

## Outlook for 5Y JGB Auction

### No hesitation needed to buy JS145 around -0.09%

- ✓ We think about our bidding stance, expecting the 5Y JGB yield to move in a core range of -0.120 - -0.080% over the next one month. If we can take new 5Y notes at around -0.080%, it would be worth considering taking some outright positions.
- ✓ In terms of relative value, we think about buying asset swaps or switching out from 7Y sector, including positioning vs. JGB futures.

Strategic Memorandum DSTE407  
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### Auction Details

<b>Auction Date:</b>	October 8, 2020
<b>Issue Date:</b>	October 9, 2020
<b>Maturity Date:</b>	September 20, 2025
<b>Offering Amount:</b>	About 2.5 trillion yen

\* New 5Y JGBs, JS145, will likely carry a 0.1% coupon.

\*\* On October 7, WI barely traded, and closed at -0.090% (unch v. previous day's close). JS144 traded and closed at -0.100% (unch).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

**On the current JS curve, bidding for new 5Y JGBs in new maturity basket will likely take place at around -0.09% tomorrow (as of 14:00 on Oct. 7)**

After the previous 5Y JGB auction went poorly at the -0.095 - -0.090% level (-1.0bp - -0.5bp vs. previous day's close), the 5Y JGB yield (JS 144 on conventional yield basis) headed down to -0.135% (during intraday trading in late September) amid the firmness of the JGB market. Since then, the JGB market has softened reflecting growing expectations for an agreement on additional economic measures in the US, pushing up the 5Y JGB yield to -0.10% during intraday trading yesterday and today. On the current JS yield curve, bidding for new 5Y JGBs in new maturity basket will likely take place at around -0.09% (as of 14:00 on Oct. 7).

**Unable to factor in US-specific factors, but the Fed is likely to maintain accommodative monetary easing stance, and the BOJ would keep the current YCC policy persistently, regardless of who the next US president will be**

We look at the environment surrounding JGBs. US President Donald Trump, who announced that he tested positive for Covid-19 on October 2, left the hospital on October 5. Caution about the turmoil in US politics due to the absence of the president diminished, which led to higher stock prices/lower bond prices. On the following day (Oct. 6), however, President Trump tweeted that "I have instructed my representatives to stop negotiating until after the election" regarding talks on pandemic relief measures between the ruling and opposition parties, pushing stock prices lower and bond prices higher. Reportedly, President Trump receives the best of the best treatment and his recovery is remarkable. However, he has the elements of "aging, obesity, and men," entailing a high risk of becoming severe. As it is said that it takes about one week to ten days to become severe after the infection, his medical condition is still unpredictable. Although he instructed suspending talks on additional economic measures, he tweeted on the same day that "If I

am sent a Stand Alone Bill for Stimulus Checks (\$1,200), they will go out to our great people immediately. I am ready to sign right now.” As such, he is leaving nothing to chance, coping with an excessive drop in stock prices ahead of the presidential election. It is too difficult to factor US-specific factors in JGBs at the moment. Putting aside the US political situation, we find caution about the spread of the coronavirus toward winter strong. That prevents us from having an optimistic outlook for the global economy. Regardless of who the next US President will be, the Fed is likely to maintain accommodative monetary easing stance, and the BOJ would keep the current yield curve control (YCC) policy persistently. In such a situation, we summarize key points to think about the bidding stance at tomorrow’s auction as follows: 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 to serve as a support to some extent:** In the 5Y sector, market participants seem to have short positions. We thus expect short-covering to serve as a decent support;
- ✓ **The yield level of around -0.09% is unlikely to discourage auction participants from buying new 5Y JGBs in new maturity basket:** Amid lingering worries about the economic outlook, the BOJ is likely to maintain the YCC policy persistently for a while. Given the fact that 5Y JGBs have been solidly supported at around -0.05% under the YCC policy (Appendix 1c), around -0.090% would not discourage auction participants from buying new 5Y notes. In addition, the Ministry of Finance will offer fresh 5Y JGBs in new maturity basket tomorrow (JS145 to be redeemed in Sep 2025). We thus can expect decent demand also from investors;
- ✓ **Not overvalued in terms of relative value:** Our analysis based on data since the previous 5Y JGB auction shows that the 5Y sector is not expensive on the curve at the current level (Appendix 4). The 5Y sector does not appear overvalued against swaps, either (Appendix 7);
- ✓ **At least six purchase operations expected to be offered by the BOJ:** The next 5Y JGB auction is scheduled for November 12. In the period from tomorrow’s auction to the next auction, we expect the BOJ to offer at least six purchase operations in the 3-5Y zone (four this month and we expect at least two in Nov.). The total purchase amount is estimated at around 2.1tn yen (= 350bn yen x 6 times) vs. tomorrow’s issuance amount of 2.5tn yen.

