

## Outlook for 10Y JGBi Auction

### Tough bidding expected in the face of headwinds from market environment and timing

- ✓ Tomorrow's auction will be held at the negative BEI level for the first time in JGBi issuance history
- ✓ Domestic inflation will likely discourage investors from purchasing JGBis aggressively
- ✓ Negative carry is expected toward October
- ✓ BOJ and MOF are expected to purchase at least 330bn yen of JGBis by the next JGBi auction scheduled for August
- ✓ We think about our bidding stance, watching investor demand at the below-par and -25 to -20bp BEI level carefully

Strategic Memorandum DSTE377  
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### Auction Details

<b>Auction Date:</b>	May 8, 2020
<b>Issue Date:</b>	May 11, 2020
<b>Maturity Date:</b>	March 10, 2030
<b>Offering Amount:</b>	About 200 billion yen
<b>Auction Method:</b>	Dutch auction on an inflation-not-adjusted price with the increment of 0.05 yen
<b>Base CPI:</b>	102.20 (Nat'l core-CPI in Dec. 2019)
<b>Ref. CPI:</b>	101.90 (as on May 11)
<b>Index ratio:</b>	0.99706 (as on May 11)

\* New 10Y JGBis, JBI25, will likely to carry a 0.2% coupon.

\*\* On May 7, WI barely traded, and closed at 0.180% (unch v. previous day's close). JBI24 traded at 99.75 yen (unch v. previous day's close) and closed at 99.75 yen (unch). WI BEI is estimated to be about -18.4bp, up from 21.0bp on May 1.

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### Auction to be held at the negative BEI level for the first time in JGBi issuance history

After the previous JGBi auction went well at the 7bp level in the break-even inflation rate (or BEI), the BEI of on-the-run JBI24 temporarily declined to around -35bp in mid-March (Chart 1) amid a decline in crude oil prices and a sharp fall in US TIPS BEIs triggered by the global COVID-19 outbreak. When US BEIs bounced back, Japan BEI also momentarily rose to around -9bp. However, once the Japanese government declared a state of emergency on coronavirus to suppress economic activities, the BEI declined to around -24bp at one point amid increasing worries about the economic outlook. Recently, it is moving at around -20bp. Tomorrow's auction will be held at the negative BEI level for the first time in the JGBi issuance history. In such an environment, key points to think about placing bids at the auction are as follows.

### Near-term inflation outlook may discourage investors from purchasing JGBis aggressively

First of all, we check domestic inflation. Recently-announced March 2020 nationwide core CPI grew by 0.4% y/y, down 0.2%pt vs. the previous month. Given the April CPI in the ward-area of Tokyo released on May 1, we forecast that the y/y change in nationwide core CPI will fall into negative territory in April and that it will stay in negative territory for the time being (Char 5). The COVID 19 pandemic disrupts normal economic activity. Japan's economy is expected to rapidly deteriorate, driven by decline in demand. In addition to the deterioration of the balance of supply and demand in macro terms, the collapse of energy prices resulting from plunging crude oil prices is expected to put downward pressure on prices. As Japan's inflation expectation is greatly influenced by "adaptive expectation formation" in comparison with other nations, the current weakness in observed inflation tends to have an impact on JGBi investor sentiment. In addition, caution remains strong about deflation around the globe. In terms of domestic inflation, it is difficult to expect aggressive demand for JGBis for a while.

### From viewpoint of index ratio path, it is not a good timing to buy JGBis

We confirm the index ratio path based on our nationwide core CPI forecasts. The ratio is likely to remain largely flat toward June. After that, it is expected to decline toward October and return to the May auction level in January 2021 (Chart 6). This implies that we are likely to continuously earn negative return from JGBis if JGBi prices remain unchanged during the investment horizon (Chart 7). Unless we expect JGBi prices to constantly gain, it is not a good timing now to buy JGBis in an aggressive stance.

