

Outlook for 20Y JGB Auction

A smooth auction expected, but upside may be limited

- ✓ JL175 tap will likely be sold smoothly partly as primary dealers appear to be deeply short. Upside of 20Y JGBs, however, may be limited to around 0.470% in the secondary market. We would like to think of our bidding stance, keeping that in mind.
- ✓ In terms of the relative value, it would be worth considering switching out from the 10Y sector in a short horizon or buying asset swaps.

Strategic Memorandum DSTE431
FICC Research Dept.

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Auction Details

Auction Date: February 18, 2021
Issue Date: February 19, 2021
Maturity Date: December 20, 2040
Offering Amount: About 1.2 trillion yen

* New 20Y JGBs will be the first reopening of JL175 carrying a 0.5% coupon.

** On February 17, JL175 traded at 0.480-0.495% (+0.5 to +2.0bp v. previous day's close) and closed at 0.490% (+1.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Highest bidding yield level since December 2018

Since the previous 20Y JGB auction went smoothly at the 0.440-0.445% level (vs. WI closing at 0.450% on the previous day), the 20Y JGB yield has been mostly on an uptrend. UST yields have been facing strong upward pressure. Market participants have been cautious to the BOJ's talks to widen the current operational target range of the 10Y JGB yield. JGB market sentiment has been deteriorated by those factors. Today (Feb. 17), the 20Y JGB yield temporarily rose to 0.495% on an intraday basis. Tomorrow's auction will be held at the highest bidding yield level since the auction in December 2018 with a high probability.

As superlong JGBs are becoming more attractive in terms of absolute yield level, demand appears strong from investors heading to the fiscal year end

We check the environment surrounding the JGB market. In the US, UST yields are gaining upward momentum as shown by a rise in the 10Y Treasury yield to the 1.3% level. Upward pressure on UST yields seems to remain strong because both of "good yield increase" (rise in potential growth rate and economic growth, which outpaces the potential growth rate) and "pernicious yield increase" (fiscal deterioration, rise in inflation rate without economic expansion) appear possible under President Joe Biden. In Japan, as speculations are persisting regarding the BOJ's widening of the operational target band for the 10Y JGB yield, the yield's sensitivity to the uptrend of the US long-term interest rate appears to be increasing. During intraday trading today (Feb. 17), the 10Y JGB yield rose to 0.095% at one point. However, given the current operational target band for the 10Y JGB yield of "around double the range of plus or minus 0.1 percent," we think that the upside

potential in the yield remains large. Meanwhile, investor demand for superlong JGBs appears strong, while they start paying attention to end-FY portfolio. In such a situation, we summarize key points to think about our bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers appear to be gaining short positions:** Their short-covering activities will likely help the Ministry Finance of Japan to sell JL175 tap smoothly;
- ✓ **In terms of the absolute yield level, a certain degree of investor demand is also expected:** During intraday trading today (Feb. 17), the 20Y and 30Y JGB yields momentarily rose to 0.495% and 0.685%, respectively, both of which are the highest levels since January 2019. As superlong JGBs look attractive in terms of the absolute yield level, a certain degree of investor demand is expected;
- ✓ **Lacking strong relative-value advantages:** Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is neither noticeably cheap nor rich on the intermediate to superlong zone of the curve at the current level (Appendix 3). The 20Y asset swap spread has been increasingly widening since the previous auction (Appendix 6). We thus can say that 20Y cash is overvalued against swaps at the current level.

A smooth auction expected, but upside may be limited in the secondary market at around 0.470%

