

Outlook for 20Y JGB Auction

Unenthusiastic bidding expected below 0.45%

- ✓ We think about our bidding stance, expecting the 20Y JGB yield to remain in a narrow range centered at 0.45% in the near term. The auction may tail if it is held at a level below 0.45%.
- ✓ In terms of the relative value, it would be worth considering switching out from the 40Y sector, albeit passively.

Strategic Memorandum DSTE441
FICC Research Dept.

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Auction Details

Auction Date: May 21, 2021
Issue Date: May 24, 2021
Maturity Date: March 20, 2041
Offering Amount: About 1.2 trillion yen

* New 20Y JGBs will be the first reopening of JL176 carrying a 0.5% coupon.

** On May 20, JL176 traded at 0.440-0.445% (unch - +0.5bp v. previous day's close) and closed at 0.445% (+0.5bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Range-bound at the 0.420-0.455% level

The previous 20Y JGB auction went well at the 0.440-0.445% level (vs. WI closing at 0.455% on previous day). Since then, the 20Y JGB yield has remained largely flat at the 0.420-0.455% level on an intraday basis amid the lack of a clear direction in the JGB market. As of 15:00 today (May 20), JL176 trades at 0.440-0.445% (unchanged - +0.5bp vs. previous day's close).

Caution remains strong about upward yield pressure though...

In the US, recent economic indicators appear mixed, but the COVID-19 vaccinations go quite smoothly, easing worries about the economic outlook. Given increasing inflation expectations and the Biden administration's policies, we think upward pressure on UST yields remains strong. However, the market has not started factoring in normalization of US monetary policy yet. In light of recently-intensified caution about a correction of the global stock market, upward yield pressure is unlikely to strengthen rapidly, especially in the near term. In Japan with the third state of emergency, although the government finally rushes in Covid-19 vaccinations, caution remains about another extension of the state of emergency and expansion of the target areas due to the current spread trend of coronavirus infection. Under the circumstances, we summarize the key points of our bidding stance at tomorrow's auction as follows:

- ✓ **Demand from investors is likely to strengthen above 0.45%:** Investor base of 20Y JGBs is broader than that of, for example, 30Y and 40Y JGBs. Potential demand for 20Y JGBs looks solid because of investors' strong confidence and believe in more attractive carry and higher liquidity of 20Y JGBs than those of other sectors. Demand from investors is likely to strengthen if the 20Y JGB yield rises above 0.45%;
- ✓ **Strongly overvalued vs. the 29-30Y and 40Y sectors on the curve:** Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is not cheap on the intermediate to superlong zone of the curve at the current level. Rather, it is strongly overvalued vs. the 29-30Y and 40Y sectors on the curve (Appendix 3). Since the previous auction, the 20Y asset swap spread has been tightening, albeit quite moderately. We thus can say that 20Y cash is undervalued against swaps at the current level (Appendix 6);
- ✓ **Primary dealers seem to be still short:** A certain degree of support is expected from short-covering.

The auction may tail if held at a level below 0.45%

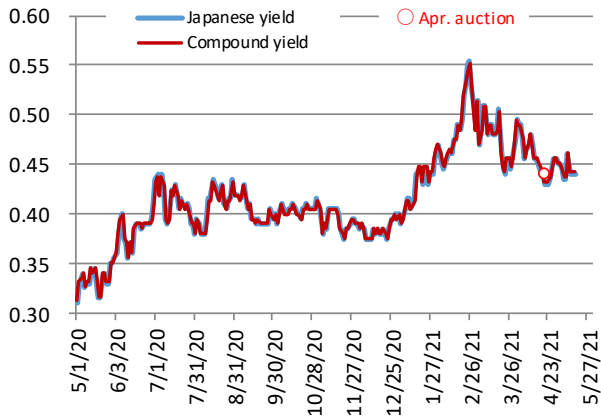
Given the above, we would like to think about our bidding stance, expecting the 20Y JGB yield to remain in a narrow range centered at 0.45% in the near term. The auction may tail if it is held at a level below 0.45%. In terms of relative value, it may be worth considering switching out from the 40Y sector, albeit passively. 40Y JGBs are to be auctioned on Thursday, 27th, with an increase in the issuance amount (500bn yen to 600bn yen). Looking at the trends of the 20Y/40Y spread around 40Y JGB auctions with increased issuance in the past, we can find that (1) the spread tends to steepen toward one- to two-business days before the auction day or remain largely flat and (2) it tends not to flatten immediately after the auction (Appendix 5). Although the 20Y sector is already at an overvalued level vs. the 40Y sector, we also assume the possibility that the 20Y/40Y spread may widen to the 25-30bp level.