### BOJ and MOF together expected to buy at least 330bn yen of JGBis by the next JGBi auction in August

A supportive factor is a reduction in the issuance amount. On May 1, the MOF announced "Alteration in the Issuance of the Inflation-Indexed Bonds in April-June 2020" and reduced the issuance amount in the May auction from 300bn yen to 200bn yen. By the next JGBi auction scheduled for August, the BOJ is expected to purchase at least 180bn yen (=30bn yen/operation × 2 times/month × 3 months) and the MOF is to buy back around 150bn yen (=50bn yen/month × 3 months) vs. the issuance worth 200bn yen at tomorrow's auction.

### Think about our bidding stance, watching investor demand at the below-par and -25 to -20bp BEI level carefully

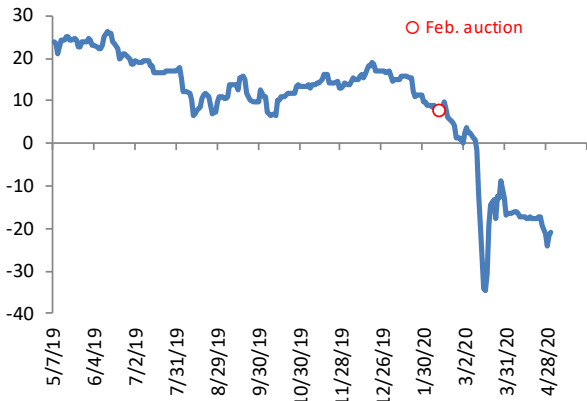
Amid lingering concerns about the global economy due to the COVID-19 pandemic, the collapse of crude oil prices as well as weak BEI in Europe and the US are preventing us from expecting a sharp rise in inflation expectations. According to some surveys, 10-year inflation expectations have been trending down to the lowest level under the BOJ's yield curve control policy (Chart 9). Partly because of this, worries are left for post-auction performance. That said, we think that the BEI in negative territory still points to quite cheapness of JGBis in comparison to 10-year inflation expectations (around 0.7% as of April based on survey in Chart 9). It appears that hesitation will be unnecessary to buy JGBis for investors with longer investment horizon. All in all, we would like to think about our bidding stance, watching investor demand at the below-par and -25 to 20bp BEI level (Table 2).

### 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) (Note3)	Expected range	
5/8/20	25	0.2*	3/10/30	200**										
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
2/15/19	23R	0.1	3/10/28	421.8	3.34	103.60	-0.287	16.3120	21.6	21.7	0.1	103.50	103.40-103.50	Good
11/6/18	23R	0.1	3/10/28	435.4	3.70	103.90	-0.305	43.0272	41.1	41.1	0.0	103.85	103.75-103.90	Avg
8/7/18	23R	0.1	3/10/28	418.4	3.12	104.05	-0.309	6.3636	48.0	41.0	-7.0	104.00	103.75-104.30	Avg
5/10/18	23	0.1	3/10/28	447.1	4.02	106.35	-0.513	32.0441	56.5	58.7	2.2	106.20	106.10-106.30	Good

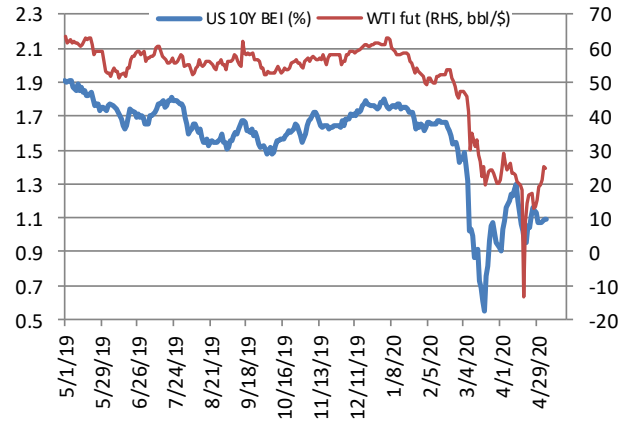
\* Daiwa forecast (as of May 1) \*\* Planned by MoF (Note 1) Inflation unadjusted price (Note2) Closing price; WI basis for new issues; as of May 1 for the May 2020 auction (Note 3) Bloomberg  
Source: Ministry of Finance, Daiwa Securities

Chart 1: BEI (bp)



