

## Outlook for 5Y JGB Auction

### Smooth primary sale expected for JS144 tap

- ✓ Expecting the 5Y JGB yield to move in the -0.110 - -0.070% range over the next one month, we think about our bidding stance including buying outright at -0.080% or above.
- ✓ In terms of relative value, it would be worth considering switching out from the 2Y sector.

Strategic Memorandum DSTE400  
FICC Research Dept.

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

### Auction Details

**Auction Date:** September 8, 2020  
**Issue Date:** September 9, 2020  
**Maturity Date:** June 20, 2025  
**Offering Amount:** About 2.5 trillion yen

\* New 5Y JGBs will likely be the last reopening of JS144 carrying a 0.1% coupon.

\*\* On September 7, JS144 traded at -0.085 - -0.080% (unch - +0.5bp v. previous day's close) and closed at -0.085% (unch).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

**-0.095% and -0.070% range since previous auction**

Since the previous 5Y JGB auction went smoothly at the -0.095 - -0.090% level (-0.5bp - unch vs. previous day's close), the 5Y JGB yield has remained range-bound between -0.095% and -0.070%. As of 14:00 today (Sep. 7), the yield is moving at -0.085 - -0.080%, around the median of the range.

**Even under new administration, top priority should be measures to cope with pandemic; current fiscal/monetary policies to be maintained or expanded/enhanced, if necessary**

We look at the conditions surrounding the JGB market. Excessive concern over the economy appears to be receding in the US, but in Europe, anxiety appears strong over the direction of the European economy, in part because of the second wave of virus infections. Although there are heightening expectations for the practical use of COVID-19 vaccines in the immediate future, it remains difficult to be optimistic about the future path of economic activity. Even the US lacks progress in discussions over a new pandemic relief package to replace the one that has already expired. In Japan, the process of preparing for a new administration has started since Prime Minister Abe announced to resign. Among those candidates for the LDP presidential election scheduled for September 14, Chief Cabinet Secretary Yoshihide Suga appears to be the closest to the presidential seat at the moment. Under this assumption, current fiscal/monetary policies will likely be maintained with a high probability amid the pandemic. In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Short-covering:** In the 5Y sector, market participants seem to be short enough. We thus expect solid demand for short-covering;
- ✓ **The absolute yield level is unlikely to discourage auction participants from buying new 5Y notes:** Amid lingering worries about the economic outlook, the BOJ is likely to maintain the current yield curve control (YCC) policy persistently in the near term. Given the fact that 5Y JGBs have been solidly supported at around -0.05% under the YCC policy (Appendix 1c), auction participants would not be discouraged from buying new 5Y notes around -0.080%;
- ✓ **Not cheap enough on the curve:** Our analysis based on data since the previous 5Y JGB auction shows that the 5Y sector is not cheap enough on the curve at the current level. Rather, it is noticeably overvalued vs. the 15Y sector (Appendix 4). The 5Y sector appears to be more undervalued against swaps than it was in the previous auction (Appendix 7);
- ✓ **At least five purchase operations expected to be offered by the BOJ:** The next 5Y JGB auction is scheduled for October 8. In the period from tomorrow's auction to the next auction, we expect the BOJ to offer at least five purchase operations in the 3-5Y zone (four this month and we expect at least one in Oct.). The purchase amount is estimated at around 1.75tn yen (= 350bn yen x 5 times) vs. tomorrow's issuance amount of 2.5tn yen.

**Buying outright at -0.080% or above/switching out from 2Y at around 5bp**

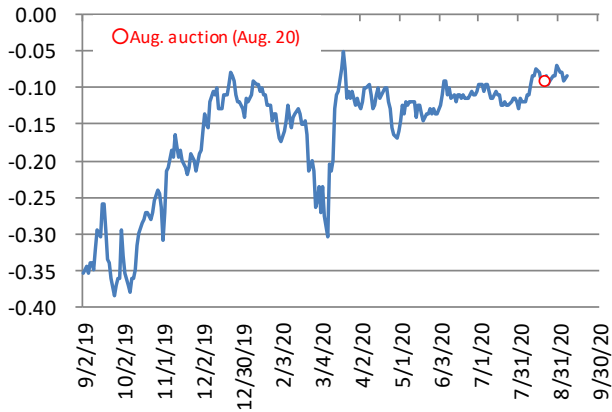
All in all, we would like to think about our bidding stance, expecting the 5Y JGB yield to move in the -0.110 - -0.070% range over the next one month. If we can take new 5Y notes at the -0.080 - -0.070% level, it would be worth considering taking some outright positions. In terms of the relative value, we think about switching out from the 2Y sector. Partly because of the current decline in GC repo rate we have been seeing since the end of last week, market sentiment in the short-term zone has been solid. However, the downtrend of the GC repo rate may let up once a new reserve maintenance period starts. If we see that steepening in the 2-5Y zone, which has been led by the solid 2Y, will also lose momentum, it would be worth switching out from the 2Y sector especially at around 5bp of the 2Y/5Y spread (Appendix 6).

