

## Outlook for 10Y JGB Auction

### Placing bids to take around the lowest accepted price with a high probability of the auction going to tail in mind

- ✓ Buyers would be discouraged from bidding aggressively due to growing speculation on the BOJ's operational target band of the 10Y JGB yield. We expect the auction to tail with a high probability. Meanwhile, with a quite slim chance of the BOJ trimming purchase in the 5-10Y zone before the March MPM, the 10Y JGB yield is unlikely to gain momentum to 0.1% in the immediate future. We would like to place our bids to take the minimum necessary amount of JB361 tap around the lowest accepted price.

[BOX] BOJ's JGB purchases in February 2021: A technical adjustment

Strategic Memorandum DSTE427  
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### Auction Details

**Auction Date:** February 2, 2021  
**Issue Date:** February 3, 2021  
**Maturity Date:** December 20, 2030  
**Offering Amount:** About 2.6 trillion yen

\* New 10Y JGBs will be the first reopening of JB361 carrying a 0.1% coupon.

\*\* On February 1, JB361 traded at 0.055-0.060% (+0.5 - +1.0bp v. previous day's close) and closed at 0.055% (+0.5bp).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

#### Intensifying uptrend of 10-year JGB yield

After the previous 10-year JGB auction had an average result at the 0.015-0.020% level, an uptrend of the 10-year JGB yield is intensifying amid growing speculation on a widening of the operational target band for the 10-year JGB yield associated with the BOJ's "monetary policy assessment." Since the end of last week, the yield has been moving at a level above 0.05%, the highest level since last August.

#### The 10Y JGB yield is unlikely to gain upward momentum toward 0.1% in the immediate future unless the BOJ trims purchases in the 5-10Y zone

Reading the Summary of Opinions at the Monetary Policy Meeting (MPM) on January 20 and 21, 2021 (released Jan 28), market participants get cautious about a possible widening of the operational target band of the 10-year JGB yield. Partly due to this, the 10Y JGB yield faces upward pressure. With accommodative monetary policy currently predominating worldwide under the context of a pandemic, the 10-year JGB yield has been low and stable in a range of 0.00-0.05% for an extended period. Although reaction of Japanese long-term rates to the recent upward movement of US long-term rates has been limited, it appears to be not because the operational target band for the 10-year JGB yield is currently set to "about double the range of around plus or minus 0.1 percent." Given this, any discussions about widening that band would seem fairly abrupt. However, what could be posited as an issue in the on-going assessment are the side effects on the JGB market from declines in liquidity and the deterioration of market functionality resulting from the 10-year JGB yield remaining low and extremely stable. From that point, if the BOJ reassess the stock effect of

JGB purchases and finds an appropriate amount of purchases for controlling the yield curve, that should enable the Bank to manage purchases in a more flexible and balanced manner. We do not think the market would mistakenly see the purchase reductions that could result from the assessment findings as a shift in policy toward tapering and normalization. In fact, there is relatively large leeway for purchase reductions from a policy perspective. The commitment to overshooting inflation is a core component of the framework of the quantitative and qualitative monetary easing with yield curve control, which the BOJ says it will not change. Therefore, it will be a difficult task for the BOJ, but it is highly likely that the central bank will widen the trading band via reductions in purchases. However, the assessment results are to be announced at the March MPM. If the 10-year JGB yield moves within “about double the range of around plus or minus 0.1 percent” until then, the chance for adjustments of the offer amount in the over-5-year to 10-year zone is quite slim. In the near term, the 10Y JGB yield is unlikely to gain upward momentum to 0.1% in a short span of time. In such a situation, we summarize key points to think about the bidding stance at tomorrow’s auction as follows:

- ✓ **Demand from investors at a level above 0.05% should be carefully checked:** As 10-year JGBs are in positive yield territory and we can expect a relatively high carry, investor demand appears to remain strong. Under the current situation, we would like to carefully check demand from investors at a level above 0.05%;
- ✓ **More undervalued in terms of relative value:** Our analysis based on data especially since the previous 10-year JGB auction shows that the 10-year sector is noticeably undervalued vs. the 3- to 5-year and 30-year sectors (Appendix 3). This suggests that the 10-year sector is not expensive on the curve. Regarding asset swaps, 10-year cash has become more undervalued against swaps partly because of the tightening trend especially since last week (Appendix 4);
- ✓ **In February, 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 February 2021, released on January 29, the offer range and the number of offers in the over-5-year to 10-year zone were unchanged from those for January (see [BOX]). In its first operation in February, the offer amount is expected to be unchanged from that in the last operation in January at Y420bn. Given the fact that (1) the 10-year JGB yield is still moving within the current allowable range of about double the  $\pm 0.1\%$ , despite the recent uptrend and (2) recent purchase operations have been conducted without major disruptions (although results were mixed by operation), we think that the BOJ is unlikely to reduce the offer amount in the over-5-year to 10-year zone shortly, ahead of the March “monetary policy assessment.” After tomorrow’s auction, the BOJ’s purchases totaling around Y2.1tn (Y420bn x five times) are expected to continue until the auction in March, which could support 10-year JGBs to some extent.

