

Outlook for 10Y JGB Auction

Further decline may be needed for successful auction

- ✓ We would like to think about our bidding stance at tomorrow's auction, assuming that the 10Y JGB yield will move in the 0.00-0.05% range over the next month. If the auction is held at 0.03-0.04%, it will go smoothly on the back of solid demand.
- ✓ In terms of relative value, it would be worth considering switching out from 5Y or 20Y. At the Yen LIBOR plus spread level, it would be worth considering buying asset swaps in small lot as well.

[BOX] August BOJ JGB Purchase: Keeping slim hope of an increase in 1-3Y purchases

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FICC Research Dept.

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Auction Details

Auction Date:	August 4, 2020
Issue Date:	August 5, 2020
Maturity Date:	June 20, 2030
Offering Amount:	About 2.6 trillion yen

* New 10Y JGBs will likely be the first reopening of JB359 carrying a 0.1% coupon.

** On August 3, JB359 traded at 0.020-0.025% (+1.0 - +1.5bp v. previous day's close) and closed at 0.020% (+1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

A further decline may be needed for successful primary sale

The previous 10Y JGB auction in July went well despite strong caution about possible deterioration in the supply-and-demand balance by the largest issuance with the largest increase in the modern history of the 10Y JGB auction. It was because market adjustment toward the auction led the 10Y JGB yield up and the auction was held the 0.060-0.065% level. After the successful auction, the 10Y JGB yield temporarily declined to 0.010% in mid-July amid the solid performance of the JGB market. In late July, the yield remained roughly flat at the 0.01-0.02% level, while the JGB market traded in a narrow range around the recent high. Today (Aug 3), the 10Y JGB yield moved at 0.020-0.025%, while the JGB futures fell below 152.20 yen for the first time since July 15. A further decline may be needed for successful primary sale.

If tomorrow's auction is held at 0.03-0.04%, a trouble-free auction is expected

Let's check the environment surrounding the JGB market. In the US, it is highly likely that calls to suspend operations in the services sector and refrain from non-essential/non-urgent activities will be strengthened in the regions with growing number of COVID-19 infections. The US administration's measure to address the pandemic (unemployment benefits) has expired at the end of July, and there is no prospect yet that the US Congress will pass the related bills to extend the benefit program. Despite some good economic data, we are unable to become completely optimistic about the economic outlook. As caution about escalating US-China tensions is also lingering, we see that upward pressure on yields is unlikely to increase especially in the near term. In Japan as well, the number of COVID-19

infections has been increasing mainly in the Tokyo metropolitan area. In such an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers do not seem to be short:** A key for tomorrow's auction would be demand from investors;
- ✓ **The 10Y sector is undervalued in terms of the relative value:** Our analysis based on data since the previous 10Y JGB auction shows that the 10Y sector is undervalued vs. the 5Y, 20Y, and 30Y sectors on the curve at the current level (Appendix 3). As the 10Y asset swap spread has been tightening (cash cheaper against swaps) since the previous 10Y JGB auction, 10Y cash is considerably undervalued against swaps at the current level (Appendix 4);
- ✓ **In August, the BOJ is expected to continue five purchase operations totaling around 2.1tn yen in the 5-10Y zone:** At the end of last week, the BOJ announced the Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for August 2020, in which the offer range and the number of offers in the 5-10Y zone were unchanged from those for July (see [BOX]). The BOJ's purchases totaling (at least) around 2.1tn yen (420bn yen x five times) are expected to continue also in August. The market appears to be aware of a possible increase in the purchase amount if judged necessary, amid further enhancement of monetary easing via aggressive JGB purchases and other measures. We can say that support from the BOJ remains rock-solid.

Switching out from 5Y or 20Y

Overall, we would like to think about our bidding stance at tomorrow's auction, assuming that the 10Y JGB yield will move in the 0.00-0.05% range over the next month. If tomorrow's auction is held at 0.03-0.04%, where demand from investors is likely to increase, a trouble-free auction is expected. In terms of relative value, it would be worth considering switching out from 5Y or 20Y sector. As mentioned above, the 10Y sector is currently undervalued vs. those sectors. On the following day (Aug. 5), the BOJ is scheduled to conduct purchase operations in the 3-5Y and 10-25Y zones, it may be relatively easy to go in those switches. In addition, at the Yen LIBOR plus spread level, it would be worth considering buying 10Y asset swaps in small lot as well. Although we are concerned about the recent tightening trend in asset swaps, some market players may show up for the 10Y asset swaps with expected positive carry at the level.

