

Outlook for 40Y JGB Auction

A smooth auction expected

- ✓ We think of our bidding stance to buy only the minimum necessary amount at the 0.4% level, closely watching primary demand from investors

Strategic Memorandum DSTE369
FICC Research Dept.

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Auction Details

Auction Date:	March 26, 2020
Issue Date:	March 27, 2020
Maturity Date:	March 20, 2059
Offering Amount:	About 400 billion yen

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

** On March 25, JU12 traded at 0.435% (-0.5bp v. previous day's close, 0.439% on compound yield) and closed at 0.435% (-0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Thinking of our bidding stance to buy only the minimum necessary amount at the 0.4% level

Since the previous auction, before which JU12 traded at the at the 0.385-0.390% level (-1.0 to -0.5bp v. previous day's close; 0.392-0.396% compound) in pre-auction trading, went smoothly on January 28, the JGB market has firmed up amid stronger risk-off sentiment reflecting the spread of the new coronavirus. The 40Y JGB yield (on conventional basis) also declined from 0.460% (Feb. 6) to 0.275% (Mar. 9) on an intraday basis. In mid-March, the yield temporarily rose to 0.440% in the phase of the plunge in the JGB market. As of 14:00 today (Mar. 25), JU12 trades at 0.435% (-0.5bp v. previous day's close; 0.439% compound).

Let's check the environment surrounding the JGB market. Amid the global COVID-19 pandemic, concerns about the economic outlook are intensified by the news on the postponement of the Tokyo 2020 Olympic Games. 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. In particular, it is interesting that Germany has decided to issue new government bonds (156 billion euro, worth 18 trillion yen) for the first time in seven years by sealing the fiscal soundness policy. Amid the trend of global fiscal expansion, JGB market participants appear to be also strongly anticipating fiscal expansion (via an increase in issuance amount of deficit JGBs) and the resultant increase in JGB market issuance on a calendar basis. However, as the whole picture of an economic package, whose scale is expected to be large, has not yet

been unveiled, it is difficult to aggressively factor in it. In the near term, JGB yields may not face strong upward pressure. In such an environment, the key points to consider placing bids at tomorrow's auction can be summarized as follows:

- ✓ **While liquidity remains quite low, primary dealers would hesitate to aggressively place bids:** They are likely to place bids, closely watching primary demand from investors;
- ✓ **A certain level of demand is expected from investors at the last auction for superlong JGBs in FY19:** Tomorrow's auction will be the last supply of superlong JGBs in FY19, providing the last opportunity to buy in a relatively good size amid quite low liquidity in the secondary market. In addition, potential demand for 40Y JGBs appears strong, ahead of the introduction of capital regulations based on an economic value. 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;
- ✓ **The richness on the curve has been corrected:** The 40Y sector became rich on the curve due to flattening of the curve in mid-March, but it has been corrected. Currently, the 40Y sector looks neither rich nor cheap on the curve.

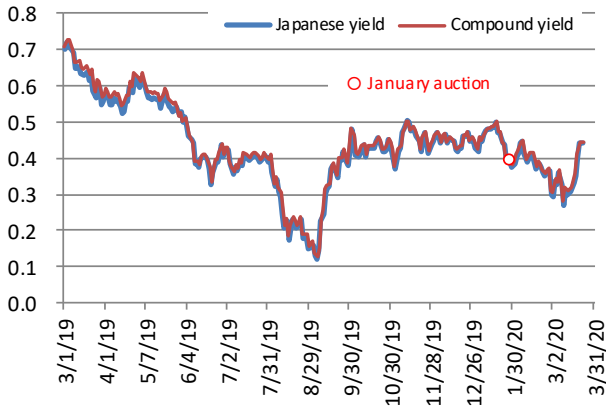
All in all, we would like to think about our bidding stance to take the minimum necessary amount at the 0.4% level. As mentioned, the 40Y sector currently looks neither rich nor cheap relative to the curve. That said, the 30Y/40Y spread is at around 1.6bp (as of Mar 24 closing), which is the tightest level at the time of 40Y JGB auctions under the BOJ's YCC policy. Given this as well, the current level would discourage market participants from building of new curve positions under the current circumstances aggressively.

