

Outlook for 30Y JGB Auction

Counting on demand from investors above 0.4%

- ✓ As primary dealers look unprepared yet, the key for a successful auction will be investor appetite for reopened 30Y JGBs at the level above 0.4%.
- ✓ In terms of relative value, we think about switching out from the 7Y sector

Strategic Memorandum DSTE358
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Auction Details

Auction Date: February 6, 2020
Issue Date: February 7, 2020
Maturity Date: December 20, 2049
Offering Amount: About 700 billion yen

* New 30Y JGBs will be the first reopening of the December 2049 bonds carrying a 0.4% coupon, JX65.

** On Feb. 5, JX65 traded at 0.410-0.415% (+2.0 - +2.5bp v. previous day's close) and closed at 0.415% (+2.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Rushing up to the 0.4% level

After the previous 30Y JGB auction went well at the 0.430-0.435% level (vs. previous day's WI closing at 0.415%), the JGB market softened amid higher US stocks/declining USTs partly due to receding concerns about the Middle East situation and expectations for progress in US-China trade talks. The 30Y JGB yield (conventional yield of on-the-run issue) thus temporarily rose to 0.470% on an intraday basis. Subsequently, the JGB market firmed up due to growing caution about the spread of new coronavirus, pushing down the 30Y JGB yield to 0.340% at one point. Today, the yield momentarily rose to 0.415% on an intraday basis amid a pause in excessive risk-off activities since the beginning of this week.

As dealers are not hungry enough, the key for successful sale will be investor appetite above 0.4%

Let's look at the environment surrounding JGBs. Recently, the unwinding of excessive risk-off activities has been observed, reflecting expectations for China's aggressive economic measures to cope with the spread of the new coronavirus. However, it is difficult to accurately forecast negative impact on the economy as ultimate measures to tackle with the infection have not been set yet. It is thus highly possible that worries about the global economic downturn will continue to linger. Given the fact that the global economy is already in a low inflation environment, we think that the US, Europe and Japan will likely keep their current easing policies or move for additional easing. From the viewpoint of fundamentals, JGB yields are unlikely to gain upward momentum in the current environment. Regarding external factors, we are still cautious about a possible correction in US stocks, which are

moving at the historically highest level. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **Primary dealers look unprepared yet for tomorrow's auction:** In addition to the fact that new 40Y JGBs were just auctioned last week, JGBs have been volatile for the past few days. Accordingly, primary dealers may be unprepared yet for tomorrow's auction. Demand from investors would be the key for successful primary sale;
- ✓ **Strong concern would be unnecessary for demand from investors at the 0.40-0.45% level:** Regarding demand from investors, 30Y JGBs have been finding decent buyers at the 0.400-0.450% level. If 30Y JGBs are properly adjusted in pre-auction trading to enable auction participants to take new 30Y JGBs at the 0.4% level, strong worry about investor demand would be unnecessary. There are expectations on seasonal demand for superlong JGBs in the Jan-Mar quarter, the last quarter in FY2019, as well;
- ✓ **Not overvalued in terms of the relative value:** At the current level, the 30Y sector is undervalued vs. the 7Y sector on the intermediate to superlong zone of the curve (Appendix 3). Against other sectors, the 30Y sector is neither noticeably cheap nor rich on the curve (Appendix 3). The 30Y asset swap spread vs. the Yen LIBOR is positive and the widest level in 12 months, implying that 30Y cash is strongly undervalued against swaps at the current level (Appendix 4);
- ✓ **Trimming in BOJ's JGB purchase:** In the Outline of Outright Purchases of Japanese Government Securities (announced on Jan 31), the BOJ reduced the number of monthly offers in the over 10Y zone to two times. As the offer range in the over 25Y zone is unchanged, it is highly possible that the offer amount in February's first operation in the zone will be unchanged, at 30bn yen, from that at the last operation in January. Based on this projection, the monthly purchase amount in the over 25Y zone is expected to decrease from 90bn yen in January to 60bn yen in February. However, as the BOJ's holding ratios of 30Y and 40Y JGBs (on-the-run and neighboring issues) are quite low, this trimming impact on tomorrow's primary sale would be limited.

Thinking about switching out from the 7Y sector

All in all, auction participants are expected to place bids for new 30Y JGBs by carefully watching demand from investors at the 0.4% level. We would like to think about our bidding stance to be tolerable for possible downside to around 0.45% in the investment horizon. In terms of the relative value, we think of switching out from the 7Y sector (Appendix 7). As mentioned above, the 30Y sector is noticeably undervalued vs. the 7Y sector. Such switching would be attractive if higher stock prices/lower bond prices are assumed especially in the near term. Meanwhile, we are unable to aggressively build new positions against swaps, given receiving pressure in the superlong zone on the swap market, despite the cheapness against swaps.

