

Outlook for 5Y JGB Auction

JS146 tap may receive cold response from buyers

- ✓ While BOJ struggles to communicate with market participants on “monetary policy assessment,” we cannot factor in “deeper negative interest rates.”
- ✓ We think about our bidding stance, expecting the 5Y JGB yield to move in a core range of -0.115 - -0.090% over the next one month. Tomorrow’s auction may tail if it is held at the yield level below -0.1%.

Strategic Memorandum DSTE430
FICC Research Dept.

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Auction Details

Auction Date: February 16, 2021
Issue Date: February 17, 2021
Maturity Date: December 20, 2025
Offering Amount: About 2.5 trillion yen

* New 5Y JGBs will likely be the first reopening of JS146 carrying a 0.1% coupon.

** On February 15, JS146 traded at -0.105% (+1.0bp v. previous day's close) and closed at -0.105% (+1.0bp).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

-0.125 - -0.095% range since previous auction

After the previous 5Y JGB auction went poorly at the -0.115 - -0.110% level (vs. WI closing of -0.110% on the previous day), as shown by the cut-off price of Y101.02 (-0.105%), the 5Y JGB yield (JS146 on conventional yield basis) temporarily declined to -0.125% (during intraday trading) amid the firmness of the JGB market. Subsequently, the yield rose to -0.095% as the JGB market softened. Reflecting the media report in the middle of last week (Feb. 10) regarding the BOJ’s intention to clarify its room for deeper negative interest rates, the 5Y JGB yield momentarily declined to -0.115% during intraday trading on Feb. 12 after the national holiday. Today (Feb. 15), JS146 trades at -0.105% (-1.0bp vs. previous day’s close) amid the softness of the JGB market reflecting an overnight rise in US Treasury yields.

While BOJ struggles to communicate with market participants on “monetary policy assessment,” we cannot factor in a deeper negative interest rate

We check the environment surrounding the JGB market. In the US, the 10Y Treasury yield has topped 1.2%. Upward pressure on UST yields is seen to remain strong because both of “good yield increase” (rise in potential growth rate and economic growth, which outpaces the potential growth rate) and “pernicious yield increase” (fiscal deterioration, rise in inflation rate without economic expansion) appear possible under President Joe Biden. In Japan, the number of media reports is increasing regarding the BOJ’s “monetary policy assessment.” After the January Monetary Policy Meeting (MPM), JGB yields faced upward pressure because discussions on a widening of the operational target band for the 10-year JGB yield appear to have pointed in a certain direction at the MPM. Last week, the

10-year JGB yield rose to 0.075%, ignoring the contents of a lecture by BOJ deputy governor Masazumi Wakatabe, a known reflationist, on Feb. 3. Then emphatic speculative articles/reports, such as “the BOJ would clarify that it has room to deepen negative interest rates,” were delivered on Feb. 10 before a national holiday on Feb.11. As such, the BOJ appears to be struggling to communicate with market participants on the on-going monetary policy assessment. Although the tone of those articles/reports is strong by saying “a deeper negative interest rate,” they sound not much different from the stance of Governor Kuroda’s mantra—the BOJ “will not hesitate to take additional easing measures if necessary.” We thus do not think that “deeper negative” talks will serve as a support for tomorrow’s auction. In such a situation, we summarize key points to think about the bidding stance at tomorrow’s auction as follows:

- ✓ **Primary dealers’ short positions appear to be being covered:** It is difficult to strongly expect strong support from their short-covering activities;
- ✓ **Demand from investors can be expected:** We can easily expect demand from investors partly because the 5Y JGB yield is now at around the upper limit of the range since December 2020, although we need to carefully watch the level of their demand;
- ✓ **Difficult to aggressively build new positions in terms of relative value:** Our analysis based on data since the previous 5Y JGB auction shows that the 5Y sector is not cheap on the curve at the current level (Appendix 4). Looking at data over the past three months or so, we think that it is difficult to aggressively build new (5Y long) positions on the curve partly because the 5Y sector is noticeably overvalued vs. sectors with longer maturities. As the 5Y swap spread has been in a widening trend since the previous auction, 5Y cash is overvalued against swaps at the current level (Appendix 5);
- ✓ **The BOJ may offer only three to four purchase operations in the 3-5Y zone:** The next 5Y JGB auction is scheduled for March 9. In the period from tomorrow’s auction to the next auction, it is highly likely that the BOJ will offer only three to four purchase operations in the 3-5Y zone (twice this month and we expect one to twice in Mar). If we assume that the current offer amount will be unchanged, the total purchase amount is estimated at around 1.11-1.48tn yen (= 370bn yen x three to four times) vs. tomorrow’s issuance amount of 2.5tn yen. Compared to the purchased amount of 2.37tn yen during the period from the previous auction (Jan 13) to this auction, the supply/demand balance may not tighten. Regarding the 3-5Y zone, caution remains about another reduction in the offer amount even under the current operation policy.

