

Outlook for 40Y JGB Auction

Thinking about placing bids to take at the 0.4% level

- ✓ We would like to think about our bidding stance to take minimum necessary amount of new 40Y JGBs at the 0.4% level, closely watching the level of demand from investors

Strategic Memorandum DSTE356
FICC Research Dept.

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Auction Details

Auction Date: January 28, 2020
Issue Date: January 29, 2020
Maturity Date: March 20, 2059
Offering Amount: About 400 billion yen

* New 40Y JGBs will be the fourth reopening of the March 2059 bonds carrying a 0.5% coupon, JU12.

** On Jan. 27, JU12 traded at 0.395% (-4.0bp v. previous day's close, 0.401% on compound yield) and closed at 0.395% (-4.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Since the previous auction went well at the 0.470-475% level (unch - +0.5bp v. previous day's close; 0.472-0.476% compound) on November 26, 2019, the 40Y JGB yield has been range-bound at 0.410-0.500%. During that period, the long to superlong zone of the yield curve has mostly flattened amid a downtrend to an uptrend in the JGB market reflecting risk-on/risk-off sentiment (Appendix 2). Last week, the 40Y JGB yield slid from 0.50% to 0.43% on an intraday basis. As of 15:00 today (Jan 27), JU12 trades at 0.395% (-4.0bp v. previous day's close; 0.401% compound) amid growing caution about the spread of the new coronavirus. In such an environment, the key points to consider placing bids at tomorrow's auction can be summarized as follows:

- ✓ **Primary dealers may have little short in the 40Y sector:** They are likely to place bids, closely watching the level of demand from investors;
- ✓ **Expect certain investor demand:** Looking at the trading volume of major investors around the long end of the curve, we found that the figures during Sep-Dec 2019 were higher than the average for the FY13-18 on both net and gross (Appendix 7). This, combined with the 40Y JGB yield trend, indicates relatively firm demand for 40Y JGBs above 0.40%. Ahead of the introduction of capital regulations based on an economic value, it is said that investors have been having difficulty to reduce interest rate risk exposure. Under the circumstances, potential demand for 40Y JGBs appears strong in

terms of securing higher yields and reducing interest rate risk exposure. Given the fact that the issuance amount of 40Y JGBs is small at 400bn yen and they are launched once every two months, we need to consider such potential demand in thinking about the bidding stance;

- ✓ **Neither rich nor cheap relative on the curve:** The 40Y sector currently looks neither rich nor cheap on the curve. On the current yield curve, few curve players are expected to build new positions in an aggressive stance;
- ✓ **JU12 is likely to remain excluded from BOJ's purchase list:** Since January 6, the BOJ has been excluding JU12 from its purchase list in JGB purchase operations. Partly because the central bank has been excluding on-the-run 20Y and 30Y JGBs from the list, JU12 is likely to remain excluded. However, the share of JU12 held by the BOJ is fairly low at 4.3%, suggesting that there is strong investor demand at the primary stage. The impact especially on the bidding stance by primary dealers appears limited.

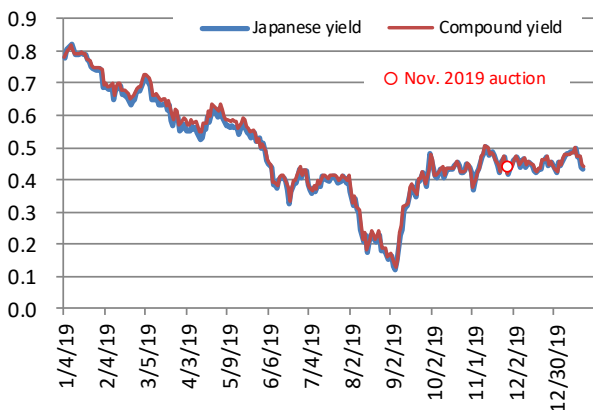
All in all, we would like to think about our bidding stance to take the necessary amount at the 0.4% level. As mentioned, the 40Y sector currently looks neither rich nor cheap relative to the curve. The current shape of the yield curve will discourage curve players from aggressively building new positions with 40Y JGBs. Generally, however, a smooth 40Y JGB auction tends to lead the 30Y/40Y spread to tighten after the auction (Appendix 9). We may see short-term switching out from the 30Y sector, albeit a passive stance.

