

Outlook for 10Y JGB Auction

Hoping to buy at 0.03-0.04% level

- ✓ We think about our bidding stance to buy at the 0.03-0.04% level.

[BOX] December BOJ JGB Purchase: Unchanged from November

Strategic Memorandum DSTE414
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Auction Details

Auction Date: December 1, 2020
Issue Date: December 2, 2020
Maturity Date: September 20, 2030
Offering Amount: About 2.6 trillion yen

* New 10Y JGBs will be the last reopening of JB360 carrying a 0.1% coupon.

** On November 30, JB360 traded at 0.030% (+0.5bp v. previous day's close) and closed at 0.025% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Rather stably in the 0.01-0.04% range, despite stock rally

The previous 10-year JGB auction, which was held in the vote counting stage in the US presidential election, went well at the 0.045-0.050% level (+0.5 - +1.0bp vs. previous day's close). After the auction, the 10-year JGB yield temporarily declined to 0.015% (during intraday trading) amid the firmness of the JGB market. Then, the yield rose to 0.04% at one point, but momentarily declined to 0.01% in mid-November as the JGB market firmed up again. Since late November, the yield has edged up, and it temporarily rose to 0.03% during intraday trading today (Nov 30). Since the previous auction, stock prices have been setting record highs around the globe. However, the 10-year JGB yield has been moving in the 0.01-0.04% range with the JGB futures lacking a clear direction in the 151.80-152.20 yen range.

Although we need to pay attention to the development of discussions on JGB issuance plan, impact on 10-year JGBs may be limited

Despite an increase in positive headlines related to the development of COVID-19 vaccines, worries about the economic outlook remain strong amid increasing Covid-19 infections. The global trend of fiscal expansion is unlikely to change for a while. Also in Japan, we have seen an increase in the number of media reports, in which the scale of additional economic measures and the expenditure size of a third supplementary budget are estimated bigger and bigger, since Prime Minister Yoshihide Suga instructed to formulate additional economic measures. At the moment, however, we have the impression that those figures have no rational foundation yet. As long as we look at the "Points of Minutes" at the JGB Market Special Participants Meeting and the Meeting of JGB Investors, both of which were

held on November 26, the Ministry of Finance and market participants appear to have slightly different opinions with respect to increase/decrease of the issuance amount of superlong JGBs in the FY21 JGB issuance plan. On the other hand, many market participants apparently forecast that the issuance amount of 10-year JGBs can be increased or decreased because they assume that the BOJ will change the purchase amount under the YCC policy in line with the change in the issuance amount. We need to pay attention to the development of discussions on the JGB issuance plan related to the third supplementary budget of FY2020 and the FY21 initial budget, which are likely to become more active over the next 2-3 weeks. However, impact on 10-year JGBs by those talks about JGB issuance plans may be limited. In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers do not appear to be short that much in the 10-year sector:** We are unable to expect strong support from short-covering;
- ✓ **Decent demand expected from investors:** Investor demand for 10-year JGBs in positive yield territory appears to remain strong. In addition to the fact that the BOJ is adopting the YCC policy, market participants now appear to be cautious about the resurgence of coronavirus infections, which is preventing growth of upward momentum for the 10-year JGB yield. If we assume that the 10-year JGB yield may continue to stay in the 0.01-0.04% range after tomorrow's auction, the 0.035-0.040% level would not discourage market participants from buying 10Y JGBs;
- ✓ **Neither noticeably overvalued nor undervalued vs. major sectors on the curve:** Our analysis based on data especially since the previous 10-year JGB auction shows that the 10-year sector is neither noticeably overvalued nor undervalued vs. major sectors on the curve (Appendix 3). Since the previous 10-year auction, the JB360 asset swap has shifted from the widening to tightening trend in a quite narrow range. It is currently at a slightly tighter level than it was at the previous auction. On top of this, Z scores suggest that 10-year cash is undervalued against swaps at the current level (Appendix 4).
- ✓ **In December, the BOJ is expected to continue to offer five purchase operations totaling around Y2.1tn in the over-5- to 10-year zone:** In the BOJ's Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for December 2020, released on November 27, the offer range and the number of offers in the over-5-year to 10-year zone were unchanged from those for November (see [BOX]). The BOJ's purchases totaling (at least) around Y2.1tn (Y420bn x five times) are expected to continue also in December.

