

Outlook for 10Y JGB Auction

0.02% may discourage buyers to respond to fresh JB361 enthusiastically

- ✓ We think about our bidding stance to buy only the minimum necessary amount, unless the WI yield rises above 0.02%, expecting the yield of fresh 10Y JGBs, JB361, to move in the 0.01-0.04% core range over the next one month.
- ✓ In terms of relative value, it may be worth considering switching out from 5-year sector at 14bp.

[BOX] BOJ's JGB purchases in January 2021: Range of offered amounts in the 1-3Y zone revised down

Strategic Memorandum DSTE421
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Auction Details

Auction Date:	January 6, 2021
Issue Date:	January 7, 2021
Maturity Date:	December 20, 2030
Offering Amount:	About 2.6 trillion yen

* New 10Y JGBs, JB361, will likely carry a 0.1% coupon.

** On January 5, WI traded at 0.020% (-1.0bp v. previous day's close) and closed at 0.020% (-1.0bp). JB360 traded at 0.010% (-1.0bp) and closed at 0.010% (-1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Buyers may be discouraged to take aggressive stance at the current yield level

After the previous 10-year JGB auction went smoothly at the 0.015-0.020% level (-1.0 - -0.5bp vs. previous day's close), the 10-year JGB yield temporarily declined to 0.000% in mid-December during intraday trading amid the firmness of the JGB market. Then, stock prices performed well around the globe partly because an additional economic package, which was a nagging concern, was enacted in the US, while the outlook for the diffusion of COVID-19 vaccines became more optimistic. In Japan, the 10-year JGB yield rose to 0.02% at one point on an intraday basis amid the softness of the JGB market. 2021 has started in the midst of the rapid spread of COVID-19. While Japanese stock prices turn to bearish as the Japanese government is expected to declare another state of emergency, the 10-year JGB yield temporarily declined to 0.010% during intraday trading today. Even if we consider the yield spread between JB360 and new 10-year JGBs, JB361, the current absolute yield level would discourage buyers from aggressively placing primary bids.

Both upside and downside appear to be limited

We check the environment surrounding the JGB market. In the US, the Georgia Senate runoff elections will be held to determine two seats on January 5. In this race, the approval ratings of candidates in ruling and opposition parties are close, but it appears difficult for the Democratic Party to secure both two seats. Therefore, the chance of "blue wave" looks quite slim. With the possibility that the election result will not be found out until after the closure of the JGB market on January 6 (JST), we would not need to concern about negative impact on JGBs too much. In Japan, the government is expected to declare

another state of emergency for Tokyo and three neighboring prefectures on January 7 amid the rapid spread of the COVID-19. Compared to the previous state of emergency, the target will be limited only to Tokyo and three neighboring prefectures, and the range of restrained social economic activities (based on government's request) will be narrower. Therefore, the impact on real GDP may be much smaller than that from the previous state of emergency. Under the circumstances, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **Primary dealers do not appear to be short that much in the 10-year sector:** We are unable to expect strong support from short-covering;
- ✓ **Decent demand expected from investors:** Investor demand for 10-year JGBs in positive yield territory appears to remain strong. In addition, new 10-year JGBs (JB361 to be redeemed in Dec 2030) will be the last 10Y JGB fresh (not tap) issues in this fiscal year. Strong worries are unnecessary for demand from investors;
- ✓ **Not cheap on the curve:** Our analysis based on data especially since the previous 10-year JGB auction shows that the 10-year sector is noticeably overvalued vs. the 4-year, 8-year, 9-year, 15-year, and 20-year sectors (Appendix 3). This suggests that the 10-year sector is not cheap on the curve. Since the previous 10-year auction, the asset swap has largely remained flat in a quite narrow range. We thus can say that 10-year cash is neither noticeably overvalued nor undervalued against swaps (Appendix 4).
- ✓ **In January, the BOJ is expected to continue to offer five purchase operations totaling around Y2.1tn in the over-5- to 10-year zone:** In the BOJ's Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for January 2021, released on December 28, the offer range and the number of offers in the over-5-year to 10-year zone were unchanged from those for December (see [BOX]). In its first operation in 2021, held today (Jan 5), the offer amount was unchanged from that in the last operation in December at Y420bn. Given the fact that the 10-year JGB yield has been quite stable under the BOJ's control and recent operations have been conducted without major disruptions, we think that the BOJ is unlikely to reduce the offer amount in the over-5-year to 10-year zone shortly. The BOJ's purchases totaling around Y2.1tn (Y420bn x five times) are expected to continue until the auction in February, which should support 10-year JGBs.

