

Outlook for 20Y JGB Auction

Good primary sale expected, but JL174 tap is unlikely to accelerate up

- ✓ We think about our bidding stance, expecting the 20Y JGB yield to move at the 0.365-0.400% range toward end-2020
- ✓ In terms of relative value, it would be worth considering the 16-17Y/20Y/22-23Y butterfly trade

Strategic Memorandum DSTE417
FICC Research Dept.

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Auction Details

Auction Date:	December 10, 2020
Issue Date:	December 11, 2020
Maturity Date:	September 20, 2040
Offering Amount:	About 1.2 trillion yen

* New 20Y JGBs will be the last reopening of JL174 carrying a 0.4% coupon.

** On December 9, JL174 traded at 0.375-0.380% (unch - +0.5bp v. previous day's close) and closed at 0.375% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Moving in the 0.375-0.395% range since previous auction

Since the previous 20Y JGB auction went well at the 0.390-0.395% level (-1.0 - -0.5bp vs. previous day's close), the 20Y JGB yield has been moving in the 0.375-0.395% range on an intraday basis. At 15:00 today (Dec. 9), JL174 trades at 0.375-0.380% (unchanged -+0.5bp vs. previous day's close). We have the impression that there are buyers for 20Y JGBs even at the level below 0.40% in a matter-of-fact way.

MOF may not need to issue more JGBs in the market for the economic packaged, but market participants have been requesting further issuance of 20Y and 40Y JGBs persistently

Despite the recent increase in positive headlines related to the development/diffusion of COVID-19 vaccines, worries about the economic outlook remain strong amid increasing Covid-19 infections around the globe. The global trend of fiscal expansion is unlikely to change substantially for a while. Also in Japan, the Suga administration approved for an additional economic package worth around 40tn yen in fiscal spending at a Cabinet meeting on December 8. At the moment, there is a possibility that the calendar-based market issuance amount after the third supplementary budget will be unchanged from the figure after the second supplementary budget. Compared to the amount after the second extra budget, the degree of decline in the FY21 calendar-based market issuance amount may not be so large. Depending on how to increase FILP bonds, the calendar-based issuance in FY2021 could remain flat or even increase slightly vs. that after the second supplementary budget in FY2020, we estimate. Regarding an increase/decrease of the issuance of superlong JGBs in the JGB issuance plan, the Ministry of Finance (MOF) and market participants appear to have slightly different opinions. However, market participants have

been requesting further issuance of 20Y JGBs and 40Y JGBs persistently. We will be watching closely responses by the MOF, which appears to have a strong commitment to the issuance management by maturity structure that meets market needs. 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 deeply short in the 20Y sector:** It is difficult to strongly expect support from short-covering. The key for the auction would be the level of demand from investors;
- ✓ **There are no strong worries about demand from investors even at the level below 0.4%:** As witnessed by the fact that 20Y JGBs have been traded in the 0.375-0.395% range since the previous auction, we have the impression that there are buyers even at the level below 0.4% in a matter-of-fact way. It is highly likely that bids will be placed at the level below 0.4% tomorrow, but there are no strong worries about demand from investors;
- ✓ **Noticeably undervalued vs. around the 23Y sectors on the curve:** Our analysis based on data since the previous 20Y JGB auction shows that the 20Y sector is noticeably undervalued vs. around the 23Y sectors on the intermediate to superlong zone of the curve. On the other hand, we can say that the 20Y sector is overvalued vs. the 10Y sector (Appendix 3). The 20Y asset swap spread has been widening, albeit quite moderately, after hitting a peak at around the Yen LIBOR+20bp in August (Appendix 6). Although the current level points to a slight widening compared to the level as of the previous auction, we can say that it is not expensive based on Z scores and other data;
- ✓ **No large-lot supply to superlong JGBs until the 30Y JGB auction scheduled for January 2021:** After tomorrow's 20Y JGB auction, there will be no large-lot supply to superlong JGBs supply until the 30Y JGB auction scheduled for January 8 (excl. the 500bn yen tap auction on December 22). By then, the BOJ could offer two purchase operations in the 10-25Y zone (once this month and we expect once in Jan).