#### 5Y JGB Auction Results

Auction Date	Issue #	Marurity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
9/8/20	144R	6/20/25	0.1	2.5*									
8/20/20	144R	6/20/25	0.1	2.5	3.55	100.94	100.93	0.01	-0.093	-0.091	0.002	99.4049	Avg.
7/9/20	144	6/20/25	0.1	2.7	4.25	101.01	101.00	0.01	-0.103	-0.101	0.002	82.5283	Good
6/18/20	143R	3/20/25	0.1	1.9	3.78	101.05	101.04	0.01	-0.119	-0.117	0.002	37.4921	Avg
5/18/20	143R	3/20/25	0.1	2.0	4.49	101.07	101.05	0.02	-0.122	-0.119	0.003	49.2132	Good
4/9/20	143	3/20/25	0.1	2.1	4.98	100.97	100.96	0.01	-0.095	-0.093	0.002	43.4187	Good
3/10/20	142R	12/20/24	0.1	1.9	2.73	101.55	101.37	0.18	-0.220	-0.184	0.036	21.4893	Poor
2/18/20	142R	12/20/24	0.1	2.1	4.49	101.19	101.18	0.01	-0.144	-0.142	0.002	13.8811	Good
1/15/20	142	12/20/24	0.1	2.1	4.48	100.93	100.93	0.00	-0.087	-0.087	0.000	90.2740	Good
12/10/19	141R	9/20/24	0.1	2.2	4.02	100.88	100.80	0.08	-0.083	-0.066	0.017	43.9215	Poor
11/14/19	141R	9/20/24	0.1	2.2	4.03	101.42	101.41	0.01	-0.190	-0.188	0.002	76.6232	Good
10/17/19	141	9/20/24	0.1	1.9	3.69	101.90	101.87	0.03	-0.280	-0.274	0.006	45.4644	Poor
9/11/19	140R	6/20/24	0.1	1.9	3.61	100.98	100.95	0.03	-0.308	-0.302	0.006	47.6063	Poor
8/15/19	140R	6/20/24	0.1	2.2	4.68	102.04	102.02	0.02	-0.314	-0.310	0.004	37.9896	Avg

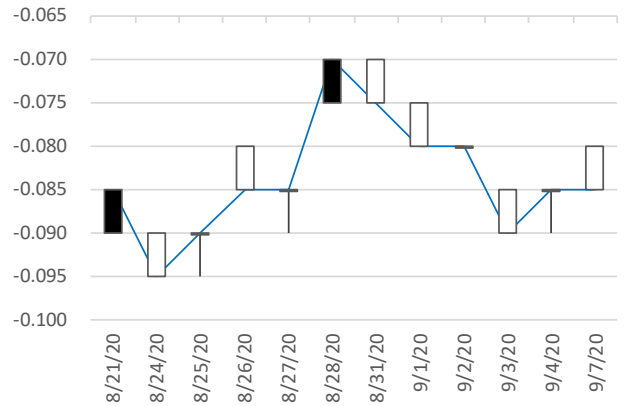
\* Amount the MOF plans to issue  
Source: Ministry of Finance, Daiwa Securities.

Appendix 1a: 5Y JGB Yield (%)



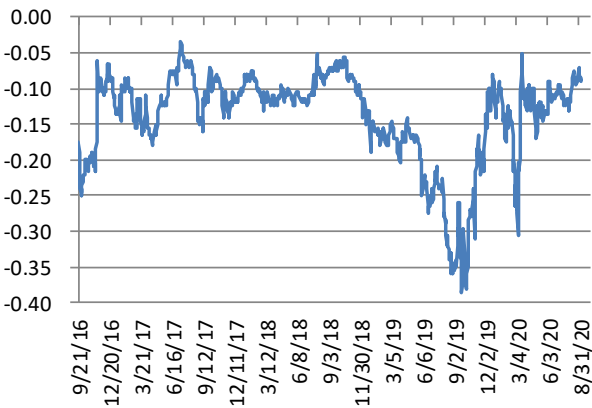
Note: On-the-run issue  
Source: Daiwa Securities.