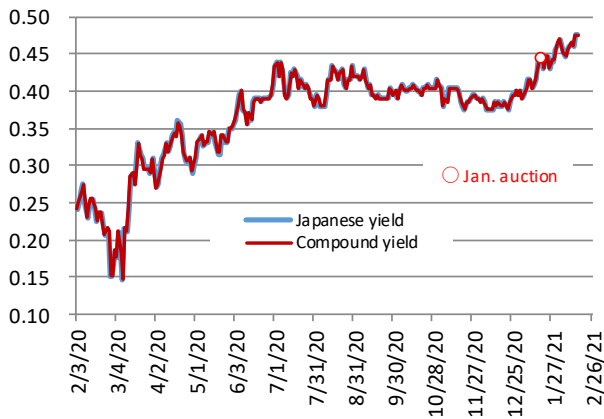
Given all factors together, we expect primary sale of JL175 tap tomorrow to go smoothly. However, we would like to think of our bidding stance, keeping in mind that upside may be limited in the secondary market at around 0.470%. In terms of the relative value, it would be worth considering short-term switching out from the 10Y sector and buying asset swaps. Regarding the 10Y/20Y spread, its widening trend until February has let up (Appendix 5), as demand for 20Y JGBs increased due to a rise in the yield to the level of above 0.45% amid growing upward momentum of the 10Y JGB yield since the beginning of February. In the phase of rising yields, the spread appears to have room to flatten slightly because (1) the 10Y JGB yield has been controlled at "around double the range of plus or minus 0.1 percent" by the BOJ and the Bank will not be bothered by the current 10-year yield level and (2) index duration extension activities are anticipated at the end of the month. With respect to asset swaps, we think that the widening trend may continue in the near term, given that (1) the spread tends to widen further in the phase of rising yield and (2) the supply/demand condition for cash superlong JGBs is favorable. It would be worth considering buying asset swaps in a slightly longer-term investment horizon, despite the richness against swaps.

20Y JGB Auction Results

Auction Date	Issue #	Coupon (%)	Maturity Date	Issue Size (billion yen)	B/C	Average Accepted Price (Yen)	Lowest Accepted Price (Yen)	Tail (Yen)	Average Accepted Yield (%)	Highest Accepted Yield (%)	Tail (%)	Allotment (%)	Rating
2/18/21	175R	0.5	12/20/40	1,200*									
1/19/21	175	0.5	12/20/40	1,209.0	3.35	101.04	100.95	0.09	0.443	0.448	0.005	78.8026	Avg
12/10/20	174R	0.4	9/20/40	1,199.6	3.01	100.62	100.50	0.12	0.366	0.372	0.006	14.6471	Avg
11/18/20	174R	0.4	9/20/40	1,280.3	3.61	100.22	100.15	0.07	0.388	0.391	0.003	17.0997	Good
10/20/20	174	0.4	9/20/40	1,304.1	3.86	100.10	100.05	0.05	0.394	0.397	0.003	18.5341	Good
9/10/20	173R	0.4	6/20/40	1,243.1	3.69	99.85	99.75	0.10	0.408	0.413	0.005	75.5975	Avg
8/25/20	173R	0.4	6/20/40	1,316.2	3.92	99.94	99.90	0.04	0.403	0.405	0.002	67.8187	Good
7/21/20	173	0.4	6/20/40	1,313.4	3.80	99.70	99.65	0.05	0.416	0.419	0.003	28.5714	Good
6/26/20	172R	0.4	3/20/40	977.7	3.87	100.24	100.20	0.04	0.386	0.389	0.003	59.9036	Good
5/20/20	172R	0.4	3/20/40	957.3	4.25	101.26	101.20	0.06	0.332	0.335	0.003	36.3983	Good
4/21/20	172	0.4	3/20/40	899.4	3.58	101.21	101.10	0.11	0.335	0.340	0.005	16.5349	Avg
3/12/20	171R	0.3	12/20/39	963.5	3.69	100.98	100.90	0.08	0.248	0.252	0.004	97.2897	Good
2/20/20	171R	0.3	12/20/39	969.8	3.99	101.27	101.25	0.02	0.232	0.234	0.002	81.9560	Good
1/17/20	171	0.3	12/20/39	899.1	3.83	99.99	99.90	0.09	0.300	0.305	0.005	93.4722	Good

