

Outlook for 20Y JGB Auction

Range-bound trading to continue

- ✓ The December 2039 bonds will likely carry a 0.3% coupon. Under the new auction rule, however, we may see the lowest coupon in the 20Y JGB auction history, if 20Y JGBs trade below 0.3% in the pre-auction market before MOF sets the coupon.
- ✓ Expecting 20Y JGBs to trade in a range centered at 0.28-0.32% over the next one month, we would like to think about our bidding stance.
- ✓ In terms of relative value, it will be worth buying asset swaps. On the JGB yield curve, 7Y/15Y/20Y butterfly with 15Y short may work.

Strategic Memorandum DSTE355
FICC Research Dept.

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Auction Details

Auction Date: January 17, 2020
Issue Date: January 20, 2020
Maturity Date: December 20, 2039
Offering Amount: About 900 billion yen

* New 20Y JGBs, JL171, will likely carry a 0.3% coupon.

** On Jan. 16, WI barely traded, and closed at 0.315% (+0.5bp v. previous day's close). JL170 traded at 0.295 - 0.310% (-1.0 - +0.5bp) and closed at 0.310% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Largely moving in 0.275-0.310% range since previous auction

Since the previous 20Y JGB auction went well at the 0.290-0.295% level (+1.0 to +1.5bp vs. previous day's close) on December 17, 2019, the JGB market has been moving volatile at the lowest level in FY19. In such a situation, the 20Y JGB yield (on conventional yield of the on-the-run issue) has been largely moving in the 0.275-0.310% range.

Expecting 20Y JGBs to trade in a range centered at 0.28-0.32% over the next one month, we would like to think about our bidding stance

We would like to check the environment surrounding JGBs. JGBs started 2020 in a volatile mood. Over the next one month, however, the US, Europe and Japan are expected to keep their current easing policies with giving no sign on other measures amid lingering concerns about the global economy and low inflation. From the viewpoint of fundamentals, JGB yields would not show a clear direction either upward or downward. In terms of external factors, caution will remain strong about possible correction in US stocks, which have been setting record highs for recent days. In terms of the supply/demand balance in JGBs, demand from investors is expected to increase especially for superlong JGBs as investors will likely 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:

- ✓ **Short-covering by primary dealers expected to be not so strong:** Investor demand will be the key for primary sale of new 20Y JGBs;
- ✓ **Good demand expected for fresh 20Y JGBs from investors:** 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, tomorrow's auction will be held for new 20Y JGBs in new maturity basket to be redeemed in December 2039 (JL171);
- ✓ **In terms of relative value, the 20Y sector is neither noticeably cheap nor rich:** The data from the previous auction and also for the past three months show that the 20Y sector is neither noticeably cheap nor rich on the intermediate to superlong zone of the curve (Appendix 3). In the same horizons, 20Y JGBs are neither cheap nor rich against swaps as well (Appendix 4);
- ✓ **Lingering caution about BOJ tapering:** This serves as a factor to discourage primary dealers from keeping their inventories big or going long aggressively around the long end of the curve;
- ✓ **New 20Y JGBs, JL171, will be excluded from the BOJ's purchase list with a high probability.**

**Buying asset swaps recommended/
7Y/15Y/20Y butterfly may work too**

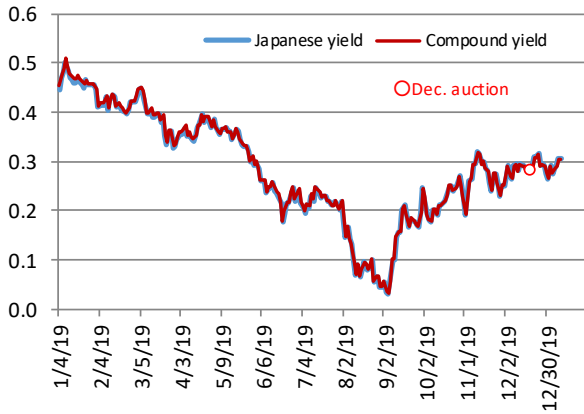
All in all, we would like to think of our bidding stance at tomorrow's auction, assuming that the 20Y JGB yield will trade in a range centered at 0.28-0.32% over the next one month. In terms of the relative value, we think of buying asset swaps because (1) they have been in the cheapest level in the past year and (2) we can expect positive carry (Appendixes 6a, 7). Around the LIBOR flat level, we can take an aggressive stance on the asset swap purchase. From the view point of the yield curve, it is difficult to find good reasons to buy. However, it would be worth considering the 7Y/15Y/20Y butterfly position (selling 15Y/buying 7Y and 20Y) may work because a barbell position performs well in the environment steepening loses momentum. Additionally, the 7Y/15Y/20Y butterfly spread is very close to a reversal point (Appendix 4).

