

## Outlook for 40Y JGB Auction

### Watch investor demand closely amid speculation of issuance increase in 40Y JGBs

- ✓ Assuming it possible that the 40-year JGB yield (compound basis) will move at around 0.45-0.50% over the next month or so, we recommend placing bids near the upper end of that yield range so as to purchase minimum necessary amount of new 40Y JGBs

Strategic Memorandum DSTE345  
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### Auction Details

**Auction Date:** November 26, 2019  
**Issue Date:** November 27, 2019  
**Maturity Date:** March 20, 2059  
**Offering Amount:** About 400 billion yen  
**Auction Method:** Dutch auction on a compound yield with the increment of 0.5bp

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

\*\* On November 25, JU12 traded at 0.455- 0.475% (unch - +2.0bp v. previous day's close; 0.458-0.476% compound) and closed at 0.470% (+1.5bbp; 0.472%).

### Exp. Rating on Auction Results

|        |      |         |      |             |
|--------|------|---------|------|-------------|
| 1      | 2    | 3       | 4    | 5           |
| Failed | Poor | Average | Good | Outstanding |

Since the previous auction on September 25, which took place around 0.395% (unch v. Sep. 24 close; 0.401% compound) and went poorly, the 40Y JGB yield has been roughly range-bound at 0.35-0.45%. With the JGB market accelerating down in early November, that yield rose from 0.365% on November 1 to 0.515% on November 13, after which it has been in the range of 0.45% to 0.50%.

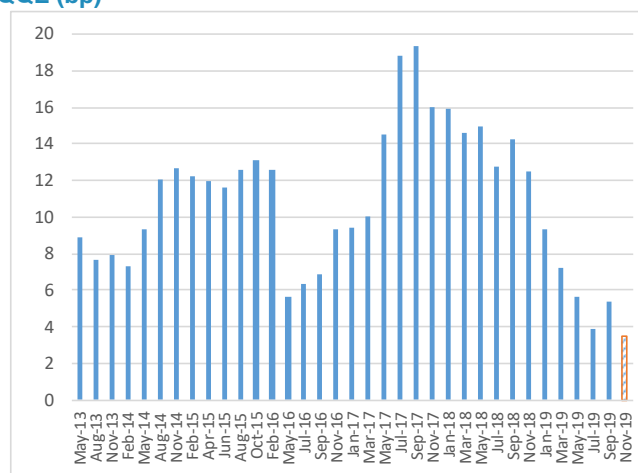
Now the focus is on the JGB issuance plan tied to the FY19 supplementary budget and also the FY20 budget. Some media outlets have reported that MOF is considering raising the amount of 40-year JGBs issued at each auction from the current Y400 billion to Y500 billion, which would mean an annual increase of Y600 billion relative to the initial FY19 issuance plan. 40Y JGBs faced downward pressure today possibly in response to those reports ahead of the auction scheduled for tomorrow. In such an environment, the key points to consider placing bids at tomorrow's auction can be summarized as follows:

- ✓ **Dealers can be short in the 40Y sector, but....** They can be rather long in the superlong zone as a whole;

- ✓ **Looks neither rich nor cheap relative to the curve:** The 40-year sector currently looks neither rich nor cheap relative to the curve. Based on the curve, an aggressive entry to curve positioning looks unlikely;
- ✓ **Expect certain investor demand:** With the “leveling” purchase stance of leading investors around the long end of the curve, the October trend in their trading volume was as it was in September, higher than average on both a net and gross basis (Appendix 7). That, combined with the 40Y JGB yield trend, indicates support from relatively firm demand above 0.40%. Speculation of an increase in 40-year JGB issuance has begun to emerge, however. In such a situation, it is important to keep a close eye on investor appetite at the primary stage;
- ✓ **The BOJ may exclude JU12 from its purchase list (just as the Bank does for on-the-run issues of 20Y and 30Y JGBs):** Even if the BOJ does, however, negative impact will likely be limited as the share of the most recently issued superlong JGBs held by the BOJ is fairly low which suggests there is strong investor demand at the primary stage.

Overall, assuming the possibility of the 40-year JGB yield (compound basis) trading around 0.45-0.50% over the next month or so, we recommend placing bids near the upper end of that yield range so as to purchase minimum necessary amount of new 40Y JGBs. As noted, the 40-year sector currently looks neither rich nor cheap relative to the curve. The current yield curve shape will discourage curve players from aggressively building new positions with 40Y JGBs, as witnessed by the fact that the 30Y/40Y JGB spread will be the narrowest it has been at auction since QQE was introduced (see Chart below).

**30Y/40Y Spread on the Day before 40Y JGB Auction under QQE (bp)**



Source: Daiwa Securities.

