

Outlook for 20Y JGB Auction

Bidding with 0.25-0.30% range in mind

Strategic Memorandum DSTE350
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Auction Details

Auction Date: December 17, 2019
Issue Date: December 18, 2019
Maturity Date: September 20, 2039
Offering Amount: About 900 billion yen

* New 20Y JGBs will be the final reopening of JL170 carrying a 0.3% coupon.

** On Dec. 16, JL170 traded at 0.275-0.285% (-1.5 - -0.5bp v. previous day's close) and closed at 0.280% (-1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

20Y JGB yield mostly in the 0.25-0.30% range since November auction

Since the previous 20Y JGB auction went well at the 0.265-0.270% level (-1.5 to -1.0bp vs. previous day's close) on November 20, the yield of on-the-run 20Y JGBs (on conventional yield basis) has largely moved in the 0.25-0.30% level. The yield temporarily rose to 0.310% on an intraday basis on December 13 amid a bumpy but downward trend of the JGB market, which started near the end of November. As of 14:00 today (Dec. 16), one day before the auction, 20Y JGBs trade at the 0.275-0.285% level (-1.5 to -0.5bp vs. previous day's close).

Fundamental factors unlikely trigger major uptrend/downtrend in JGB yields

Let's look at the environment surrounding JGBs. The JGB market has been volatile, swayed by risk-on/risk-off mode in overseas markets. However, the US has agreed not to impose the fourth round of tariffs on Chinese products. In the UK, the ruling Conservative Party won a single-party majority at the general election, which will likely promote the preparation of the Brexit set at the end of January 2020. As those have been seen as major risk factors, risk-on/risk-off activities on those may calm down. In the longer term, however, we still have uncertain factors (such as the outlook for "phase two" deal in US-China trade talks), and therefore it would be difficult to fully eliminate worries about the global economy. In the US, it can be said that the hurdle for the Fed' rate cuts was set higher at the last week's FOMC meeting. That said, as a key of a rate hike in 2021 and beyond is "persistent/significant inflation," it is also difficult to factor in the hike as a done deal. In Europe, Christine Lagarde chaired her first ECB Governing Council meeting. At the post-meeting press conference,

she said that the ECB would begin strategic review of monetary policy in January 2020, aiming to complete it before the end of 2020. It would be difficult to assume a major policy change during the course of the review. It is highly possible that current monetary policies in the US and Europe will be maintained for the time being. As such, fundamental factors are preventing us from expecting a major uptrend/downtrend in JGB yields. In such an environment, we summarize the key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Decent short-covering expected:** Short-covering by primary dealers is expected to support tomorrow's auction. However, given the recent low liquidity, it will be difficult to take an aggressive stance more than necessary;
- ✓ **Certain demand from investors is expected:** Compared to 30Y and 40Y JGBs, 20Y JGBs have the broad base of investors and the market size is large. Given the fact that the direct impact from the BOJ's monetary policy is limited unlike 10Y JGBs, we think that potential demand for 20Y JGBs from investors can be strong. In addition, a large amount of JGBs are scheduled to be redeemed in December;
- ✓ **In terms of relative value, the 20Y sector appears to be noticeably undervalued vs. the 21-28Y sectors and 40Y sector on the curve:** The data from the previous auction and also for the past three months show that the 20Y sector is noticeably undervalued vs. the 21-28Y sectors and 40Y sector (Appendix 3). In addition, 20Y JGBs appear to have an advantage in terms of returns (Appendix 5) vs. 30Y JGBs with around 20 years left to maturity on top of the fact that the yield spread between them has been tightening (Appendix 6);

Adding some to holding flattening positions in 7Y/20Y or 10Y/20Y may be worth considering

