Daiwa Securities

Outlook for 30Y JGB Auction

Bidding properly at least to cover

- ✓ Expecting the 30Y JGB yield to remain in the range centered at 0.40-0.45% for a while, we would like to think about our bidding stance
- ✓ It would be worth considering buying new 30Y JGBs against swaps

Strategic Memorandum DSTE354
FICC Research Dept.

Senior JGB Strategist
Keiko Onogi
+813 5555 8788
keiko.onogi@daiwa.co.jp

Daiwa Securities Co. Ltd.

Auction Details

Auction Date:	January 9, 2020
Issue Date:	January 10, 2020
Maturity Date:	December 20, 2049
Offering Amount:	About 700 billion yen

* New 30Y JGBs, JX65, will likely carry a 0.4% coupon.

** On Jan. 8, WI barely traded, and closed at 0.415% (-1.5bp v. previous day's close). JX64 traded at 0.395-0.420% (-3.5 - -1.0bp v. previous day's close) and closed at 0.415% (-1.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Bidding expected at frequently-traded level

Since the previous 30Y JGB auction went well at the 0.435-0.440% level (+0.5 to +1.0bp vs. previous day's close) on December 5, the 30Y JGB yield (conventional yield of on-the-run issue) had moved mostly in the 0.40-0.45% range amid a downtrend in the JGB market. In late December, the JGB market started losing downward momentum. After the start of New Year, the 30Y JGB yield temporarily declined to 0.375% on an intraday basis (Jan 7) amid growing concerns about geopolitical risk. Since then, it has moved mostly in the 0.400-0.435% level. Tomorrow's primary sale of new 30Y JGBs is expected to be done at the frequently-traded level.

Let's look at the environment surrounding JGBs. JGBs started 2020 in a volatile mood. Over the next one month, however, 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, as they appear overheated by setting record-highs for several years. As we now have to pay heed also to geopolitical risk due to escalating tension between U.S. and Iran, risk-on/off activities should be carefully monitored. In terms of the supply/demand balance in JGBs, demand from investors is expected to strengthen especially for superlong JGBs as investors are expected to get more sensitive to end-FY portfolios. Moreover, due to reduction in the maximum bidding amount at Non-price Competitive Auctions II from

January, the actual issuance amount is to decline across the curve. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Absolute yield level:** 30Y JGBs have been finding decent buyers at the 0.400-0.450% level However, if tomorrow's auction is held at around 0.4%, auction participants may place bids with a cautious stance amid growing uncertainty about the level of demand from investors;
- ✓ **Relative value:** At the current level, the 30Y sector is neither noticeably cheap nor rich on the intermediate to superlong zone of the curve (Appendix 3). The 30Y asset swap has been tightening into positive territory v. Yen LIBOR level (Appendix 4);
- ✓ **Short-covering may be not so strong, but...:** We could expect a certain level of inventory demand, given expected potential demand from investors for new 30Y JGBs in new maturity basket;
- ✓ **Lingering caution about BOJ tapering in superlong JGBs:** Primary dealers may hesitate to place aggressive bids for new 30Y JGBs more than necessary.

Thinking about buying new 30Y JGBs against swaps

All in all, expecting the 30Y JGB yield to remain in the range centered at 0.40-0.45% for a while, we would like to think about our bidding stance at tomorrow's auction. In terms of the relative value, it would be worth considering buying new 30Y JGBs against swaps. Although we need to pay attention to recent receiving pressure in the superlong zone, the 30Y swap spread (= difference between 30Y swap rate and 30Y JGB yield) is at the tightest level in the past one year and close to last autumn's reversal level. Therefore, reversal moves are expected (Appendix 6). In addition, we can expect positive carry from buying 30Y cash/paying swaps.

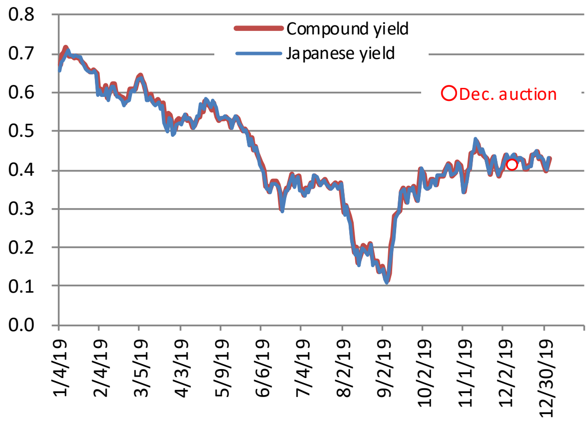
30Y JGB Auction Results

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 (%)
1/9/20	**65**	**0.4***	**12/20/49**	**700****										
12/5/19	64R	0.4	9/20/49	802.5	3.69	99.20	99.15	0.05	0.430	0.432	0.002	88.7986	Good	0.415
11/12/19	64R	0.4	9/20/49	699.5	3.66	98.46	98.30	0.16	0.458	0.464	0.006	6.0070	Poor	0.480
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

* Daiwa forecast * Amount the Ministry of Finance plans to issue

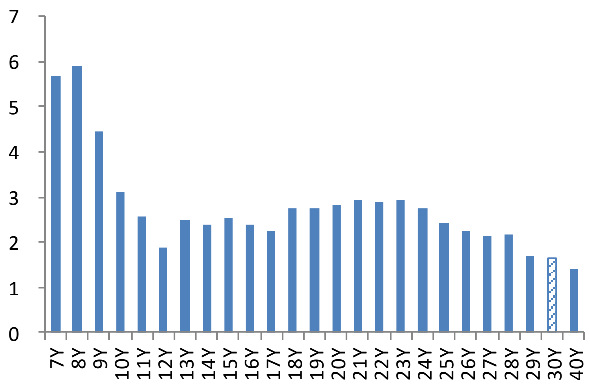
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