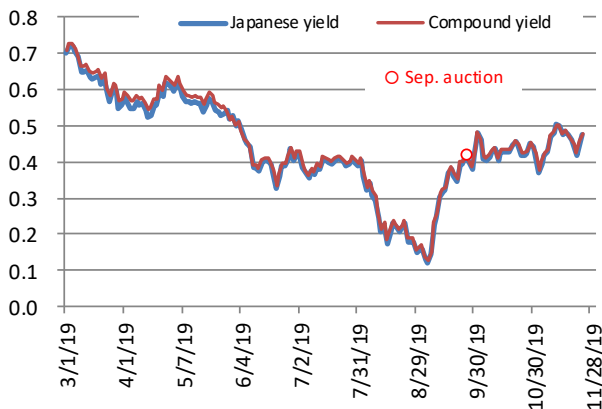
#### 40Y JGB Auction Results

| 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)** |      |
|------------|--------|--------------------|---------------|-----------------------|------|----------------------------|---------------|-------------------|----------------------------------|-------------------------------------|---|--|------|
| 11/25/19   | 12R    | 0.5                | 3/20/59       | 400*                  |      |                            |               |                   | 0.458                            | 3.5                                 |   |  |      |
| 9/25/19    | 12R    | 0.5                | 3/20/59       | 455.6                 | 2.69 | 0.435                      | 46.0000       | 102.36            | 0.401                            | 5.4                                 | 0.425                                   | 6.8  | Poor |
| 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 Nov. 22 close for the Nov. 2019 auction

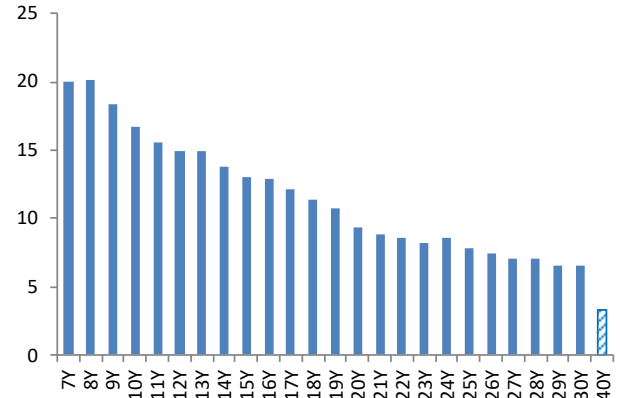
Source: Ministry of Finance (MOF), Daiwa Securities.

### Appendix 1: 40Y JGB Yield (%)



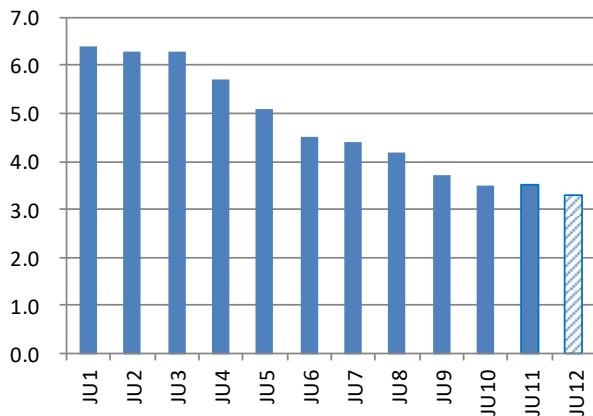
Source: Daiwa Securities.

### Appendix 2: JGB Yield Change (bp): Sep.25 v. Nov. 22



Source: Daiwa Securities.

### Appendix 3: JU Yield Change (bp): Sep.25 v. Nov. 22



Source: Daiwa Securities.

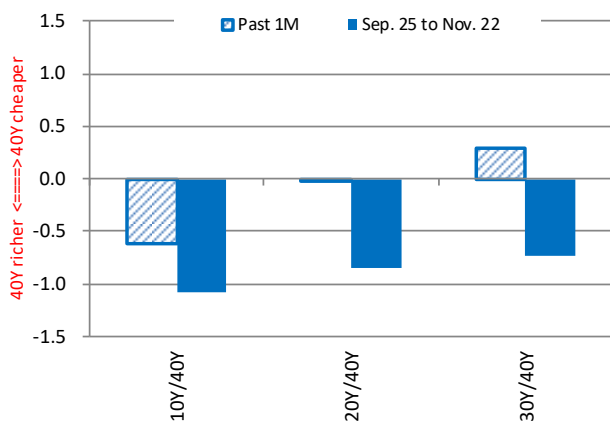
### Appendix 4: 40Y JGBs held by BOJ (Yen billions)

|      | MOF Issue Size | BOJ Holding | % of BOJ Holding | Market Outstanding |
|------|----------------|-------------|------------------|--------------------|
| JU1  | 1,051.7        | 260.9       | 24.8%            | 790.8              |
| JU2  | 1,343          | 77          | 5.8%             | 1,265              |
| JU3  | 1,362          | 197         | 14.5%            | 1,164              |
| JU4  | 1,962          | 224         | 11.4%            | 1,739              |
| JU5  | 1,961          | 136         | 6.9%             | 1,825              |
| JU6  | 2,002          | 932         | 46.5%            | 1,071              |
| JU7  | 2,167          | 1,066       | 49.2%            | 1,101              |
| JU8  | 2,319          | 1,261       | 54.4%            | 1,058              |
| JU9  | 3,439          | 1,528       | 44.4%            | 1,911              |
| JU10 | 3,398          | 1,155       | 34.0%            | 2,243              |
| JU11 | 2,603          | 472         | 18.1%            | 2,132              |
| JU12 | 1,260          | 60          | 4.7%             | 1,200              |

