

Outlook for 40Y JGB Auction

Market participants shouldn't be optimistic about JU13 tap sale

- ✓ Considering that the 40Y JGB yield could go above 0.7% on Japanese yield basis before the next 40Y JGB auction in January 2021, we would like to think about our bidding stance to take only the necessary amount with extensive attention to demand from investors

Strategic Memorandum DSTE413
FICC Research Dept.

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Auction Details

Auction Date:	November 25, 2020
Issue Date:	November 26, 2020
Maturity Date:	March 20, 2060
Offering Amount:	About 500 billion yen
Auction Method:	Dutch auction on a compound yield with the increment of 0.5bp

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

** On November 24, JU13 traded at 0.675% (+1.5bp v. previous day's close, 0.657% on compound yield) and closed at 0.675% (+1.5bp, 0.657%).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Tomorrow's auction is to be held at the highest bidding yield level since the auction in Jan 2019

Since the previous 40Y JGB auction had an average result at the 0.615-0.620% level (0.604-0.608% on compound yield basis) on September 24, the 40Y JGB yield (on conventional basis) had edged up and temporarily risen to 0.695% on intraday basis on November 13. Since then, the yield has mostly moved in the 0.660-0.685% level. Tomorrow's auction is expected to be held at the highest bidding yield level since the auction in January 2019.

Difficult to factor in a third extra budget in tomorrow's auction as reported figures appear to have no rational foundation yet

Despite an increase in positive headlines related to the development of COVID-19 vaccines, worries about the economic outlook remain strong amid increasing Covid-19 infections. The global trend of fiscal expansion is unlikely to change for a while. Also in Japan, we have seen an increase in the number of media reports, in which the scale of additional economic measures and the expenditure size of a third supplementary budget are estimated largely, since Prime Minister Yoshihide Suga instructed to formulate additional economic measures. At the moment, however, we have the impression that these figures have no rational foundation. With those figures, it is difficult to factor in the JGB issuance plan in tomorrow's

auction, ahead of the Meeting of JGB Market Special Participants and the Meeting of JGB Investors both scheduled for November 26. In such an environment, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Strong steepening trend in the 20-40Y zone:** Since the substantial increase in JGB issuance in July, market sentiment for 30Y JGBs has been unstable, and the fragile sentiment has been spreading to 40Y JGBs, as witnessed by the widening of the 20Y/30Y and 20Y/40Y spreads (Appendix 7). As both 30Y and 40Y JGBs appear to have found decent demand at their new price levels, 30Y and 40Y JGB yields have not risen with strong momentum. However, they seem to lack buyers with large-lot;
- ✓ **A certain level of demand is expected from investors:** Ahead of the introduction of capital regulations based on an economic value, potential demand for 40Y JGBs appears strong. As 40Y JGBs are issued bimonthly in relatively small amounts, such demand can be expected to some extent. However, as the 40Y JGB yield has been mostly moving at the 0.660-0.685% level since mid-November, investors may have filled their appetite for 40Y JGBs at that level. The degree of investor demand needs to be carefully checked;
- ✓ **The 40Y sector's cheapness vs. the 20Y sector is somewhat notable on the curve:** Our analysis based on data since the previous 40Y JGB auction shows that the 40Y sector's cheapness vs. the 20Y sector is slightly notable at the current level (Appendix 5). Among 40Y JGBs, JU13's cheapness vs. JU1 (to be redeemed in Mar 2048, coupon of 2.4%) is somewhat notable (Appendix 5). However, as we do not expect a major flattening in the 20-40Y zone especially in the near term, it is difficult to take a curve position aggressively by switching;
- ✓ **Perception gap regarding market short positions:** Support from short-covering is uncertain.

Market participants shouldn't be optimistic about JU13 tap sale

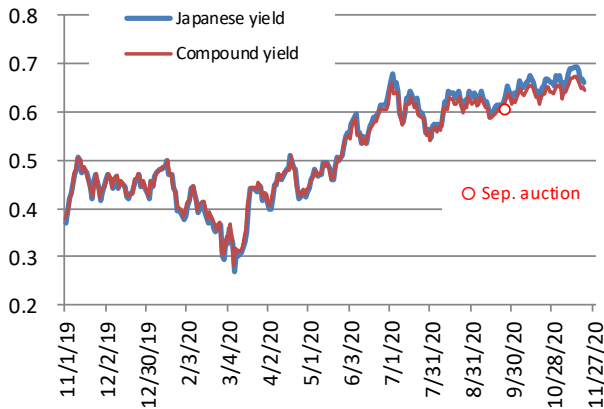
Given all factors above together, we don't think that market participants should be optimistic about JU13 tap sale. Considering that the 40Y JGB yield could go above 0.7% on Japanese yield basis before the next 40Y JGB auction in January 2020, we would like to think about our bidding stance to take only the necessary amount with extensive attention to demand from investors.