We think about our bidding stance, expecting the 20Y JGB yield to move at the 0.365-0.400% level by end-2020

Overall, we would like to think about our bidding stance at tomorrow's auction, expecting the 20Y JGB yield to move at the 0.365-0.400% level by the end of the year. Given this level, we think that a cautious stance is necessary to take big outright positions at the 0.375-0.380%. In terms of the relative value, it would be worth considering the 16-17Y/20Y/22-23Y butterfly trade (buying 20Y/selling 16Y and 22-23Y, Appendix 5). This is partly because (1) the 20Y sector is strongly undervalued vs. winnings in such sectors and (2) spreads are now close to their reversal levels.

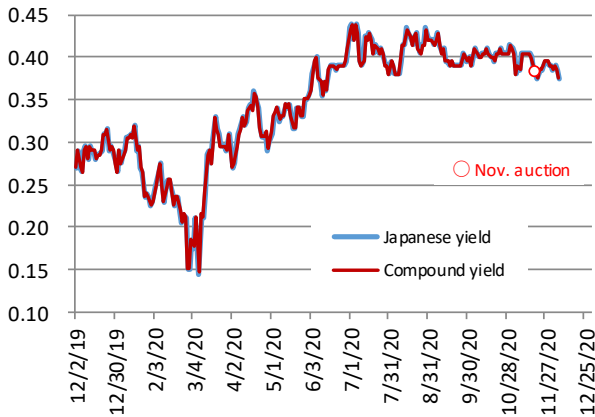
20Y JGB Auction Results

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
12/10/20	174R	0.4	9/20/40	1,200*									
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
3/12/20	171R	0.3	12/20/39	963.5	3.69	100.98	100.90	0.08	0.248	0.252	0.004	97.2897	Good
2/20/20	171R	0.3	12/20/39	969.8	3.99	101.27	101.25	0.02	0.232	0.234	0.002	81.9560	Good
1/17/20	171	0.3	12/20/39	899.1	3.83	99.99	99.90	0.09	0.300	0.305	0.005	93.4722	Good
12/17/19	170R	0.3	9/20/39	1,027.5	4.10	100.25	100.20	0.05	0.286	0.289	0.003	30.5611	Good
11/20/19	170R	0.3	9/20/39	1,032.8	4.21	100.63	100.60	0.03	0.266	0.268	0.002	43.6701	Good

* Amount the Ministry of Finance plans to issue

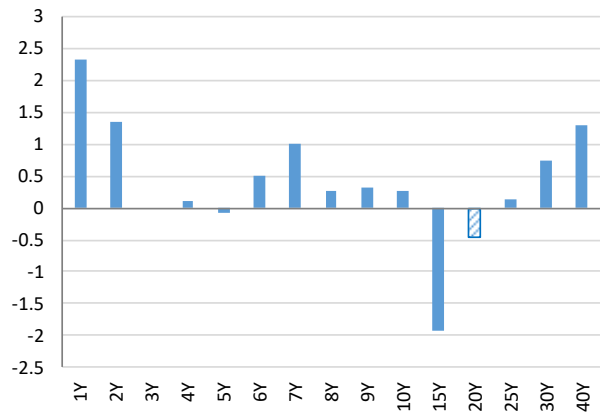
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 20Y JGB Yield (%)



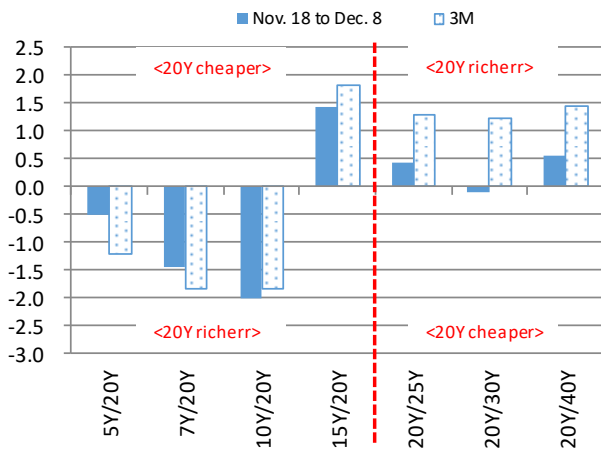
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp): Nov. 18 vs. Dec. 8