We think about our bidding stance to buy at the 0.03-0.04% level

All in all, we would like to think of our bidding stance to buy at the 0.03-0.04% level. In terms of relative value, it is difficult to take an aggressive stance. However, it would be worth considering, for example, short-term switching out from the 20-year sector, because the superlong zone is unlikely to flatten substantially amid strong uncertainty about the JGB issuance plan and also ahead of this week's 30-year JGB auction (Dec. 3) and next week's 20-year JGB auction (Dec. 10).

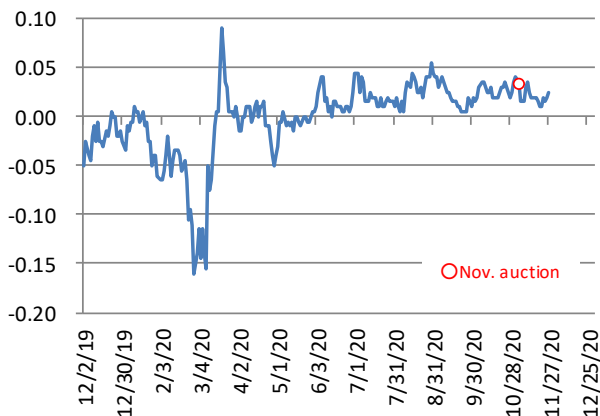
10Y JGB Auction Results

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 %	
12/1/20	360R	0.1	9/20/30	2,600*									
11/4/20	360R	0.1	9/20/30	2,824	4.13	100.53	100.52	0.01	0.046	0.047	0.001	73.1880	Good
10/1/20	360	0.1	9/20/30	2,814	4.06	100.75	100.74	0.01	0.024	0.025	0.001	51.3823	Good
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

* Amount the MOF plans to issue

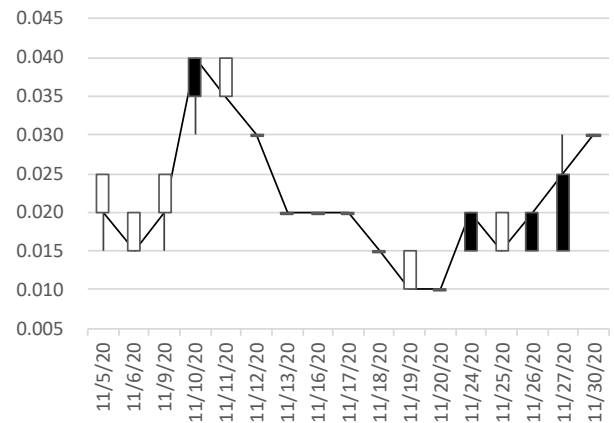
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1a: 10Y JGB Yield (%)



Source: Daiwa Securities.

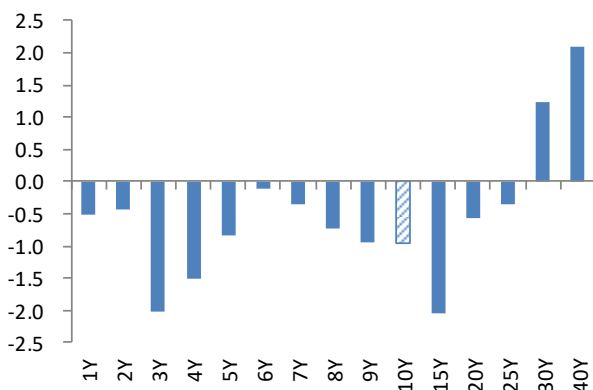
Appendix 1b: JB360 Yield Candle Chart (%)



