

Outlook for 10Y JGBi Auction

Purchase in positive yield territory

- ✓ Hard to say that tomorrow's auction will be an ideal opportunity for buying in terms of market environment and timing, but investors with longer investment horizon shouldn't be bothered by the situation.
- ✓ Given the lack of liquidity in the secondary market, we think that JGBi auctions are the only opportunity to be able to buy in relatively large lot near a targeted price. At the positive yield level, little caution will be needed for primary sale of JBI25 tap, which carries a 0.2% coupon.

Strategic Memorandum DSTE394
FICC Research Dept.

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Auction Details

Auction Date:	August 6, 2020
Issue Date:	August 7, 2020
Maturity Date:	March 10, 2030
Offering Amount:	About 200 billion yen
Auction Method:	Dutch auction on an inflation-not-adjusted price with the increment of 0.05 yen
Base CPI:	102.20 (Nat'l core-CPI in Dec. 2019)
Ref. CPI:	101.60 (as on Aug. 7)
Index ratio:	0.99413 (as on Aug. 7)

* New 10Y JGBis will be the first reopening of JBI25 carrying a 0.2% coupon.

** On Aug. 6, JBI25 traded at 102.10-15 yen (+0.20 - +0.25 yen v. previous day's close) and closed at 102.10 yen. At the closing price, BEI of JBI25 is 0.8bp.

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Japan's BEI is weak, despite signs of improvement in Europe and US

The previous JGBi auction was held at the negative BEI level for the first time in the JGBi issuance history, but it went well. Since then, the BEI of on-the-run JBI25 has been largely range-bound at around 0bp (Chart 1). Those BEIs of other JBIs have been moving hopelessly in the -30 to -20bp level. We can say that Japan BEI is sluggish, compared to BEIs in Europe and the US, which have been on a moderate uptrend (Chart 7) despite strong worries about the economic outlook due to the COVID-19 pandemic. We think that the main reason for the sluggish movement can be the supply/demand factor, such as the possibility of deterioration in investor sentiment due to greater uncertainty about the Ministry of Finance (MOF)'s commitment to JGBis because the MOF substantially reduced the per-auction issuance amount of JGBis in FY20 from 400bn yen as of the initial budget to 200bn yen. In such an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows.

Domestic inflation expected to move at around 0%

First of all, we check domestic inflation. The y/y change in recently-announced June 2020 nationwide core CPI was +0.0%, up 0.2 percentage points from the previous month. Given the July CPI in the ward-area of Tokyo released on August 4, we forecast that the y/y change in July nationwide core CPI will likely be +0.0%. Until the push-up impact of the consumption tax hike will disappear, the y/y change in nationwide core CPI is likely to stay at around 0% partly on the impact of higher energy prices. The economy is seen as having bottomed out around the month of May with the full-scale lifting of the state of emergency and the effects of government measures. However, as the recovery is moderate, the supply/demand imbalance in macro terms will likely continue to put downward pressure on prices.

Not a favorable timing to buy JGBis from viewpoint of index ratio path

We confirm the index ratio of JBI25 based on our nationwide core CPI forecasts. The ratio is likely to remain largely flat toward September. After that, it is expected to decline toward October. The ratio is unlikely to stably rise above the August auction level until January 2021 (Chart 6). If we buy at tomorrow's auction and the price remains unchanged during the investment horizon, it would be difficult to expect positive return from JBI25 for a while (Chart 4). Unless we expect JBI25 price to constantly gain, it is not a favorable timing now to buy it in an aggressive stance.

Total purchases by BOJ and MOF by November auction expected to mount to at least 300bn yen

The BOJ's purchases and the MOF's buybacks will provide good support to JGBis. By the next JGBi auction scheduled for November, the total purchase amount by the BOJ and the MOF are expected to mount to at least 300bn yen vs. tomorrow's issuance worth 200bn yen. Specifically, the BOJ is expected to buy at least 150bn yen (= 30bn yen in August + 30bn yen/operation × 2 times each in September and October) and the MOF is to buy back around 150bn yen (=50bn yen/month × 3 months).

