

JGB Insight

JGBs from 2019 to 2020

- ✓ JGBs will start 2020 with relatively high volatility; steepening is unlikely to gain momentum in January-March partly because of expected demand especially for superlong JGBs
- ✓ It would be worth considering building/adding barbell positions (incl. butterfly trade)

[BOX] BOJ's JGB Purchase Plan for January 2020: Offer amount at the first operation in each target zone will likely keep unchanged from that at the last operation in December 2019 with a high probability

Strategic Memorandum DSTE353
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In 2019, JGB futures set a record high and expected to close in the lowest territory of the year

Today is the last trading day of 2019. Looking back at the JGB market over the past year, we find that the market had been quite stable for a while after the start of the year, and then it largely extended up and closed around the lowest level. The JGB futures set a record high (as a leading contract) in September and is expected to close in the lowest territory of 2019 (Chart 1). Throughout the year, the JGB market has been swayed by risk on/off movements influenced by US-China conflicts (mainly on trade) and Brexit etc. In such circumstances, the JGB market had experienced a major uptrend until around autumn due to concerns over the global economic outlook and the trends of global monetary easing (such as rate cuts in the US). In late 2019, on the other hand, the downtrend has intensified amid diminishing excessive expectations for additional easing. The JGB futures appears to have been substantially sold in comparison to, for example, US Treasury futures (Chart 2).

Despite aggressive cuts in purchases by BOJ, flattening pressure has stayed, as witnessed by shift from bull flattening to bear flattening

In the cash bond market, yields had trended down toward September. However, they then trended up amid diminishing excessive expectations for additional easing (especially by the BOJ, Chart 3). While yields of the major sectors in the short- to long-term zone are expected to close 2019 at the highest levels of the year, those in the superlong zone are likely to end at the average level (Chart 4). Regarding volatility, all sectors are expected to end the year at relatively high volatility levels (Chart 5).

It can be said that the superlong zone of the JGB yield curve has substantially flattened over the past year (vs. end-2018, Chart 6). As the BOJ aggressively reduced purchases across the curve, the pace of monthly purchases has slowed down from 6.3-6.4tn yen per month as of December 2018 to 5.0-5.1tn yen as of December 2019. In such a situation, the negative 2Y/5Y and 5Y/7Y spreads, both of which were temporarily remarkable, were corrected, and the 7Y/10Y spread has tightened toward the end of the year after posting a strong widening trend (Chart 7). On the other hand, the supply/demand balance of superlong JGBs has remained tight, despite tapering by the BOJ. Flattening pressure has remained around the long end of the curve, as witnessed by a shift from bull flattening to bear flattening.

It would be worth considering building or adding barbell positions

Although JGBs will likely start 2020 with relatively high volatility, in the first quarter (January-March), accommodative monetary policy will likely be maintained in Japan, the US, and Europe amid low inflation and lingering concerns about the global economy. From the viewpoint of fundamentals, JGB yields may not show a clear direction. Regarding external factors, caution is left for possible correction in US stocks, which are increasingly overheating, as witnessed by the fact that they are recently setting record highs for consecutive days. In terms of the supply/demand balance in JGBs, demand from investors is expected to strengthen especially for superlong JGBs as investors are paying attention to end-FY portfolios. Moreover, due to reduction in the maximum bidding amount at Non-price Competitive Auctions II from January 2020, the actual issuance amount is to decline across the curve. All in all, if we consider those with the possibility that (1) the aforementioned factors will not lead to a major steepening trend in the long-superlong zone and (2) volatility

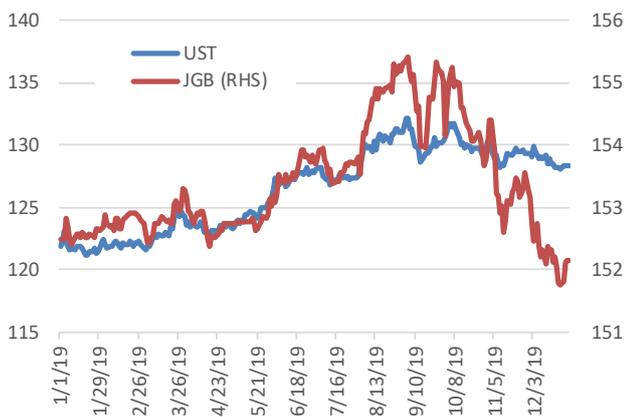
will remain high (partly due to risk-on/off activities), it would be worth considering building or adding barbell positions (incl. butterfly trade) in the zone as an initial action in 1Q 2020. For the first two trading weeks in 2020, a series of JGB issuance in new maturity basket and BOJ purchase operations are scheduled. Caution about BOJ's tapering in the 10-24Y zone is likely to linger as well. We would like to find the best combination and the best timing—e.g., the 10Y/20Y/30Y butterfly trade by buying 10Y and 30Y JGBs in new maturity basket vs. selling current on-the-run 20Y JGB or its neighboring issues