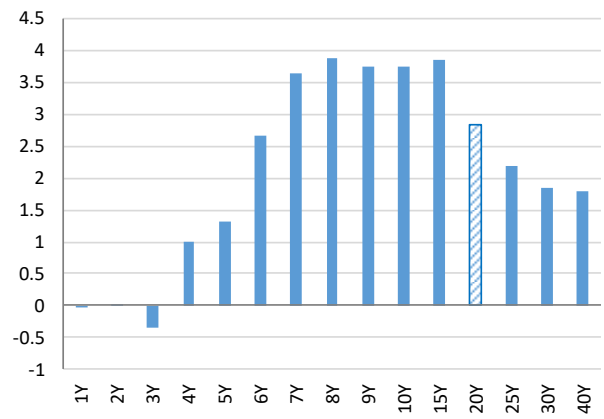
* Amount the Ministry of Finance plans to issue
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



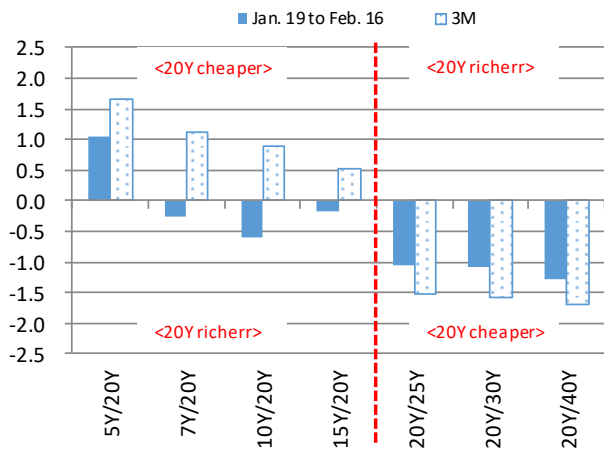
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Jan. 19 vs. Feb. 16



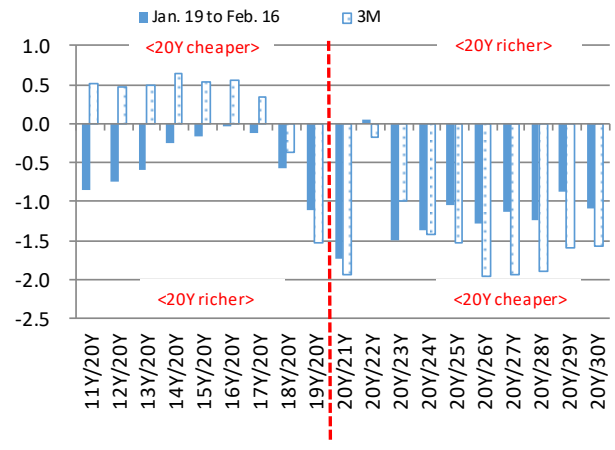
Source: Daiwa Securities.

Appendix 3a: Z-score I



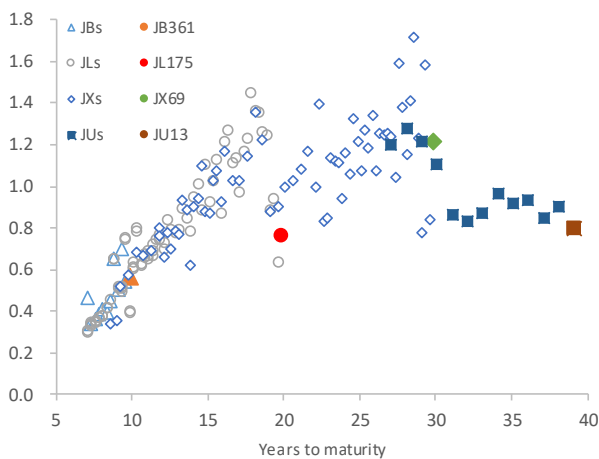
Source: Daiwa Securities.

Appendix 3b: Z-score II



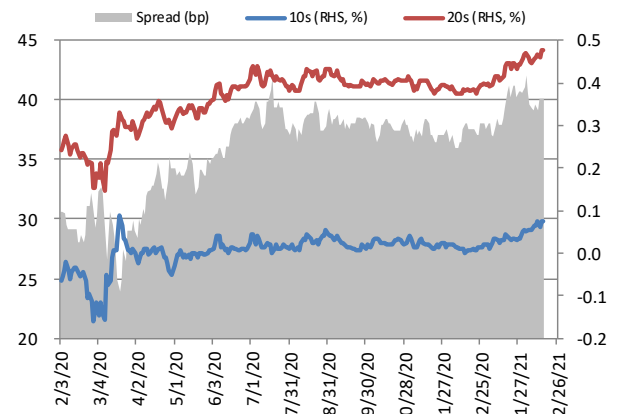
Source: Daiwa Securities.