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)**	
3/26/20	12R	0.5	3/20/59	400*					0.444	1.6			
1/28/20	12R	0.5	3/20/59	404.2	2.86	0.400	95.9031	103.62	0.371	3.0	0.406	3.0	Avg
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
1/12/18	10R	0.9	3/20/57	572.1	3.67	0.985	10.8072	97.24	0.995	15.9	0.982	15.5	Good

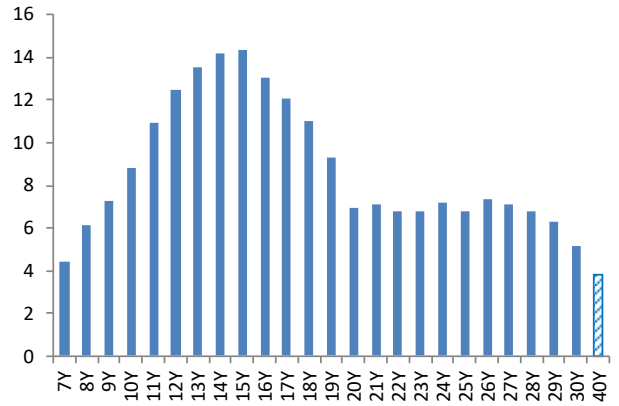
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Mar. 24 close for the March 2020 auction
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



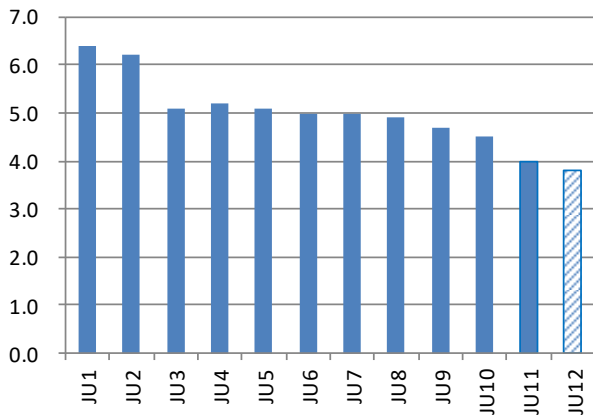
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Jan. 28 v. Mar. 24



Source: Daiwa Securities.

Appendix 3: JU Yield Change (bp): Jan. 28 v. Mar. 24



Source: Daiwa Securities.

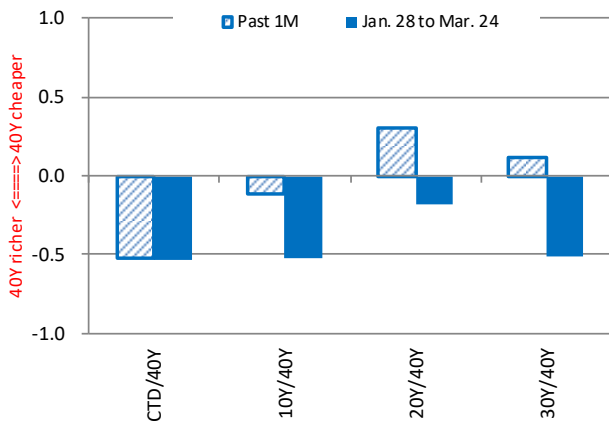
Appendix 4: 40Y JGBs held by BOJ

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,051.7	266.1	25.3%	785.6
JU2	1,343	77	5.8%	1,266
JU3	1,362	197	14.5%	1,164
JU4	1,962	231	11.8%	1,732
JU5	1,961	144	7.4%	1,817
JU6	2,002	934	46.6%	1,069
JU7	2,168	1,066	49.2%	1,102
JU8	2,319	1,262	54.4%	1,057
JU9	3,678	1,528	41.5%	2,150
JU10	3,426	1,177	34.3%	2,250
JU11	2,697	474	17.6%	2,223
JU12	2,119	74	3.5%	2,045

