

Outlook for 40Y JGB Auction

JU13 tap may receive unenthusiastic response from buyers

- ✓ With yields having dropped significantly in March, there is considerable uncertainty over the strength of investor demand at the current 40Y JGB yield level. Although the auction should be supported by demand to cover short positions, upside of 40Y JGBs from the current level may be limited. We recommend placing minimum necessary bids at this auction.

Strategic Memorandum DSTE436
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Auction Details

Auction Date: March 25, 2021
Issue Date: March 26, 2021
Maturity Date: March 20, 2060
Offering Amount: About 500 billion yen

* New 40Y JGBs will be the last reopening of JU13 carrying a 0.5% coupon.

** On March 24, JU13 traded at 0.655-0.675% (-1.5 - +0.5bp v. previous day's close; 0.639-0.657% on compound yield) and closed at 0.675% (+0.5bp, 0.657%).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

This auction may see bids at their lowest yield levels since the auction that was held in September 2020

After the previous 40Y JGB auction on January 26 was a satisfactory one held at yields of 0.695-0.700% (-0.5bp - unch v. previous day's close; compound yields of 0.674-0.679%), the 40-year JGB yield headed up and temporarily rose to 0.815% (during intraday trading) at end-February, its highest level since January 2019. With the fiscal year-end approaching and demand for superlong JGBs strong, the 40-year yield JGB has been in an accelerating downward trend since the beginning of March. As of 14:00 today (March 24), JU13 trades at 0.655% (-1.5bp v. previous day's close; compound yield of 0.639%). It is becoming more likely that bids at this auction will be the lowest they have been since the auction held in September 2020.

BOJ notes that excessive declines in superlong yields have an adverse impact on economic activity and the functioning of financial markets

We look next at the conditions surrounding the JGB market. In the US, the Biden administration is expected to announce an infrastructure spending plan worth nearly \$3 trillion. With Mr. Biden as president, there are strongly rooted expectations of a rise in interest rates, and both the good kind of interest rate rise (from an increase in the potential growth rate and an even faster economic expansion) and the bad kind (from a worsening of the fiscal balance and an increase in inflation without economic growth) appear to be possible. In Europe, an uptick in new covid-19 cases and broadening restrictions on economic activity are amplifying concerns over the direction of the economy. In Japan, after

the BOJ announced the results of its monetary policy assessment, there was a further weakening of share prices and strengthening of JGBs. Yields on superlong JGBs are also declining, led by the 20-year sector. However, the BOJ noted in its summary of assessment results that excessive declines in superlong yields have an adverse impact on economic activity and the functioning of financial markets. Including from the perspective of restoring market functionality and improving liquidity, we think there is a growing probability of the April Outline of Purchases showing a reduction and/or reorganizing of the BOJ's purchases in the over-10-year zone (see below for details). Under these conditions, the key points to consider ahead of the auction can be summarized as follows.

- ✓ **Focus on strength of investor demand:** In anticipation of the introduction of capital requirements based on economic value, there appears to be strong potential demand for 40-year JGBs. Given that 40-year JGBs will be issued in relatively small amounts every two months, we expect that demand to materialize to an extent. There is a possibility that investors had already bought the amounts they needed for the current fiscal year when interest rates were rising in Jan-Feb, however (Reference 8). With yields having started declining in March, there is unlikely to be much incentive for investors to front-load purchases planned for next fiscal year.
- ✓ **Cheap relative to the 30-year sector:** From the previous auction until now, as well as over the past one month, the 40-year sector has become notably cheap relative to the 30-year sector within the long-term to superlong sectors of the curve (Reference 5a). The most attractive of the 40-year JGB issues are the JU2, the JU6, and the JU7 (Reference 5b).
- ✓ **Heightening concerns that the BOJ will reduce offer amounts and/or reorganize purchase zones in response to the recent sharp decline in yields:** At its monetary policy meeting last week, the BOJ released the results of its Assessment for Further Effective and Sustainable Monetary Easing, wherein it noted that " an excessive decline in super-long-term interest rates could lead to anxiety about the future sustainability of the functioning of financial activities in a broader sense and have a negative impact on economic activity by, for example, undermining people's sentiment." Superlong JGB yields dropped sharply after the policy meeting. In particular, JGB yields in the 30-year and 40-year sectors dropped back to their levels in December 2020, when the BOJ announced it would conduct a policy assessment that reflects its understanding of the issues. Although the pandemic is still a factor, there remains a strong possibility of the BOJ reducing offer amounts and/or reorganizing the maturities it targets in the over-10-year zone in order to restore market functionality and improve liquidity. This is especially true considering that, on top of the fixed-rate purchase operations already in place, it has introduced fixed-rate purchase operations for consecutive days to deal with any excessive rise in interest rates, while it could respond to solely by reducing its purchase amounts to deal with any excessive decline in interest rates.