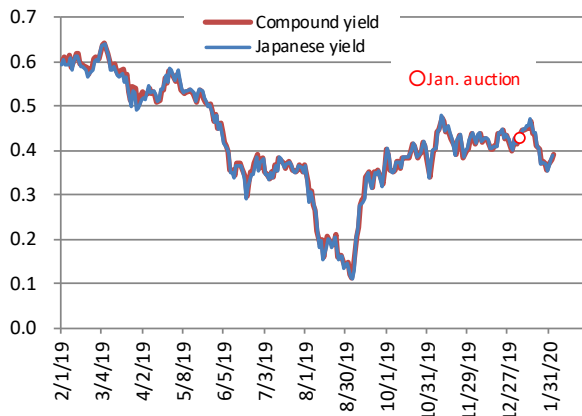
30Y JGB Auction Results

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 (%)
2/6/20	65R	0.4	12/20/49	700*										
1/9/20	65	0.4	12/20/49	699.0	3.66	99.18	99.10	0.08	0.430	0.433	0.003	5.2076	Good	0.430
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

* Amount the Ministry of Finance plans to issue

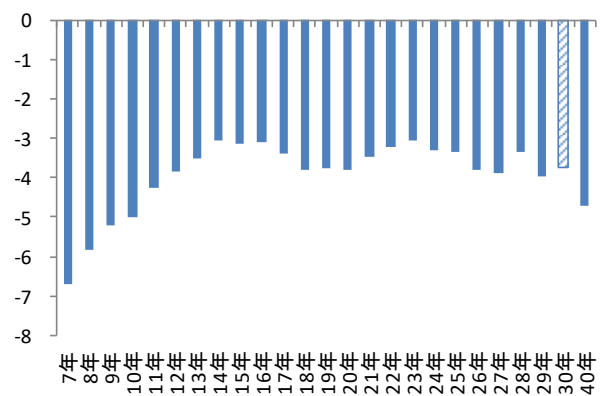
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



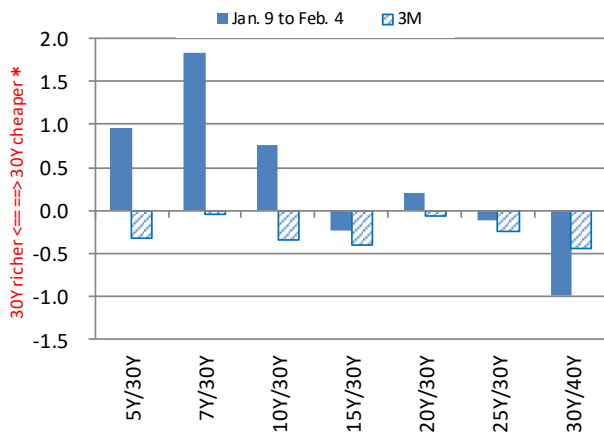
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Jan. 9 v. Feb. 4)



Source: Daiwa Securities.

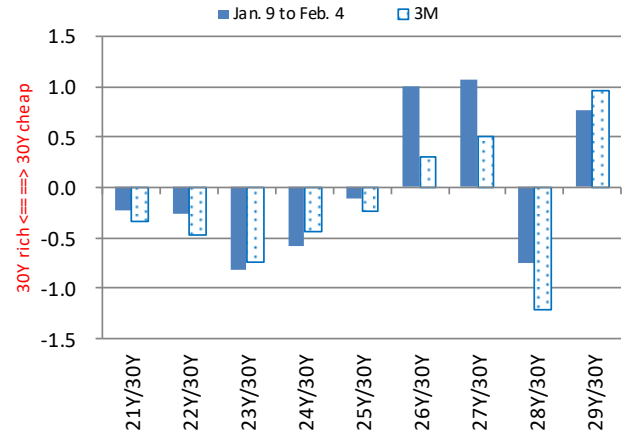
Appendix 3a: Z-scores of JGB Yield Spreads



Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y

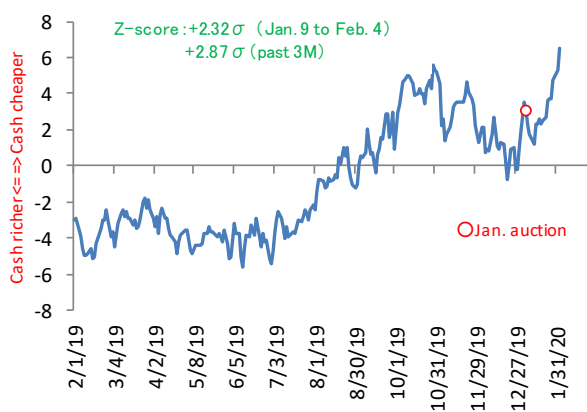
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



Source: Daiwa Securities.

