

## Outlook for 20Y JGB Auction

### Bidding with expectation on support around 0.25%

- ✓ Amid quite low liquidity, primary dealers would have to take a cautious stance at tomorrow's auction
- ✓ Meanwhile, a certain level of investor demand can be expected if investors gain confidence to be able to take 20Y JGBs at the 0.2% level at the auction
- ✓ We think about our bidding stance, assuming a new-term downside limit around 0.25%
- ✓ Although it is difficult to aggressively build new relative-value positions, switching out from 7Y may collect attention if the 7Y/20Y spread widens to 55-60bp

Strategic Memorandum DSTE367  
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### Auction Details

**Auction Date:** March 12, 2020  
**Issue Date:** March 13, 2020  
**Maturity Date:** December 20, 2039  
**Offering Amount:** About 900 billion yen

\* New 20Y JGBs will be the final reopening of the December 2039 bonds carrying a 0.3% coupon, JL171.

\*\* On March 11, JL171 traded at 0.185 - 0.220% (-3.0 - +0.5bp v. previous day's close) and closed at 0.210% (-0.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

#### JL171 yield rose from 0.1% to 0.225% this week

After the previous 20Y JGB auction went well at the 0.235-0.240% level (vs. the previous day's close of 0.235%), the JL171 yield momentarily declined to 0.100% during intraday trading on March 9 amid the global bond rally. On the following day (Mar 10), the yield rose to 0.225% at one point amid a plunge of bonds globally. Today (as of 14:00), the yield rose to 0.220% after falling to 0.185%..

#### Primary dealers would have to take a cautious stance at tomorrow's auction

Under the situation where JGBs have been quite volatile and face a very low liquidity crisis, primary dealers appear to be unprepared for tomorrow's auction. There is the fact that the 5Y JGB auction, held by the Ministry of Finance on March 10, went much more poorly than expected. Primary dealers would have to take a cautious stance at tomorrow's auction.

#### Certain level of investor demand can be expected at the level above 0.2%

Meanwhile, we should watch for demand 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. Tomorrow's auction will be the last 20Y JGB auction in FY19. The current absolute yield level can be too low. Nevertheless, we anticipate a certain level of demand from investors at the auction, where they can buy in a relatively good size, as (1) the possibility that JGB yields are unlikely to show upward momentum for the time being even after the start of the new fiscal year and

(2) the liquidity in the secondary market is remarkably low. Investor demand can be expected, if the 20Y JGB yield rises to the 0.2% level in pre-auction trading.

**Bidding with assumption of near-term downside limit around 0.25% and higher probability of tail**

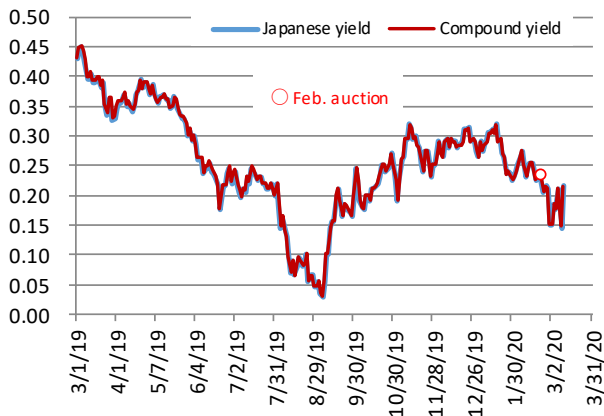
All in all, we expect tomorrow’s auction to have a longer tail than 20Y JGB auctions generally have. We would like to think about our bidding stance, assuming a near-term downside limit of 20Y JGBs at around 0.25%. Under the current situation, it is difficult to aggressively build new positions in terms of the relative value. However, activities to switch out from the 7Y sector should be well watched. Amid a remarkable decline in liquidity in the JGB cash market, the firmness of JGB futures has been stunning market participants. That said, we can also expect a reversal of the 7Y/20Y spread, which has recently widened sharply, because (1) the panicked trend of lower stock prices/higher bond prices appears to have started to pause in the US market and (2) the JGB futures virtually rolled to the June 2020 contract in today’s morning session. It would be worth considering the switching if the 7Y/20Y spread widens to 55-60bp.

