

Outlook for 40Y JGB Auction

JU13 tap sale expected to go smoothly

- ✓ A trouble-free auction is expected tomorrow, backed by short-covering; we intend to place bids to solidly take necessary amount
- ✓ Upside of 40Y JGBs in the secondary market may be limited compared to that of 30Y JGBs

Strategic Memorandum DSTE404
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Auction Details

Auction Date: September 24, 2020
Issue Date: September 25, 2020
Maturity Date: March 20, 2060
Offering Amount: About 500 billion yen

* New 40Y JGBs will be the second reopening of JU13 carrying a 0.5% coupon.

** On September 23, JU13 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

Tomorrow's auction is to be held at the highest bidding yield level since the auction in January 2019, but the level is not fresh at around the lower end of the range since late August

After the previous 40Y JGB auction went well at the 0.575-0.580% level (-2.0 - -1.5bp vs. previous day's close, the 0.568-0.572% level on compound yield basis) on July 28, the 40Y JGB yield (on conventional basis) temporarily declined to 0.535% on intraday basis on July 31. Amid the softness of the JGB market since the beginning of August, the yield rose to 0.645% at one point in late August. Since then, the yield has been mostly moving in the 0.610-0.645% range. As of 15:00 today (Sep 23), JU13 trades at 0.610-0.615% (-0.5bp - unch vs. previous day's close, 0.599-0.604% on compound yield). Tomorrow's auction is to be held at the highest bidding yield level since the auction in January 2019. However, it can be said that the level is not fresh at around the lower end of the range since late August.

Amid lingering worries about global economic recovery, yields are unlikely to show upward momentum

We look at the environment surrounding the JGBs. Concerns over sluggish economic activities are growing because measures to contain Covid-19 infections (such as restrictions on outings) have been strengthened in line with the resurgence of virus cases in Europe. In the US, excessive concern over the economy appears to be receding. But the reality that there is no progress in discussions over a pandemic relief package forces us to be aware of uncertainty about a path of US economic recovery. With the November's US presidential election looming, US-China conflict is also escalating. Amid lingering worries about a global economic recovery, yields are unlikely to show upward momentum. In such

an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Short-covering by primary dealers would be supportive:** As primary dealers seem to be short in the 40Y sector, their bidding to cover their positions at the auction will likely support the primary sale to some extent;
- ✓ **A certain level of demand is expected from investors:** Ahead of the introduction of capital regulations based on an economic value, potential demand for 40Y JGBs appears strong. As 40Y JGBs are issued bimonthly in relatively small amounts, such demand can be expected to some extent. However, the level of such demand needs to be carefully checked this time partly because tomorrow's auction is expected to be held at a frequently-traded level;
- ✓ **Cheap on the curve:** Our analysis based on data since the previous 40Y JGB auction and that in the past month show that the 40Y sector is not expensive on the curve at the current level. It is undervalued vs. the 30Y sector. Among 40Y JGBs, JU13 is noticeably undervalued vs. JU3, JU4, and JU9 (Appendix 5).

A trouble-free auction is expected tomorrow, backed by short-covering; we intend to place bids to solidly take necessary amount

All in all, a trouble-free auction is expected tomorrow, backed by short-covering. We would like to think of our bidding stance to solidly take the necessary amount. In the secondary market, the upside of 40Y JGBs may be limited especially in comparison with that of 30Y JGBs. This is because the 30Y/40Y spread is still narrower than 2bp with little room for further flattening (Appendix 7), in addition to the lack of attractiveness in terms of carry (Appendix 6), although the 40Y sector is undervalued vs. the 30Y sector. It is thus difficult to expect strong demand related to building new curve positions.

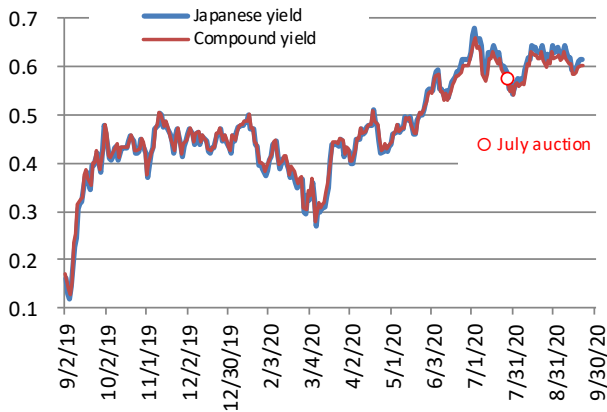
40Y JGB Auction Results

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)**	
9/24/20	13R	0.5	3/20/60	500*					0.604	1.8			
7/28/20	13R	0.5	3/20/60	505.3	3.11	0.575	3.4161	97.34	0.586	1.4	0.577	1.5	Good
5/26/20	13	0.5	3/20/60	509.9	3.06	0.505	93.4959	99.82	0.465	2.3	0.504	2.9	Avg
3/26/20	12R	0.5	3/20/59	415.1	2.66	0.450	30.5135	101.79	0.439	2.5	0.453	3.5	Avg
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

* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Sep. 18 close for the Sep-2020 auction

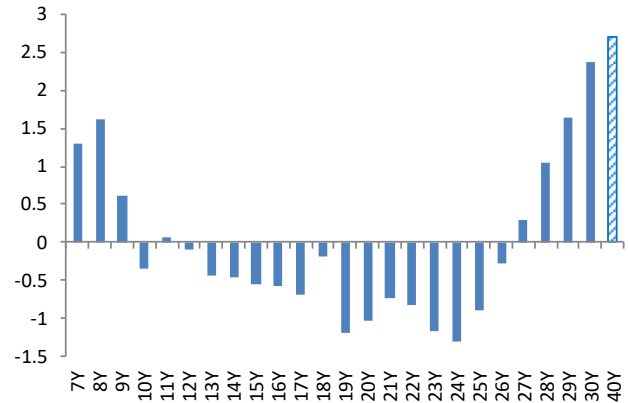
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



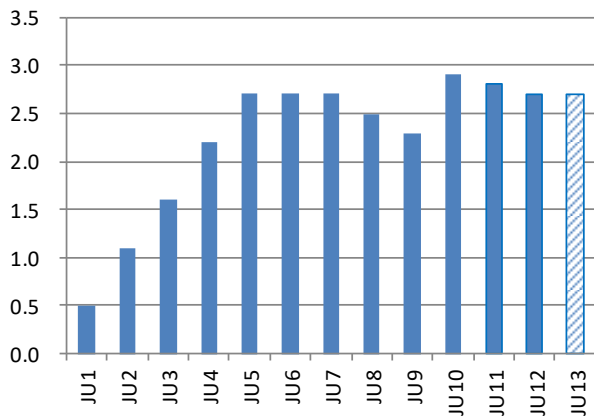
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): July 28 vs. Sep. 18



Source: Daiwa Securities.

Appendix 3: 40Y JGB Yield Change: July 28 vs. Sep. 18



Source: Daiwa Securities.

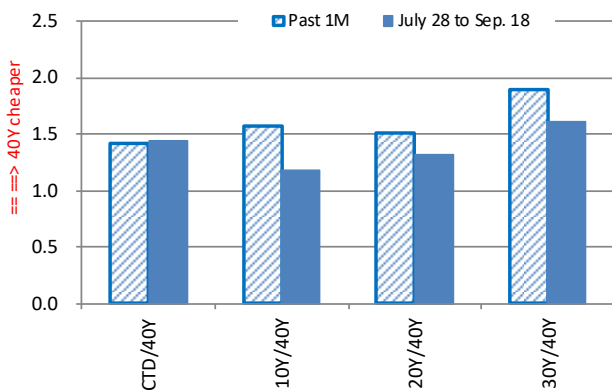
Appendix 4: BOJ Holding and Market Outstanding of 40Y JGBs

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,060.5	275.0	25.9%	785.5
JU2	1,346	77	5.7%	1,269
JU3	1,384	200	14.5%	1,184
JU4	1,964	234	11.9%	1,730
JU5	1,962	147	7.5%	1,815
JU6	2,004	934	46.6%	1,071
JU7	2,181	1,066	48.9%	1,115
JU8	2,324	1,263	54.3%	1,062
JU9	3,723	1,550	41.6%	2,173
JU10	3,429	1,178	34.3%	2,252
JU11	2,711	486	17.9%	2,224
JU12	2,786	92	3.3%	2,694
JU13	1,015	0	0.0%	1,015

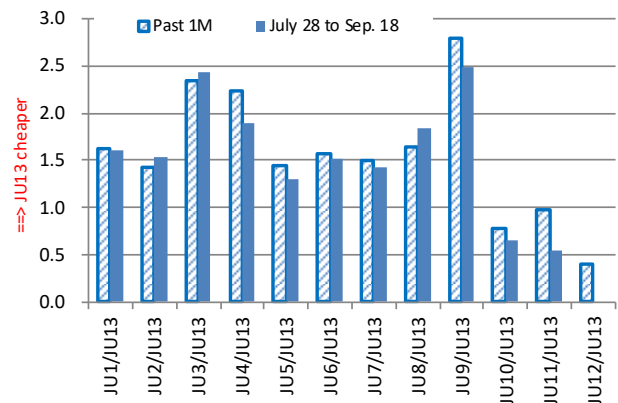
Source: Bank of Japan, Daiwa Securities.

