

Outlook for 10Y JGBi Auction

In a favorable environment, BEI may rise near to 20bp

- ✓ Inflation rate is expected to stay in negative territory in the near term. JGBis lack attractiveness in terms of carry. JBI25 is disfavored as it looks overvalued especially vs. JBI24. Those factors may discourage auction participants from placing aggressive bids at the auction.
- ✓ However, in a favorable environment with rising inflation expectation globally, Japan BEI could rise near to 20bp by the next auction scheduled for May.
- ✓ Option not to buy at all is unlikely. We would like to think about our bidding stance at the 10-13bp level in BEI.

Strategic Memorandum DSTE429
FICC Research Dept.

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Auction Details

Auction Date:	February 8, 2021
Issue Date:	February 9, 2021
Maturity Date:	March 10, 2030
Offering Amount:	About 200 billion yen
Auction Method:	Dutch auction on an inflation-not-adjusted price with the increment of 0.05 yen
Base CPI:	102.20 (Nat'l core-CPI in Dec. 2019)
Ref. CPI:	101.203 (as on Feb. 9)
Index ratio:	0.99024 (as on Feb. 9)

* New 10Y JGBis will be the final reopening of JBI25 carrying a 0.2% coupon.

** On Feb. 4, JBI25 closed at 102.85 yen (+0.05 yen v. previous day's close). With the closing price, BEI of JBI25 is 13.7bp, up from 12.6bp at the previous day's close.

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

BEI rising globally

Since the previous auction went well, despite BEI being in negative territory, in November 2020, BEI of JBI25 has been mostly on an uptrend. Recently, it is moving at the level of above 10bp, the highest level over the past year (since the initial issuance of JBI25) (Chart 1). The main background factor is a strong uptrend of BEIs in Europe and the US along with a rise in crude oil prices (Chart 9 a-b). Those are consequences of diminishing excessive concerns about the economic outlook due to the start of the new Biden administration in the US and the progress of vaccine distribution in Europe and the US although we are still in the midst of the Covid-19 pandemic. In such a situation, we summarize key points to think about the bidding stance at this auction as follows.

Domestic inflation expected to stay in negative territory in the near term, but the drop likely to narrow gradually

First of all, we check domestic inflation. The y/y change in recently-announced December 2020 nationwide core CPI was -1.0%, down 0.1%pt from the previous month. Although energy-related downward pressure is likely to weaken toward this spring, the inflation rate is expected to stay in negative territory for the time being due to downward pressure by the government's Go To Campaigns and the government-led reduction in mobile phone charges from this spring. Partly due to a delay in improvement in the supply/demand balance in macro terms, downward pressure on prices is likely to continue. That said, given the January CPI in the ward-area of Tokyo released on January 29 (core CPI fell for six months in a row at -0.4%, but this was less negative than the 0.9% drop in December), we forecast that the y/y decline in January nationwide core CPI will be around -0.8%, less negative than that in the previous month. Although the inflation rate will stay in negative territory for a while, it appears to have bottomed out.

Not a good timing to buy JGBis from viewpoint of index ratio path

We check the index ratio path of JBI25 based on our nationwide core CPI forecasts. The ratio is likely to remain roughly flat until autumn (Chart 6). If we buy JGBis at this auction and the price remains unchanged during the investment horizon, it would be difficult to expect positive return in the near term (Chart 4). Unless we expect JBI25 price to gain substantially, it is not a good timing now to buy JGBis in an aggressive stance.

BOJ's purchases and MOF's buybacks will likely continue

The BOJ's purchases and the MOF's buybacks will continue to provide good support to JGBis (Table 2). By the next JGBi auction scheduled for May, the total purchase amount by the BOJ and the MOF are estimated at 280-330bn yen vs. next week's issuance worth 200bn yen. Specifically, the BOJ is expected to buy around 180bn yen (=30bn yen/operation x 2 times/month x 3 months) and the MOF is to buy back around 100-150bn yen (=50bn yen/month x 2-3 months). Regarding the MOF's buybacks, there have been concerns about reduction or suspension in the next fiscal. However, the impact on this auction appears limited.