**We think about buying asset swaps or switching out from 7Y sector, including positioning vs. JGB futures**

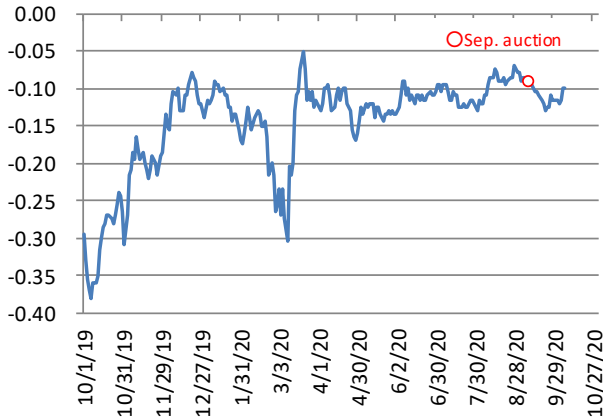
All in all, we would like to think about our bidding stance, expecting the 5Y JGB yield to move in a core range of -0.120 - -0.080% over the next one month. If we can take new 5Y notes at around -0.080%, it would be worth considering taking some outright positions. In terms of relative value, we think about switching out from the 7Y sector, including positioning vs. JGB futures. As mentioned above, the 5Y sector is not expensive on the curve. In fact, it is noticeably undervalued vs. the 7Y sector (on generic yield basis though, Appendix 4). Given the spread between JS144 and new 5Y JGBs (JS145), we think that switching out from the 7Y sector, including positioning vs. JGB futures, will perform well. In addition, it would be worth considering buying asset swaps (Appendix 6). The 5Y asset swaps had been in a narrow range, but recently started to tighten toward the upper end of the range (Appendix 7). Partly because of positive carry, no hesitation would be needed to buy 5Y JGBs in new maturity basket at around the LIBOR-5bp.

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 (%)	
10/8/20	145	9/20/25	0.1*	2.6**									
9/8/20	144R	6/20/25	0.1	2.5	3.56	100.92	100.90	0.02	-0.091	-0.087	0.004	96.8040	Poor
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

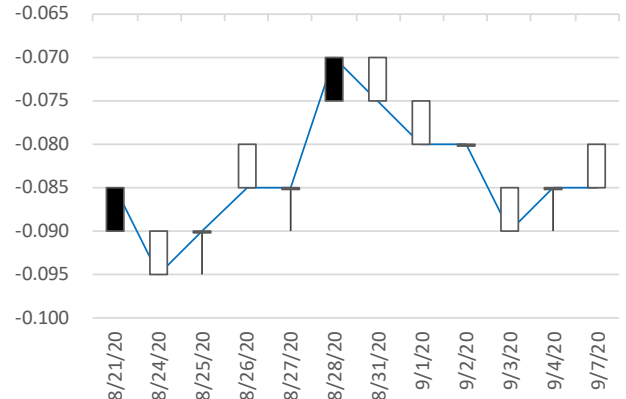
\* Daiwa forecast as of Oct. 7 \*\* Amount the MOF plans to issue  
 Source: Ministry of Finance, Daiwa Securities.

