

Outlook for 10Y JGB Auction

JB360 tap to count on investor demand at 0.050-0.095% level

- ✓ This auction will be held in the counting stage of Florida votes in the US presidential election. Primary dealers will face difficulty to hedge effectively in such a situation and thus be discouraged from bidding aggressively. The auction could tail with a high probability. Both primary and secondary sale of JB360 tap will count on investor demand at the 0.050-0.095% level.
- ✓ In terms of relative value, if any, it may be worth considering switching out from the 5-year sector.

[BOX] November BOJ JGB Purchase: The BOJ trims the number of offers in the short-term/intermediate zone

Strategic Memorandum DSTE409
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Auction Details

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

* New 10Y JGBs, JB360, will likely be the first reopening of JB360.

** On November 2, JB360 traded and closed at 0.040% (+0.5bp v. previous day's close).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Since the previous 10-year JGB auction went well at the 0.025-0.030% level on October 1, the 10-year JGB yield has mostly moved in the 0.020-0.035% range, while the JGB market has largely remained range-bound. Recently, the yield is moving from the lower end to the upper end of the range. During intraday trading on October 30 and today (Nov. 2), the yield edged up to 0.040%.

This auction to be held in the counting stage of Florida votes in the US presidential election

The voting deadline in Florida, one of major and key voting blocs, is at 9:00am on November 4 (JST). As, in the state, early votes will be fully counted by then and postal voting is due on that day, the Florida results will roughly turn out around noon. In the previous US presidential election four years ago, for example, the results in Florida turned out around 12:27. If Mr. Joe Biden wins in the state, the re-election of President Trump will likely be quite difficult. Although there is a possibility that Mr. Trump will file a suit regarding postal voting, Mr. Biden's victory in Florida, which would serve as a surprise, may lead to lower bond prices as an initial reaction. If Mr. Trump wins in the state, the bond market is likely to lack a clear direction because it will take some time before we find out the overall outcome.

Putting aside the US political situation to have a slightly longer-term perspective, we can say that caution remains strong about the spread of the coronavirus toward winter. This prevents us from having an optimistic outlook for the global economy. Regardless of who

the next US President will be, a fiscal contraction is not expected, and the Fed is likely to maintain accommodative monetary easing stance. Also in Japan, the government is expected to formulate additional economic measures if needed, and the BOJ would keep the current yield curve control (YCC) policy persistently. In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers appear to be not short that much in the 10-year sector:** We are unable to expect strong support from short-covering;
- ✓ **Decent demand is expected from investors:** Investor demand for 10-year JGBs in positive yield territory appears strong. Under the BOJ's YCC policy, expectation on demand from investors is likely to strengthen at a level between 0.050% and 0.095% (the low price in Mar.);
- ✓ **Not expensive on the curve and against swaps:** Our analysis based on data since the previous 10-year JGB auction shows that the 10-year sector is noticeably expensive on the curve. On the contrary, it is remarkably undervalued vs. the 5- to 6-year sector (Appendix 3). Since the previous 10-year auction, asset swaps have been moving in a quite narrow range. We thus can say that 10-year cash is neither noticeably overvalued nor undervalued against swaps at the current level;
- ✓ **In November, the BOJ is expected to continue to offer five purchase operations totaling around Y2.1tn in the over-5-year to 10-year zone:** In the BOJ's Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for November 2020 released on October 30, the offer range and the number of offers in the over-5-year to 10-year zone were unchanged from those for October (see BOX). The BOJ's purchases totaling (at least) around Y2.1tn (Y420bn x five times) are expected to continue also in November. The BOJ is likely to persistently conduct the current YCC policy, setting the target for the long-term interest rate at "around 0%." The BOJ's support for 10-year JGBs appears to remain rock-solid.

This auction to tail with a high probability

This auction will be held in the counting stage of Florida votes in the US presidential election. Primary dealers will face difficulty to hedge effectively in such a situation and thus be discouraged from bidding aggressively. The auction could tail, possibly by about 3bp, with a high probability. Both primary and secondary sale of JB360 tap will count on investor demand at the 0.050-0.095% level. In terms of relative value as well, it is difficult to aggressively build new positions. However, we think that it could be worth considering switching out from the 5-year sector, given the schedules for upcoming auctions and the BOJ's purchases etc.