In a favorable environment, there is a chance that BEI would rise near to 20bp, we see

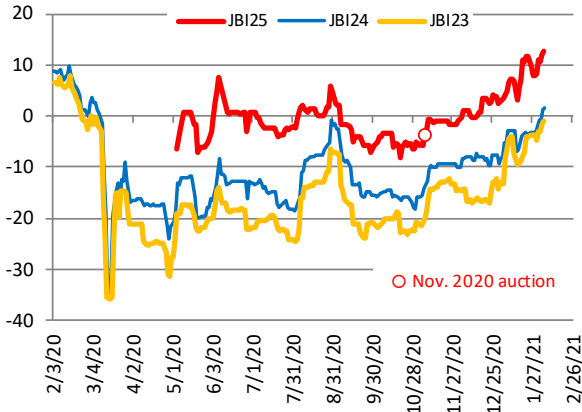
All in all, it is difficult to take an aggressive stance at this auction because (1) the inflation rate is expected to stay in negative territory in the near term, partly due to downward pressure by the government fiscal programs, (2) JBI25 is currently not attractive in terms of carry, and (3) the issue is disfavored as it looks overvalued especially vs. JBI24 (chart 3a-c). However, as we can say that the environment, such as crude oil prices and the uptrend in BEIs in Europe and the US, is favorable, strong demand is expected especially from overseas investors. Amid the lack of liquidity in the secondary market, the auction would provide a good opportunity to buy JGBis in a relatively large lot. It appears that the BEI could rise near to 20bp by the next auction scheduled for May (Chart 1). In a favorable environment, investors would not take a not-buying-at-all stance. We would like to think about our bidding stance at the 10-13bp level in BEI.

10Y JGBi Auction Results

Auction Date	Issue #	Coupon (%)	Maturity Date	Issue Size (billion yen)	B/C	Lowest Accepted Price/Issue Price (Yen) (Note 1)	Highest Accepted Yield (%)	Allotment (%)	BEI Before Auction (Note 2)	BEI on Auction Day (bp) (Note 2)	Change from p.d. (bp)	Market Expectation of Lowest Accepted Price (Yen) (Note 3)	Expected range	
2/8/21	25R	0.2	3/10/30	200*					12.6					
11/6/20	25R	0.2	3/10/30	199.6	3.31	101.55	0.033	93.0348	-5.9	-3.8	2.1	101.45	101.30-101.50	Good
8/6/20	25R	0.2	3/10/30	199.9	3.21	101.85	0.006	72.5000	0.8	1.8	1.0	102.10	101.80-102.50	Poor
5/8/20	25	0.2	3/10/30	200.0	3.84	100.80	0.117	18.0000	-18.4	-6.6	11.8	100.30	100.00-100.40	Good
2/12/20	24R	0.1	3/10/29	415.3	3.75	102.30	-0.150	8.4317	7.2	7.6	0.4	102.20	101.80-102.20	Good
11/8/19	24R	0.1	3/10/29	410.3	3.43	102.90	-0.204	83.6431	12.8	13.8	1.0	102.90	102.50-102.95	Good
8/8/19	24R	0.1	3/10/29	414.3	3.84	104.25	-0.329	86.6906	12.3	11.8	-0.5	104.20	103.90-104.65	Avg
5/10/19	24	0.1	3/10/29	430.2	3.72	103.70	-0.266	94.4029	21.5	22.6	1.1	103.50	103.30-103.60	Good