From the viewpoint of BOJ's monetary policy, support for JGBis appears rock-solid especially in medium to long term

At a press conference following the July monetary policy meeting, BOJ governor Haruhiko Kuroda stated that "It's true short-term inflation expectation gauges are falling due to the impact of the COVID-19 pandemic and recent weakness in prices, but those for long-term inflation expectations are not falling much. I don't think there is a risk that Japan will slide into deflation. In the Outlook for Economic Activity and Prices report (Outlook Report), the y/y change in CPI is expected to be negative for FY20, but positive growth is expected for FY21 and higher growth is projected for FY22. I do not think that a risk of deflation, which is the continued period of price declines, is increasing." In fact, some surveys show that short-term inflation expectations have plunged to around 0%, while long-term inflation expectations have posted only a moderate decline (Chart 9). According to the Outlook Report, there is no prospect that the 2% price stability target will be achieved during Governor Kuroda's term of office which expires in April 2023. At the moment, however, it seems that the BOJ will not intend to remove the price target or make a downward revision at all. From the viewpoint of the BOJ's monetary policy, support for JGBis appears rock-solid, despite in the medium to long term.

JGBi auctions are the only opportunity to be able to buy in relatively large lot near a targeted price

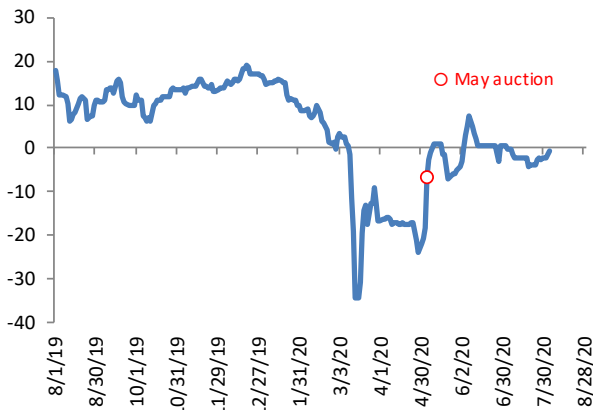
Amid lingering concerns about the global economy due to the COVID-19 pandemic, it is now difficult to expect a sharp rise in inflation expectations. Due to the lack of attractiveness in terms of carry, worries are left for post-auction performance. That said, if we base on the aforementioned surveys, we think that JGBis with BEI at around 0bp still appear quite undervalued vs. the average inflation expectations over the next ten years (around 0.7% as of June). In addition, there are supportive factors, such as, the BOJ's purchases and the MOF's buybacks, as mentioned above. Given the lack of liquidity in the secondary market, we think that tomorrow's auction can be a good opportunity to purchase JGBis in relatively large lot near a targeted price. At the positive yield level, little caution will be needed for primary sale of JBI25 tap, which carries a 0.2% coupon. We would like to place our bids in the positive yield territory.

10Y JGBi Auction Results

Auction Date	Issue #	Coupon (%)	Maturity Date	Issue Size (billion yen)	B/C	Lowest Accepted Price/Issue Price (Yen) (Note 1)	Highest Accepted Yield (%)	Allotment (%)	BEI Before Auction (Note 2)	BEI on Auction Day (bp) (Note 2)	Change from p.d. (bp)	Market Expectation of Lowest Accepted Price (Yen) (Note3)	Expected range	
8/6/20	25R	0.2	3/10/30	200*					0.8					
5/8/20	25	0.2	3/10/30	200.0	3.84	100.80	0.117	18.0000	-18.4	-6.6	11.8	100.30	100.00-100.40	Good
2/12/20	24R	0.1	3/10/29	415.3	3.75	102.30	-0.150	8.4317	7.2	7.6	0.4	102.20	101.80-102.20	Good
11/8/19	24R	0.1	3/10/29	410.3	3.43	102.90	-0.204	83.6431	12.8	13.8	1.0	102.90	102.50-102.95	Good
8/8/19	24R	0.1	3/10/29	414.3	3.84	104.25	-0.329	86.6906	12.3	11.8	-0.5	104.20	103.90-104.65	Avg
5/10/19	24	0.1	3/10/29	430.2	3.72	103.70	-0.266	94.4029	21.5	22.6	1.1	103.50	103.30-103.60	Good
2/15/19	23R	0.1	3/10/28	421.8	3.34	103.60	-0.287	16.3120	21.6	21.7	0.1	103.50	103.40-103.50	Good
11/6/18	23R	0.1	3/10/28	435.4	3.70	103.90	-0.305	43.0272	41.1	41.1	0.0	103.85	103.75-103.90	Avg
8/7/18	23R	0.1	3/10/28	418.4	3.12	104.05	-0.309	6.3636	48.0	41.0	-7.0	104.00	103.75-104.30	Avg
5/10/18	23	0.1	3/10/28	447.1	4.02	106.35	-0.513	32.0441	56.5	58.7	2.2	106.20	106.10-106.30	Good

