

Outlook for 30Y JGB Auction

JX67 tap may receive a less-than-enthusiastic response from investors at the current 0.610-0.615% level

- ✓ We would like to think about our bidding stance, assuming that the 30Y JGB yield will move in the 0.60-0.65% level over the next one month. The key to smooth primary sale of JX67 tap will likely be demand from investors above 0.6%. We see that there is a possibility that tomorrow's auction will tail slightly, if it is held at the current 0.610-0.615% level.
- ✓ Expecting the yield curve to steepen in a tight issuance schedule around the long end of the curve toward early September, we lack strong appetite for building new curve positions with 30Y. If any, however, it may be worth considering buying 20Y/30Y/40Y butterfly.

Strategic Memorandum DSTE395
FICC Research Dept.

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Auction Details

Auction Date: August 18, 2020

Issue Date: August 19, 2020

Maturity Date: June 20, 2050

Offering Amount: About 900 billion yen

* New 30Y JGBs will be the first reopening of JX67 carrying a 0.4% coupon.

** On August 17, JX67 traded at 0.610-0.615% (-0.5bp - unch v. previous day's close) and closed at 0.615% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Swinging back to the 0.6% level

After the previous 30Y JGB auction went well at the 0.615-0.620% level (vs. WI closing at 0.620% on previous day) amid growing caution about the substantial increase in JGB issuance, the 30Y JGB yield momentarily fell to 0.540% (during intraday trading on July 9) partly because superlong JGBs lured investors again. Meanwhile, better sellers in large lot came out around the level, pushing the 30Y JGB yield up to 0.615% at one point (during intraday trading on July 16). Then, the yield temporarily declined to 0.510% at the end of July on an intraday basis, while the 20Y and 40Y JGB auctions went well as well. Since the beginning of August, the 30Y JGB yield has been on an uptrend amid a clearer trend of higher stock prices/lower bond prices partly due to increasing expectations for practical use of COVID-19 vaccines in the immediate future. JX67 has traded at 0.615% for the past two days.

The key to smooth primary sale of JX67 tap will likely be demand from investors at 0.610-0.615%

We check the environment surrounding the JGB market. On August 13, the UK government decided to resume a 2-week self-isolation rule to those who arrive in the UK from some countries including France. Partly due to stronger concerns about another downturn in European economic activities, we saw a rebound in US Treasuries, on which the 10Y Treasury yield had risen above 0.7%, a threshold level. Following US Treasuries, JGBs also rebounded today. Although expectations for practical use of COVID-19 vaccines in the immediate future are increasing, we are unable to become completely optimistic about economic activities especially in the near term. In the US, there has been no progress in

discussions regarding the expired economic measures to cope with the pandemic. We think that the recent plunge in JGBs via US Treasuries may let up in the near term. Meanwhile, from tomorrow's 30Y JGB auction to the 20Y JGB auction scheduled for September 10, the MOF will supply superlong JGBs every week, totaling about 4.2tn yen. As an anomaly under the YCC policy, there is a possibility that the yield curve in the superlong zone is more likely to steepen in a tight supply schedule around the long end of the curve. In such an environment, we summarize key points to think about our bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers do not appear fully prepared for tomorrow's auction:** Short-covering by primary dealers may be limited in the 30Y sector at tomorrow's auction. Currently, it is difficult to aggressively take risk in a volatile market. Under the circumstances, primary dealers do not appear fully prepared for tomorrow's auction. The key to smooth primary sale of JX67 tap will likely be demand from investors;
- ✓ **No worries needed about demand from investors above 0.615%, new price for JX67, though:** Regarding demand from investors, major investors have been increasing their purchases of superlong JGBs since the beginning of FY20, indicating an increase in the "leveling" purchases. If JX67 is set above 0.615%, new price level, additional demand over leveling purchases is expected;
- ✓ **Not overvalued in terms of relative value:** Our analysis based on data since the previous 30Y JGB auction and that during the past three months shows that the 30Y sector is not expensive on the intermediate to superlong zone of the curve. Rather, it is noticeably undervalued vs. the 25-28Y sectors (Appendix 3). Since the previous 30Y JGB auction, the 30Y asset swap spread had tightened (cash cheaper against swaps). However, the spread has been widening over the past few days. As of closing on August 14, the spread stayed at around the level as of the previous 30Y JGB auction.

