

Outlook for 30Y JGB Auction

Bidding with near-term support around 0.45% in mind

- ✓ Discouraged from taking unnecessary risk in this particular situation, primary dealers, who appear to be not deeply short, are likely to take a cautious bidding stance
- ✓ Meanwhile, decent demand is expected from investors if they gain confidence to be able to take new 30Y JGBs, which will be new series, JX66, to be redeemed in March 2050, above 0.4%
- ✓ We would like to think about our bidding stance, assuming 30Y JGBs will be supported around 0.45% for the time being, with slight possibility of a longer tail

Strategic Memorandum DSTE372
FICC Research Dept.

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

Auction Details

Auction Date: April 7, 2020

Issue Date: April 8, 2020

Maturity Date: March 20, 2050

Offering Amount: About 700 billion yen

* New 30Y JGBs, JX66, will likely carry a 0.4% coupon.

** On April 6, WI barely traded, and closed at 0.420% (+2.5bp v. previous day's close). JX65 traded at 0.400 - 0.420% (+1.0 - +3.0bp) and closed at 0.420% (+3.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

30Y JGBs moving around 0.4%

After the previous 30Y JGB auction went well at the 0.335-0.340% level (+2.5 to +3.5bp vs. previous day's close), the 30Y JGB yield declined from 0.350% (afternoon session on March 5) to 0.215% (on March 9) on an intraday basis amid growing risk-off sentiment due to the global spread of the new coronavirus. While the financial markets faced the extreme confusion in mid-March, JGBs plunged. That pushed the 30Y JGB yield up to 0.450% at one point on March 19 on an intraday basis. Subsequently, some investors, heading to the fiscal-year end, showed up for last-minute buying 30Y JGBs, which traded above 0.4%. The 30Y JGB yield thus momentarily declined to 0.395% on March 30. Since then, the yield has been moving at around 0.4%.

Discouraged from taking unnecessary risk in this particular situation, primary dealers, who appear to be not deeply short, are likely to take a cautious bidding stance

Let's check the environment surrounding the JGB market. While the COVID-19 virus has been rampant globally with no prospect on when the pandemic will come under control, caution about the economic downtrend remains strong partly as the Japanese government has decided to declare a state of emergency. In Europe and the US, the authorities have started to announce aggressive policies also in the fiscal front, in addition to strengthening of monetary easing policy amid the aggravation of the pandemic. Under the trend of global fiscal expansion, the probability on fiscal expansion (via an increase in issuance amount of deficit JGBs) and the resultant increase in JGB market issuance on a calendar basis is increasing also in Japan. However, upward pressure on yields is unlikely to rapidly strengthen as the increase in issuance is expected to start in July and the BOJ has

increased its purchase amount in the April plan. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

- ✓ **While liquidity remains quite low, primary dealers are unlikely to place aggressive bids:** Primary dealers seem to be not deeply short in the 30Y sector. As many of them are in the BCP mode, this would prevent them from keeping big positions. In addition, there are strong uncertainty about the developments of the JGB market after the declaration of the state of emergency. Discouraged from taking unnecessary risk in this particular situation, primary dealer are likely to place aggressive bids. Primary demand from investors will be the key for smooth sale of new 30Y JGBs;
- ✓ **Decent demand is expected from investors:** At tomorrow's auction, the Ministry of Finance will sell new 30-year JGBs in new maturity basket to be redeemed in March 2050 (JX66). As JGB yields are unlikely to show upward momentum for the time being, demand from investors would strengthen if they gain their confidence to be able to take new 30Y JGBs at the level above 0.4% at the primary stage. This is partly because they can buy in a relatively good size at the auction amid a remarkable decline in liquidity in the secondary market;
- ✓ **Neither noticeably rich nor cheap on the intermediate- to superlong-term zone of the curve:** Our analysis based on data since the previous 30Y JGB auction and that over the past three months shows that the 30Y sector is currently neither noticeably rich nor cheap on the intermediate to superlong zone of the curve (Appendix 3);
- ✓ **A wave of supplies expected in the superlong zone:** After tomorrow's auction, a wave of supplies are expected in the superlong zone—the Liquidity Enhancement Auction for the remaining maturity of the 15.5-39Y zone on April 14 (500bn yen) and 20Y JGB auction on April 21 (900bn yen). Moreover, the Liquidity Enhancement Auction for the remaining maturity of 15-15.5Y zone is scheduled for April 16 as well. In the BOJ's purchase plan for April, the BOJ keeps the purchase amounts in the 10-25Y and the over-25Y zone unchanged from those in March, while they increases the monthly total purchase amounts in other targeted zones. Given this, we are worried about the performance of superlong JGBs on the curve;
- ✓ **Paying attention to the additional issuance amount to be announced this week:** While the additional issuance of JGBs appears to start in July, the amount by maturity zone is expected to be announced this week in line with the cabinet decision on the first supplementary budget of FY2020. Most market participants appear to forecast Y100bn increase each in 20Y JGBs and 30Y JGBs, and no increase in 40Y JGBs or Liquidity Enhancement Auctions. If the issuance amount of 20Y JGBs increases by 200bn yen or more, this may temporarily worsen market sentiment in the superlong zone.