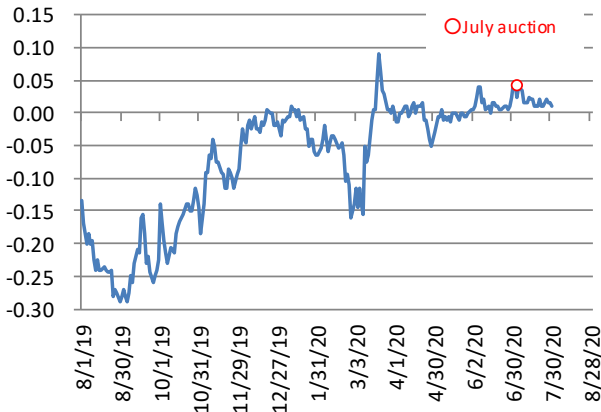
10Y JGB Auction Results

Auction Date	Issue#	Coupon %	Maturity Date	Issue Size (billion yen)	Bid/Cover	Average Accepted Price	Lowest Accepted Price	Tail (yen)	Average Accepted Yield	Highest Accepted Yield	Tail (%)	Allotment %	
8/4/20	359R	0.1	6/20/30	2,600*									
7/2/20	359	0.1	6/20/30	2,844	3.66	100.41	100.39	0.02	0.058	0.060	0.002	48.3429	Good
6/2/20	358R	0.1	3/20/30	2,099	3.36	100.98	100.96	0.02	0.000	0.001	0.001	86.4694	Avg.
5/12/20	358R	0.1	3/20/30	2,308	4.09	101.00	100.99	0.01	-0.001	0.000	0.001	72.6710	Good
4/2/20	358	0.1	3/20/30	2,306	4.19	100.76	100.75	0.01	0.023	0.024	0.001	83.0105	Good
3/3/20	357R	0.1	12/20/29	2,309	3.20	101.98	101.84	0.14	-0.100	-0.086	0.014	28.9846	Poor
2/4/20	357R	0.1	12/20/29	2,271	3.63	101.50	101.48	0.02	-0.051	-0.049	0.002	77.1508	Avg.
1/7/20	357	0.1	12/20/29	2,171	3.70	101.05	101.03	0.02	-0.005	-0.003	0.002	78.8770	Good
12/3/19	356R	0.1	9/20/29	2,100	3.28	101.40	101.24	0.16	-0.042	-0.026	0.016	95.7891	Poor
11/6/19	356R	0.1	9/20/29	2,100	3.62	101.99	101.94	0.05	-0.099	-0.094	0.005	80.6774	Avg.
10/1/19	356	0.1	9/20/29	2,100	3.42	102.62	102.33	0.29	-0.158	-0.130	0.028	6.1227	Poor
9/3/19	355R	0.1	6/20/29	2,412	3.60	103.68	103.66	0.02	-0.265	-0.264	0.001	99.4435	Avg.
8/1/19	355R	0.1	6/20/29	2,099	3.76	102.53	102.51	0.02	-0.152	-0.150	0.002	1.7771	Avg.
7/2/19	355	0.1	6/20/29	2,099	3.92	102.42	102.40	0.02	-0.139	-0.137	0.002	93.8948	Avg.

* Amount the MOF plans to issue

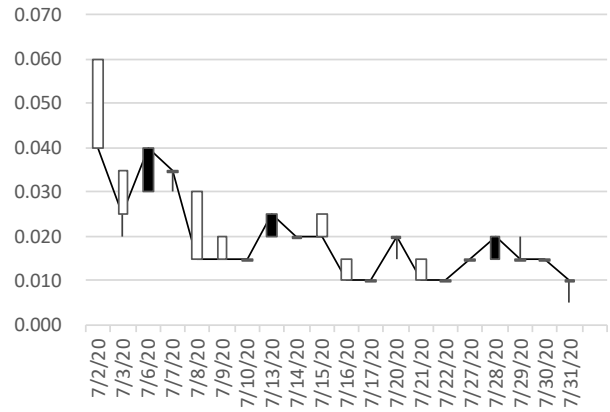
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 10Y JGB Yield (%)



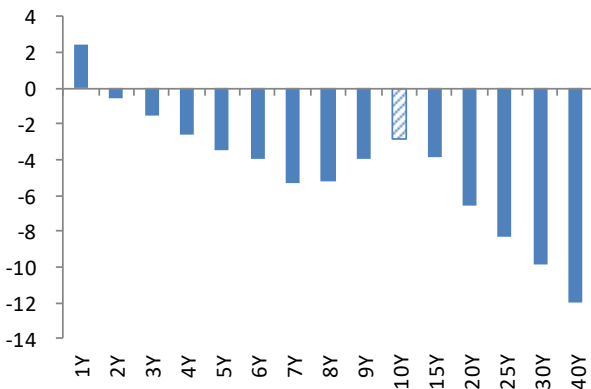
Source: Daiwa Securities.