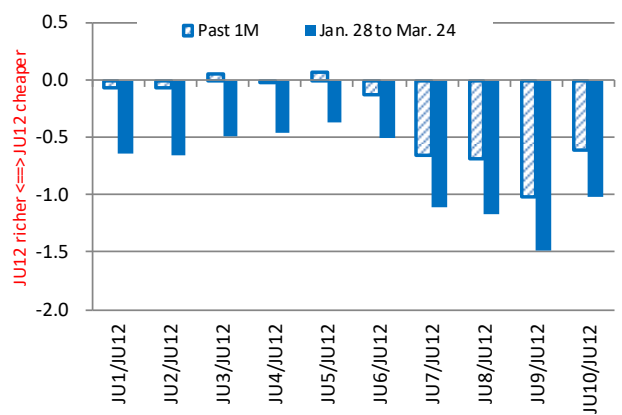
Note: as of Mar. 19 on BOJ start day
Source: Daiwa Securities.

Appendix 5a: Z-score I



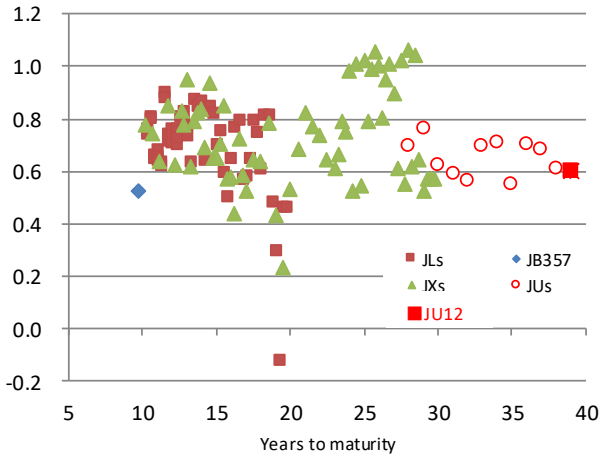
Source: Daiwa Securities. Note: Based on on-the-run issues

Appendix 5b: Z-score II



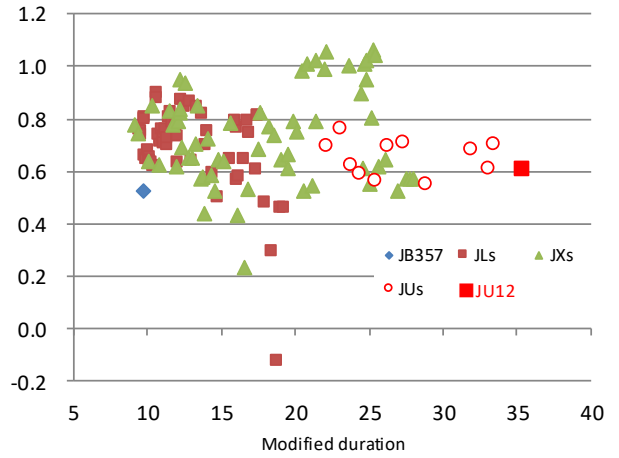
Source: Daiwa Securities.

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



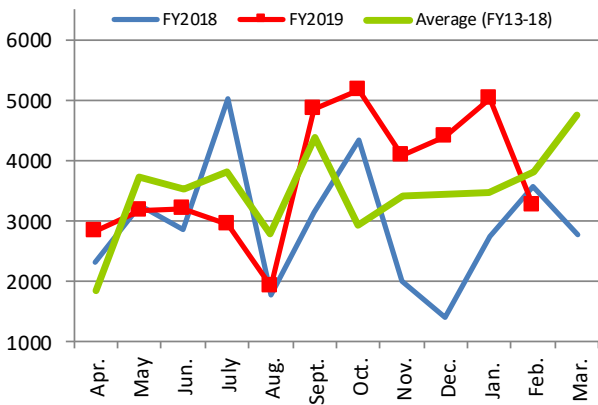
Note: Assuming that the yield curve shape as on Mar.. 24 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities