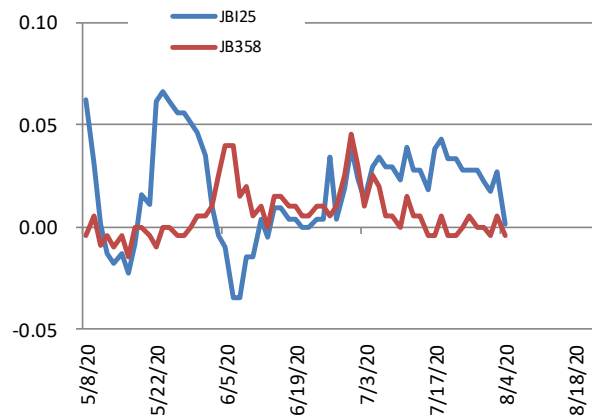
* Planned by MoF (Note 1) Inflation unadjusted price (Note2) Closing price; WI basis for new issues; as of Aug. 5 for the Aug. 2020 auction (Note 3) Bloomberg
 Source: Ministry of Finance, Bloomberg, Daiwa Securities

Chart 1: BEI (bp)



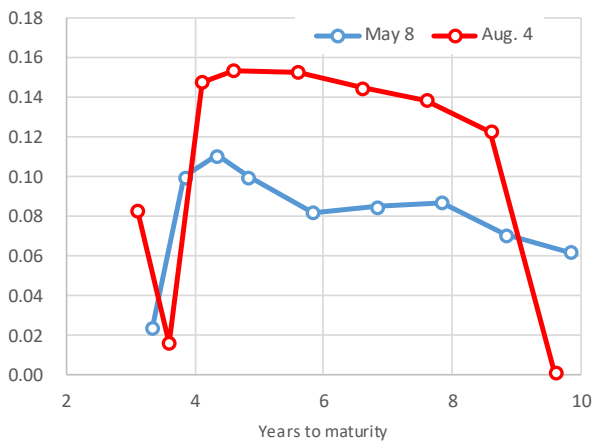
Note: On-the-run issues basis
 Source: Daiwa Securities

Chart 2: JBi25 and JBi358 Yields (%)



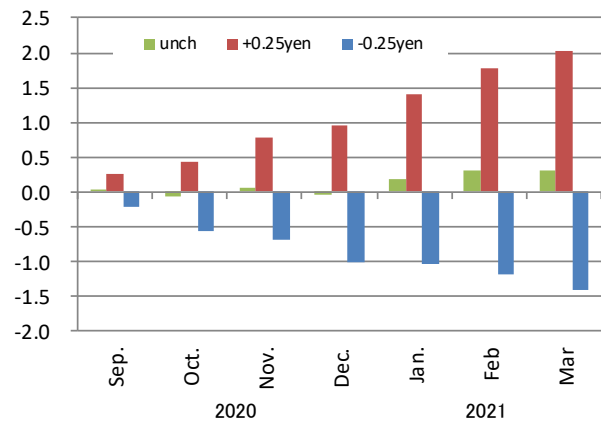
Source: Bloomberg

Chart 3: JGBi Yield Curve (%)