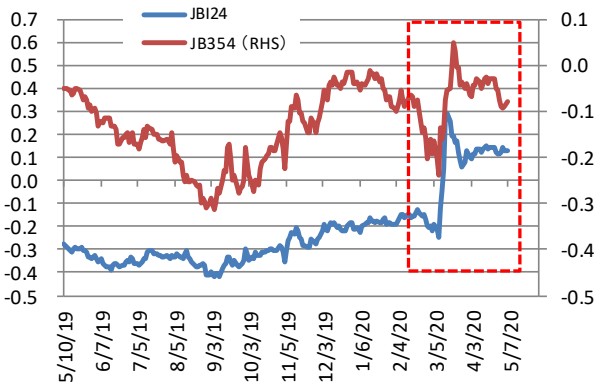
Note: On-the-run issues basis  
Source: Daiwa Securities

Chart 2: 10Y US BEI and Oil Price



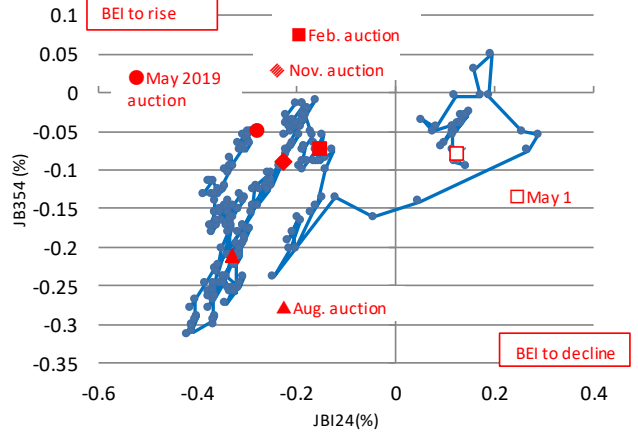
Source: Bloomberg

Chart 3: JBI24 and JB354 Yields (%)



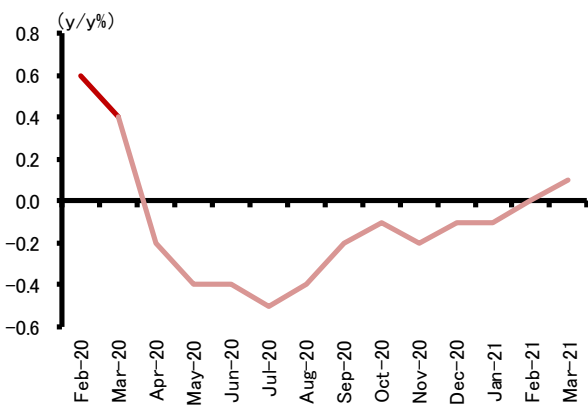
Source: Daiwa Securities

Chart 4: Correlation between JBI24 and JB354



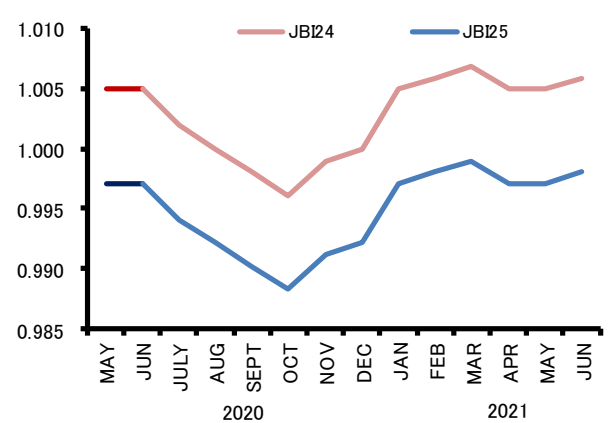
Source: Daiwa Securities

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



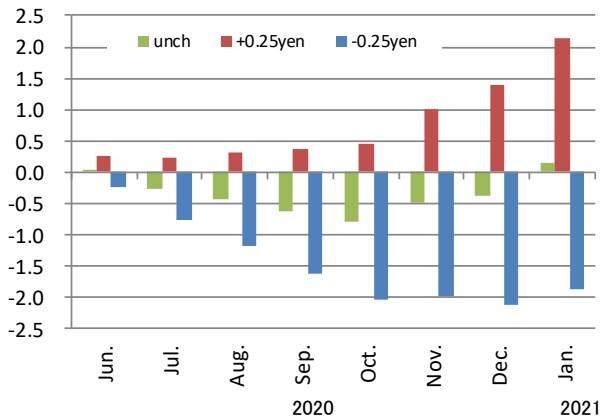
Note: Actual for Feb-Mar 2020  
Source: Daiwa Securities

