

Outlook for 20Y JGB Auction

A smooth auction expected, but JL174 tap's upside to be limited below 0.4%

- ✓ While the downside of 20Y JGBs has been supported well above 0.4% by demand from investors, the upside has been limited below 0.4%.
- ✓ We would like to think about our bidding stance, expecting the 20Y JGB yield to remain in a narrow range centered at 0.40%.
- ✓ In terms of relative value, it is worth considering switching out from the 11-15Y sectors

Strategic Memorandum DSTE412
FICC Research Dept.

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Auction Date: November 18, 2020

Issue Date: November 19, 2020

Maturity Date: September 20, 2040

Offering Amount: About 1.2 trillion yen

* New 20Y JGBs will be the first reopening of JL174 carrying a 0.4% coupon.

** On November 17, JL174 traded and closed at 0.400% (-0.5bp v. previous day's close).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Moving in the 0.380-0.415% range since previous auction

The previous 20Y JGB auction went well at the 0.395-0.400% level (vs. WI closing at 0.410% on previous day). Since then, the 20Y JGB yield has moved in the 0.380-0.415% range on an intraday basis. At 14:00 today (Nov. 17), JL174 trades at 0.400% (-0.5bp vs. previous day's close). While the downside of 20Y JGBs has been supported by demand from investors above 0.4%, the upside has been limited below 0.4%.

While the downside of 20Y JGBs is supported above 0.4% by demand from investors, the upside is limited below 0.4%

We look at the environment surrounding the JGB market. Currently the market is posting a trend of higher stock prices/lower bond prices amid a series of headlines related to the development of COVID-19 vaccines. However, from a practical viewpoint, it will take a considerable time before vaccines are widely diffused. Amid the spread of COVID-19 infections around the globe, we are unable to have an optimistic outlook for the global economy. In the US, as the results of the presidential election became clear in all the 50 states, it is now certain that former Vice President Democrat Joe Biden won the election. At the moment, the chance of a "blue wave" is not zero, but it remains quite low. Partly because of this, some think it difficult for Mr. Biden to realize his own policies with a dividend congress. However, the direction toward fiscal expansion and monetary easing is unlikely to be changed amid strong worries about the economic outlook due to the pandemic. Also in Japan, Prime Minister Yoshihide Suga instructed on November 10 to formulate additional economic measures. The BOJ is also likely to keep the current yield curve control policy persistently. A noteworthy topic regarding 20Y JGBs is the development of discussions on

the FY21 JGB issuance plan. At the moment, we have the impression that the Ministry of Finance (MOF) is negative about a further increase in the issuance of superlong JGBs. However, the market appears to have a strong request for further issuance of 20Y and 40Y JGBs. We thus need to watch closely how the discussion progresses also in terms of the MOF's commitment to "a maturity structure that meets market needs." In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **There are no strong worries about demand from investors above 0.4%:** While the downside of 20Y JGBs has been supported by demand from investors above 0.4%, the upside has been limited below 0.4%. If JL174 tap is expected to be sold above 0.4% or under par, no worries would be needed about demand from investors;
- ✓ **In terms of relative value, the 20Y sector is strongly undervalued vs. the 5Y, 11-15Y, 18Y, and 19Y sectors on the curve:** Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is noticeably undervalued vs. the 5Y, 11-15Y, 18Y, and 19Y sectors on the intermediate to superlong zone of the curve (Appendix 3). Since the previous auction, the 20Y asset swap spread has tightened, albeit moderately. This suggests that 20Y cash is at a cheaper level than it was at the previous auction (Appendix 6);
- ✓ **Primary dealers seem to be short in the 20Y sector:** Decent short-covering is likely to support the auction to some extent;
- ✓ **Tight issuance schedule for superlong JGBs:** Starting from last week's 30Y JGB auction, the superlong zone will have a concentrated supply until next month's 20Y JGB auction slated for December 10. It appears risky to make big long positions at tomorrow's auction.

