

## Outlook for 10Y JGB Auction

### Primary sale of JB360 to go smoothly around 0.03%

- ✓ We think our bidding stance, assuming that the 10Y JGB yield will stay at the 0.00-0.05% level over the next one month. Given this level, we think that fresh 10Y JGBs in a new maturity basket will receive good primary response from investors around 0.03%. Primary dealers appear to be not short in the 10Y sector, but the recent 7-10Y steepening will make them comfortable to take 10Y JGBs vs. the futures.
- ✓ In terms of the relative value, it would be worth considering switching out from the 15Y sector as well.

**[BOX] October BOJ JGB Purchase:** Making a minor change to ring a bell on their close attention to the market?

Strategic Memorandum DSTE406  
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### Auction Details

<b>Auction Date:</b>	September 1, 2020
<b>Issue Date:</b>	September 2, 2020
<b>Maturity Date:</b>	June 20, 2030
<b>Offering Amount:</b>	About 2.6 trillion yen

\* New 10Y JGBs will likely be the second reopening of JB359 carrying a 0.1% coupon.

\*\* On August 31, JB359 traded at 0.045 - 0.050% (-1.0 - -0.5bp v. previous day's close) and closed at 0.045% (-1.0bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

#### Bidding most likely around 0.03%

After the previous 10Y JGB auction went poorly at the 0.030-0.035% level (-1.5 to -1.0bp vs. previous day's close), the 10Y JGB yield declined to 0.005% on an intraday basis amid the firmness of the JGB market. This week, the yield is moving in the 0.010-0.015% range during intraday trading. Based on the current level and the shape of the yield curve, bidding for JB360 will take place most likely around 0.03%.

#### 10Y JGB yield is expected to remain at the 0.00-0.05% level over the next one month

We look at the environment surrounding the JGB market. Concerns over sluggish economic activities are growing because measures to contain Covid-19 infections (such as restrictions on outings) have been strengthened in line with the resurgence of virus cases in Europe. In the US, excessive concern over the economy appears to be receding. But, the lack of major progress in discussions over a pandemic relief package forces us to be aware of uncertainty about a path of US economic recovery. With the November US presidential election approaching, US-China conflict is also escalating. Worries about a global economic recovery are lingering. Under the circumstances, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers appear to be not short in the 10Y sector:** We are unable to expect strong support from short-covering;

- ✓ **Decent demand is expected from investors:** Investor demand for 10Y JGBs in positive yield territory appears strong. Strong worries would be unnecessary because what the Ministry of Finance will offer tomorrow will be fresh 10Y JGBs in new maturity basket (JB360 to be redeemed in September 2030);
- ✓ **Noticeably undervalued vs. the 7-8Y and 15Y sectors:** Our analysis based on data since the previous 10Y JGB auction shows that the 10Y sector is noticeably undervalued vs. the 7-8Y and 15Y sectors (Appendix 3). Since the previous 10Y auction, asset swaps have been moving in a quite narrow range. We thus can say that 10Y cash is neither noticeably overvalued nor undervalued against swaps at the current level. Demand at the Yen LIBOR plus spread level deserves attention;
- ✓ **In October, the BOJ is expected to continue to offer five purchase operations totaling around 2.1tn yen in the 5-10Y zone:** In the BOJ's Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for October 2020 released yesterday (September 29), the offer range and the number of offers in the 5-10Y zone were unchanged from those for September (see BOX). The BOJ's purchases totaling (at least) around 2.1tn yen (420bn yen x five times) are expected to continue also in October. Even under the Suga administration, the BOJ is likely to unwaveringly implement the ongoing monetary easing via "aggressive JGB purchases and other measures," and to persistently conduct the current YCC policy. The BOJ's support for 10Y JGBs appears to remain rock-solid.