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



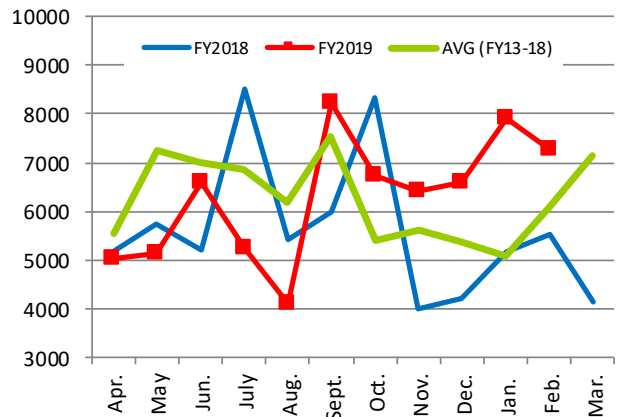
Note: Assuming that the yield curve shape as on Mar.. 24 is unchanged and factoring in roll-down effect etc.
Source: Daiwa Securities

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



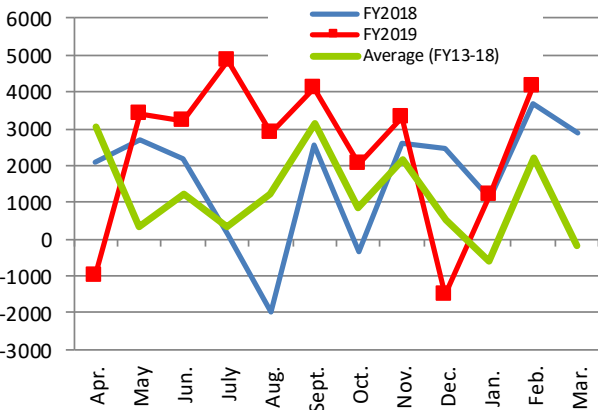
Source: JSDA

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



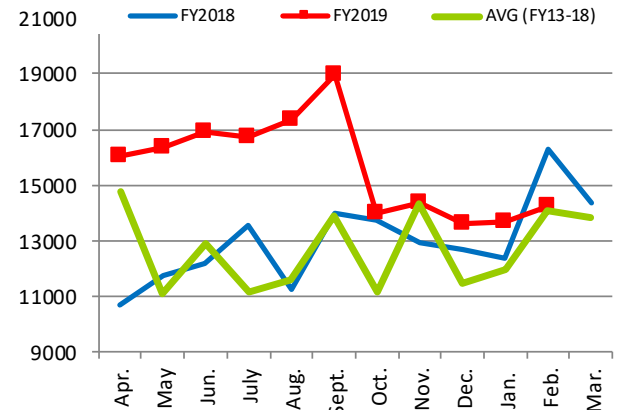
Source: JSDA

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



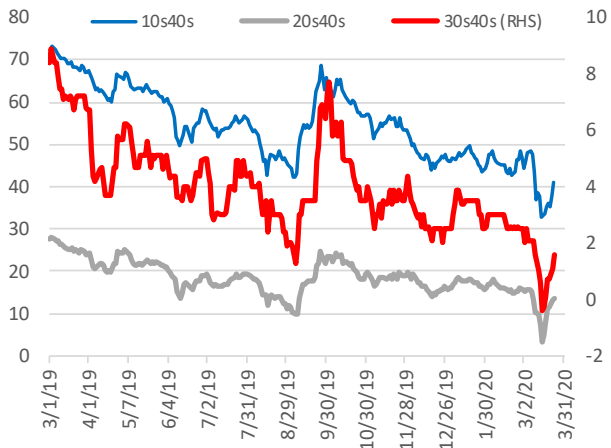
Source: JSDA

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



Source: JSDA

Appendix 9: JGB 10s40s, 20s40s and 30s40s Spreads (bp)



Source: 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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[Standard & Poor's]

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[Moody's]

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February 2020

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