Bidding with near-term support around 0.45% in mind

All in all, we would like to think about our bidding stance, assuming 30Y JGBs will be supported around 0.45% for the time being, with slight possibility of a longer tail.

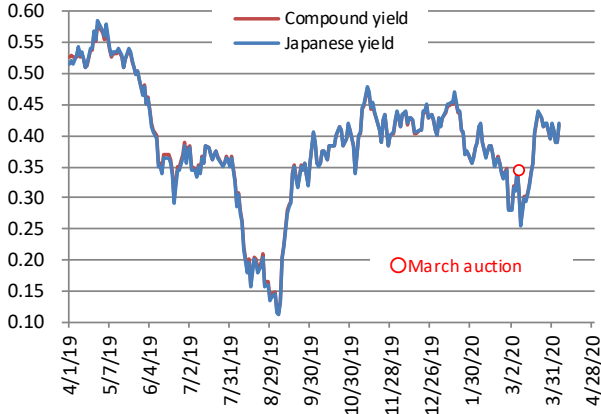
30Y JGB Auction Results

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 (%)
4/7/20	66	0.4*	3/20/50	700**										
3/5/20	65R	0.4	12/20/49	720.5	3.65	101.75	101.65	0.10	0.335	0.339	0.004	29.4762	Good	0.345
2/6/20	65R	0.4	12/20/49	701.6	3.73	99.30	99.25	0.05	0.426	0.428	0.002	70.0249	Good	0.420
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

* Daiwa forecast as of Apr. 6 ** Amount the Ministry of Finance plans to issue

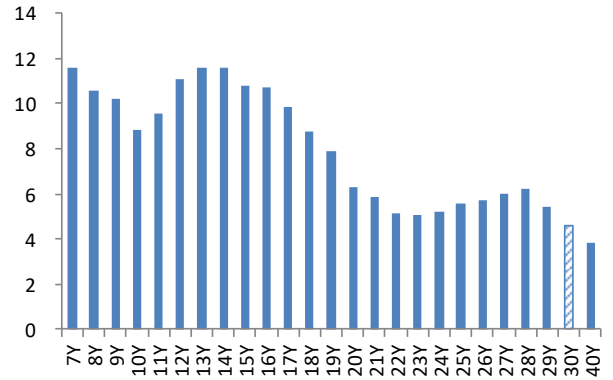
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



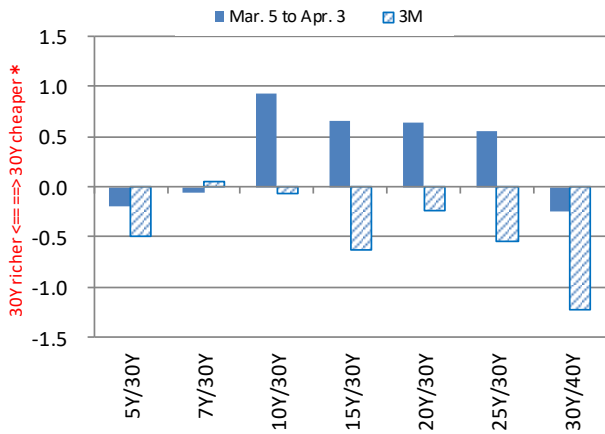
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (Mar. 5 v. Apr. 3)



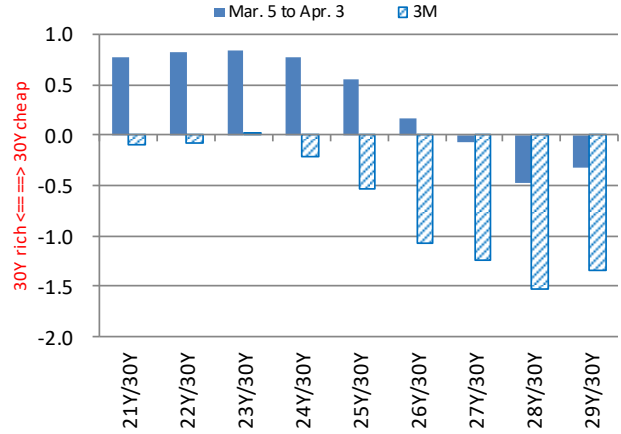
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



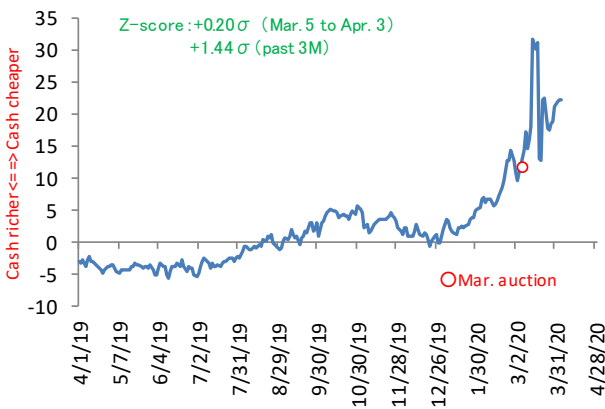
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