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
1/17/20	171	0.3*	12/20/39	900**									
12/17/19	170R	0.3	9/20/39	1,028	4.10	100.25	100.20	0.05	0.286	0.289	0.003	30.5611	Good
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

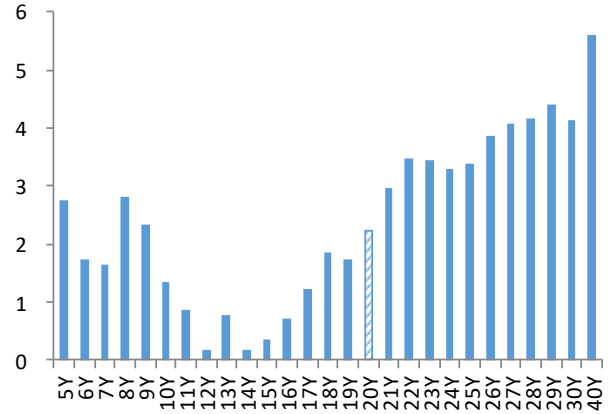
* Daiwa forecast (as of Jan. 16) ** Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



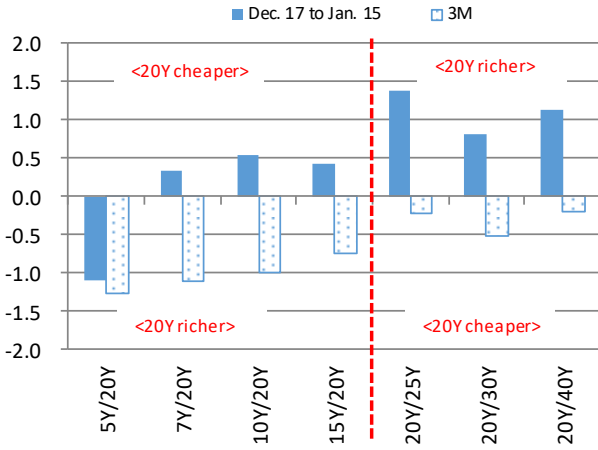
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Dec. 17 v. Jan. 15



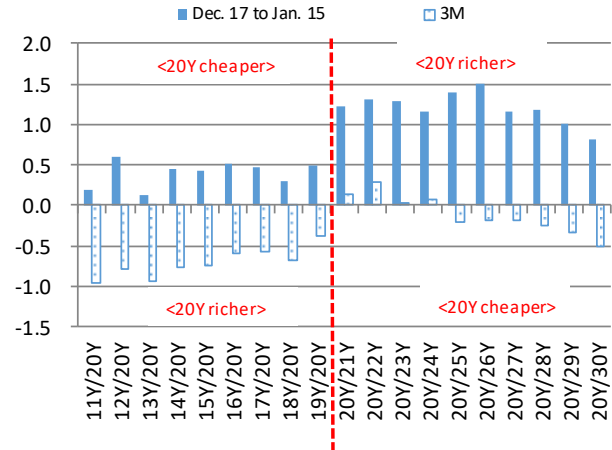
Source: Daiwa Securities.

Appendix 3a: Z-score I



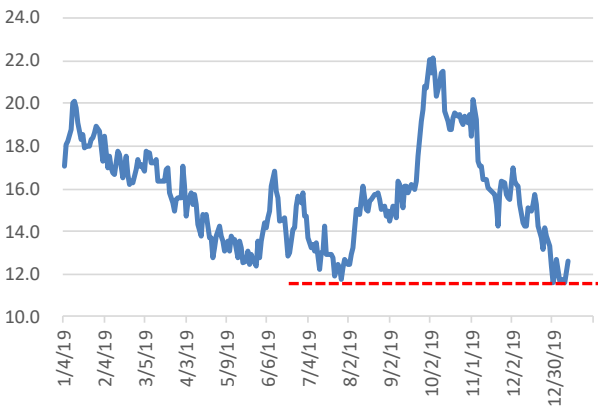
Source: Daiwa Securities.