We think about our bidding stance to buy only minimum necessary amount

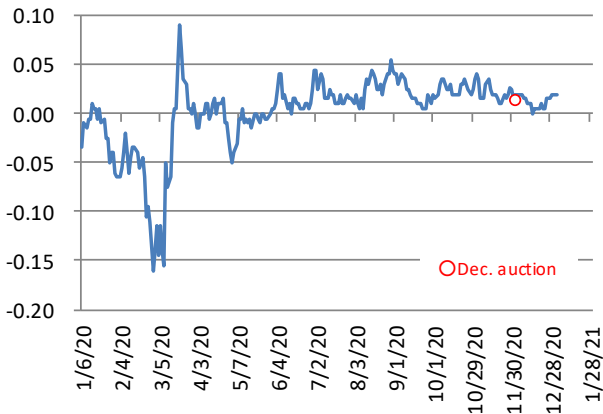
All in all, we would like to think of our bidding stance to buy only the minimum necessary amount if the absolute yield level gets higher in pre-auction trading, assuming the 0.01-0.04% core range of the 10-year JGB yield over the next one month. In terms of relative value, we have to take a passive stance at the current levels. However, it would be worth considering switching out from the 5-year sector because (1) the auction for new 5-year JGBs in a new maturity basket is scheduled for Wednesday, January 13, and (2) there is strong expectations for reduction in the BOJ's offer amount in the over-3-year to 5-year zone. If the 5-year/10-year spread widens to around 14bp, the switching would work well.

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 %	
1/6/21	361	0.1*	12/20/30	2,600**									
12/1/20	360R	0.1	9/20/30	2,812	3.42	100.79	100.77	0.02	0.019	0.021	0.002	69.6232	Avg
11/4/20	360R	0.1	9/20/30	2,824	4.13	100.53	100.52	0.01	0.046	0.047	0.001	73.1880	Good
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

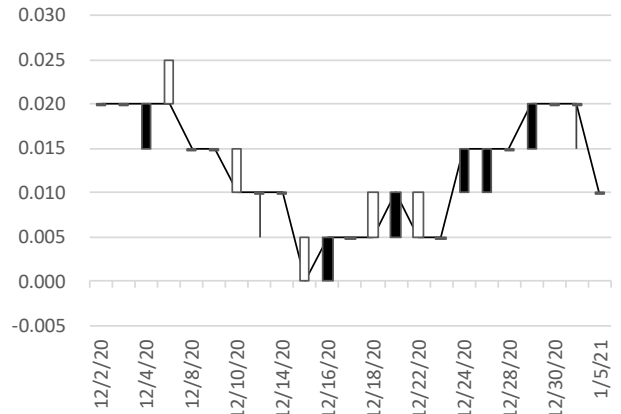
* Daiwa forecast (as of Jan. 5) ** Amount the MOF plans to issue
 Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1a: 10Y JGB Yield (%)



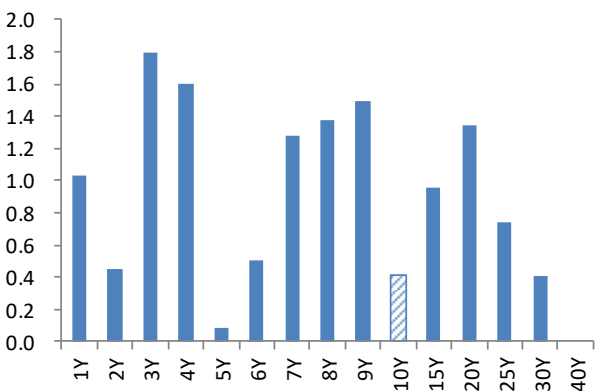
Source: Daiwa Securities.