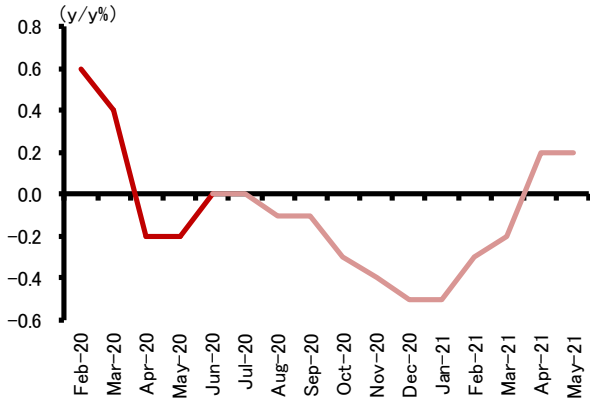
Source: Daiwa Securities

Chart 4: HPR of JBi25



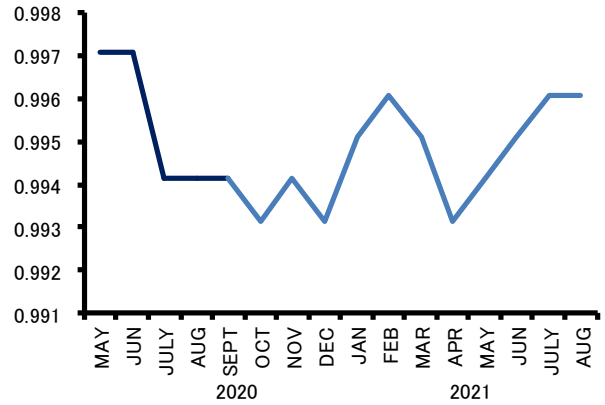
Note: From Aug. 6 to each point assuming the price is (1) unchanged, (2) increased by 0.25 yen every month and (3) decreased by 0.25 yen
 Source: Daiwa Securities

Chart 5: Nationwide Core-CPI Growth Outlook (y/y %)



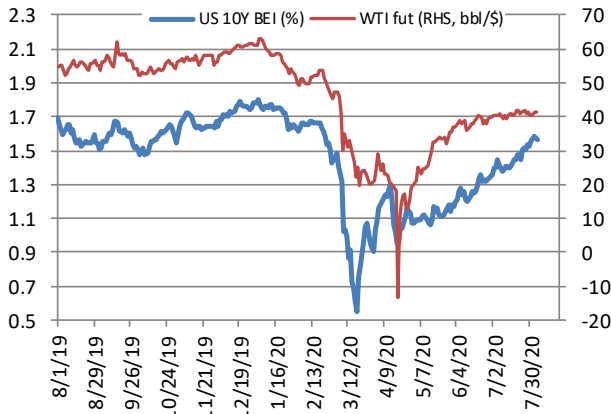
Note: Actual for Feb-Jun. 2020
Source: Daiwa Securities

Chart 6: JBI25 Index Ratio Forecast



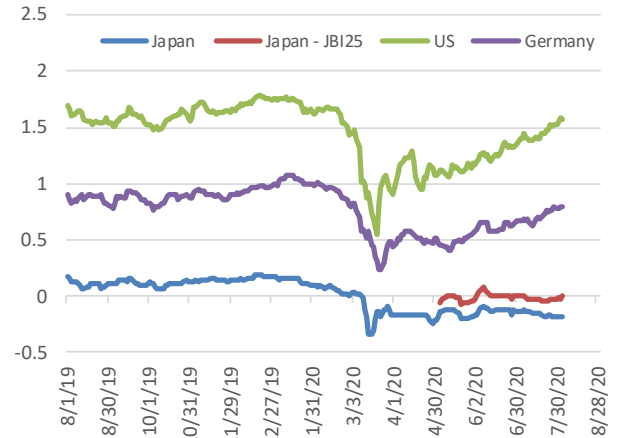
Note: Based on Chart 5, actual for May to Sep., 2020
Source: Daiwa Securities