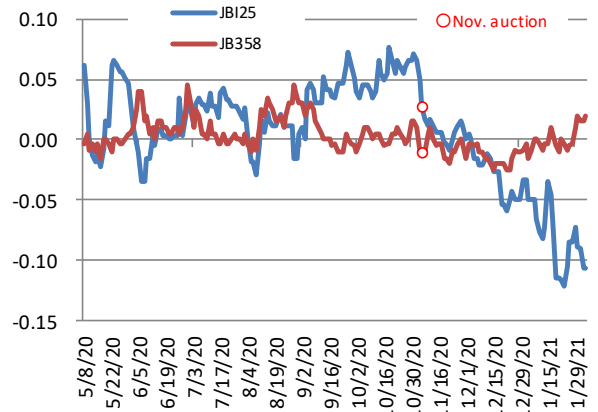
* Planned by MoF (Note 1) Inflation unadjusted price from October 2017 (Note 2) WI basis for new issues; as of Feb. 4 for the Feb. 2021 auction (Note 3) Bloomberg
Source: Ministry of Finance, Bloomberg, Daiwa Securities

Chart 1: BEI (bp)



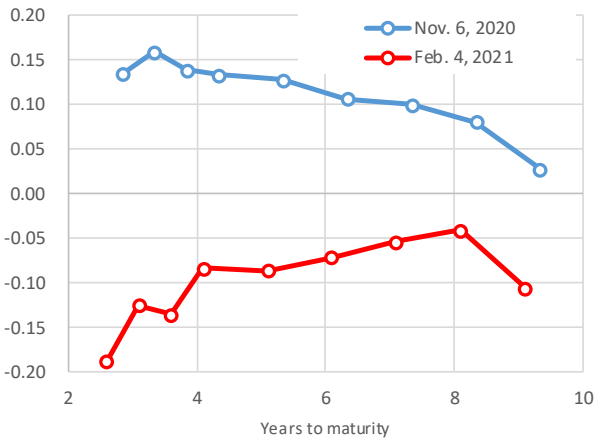
Source: Daiwa Securities

Chart 2: JBi25 and JBi358 Yields (%)



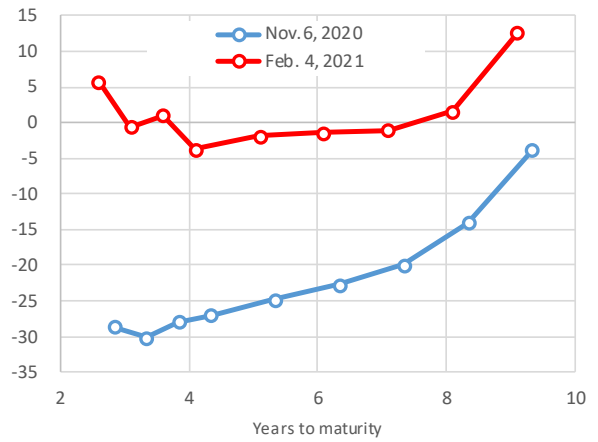
Source: Bloomberg

Chart 3a: JGBi Yield Curve (%)



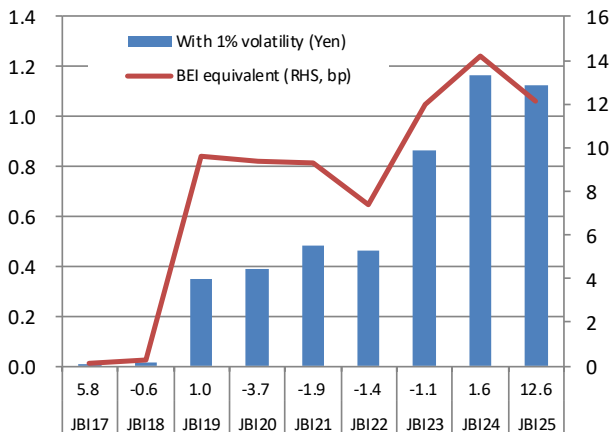
Source: Daiwa Securities

Chart 3b: BEI Curve (bp)



