

Daiwa's View

The most notable event will be the 30-year JGB auction

- Yesterday's 10-year JGB auction had a favorable outcome, a reassuring factor regarding investor demand in intermediate/long-term zones
- That said, the most notable event will be tomorrow's 30-year JGB auction
- Focus will be on whether auction goes smoothly amid market segmentation, critical illiquidity, weaker demand from life insurers, and less attractive investment return for overseas investors (i.e., a tighter \$ASW)
- A 30-year JGB compound yield of 2.7% would become a barrier in terms of balance vs. UK gilts

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Yesterday's 10-year JGB auction, which attracted great attention from the global market, turned out to be much better than expected, which was a relief. In addition to the lowest accepted price (Y99.03) exceeding the advance estimate (Y98.95), the bid-to-cover ratio came in at 3.66X, the highest since April 2024, which is good news. This seems to be a reassuring factor regarding demand for intermediate/long-term bonds.

Of course, this outcome will likely serve as an important factor to consider during the revision to the MOF's issuance plan, which is likely to be implemented from July onwards. It is likely to accelerate discussions towards the widely-anticipated reduction in the issuance of superlong JGBs and the supplementary increase in the issuance of short-term and intermediate JGBs.

30-year JGB auction

That said, the most notable event in the global market will be tomorrow's 30-year JGB auction, not the 10-year JGB auction. The current JGB market is experiencing segmentation between zones up to 10 years and zones of more than 10 years, with liquidity declining markedly in the superlong zone, which is segmented from long-term JGB futures (approximately 7 years). We must carefully monitor the situation to see whether the market can absorb a new supply of superlong JGBs worth Y800bn under these circumstances. (As of June, there has yet to be a reduction in the amount issued.)

Recently, the presence of Japanese insurers has declined sharply in the superlong JGB market, while that of overseas investors has increased rapidly. Therefore, a global comparison of the valuation of 30-year JGBs has become indispensable from the perspective of overseas investors. In this regard, when comparing the dollar-denominated yield of cash flows of the on-the-run 30-year JGB (CTJPY30, see Chart on next page), we found that the position has improved somewhat since the release of our previous report.

Specifically, the dollar-denominated yield of the CTJPY30 is now 5.39%, and the dollar-denominated asset swap spread (\$ASW) is +126bp, both of which are around 13bp tighter than the 5.54% and \$ASW of +139bp at the time of the release of our previous report. Even after taking into account the 3–5bp tightening in superlong \$ASW across the global market during this period, the JGB's outperformance (tightening about 8-10bp) is still quite significant.

One specific factor, the speculation about the MOF's revision to the JGB issuance plan, probably had a positive impact. As a result of this outperformance, the \$ASW for the 30-year JGB has now shifted to around the midpoint between the UK (\$ASW: +101bp) and France (\$ASW: +150bp). Tomorrow's auction will test whether overseas investors will continue investing in JGBs in a situation in which the relative position has improved somewhat (i.e., investment returns are declining).

Challenge of exceeding UK

In order to further outperform the global market going forward, the 30-year JGB yield needs to exceed the valuation of UK gilts on a dollar-denominated basis. Of course, if we were to see improvement with JGB market segmentation and the liquidity of superlong JGBs, there would be a reasonable chance of yields declining further. However, if people assume that it will be difficult to sustain the outperformance of JGBs' dollar-denominated valuation vs. UK gilts (assuming that US yields and XCCY remain constant), the 30-year JGB compound yield is likely to encounter a barrier around 2.7%.

30yr Government Bond Yields and Dollar-denominated ASW in Major Nations (as of the morning of 4 Jun)

On-the-run 30yr government bonds	ISIN	Maturity date	Local currency-denominated yield (% , compound)	Local currency-denominated ASW (bp)	Dollar-denominated yield (%)	Dollar-denominated ASW (bp)
US	US912810UK2	5/15/2055	4.98	84	4.98	84
Switzerland	CH0344958472	05/24/2055	0.36	-26	4.24	12
Germany	DE000BU2D004	8/15/2054	3.01	33	4.58	46
Australia	AU0000300535	6/21/2054	4.94	57	4.69	56
UK	GB00BPSNBB36	07/31/54	5.37	78	5.15	101
Japan	JP1300861R49	3/20/2055	2.81	59	5.39	126
France	FR001400OHF4	5/25/2055	3.96	118	5.62	150
Italy	IT0005611741	10/1/2054	4.35	166	6.23	209

Source: Bloomberg compiled by Daiwa.

Note: Figures are rounded off.

Reference: 30yr Government Bond Yields and Dollar-denominated ASW in Major Nations at Time of Our Previous Report (as of the morning of 26 May)

On-the-run 30yr government bonds	ISIN	Maturity date	Local currency-denominated yield (% , compound)	Local currency-denominated ASW (bp)	Dollar-denominated yield (%)	Dollar-denominated ASW (bp)
US	US912810UK2	5/15/2055	5.04	87	5.04	87
Switzerland	CH0344958472	05/24/2055	0.49	-24	4.25	11
Germany	DE000BU2D004	8/15/2054	3.08	37	4.47	51
Australia	AU0000300535	6/21/2054	5.1	64	4.76	61
UK	GB00BPSNBB36	07/31/54	5.48	82	5.23	107
Japan	JP1300861R49	3/20/2055	2.91	65	5.54	139
France	FR001400OHF4	5/25/2055	4.05	123	5.7	155
Italy	IT0005611741	10/1/2054	4.47	172	6.32	216

Source: Bloomberg compiled by Daiwa.

Note: Figures are rounded off.

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