We think about our bidding stance, assuming that the 30Y JGB yield will move in the 0.60-0.65% level over the next one month

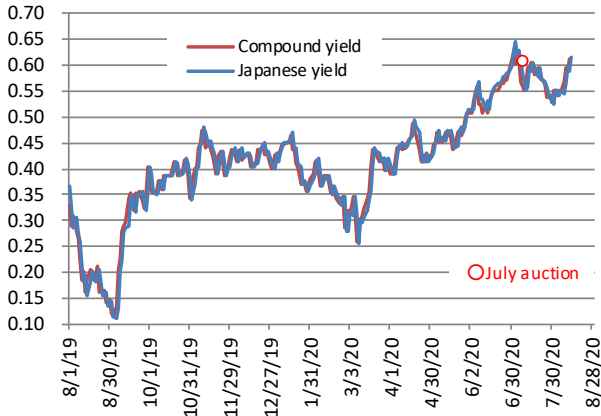
All in all, we would like to think about our bidding stance, assuming that the 30Y JGB yield will move in the 0.60-0.65% level over the next one month. The key to smooth primary sale of JX67 tap will likely be demand from investors above 0.6%. We see that there is a possibility that tomorrow's auction will tail slightly, if it is held at the current level (0.610-0.615%). In terms of relative value, expecting the yield curve to steepen in a busy issuance schedule around the long end of the curve toward early September, we lack strong appetite for building new curve positions with 30Y. If any, however, it may be worth considering buying 20Y/30Y/40Y butterfly (buying 30Y/selling 20Y and 40Y). The 30Y sector is relatively cheap on the 20-40Y zone of the curve (Appendix 7). In addition, positive carry is expected from the position even if the shape of the curve is unchanged in an investment horizon.

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 (%)
8/18/20	67R	0.6	6/20/50	900*										
7/7/20	67	0.6	6/20/50	966.7	3.92	99.68	99.60	0.08	0.612	0.615	0.003	29.2307	Good	0.610
6/4/20	66R	0.4	3/20/50	699.3	2.84	96.66	96.55	0.11	0.529	0.534	0.005	33.7612	Avg	0.540
5/14/20	66R	0.4	3/20/50	719.4	3.69	98.69	98.60	0.09	0.449	0.453	0.004	65.4037	Avg	0.455
4/7/20	66	0.4	3/20/50	699.7	3.53	99.29	98.90	0.39	0.426	0.441	0.015	28.6764	Poor	0.445
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

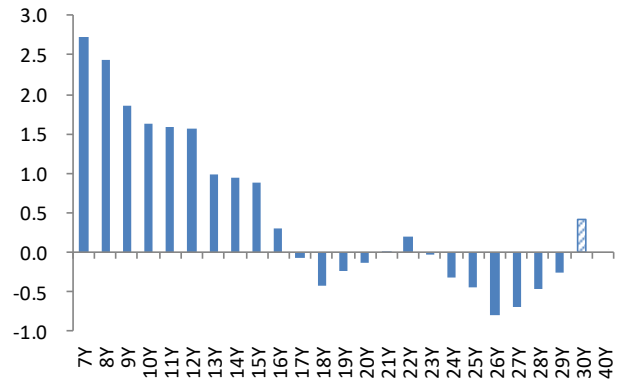
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



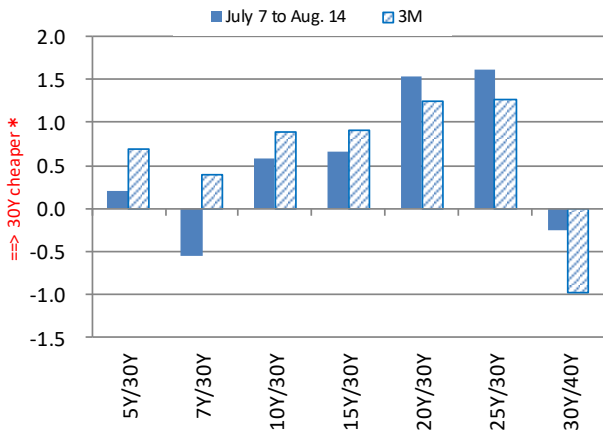
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (July 7 vs. Aug. 14)



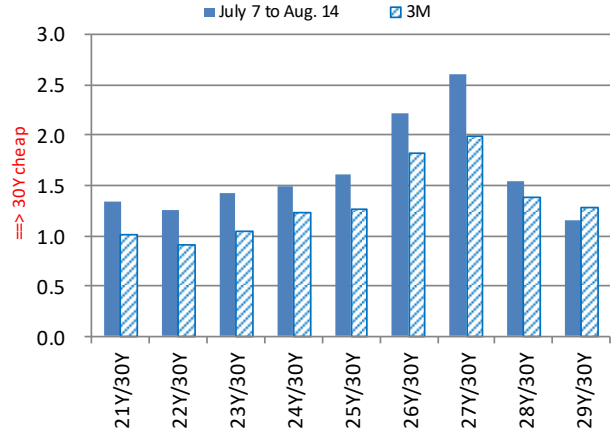
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