JU13 tap will likely receive unenthusiastic response from buyers

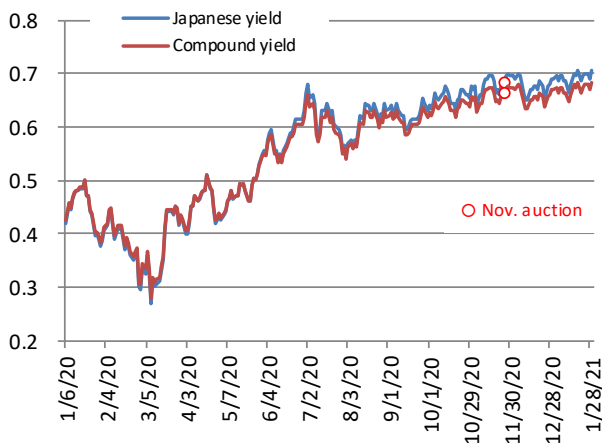
Given the above, it will be difficult to bid aggressively in the upcoming auction. Although the auction should be supported by demand to cover short positions, upside of JU13 may be limited from the current level in the secondary market. We recommend placing minimum necessary bids at this auction.

40Y JGB Auction Results

Offer Date	Issue#	Nominal Coupon (%)	Maturity Date	Issue Size (100M yen)	B/C	Highest Accepted Yield (%)	Allotment (%)	Issue Price (yen)	Yield on the previous day (%)***	30Y/40Y on the previous day (bp)**:	Yield at close on the auction day (%)**	30Y/40Y at close on the auction day (bp)**	
1/26/21	13R	0.5	3/20/60	500**					0.674	2.1			
11/25/20	13R	0.5	3/20/60	530.6	2.67	0.665	21.4007	94.30	0.657	2.1	0.665	2.4	Good
9/24/20	13R	0.5	3/20/60	544.1	2.65	0.610	86.3557	96.15	0.604	1.8	0.608	1.8	Avg
7/28/20	13R	0.5	3/20/60	505.3	3.11	0.575	3.4161	97.34	0.586	1.4	0.577	1.5	Good
5/26/20	13	0.5	3/20/60	509.9	3.06	0.505	93.4959	99.82	0.465	2.3	0.504	2.9	Avg
3/26/20	12R	0.5	3/20/59	415.1	2.66	0.450	30.5135	101.79	0.439	2.5	0.453	3.5	Avg
1/28/20	12R	0.5	3/20/59	404.2	2.86	0.400	95.9031	103.62	0.371	3.0	0.406	3.0	Avg
11/25/19	12R	0.5	3/20/59	455.0	3.50	0.460	73.5926	101.44	0.472	3.9	0.444	3.5	Good
9/25/19	12R	0.5	3/20/59	455.6	2.69	0.435	46.0000	102.36	0.401	5.4	0.425	6.8	Poor
7/23/19	12R	0.5	3/20/59	399.6	3.02	0.425	25.1445	102.73	0.415	3.9	0.415	4.9	Poor
5/28/19	12	0.5	3/20/59	404.5	3.87	0.535	84.4117	98.75	0.560	5.6	0.541	5.1	Good
3/26/19	11R	0.8	3/20/58	413.3	3.50	0.610	8.9655	106.58	0.584	7.2	0.617	7.2	Poor
1/29/19	11R	0.8	3/20/58	399.5	3.79	0.740	10.2272	102.04	0.746	9.3	0.746	9.3	Good
11/27/18	11R	0.8	3/20/58	449.2	3.85	0.940	57.2420	95.41	0.943	12.5	0.934	12.1	Good

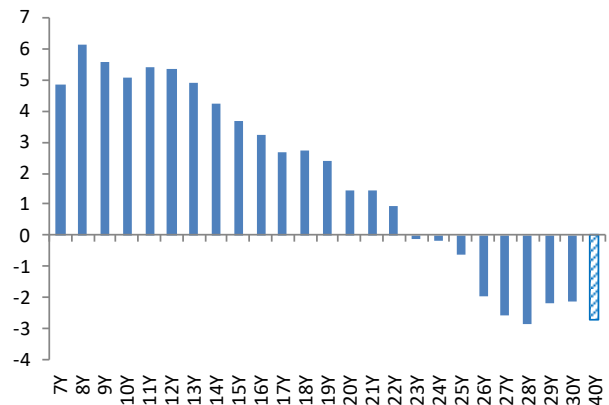
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Jan. 22 close for the Jan-2021 auction
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