**Fresh 10Y JGBs in new maturity basket will stimulate investor appetite around 0.03%**

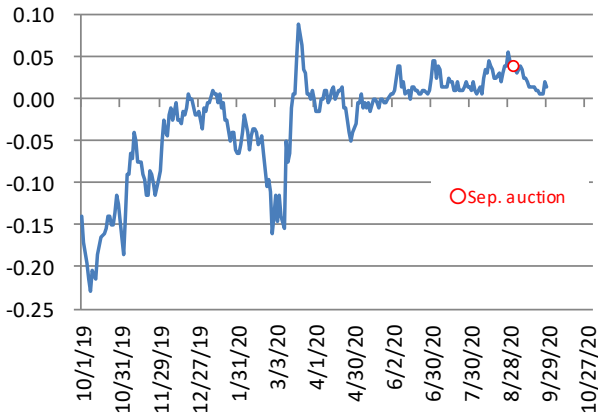
All in all, we would like to think of our bidding stance, assuming that the 10Y JGB yield will stay at the 0.00-0.05% level over the next one month. We think our bidding stance, assuming that the 10Y JGB yield will stay at the 0.00-0.05% level over the next month. Given this level, we think that fresh 10Y JGBs in a new maturity basket will receive good primary response from investors around 0.03%. The recent 7-10Y steepening will make bidders comfortable to take 10Y JGBs especially against the futures as well. In terms of the relative value, it would be worth considering switching out from the 15Y sector (Appendix 6). As mentioned above, the 10Y sector is currently undervalued vs. the 15Y sector. As the 15Y sector is becoming more expensive also in the superlong zone of the curve, correction in the richness can be expected to some extent. For example, new 10Y JGBs to be sold tomorrow are comparable to the 15Y sector in terms of carry or return (Appendix 5).

#### 10Y JGB Auction Results

Auction Date	Issue#	Coupon %	Maturity Date	Issue Size (billion yen)	Bid/Cover	Average Accepted Price	Lowest Accepted Price	Tail (yen)	Average Accepted Yield	Highest Accepted Yield	Tail (%)	Allotment %	
10/1/20	360	0.1*	9/20/30	2,600**									
9/1/20	359R	0.1	6/20/30	2,600	3.15	100.64	100.53	0.11	0.034	0.045	0.011	21.1681	Poor
8/4/20	359R	0.1	6/20/30	2,809	3.64	100.80	100.77	0.03	0.018	0.021	0.003	61.8502	Avg
7/2/20	359	0.1	6/20/30	2,844	3.66	100.41	100.39	0.02	0.058	0.060	0.002	48.3429	Good
6/2/20	358R	0.1	3/20/30	2,099	3.36	100.98	100.96	0.02	0.000	0.001	0.001	86.4694	Avg
5/12/20	358R	0.1	3/20/30	2,308	4.09	101.00	100.99	0.01	-0.001	0.000	0.001	72.6710	Good
4/2/20	358	0.1	3/20/30	2,306	4.19	100.76	100.75	0.01	0.023	0.024	0.001	83.0105	Good
3/3/20	357R	0.1	12/20/29	2,309	3.20	101.98	101.84	0.14	-0.100	-0.086	0.014	28.9846	Poor
2/4/20	357R	0.1	12/20/29	2,271	3.63	101.50	101.48	0.02	-0.051	-0.049	0.002	77.1508	Avg
1/7/20	357	0.1	12/20/29	2,171	3.70	101.05	101.03	0.02	-0.005	-0.003	0.002	78.8770	Good
12/3/19	356R	0.1	9/20/29	2,100	3.28	101.40	101.24	0.16	-0.042	-0.026	0.016	95.7891	Poor
11/6/19	356R	0.1	9/20/29	2,100	3.62	101.99	101.94	0.05	-0.099	-0.094	0.005	80.6774	Avg
10/1/19	356	0.1	9/20/29	2,100	3.42	102.62	102.33	0.29	-0.158	-0.130	0.028	6.1227	Poor
9/3/19	355R	0.1	6/20/29	2,412	3.60	103.68	103.66	0.02	-0.265	-0.264	0.001	99.4435	Avg