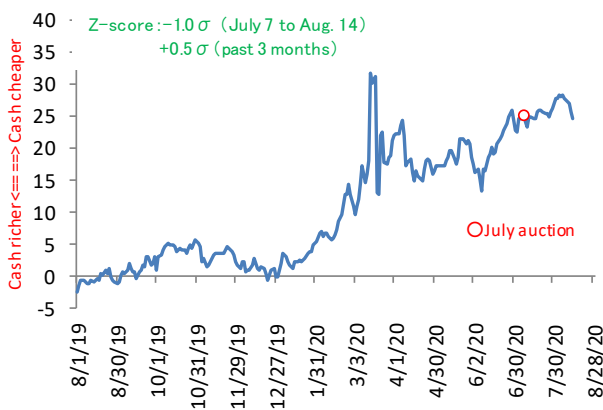
Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



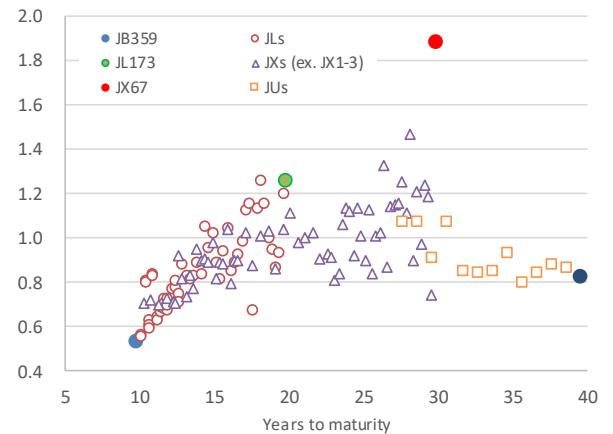
Source: Daiwa Securities.

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



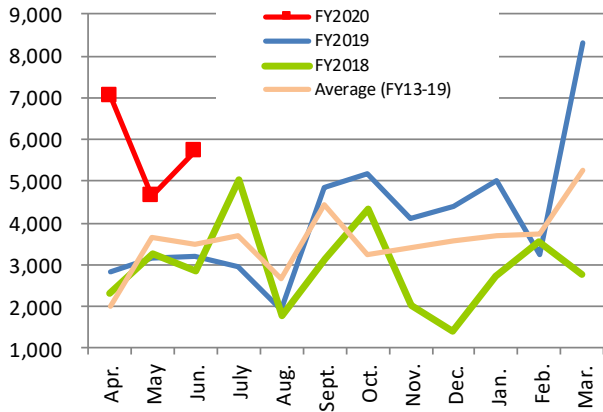
Note: 6M Yen LIBOR basis.
Source: Daiwa Securities.

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



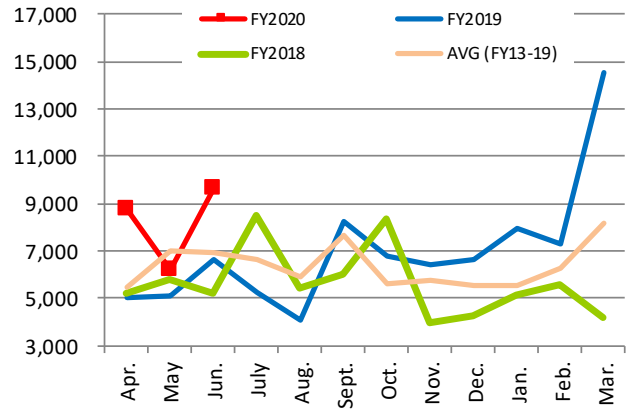
Note: Based on JGB yield curve on Aug. 14, assuming that the yield curve shape does not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



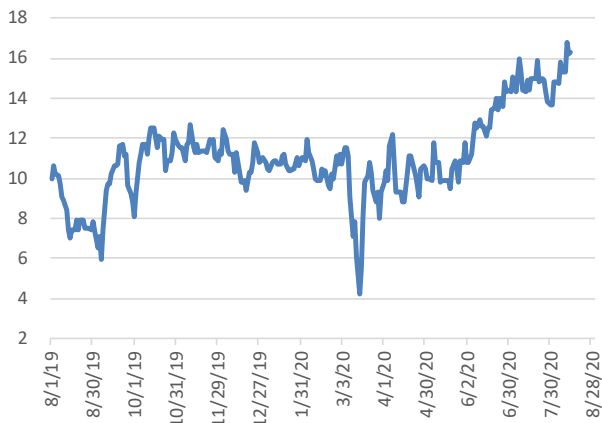
Source: JSDA

Appendix 6b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 7: JGB 20Y/30Y/40Y Butterfly Spread (bp)



Source: Daiwa Securities

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[Standard & Poor's]

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[Moody's]

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February 2020

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