

## Outlook for 20Y JGB Auction

### Bidders may respond less aggressively than they did in July

- ✓ We expect the 20Y JGB yield to move in the 0.40-0.45% level until the next 20Y JGB auction in September. We would place our bids only to cover our positions if the auction is held around 0.410%.
- ✓ JL173 tap may receive a less-enthusiastic response from buyers in terms of relative value, but it would be worth considering the 10Y/20Y/30Y butterfly (buying 20Y and selling 10Y and 30Y) at the 22-24bp level.

Strategic Memorandum DSTE396  
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### Auction Details

**Auction Date:** August 25, 2020  
**Issue Date:** August 26, 2020  
**Maturity Date:** June 20, 2040  
**Offering Amount:** About 1.2 trillion yen

\* New 20Y JGBs will be the first reopening of JL173 carrying a 0.4% coupon.

\*\* On August 24, JL173 traded at 0.410 - 0.420% (-2.0 - -1.0bp v. previous day's close) and closed at 0.410% (-1.0bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

After the previous 20Y JGB auction went well at the 0.420-0.425% level (vs. WI closing at 0.425% on previous day), the 20Y JGB yield momentarily declined to 0.365% (during intraday trading on July 31) amid the firmness of the JGB market. Since around the middle of August, we have seen a clearer trend of higher stock prices/lower bond prices partly due to increasing expectations for the practical use of COVID-19 vaccines in the immediate future. In such a situation, the 20Y JGB yield increased to 0.430% at one point. As investors appear to have good appetite for 20Y JGBs at the level, the yield has been range-bound between 0.415% and 0.430% since last week. On Aug. 24, one day before the auction, JL173 traded at the 0.410-0.420% level (-2.0 to -1.0bp vs. previous day's close) and closed at 0.410%.

### 20Y JGB yield is likely to move in the 0.40-0.45% level

We confirm the environment surrounding the JGB market. While excessive concerns about a US economic recession appear to be diminishing, worries about the European economic outlook are growing partly due to the resurgence of COVID-19 infections across Europe. Although expectations for the practical use of COVID-19 vaccines in the immediate future are increasing, we are unable to be completely optimistic about economic activity especially in the near term. In addition, the US is showing no progress in discussions regarding the expired economic measures to cope with the pandemic. In such an environment, we summarize key points to consider our bidding stance at tomorrow's auction as follows:

- ✓ **We expect decent short covering by dealers:** As primary dealers seem to be short in the 20Y sector, some their covering their positions will likely support primary sale of JL173 tap;
- ✓ **Solid demand expected from investors above 0.4%:** Demand from investors for 20Y JGBs sold under par appears strong;
- ✓ **Not particularly cheap or rich in terms of relative value:** Our analysis based on data since the previous 20Y JGB auction and that during the past three months shows that the 20Y sector is neither noticeably cheap nor rich on the intermediate to superlong zone of the curve (Appendix 3). Since the previous auction, the 20Y asset swap spread has been roughly flat at the Yen LIBOR+15-20bp level. We thus can say that 20Y cash is neither especially undervalued nor overvalued against swaps at the current level (Appendix 6a);
- ✓ **A tight supply schedule for superlong JGBs:** From last week's 30Y JGB auction (Aug 18) to the next 20Y JGB auction scheduled for September 10, the MOF will supply superlong JGBs every week, totaling about 4.2tn yen. During that period, the total purchase amount by the BOJ in the over 10Y zone is estimated at only around 210bn yen (= one operation in the 10-25Y zone [120bn yen] + 3 operations in the over 25Y zone x 30bn yen). Therefore, the supply/demand balance may worsen easily, depending on demand from investors.