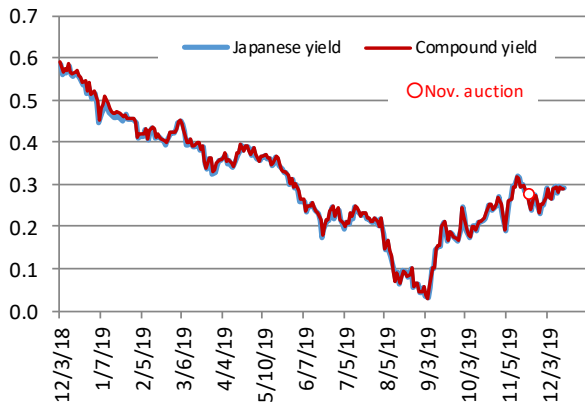
All in all, we would like to think of our bidding stance at tomorrow's auction, assuming that the 20Y JGB yield will likely move in the 0.25-0.30% level until the next auction. In terms of the relative value, new 20Y JGBs appear undervalued vs. off-the-run sectors. However, we think it difficult to build new positions in the current low-liquidity environment. Demand from the viewpoint of the relative value is likely to be limited. If any, adding some to holding flattening positions in 7Y/20Y or 10Y/20Y may be worth considering.

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
12/17/19	170R	0.3	9/20/39	900*									
11/20/19	170R	0.3	9/20/39	1,033	4.21	100.63	100.60	0.03	0.266	0.268	0.002	43.6701	Good
10/24/19	170	0.3	9/20/39	899	3.91	101.04	100.95	0.09	0.245	0.249	0.004	57.2532	Avg
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

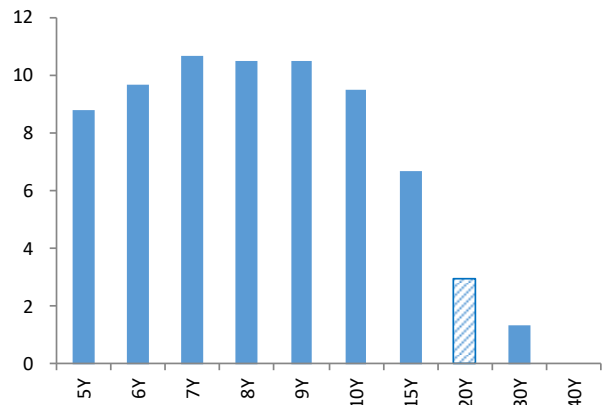
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



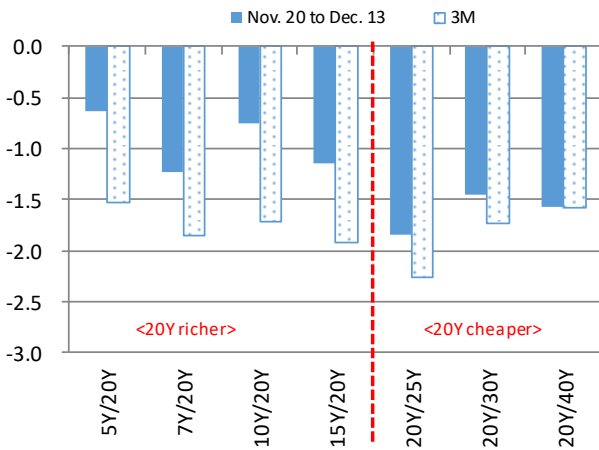
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Nov. 20 v. Dec. 13



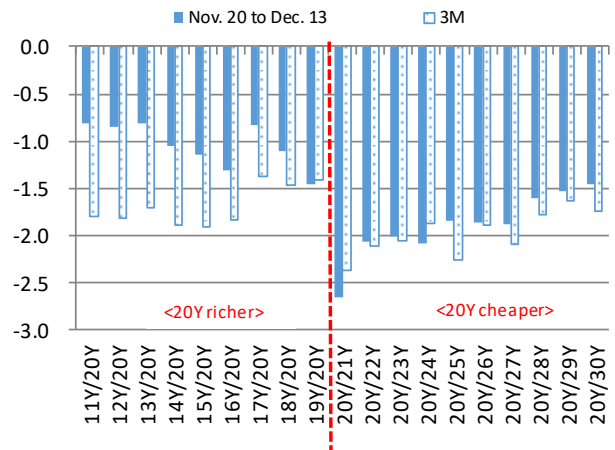
Source: Daiwa Securities.