**Placing bids to take minimum necessary amount of JB361 tap around the lowest accepted price with the auction going to tail with a high probability / Switching out from 5Y or buying asset swaps at the LIBOR plus level**

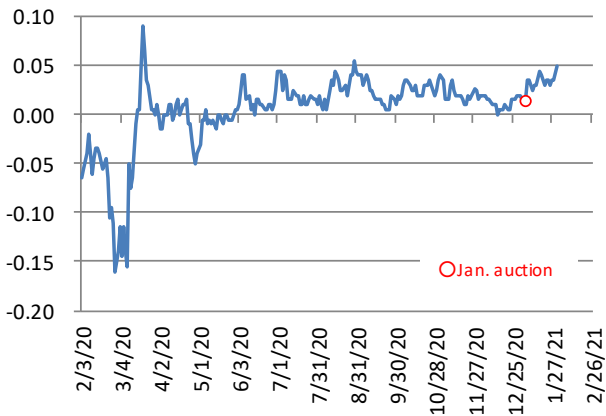
All in all, buyers would be discouraged from bidding aggressively at tomorrow’s auction amid growing caution about an uptrend of the 10Y JGB yield triggered by the BOJ’s “assessment.” We thus think that the auction would tail with a high probability. Meanwhile, as the BOJ is unlikely to reduce the offer amount in the over-5-year to 10-year zone shortly, the 10Y JGB yield is unlikely to gain upward momentum to 0.1% sometime in the near future. We would like to place our bids to taken the minimum necessary amount of JB361 tap around the lowest accepted price. In terms of relative value, it would be worth considering switching out from the 3- to 5-year sectors as well as buying asset swaps in the range where the spread is positive vs. the Yen LIBOR. As mentioned above, the 10-year sector is strongly undervalued vs. the 3- to 5-year sectors at current levels. In particular, the widening of the 5-year/10-year spread was driven by the recent rise in the 10-year yield, but (1) the uptrend may temporarily let up in the near term, (2) the level above 15bp appears to be a reversal point, and (3) the BOJ cut the purchase amount in the over-3-year to 5-year zone. Regarding asset swaps, 10-year cash has become more undervalued against swaps partly due to the tightening trend especially since last week. However, we can expect a certain degree of support in the range where the spread is positive vs. the Yen LIBOR.

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 %	
2/2/21	361R	0.1	12/20/30	2,600*									
1/6/21	361	0.1	12/20/30	2,599	3.40	100.80	100.77	0.03	0.019	0.022	0.003	32.9842	Avg
12/1/20	360R	0.1	9/20/30	2,812	3.42	100.79	100.77	0.02	0.019	0.021	0.002	69.6232	Avg
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

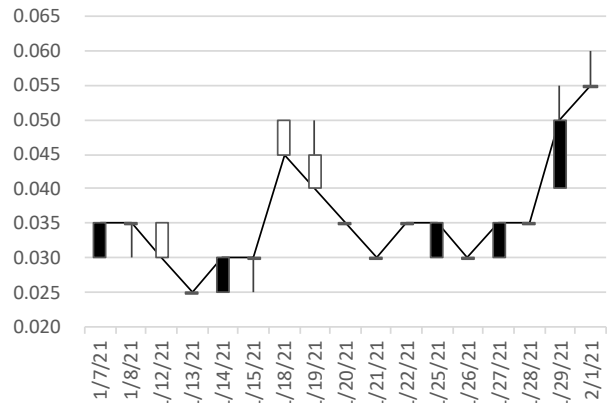
\* Amount the MOF plans to issue  
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1a: 10Y JGB Yield (%)



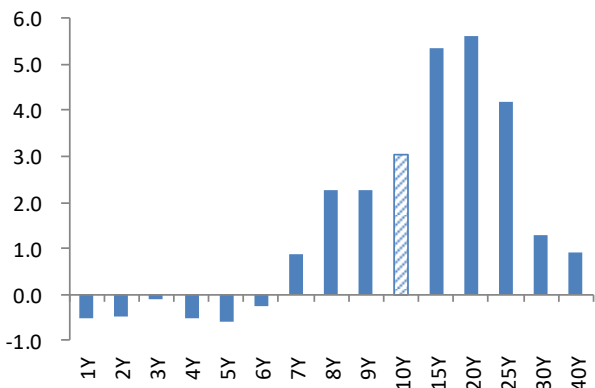
Source: Daiwa Securities.