**Placing our bids only to cover our positions if bidding is done around 0.41%**

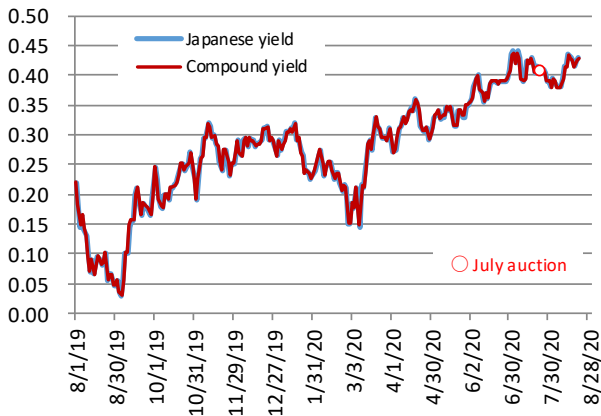
Overall, we expect that the 20Y JGB yield will stay in the 0.40-0.45% level until the next 20Y JGB auction in September. If tomorrow's auction is held at the current level (around 0.410%), we would like to place our bids only to cover our positions. JL173 tap may receive a less-enthusiastic response from buyers in terms of relative value, but it would be worth considering the 10Y/20Y/30Y butterfly (buying 20Y and selling 10Y and 30Y) at the 22-24bp level. This is because positive carry can be expected from the position, even if the curve shape is unchanged. Moreover, the position can deal with steepening and low volatility (Appendix 4).

#### 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
8/25/20	173R	0.4	6/20/40	1,200*									
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
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

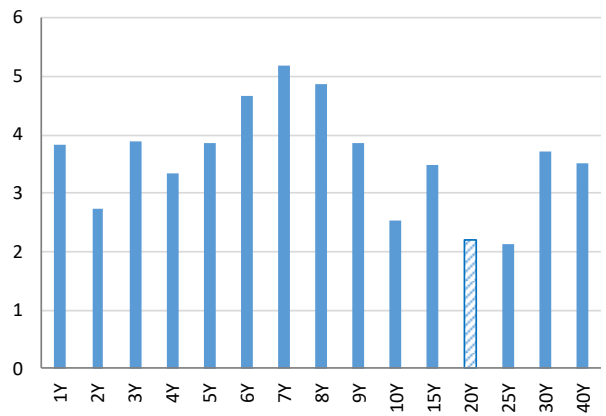
\* Amount the Ministry of Finance plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

**Appendix 1: 20Y JGB Yield (%)**



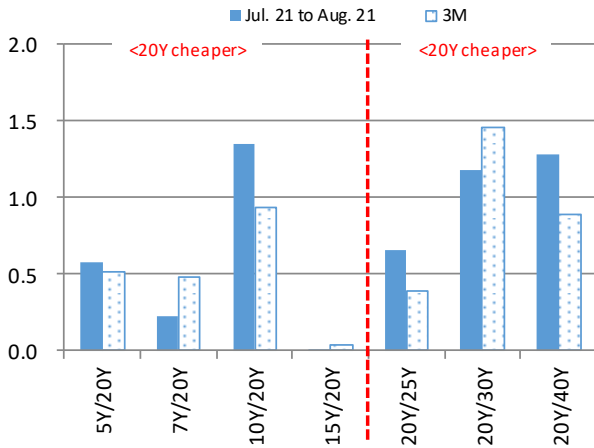
Source: Daiwa Securities.

**Appendix 2: JGB Yield Change (bp): July 21 vs. Aug. 21**



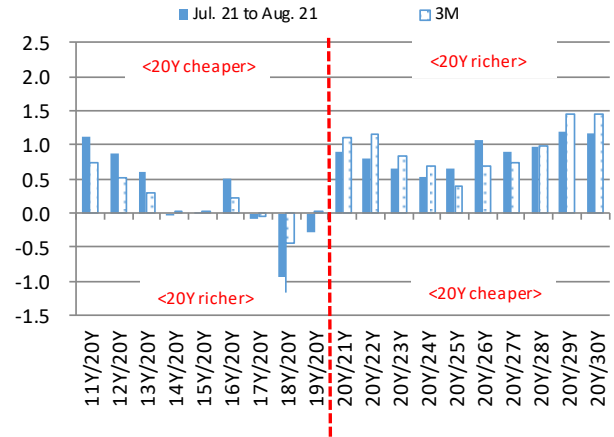
Source: Daiwa Securities.

