

Daiwa's View

20-year JGB auction: Buy

- Will revision to regional bank-related facility lead to additional demand?

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Daiwa Securities Co. Ltd.

Will revision to regional bank-related facility lead to additional demand?

20-year JGB auction: Buy

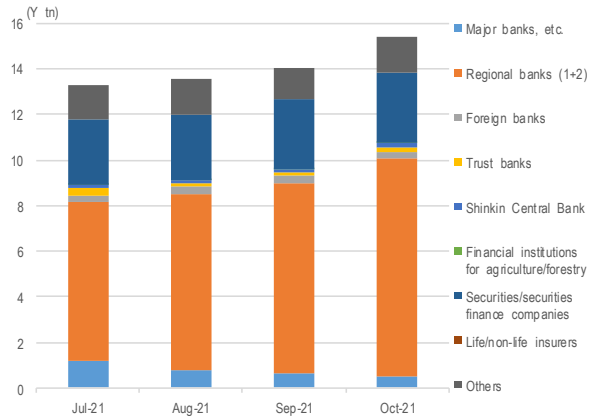
A 20-year JGB auction is to be conducted on Thursday, 18 November. The scheduled maturity date is 20 September 2041, and the planned issuance amount is around ¥1.2tn, the same as in the previous auction. These new 20-year JGBs will be a reopening of the October issue (JL178). As of 15:00 on the 16th, the yield of JL178 closed at 0.465% on a conventional basis (up 0.5bp vs. the previous day's close).

Due to the Special Deposit Facility to Enhance the Resilience of the Regional Financial System, fund management at regional financial institutions has partially shifted from bond investment to fund management via short-term interest rates. While this is a negative factor for auctions, it isn't expected to be an issue since a certain degree of demand is expected from life/non-life insurers even with current yield levels. Investors who can adopt a long-term horizon probably have ample leeway to consider buying at the auction with current yield levels.

After the previous auction, the bond market fluctuated, reflecting market pricing of rate hikes by each central bank. In the lower house election on 31 October, the Liberal Democratic Party gained an absolute and secure majority. The following day, the 10-year JGB auction did not go favorably, but, having made it through a major event, the JGB market firmed up later that day in the afternoon session. Then, at its Monetary Policy Committee on 4 November, the Bank of England decided to maintain the policy interest rate against the market consensus, which pushed down intermediate yields in the US, and rate-hike pricing receded in the US as well as in the UK. JGB yields were also influenced by this trend, with the 20-year JGB yield declining to 0.440% at one point on a closing basis. Subsequently, with the announcement of the US CPI in October, which confirmed inflation with a wider range of items, rate-hike pricing in the US returned. In line with this, the level of the 20-year JGB yield has returned, but tomorrow's auction will likely be held at a slightly lower level than the previous auction.

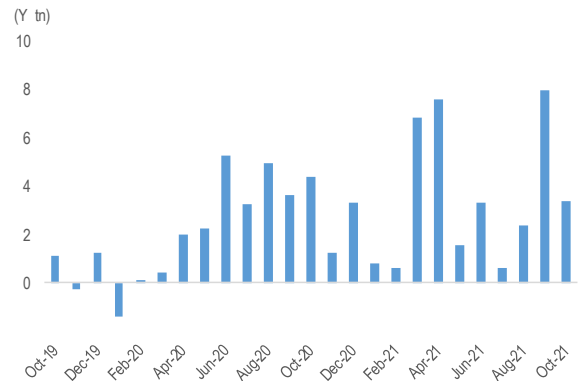
As we stated in previous reporting, the impact of the Special Deposit Facility to Enhance the Resilience of the Regional Financial System is larger than initially expected. Among outstanding amounts in the call money market, the amount borrowed by regional banks (first- and second-tier) in October continued to increase for the second consecutive month, rising by as much as ¥1.2tn m/m. Regional financial institutions already account for more than 60% of the outstanding amount borrowed in the call money market (left-hand chart below). In addition, we can confirm that funds raised in the call money market are flowing into the BOJ's current accounts (right-hand chart below). Given this, we should note that regional financial institutions have been participating in the 20-year JGB market less than before.

Average Outstanding Amount in Call Money Market by Borrower Group



Source: BOJ; compiled by Daiwa Securities.

M/m Change in BOJ Current Account Balances (first- and second-tier regional banks)

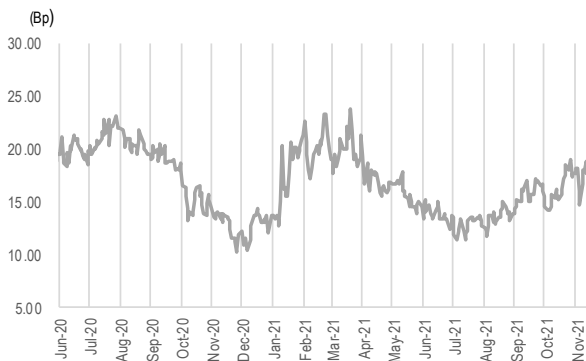


Source: BOJ; compiled by Daiwa Securities.

