

Outlook for 20Y JGB Auction

Good primary sale expected, but cautious stance needed for outright positions as upside may be limited

- ✓ We think about our bidding stance, expecting the 20Y JGB yield to move in a narrow range centered at 0.40% for a while
- ✓ In terms of the relative value, it would be worth considering (1) switching out from the 7Y sector, (2) the 10Y/20Y/30Y butterfly position at a level close to 20bp, or (3) purchasing asset swaps in long-term horizon

Strategic Memorandum DSTE408
FICC Research Dept.

Senior JGB Strategist
Keiko Onogi
+813 5555 8788
keiko.onogi@daiwa.co.jp
Daiwa Securities Co. Ltd.

Auction Details

Auction Date: October 20, 2020
Issue Date: October 21, 2020
Maturity Date: September 20, 2040
Offering Amount: About 1.2 trillion yen

* New 20Y JGBs, JL174, will likely carry a 0.4% coupon.

** On October 19, WI barely traded, and closed at 0.410% (unch v. previous day's close). JL173 traded at 0.400-0.405% (unch - +0.5bp) and closed at 0.400% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Moving in the 0.385-0.410% range since previous auction

The previous 20Y JGB auction was held at the 0.405-0.410% level (unch - +0.5bp vs. previous day's close) and went smoothly with the lowest accepted price of 99.75 yen (0.413%) vs. surveyed cut-off price range of 99.70-99.80 yen (0.410-0.416%). Since the auction, the 20Y JGB yield has remained range-bound between 0.385% and 0.410% on intraday basis. As of 15:00 today (Oct 19), WI barely traded, and on-the-run JL173 traded at 0.400-0.405% (unch - +0.5bp vs. previous day's close). With the yield level and also the current JL yield curve shape, bidding for new 20Y JGBs in new maturity basket (JL174) will likely take place at around 0.410-0.415%.

Due to Covid-19 pandemic, the global trend of fiscal expansion and accommodative monetary policy will likely continue

We look at the environment surrounding the JGB market. US President Donald Trump, who tested positive for Covid-19 at the beginning of this month, has recovered incredibly and resumed campaign rallies for the presidential election. It seems that the mood of presidential candidate Joe Biden's advantage over President Trump is mounting. However, we think that an outcome of the presidential election is uncertain, given Mr. Trump's recent onslaught and the fact that his dramatic victory four years ago is still fresh in our mind. It is too difficult to factor US-specific factors in JGBs at the moment. Putting aside the US political situation to have a slightly longer-term perspective, we can say that caution remains strong about the spread of the coronavirus toward winter. This prevents us from having an optimistic outlook for the global economy. Regardless of who the next US President will be, a fiscal contraction is not expected, and the Fed is likely to maintain

accommodative monetary easing stance. Also in Japan, the government is expected to formulate additional economic measures if needed, and the BOJ would keep the current yield curve control (YCC) policy persistently. In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Strong expectation on demand for new 20Y JGBs in new maturity basket (JL174) from investors above 0.4%:** There are no strong worries about demand from investors for new 20Y JGBs in new maturity basket which are likely to be sold under par. This should serve as a good support for tomorrow's auction;
- ✓ **In terms of relative value, the 20Y sector is undervalued vs. the 7Y sector on the curve:** Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is not noticeably expensive on the intermediate to superlong zone of the curve (Appendix 3). Rather, it has become more undervalued vs. the 7Y sector. During the most of the period since the previous auction, the 20Y asset swap spread has widened (cash richer), albeit moderately. However, we think that even the current level would not discourage market participants from buying new 20Y JGBs (given Z scores and others, Appendix 6);
- ✓ **Primary dealers do not appear short enough in the 20Y sector:** As short-covering is limited, upside may be limited in the secondary market even if tomorrow's auction goes well. 20Y JGBs have been facing strong upside resistance at the level below 0.4% in the secondary market.