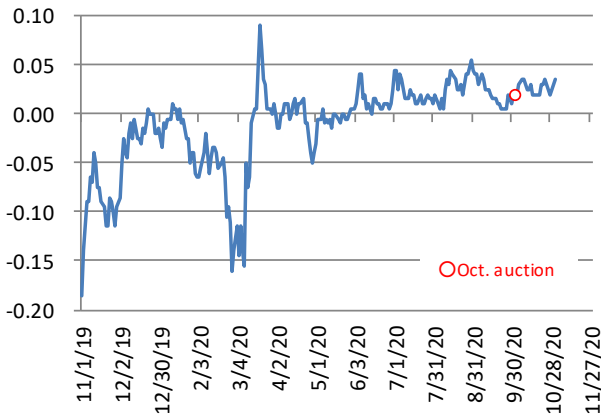
10Y JGB Auction Results

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 %	
11/4/20	360R	0.1	9/20/30	2,600*									
10/1/20	360	0.1	9/20/30	2,814	4.06	100.75	100.74	0.01	0.024	0.025	0.001	51.3823	Good
9/1/20	359R	0.1	6/20/30	2,600	3.15	100.64	100.53	0.11	0.034	0.045	0.011	21.1681	Poor
8/4/20	359R	0.1	6/20/30	2,809	3.64	100.80	100.77	0.03	0.018	0.021	0.003	61.8502	Avg
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

* Amount the MOF plans to issue

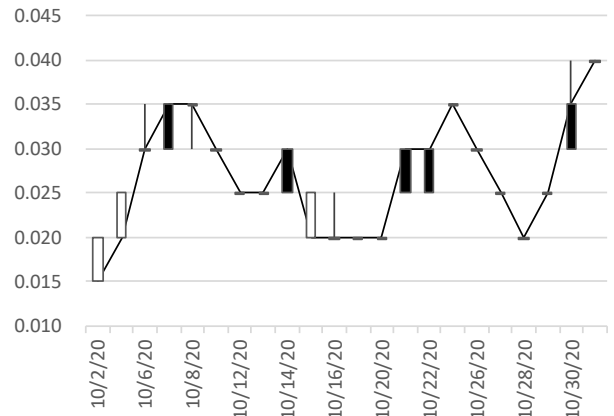
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1a: 10Y JGB Yield (%)



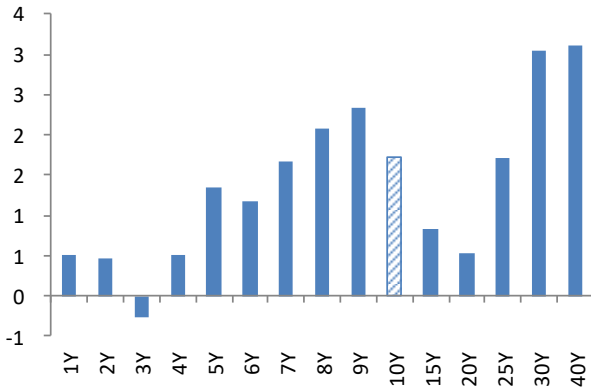
Source: Daiwa Securities.

Appendix 1b: JB360 Yield Candle Chart (%)



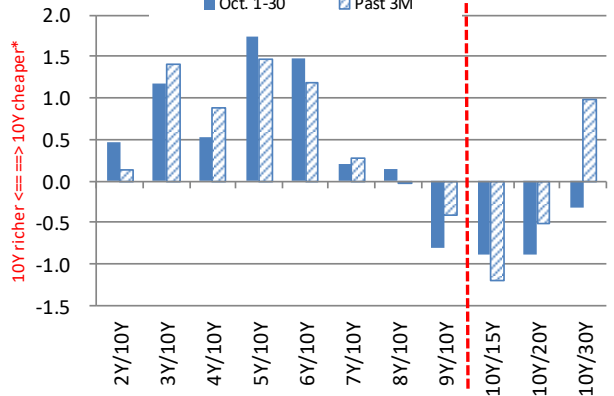
Note: As of 14.00 JST on Sep. 30
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Oct. 1 vs. Oct. 30)