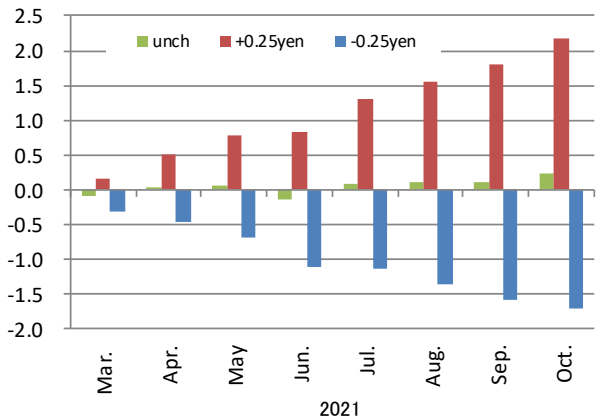
Source: Daiwa Securities

Chart 3c: Floor Option Value



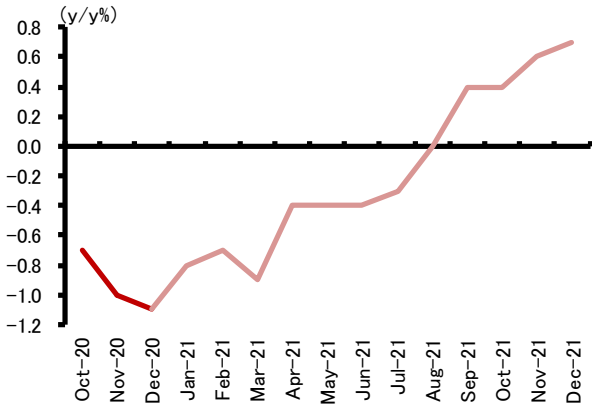
Note: Figures above issue code is BEI in basis points as of Feb. 4.
Source: Daiwa Securities

Chart 4: HPR of JBi25



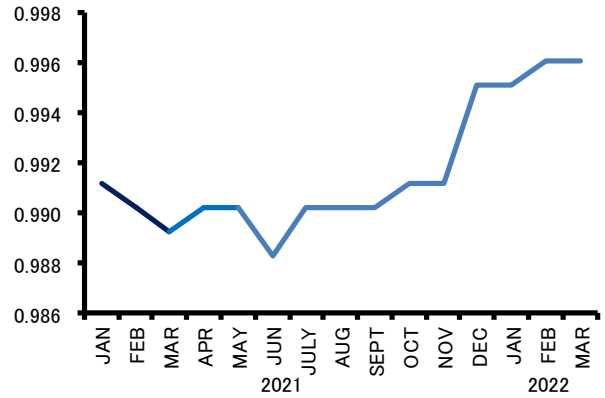
Note: From Feb. 9 to each point assuming the price is (1) unchanged, (2) increased by 0.25 yen every month and (3) decreased by 0.25 yen
Source: Daiwa Securities

Chart 5: Nationwide Core-CPI Growth Outlook (y/y %)



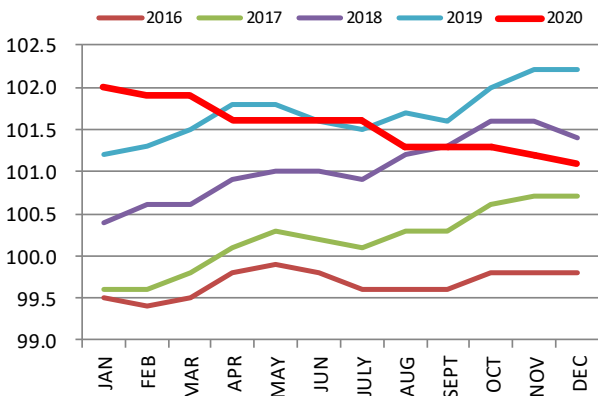
Note: Actual for Oct-Dec 2020
Source: Daiwa Securities