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
5/21/21	176R	0.5	3/20/41	1,200*									
4/20/21	176	0.5	3/20/41	1,225.2	3.34	101.12	101.10	0.02	0.438	0.439	0.001	79.6285	Good
3/11/21	175R	0.5	12/20/40	1,300.2	3.40	99.75	99.65	0.10	0.513	0.519	0.006	33.1567	Avg
2/18/21	175R	0.5	12/20/40	1,273.4	3.13	100.31	100.20	0.11	0.482	0.488	0.006	47.0278	Avg
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

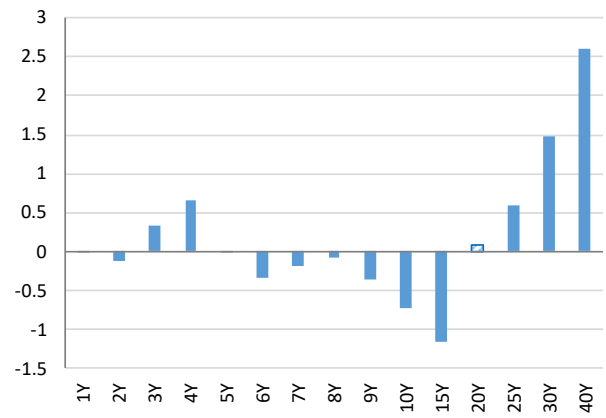
* Amount the Ministry of Finance plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



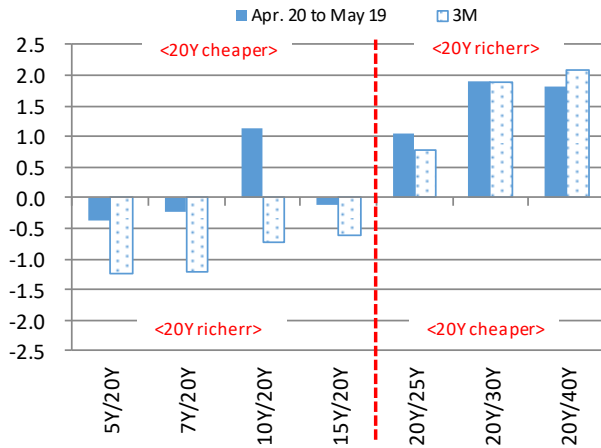
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Apr. 20 v. May 19



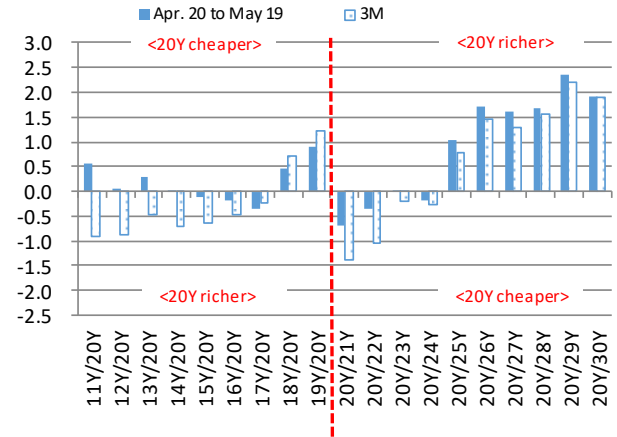
Source: Daiwa Securities.

Appendix 3a: Z-score I



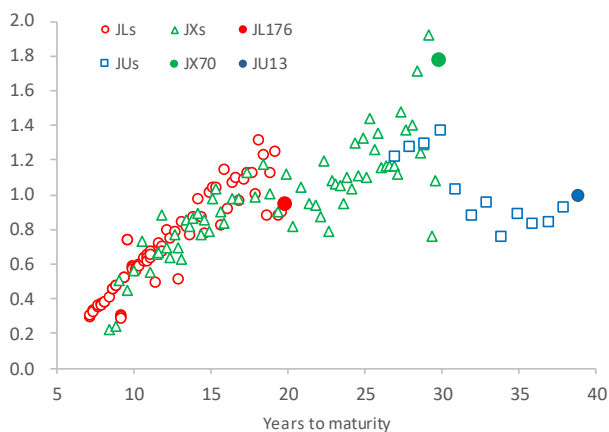
Source: Daiwa Securities.

