

Outlook for 20Y JGB Auction

Unlikely to improve market sentiment around the long end of the curve

- ✓ We would like to think about our bidding stance to take only the necessary amount, keeping in mind that the 20Y JGB yield may stay longer at the 0.40-0.45% level over the next one month than it has done for the past one month. .

Strategic Memorandum DSTE389
FICC Research Dept.

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Auction Details

Auction Date: June 25, 2020
Issue Date: June 26, 2020
Maturity Date: March 20, 2040
Offering Amount: About 900 billion yen

* New 20Y JGBs will be the last reopening of JL172 carrying a 0.4% coupon.

** On June 24, JL172 traded at 0.390-0.395% (unch - +0.5bp v. previous day's close) and closed at 0.390% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Tomorrow's auction will likely be held at the highest bidding yield level since February 2019

After the previous 20Y JGB auction went well at the 0.335-0.340% level (-1.0 to -0.5bp vs. previous day's close), the 20Y JGB yield temporarily declined to 0.315% on an intraday basis on May 21-22. After that, superlong JGBs softened partly because of growing concerns about possible deterioration of the supply-and-demand balance from July, leading the 20Y JGB yield up to 0.405% on an intraday basis in early June. Then, the yield has mostly moved in the 0.345-0.390% level. Today, it rose to 0.395% at one point on an intraday basis. There is a high possibility that tomorrow's auction will be held at the highest bidding yield level since February 2019.

In the near term, it is difficult to become completely optimistic about improvement of market sentiment for superlong JGBs

Ahead of substantial increase in JGB issuance across nearly the entire yield curve from July, market sentiment for superlong JGBs has been worsening. Regarding the BOJ's JGB purchases in July, it is highly likely that the offer amount in the short-term to the long-term zone in the first operation in the month will be increased compared to June, while the offer amount in the superlong zone will likely remain unchanged¹. It is difficult to become completely optimistic about improvement of market sentiment for superlong JGBs in the near term before a 30Y JGB auction is scheduled for July 7. In such an environment, key points to think about the bidding stance at tomorrow's auction are as follows:

¹ See "JGB Insight: The BOJ's JGB Purchases in July (DSTE388)" dated June 19

Primary dealers do not seem to be short enough: There is a possibility that they will place bids by carefully watching demand from investors;

In the current situation, the level of investor demand is uncertain even at the current yield level: As mentioned above, there is a high possibility that tomorrow's auction will be held at the highest bidding yield level since February 2019. In terms of the absolute yield level, new 20Y JGBs appear to be attractive for investors. Compared to 30Y and 40Y JGBs, 20Y JGBs have the broad base of investors as well. Potential demand for 20Y JGBs should be strong. In the current situation, where market participants remain cautious about possible upward pressure on superlong JGB yields from July, however, the level of investor demand at tomorrow's auction is uncertain even at the current yield level;

Not a good timing to build new positions in terms of the relative value: Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is noticeably undervalued vs. 5Y, 7Y, and 10-15Y sectors at the current level. Meanwhile, the 20Y sector is overvalued vs. the 30Y and 40Y sectors (Appendix 3). Since the beginning of June, 20Y asset swaps had widened in positive territory vs. the Yen LIBOR (cash cheaper). Recently, the asset swap is approaching the Yen LIBOR+15bp, which appears to be a reversal point since late March (Appendix 6). In terms of relative value, 20Y JGBs appear to be not at the level investors hesitate to take. However, it is not a good timing to aggressively build new positions in the current situation;

The BOJ may conduct two purchase operations by 30Y JGB auction to be held on July 7: The BOJ will likely conduct two purchase operations in the 10-25Y zone (once in June and we expect once in July) in the period from tomorrow's auction to the next 30Y JGB auction scheduled for July 7. If we assume that the offer amount will be unchanged, the purchase amount is estimated at around 240bn yen.

All in all, we would like to think about our bidding stance to take only the necessary amount, keeping in mind that the 20Y JGB yield may stay longer at the 0.40-0.45% level over the next one month than it has done for the past one month.

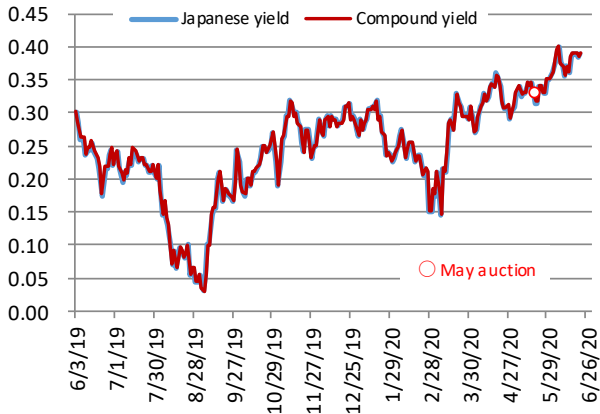
20Y JGB Auction Results

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
6/26/20	172R	0.4	3/20/40	900*									
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
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