Appendix 1b: Candle of JS144 Yield (%)



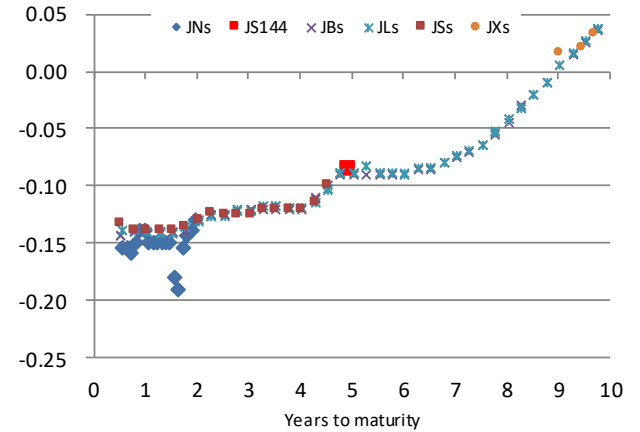
Source: Daiwa Securities.

Appendix 1c: 5Y JGB Yield under YCC (%)



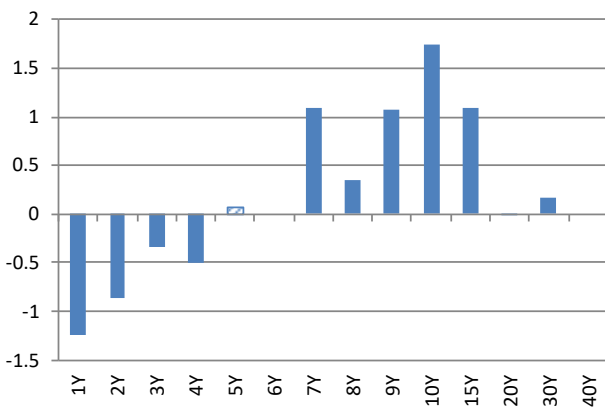
Note: On-the-run issue  
Source: Daiwa Securities.

Appendix 2: JGB Yield Curve (% as of Sep. 7)



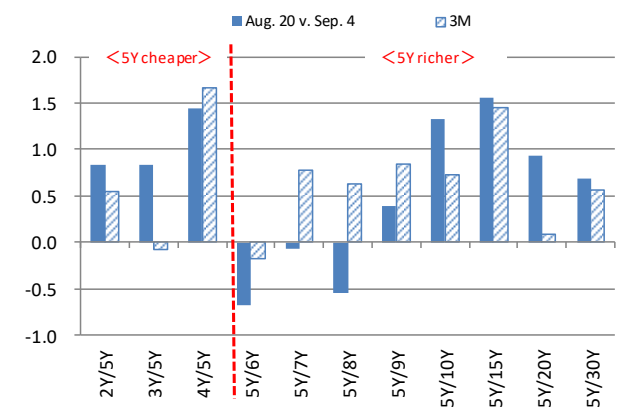
Source: Daiwa Securities.

Appendix 3: JGB Yield Change (bp): Aug. 20 v. Sep. 4



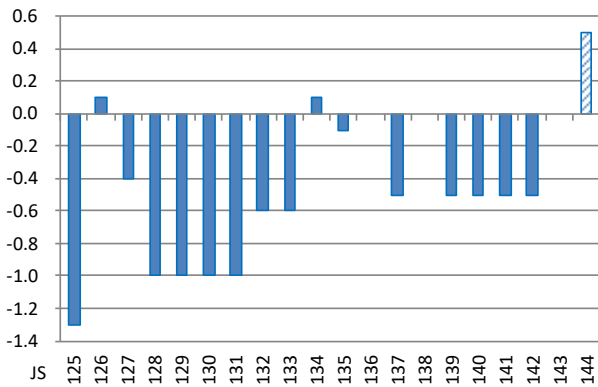
Source: Daiwa Securities.