Good primary sale expected, but cautious stance needed for outright positions as upside may be limited

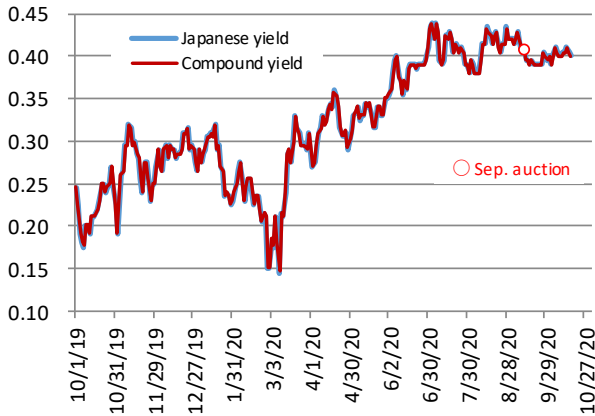
All in all, tomorrow's auction is expected to go well backed by demand from investors. However, as mentioned above, the upside may be limited in the secondary market, which should lead to a cautious stance in taking outright positions. We would like to think about our bidding stance, expecting the 20Y JGB yield to move in a narrow range centered at 0.40% in the near term. In terms of relative value, we think about switching out from the 7Y sector (including positioning vs. JGB futures) in anticipation of a correction of the aforementioned cheapness. In addition, the 10Y/20Y/30Y position (buying 20Y/selling 10Y and 30Y) may work well at the level near to 20bp (based on JL174, Appendix 5). Even if the shape of the yield curve is unchanged, positive carry is expected, and the position can serve as a cushion in the case of steepening of the 10-30Y zone. Moreover, buying asset swaps is also worth considering, especially for investors with longer investment horizon. We can expect positive carry, and moderate widening may continue partly due to the widening trend in the US superlong zone (30Y) which is probably caused by cautions about fiscal expansion.

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
10/20/20	174	0.4*	9/20/40	1,200**									
9/10/20	173R	0.4	6/20/40	1,243.1	3.69	99.85	99.75	0.10	0.408	0.413	0.005	75.5975	Avg
8/25/20	173R	0.4	6/20/40	1,316.2	3.92	99.94	99.90	0.04	0.403	0.405	0.002	67.8187	Good
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

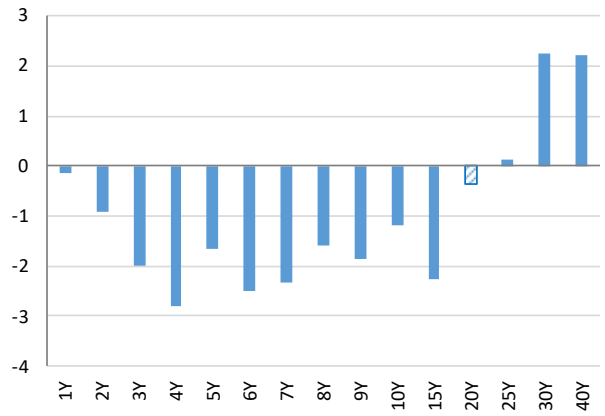
* Daiwa forecast as of Oct. 19 ** Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



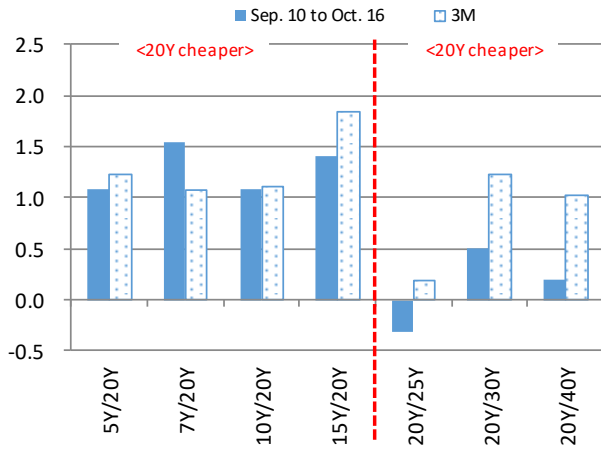
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Sep. 10 vs. Oct. 19



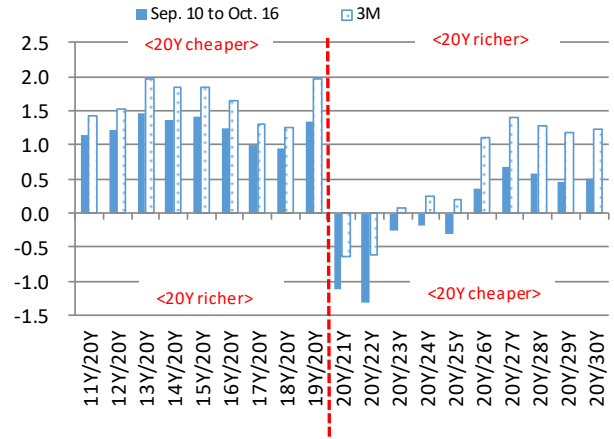
Source: Daiwa Securities.