Appendix 1b: JB361 Yield Candle Chart (%)



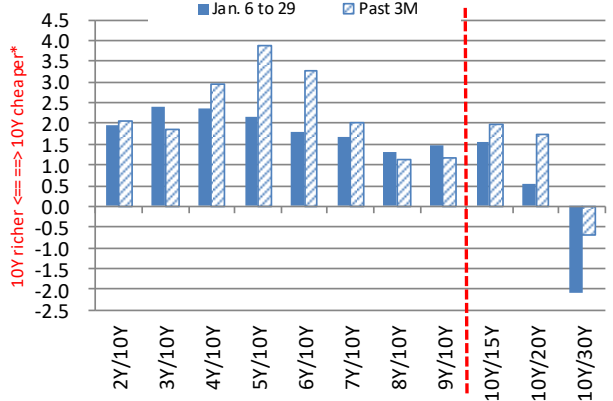
Note: As of 14.00 JST on Nov. 30  
 Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Jan. 6 vs. Jan. 29)



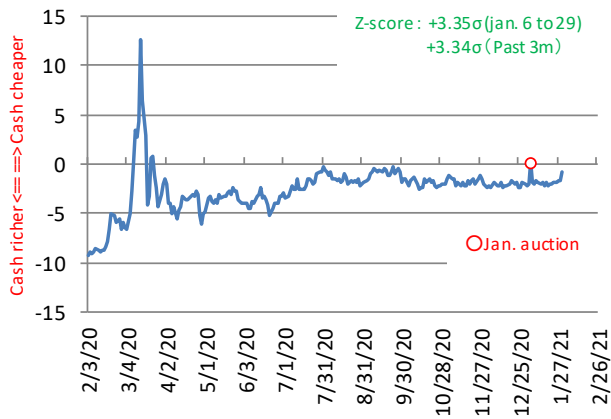
Source: Daiwa Securities.

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



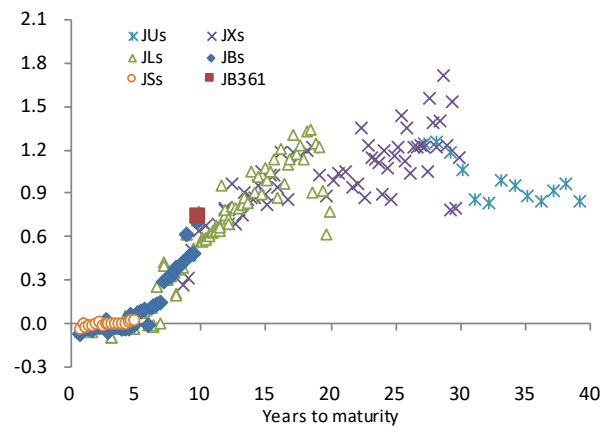
+ (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y  
 Source: Daiwa Securities.

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



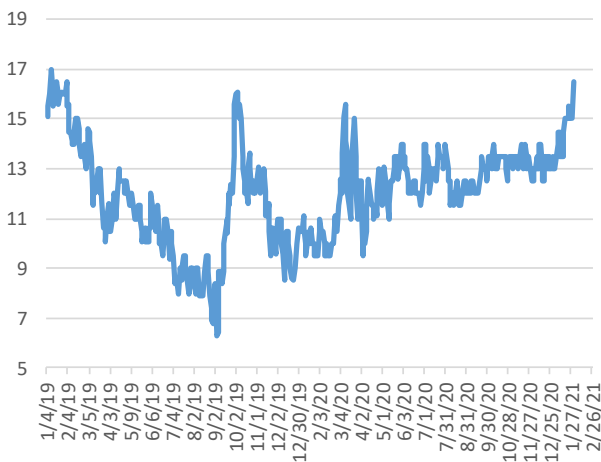
\* Yen LIBOR basis  
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on Jan. 29; assuming that those yield curve shapes do not change and factoring roll-down effect etc.  
Source: Daiwa Securities

**Appendix 6: JGB 5Y/10Y Spread (bp)**



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

**BOJ's JGB Purchases in February 2021: A technical adjustment**

The BOJ announced its Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for February 2021 at 17:00 on January 29. Key changes from the January schedule are as follows.