Appendix 4: JGB Total Return Curve (3M, %)

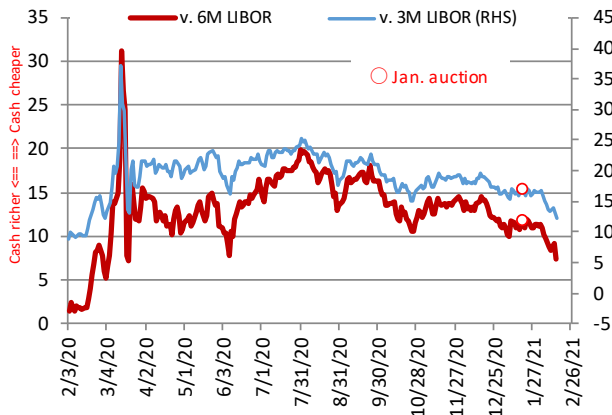


Note: Based on the Feb-16 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

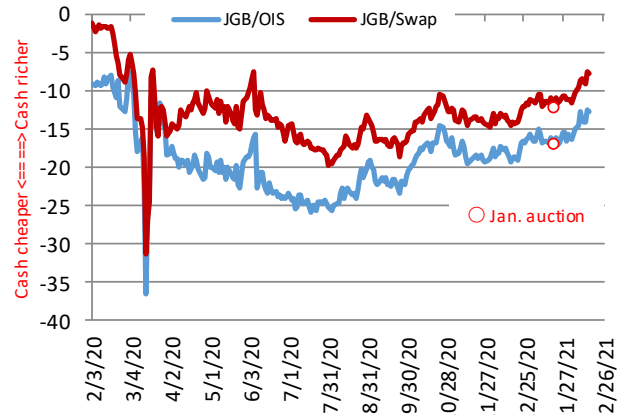
Appendix 5: JGB 10Y/20Y Spreads (bp)



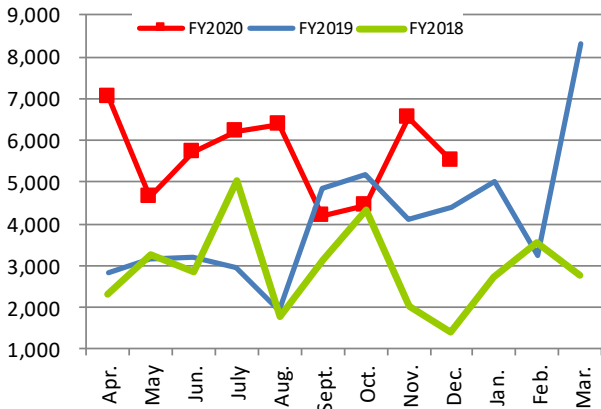
Note: On-the-run issue compound yield
Source: Daiwa Securities

Appendix 6a: 20Y JGB Asset Swap Spread (bp)


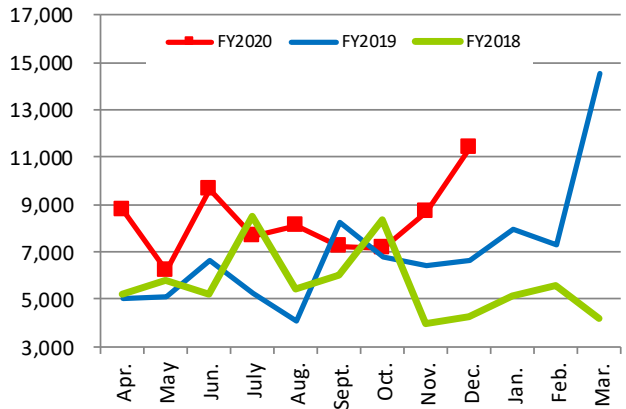
Source: Daiwa Securities.