Appendix 3a: Z-score I



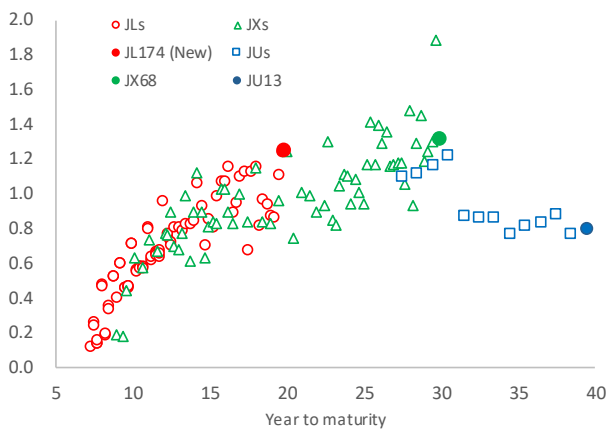
Source: Daiwa Securities.

Appendix 3b: Z-score II



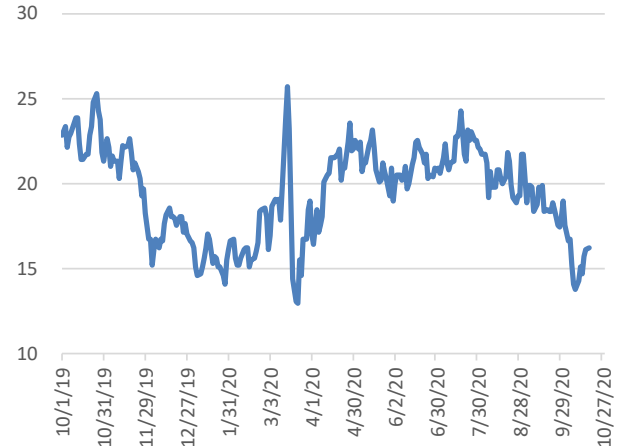
Source: Daiwa Securities.

Appendix 4: J JGB Total Return Curve (3M, %)



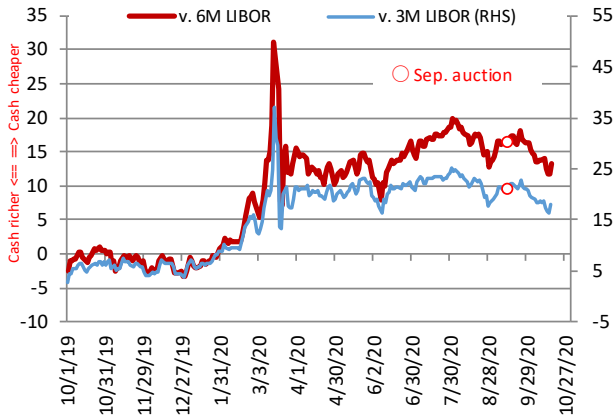
Note: Based on the Oct-19 JGB yield curve; factoring in roll-down effect etc.; JL174 is supposed to have a 0.4% coupon and 1bp spread (Japanese yield) to JL173.
Source: Daiwa Securities.

Appendix 5: JGB 10Y/20Y/30Y Butterfly Spread (bp)



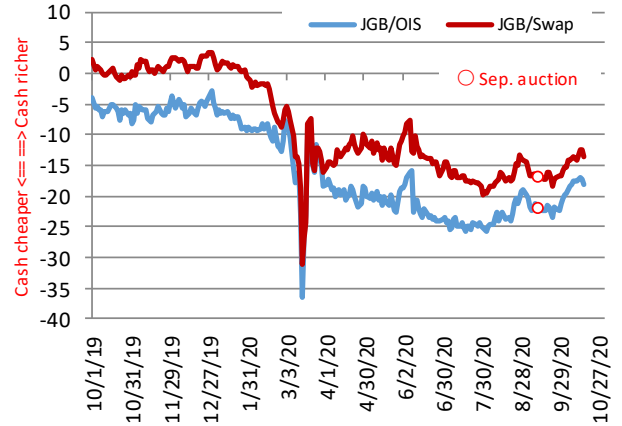
Note: On-the-run compound yield
Source: Bloomberg.