Chart 6: JBI24 Index Ratio Forecast



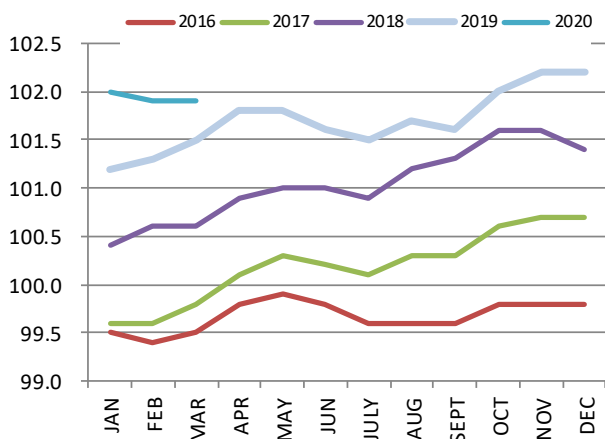
Note: Based on Chart 5, actual for May-Jun., 2020  
Source: Daiwa Securities

Chart 7: Holding Period Return on JBI25 (%)



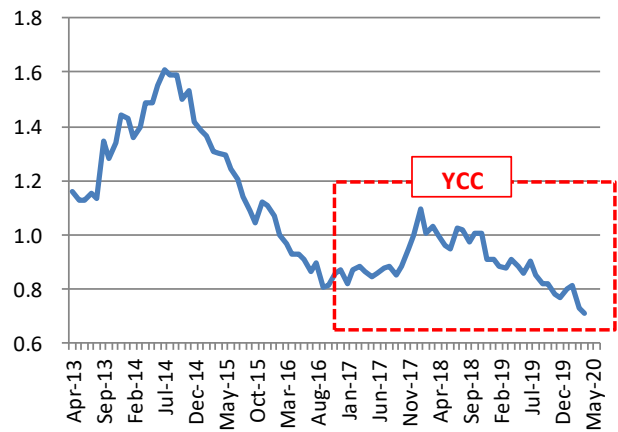
Note: Coupon is assumed to be 0.2%; from Feb. 13 to each point assuming the price is (1) unchanged, (2) increased by 0.25 yen every month and (3) decreased by 0.25 yen  
Source: Daiwa Securities

Chart 8: Seasonality of Nationwide Core-CPI



Source: Ministry of Internal Affairs and Communications, Daiwa Securities

Chart 9: CPI Core Change Forecast: 10Y average (%)



Source: QUICK

Table 1: Results of BOJ Purchase and MOF Buyback

	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)
1/10/20	102.65	30	-0.070	-0.103	11.5	5.95	102.60
1/16/20	102.55	20	0.010	-0.012	8.0645	6.61	102.55
1/23/20	102.60	30	-0.100	-0.127	90.7	6.22	102.50
2/7/20	102.25	30	-0.020	-0.059	32.1	4.99	102.30
2/17/20	102.40	20	-0.120	-0.132	69.6296	6.25	102.30
2/25/20	102.20	30	0.000	-0.036	27.6	5.28	102.35
3/4/20	102.70	20	0.190	0.089	60.0000	4.38	102.90
3/11/20	102.00	30	-0.360	-0.363	86.1	4.54	101.30
3/18/20	98.60	50	-0.030	-0.164	6.0	4.60	99.20
3/25/20	99.35	300	0.550	0.279	40.0000	1.25	99.80
4/1/20	99.75	30	-0.060	-0.113	28.3	4.37	99.85
4/17/20	99.70	50	-0.200	-0.298	96.2500	3.51	99.60
4/24/20	99.85	30	-0.110	-0.214	100.0	5.16	99.85

Note: Previous Day's Close and Close Price are based on JBI24; Buyback by the Ministry of Finance for Jan. 16, Feb. 17, Mar. 4, Mar. 25 and Apr. 17  
Source: Bank of Japan, Ministry of Finance, Daiwa Securities