Appendix 4: Z-scores of JGB Yield Spreads



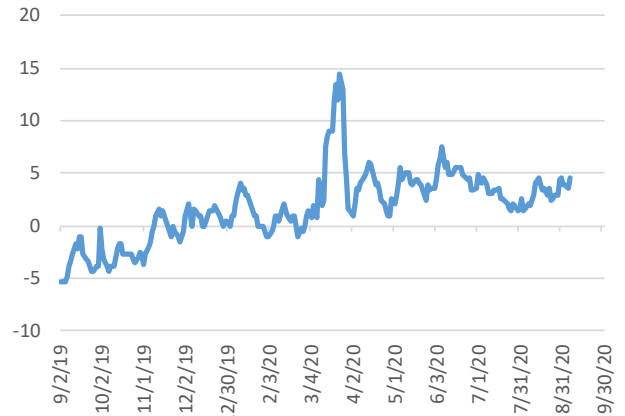
Source: Daiwa Securities.

Appendix 5: JS Yield Change (bp): Aug. 20 v. Sep. 4



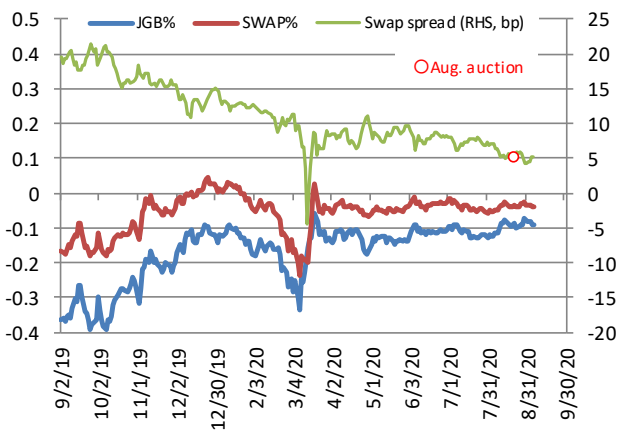
Source: Daiwa Securities.

Appendix 6: JGB 2Y/5Y Spread (bp)



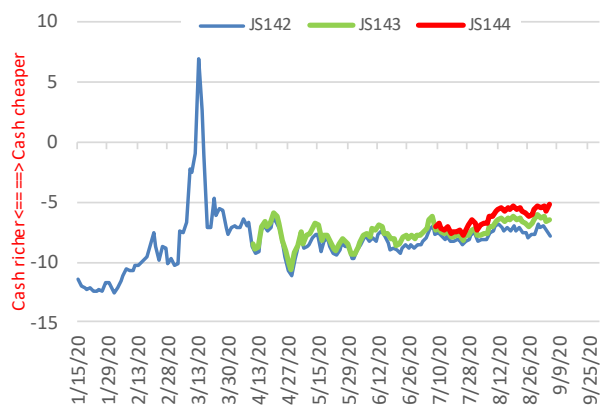
Note: On-the-run issue compound yield  
Source: Daiwa Securities.

Appendix 7a: 5Y Swap Spread (bp)



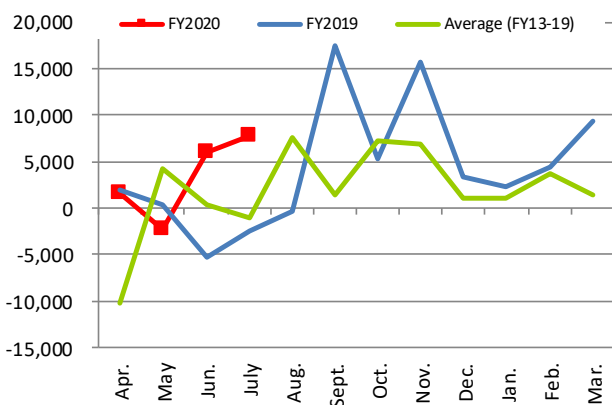
Source: Daiwa Securities.

Appendix 7b: JS Asset Swap (bp)



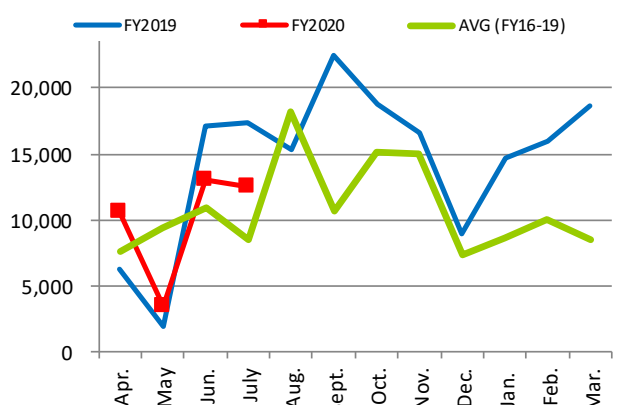
Note: Yen-Libor basis  
Source: Daiwa Securities.