Chart 1: Candle Chart of JGB Futures (Jan. 4 to Dec. 27, 2019, Yen)



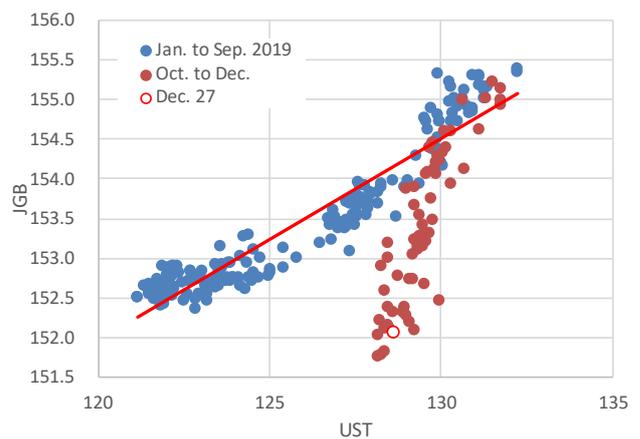
Note: Except evening; actual roll-over basis
Source: Daiwa Securities

Chart 2a: UST and JGB Futures



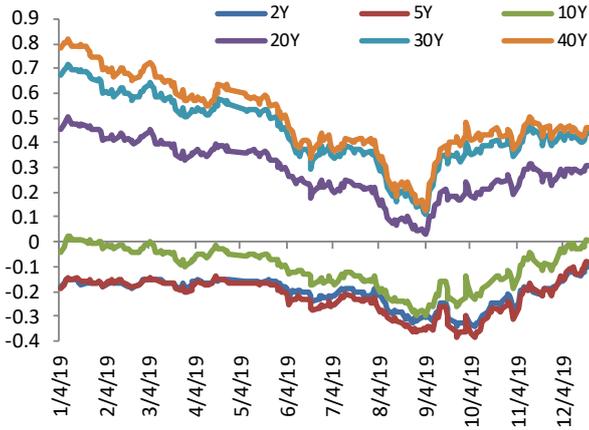
Note: Based on TY1 and JB1
Source: Bloomberg

Chart 2b: Correlation between UST Fut and JGB Fut



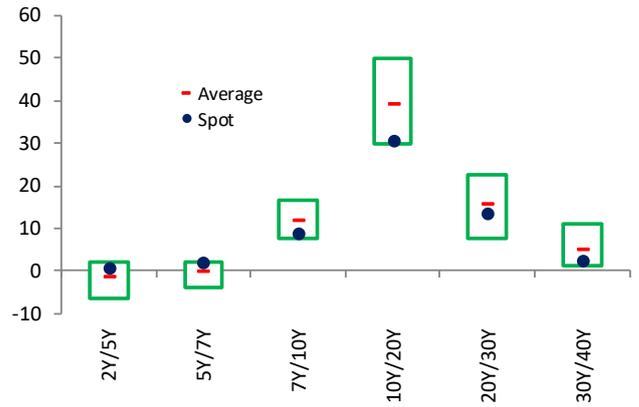
Note: Based on TY1 and JB1
Source: Bloomberg

Chart 3: JGB Yields (%)



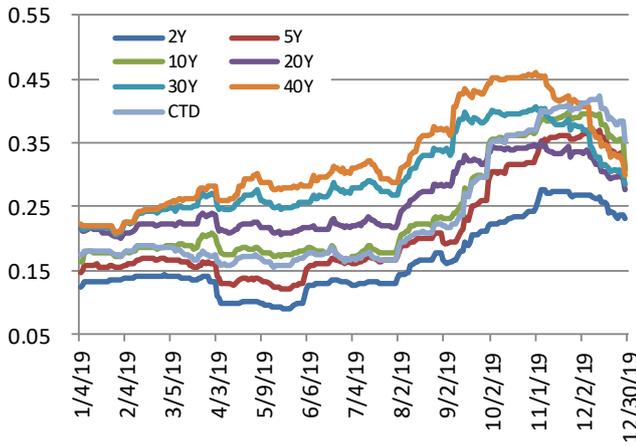
Note: On-the-run issue and CTD semi-annual compound yield basis
Source: Daiwa Securities