Appendix 3a: Z-score I



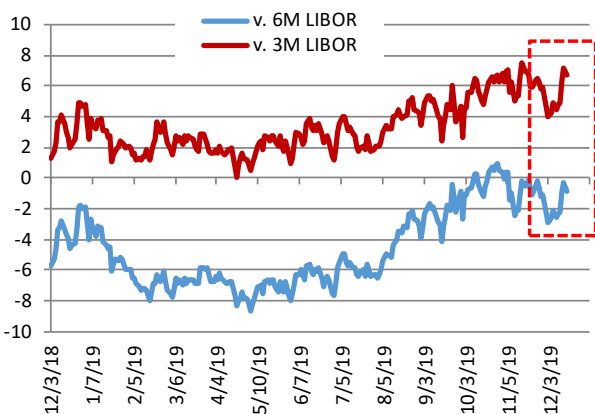
Source: Daiwa Securities.

Appendix 3b: Z-score II



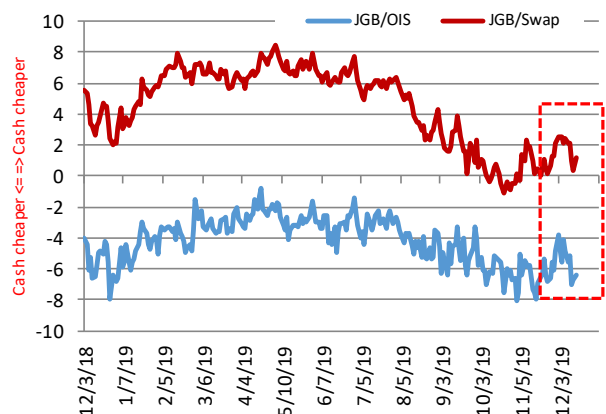
Source: Daiwa Securities.

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



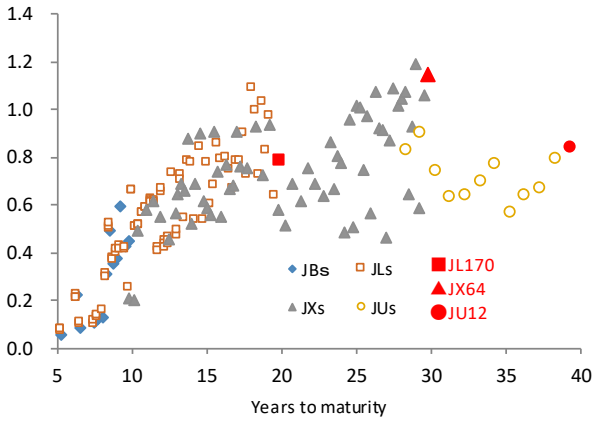
Note: since the Nov. auction
Source: Daiwa Securities.

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



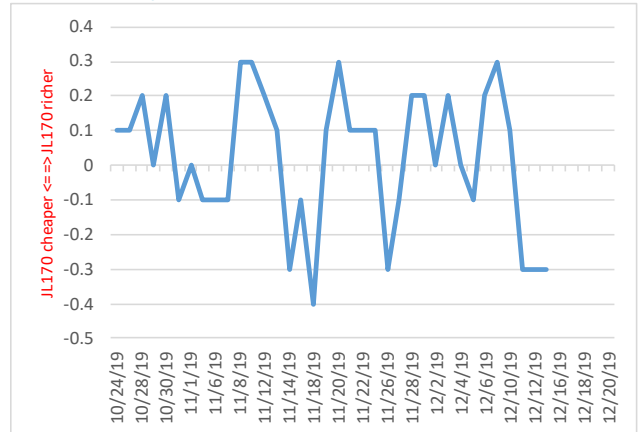
Note: since the Nov. auction
Source: Daiwa Securities.