Placing bids to take only the necessary amount with expectation that the 20Y JGB yield will remain in a narrow range centered at 0.40%

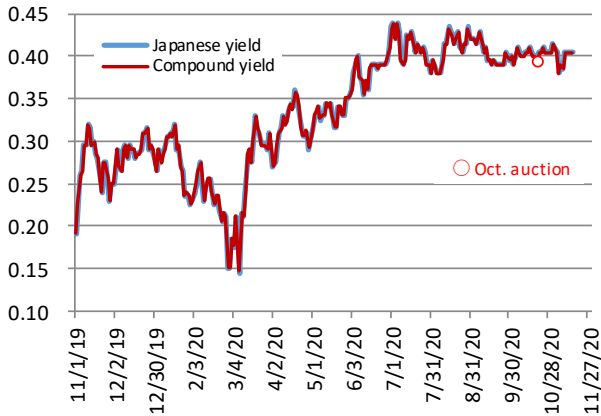
Overall, we would like to think about our bidding stance to take only the necessary amount at tomorrow's auction, expecting the 20Y JGB yield to remain in a narrow range centered at 0.40% (for example, 0.38-0.42%). In terms of relative value, we would like to consider switching out from the 11-15Y sectors. As mentioned above, the 20Y sector is strongly undervalued vs. these sectors at current levels. In addition, these sectors are quite expensive in the 10-20Y zone of the curve. Moreover, as the 11-15Y/20Y spreads have widened to their reversal levels seen in July (Appendix 5), it would be worth considering switching out from the 11-15Y sectors.

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
11/18/20	174R	0.4	9/20/40	1,200*									
10/20/20	174	0.4	9/20/40	1,304.1	3.86	100.10	100.05	0.05	0.394	0.397	0.003	18.5341	Good
9/10/20	173R	0.4	6/20/40	1,243.1	3.69	99.85	99.75	0.10	0.408	0.413	0.005	75.5975	Avg
8/25/20	173R	0.4	6/20/40	1,316.2	3.92	99.94	99.90	0.04	0.403	0.405	0.002	67.8187	Good
7/21/20	173	0.4	6/20/40	1,313.4	3.80	99.70	99.65	0.05	0.416	0.419	0.003	28.5714	Good
6/26/20	172R	0.4	3/20/40	977.7	3.87	100.24	100.20	0.04	0.386	0.389	0.003	59.9036	Good
5/20/20	172R	0.4	3/20/40	957.3	4.25	101.26	101.20	0.06	0.332	0.335	0.003	36.3983	Good
4/21/20	172	0.4	3/20/40	899.4	3.58	101.21	101.10	0.11	0.335	0.340	0.005	16.5349	Avg
3/12/20	171R	0.3	12/20/39	963.5	3.69	100.98	100.90	0.08	0.248	0.252	0.004	97.2897	Good
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

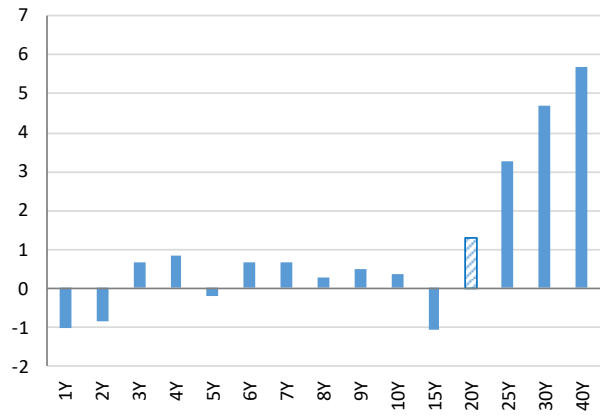
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



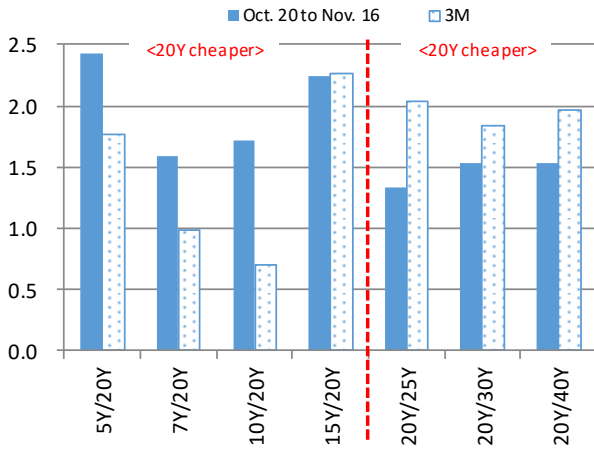
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Oct. 20 v. Nov. 16