Chart 4: JGB Yield Range (%)



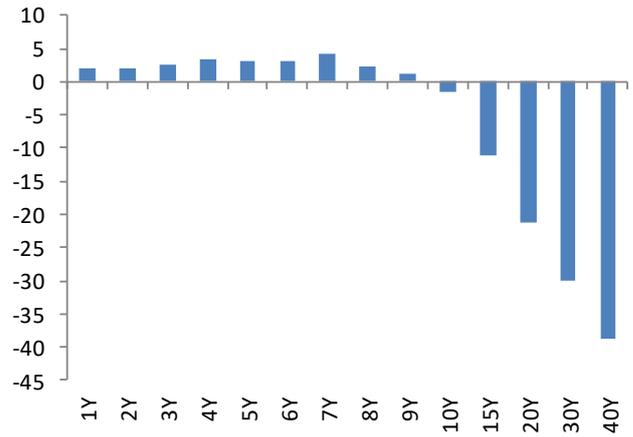
Note: Jan. 4 to Dec. 27, 2019; On-the-run issue and CTD semi-annual compound yield basis
Source: Daiwa Securities

Chart 5: Historical Yield Volatility of JGB Yield (%)



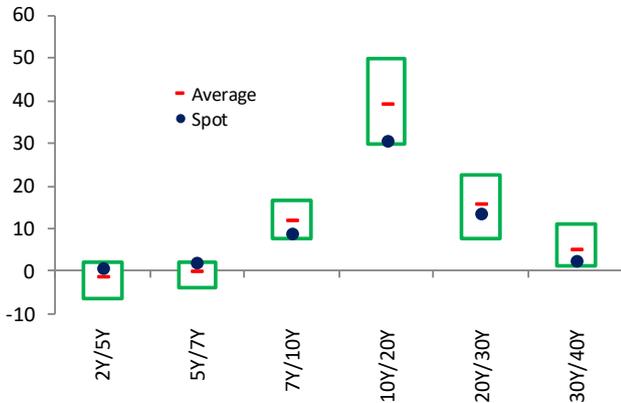
Note: 3 month annualized; On-the-run issue and CTD semi-annual compound yield basis
Source: Daiwa Securities

Chart 6: JGB Yield Change (bp): Dec. 28, 2018 v. Dec. 27, 2019



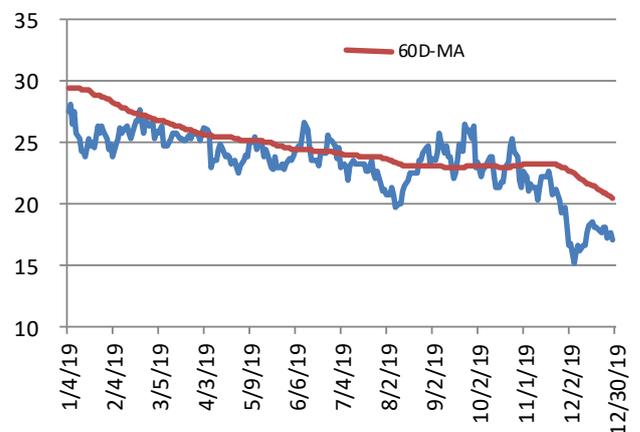
Note: Generic semi-annual compound yield basis
Source: Daiwa Securities

Chart 7: JGB Yield Spread Range (bp)



Note: Jan. 4 to Dec. 27, 2019; On-the-run issue and CTD semi-annual compound yield basis
Source: Daiwa Securities

Chart 8: JGB 10Y/20Y/30Y Butterfly Spread (bp)



Note: On-the-run issue and CTD semi-annual compound yield basis
Source: Daiwa Securities

[BOX] BOJ JGB Purchases in January 2020: offer amount at the first operation expected to be unchanged from December

On December 26, the BOJ disclosed its JGB purchase plan for January 2020 by updating the Outline of Outright Purchases of Japanese Government Securities. The frequency and range of offer amounts in all target zones (incl. sub zones) have been unchanged from those in December. The number of monthly offers has increased from six times in December to seven times, the same as those in October and November.