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



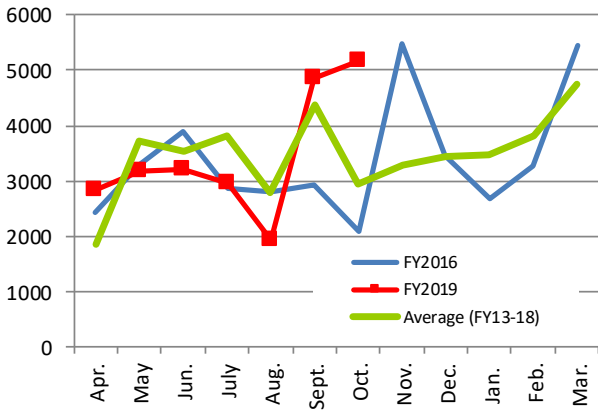
Note: Based on the Dec. 13 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 6: Spread between JL170 and JX with 20 years left to maturity (bp)



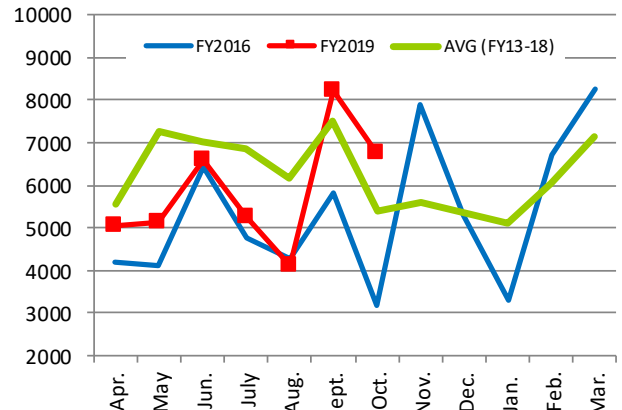
Source: Daiwa Securities.

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



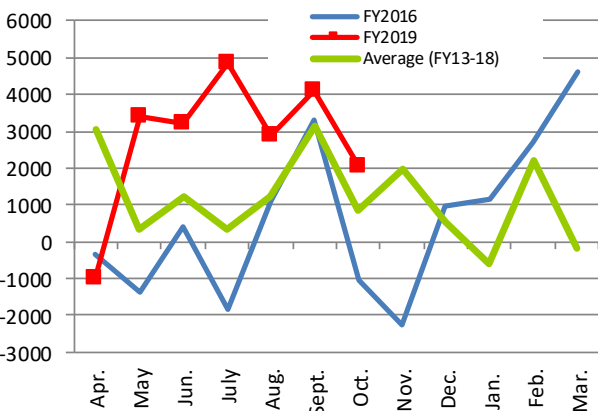
Source: JSDA

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



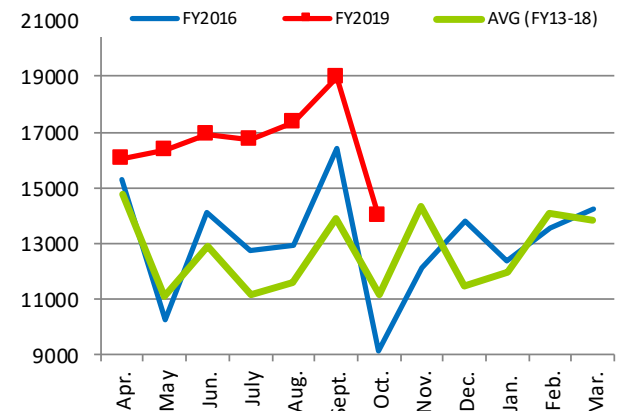
Source: JSDA

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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[Standard & Poor's]

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