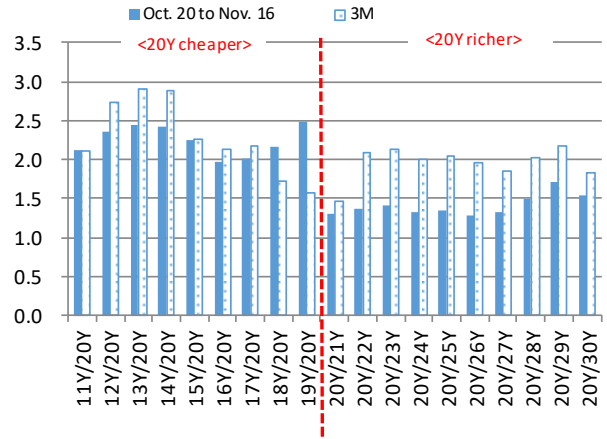
Source: Daiwa Securities.

Appendix 3a: Z-score I



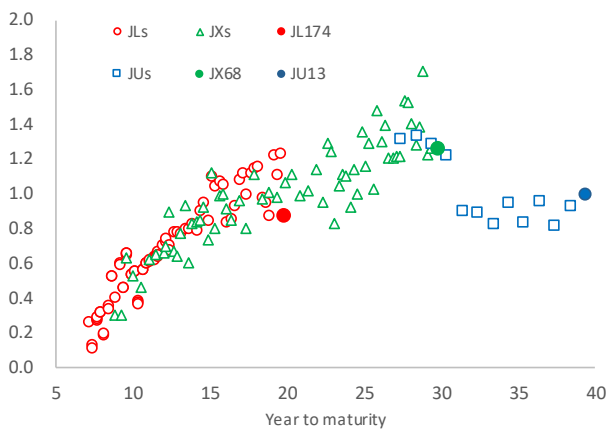
Source: Daiwa Securities.

Appendix 3b: Z-score II



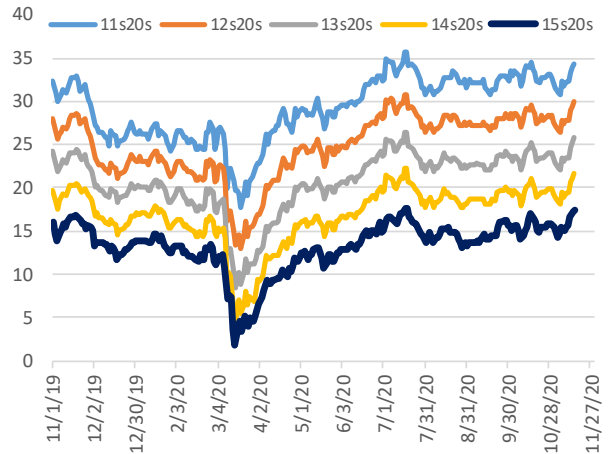
Source: Daiwa Securities.

Appendix 4: JGB Total Return Curve (3M, %)



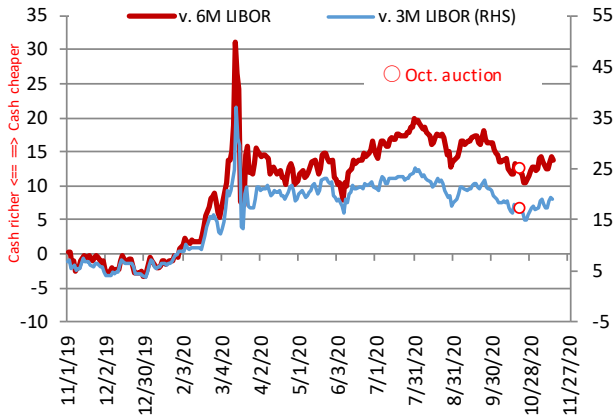
Note: Based on the Nov-16 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 5: JGB 11-15Y/20Y Spreads (bp)