Note: as of Nov. 20 on BOJ start day

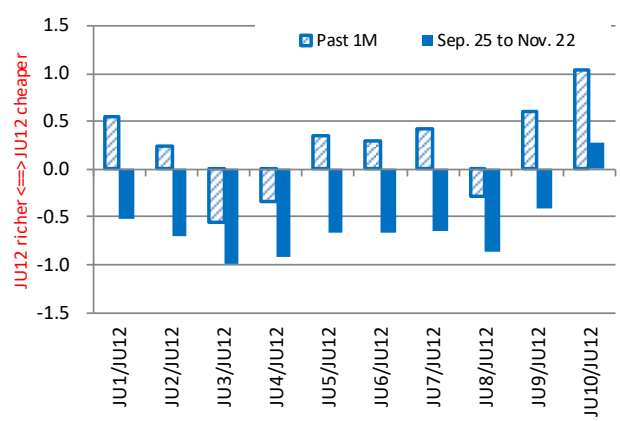
Source: Daiwa Securities.

### 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 Nov. 22 is unchanged and factoring in roll-down effect etc.

Source: Daiwa Securities

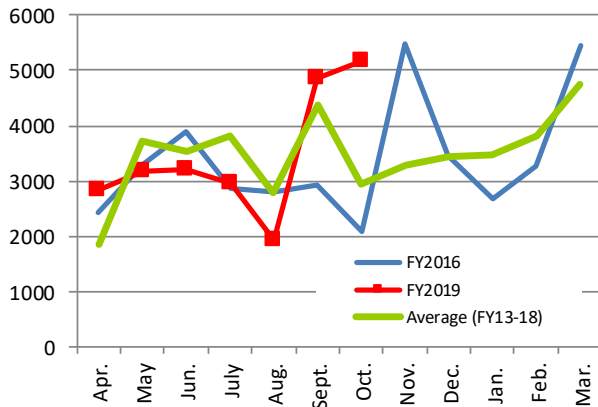
**Appendix 6b: 3M Total Return Curve on Modified Duration (%)**



Note: Assuming that the yield curve shape as on Nov. 22 is unchanged and factoring in roll-down effect etc.

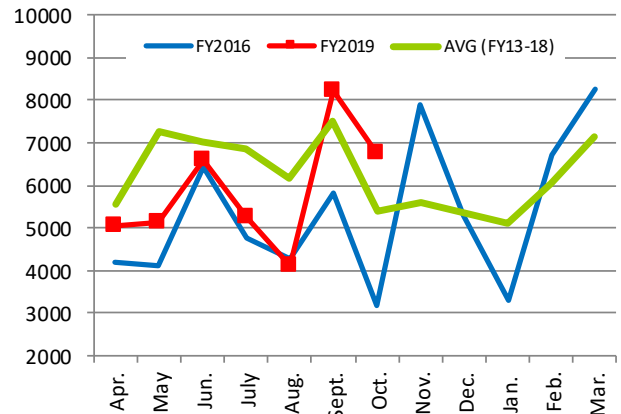
Source: Daiwa Securities

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



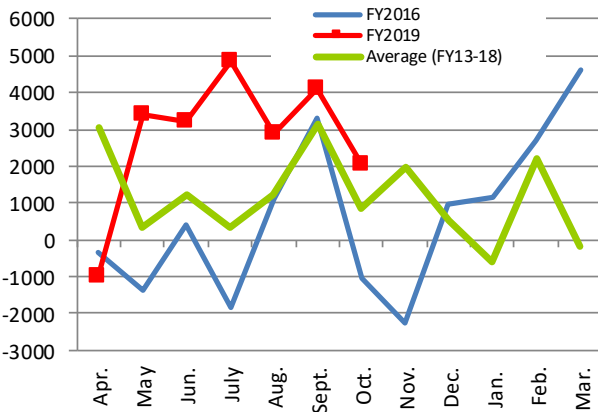
Source: JSDA

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



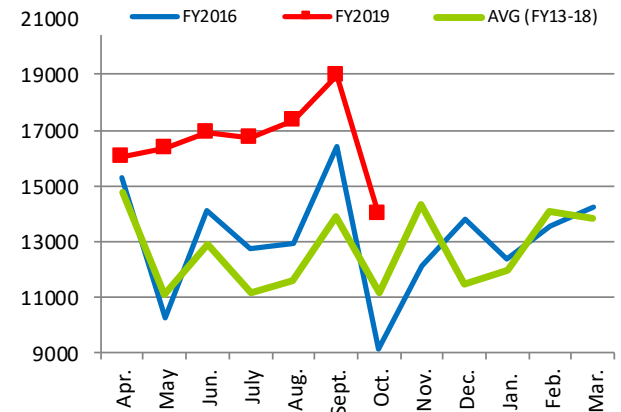
Source: JSDA

**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

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May 2018

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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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