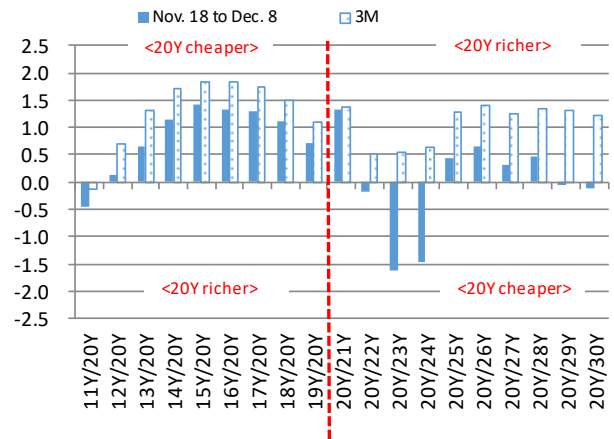
Source: Daiwa Securities.

Appendix 3a: Z-score I



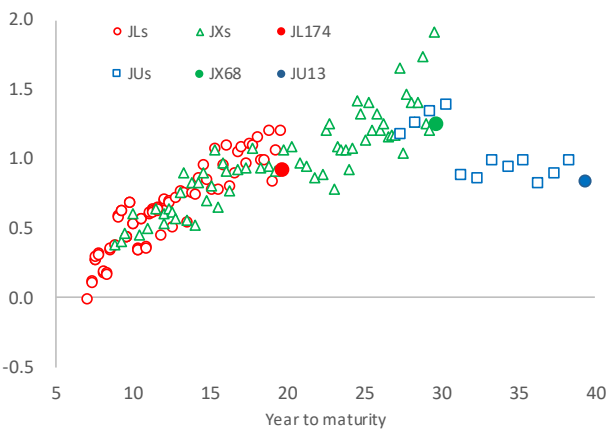
Source: Daiwa Securities.

Appendix 3b: Z-score II



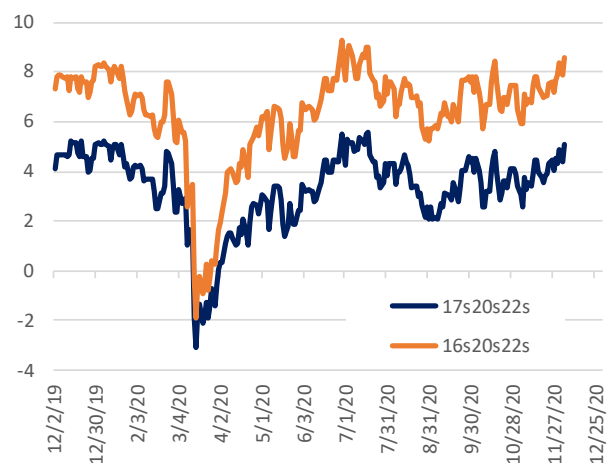
Source: Daiwa Securities.

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



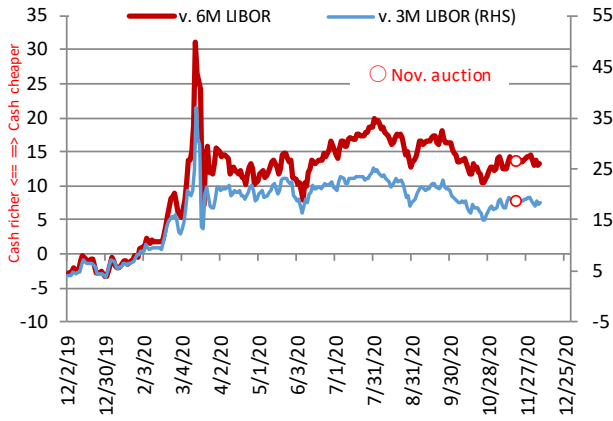
Note: Based on the Dec-8 JGB yield curve; factoring in roll-down effect etc.
Source: Daiwa Securities.