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)**	
1/28/20	12R	0.5	3/20/59	400*					0.439	3.5			
11/25/19	12R	0.5	3/20/59	455.0	3.50	0.460	73.5926	101.44	0.472	3.9	0.444	3.5	Good
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

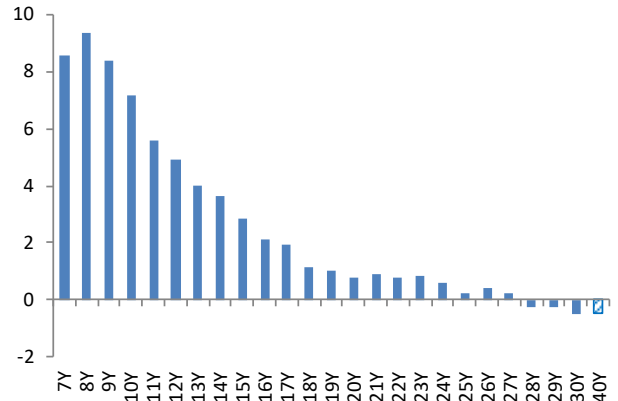
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Jan. 24 close for the Jan. 2020 auction
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



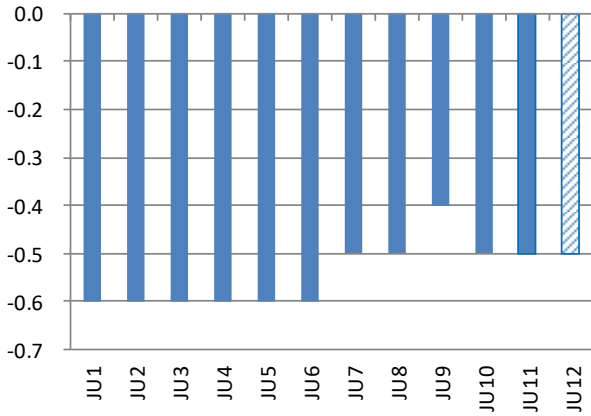
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Nov. 26 v. Jan. 24



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): Nov. 26 v. Jan. 24



Source: Daiwa Securities.

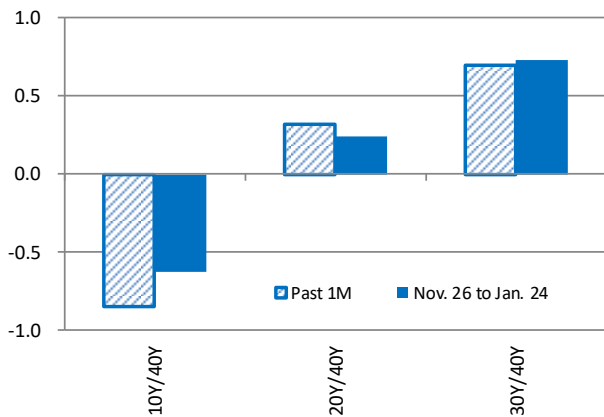
Appendix 4: 40Y JGBs held by BOJ

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,051.7	261.9	24.9%	789.8
JU2	1,343	77	5.8%	1,265
JU3	1,362	197	14.5%	1,164
JU4	1,962	227	11.5%	1,736
JU5	1,961	144	7.3%	1,817
JU6	2,002	932	46.5%	1,071
JU7	2,168	1,066	49.2%	1,102
JU8	2,319	1,262	54.4%	1,057
JU9	3,538	1,528	43.2%	2,010
JU10	3,410	1,156	33.9%	2,254
JU11	2,631	474	18.0%	2,157
JU12	1,715	74	4.3%	1,641

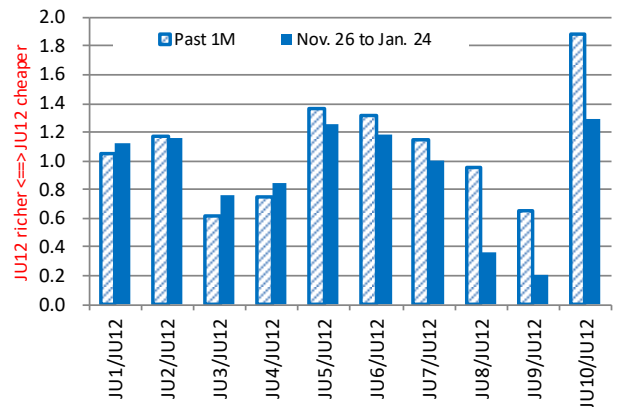
Note: as of Jan. 20 on BOJ start day
Source: Daiwa Securities.

Appendix 5a: Z-score I



Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 5b: Z-score II



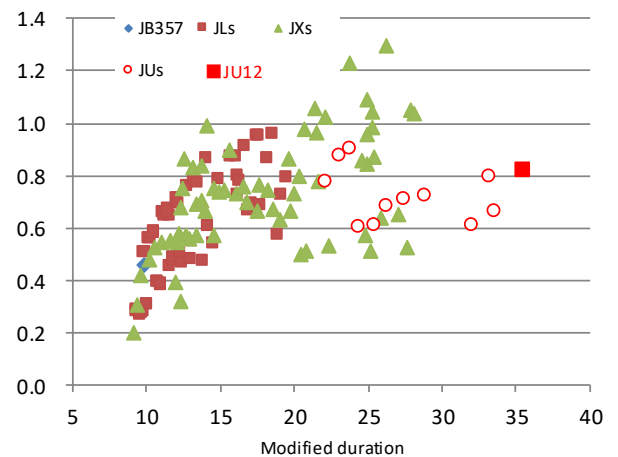
Source: Daiwa Securities.