Appendix 5a: Z-score I



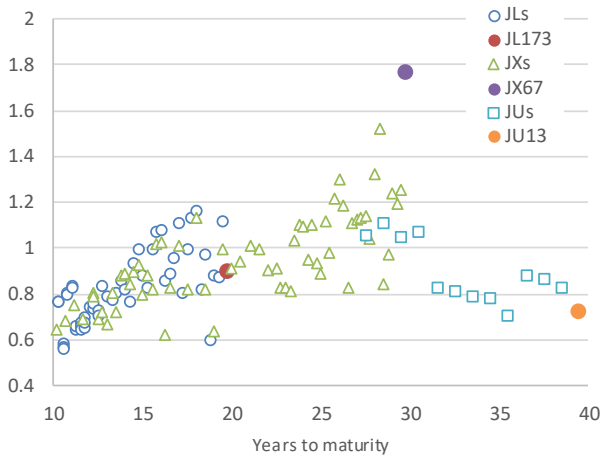
Note: On-the-run and CTD basis
Source: Daiwa Securities.

Appendix 5b: Z-score II



Source: Daiwa Securities.

Appendix 6: JGB Total Return Curve (3M, %)



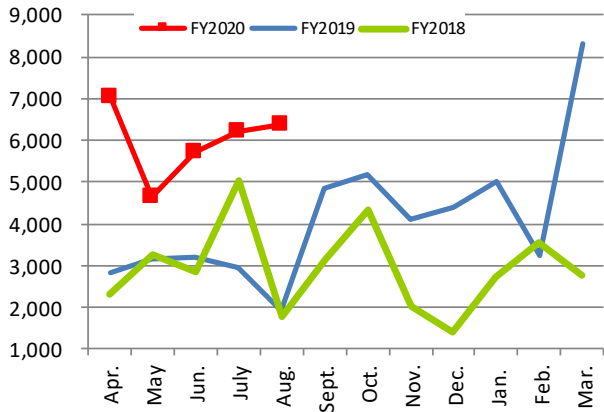
Note: Based on the July-22 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 7: JGB 30Y/40Y Spreads (bp)



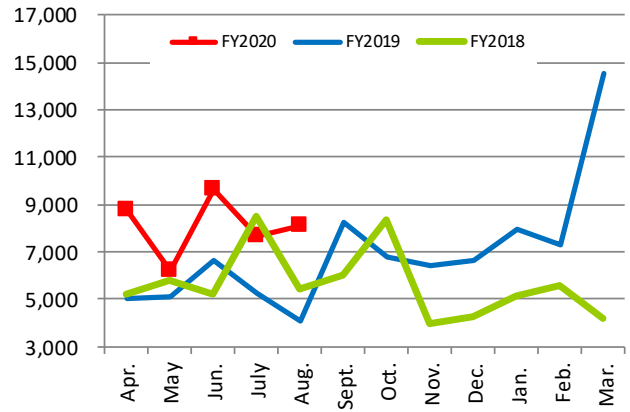
Note: On-the-run basis
Source: Daiwa Securities.

Appendix 8a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



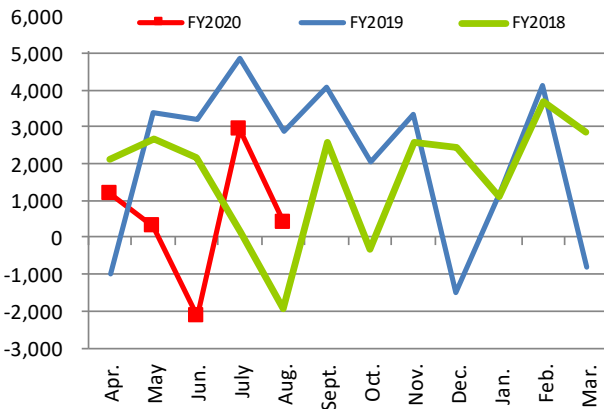
Source: JSDA

Appendix 8b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



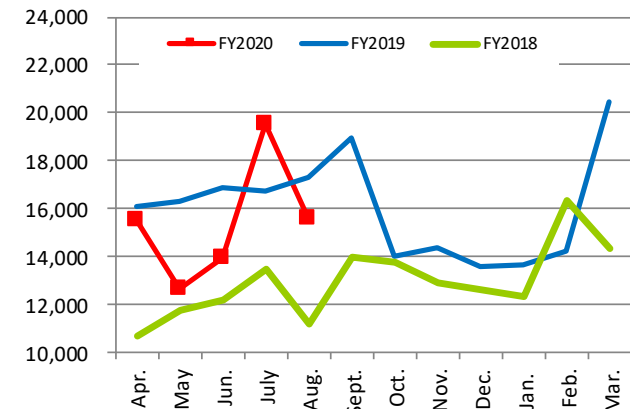
Source: JSDA

Appendix 9a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 9b: 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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