This may be backed up by the following: (1) since end-September, 20-year JGBs have become more undervalued vs. neighboring sectors and (2) the 10-year/20-year/30-year butterfly spread has widened the most since the beginning of FY21. However, yesterday (16 Nov), the BOJ announced [a partial amendment](#) to the Special Deposit Facility to Enhance the Resilience of the Regional Financial System. Given the increase in the macro add-on balance via Special COVID-19 operations and interest payments by the BOJ, the central bank intends to rein in interest payments by virtually excluding the increased portion in current accounts since the start of Special COVID-19 operations from current accounts for which the IOER is applied. Given this, we could point out that funds managed by regional banks may shift back from the short-term money market to the bond market from FY22 onwards. Superiority in terms of relative value can be seen as ease of buying in the long term.

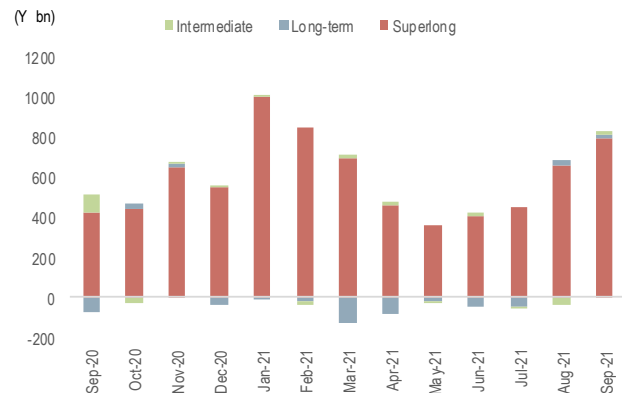
Due to the aforementioned factors, demand from regional financial institutions is expected to weaken slightly at tomorrow's auction. However, a certain degree of demand is expected from life insurers. Although the yield level has declined slightly from its peak hit in October, superlong yields remain at a high level even compared to the yield level in September, when life/non-life insurers' net buying of superlong JGBs increased to the highest level since the outset of FY21. At the 30-year JGB auction held on 9 November, the bid-to-cover ratio (3.45X) was at the highest level since July 2021. As such, the cautious stance seen in the entire JGB market throughout October seems to have diminished to some extent.

10-yr/20-yr/30-yr JGB Butterfly Spread



Source: Bloomberg; compiled by Daiwa Securities.

Net Buying of Coupon JGBs by Life/non-life Insurers



Source: Japan Securities Dealers Association; compiled by Daiwa Securities.

The details of economic measures, including cash handouts, are expected to be compiled this week on 19 November. [As previously reported](#), we do not expect an increase in the amount of the calendar-basis JGB market issuance. In that respect, the compilation of the supplementary budget to fund the economic measures is unlikely to have a major negative impact on the JGB market.

As the yield uptrend has let up, we think it will be easier for investors to buy at tomorrow's auction compared to the October auction. However, we do not expect the auction to go favorably because special collateral repo transactions show that primary dealers are not sufficiently short in JL178. Investors who can adopt a long-term horizon probably have ample leeway to consider buying at the auction with current yield levels.

20-year JGB Auction Results

Auction date	Issue #	Maturity date	Coupon (%)	Issuance amount (Y bn)	Bid-to-cover ratio (X)	Average accepted yield (%)	Highest accepted yield (%)	Weighted average price (Y)	Lowest accepted price (Y)	Tail (Y)	Allotment	Bloomberg consensus (Y)
18-Nov-21	178R	20-Sep-41	0.50	1,200.0*								
19-Oct-21	178	20-Sep-41	0.50	1,199.0	2.69	0.471	0.475	100.51	100.45	0.06	81.1%	100.45
16-Sep-21	177R	20-Jun-41	0.40	1,199.0	3.20	0.412	0.416	99.77	99.70	0.07	64.1%	99.70
26-Aug-21	177R	20-Jun-41	0.40	1,281.9	3.65	0.405	0.408	99.89	99.85	0.04	72.7%	99.80
13-Jul-21	177	20-Jun-41	0.40	1,266.2	3.51	0.404	0.408	99.92	99.85	0.07	9.4%	99.80
24-Jun-21	176R	20-Mar-41	0.50	1,206.9	3.62	0.433	0.436	101.21	101.15	0.06	31.1%	101.15
21-May-21	176R	20-Mar-41	0.50	1,218.7	3.48	0.445	0.450	101.00	100.90	0.10	37.5%	100.90
20-Apr-21	176	20-Mar-41	0.50	1,225.2	3.34	0.438	0.439	101.12	101.10	0.02	79.6%	101.00
11-Mar-21	175R	20-Dec-40	0.50	1,300.2	3.40	0.513	0.519	99.75	99.65	0.10	33.2%	99.60
18-Feb-21	175R	20-Dec-40	0.50	1,273.4	3.13	0.482	0.488	100.31	100.20	0.11	47.0%	100.20
18-Jan-21	175	20-Dec-40	0.50	1,209.0	3.35	0.443	0.448	101.04	100.95	0.09	78.8%	100.95

Source: MOF; compiled by Daiwa Securities.

*Scheduled issuance amount.

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