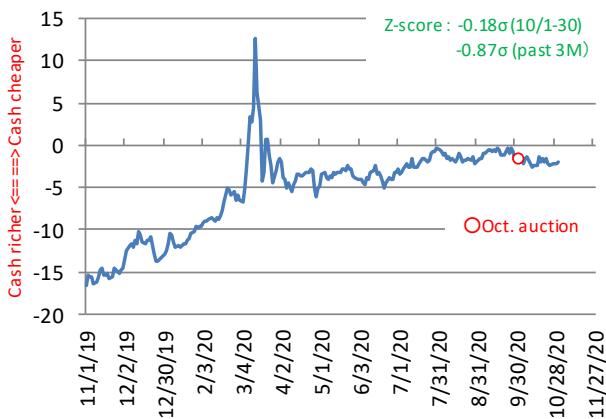
Source: Daiwa Securities.

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



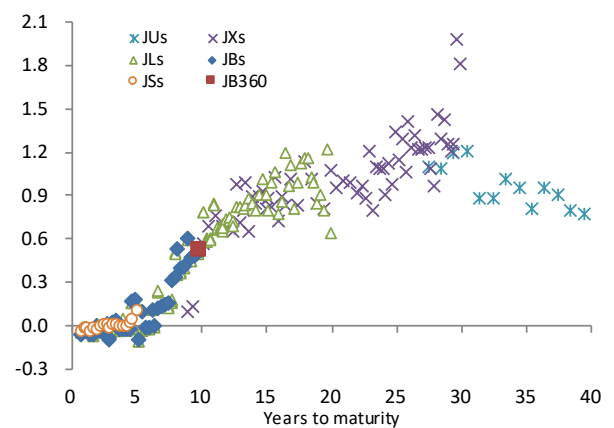
Note: + (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
Source: Daiwa Securities.

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 Oct. 30; assuming that those yield curve shapes do not change and factoring roll-down effect etc.
Source: Daiwa Securities

[BOX] November BOJ JGB Purchase: The BOJ trims the number of offers in the short- to intermediate-term zone

The BOJ announced its *Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method)* for November 2020 at 5:00pm on October 30. The changes from the October purchase plan are as follows:

- ✓ A decrease in the number of offers (from three to two) and an upward revision to the offer range (Y50bn-150bn to Y100-200bn) in the zone up to one year
- ✓ A decrease in the number of offers (from six to five) and an upward revision to the offer range (Y250-600bn to Y350-650bn) in the over-1-year to 3-year zone
- ✓ A decrease in the number of offers (from six to five) and an upward revision to the offer range (Y200-500bn to Y250-600bn) in the over-3-year to 5-year zone
- ✓ The number of monthly offer days has declined to seven days, from eight days in October. This is the first change since March at the timing of the monthly schedule release.

In November, the number of offers in the short-term/intermediate zone will decrease compared to October. Reasons for this include the BOJ's intention, due in part to recent recovery in liquidity and improvement in market function, to reduce the number of offers in these zones, which had been increased in order to respond to the crisis in April. If the BOJ tried to set an operation schedule finely with their care to the MOF auction schedule etc., it might have proved difficult for it to conduct flexible operations in November, which only has 10 available days for offers compared to 13 in October (excl. two business days when the Monetary Policy Meeting is held). With caution to higher predictability on the operation schedule among market participants, the BOJ decided to reduce the number of offers they increased in April as a crisis-response measure in order to minimize its involvement in the market via an adjustable schedule, we think.

In the zone up to one year, the over-1-year to 3-year zone, and the over-3-year to 5-year zone, the BOJ upward revised their monthly offer ranges along with the reduction of the number of offers.

Expecting initial offer amounts in November are Y150bn in the zone up to one year, Y500bn in the over-1- to 3-year zone, and Y420bn in the over-3- to 5-year zone

In light of the announcement of the monthly schedule, we forecast that the offer amount at the first operation in each targeted zone in November will be as follows: Y150bn in the zone up to one year (up Y50bn vs. the last operation in Oct), Y500bn in the over-1-year to 3-year zone (up Y80bn), and Y420bn in the over-3-year to 5-year zone (up Y70bn), but otherwise the same as October's last operations in other target zones (see Table on next page). Based on this forecast, the purchase amount in November (excl. linkers and floaters) is estimated at around Y7.3tn, largely unchanged from Y7.32tn in October. The degree of increase in the offer amounts in the over-1-year to 3-year zone and the over-3-year to 5-year zone is expected to be the greatest since July when the offer amounts were upped in line with the substantial increase in the JGB issuance. Amid further monetary easing during the COVID-19 pandemic, the BOJ appears to be taking the stance of maintaining the same total monthly purchases as in October.