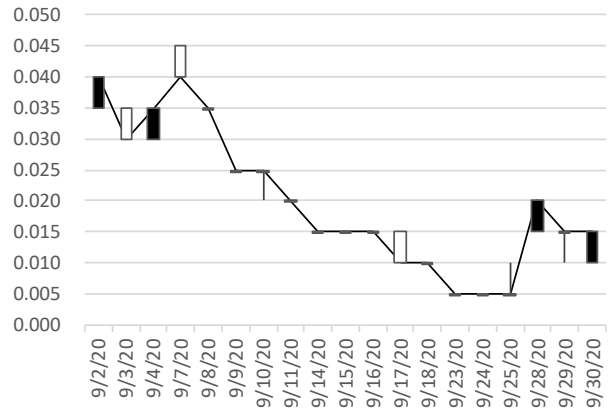
\* Daiwa forecast as of Sep. 30 \*\* Amount the MOF plans to issue  
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1a: 10Y JGB Yield (%)



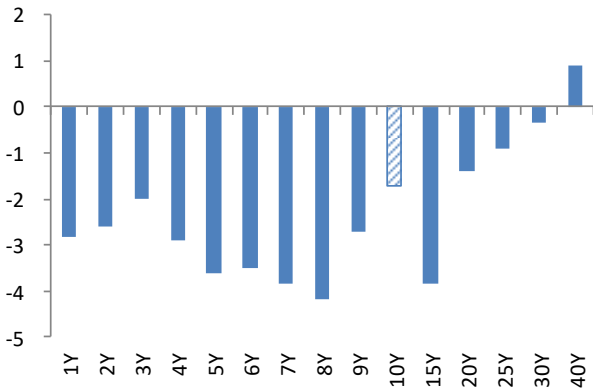
Source: Daiwa Securities.

Appendix 1b: JB359 Yield Candle Chart (%)



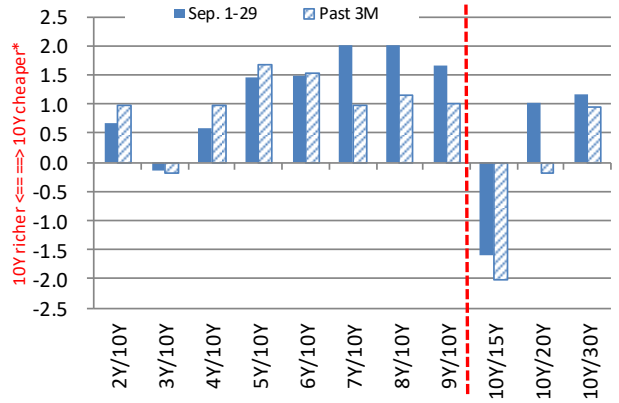
Note: As of 14.00 JST on Sep. 30  
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Sep. 1 v. Sep. 29)



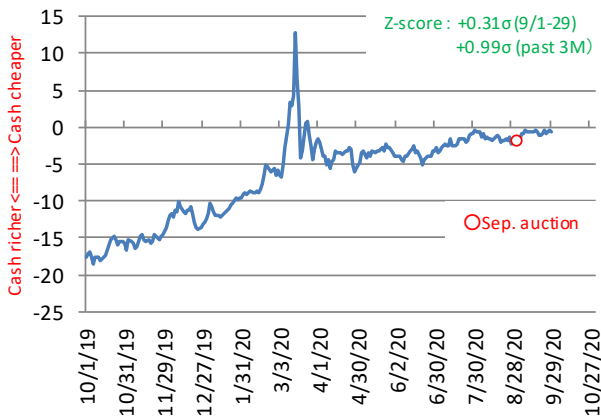
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads ( $\sigma$ )