Appendix 6b: 20Y JGB/Swap and JGB/OIS Spreads (bp)


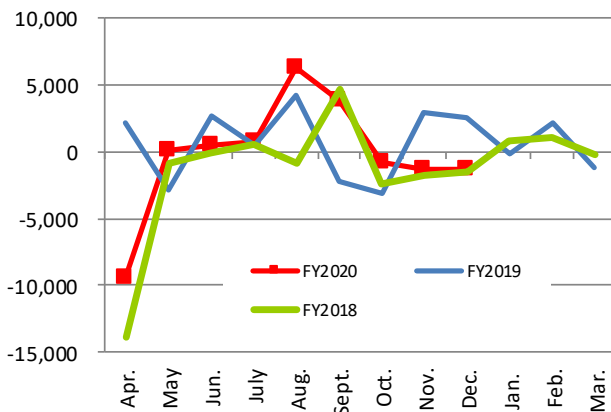
Source: Daiwa Securities.

Appendix 7a: Trend of Life- and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)


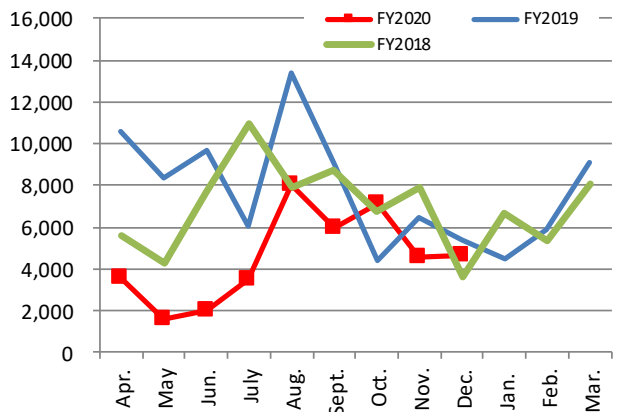
Source: JSDA

Appendix 7b: Trend of Life- and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)


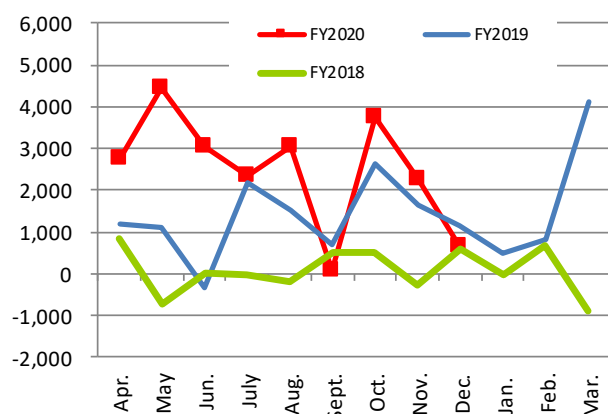
Source: JSDA

Appendix 8a: Trend of Major Banks' Net Purchase of Superlong JGBs (Yen 100M)


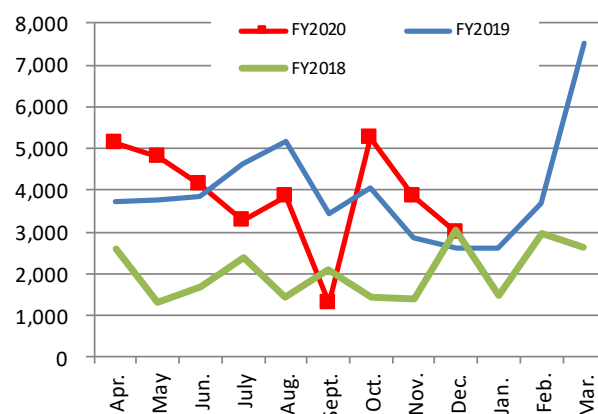
Source: JSDA

Appendix 8b: Trend of Major Banks' Gross Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

Appendix 9a: Trend of Regional Banks' Net Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

Appendix 9b: Trend of Regional Banks' Gross Purchase of Superlong JGBs (Yen 100M)


Source: JSDA

Explanatory Document of Unregistered Credit Ratings

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[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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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.
- 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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- 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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