*Amount the Ministry of Finance plans to issue

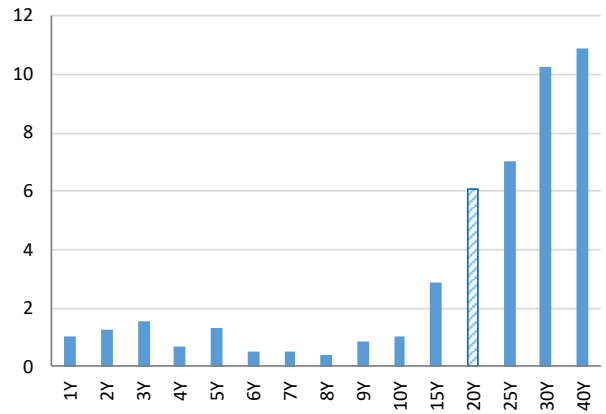
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



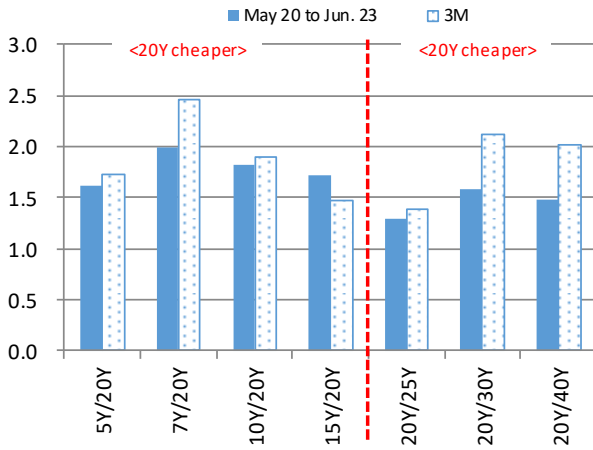
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): May 20 vs. Jun. 23



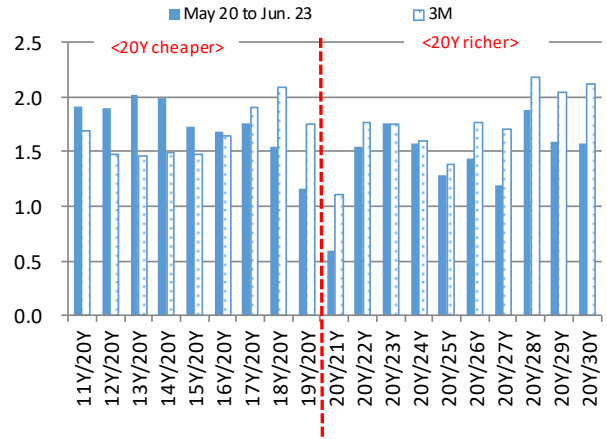
Source: Daiwa Securities.

Appendix 3a: Z-score I



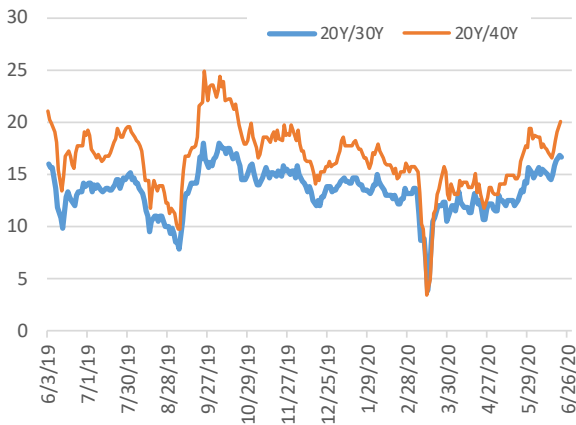
Source: Daiwa Securities.

Appendix 3b: Z-score II



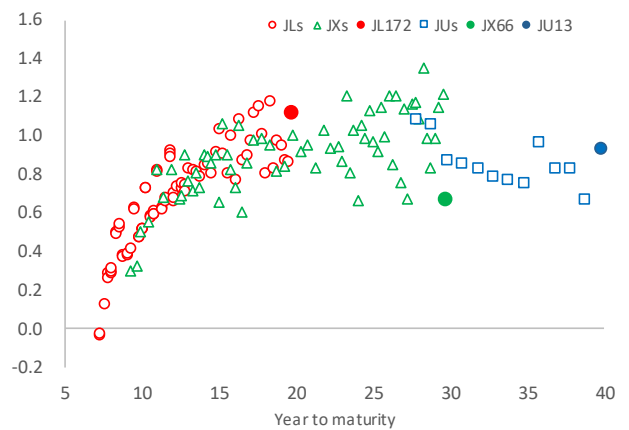
Source: Daiwa Securities.