Appendix 1a: 5Y JGB Yield (%)



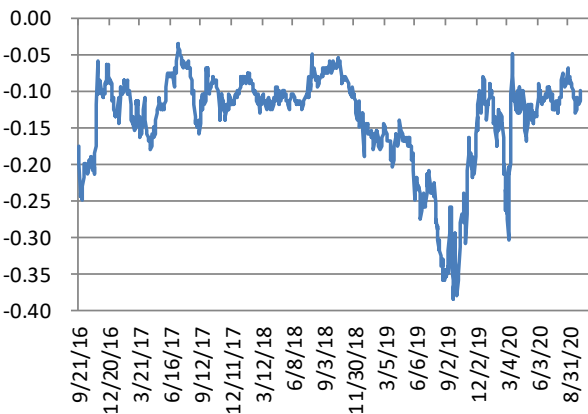
Note: On-the-run issue  
 Source: Daiwa Securities.

Appendix 1b: Candle of JS144 Yield (%)



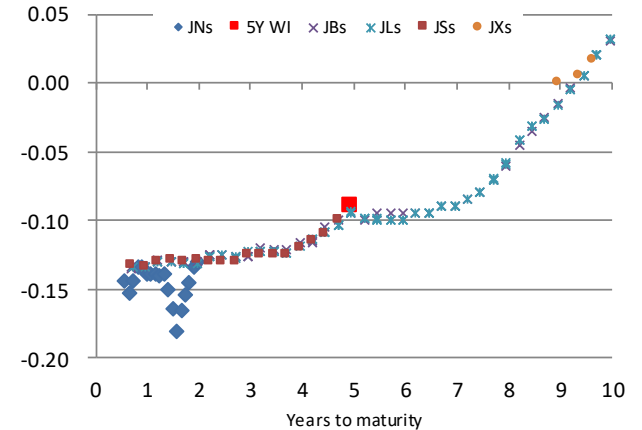
Source: Daiwa Securities.

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



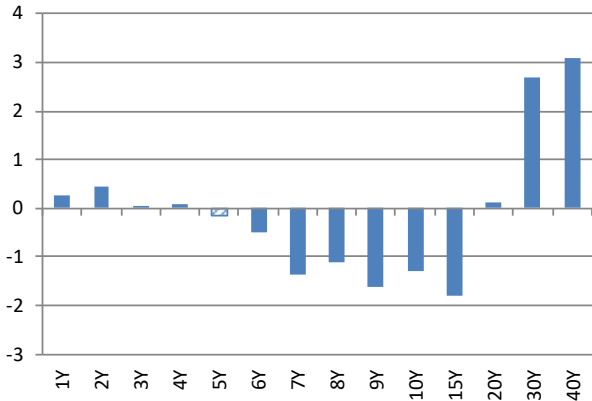
Note: On-the-run issue  
 Source: Daiwa Securities.

Appendix 2: JGB Yield Curve (% as of Oct. 6)



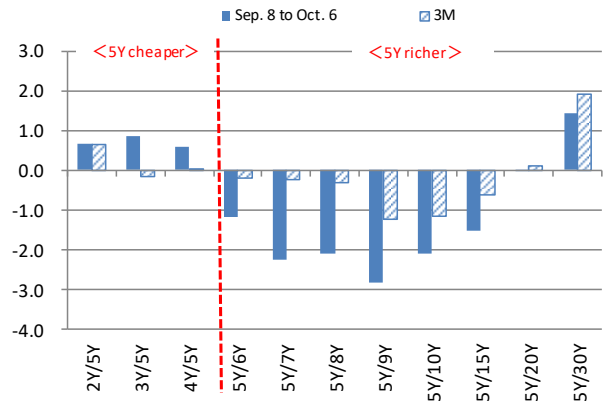
Source: Daiwa Securities.