First operations in November to be conducted after the US presidential and congressional election

Market reactions to the November purchase plan were limited at the release on October 30. But the first operation in the over-1-year to 3-year zone warrants particularly close attention because (1) the over-1-year to 3-year zone is substantially concave in the over-0-year to 5-year zone of the yield curve and (2) the increasing number of cases of the bid-to-cover ratio falling below 2.0x for the Y420bn offer amount thus far. On all target zones, the first operations in November will be conducted after the US presidential and congressional election. If the market becomes volatile, expectations on flexible operations by the BOJ will likely grow.

T-bill purchases within a range of Y500bn to Y3tn to continue

The *Outline of Outright Purchases of Japanese Government Securities* was not updated this time as well. We therefore expect the wording on its T-bill purchases to be the same as it was in its outline of purchases dated April 27, 2020, with the Bank deciding the purchase size per auction considering the effects on financial markets, and purchasing about Y500bn to Y3.0tn of T-Bills per auction for the time being. However, for the sake of market stability,

we still think it would be desirable for the BOJ to provide guidance on its T-bill purchasing operations with more clarity and in line with market trends.

BOJ's JGB Purchase Plan for November 2020

(Yen billions)

	Offer size per operation		Number of Offers (per month)	First offer size		Monthly Total exp. in Nov. (a)	MOF issuance in Nov.* (b)	(a)/(b) (%)	
	Mid				Last offer in Oct.			YCC Avg.***	
JGBs ex Linkers and Floaters									
1 year and less	100	- 200	150	2	150	100	300	-	-
Over 1 to 3 years	350	- 650	500	5	500	420	2,500	3,000	83.3 76.2
Over 3 to 5 years	250	- 600	425	5	420	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	1,400	4.3 30.8
Linkers	30	-	-	2	30	30	60	-	-
Floaters	50	-	-	1	50	-	50	-	-
TOTAL**:							7,300	10,700	68.2
Oct.:							7,320	10,700	68.4

(Note) Floaters offered in even months; Change from October in red; "First offer size" is Daiwa forecast as of Oct. 30. * Excluding auction II and AEL

Excluding JGB floaters and JGB linkers * Based on the sum of 30Y JGB issuance amount and one-half of 40Y JGB issuance amount

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

BOJ's JGB Purchase Schedule in November 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	TDBs	MOF Buyback	
11/2/20 M	11/4/20										
11/3/20 T	-	Public Holiday (Constitution Memorial Day)								-	
11/4/20 W	11/5/20	10Y JGB Auction								○	
11/5/20 TH	11/6/20		◎	◎			◎				
11/6/20 F	11/9/20	10Y JGB Linker Auction								3M	
11/9/20 M	11/10/20	○			◎	◎		○	6M		
11/10/20 T	11/11/20	30Y JGB Auction									
11/11/20 W	11/12/20		◎	◎	◎				○		
11/12/20 TH	11/13/20	5Y JGB Auction									
11/13/20 F	11/16/20	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity								3M	○
11/16/20 M	11/17/20		◎	◎	◎				○		
11/17/20 T	11/18/20	20Y JGB Auction								○	
11/18/20 W	11/19/20	20Y JGB Auction								1Y	
11/19/20 TH	11/20/20	AEL for 2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years left to maturity								3M	
11/20/20 F	11/24/20	AEL for 2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years left to maturity								3M	
11/23/20 M	-	Public Holiday (Labor Thanksgiving Day)								-	-
11/24/20 T	11/25/20		◎	◎	◎			○	6M		
11/25/20 W	11/26/20	40Y JGB Auction									
11/26/20 TH	11/27/20		◎		◎	◎			○		
11/27/20 F	12/1/20	2Y JGB Auction								3M	
11/30/20 M	12/1/20	○		◎			◎				

Note: ◎ Announced by BOJ on Oct. 30, ○ Daiwa forecast as of Oct. 30

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

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[Standard & Poor's]

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[Fitch]

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February 2020

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- 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).

- 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