Appendix 1b: JB360 Yield Candle Chart (%)



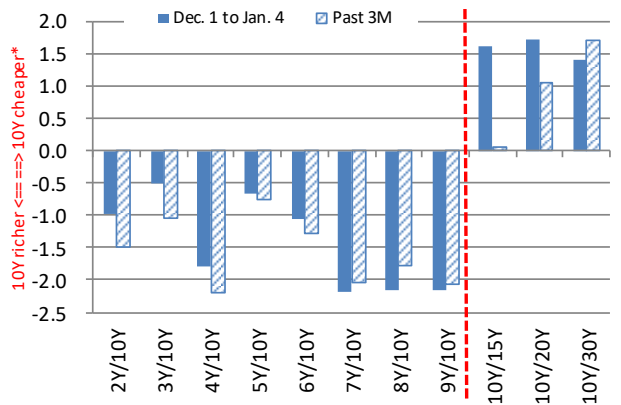
Note: As of 14.00 JST on Nov. 30
 Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Dec. 1 vs. Jan. 5)



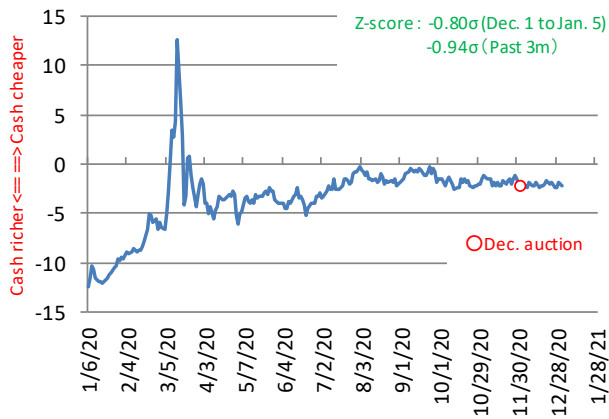
Source: Daiwa Securities.

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



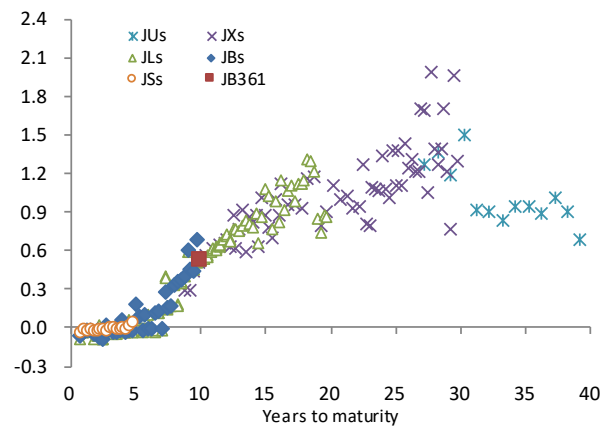
+ (-) 10Y richer (cheaper) for 10Y/15Y, 10Y/20Y and 10Y/30Y
 Source: Daiwa Securities.

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



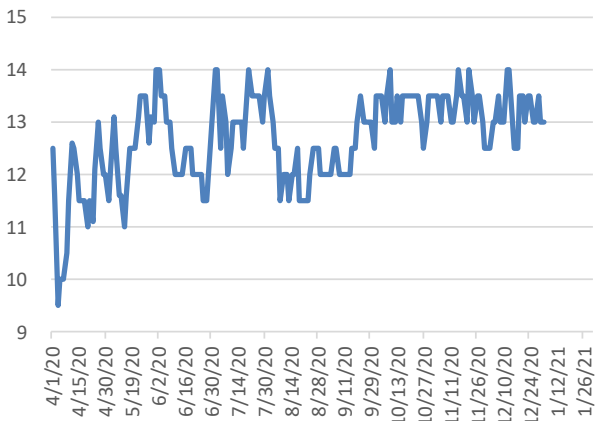
* Yen LIBOR basis
Source: Daiwa Securities.

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



Note: Based on JGB yield curve on Jan. 4; assuming that those yield curve shapes do not change and factoring roll-down effect etc.; JB361 is assumed to have a 0.1% coupon and 1bp spread to JB360.
Source: Daiwa Securities

Appendix 6: JGB 5Y/10Y Spread (bp)



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

[BOX] BOJ JGB purchase in January 2021: Range of offered amounts in the 1-3Y zone revised down

At 5:00pm on December 28, 2020, the BOJ announced its Monthly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method) for January 2021, which shows that the offer range and the number of offers in all the purchase target zones are unchanged from those for November.

- ✓ The Bank revised down its range of offer amounts in the over-1-year to 3-year zone from Y350-650bn in December to Y300-600bn.
 - There was strong demand from the market for this reduction because of the sharp decline in liquidity and deteriorated market functionality. The BOJ may have made this move in response to market concerns that the BOJ may not adjust its offer amounts under the assessment of monetary policy toward March
- ✓ The Bank has scheduled operations in the over-5-year to 10-year zone on the day before a 10-year JGB auction for the first time since Jul-Aug 2019 (when an operation on July 31 preceded an auction on August 1).
- ✓ The Bank will make offers on seven days during the month, the same as in December.