Appendix 3b: Z-score II



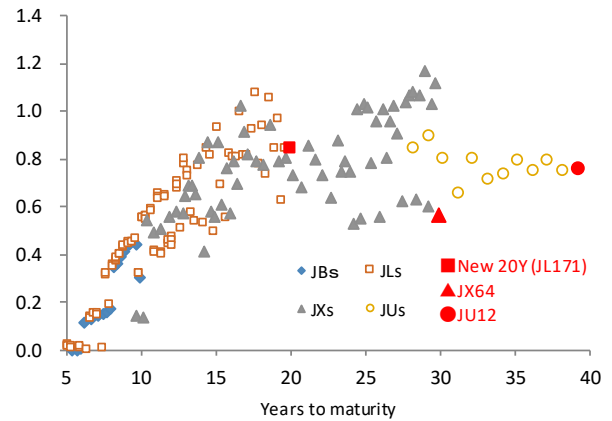
Source: Daiwa Securities.

Appendix 4: JGB 7Y/15Y/20Y Butterfly Spread (bp)



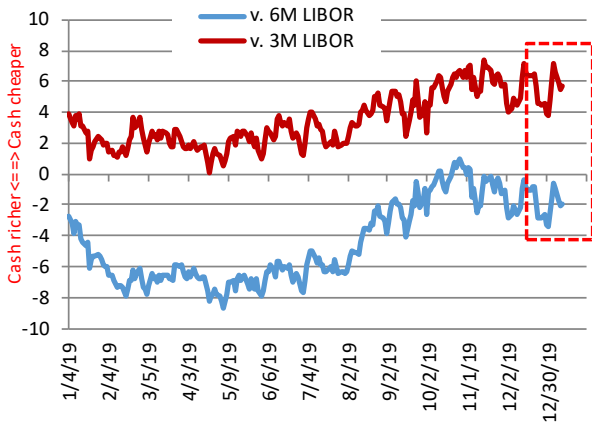
Note: 50%/50% trade, DV01 weighted
Source: Daiwa Securities.

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



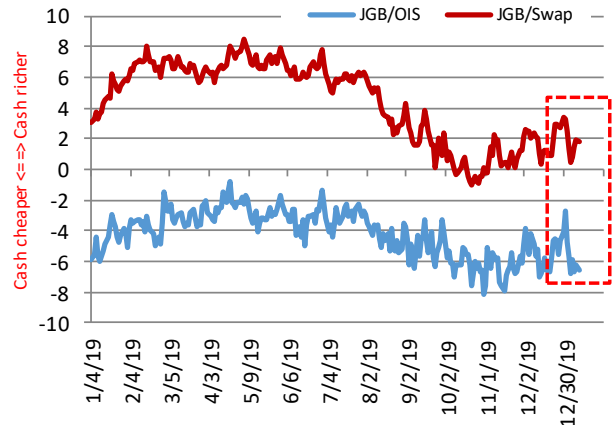
Note: Based on the Jan-15 JGB yield curve; factoring in roll-down effect etc.; JL171 is assumed to have a 0.3% coupon with 0.5bp spread to JL170.
Source: Daiwa Securities.

Appendix 6a: 20Y JGB Asset Swap Spread (bp)



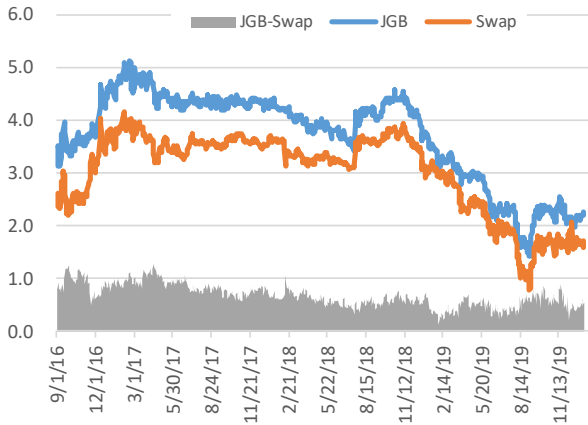
Note: since the Dec. auction
Source: Daiwa Securities.