### Appendix 3: JGB Yield Change (bp): Sep. 8 vs. Oct. 6



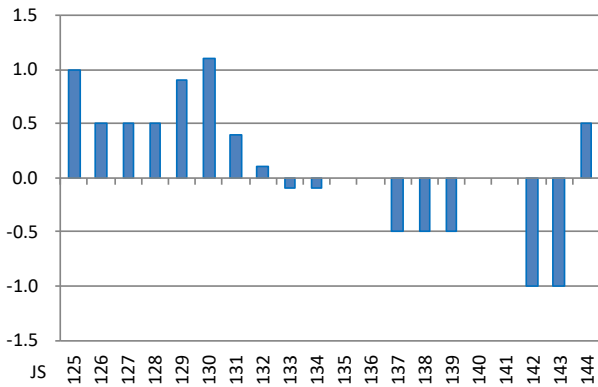
Note: Generic compound yield  
Source: Daiwa Securities.

### Appendix 4: Z-scores of JGB Yield Spreads



Note: Generic compound yield  
Source: Daiwa Securities.

### Appendix 5: JS Yield Change (bp): Sep. 8 v. Oct. 6



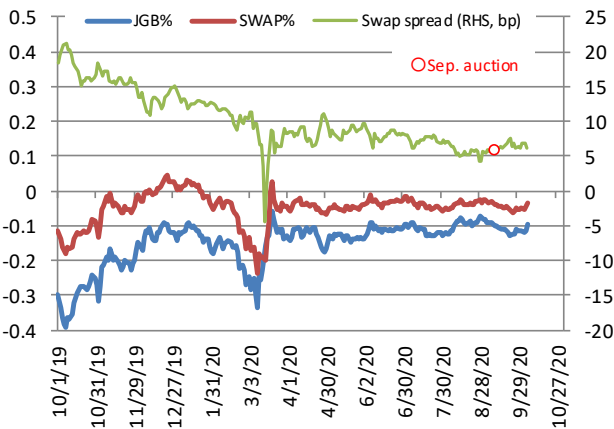
Source: Daiwa Securities.

### Appendix 6: JGB 5Y/7Y Spread (bp)



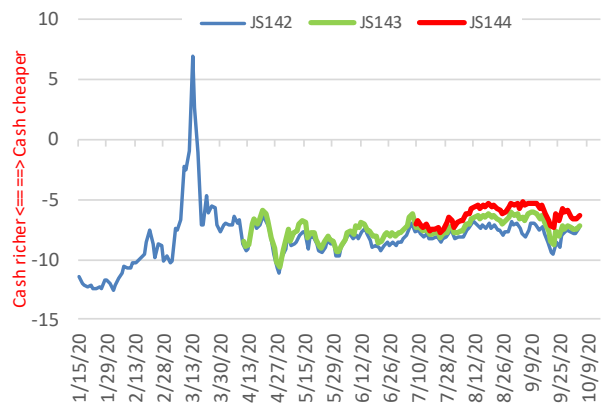
Note: Generic compound yield  
Source: Daiwa Securities.

### Appendix 7a: 5Y Swap Spread (bp)



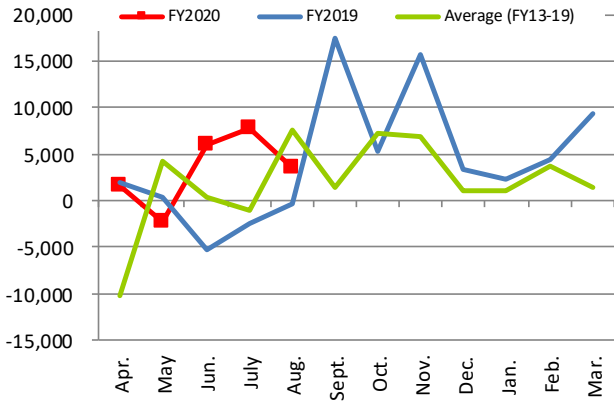
Source: Daiwa Securities.