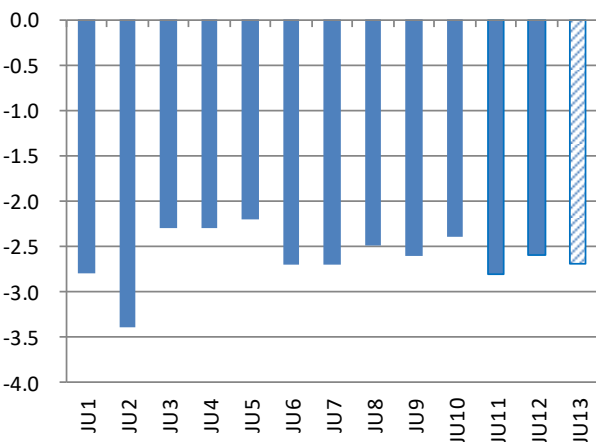
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Jan. 26 v. Mar. 23



Source: Daiwa Securities.

Appendix 3: 40Y JGB Yield Change: Jan. 26 v. Mar. 23



Source: Daiwa Securities.

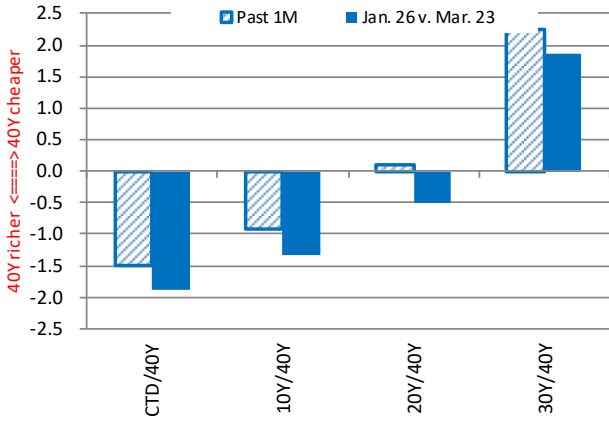
Appendix 4: BOJ Holding and Market Outstanding of 40Y JGBs

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,069.4	298.2	27.9%	771.2
JU2	1,350	78	5.8%	1,272
JU3	1,388	202	14.6%	1,186
JU4	2,012	236	11.7%	1,776
JU5	1,965	148	7.5%	1,817
JU6	2,005	934	46.6%	1,071
JU7	2,184	1,069	48.9%	1,115
JU8	2,356	1,263	53.6%	1,093
JU9	3,864	1,552	40.2%	2,313
JU10	3,485	1,178	33.8%	2,307
JU11	2,713	490	18.1%	2,223
JU12	2,878	101	3.5%	2,777
JU13	2,636	0	0.0%	2,636

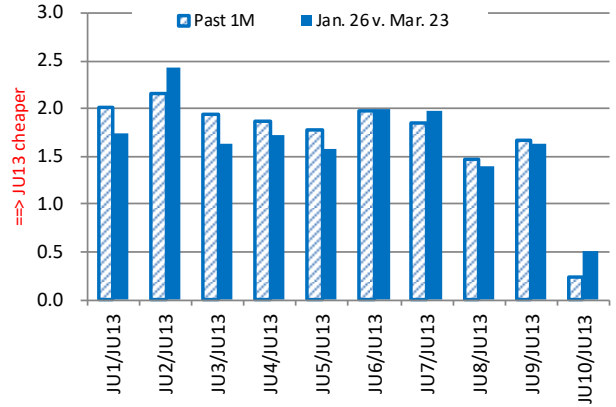
Source: Bank of Japan, Daiwa Securities.

Appendix 5a: Z-score I



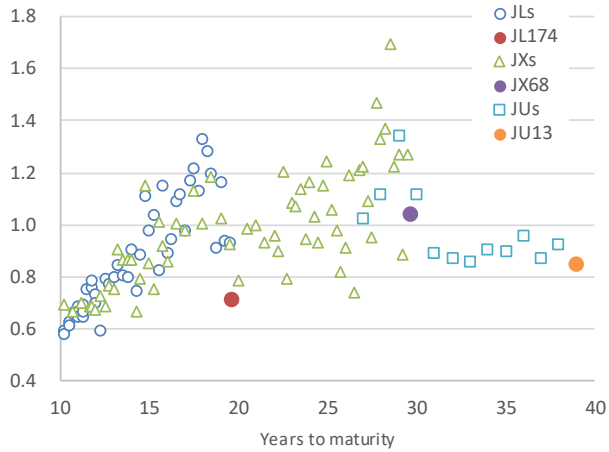
Note: On-the-run and CTD basis
Source: Daiwa Securities.