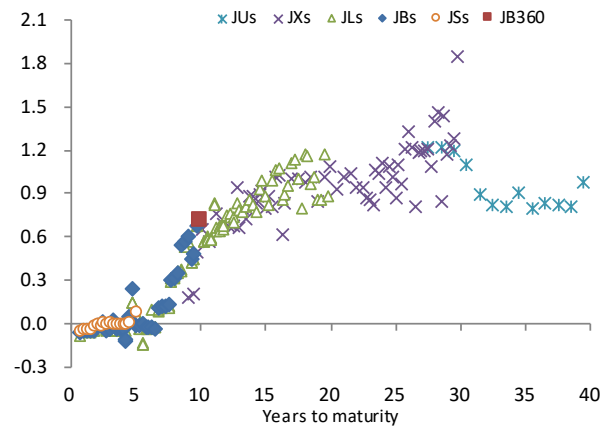
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y  
Source: Daiwa Securities.

Appendix 4: 10Y JGB Asset Swap Spread (bp)



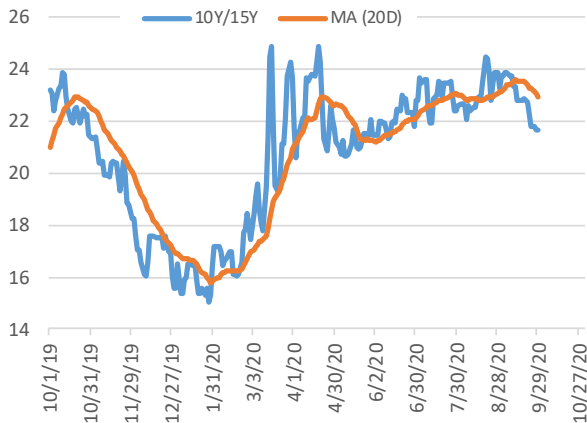
\* Yen LIBOR basis  
Source: Daiwa Securities.

Appendix 5: JGB Total Return Curve (3M, %)



Note: Based on JGB yield curve on Sep. 29; assuming that those yield curve shapes do not change and factoring roll-down effect etc.; JB360 is assumed to have a 0.1% coupon and 1.5bp spread (on Japanese yield) to JB359.  
Source: Daiwa Securities

### Appendix 6: JGB 10Y/15Y Spread (bp)



Note: Generic compound yield  
Source: Daiwa Securities.

### [BOX] October BOJ JGB Purchase: Making a minor change to ring a bell on their close attention to the market?

On September 29, the BOJ announced the Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for October 2020. Major points are as follows:

- ✓ In all the purchase target zones except for floaters, the offer range and the number of offers are unchanged from those for September;
- ✓ The offer amount of floaters is reduced from 100bn yen as at the August offer to 50bn yen and the number of offer is unchanged at one time;
- ✓ No offer will be made on the first day of the BOJ's Monetary Policy Meeting (Table 2). Skipping offers on MPM's first day when auctions of coupon-bearing JGBs (incl. liquidity enhancement auctions) are not scheduled is the first time since July 2019;
- ✓ The number of offer days per month declines to eight from nine days in September (Table 2).

Possible background factors behind the slightly surprising cut in floaters' offer amount are: (1) the Ministry of Finance (MOF) does not conduct buybacks on floaters, (2) the BOJ's average purchase ratio to the issuance amount of each issue (around 27%) is in the same level as the MOF's buyback ratio (around 29%), and (3) the bid-to-cover ratio at the August offer was low at 1.27x. In addition, there had been no change to the Monthly Schedule of Outright Purchases of Japanese Government Bonds for three months since the end of June when the July schedule was released. Therefore, the BOJ might have intended to emphasize its stance of carefully watching the market trends by making minor revisions on the monthly schedule.