### Appendix 7b: JS Asset Swap (bp)



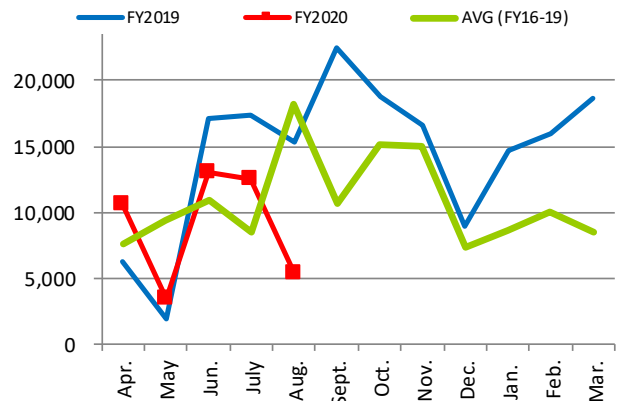
Note: Yen-Libor basis  
Source: Daiwa Securities.

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



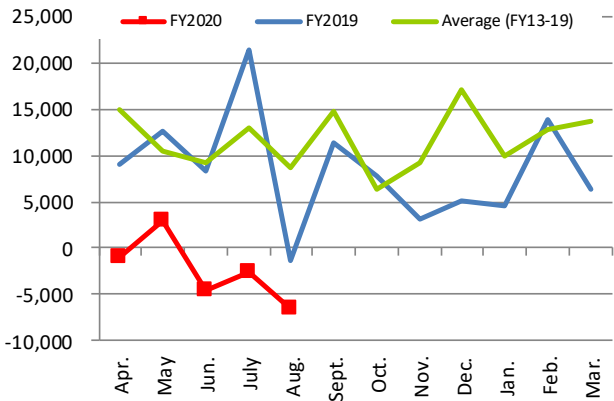
Source: JSDA

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



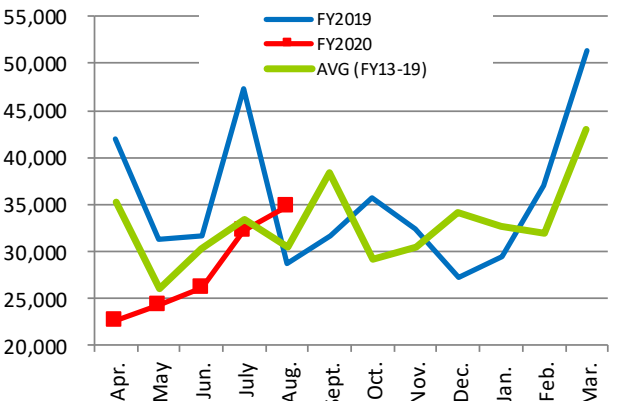
Source: JSDA

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



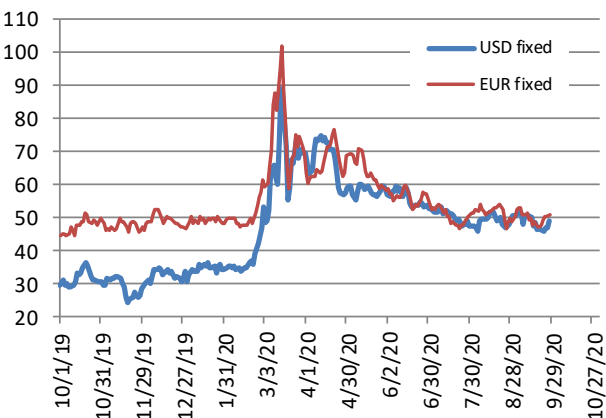
Source: JSDA

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



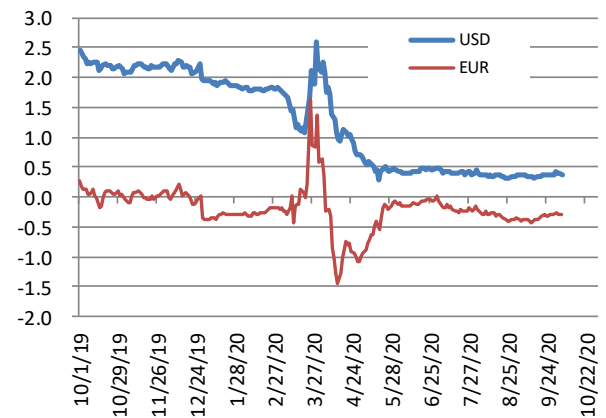
Source: JSDA

**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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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
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The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

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February 2020

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- 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).
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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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