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)**	
11/25/20	13R	0.5	3/20/60						0.644	2.1			
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

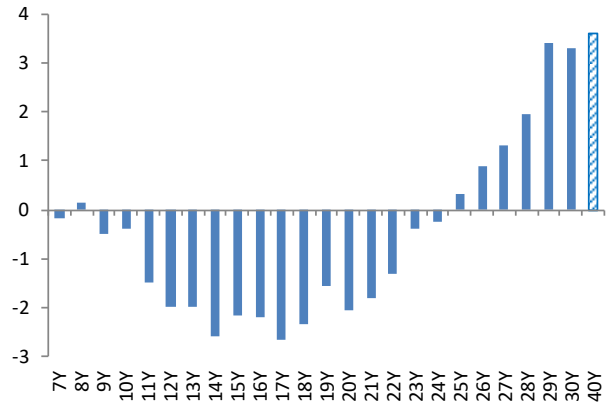
* Issue amount planned by Ministry of Finance ** Based on WI for new JU series; as of Nov. 20 close for the Nov-2020 auction
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 40Y JGB Yield (%)



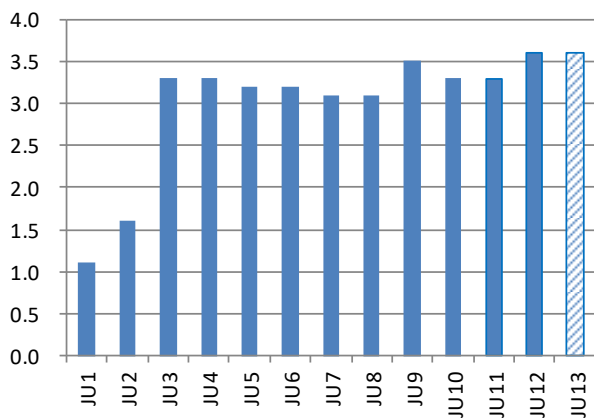
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Sep. 24 vs. Nov. 20



Source: Daiwa Securities.

Appendix 3: 40Y JGB Yield Change: Sep. 24 vs. Nov. 20



Source: Daiwa Securities.

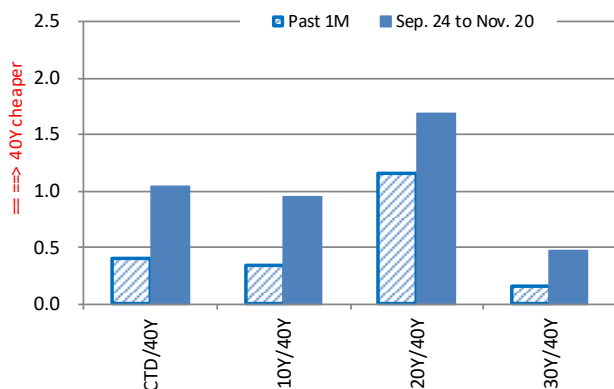
Appendix 4: BOJ Holding and Market Outstanding of 40Y JGBs

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,064.8	290.1	27.2%	774.7
JU2	1,349	77	5.7%	1,272
JU3	1,384	200	14.5%	1,184
JU4	1,964	235	12.0%	1,729
JU5	1,964	147	7.5%	1,817
JU6	2,004	934	46.6%	1,071
JU7	2,181	1,068	49.0%	1,113
JU8	2,327	1,263	54.3%	1,064
JU9	3,795	1,550	40.8%	2,245
JU10	3,429	1,178	34.4%	2,251
JU11	2,713	486	17.9%	2,226
JU12	2,863	100	3.5%	2,763
JU13	1,559	0	0.0%	1,559

Source: Bank of Japan, Daiwa Securities.

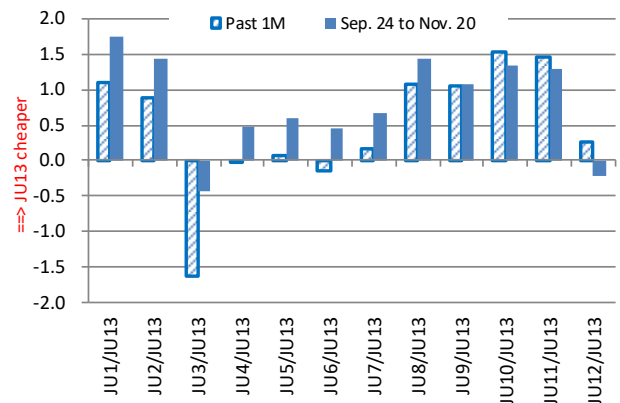
Appendix 5a: Z-score I



Note: On-the-run and CTD basis

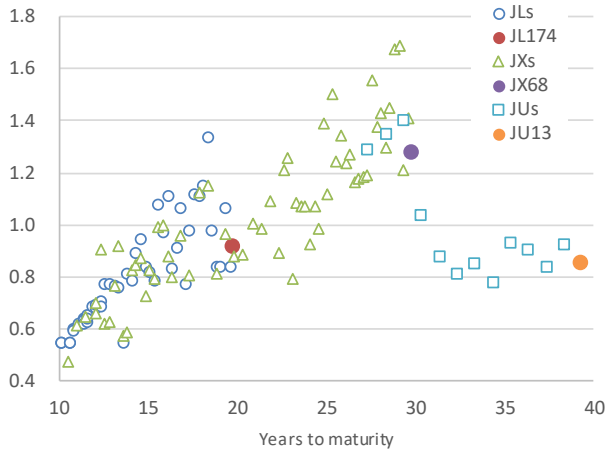
Source: Daiwa Securities.