Appendix 5b: Z-score II



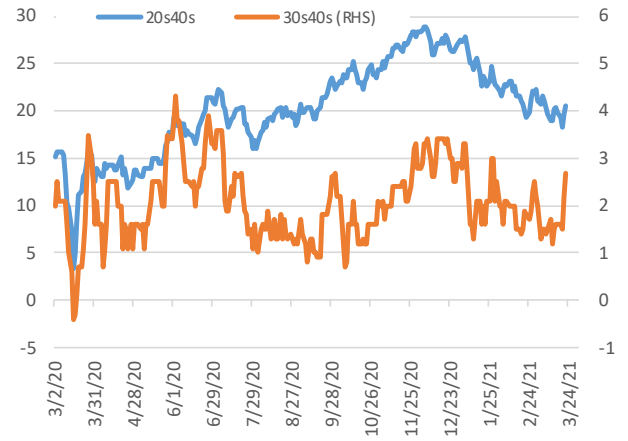
Source: Daiwa Securities.

Appendix 6: JGB Total Return Curve (3M, %)



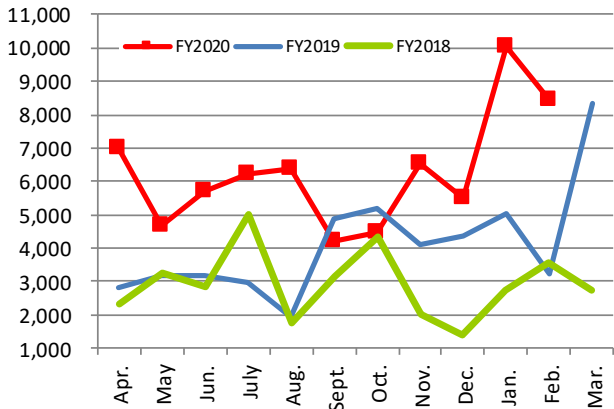
Note: Based on the Mar-23 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 7: JGB 20Y/40Y and 30Y/40Y Spreads (bp)



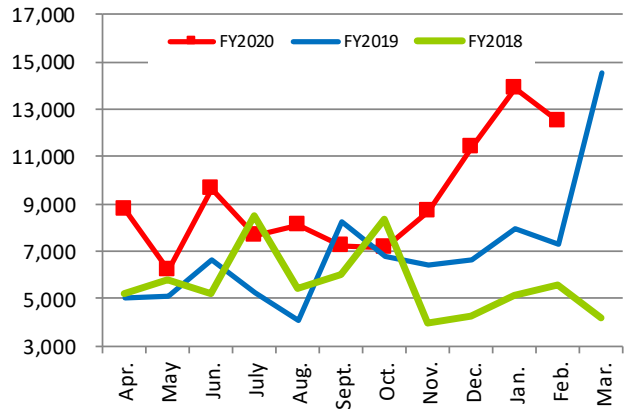
Note: On-the-run basis
Source: Daiwa Securities.

Appendix 8a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



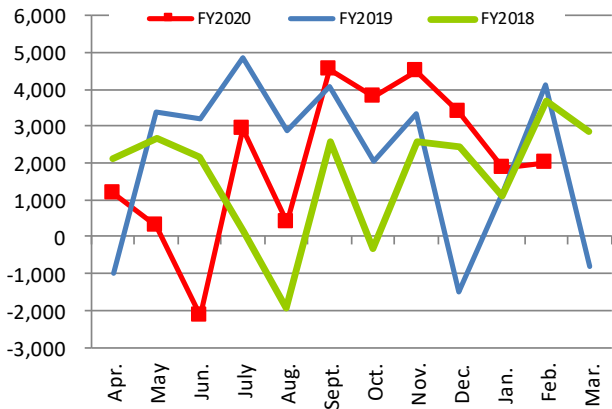
Source: JSDA

Appendix 8b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



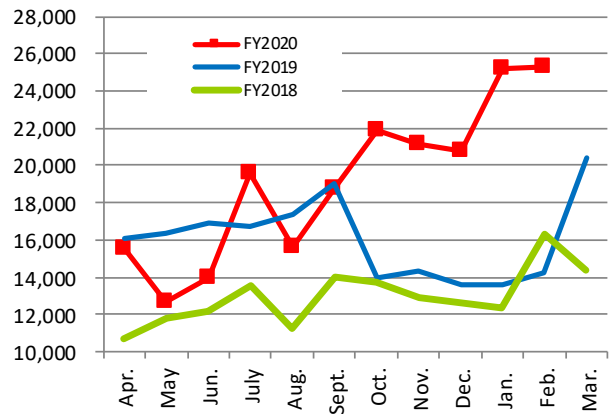
Source: JSDA

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



Source: JSDA

Appendix 9b: Trend of Overseas Accounts' 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]

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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. 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).

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- 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.

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