**Appendix 3a: Z-score I**



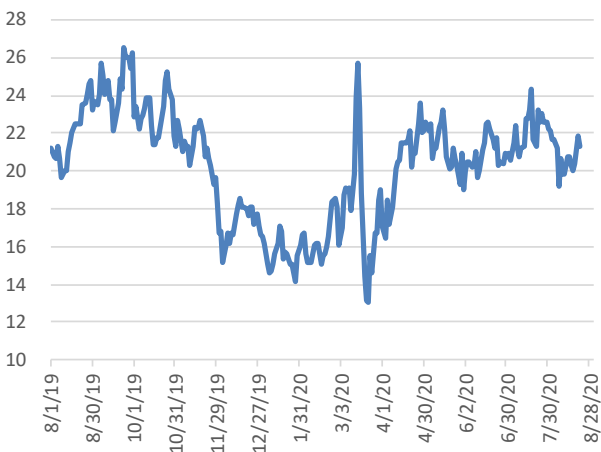
Source: Daiwa Securities.

**Appendix 3b: Z-score II**



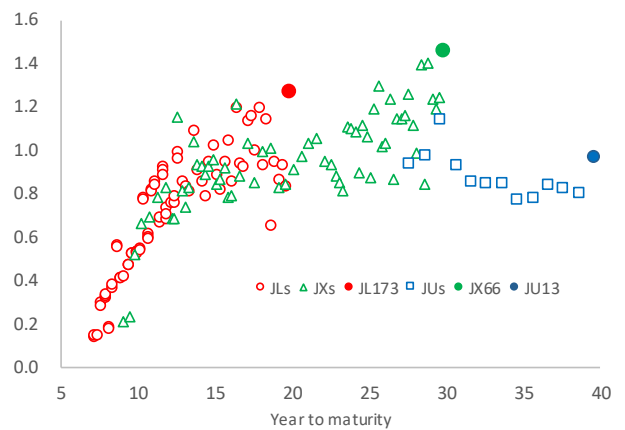
Source: Daiwa Securities.

**Appendix 4: JGB 10Y/20Y/30Y Butterfly Spread (bp)**



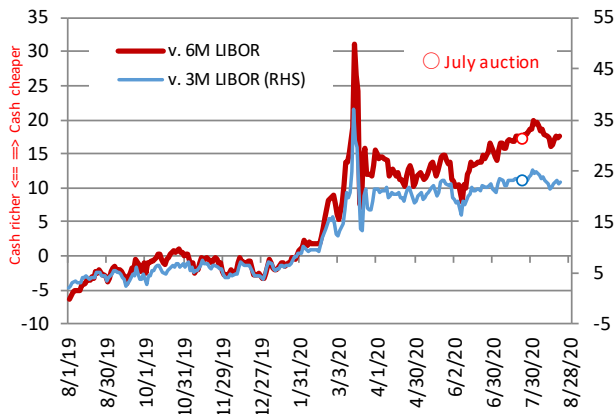
Note: On-the-run issue basis  
Source: Daiwa Securities.

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



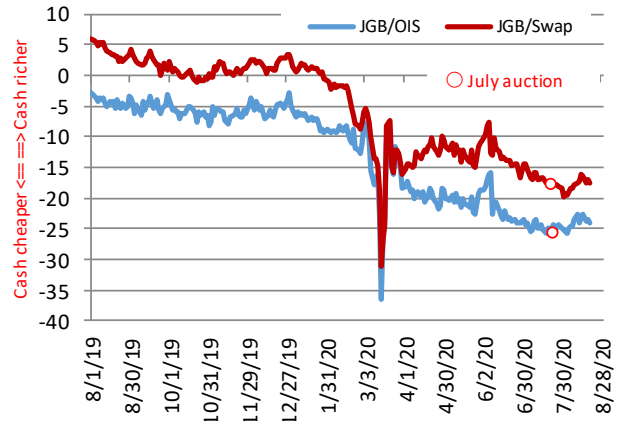
Note: Based on the Aug-21 JGB yield curve; factoring in roll-down effect etc.  
Source: Daiwa Securities.