Appendix 1a: JB359 Yield Candle Chart (%)



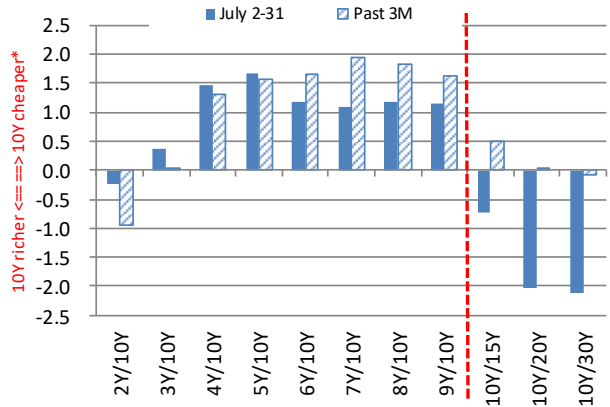
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, July 2 v. July 31)



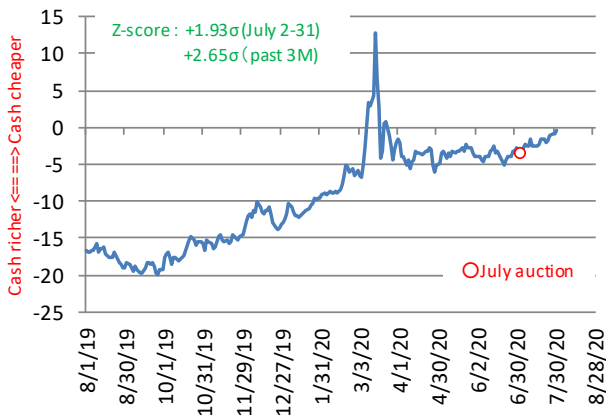
Source: Daiwa Securities.

Appendix 3: Z-scores of JGB Yield Spreads (σ)



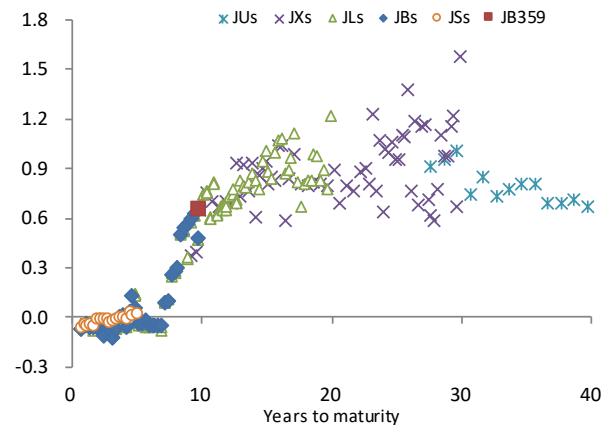
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

Appendix 4: 10Y JGB Asset Swap Spread (bp)



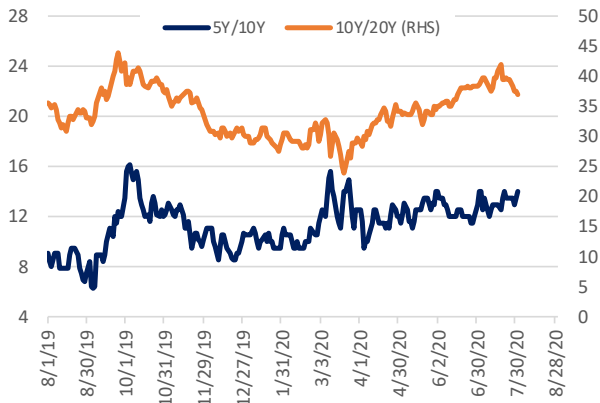
* Yen LIBOR basis
Source: Daiwa Securities.

Appendix 5: JGB Total Return Curve (3M, %)



Note: Based on JGB yield curve on July 31; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6: JGB 5Y/10Y and 10Y/20Y Spreads (bp)



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

[BOX] August BOJ JGB Purchase: Keeping slim hope of an increase in 1-3Y purchases

On July 31, the BOJ announced the Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for August 2020, in which the offer range and the number of offers in all the purchase target zones were kept unchanged from those for July. The number of monthly offer days (ten days) is also the same as that in July (Table 1 and 2).

