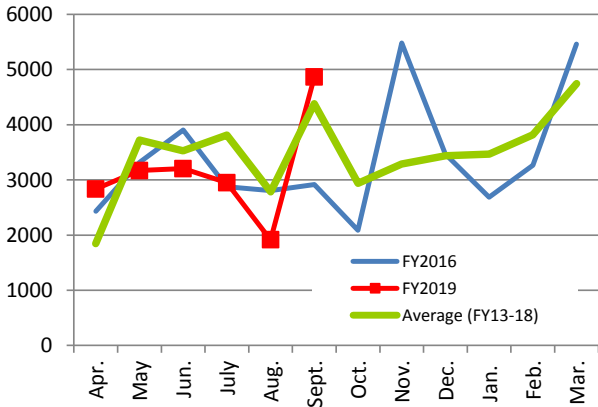
Note: 6M Yen LIBOR basis.
Source: Daiwa Securities.

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



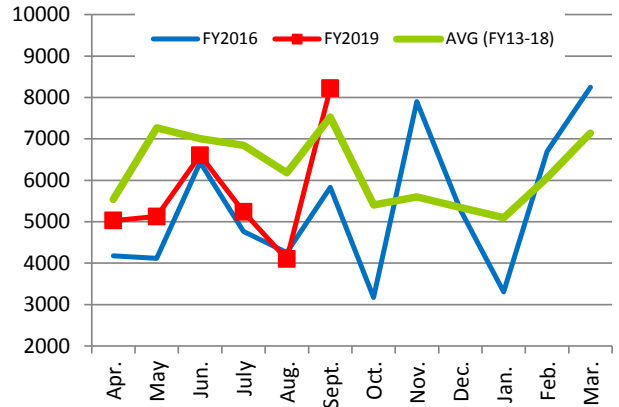
Note: Based on JGB yield curve on Nov. 8, assuming that the yield curve shape does not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



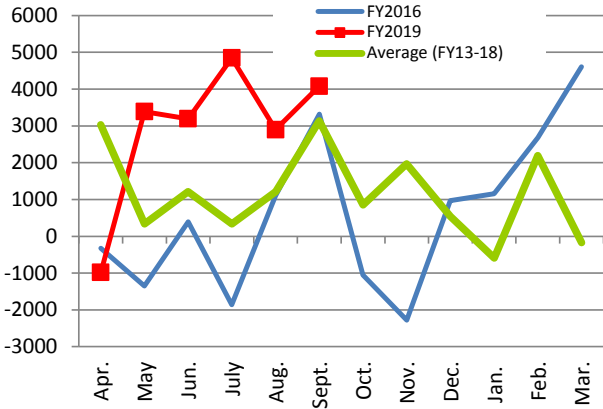
Source: JSDA

Appendix 6b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



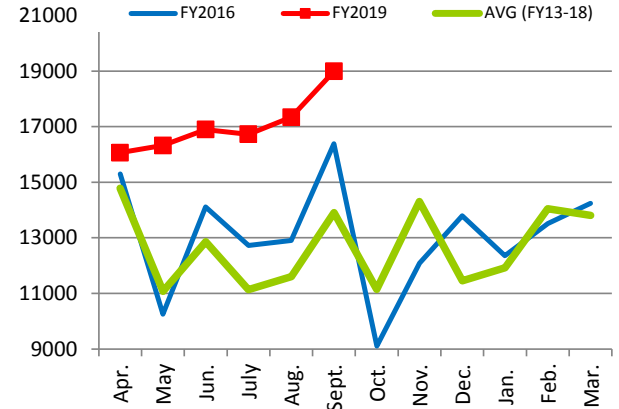
Source: JSDA

Appendix 7a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 7b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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[Standard & Poor's]

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[Moody's]

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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.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* 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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