Table 2: Market Outstanding of JBIs (Yen billions)

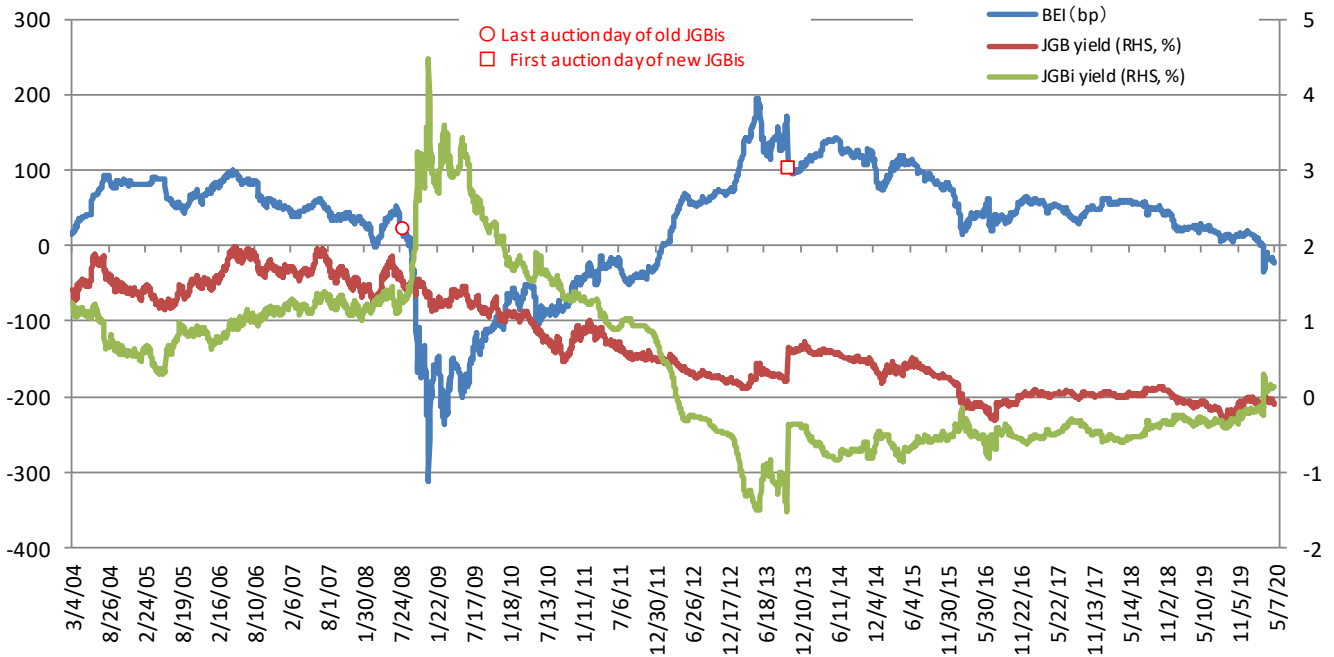
(Yen billions)

	Issue Size	MoF Buyback	BoJ Outright Purchase	Market Outstanding
JBI17	646.7	49.5	277.1	320.1
JBI18	821.7	34.8	244.6	542.3
JBI19	1,091.8	26.7	195.2	869.9
JBI20	2,139.4	109.3	412.5	1,617.6
JBI21	1,727.2	179.6	447.0	1,100.6
JBI22	1,760.4	198.6	709.7	852.1
JBI23	1,722.7	174.5	221.6	1,326.6
JBI24	1,670.1	89.2	146.6	1,434.3
TOTAL	11,580.0	862.2	2,654.3	8,063.5
%	100.0%	7.4%	22.9%	69.6%

(As of Apr. 20, 2020 on BOJ start basis)

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

Chart 10: BEI (March 2004 to present)



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

Table 3: Image of Bidding Price at Auction and BEI

(Unit: bp)