Appendix 8a: Net Purchase of Intermediate-term JGBs by Major Banks (Yen 100 millions)



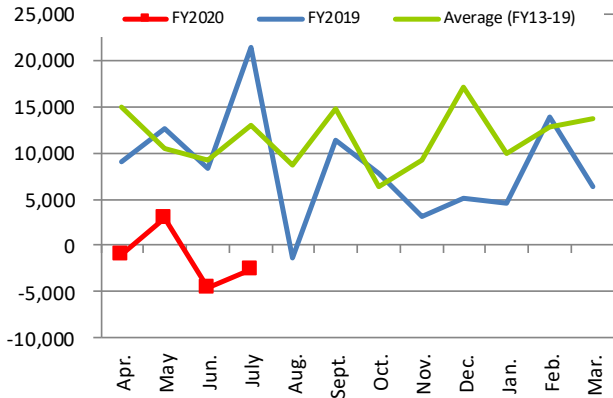
Source: JSDA

Appendix 8b: Gross Purchase of Intermediate-term JGBs by Major Banks (Yen 100 millions)



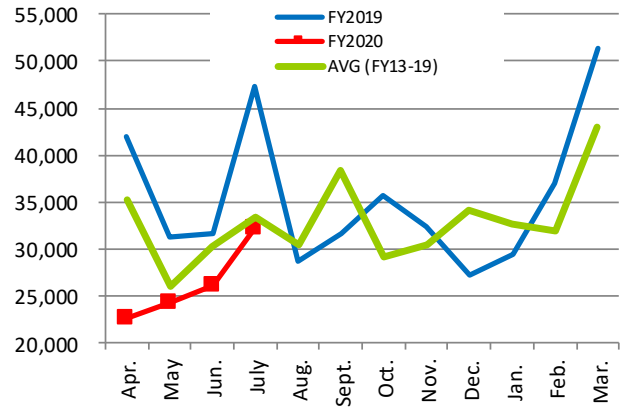
Source: JSDA

**Appendix 9a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



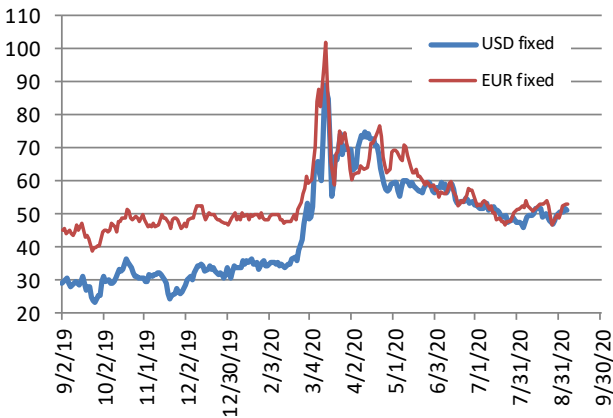
Source: JSDA

**Appendix 9b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



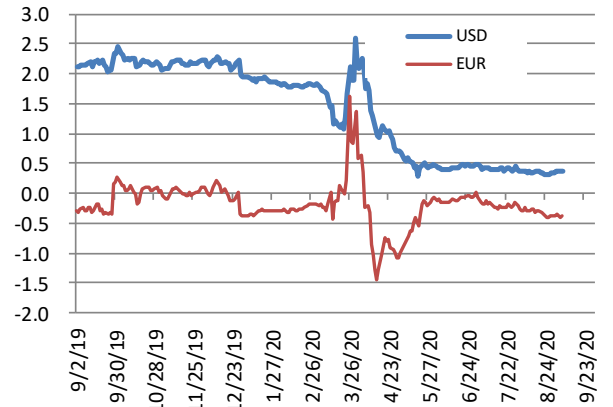
Source: JSDA

**Appendix 10a: 5Y JGB Benchmark Spreads (bp)**



Note: against 5Y UST and 5Y OBL  
Source: Daiwa Securities

**Appendix 10b: 5Y Hedged JGB Return (%)**



Source: Daiwa Securities

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February 2020

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- 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%.
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- 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.

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

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