Chart 7a: US 10Y BEI and WTI Futs Price



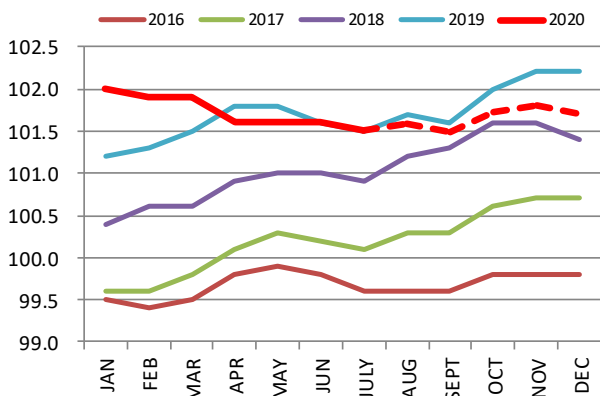
Source: Bloomberg

Chart 7b: US, Germany and Japan BEI (%)



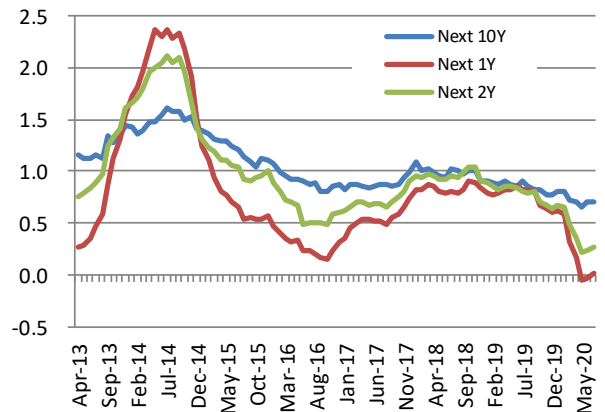
Note: 10Y for US and Germany; On-the-run and JBI25 basis for Japan
Source: Bloomberg, Daiwa Securities

Chart 8: Seasonality of Nationwide Core-CPI



Note: Daiwa forecast for July to Dec. 2020
Source: Ministry of Internal Affairs and Communications, Daiwa Securities

Chart 9: CPI Core Change Forecast: 10Y average (%)



Source: QUICK

Table 1: Results of BOJ Purchase and MOF Buyback

	Previous Day's Close (Yen)	Offer Size (Yen billions)	Pro-rata Price Spread (Yen)	Average Successful Price Spread (Yen)	Allotment on Pro-rata (%)	B/C	Close Price (Yen)
5/13/20	101.95	50.0	-0.150	-0.218	97.1014	3.63	102.10
5/19/20	102.20	30.0	-0.250	-0.290	100.0	3.47	102.05
5/25/20	101.35	30.0	-0.210	-0.266	35.2	4.37	101.30
6/1/20	101.45	30.0	-0.170	-0.226	37.5	4.48	101.50
6/11/20	102.10	30.0	-0.270	-0.324	8.2	3.71	102.10
6/26/20	101.90	50.0	-0.230	-0.368	35.7142	3.45	101.60
7/8/20	101.60	50.0	-0.130	-0.217	70.0000	3.51	101.65
7/17/20	101.75	30.0	-0.220	-0.282	100.0	5.19	101.55
7/29/20	101.65	30.0	-0.180	-0.237	50.0	5.00	101.65
8/3/20	101.75	30.0	-0.200	-0.208	73.4	4.75	101.65

Note: Previous Day's Close and Close Price are based on JBI25; Buyback by the Ministry of Finance for May 13, June 26 and July 8
 Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Table 2: Market Outstanding of JBIs (Yen billions)