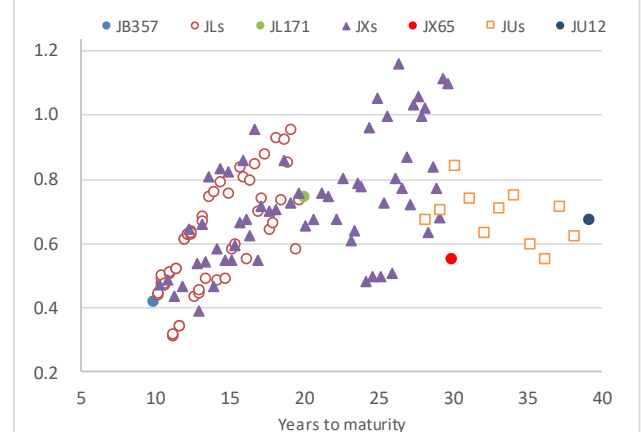
Appendix 4: 30Y JGB Asset Swap Spread (bp)



Note: 6M Yen LIBOR basis.

Source: Daiwa Securities.

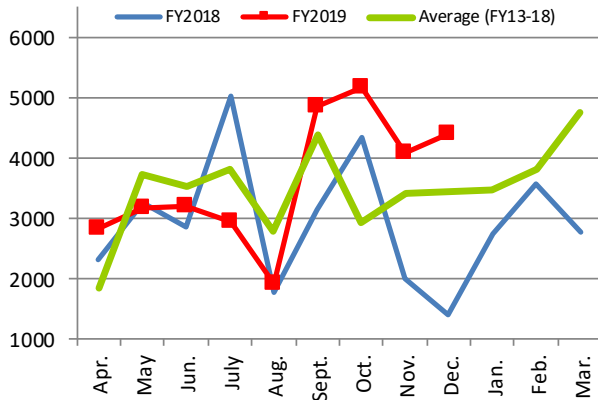
Appendix 5: JGB 3M Total Return Curve (%)



Note: Based on JGB yield curve on Feb. 4, assuming that the yield curve shape does not change and factoring roll-down effect etc.

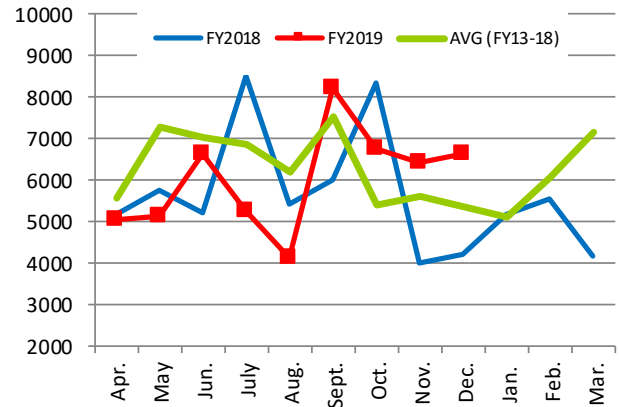
Source: Daiwa Securities

Appendix 6a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



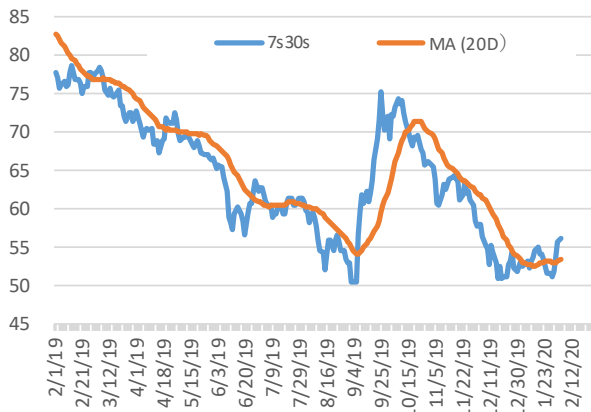
Source: JSDA

Appendix 6b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 7: JGB 7Y/30Y Spread (bp)



Note: On-the-run and CTD
Source: Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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May 2018

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- 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.
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* 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.

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