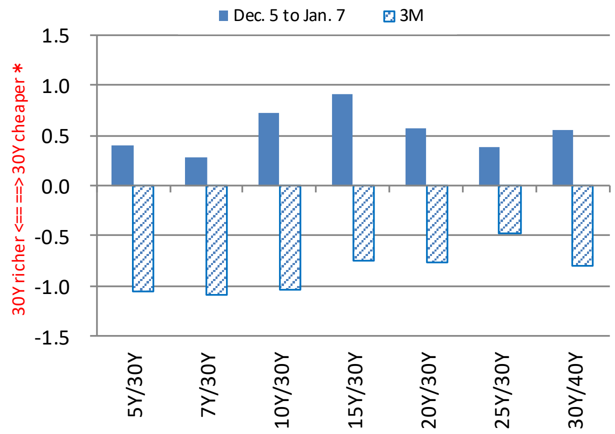
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Dec. 5 v. Jan. 7)



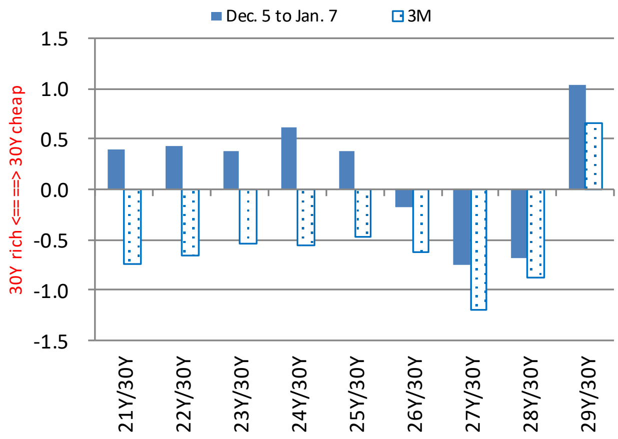
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



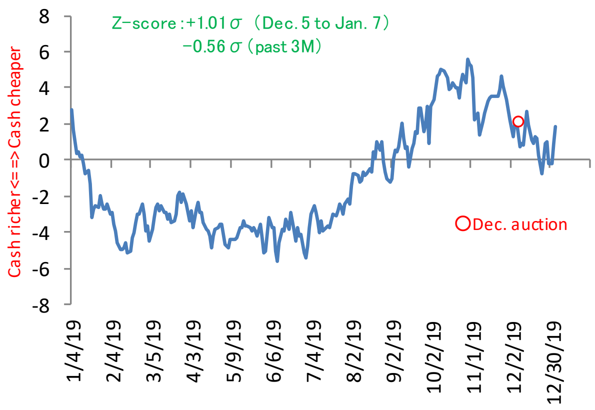
Note: For 30Y/40Y, 30Y richer at + and cheaper at – v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



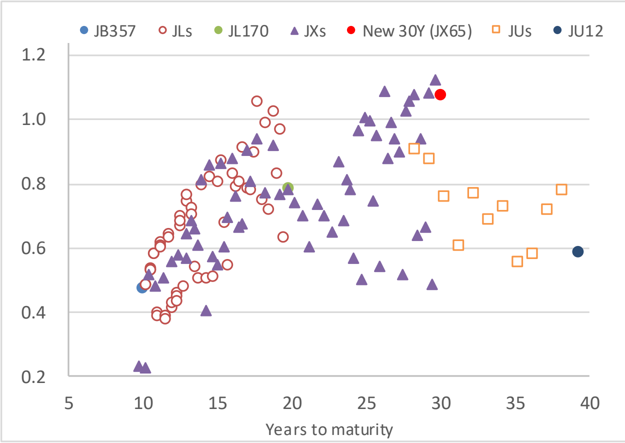
Source: Daiwa Securities.

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



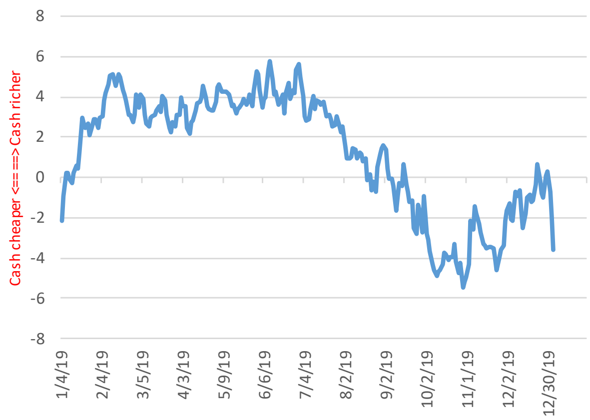
Note: 6M Yen LIBOR basis .
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on Jan. 7, assuming that the yield curve shape does not change and factoring roll-down effect etc.; New 30Y, JX65, is supposed to carry a 0.4% coupon and about 0.5bp spread to JX64
Source: Daiwa Securities

Appendix 6: 30Y Swap Spread (bp)



Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:
1) Duty of good faith.
2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")
The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (http://www.standardandpoors.co.jp/unregistered) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (http://www.standardandpoors.co.jp)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (http://www.standardandpoors.co.jp)

[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")
The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moodys.com/pages/default_ja.aspx)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moodys.com/pages/default_ja.aspx)

[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")
The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (https://www.fitchratings.co.jp/web/)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (https://www.fitchratings.co.jp/web/)

May 2018

IMPORTANT

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name:	Daiwa Securities Co. Ltd.
Registered:	Financial Instruments Business Operator Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships:	Japan Securities Dealers Association The Financial Futures Association of Japan Japan Investment Advisers Association Type II Financial Instruments Firms Association