Chart 6: JBI25 Index Ratio Forecast



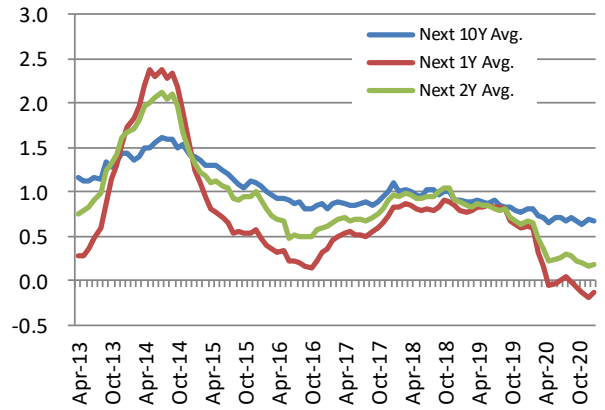
Note: Based on Chart 5, actual for Jan-Mar 2021
Source: Daiwa Securities

Chart 7: Seasonality of Nationwide Core-CPI



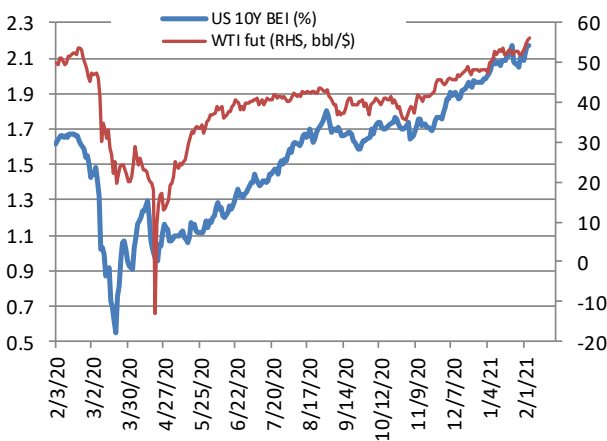
Source: Ministry of Internal Affairs and Communications, Daiwa Securities

Chart 8: CPI Core Change Forecast: 10Y average (%)



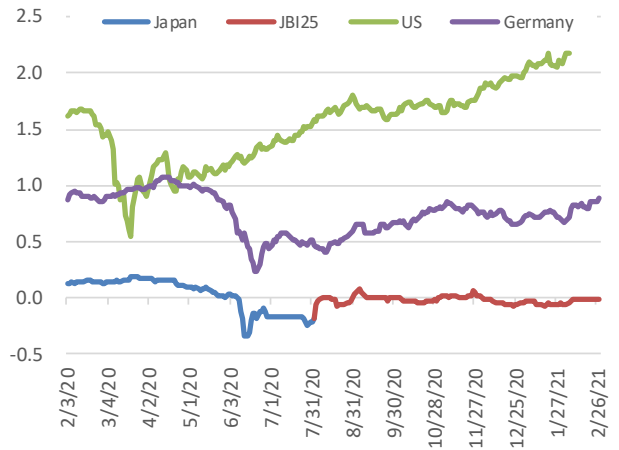
Source: QUICK

Chart 9a: US 10Y BEI and WTI Futs Price



Source: Bloomberg

Chart 9b: US, Germany and Japan BEI (%)



Note: 10Y for US and Germany; On-the-run and JBI25 basis for Japan
Source: Bloomberg, Daiwa Securities

Table 1: JGBi Outstanding in the Market (Yen billions)

	Issue Size	MoF Buyback	BoJ Outright Purchase	Market Outstanding
JB17	646.7	71.2	291.5	284.0
JB18	821.7	74.4	291.8	455.5
JB19	1,091.8	45.7	230.4	815.7
JB20	2,139.4	209.1	461.5	1,468.8
JB21	1,727.2	232.4	486.1	1,008.7
JB22	1,760.4	253.9	755.4	751.1
JB23	1,722.7	225.7	367.3	1,129.7
JB24	1,670.1	168.4	211.0	1,290.7
JB25	599.5	82.8	131.6	385.1
TOTAL	11,580.0	1,280.8	3,095.0	7,204.2
%	100.0%	11.1%	26.7%	62.2%