Appendix 5: JGB 16-17Y/20Y/22Y Butterfly Spread (bp)



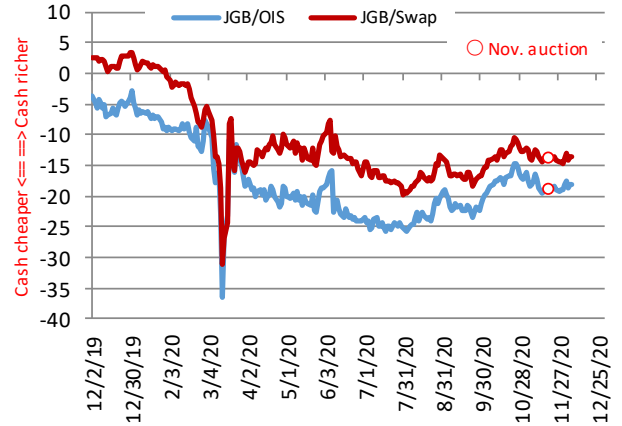
Note: Generic compound yield
Source: Daiwa Securities

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



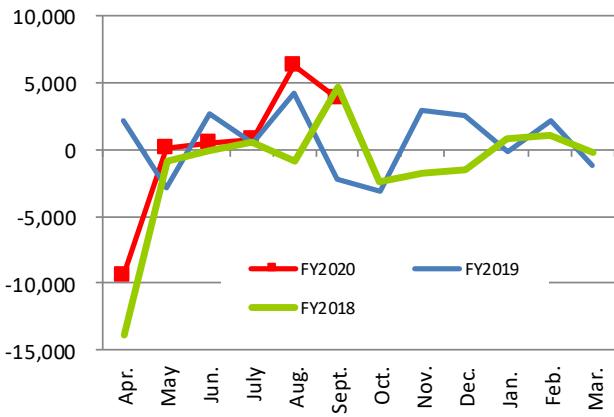
Source: Daiwa Securities.

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



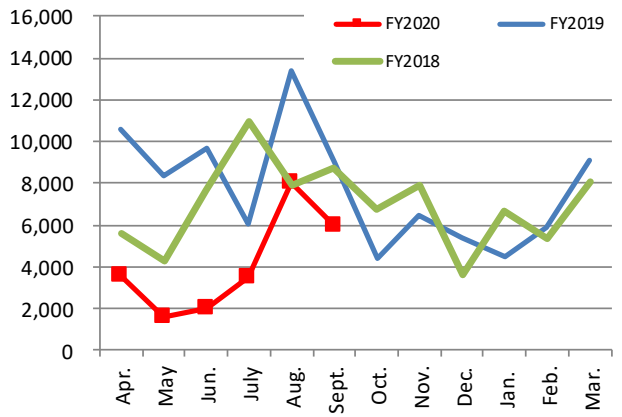
Source: Daiwa Securities.

Appendix 7a: Trend of Major Banks' Net Purchase of Superlong JGBs (Yen 100M)



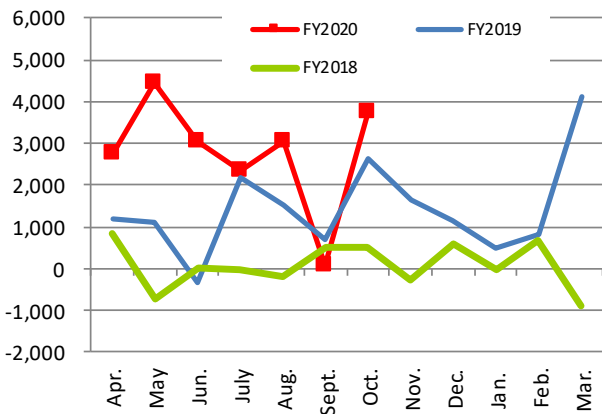
Source: JSDA

Appendix 7b: Trend of Major Banks' Gross Purchase of Superlong JGBs (Yen 100M)



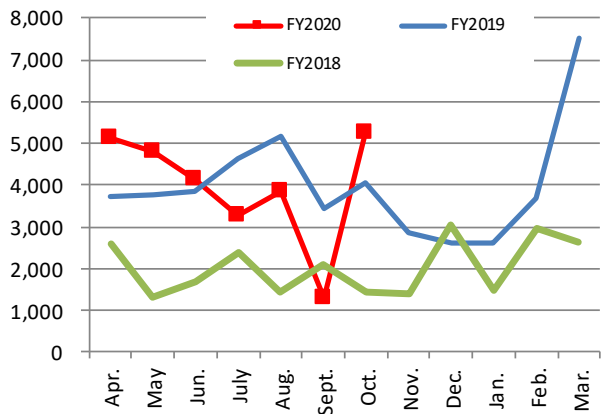
Source: JSDA

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



Source: JSDA

Appendix 8b: Trend of Regional Banks' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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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[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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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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