**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
3/12/20	171R	0.3	12/20/39	900*									
2/20/20	171R	0.3	12/20/39	969.8	3.99	101.27	101.25	0.02	0.232	0.234	0.002	81.9560	Good
1/17/20	171	0.3	12/20/39	899.1	3.83	99.99	99.90	0.09	0.300	0.305	0.005	93.4722	Good
12/17/19	170R	0.3	9/20/39	1,027.5	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	1,032.8	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	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	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	1,018.7	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	1,018.1	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	1,017.0	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	1,007.2	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	989.4	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	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	1,117.5	4.67	101.47	101.40	0.07	0.419	0.423	0.004	29.3637	Good

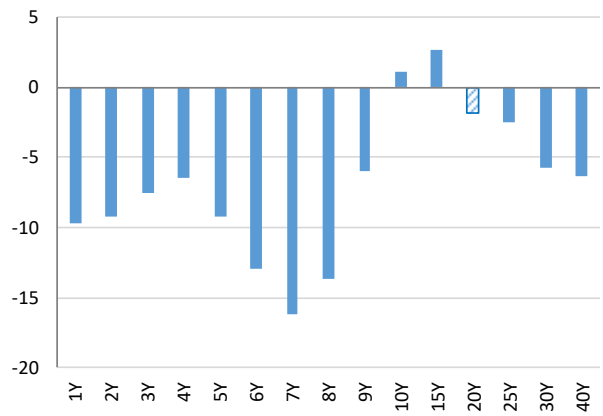
\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

**Appendix 1: 20Y JGB Yield (%)**



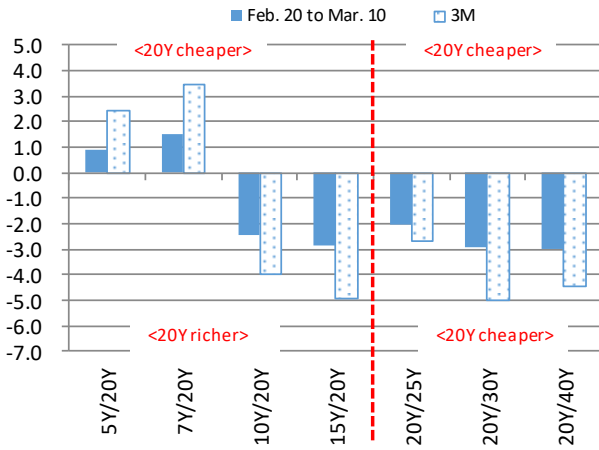
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp): Feb. 20 to Mar. 10**



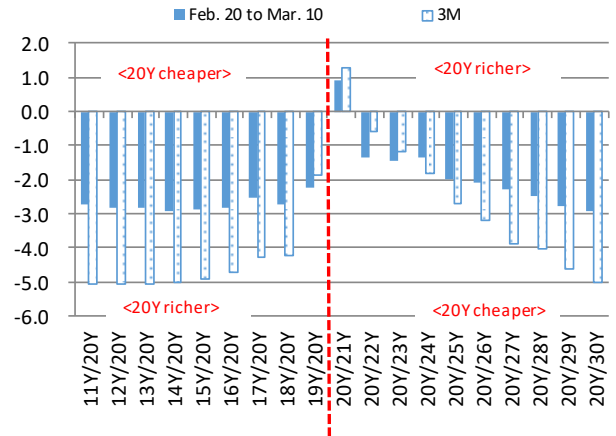
Source: Daiwa Securities.

Appendix 3a: Z-score I



Source: Daiwa Securities.

Appendix 3b: Z-score II



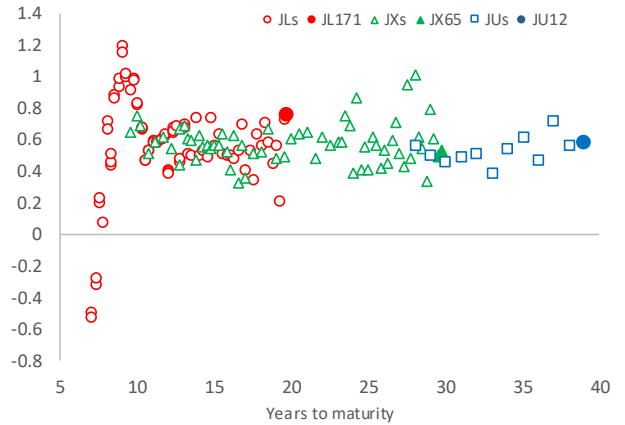
Source: Daiwa Securities.

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



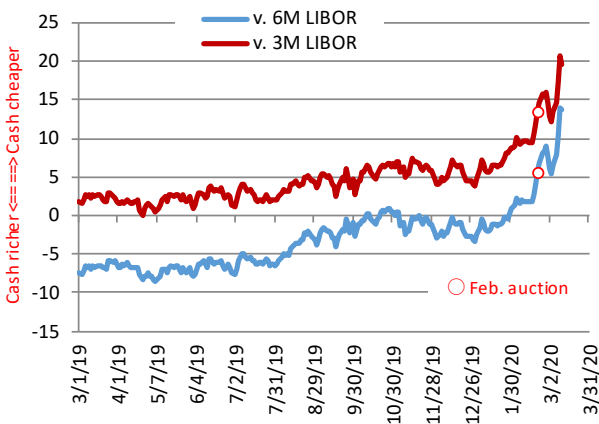
Note: On-the-run and CTD basis  
Source: Daiwa Securities.