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



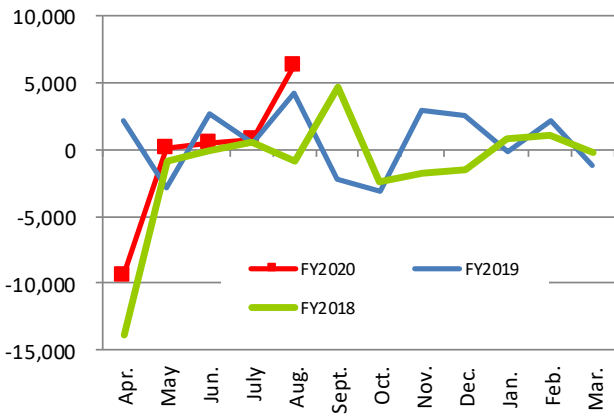
Source: Daiwa Securities.

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



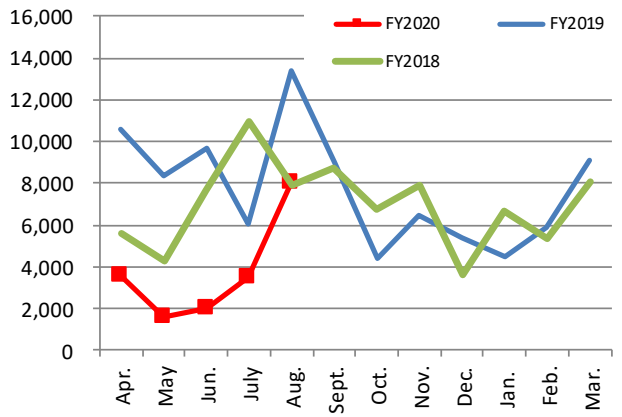
Source: Daiwa Securities.

Appendix 7a: Trend of Major Banks' Net Purchase of Superlong JGBs (Yen 100M)



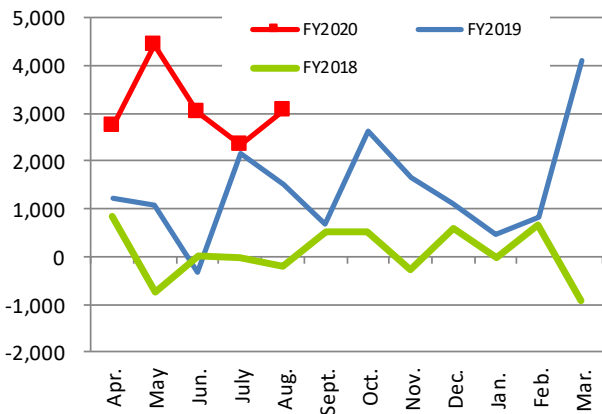
Source: JSDA

Appendix 7b: Trend of Major Banks' Gross Purchase of Superlong JGBs (Yen 100M)



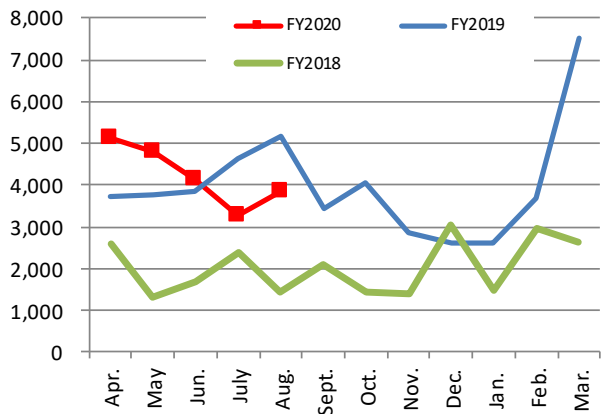
Source: JSDA

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



Source: JSDA

Appendix 8b: Trend of Regional Banks' 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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