Appendix 3b: Z-score II



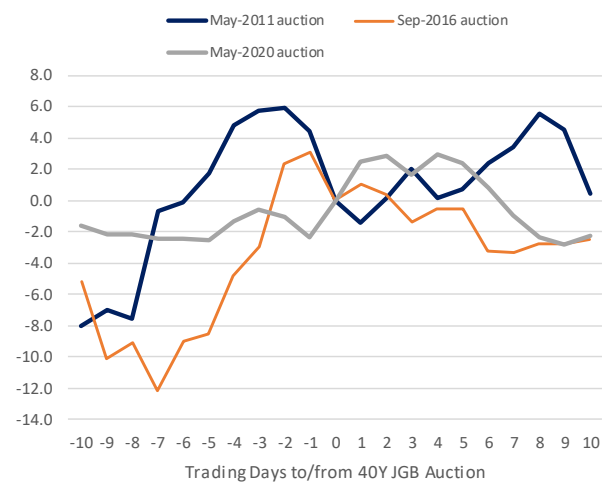
Source: Daiwa Securities.

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

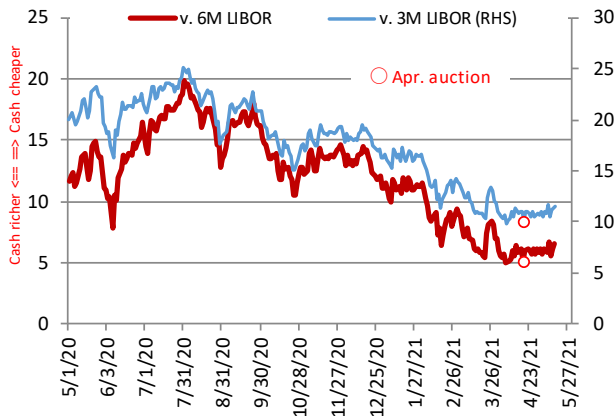


Note: Based on the May-19 JGB yield curve; factoring in roll-down effect etc.
 Source: Daiwa Securities.

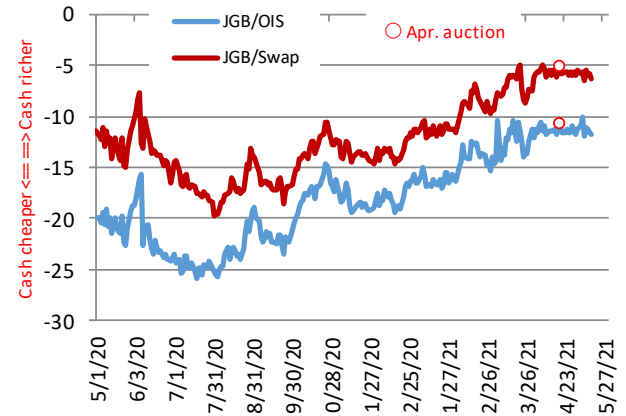
Appendix 5: Change in 20Y/40Y Spread to/from 40Y JGB Auction (bp)



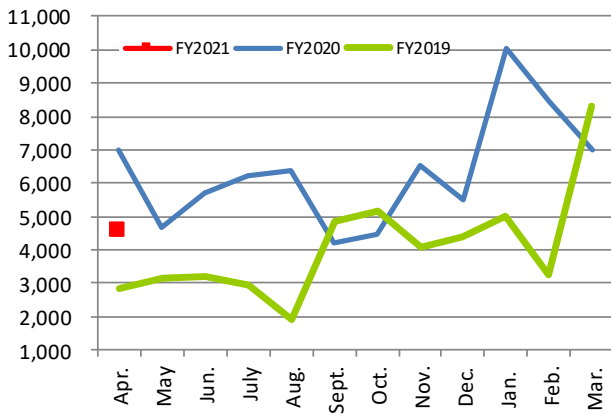
Source: Daiwa Securities

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


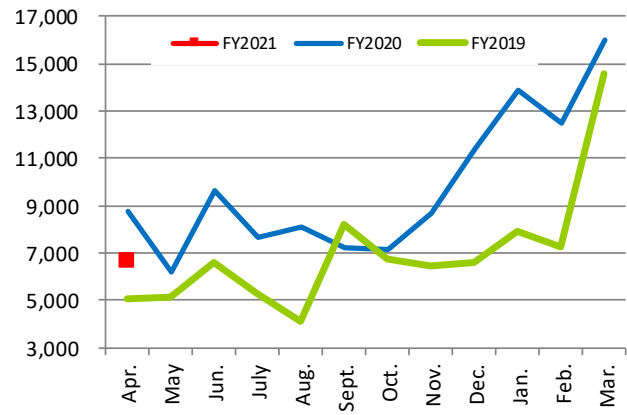
Source: Daiwa Securities.