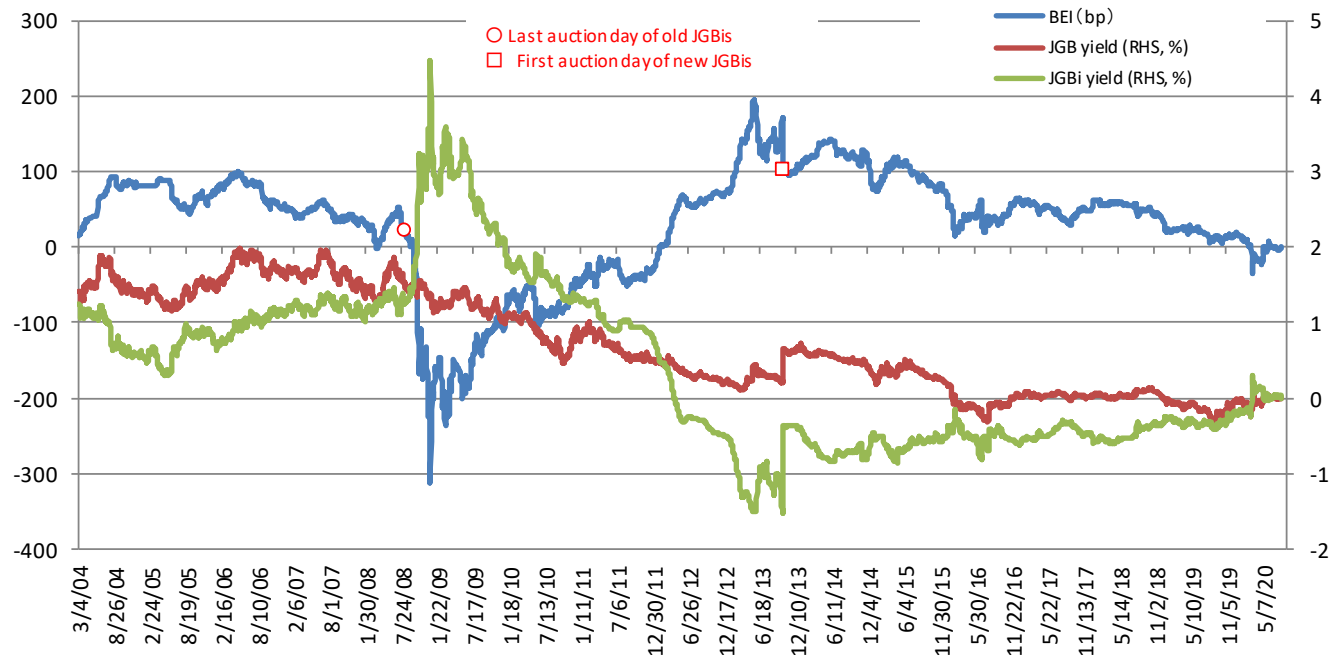
(Yen billions)

	Issue Size	MoF Buyback	BoJ Outright Purchase	Market Outstanding
JBI17	646.7	53.2	284.4	309.1
JBI18	821.7	52.5	267.0	502.2
JBI19	1,091.8	29.7	212.2	849.9
JBI20	2,139.4	141.4	430.8	1,567.2
JBI21	1,727.2	223.6	461.1	1,042.5
JBI22	1,760.4	217.2	726.1	817.1
JBI23	1,722.7	195.7	273.1	1,253.9
JBI24	1,670.1	133.2	186.5	1,350.4
JBI25	200.0	16.1	23.9	160.0
TOTAL	11,580.0	1,046.5	2,841.2	7,692.3
%	100.0%	9.0%	24.5%	66.4%

(As of July 31, 2020 on BOJ start basis)

Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Chart 10: BEI (March 2004 to present)



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

Table 3: Image of Bidding Price at Auction and BEI

(Unit: bp)