Reflecting this release, it is highly likely that the initial offer amounts in October will be the same as the amounts offered in the last operation of September for each zone (excl. floaters, whose offer amount is to be reduced from 100bn yen as of August to 50bn yen). There appears to be ample room for raising/reducing purchase amounts within the current offer range during the month, if needed. The BOJ will probably make its decision on which issues to purchase in each zone based on its holding share of the issue and the supply-demand balance.

This time, the announcement of Outline of Outright Purchases of Japanese Government Securities was skipped again, meaning that the guideline as of April 27 will remain effective. The BOJ is therefore likely to continue to buy T-bills, maintaining the guideline for the offer amount of "about 500bn yen to 3.0tn yen" per operation. For the sake of market stability, however, we think it would be desirable for the BOJ to provide guidance on its T-bill purchase operations with more clarity and in line with market trends in the near future.

The next announcement is scheduled for October 30 at 5 p.m.

Table 1: BOJ's JGB Purchase Plan for October 2020

(Yen billions)

	Offer size per operation		Number of Offers (per month)	First offer size		Monthly Total exp. in Oct. (a)	MOF issuance in Oct.* (b)	(a)/(b) (%)	
		Mid			Last offer in Sep.				YCC Avg.***
<b>JGBs ex Linkers and Floaters</b>									
1 year and less	50	- 150	100	3	100	100	300	-	-
Over 1 to 3 years	250	- 600	425	6	420	420	2,520	3,000	84.0 76.2
Over 3 to 5 years	200	- 500	350	6	350	350	2,100	2,500	84.0 88.2
Over 5 to 10 years	250	- 600	425	5	420	420	2,100	2,600	80.8 104.8
Over 10 to 25 years	50	- 200	125	2	120	120	240	1,200	20.0 78.4
Over 25 years	0	- 50	25	2	30	30	60	1,400	4.3 30.8
Linkers	30	-	-	2	30	30	60	-	-
Floaters	50	-	-	1	50	-	50	-	-
<b>TOTAL**:</b>						<b>7,320</b>	<b>10,700</b>	<b>68.4</b>	

(Note) Floaters offered in even months; Change from September in red; "First offer size" is Daiwa forecast as of Sep. 30. \* Excluding auction II and AEL

\*\*Excluding JGB floaters and JGB linkers \*\*\* Based on the sum of 30Y JGB issuance amount and one-half of 40Y JGB issuance amount

Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

Table 2: BOJ's JGB Purchase Schedule in October 2020

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	JGB Floater	TDBs	MOF Buyback
10/1/20 TH	10/2/20	10Y JGB Auction									
10/2/20 F	10/5/20			⊙		⊙		○		3M	
10/5/20 M	10/6/20		⊙		⊙						
10/6/20 T	10/7/20	30Y JGB Auction									
10/7/20 W	10/8/20	○		⊙					○		
10/8/20 TH	10/9/20	5Y JGB Auction									
10/9/20 F	10/12/20		⊙		⊙		⊙			3M	
10/12/20 M	10/13/20										○
10/13/20 T	10/14/20	AEL for 20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years left to maturity									
10/14/20 W	10/15/20	○	⊙	⊙	⊙						
10/15/20 TH	10/16/20	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity									
10/16/20 F	10/19/20									3M	
10/19/20 M	10/20/20									1Y	
10/20/20 T	10/21/20	20Y JGB Auction									
10/21/20 W	10/22/20		⊙	⊙	⊙			○		○	
10/22/20 TH	10/23/20									6M	
10/23/20 F	10/26/20									3M	
10/26/20 M	10/27/20		⊙	⊙		⊙	⊙				
10/27/20 T	11/2/20	2Y JGB Auction									
10/28/20 W	-	BOJ MPM (Day 1)									
10/29/20 TH	-	BOJ MPM (Day 2)									
10/30/20 F	11/2/20	○	⊙	⊙	⊙					3M	

Note: ⊙ Announced by BOJ on Sep. 29, ○ Daiwa forecast as of Sep. 30

Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

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February 2020

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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