Note: as of Jan. 29 (BOJ Start day)
Source: Bloomberg

Table 2: BOJ Purchases and MOF Buybacks

	Previous Day's Close (Yen)	Offer Size (Yen billions)	Pro-rata Price Spread (Yen)	Average Successful Price Spread (Yen)	Allotment on Pro-rata (%)	B/C	Close Price (Yen)
11/11/20	101.75	30	-0.050	-0.113	40.0	4.82	101.70
11/17/20	101.80	50	0.000	-0.038	18.0	4.32	101.80
11/26/20	101.80	30	-0.140	-0.197	26.4	5.87	101.75
12/4/20	101.85	50	0.140	0.019	77.3	3.53	102.00
12/11/20	102.00	30	-0.070	-0.178	100.0	5.60	101.95
12/21/20	102.35	30	-0.080	-0.141	76.0	5.56	102.35
1/14/21	102.60	30	-0.350	0.350	100.0	6.42	102.50
1/20/21	102.45	50	-0.060	-0.180	37.1	2.51	102.90
1/26/21	102.95	30	-0.160	-0.274	94.7	6.01	102.80
2/3/21	102.65	50	0.110	-0.031	42.5	3.34	102.80

Note: Based on JB25; MOF Buybacks on Nov. 17, Dec. 4, Jan. 20 and Feb. 3
Source: Bloomberg, Daiwa Securities

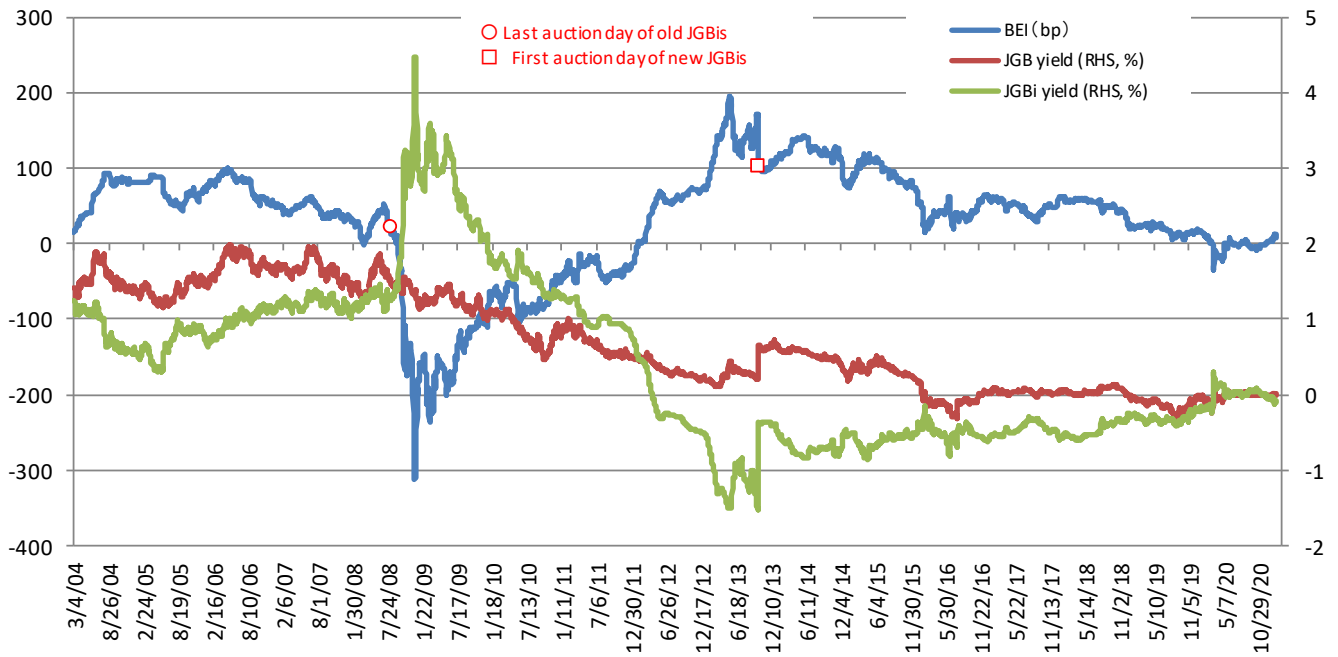
Table 3: Image of Bidding Price at Auction and BEI