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



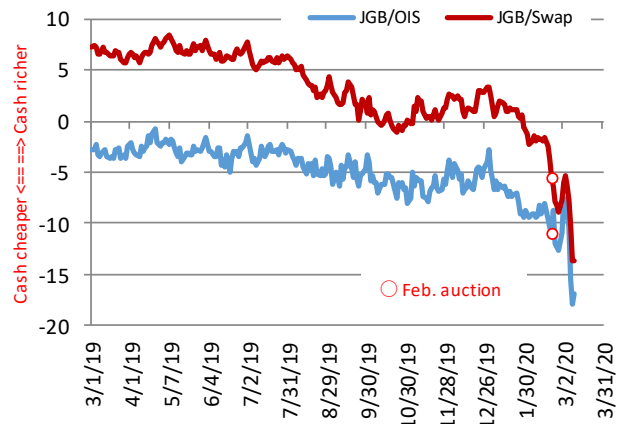
Note: Based on the March 10 JGB yield curve; factoring in roll-down effect etc.  
Source: Daiwa Securities.

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



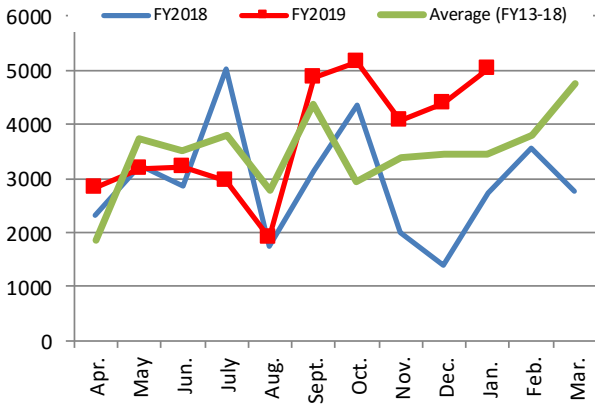
Source: Daiwa Securities.

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



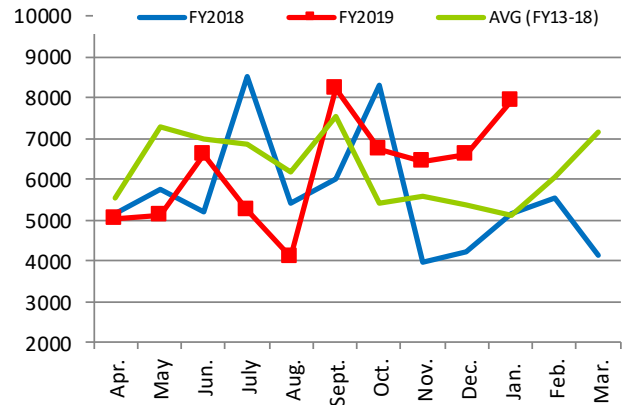
Source: Daiwa Securities.

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



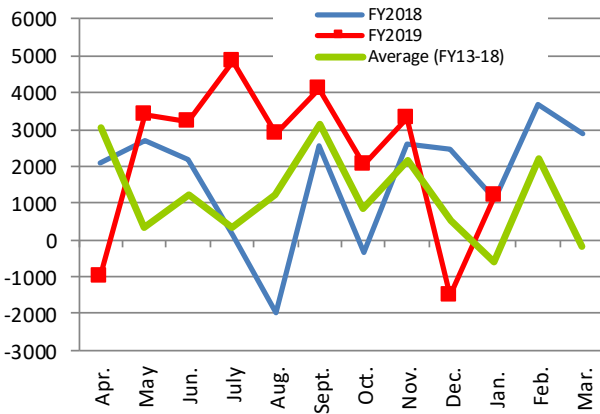
Source: JSDA

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



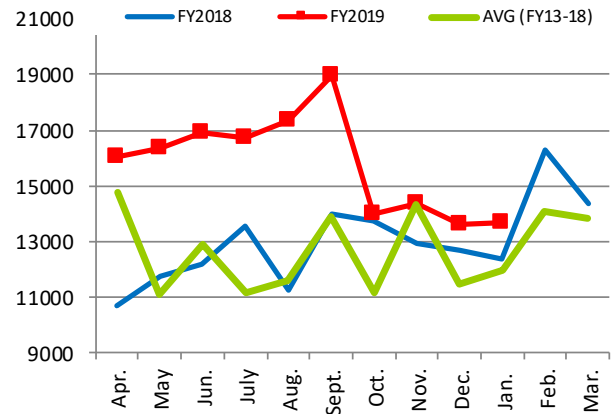
Source: JSDA

**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

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February 2020

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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.
- 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.

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