- ✓ The offer amount range in the up-to-1-year zone revised down from Y100-200bn in January to Y50-150bn.
  - In the last operation in January, the Bank cut the offer amount from Y150bn to Y100bn.
- ✓ The offer amount range in the over-1-year to 3-year zone revised down from Y300-600bn in January to Y250-550bn.
  - This was somewhat of a surprise, coming as it did after the range having been lowered in the previous month. Considering that the Bank has excluded some issues in the zone from its purchase list, we think that the Bank needed to further trim the offer size.
- ✓ The offer amount range in the over-3-year to 5-year zone revised down from Y250-600bn in January to Y200-550bn.
  - The Bank apparently responded to the market's strong request for a reduction because of the sharp decline in liquidity and deterioration in market functionality.
- ✓ The BOJ will make offers on seven days in February, the same as in January.

Given the announcement, we expect the initial offer amount in February to be Y400bn, down Y50bn from the last operation in January, in the over-1-year to 3-year zone, Y370bn, down Y50bn, in the over-3-year to 5-year zone, and the same with the last operation in January in other zones. With this expectation, we estimate that the total amount of the BOJ's JGB purchases in February (excluding JGB linkers and floaters) to be Y6.45tn, down from Y7tn in January (see Table 1).

This month's purchase reduction is **merely a technical adjustment within the current policy directive, not related to the on-going "monetary policy assessment" due in March**. Therefore we think, even in March prior to the release of the assessment, the BOJ may trim offer amounts in any zones, if they find it necessary to do due to excessive worsening of the supply-demand balance, which is implied by the bid-to-cover ratios etc. and curb negative impact on the JGB market by further decline in liquidity and deterioration in market function. Even in that case, however, we think the BOJ will try to keep the offer amount unchanged in the over-5-year to 10-year zone, as long as the 10-year JGB yield remains in the current operational target range of -0.2 to +0.2%, until the BOJ releases the assessment results at the March MPM.

#### 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. Therefore, the BOJ is likely to maintain its guideline on T-bill purchases in the outline of purchases dated April 27, 2020, "the Bank will decide the purchase size per auction considering the effects on financial markets. The Bank will purchase about 500bn to 3.0tn yen of T-Bills per auction for the time being," for their operations in February.

#### BOJ's JGB Purchase Plan for February 2021 (Yen billions)

	Offer size per operation			Number of Offers (per month)	First offer size exp.		Monthly Total exp. in Feb. (a)	MOF issuance in Feb.* (b)	(a)/(b) (%)
	Low	Mid	High		Jan.	Feb.			
<b>JGBs ex Linkers and Floaters</b>									
1 year and less	50	150	100	2	100	100	200	-	-
Over 1 to 3 years	250	550	400	5	400	450	2,000	3,000	66.7
Over 3 to 5 years	200	550	375	5	370	420	1,850	2,500	74.0
Over 5 to 10 years	250	600	425	5	420	420	2,100	2,600	80.8
Over 10 to 25 years	50	200	125	2	120	120	240	1,200	20.0
Over 25 years	0	50	25	2	30	30	60	1,400	4.3
Linkers	30	-	-	2	30	30	60	-	-
Floaters	50	-	-	1	50	-	-	-	-
	<b>TOTAL**:</b>						<b>6,450</b>	<b>10,700</b>	<b>60.3</b>
	<b>Jan.:</b>						<b>7,000</b>	<b>10,700</b>	<b>65.4</b>

(Note) Change expected from January in red \* 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 February 2021

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	
2/1/21	M 2/2/21											
2/2/21	T 2/3/21	10Y JGB Auction									○	
2/3/21	W 2/4/21		◎	◎				○				
2/4/21	TH 2/5/21	30Y JGB Auction										
2/5/21	F 2/8/21	○			◎	◎				3M		
2/8/21	M 2/9/21	10Y JGB Linker Auction										
2/9/21	T 2/10/21									6M		
2/10/21	W 2/12/21	AEL for 20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years left to maturity									○	
2/11/21	TH -	Public Holiday (National Foundation Day)									-	
2/12/21	F 2/15/21									3M	○	
2/15/21	M 2/16/21		◎	◎	◎							
2/16/21	T 2/17/21	5Y JGB Auction									○	
2/17/21	W 2/18/21											
2/18/21	TH 2/19/21	20Y JGB Auction									1Y	
2/19/21	F 2/22/21		◎	◎	◎			○		3M		
2/22/21	M 2/24/21	○				◎	◎					
2/23/21	T -	Public Holiday (Emperor's Birthday)									-	
2/24/21	W 2/25/21	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity									6M	
2/25/21	TH 2/26/21		◎	◎	◎					○		
2/26/21	F 3/1/21	2Y JGB Auction									3M	

Note: ◎ Announced by BOJ on Jan. 29, ○ Daiwa forecast as of Feb. 1

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

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

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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).

- 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