Reflecting this release, it is highly possible that each target zone's offer amount in the first operation in August will be unchanged from that in its last operation in July. The market had been concerned about JGB auctions with the significantly increased issuance amount, but those auctions have gone well thus far. From the viewpoint of supply, upward yield pressure is quite limited. The 10Y JGB yield, a long-term policy interest rate, has been very stable at around 0%. Regarding short-term and intermediate JGBs in the 1Y to 5Y zone as well, the supply/demand balance and market sentiment have not deteriorated to level, which boosts the 10Y JGB yield. As the BOJ intends to leave the superlong zone up to market forces, which was confirmed also by BOJ governor Kuroda's remarks at the press conference on July 15, we see a very slim chance that the BOJ will increase the purchase amount in the zone at the current yield level and on the shape of the yield curve.

However, under the current "further enhancement of monetary easing via aggressive JGB purchases and other measures," the BOJ will increase JGB purchases whenever it feels necessary to keep the yield curve under control. In such a case, we expect the Bank to increase in the purchase amount in the 1Y-3Y zone. We have seen the bid-to-cover ratio in the recent purchase operations in the 1Y-3Y zone exceed 3.0x. In addition, those operations tend to tail as well. Impact by the substantial increase in 2Y JGB issuance amount (up 1tn yen) appears to be gradually emerging. It is difficult for issues around the on-the-run issue to be taken by the BOJ at the recent operations as well.

This time, the BOJ did not release the Outline of Outright Purchases of Japanese Government Securities, meaning that the outline announced on April 27 will be effective. Regarding Treasury Discount Bills, the BOJ will continue to buy them, maintaining the guideline for the offer amount of "about Y500bn to Y3.0tn" per operation.

Table 1: BOJ's JGB Purchase Plan for August 2020

(Yen billions)

	Offer size per operation		Number of Offers (per month)	Offer size exp. in August		Monthly Total exp. in August (a)	MOF issuance in August* (b)	(a)/(b) (%)	
	Mid			Last offer in July				YCC Avg.	
JGBs ex Linkers and Floaters									
1 year and less	50	- 150	100	3	100	100	300	-	-
Over 1 to 3 years	250	- 600	425	6	420	420	2,520	3,000	84.0 76.2
Over 3 to 5 years	200	- 500	350	6	350	350	2,100	2,500	84.0 88.2
Over 5 to 10 years	250	- 600	425	5	420	420	2,100	2,600	80.8 104.8
Over 10 to 25 years	50	- 200	125	2	120	120	240	1,200	20.0 78.4
Over 25 years	0	- 50	25	2	30	30	60	1,150	5.2 30.8
Linkers	30	-	-	2	30	30	60	-	-
Floaters (in even months)	100	-	-	1	100	-	100	-	-
TOTAL**:						7,320	10,450	70.0	

(Note) "Offer size per operation" and "Number of offers (per month)" are as released by the BOJ on July 31. On "Offer size exp. in August," actual for 1-3Y and Linkers and Daiwa forecast for other target zones. * Excluding auction II and AEL. ** Excluding JGB linkers and floaters
Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

Table 2: BOJ's JGB Purchase Schedule in August 2020

BOJ offer day / JGB auction day	(BOJ start day/ MOF settlement day)	Up to 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 25 years	Over 25 years	JGB Linker	JGB Floater	TDBs	MOF Buyback	
8/3/20 M	8/4/20		421.0					30.5				
8/4/20 T	8/5/20	10Y JGB Auction									○	
8/5/20 W	8/6/20	○		◎		◎						
8/6/20 TH	8/7/20	10Y JGB Linker Auction									6M	
8/7/20 F	8/11/20		◎		◎				○	3M		
8/10/20 M	-	Public Holiday (Mountain Day)									-	
8/11/20 T	8/12/20										○	
8/12/20 W	8/13/20	AEL (20Y, 30Y and 40Y JGBs with over 15.5 less than 39 years to maturity)									○	
8/13/20 TH	8/14/20		◎	◎	◎							
8/14/20 F	8/17/20	AEL (10Y and 20Y JGBs with over 5 to 15.5 years to maturity)									3M	
8/17/20 M	8/18/20											
8/18/20 T	8/19/20	30Y JGB Auction									○	
8/19/20 W	8/20/20	○		◎	◎					1Y		
8/20/20 TH	8/21/20	5Y JGB Auction										
8/21/20 F	8/24/20		◎		◎		◎			3M		
8/24/20 M	8/25/20			◎				○		6M		
8/25/20 T	8/26/20	20Y JGB Auction										
8/26/20 W	8/27/20		◎	◎	◎					○		
8/27/20 TH	9/1/20	2Y JGB Auction										
8/28/20 F	8/31/20	○				◎	◎					
8/31/20 M	9/1/20		◎	◎						3M		

Note: ◎ Announced by the BOJ on July 31, ○ Daiwa forecast as of August 3; figures are actual in Yen billions.
Source: Bank of Japan, Ministry of Finance (MOF), Daiwa Securities.

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[Standard & Poor's]

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February 2020

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- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
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* 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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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