(Unit: bp)

		Nominal Yield (% JB358)										
		0.000	0.005	0.010	0.015	0.020	0.025	0.030	0.035	0.040	0.045	
Bidding Price (Yen) and Yield	103.40	-0.171	17.1	17.6	18.1	18.6	19.1	19.6	20.1	20.6	21.1	21.6
	103.35	-0.166	16.6	17.1	17.6	18.1	18.6	19.1	19.6	20.1	20.6	21.1
	103.30	-0.160	16.0	16.5	17.0	17.5	18.0	18.5	19.0	19.5	20.0	20.5
	103.25	-0.155	15.5	16.0	16.5	17.0	17.5	18.0	18.5	19.0	19.5	20.0
	103.20	-0.149	14.9	15.4	15.9	16.4	16.9	17.4	17.9	18.4	18.9	19.4
	103.15	-0.144	14.4	14.9	15.4	15.9	16.4	16.9	17.4	17.9	18.4	18.9
	103.10	-0.139	13.9	14.4	14.9	15.4	15.9	16.4	16.9	17.4	17.9	18.4
	103.05	-0.133	13.3	13.8	14.3	14.8	15.3	15.8	16.3	16.8	17.3	17.8
	103.00	-0.128	12.8	13.3	13.8	14.3	14.8	15.3	15.8	16.3	16.8	17.3
	102.95	-0.122	12.2	12.7	13.2	13.7	14.2	14.7	15.2	15.7	16.2	16.7
	102.90	-0.117	11.7	12.2	12.7	13.2	13.7	14.2	14.7	15.2	15.7	16.2
	102.85	-0.112	11.2	11.7	12.2	12.7	13.2	13.7	14.2	14.7	15.2	15.7
	102.80	-0.106	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1	14.6	15.1
	102.75	-0.101	10.1	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1	14.6
	102.70	-0.096	9.6	10.1	10.6	11.1	11.6	12.1	12.6	13.1	13.6	14.1
	102.65	-0.090	9.0	9.5	10.0	10.5	11.0	11.5	12.0	12.5	13.0	13.5
	102.60	-0.085	8.5	9.0	9.5	10.0	10.5	11.0	11.5	12.0	12.5	13.0
102.55	-0.079	7.9	8.4	8.9	9.4	9.9	10.4	10.9	11.4	11.9	12.4	
102.50	-0.074	7.4	7.9	8.4	8.9	9.4	9.9	10.4	10.9	11.4	11.9	
102.45	-0.068	6.8	7.3	7.8	8.3	8.8	9.3	9.8	10.3	10.8	11.3	
102.40	-0.063	6.3	6.8	7.3	7.8	8.3	8.8	9.3	9.8	10.3	10.8	
102.35	-0.058	5.8	6.3	6.8	7.3	7.8	8.3	8.8	9.3	9.8	10.3	
102.30	-0.052	5.2	5.7	6.2	6.7	7.2	7.7	8.2	8.7	9.2	9.7	
102.25	-0.047	4.7	5.2	5.7	6.2	6.7	7.2	7.7	8.2	8.7	9.2	
102.20	-0.041	4.1	4.6	5.1	5.6	6.1	6.6	7.1	7.6	8.1	8.6	

Note: Supposed to be settled on Feb. 9
Source: Daiwa Securities

Chart 10: BEI (March 2004 to present)



Note: on-the-run issue basis
Source: Daiwa Securities.

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[Standard & Poor's]

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February 2020

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Other Disclosures Concerning Individual Issues:

- 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. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 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).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

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