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



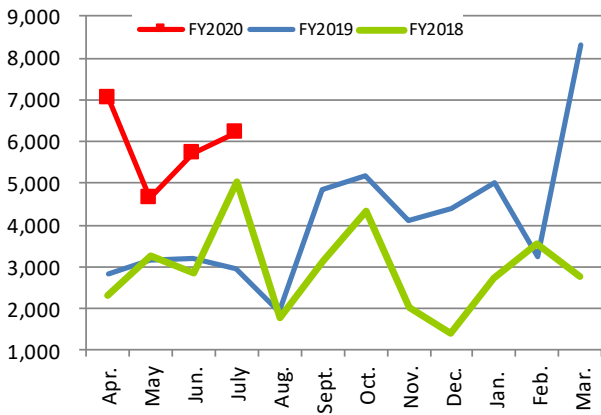
Source: Daiwa Securities.

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



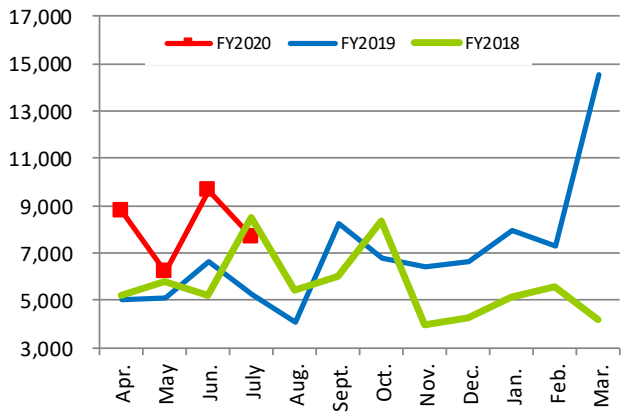
Source: Daiwa Securities.

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



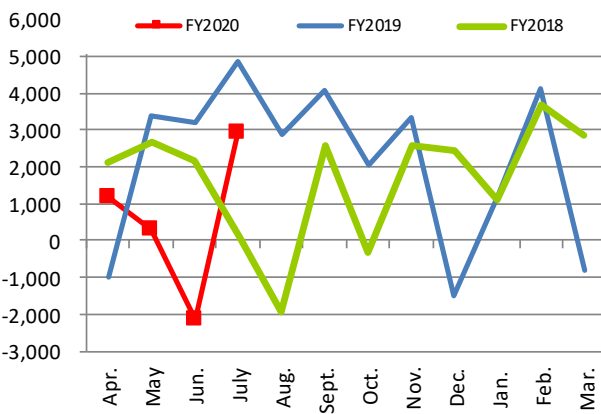
Source: JSDA

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



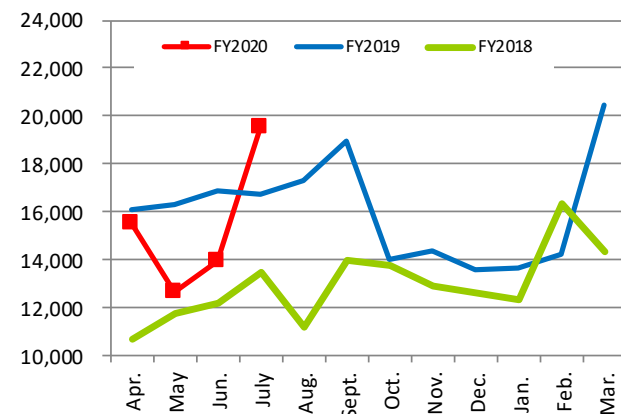
Source: JSDA

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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February 2020

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