Appendix 6a: 3M Total Return Curve on Years to Maturity (%)



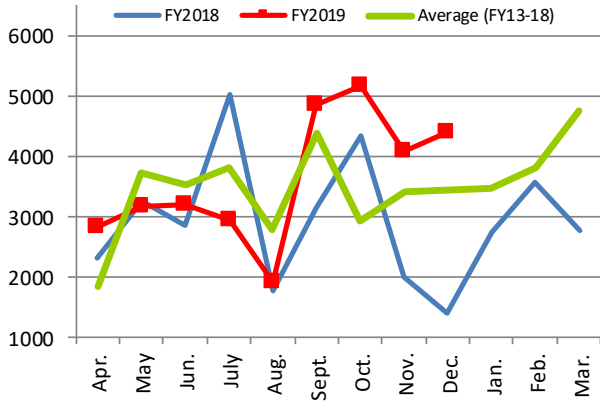
Note: Assuming that the yield curve shape as on Jan. 24 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities

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



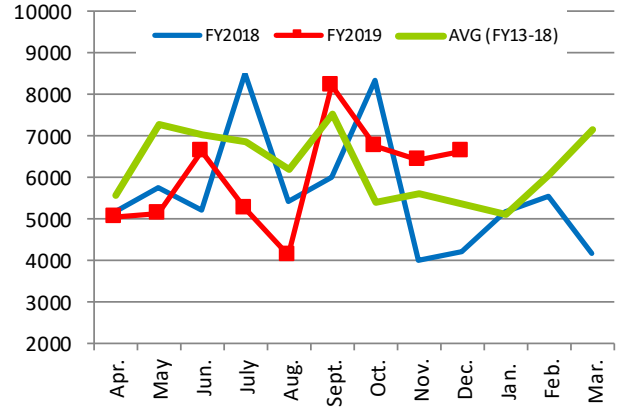
Note: Assuming that the yield curve shape as on Jan. 24 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities

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



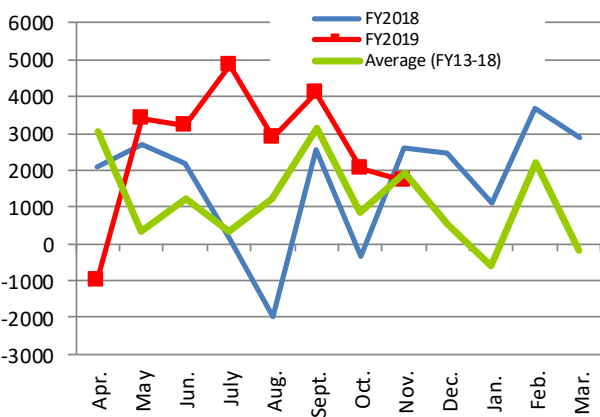
Source: JSDA

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



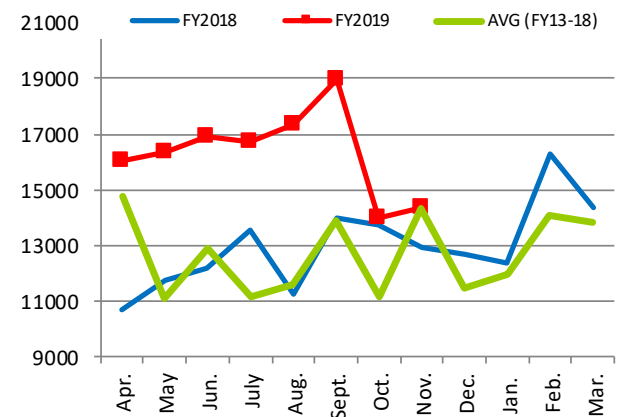
Source: JSDA

Appendix 8a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



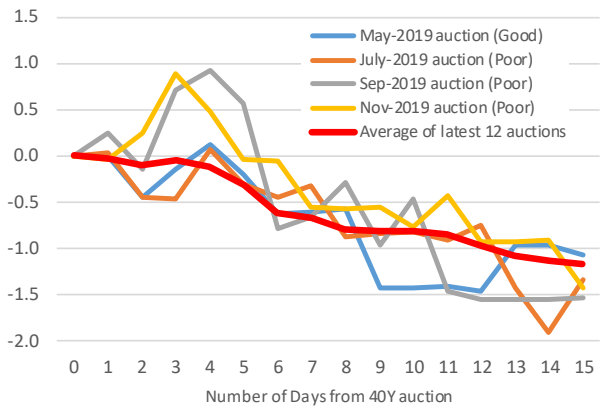
Source: JSDA

Appendix 8b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 9: 30Y/40Y Spread Change from 40Y JGB Auction (bp)



Source: Daiwa Securities

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[Standard & Poor's]

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[Moody's]

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