Because the market consensus was that there would be no changes in the January schedule from that for December, the BOJ's decision to reduce its range of offer amounts in the over-1-year to 3-year zone was a surprise. After the announcement, there were some offers for 2-year JGBs, but the impact on other maturity zones was limited.

Offer amount in over-3-year to 5-year zone reduced in first operation in 2021

Reflecting this announcement, the offer amounts in its first operation in 2021, held today (Jan 5) in the over-1-year to 3-year, over-3-year to 5-year, and over-5-year to 10-year zones, came in at Y450bn in the over-1-year to 3-year, a Y50bn reduction from the Y500bn offer in its last operation in December, but stay unchanged at Y420bn in both the over-3-year to 5-year and over-5-year to 10-year zones. We expect the initial offer amounts in other maturity zones will also be unchanged from their amounts in the last operations of December. We see that the BOJ has ample room for adjustments within the current offer amount range during the month, if necessary. In particular, as expectations for reduction in the over-3-year to 5-year zone appear strong, we would like to carefully watch the responses. Moreover, the range of JGBs in the over-1-year to 3-year zone eligible for purchase by the BOJ in today's operation was broadened considerably. The BOJ will probably remain flexible on which issues to purchase in other maturity zones based on its holding ratios and the supply-demand balance.

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. Therefore, the BOJ is likely to maintain its guideline on T-bill purchases in the outline of purchases dated April 27, 2020—"the Bank will decide the purchase size per auction considering the effects on financial markets. The Bank will purchase about 500bn to 3.0tn yen of T-Bills per auction for the time being."

BOJ's JGB Purchase Plan for January 2021

	Offer size per operation		Number of Offers (per month)	First offer size exp.		Monthly Total exp. in Jan. (a)	MOF issuance in Jan.* (b)	(a)/(b) (%)	
	Min	Mid		Min	Last offer in Dec.			YCC Avg.***	
JGBs ex Linkers and Floaters									
1 year and less	100	200	150	2	150	150	300	-	-
Over 1 to 3 years	300	600	450	5	450	500	2,250	3,000	75.0 76.2
Over 3 to 5 years	250	600	425	5	420	420	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	-	-	-
TOTAL**:						7,050	10,700	65.9	
Dec. :						7,300	10,700	68.2	

(Note) Change from December in red; "First offer size exp." is actual for 1-3Y, 3-5Y and 5-10Y as of Jan. 5 * 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 January 2021

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	
1/1/21	F	-	New Year's Day							-	-
1/4/21	M	1/5/21									
1/5/21	T	1/6/21		450.3	420.4	420.7			3M		
1/6/21	W	1/7/21	10Y JGB Auction								
1/7/21	TH	1/8/21	30Y JGB Auction							6M	
1/8/21	F	1/12/21	30Y JGB Auction								
1/11/21	M	-	Public Holiday (Coming-of-age Day)							-	-
1/12/21	T	1/13/21			⊙	⊙	⊙	○	○		
1/13/21	W	1/14/21	5Y JGB Auction								
1/14/21	TH	1/15/21	○	⊙			⊙			○	
1/15/21	F	1/18/21	AEL for 10Y and 20Y JGBs with over 5 to 15.5 years left to maturity							3M	
1/18/21	M	1/19/21							○		
1/19/21	T	1/20/21	20Y JGB Auction							1Y	
1/20/21	W	1/21/21		⊙	⊙	⊙			6M		
1/21/21	TH	-	BOJ MPM (Day 2)							○	
1/22/21	F	1/25/21	AEL for 2Y, 5Y, 10Y and 20Y JGBs with over 1 to 5 years left to maturity							3M	
1/25/21	M	1/26/21		⊙	⊙	⊙		○			
1/26/21	T	1/27/21	40Y JGB Auction							○	
1/27/21	W	1/28/21	○	⊙			⊙				
1/28/21	TH	2/1/21	2Y JGB Auction								
1/29/21	F	2/1/21			⊙	⊙	⊙				

Note: ⊙ Announced by BOJ on Dec. 28, ○ Daiwa forecast as of Jan. 5; BOJ MPM (Day 1) on Wednesday, Jan. 20

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

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February 2020

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- 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