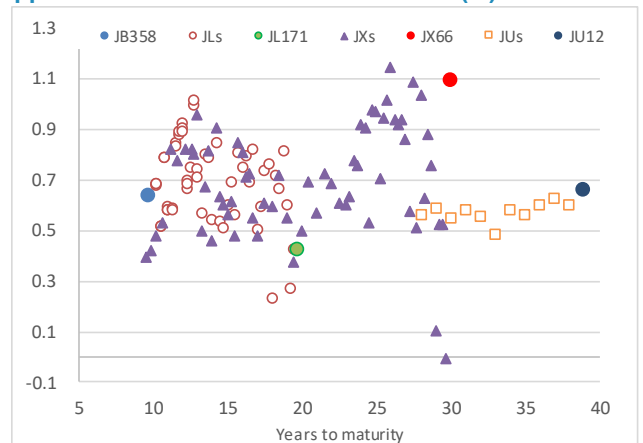
Source: Daiwa Securities.

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



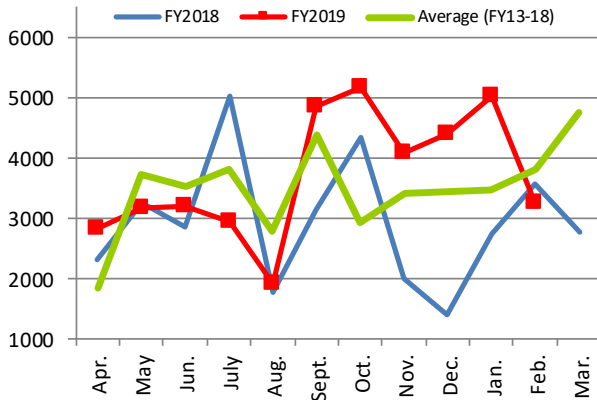
Note: 6M Yen LIBOR basis.
Source: Daiwa Securities.

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



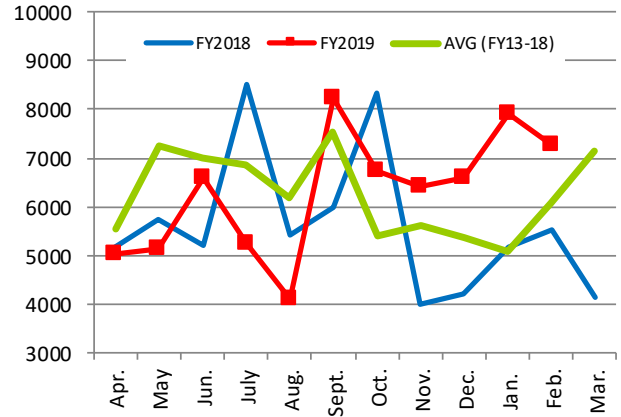
Note: Based on JGB yield curve on Apr. 3, assuming that the yield curve shape does not change and factoring roll-down effect etc.; JX66 is assumed to have a 0.4% coupon with 0.5bp spread to JX65.
Source: Daiwa Securities

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

MOF Issuance and BOJ Purchase Schedule for April 2020

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	JGB Floater	TDBs	MOF Buyback
4/1/20	W 4/2/20			280.2				30.3			
4/2/20	TH 4/3/20	10Y JGB Auction									
4/3/20	F 4/6/20		320.1	280.3		120.3	30.0			3M	
4/6/20	M 4/7/20	80.1			350.4				100.3		
4/7/20	T 4/8/20	30Y JGB Auction									
4/8/20	W 4/9/20		⊙		⊙					○	
4/9/20	TH 4/10/20	5Y JGB Auction									
4/10/20	F 4/13/20									3M	
4/13/20	M 4/14/20		⊙	⊙	⊙						○
4/14/20	T 4/15/20	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)									
4/15/20	W 4/16/20	○	⊙								
4/16/20	TH 4/17/20	AEL (20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years to maturity)									
4/17/20	F 4/20/20		⊙	⊙						3M	
4/20/20	M 4/21/20										
4/21/20	T 4/22/20	20Y JGB Auction									
4/22/20	W 4/23/20	○		⊙	⊙					○	
4/23/20	TH 5/1/20	2Y JGB Auction									
4/24/20	F 4/27/20					⊙	⊙	○		3M	
4/27/20	M 4/28/20		⊙	⊙	⊙						
4/28/20	T -	BOJ MPM (Day 2)									
4/29/20	W -	Public Holiday (ShowaDay)									
4/30/20	TH 5/1/20										

Note: ⊙ Announced by the BOJ on Mar. 31, ○ Daiwa forecast as of Apr. 6 ; Figures are actual in billion yen; Red figures are decreased and green figures are increased from previous operations.

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

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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■ Credit Rating Agencies

[Standard & Poor's]

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February 2020

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- 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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