Appendix 6b: 20Y JGB/Swap and JGB/OIS Spreads (bp)



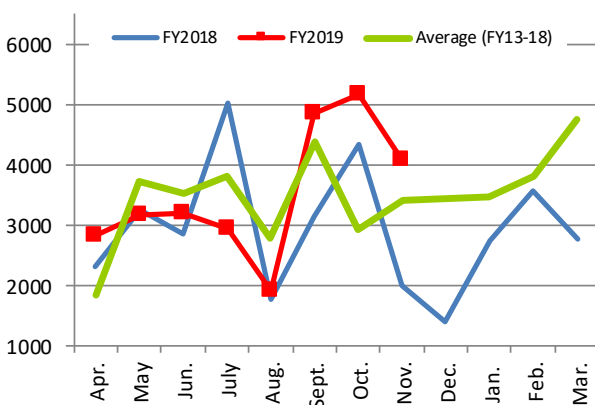
Note: since the Dec. auction
Source: Daiwa Securities.

Appendix 7: Carry & Rolldown in 20Y JGB and 20Y Swap (bp, 6M)



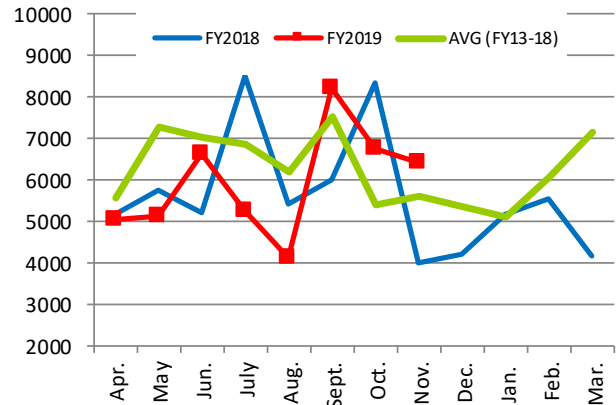
Source: Bloomberg, Daiwa Securities.

Appendix 8a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



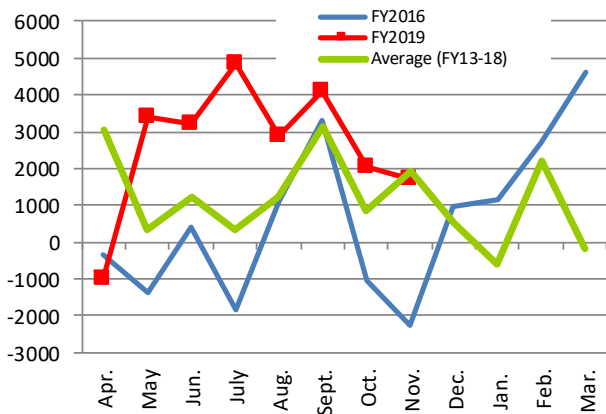
Source: JSDA

Appendix 8b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



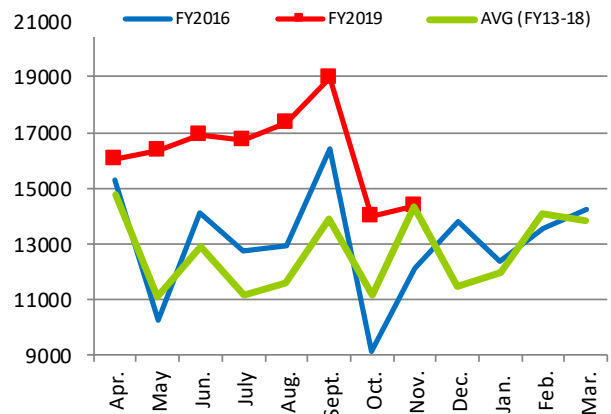
Source: JSDA

Appendix 9a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 9b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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[Standard & Poor's]

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