Note: As of 14.00 JST on Nov. 30

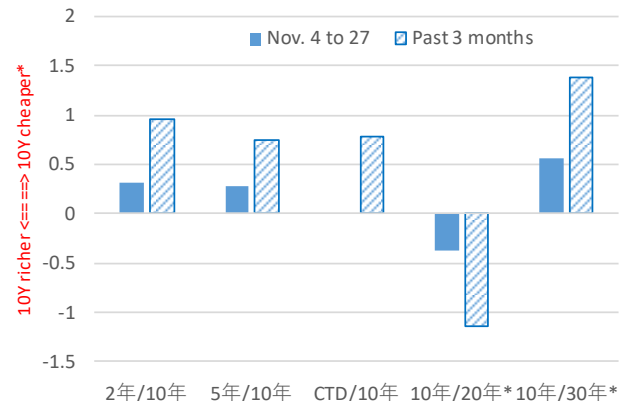
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Nov. 4 vs. Nov. 27)



Source: Daiwa Securities.

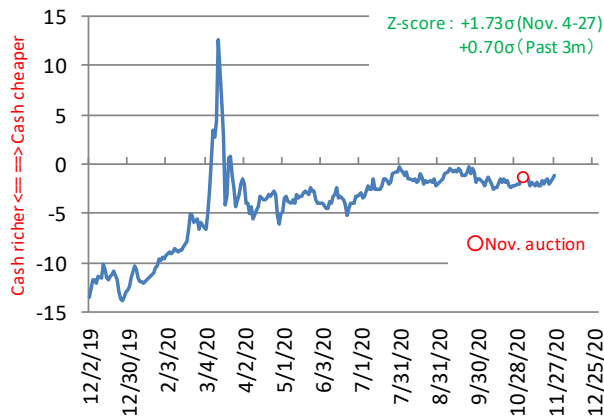
Appendix 3: Z-scores of JGB Yield Spreads (σ)



Note: On-the-run issue compound yield

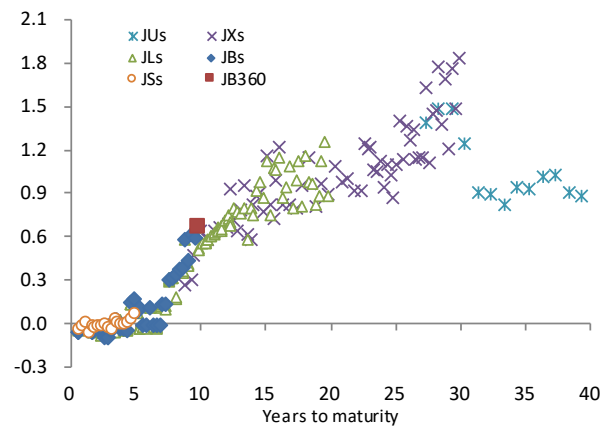
+ (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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 Nov. 27; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
 Source: Daiwa Securities

[BOX] December BOJ JGB Purchase: Both offer range and the number of offers unchanged from those for November

At 5:00pm on November 27, the BOJ announced its Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for December 2020, which shows that the offer range and the number of offers in all the purchase target zones are unchanged from those for November.

The 10-year JGB yield, which is the (long-term) policy interest rate, remains quite stable at “around 0%.” Market sentiment for short-term/intermediate JGBs in the over-1- to 5-year zone has been mostly solid partly on the recent yield stability. Although the accepted levels tend to fluctuate somewhat due to a wider gap in performance among issues, such fluctuation is not something that can be revised by adjustments to the purchase amounts, in our view. In the superlong zone, for which the BOJ has decided to “leave up to market forces,” the 20- to 40-year zone has recently been steepening further. This is likely to strengthen the market’s expectations for an increase in the purchase amounts. That said, as the yield curve does not appear to be strongly deviated from the shape of the yield curve, which is deemed as appropriate by the BOJ when the yield curve control (YCC) policy was introduced, the BOJ is unlikely to be in a hurry to increase purchases. We are not surprised by the fact that the BOJ kept the operation policy in December unchanged from that in November under the circumstances.