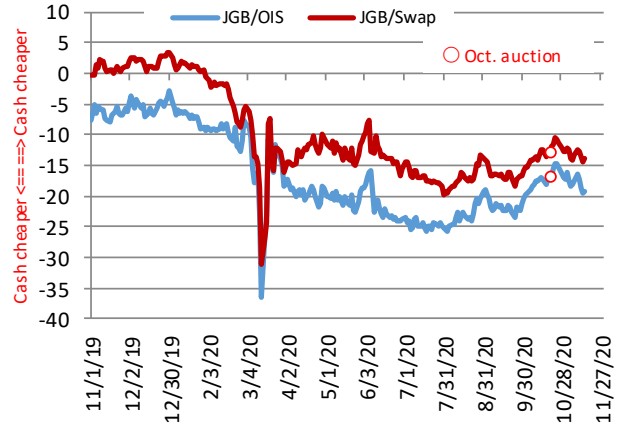
Note: Generic compound yield
Source: Daiwa Securities

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



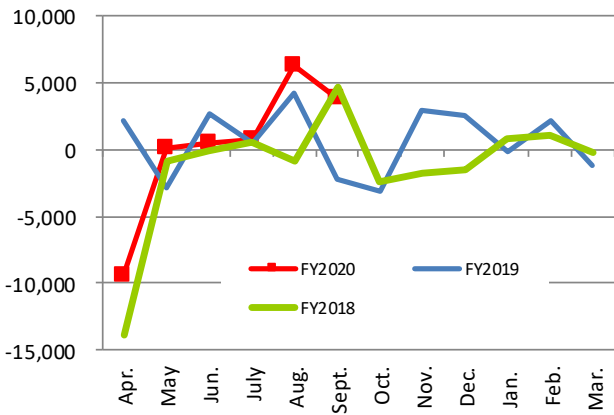
Source: Daiwa Securities.

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



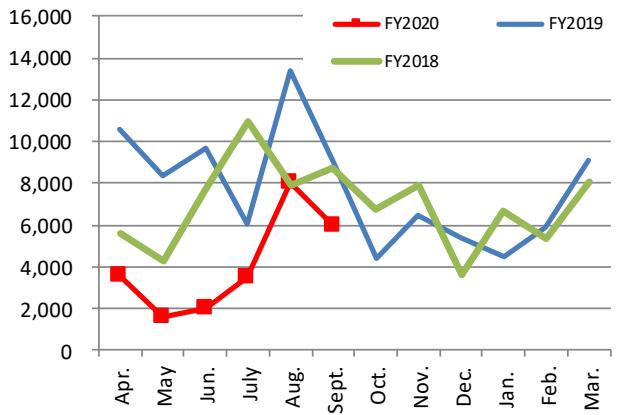
Source: Daiwa Securities.

Appendix 7a: Trend of Major Banks' Net Purchase of Superlong JGBs (Yen 100M)



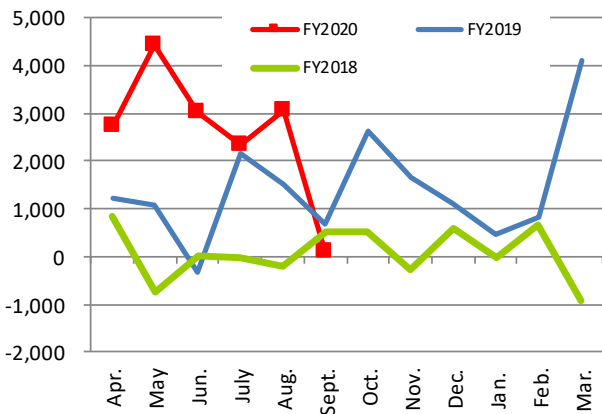
Source: JSDA

Appendix 7b: Trend of Major Banks' Gross Purchase of Superlong JGBs (Yen 100M)



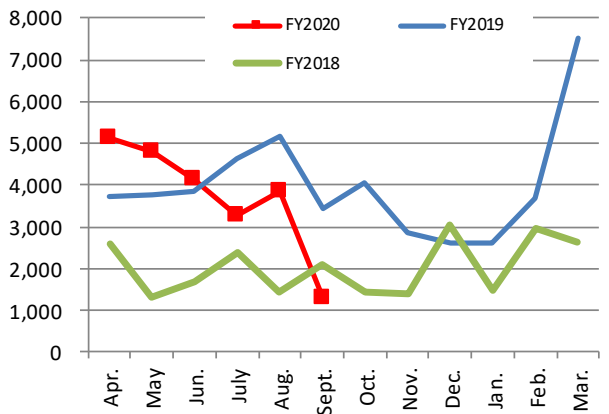
Source: JSDA

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



Source: JSDA

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



Source: JSDA

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[Standard & Poor's]

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February 2020

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