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


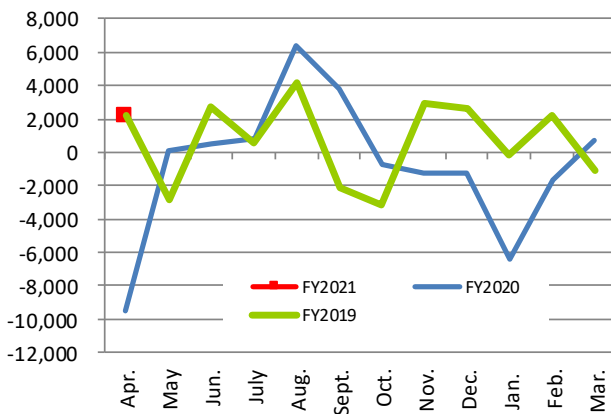
Source: Daiwa Securities.

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


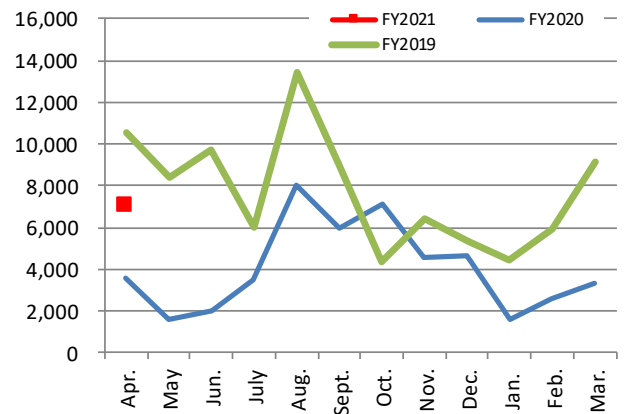
Source: JSDA

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


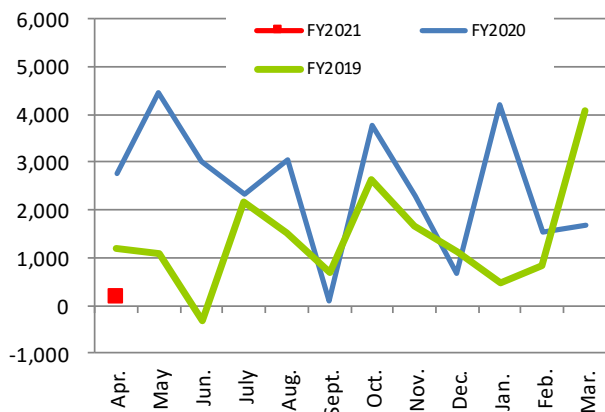
Source: JSDA

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


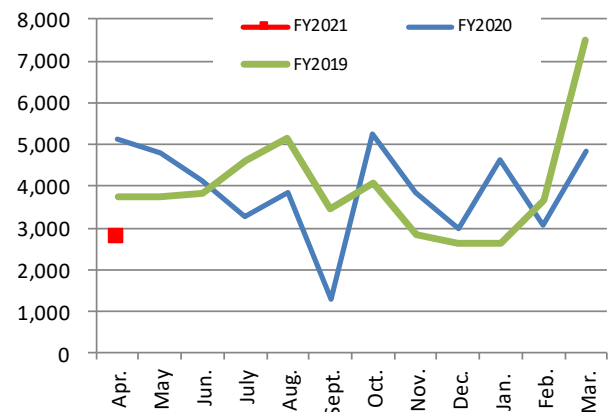
Source: JSDA

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

Appendix 10: Seasonality of 20Y JGB Yield

	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Average*	-3.8	-1.8	-3.5	1.8	1.3	4.6	1.7	-0.1	1.1	1.3	-1.6	-0.3
FY2021	-2.0	-1.4										
FY2020	-0.7	4.9	5.8	-2.9	3.9	-2.4	1.9	-1.9	0.0	6.1	9.6	-7.6
FY2019	3.6	-7.8	-6.9	-2.2	-15.5	15.0	3.0	2.5	2.4	-4.4	-7.9	15.7
FY2018	0.5	-2.4	-0.9	3.3	8.5	3.3	0.1	-5.7	-9.2	-5.1	-2.5	-8.8
FY2017	-7.7	1.0	2.4	-0.5	-4.8	3.9	1.4	-2.4	0.0	1.9	-4.3	-1.9
FY2016	-14.6	-4.9	-17.8	11.5	14.6	3.3	2.0	6.8	12.4	8.0	-2.8	1.0

Note: M/M Change in bp
 Source: Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

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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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- 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.

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Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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