Offer amount in December’s first operation will likely be unchanged from that in November’s last operation

Reflecting the monthly schedule released on November 27, it is highly likely that each target zone’s offer amount in the first operation in December will be unchanged from that in the last operation in November. The offer amount in each target zone in November was at around the median of the range. If the need arises during the month, there would be large scope for adjustments within the current offer range. The purchase target issues in each zone would also be reviewed via careful examination of the holding ratio and the supply/demand balance in each operation.

Focal point will be whether the BOJ will adjust the number of offers in the over-5-year to 10-year zone or not

From now on, a focal point will be whether the BOJ will adjust the number of offers in the over-5- to 10-year zone or not. In the monthly schedule for November, the BOJ reduced the number of offers in the short-term/intermediate zone (from six times to five), which had been increased in order to respond to the crisis in April, based on the judgment that “liquidity has improved alongside a recovery of market functions,” and substantially upped the offer amounts to avoid the decline in the monthly purchase amount. In April, the number of offers in the over-5- to 10-year zone was also increased (from four times to five). We would not be surprised if the BOJ has an intention to reduce the number of offers in this zone. We intend to keep this in mind as the central bank’s next move.

T-bill purchases within a range of Y500bn to Y3tn to continue

The Outline of Outright Purchases of Japanese Government Securities was not updated this time as well. We therefore expect the wording on its T-bill purchases to be the same as

it was in its outline of purchases dated April 27, 2020, with the Bank deciding the purchase size per auction considering the effects on financial markets, and purchasing about Y500bn to Y3.0tn of T-Bills per auction for the time being. However, for the sake of market stability, we still think it would be desirable for the BOJ to provide guidance on its T-bill purchasing operations with more clarity and in line with market trends.

The next announcement will be at 5:00pm on December 28.

BOJ's JGB Purchase Plan for December 2020

(Yen billions)

	Offer size per operation		Number of Offers (per month)	First offer size exp.		Monthly Total exp. in Dec. (a)	MOF issuance in Dec.* (b)	(a)/(b) (%)		
		Mid			Last offer in Nov.				YCC Avg.***	
JGBs ex Linkers and Floaters										
1 year and less	100	- 200	150	2	150	150	300	-	-	
Over 1 to 3 years	350	- 650	500	5	500	500	2,500	3,000	83.3	76.2
Over 3 to 5 years	250	- 600	425	5	420	420	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	30	60	-	-	
Floaters	50	-	1	50	-	50	50	-	-	
TOTAL**:						7,300	10,700	68.2		
Nov. :						7,300	10,700	68.2		

(Note) Floaters offered in even months * 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.

BOJ's JGB Purchase Schedule in December 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
12/1/20 T	12/2/20	10Y JGB Auction								○	
12/2/20 W	12/3/20		◎	◎					○		
12/3/20 TH	12/4/20	30Y JGB Auction									
12/4/20 F	12/7/20				◎	◎		○		3M	
12/7/20 M	12/8/20	○	◎				◎				
12/8/20 T	12/9/20	5Y JGB Auction								○	
12/9/20 W	12/10/20									6M	
12/10/20 TH	12/11/20	20Y JGB Auction									
12/11/20 F	12/14/20		◎	◎	◎					3M	
12/14/20 M	12/15/20										
12/15/20 T	12/16/20	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity								6M	
12/16/20 W	12/17/20		◎	◎	◎			○		1Y	
12/17/20 TH	-	BOJ MPM (Day 1)								3M	
12/18/20 F	-	BOJ MPM (Day 2)									
12/21/20 M	12/22/20	○	◎	◎	◎					○	
12/22/20 T	12/23/20	AEL for 20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years left to maturity									
12/23/20 W	12/24/20										○
12/24/20 TH	1/4/21	2Y JGB Auction									
12/25/20 F	12/28/20			◎	◎	◎	◎				
12/28/20 M	12/29/20										
12/29/20 T	12/30/20										
12/30/20 W	1/4/21										
12/31/20 TH	-	Bank Holiday								-	

Note: ◎ Announced by BOJ on Nov. 27, ○ Daiwa forecast as of Nov. 30

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

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[Standard & Poor's]

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[Moody's]

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February 2020

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- 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.
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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.
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* 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