			Nominal Yield (% JB358)									
			-0.030	-0.025	-0.020	-0.015	-0.010	-0.005	0.000	0.005	0.010	0.015
Bidding Price (Yen) and Yield	102.50	-0.059	2.9	3.4	3.9	4.4	4.9	5.4	5.9	6.4	6.9	7.4
	102.45	-0.054	2.4	2.9	3.4	3.9	4.4	4.9	5.4	5.9	6.4	6.9
	102.40	-0.049	1.9	2.4	2.9	3.4	3.9	4.4	4.9	5.4	5.9	6.4
	102.35	-0.044	1.4	1.9	2.4	2.9	3.4	3.9	4.4	4.9	5.4	5.9
	102.30	-0.039	0.9	1.4	1.9	2.4	2.9	3.4	3.9	4.4	4.9	5.4
	102.25	-0.034	0.4	0.9	1.4	1.9	2.4	2.9	3.4	3.9	4.4	4.9
	102.20	-0.029	-0.1	0.4	0.9	1.4	1.9	2.4	2.9	3.4	3.9	4.4
	102.15	-0.023	-0.7	-0.2	0.3	0.8	1.3	1.8	2.3	2.8	3.3	3.8
	102.10	-0.018	-1.2	-0.7	-0.2	0.3	0.8	1.3	1.8	2.3	2.8	3.3
	102.05	-0.013	-1.7	-1.2	-0.7	-0.2	0.3	0.8	1.3	1.8	2.3	2.8
	102.00	-0.008	-2.2	-1.7	-1.2	-0.7	-0.2	0.3	0.8	1.3	1.8	2.3
	101.95	-0.003	-2.7	-2.2	-1.7	-1.2	-0.7	-0.2	0.3	0.8	1.3	1.8
	101.90	0.001	-3.1	-2.6	-2.1	-1.6	-1.1	-0.6	-0.1	0.4	0.9	1.4
	101.85	0.007	-3.7	-3.2	-2.7	-2.2	-1.7	-1.2	-0.7	-0.2	0.3	0.8
	101.80	0.012	-4.2	-3.7	-3.2	-2.7	-2.2	-1.7	-1.2	-0.7	-0.2	0.3
	101.75	0.017	-4.7	-4.2	-3.7	-3.2	-2.7	-2.2	-1.7	-1.2	-0.7	-0.2
	101.70	0.022	-5.2	-4.7	-4.2	-3.7	-3.2	-2.7	-2.2	-1.7	-1.2	-0.7
	101.65	0.027	-5.7	-5.2	-4.7	-4.2	-3.7	-3.2	-2.7	-2.2	-1.7	-1.2
101.60	0.032	-6.2	-5.7	-5.2	-4.7	-4.2	-3.7	-3.2	-2.7	-2.2	-1.7	
101.55	0.038	-6.8	-6.3	-5.8	-5.3	-4.8	-4.3	-3.8	-3.3	-2.8	-2.3	
101.50	0.043	-7.3	-6.8	-6.3	-5.8	-5.3	-4.8	-4.3	-3.8	-3.3	-2.8	
101.45	0.048	-7.8	-7.3	-6.8	-6.3	-5.8	-5.3	-4.8	-4.3	-3.8	-3.3	
101.40	0.053	-8.3	-7.8	-7.3	-6.8	-6.3	-5.8	-5.3	-4.8	-4.3	-3.8	
101.35	0.058	-8.8	-8.3	-7.8	-7.3	-6.8	-6.3	-5.8	-5.3	-4.8	-4.3	
101.30	0.063	-9.3	-8.8	-8.3	-7.8	-7.3	-6.8	-6.3	-5.8	-5.3	-4.8	

Note: Supposed to be settled on Aug. 7

Source: Daiwa Securities

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[Standard & Poor's]

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February 2020

IMPORTANT

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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:

- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITs: Daiwa Office Investment Corporation (8976), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).
- 6) NEC (6701): NOTICE REGARDING U.S. PERSONS: This report is not intended for distribution to or use by any person in the United States. Securities issued by NEC Corporation have been suspended from registration in the U.S. and are subject to an order of the U.S. Securities and Exchange Commission dated June 17, 2008, pursuant to Section 12(j) of the Securities Exchange Act of 1934. This document is not a recommendation or inducement of any purchase or sale of such securities by any person or entity located in the U.S. Daiwa Securities Co. Ltd. disclaims any responsibility to any such person with respect to the content of this document. Any U.S. person receiving a copy of this report should disregard it.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association