Appendix 5b: Z-score II



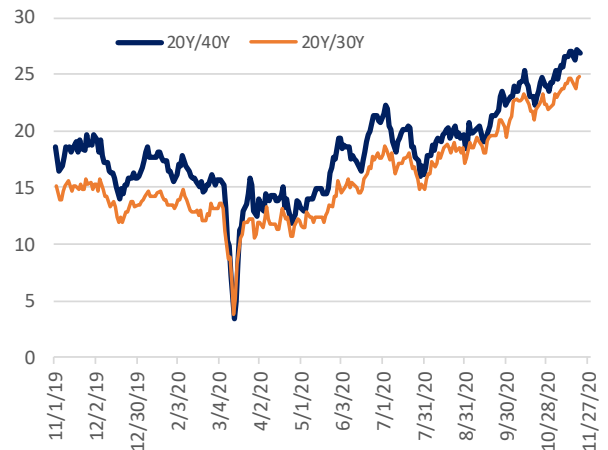
Source: Daiwa Securities.

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



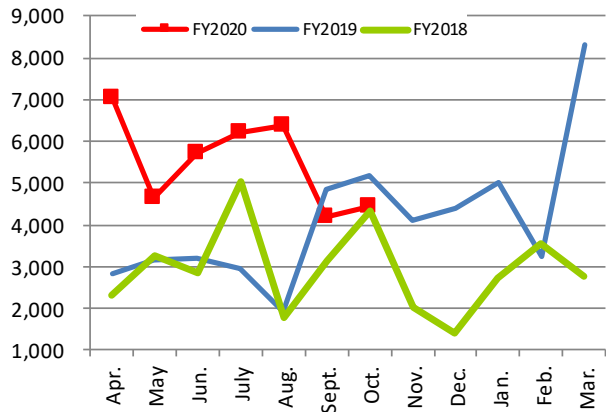
Note: Based on the Nov-20 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

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



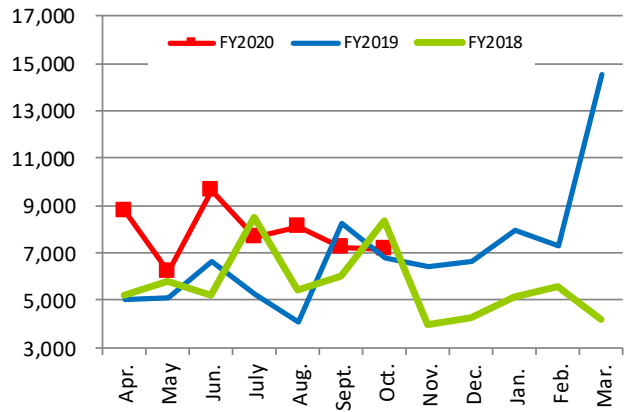
Note: On-the-run basis
Source: Daiwa Securities.

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



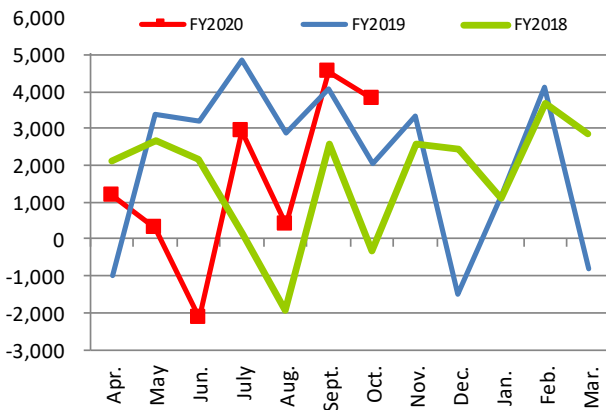
Source: JSDA

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



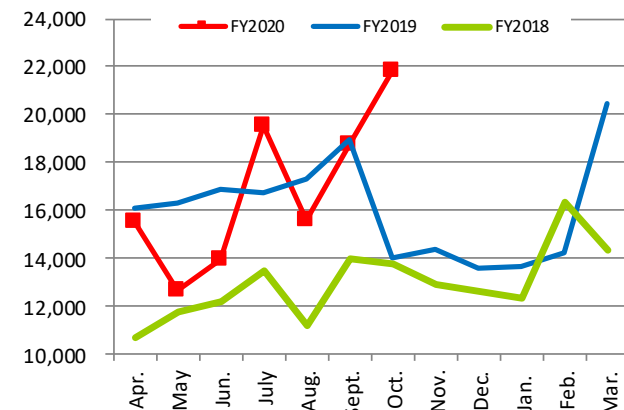
Source: JSDA

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

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[Standard & Poor's]

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[Moody's]

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[Fitch]

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February 2020

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- 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.
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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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