		Nominal Yield (% JB358)									
		-0.030	-0.025	-0.020	-0.015	-0.010	-0.005	0.000	0.005	0.010	0.015
Bidding Price (Yen)	100.60	-16.9	-16.4	-15.9	-15.4	-14.9	-14.4	-13.9	-13.4	-12.9	-12.4
	100.55	-17.4	-16.9	-16.4	-15.9	-15.4	-14.9	-14.4	-13.9	-13.4	-12.9
	100.50	-17.9	-17.4	-16.9	-16.4	-15.9	-15.4	-14.9	-14.4	-13.9	-13.4
	100.45	-18.4	-17.9	-17.4	-16.9	-16.4	-15.9	-15.4	-14.9	-14.4	-13.9
	100.40	-18.9	-18.4	-17.9	-17.4	-16.9	-16.4	-15.9	-15.4	-14.9	-14.4
	100.35	-19.4	-18.9	-18.4	-17.9	-17.4	-16.9	-16.4	-15.9	-15.4	-14.9
	100.30	-19.9	-19.4	-18.9	-18.4	-17.9	-17.4	-16.9	-16.4	-15.9	-15.4
	100.25	-20.4	-19.9	-19.4	-18.9	-18.4	-17.9	-17.4	-16.9	-16.4	-15.9
	100.20	-20.9	-20.4	-19.9	-19.4	-18.9	-18.4	-17.9	-17.4	-16.9	-16.4
	100.15	-21.5	-21.0	-20.5	-20.0	-19.5	-19.0	-18.5	-18.0	-17.5	-17.0
	100.10	-22.0	-21.5	-21.0	-20.5	-20.0	-19.5	-19.0	-18.5	-18.0	-17.5
	100.05	-22.5	-22.0	-21.5	-21.0	-20.5	-20.0	-19.5	-19.0	-18.5	-18.0
	100.00	-23.0	-22.5	-22.0	-21.5	-21.0	-20.5	-20.0	-19.5	-19.0	-18.5
	99.95	-23.5	-23.0	-22.5	-22.0	-21.5	-21.0	-20.5	-20.0	-19.5	-19.0
	99.90	-24.0	-23.5	-23.0	-22.5	-22.0	-21.5	-21.0	-20.5	-20.0	-19.5
	99.85	-24.5	-24.0	-23.5	-23.0	-22.5	-22.0	-21.5	-21.0	-20.5	-20.0
	99.80	-25.1	-24.6	-24.1	-23.6	-23.1	-22.6	-22.1	-21.6	-21.1	-20.6
	99.75	-25.6	-25.1	-24.6	-24.1	-23.6	-23.1	-22.6	-22.1	-21.6	-21.1
	99.70	-26.1	-25.6	-25.1	-24.6	-24.1	-23.6	-23.1	-22.6	-22.1	-21.6
	99.65	-26.6	-26.1	-25.6	-25.1	-24.6	-24.1	-23.6	-23.1	-22.6	-22.1
99.60	-27.1	-26.6	-26.1	-25.6	-25.1	-24.6	-24.1	-23.6	-23.1	-22.6	
99.55	-27.6	-27.1	-26.6	-26.1	-25.6	-25.1	-24.6	-24.1	-23.6	-23.1	
99.50	-28.2	-27.7	-27.2	-26.7	-26.2	-25.7	-25.2	-24.7	-24.2	-23.7	
99.45	-28.7	-28.2	-27.7	-27.2	-26.7	-26.2	-25.7	-25.2	-24.7	-24.2	
99.40	-29.2	-28.7	-28.2	-27.7	-27.2	-26.7	-26.2	-25.7	-25.2	-24.7	

Note: Based on the settlement day of May 11; Coupon is assumed to be 0.2%.  
Source: Daiwa Securities

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February 2020



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**Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.:** Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

### **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).
- 6) NEC (6701): NOTICE REGARDING U.S. PERSONS: This report is not intended for distribution to or use by any person in the United States. Securities issued by NEC Corporation have been suspended from registration in the U.S. and are subject to an order of the U.S. Securities and Exchange Commission dated June 17, 2008, pursuant to Section 12(j) of the Securities Exchange Act of 1934. This document is not a recommendation or inducement of any purchase or sale of such securities by any person or entity located in the U.S. Daiwa Securities Co. Ltd. disclaims any responsibility to any such person with respect to the content of this document. Any U.S. person receiving a copy of this report should disregard it.

### **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