Regarding the purchase plan for January, speculations on flexible operations (incl. cut in the number of offers) mounted among some market participants because BOJ governor Haruhiko Kuroda touched on the level of superlong JGB yields at the press conference after the December monetary policy meeting. Given some points, however, the probability of no change in the plan looked high as well. Those are:

- ✓ Mr. Kuroda stated that “I personally think that superlong JGB yields should be higher (than they are now), but I am not bothered by the current shape of the curve.” The tone appears to have been weaker than that in September;
- ✓ The superlong zone of the curve is not showing a strong flattening trend;
- ✓ Amid the lack of room for further reduction, the 10Y JGB yield has been moving within “about double the range of between -0.1% and +0.1%”

Some market participants expected the BOJ to avoid providing unnecessary volatility amid low liquidity at the end of the year. That said, given the fact that the BOJ made substantial revisions to the purchase plan at end-December 2014, we think that central bank does not necessarily have a rule to “avoid revisions at the end of the year.” This time around, the central bank appears to have just judged that adjustments are unnecessary under the current situation.

Given all together, we expect the offer amount at the first operation in each target zone (incl. sub zones) in January will likely be unchanged from that in the last operation in December with a high probability (appendixes 1-2).

Appendix 1: BOJ JGB Purchase and MOF Issuance in January 2020

(Yen billions)

		Offer size per operation	Number of Offers (per month)	Offer size at the first operation in Jan. 2020	Offer size at the last operation in Dec. 2019	Monthly Total exp. in October (a)	MOF issuance per month in FY2019** (b)	(a)-(b)	
		Mid							
JGBs ex Linkers and Floaters									
Up to 1 year		About 10-100	55	2	50	50	100	-	-
Over 1 to 5 years	Over 1 to 3 years	About 300-550	425	4	420	420	1,680	2,000	-320
	Over 3 to 5 years	About 200-450	325		340	340	1,360	1,900	-540
Over 5 to 10 years		About 200-500	350	4	350	350	1,400	2,100	-700
Over 10 years	Over 10 to 25 years	About 50-150	100	3	100	100	300	900	-600
	Over 25 years	About 0-50	25		30	30	90	700 - 1,100	-630 to -1,010
Linkers		About 30	-	2	30	30	60	400	-280**
Floaters (in even months)		About 100	-	1	100	100	100	-	-
TOTAL:						4,990 to 5,090	7,600 to 8,400	-2,610 to -3,310	

(Note) "Offer size per operation" and "Number of offers (per month)" are as released by the BOJ on Dec. 26, 2019 and "Offer size at the first operation in Jan. 2020" forecasted by Daiwa Securities on Dec. 30, 2019 * Excluding NPC1 and AEL; JGB linkers issued 4 times per year ** Factoring in the BOJ purchase conducted every month and the MOF quarterly issuance
Source: Ministry of Finance, Bank of Japan, Daiwa Securities

Appendix 2: January 2020 Calendar for BOJ JGB Purchases etc.

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	TDBs	MOF Buyback		
1/1/20	W	-	New Year's Day									
1/2/20	TH	-	Bank Holiday									
1/3/20	F	-	Bank Holiday									
1/6/20	M	1/7/20		◎	◎		◎	◎				
1/7/20	T	1/8/20	10Y JGB Auction								3M	
1/8/20	W	1/9/20										
1/9/20	TH	1/10/20	30Y JGB Auction								6M	
1/10/20	F	1/14/20		◎	◎	◎		○				
1/13/20	M	-	Public Holiday (Coming-of-age Day)									
1/14/20	T	1/15/20	○				◎	◎	○			
1/15/20	W	1/16/20	5Y JGB Auction									
1/16/20	TH	1/17/20			◎				1Y	○		
1/17/20	F	1/20/20	20Y JGB Auction								3M	
1/20/20	M	-	○	◎	◎							
1/21/20	T	-	BOJ MPM (Day 2)									
1/22/20	W	1/23/20	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity								○	
1/23/20	TH	1/24/20			◎	◎	◎					
1/24/20	F	1/27/20	AEL for 2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years left to maturity								3M	
1/27/20	M	1/28/20										
1/28/20	T	1/29/20	40Y JGB Auction								○	
1/29/20	W	1/30/20		◎	◎	◎		○				
1/30/20	TH	2/3/20	2Y JGB Auction									
1/31/20	F	2/3/20							3M			

Note: ◎ Announced by BOJ on Dec. 26, 2019, ○ Daiwa Forecast as of Dec. 30, 2019

Source: Ministry of Finance, Bank of Japan, Daiwa Securities

(Originally written and released in Japanese on Dec. 30, 2019)

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[Standard & Poor's]

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