Appendix 4: JGB 20Y/30Y and 20Y/40Y Spreads (bp)



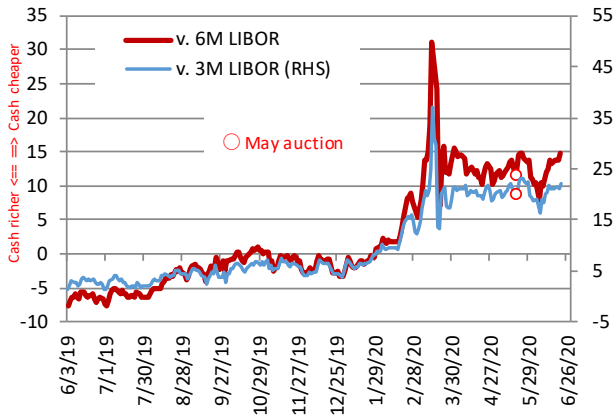
Note: On-the-run issue basis
Source: Daiwa Securities.

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



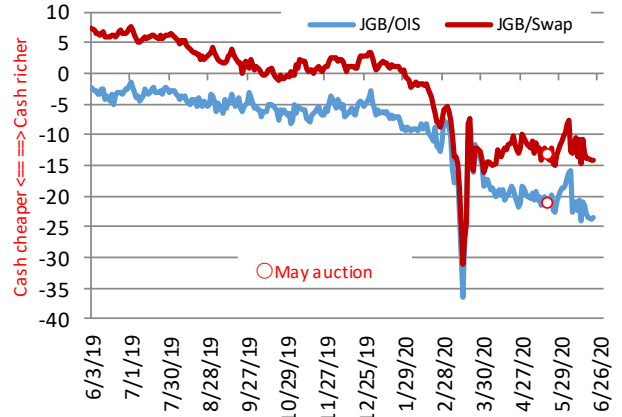
Note: Based on the June-23 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

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



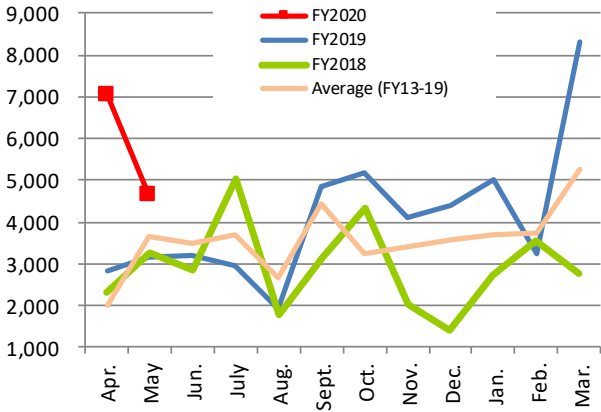
Source: Daiwa Securities.

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



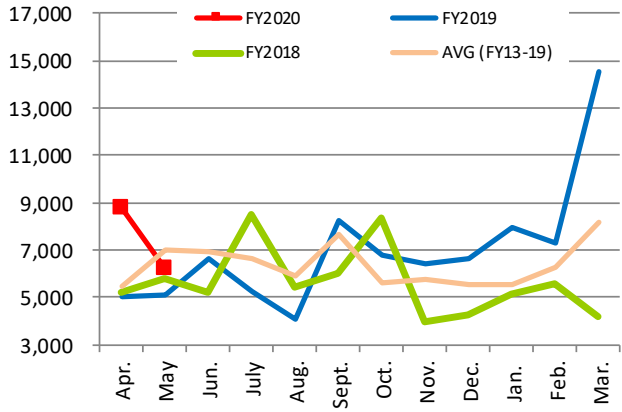
Source: Daiwa Securities.

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



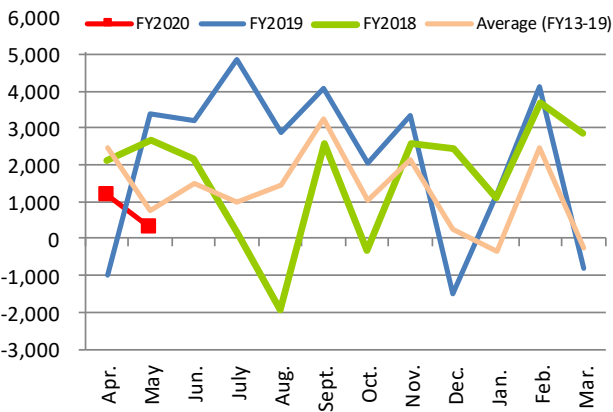
Source: JSDA

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



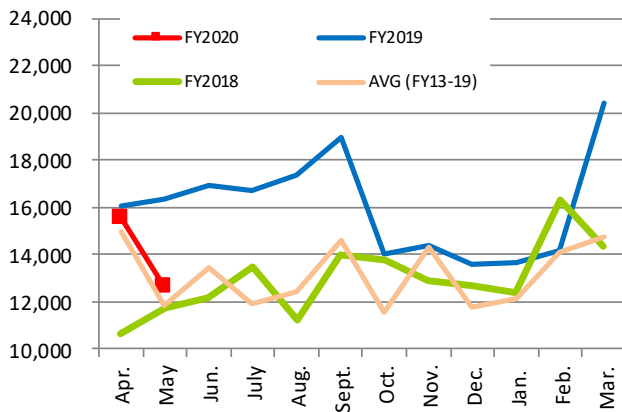
Source: JSDA

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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[Standard & Poor's]

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[Moody's]

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February 2020

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