We think about our bidding stance, expecting the 5Y JGB yield to move in a core range of -0.115 - -0.090% over the next one month

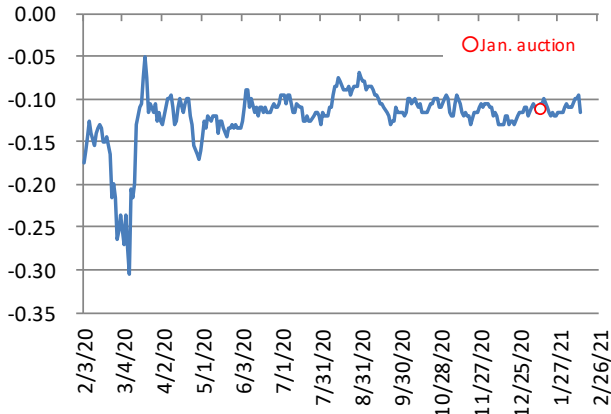
All in all, we would like to think about our bidding stance, expecting the 5Y JGB yield to move in a core range of -0.115 - -0.090% over the next one month. Tomorrow’s auction may tail if it is held at the yield level below -0.1%.

5Y JGB Auction Results

Auction Date	Issue #	Marurity Date	Coupon %	Issue Size (trillion yen)	B/C	Average Price	Lowest Price	Price Tail (yen)	Average Yield	Highest Yield	Yield Tail (%)	Allotment (%)	
2/16/21	146R	12/20/25	0.1	2.5*									
1/13/21	146	12/20/25	0.1	2.5	3.83	101.05	101.02	0.03	-0.111	-0.105	0.006	39.5061	Poor
12/8/20	145R	9/20/25	0.1	2.5	3.96	101.05	101.03	0.02	-0.118	-0.114	0.004	91.2414	Avg.
11/12/20	145R	9/20/25	0.1	2.7	3.52	101.00	101.00	0.00	-0.105	-0.105	0.000	87.5921	Good
10/8/20	145	9/20/25	0.1	2.7	4.90	100.95	100.94	0.01	-0.091	-0.089	0.002	40.8768	Good
9/8/20	144R	6/20/25	0.1	2.5	3.56	100.92	100.90	0.02	-0.091	-0.087	0.004	96.8040	Poor
8/20/20	144R	6/20/25	0.1	2.5	3.55	100.94	100.93	0.01	-0.093	-0.091	0.002	99.4049	Avg.
7/9/20	144	6/20/25	0.1	2.7	4.25	101.01	101.00	0.01	-0.103	-0.101	0.002	82.5283	Good
6/18/20	143R	3/20/25	0.1	1.9	3.78	101.05	101.04	0.01	-0.119	-0.117	0.002	37.4921	Avg.
5/18/20	143R	3/20/25	0.1	2.0	4.49	101.07	101.05	0.02	-0.122	-0.119	0.003	49.2132	Good
4/9/20	143	3/20/25	0.1	2.1	4.98	100.97	100.96	0.01	-0.095	-0.093	0.002	43.4187	Good
3/10/20	142R	12/20/24	0.1	1.9	2.73	101.55	101.37	0.18	-0.220	-0.184	0.036	21.4893	Poor
2/18/20	142R	12/20/24	0.1	2.1	4.49	101.19	101.18	0.01	-0.144	-0.142	0.002	13.8811	Good
1/15/20	142	12/20/24	0.1	2.1	4.48	100.93	100.93	0.00	-0.087	-0.087	0.000	90.2740	Good

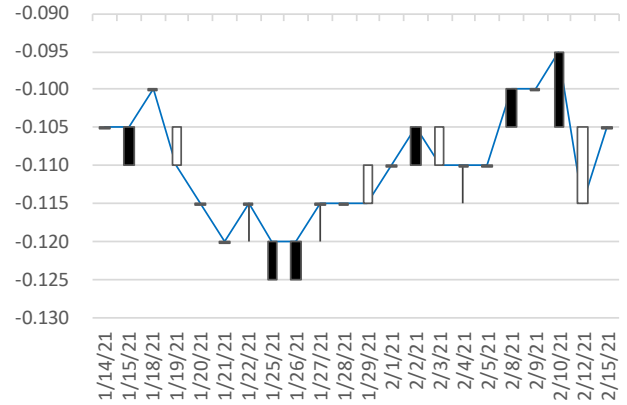
* Amount the MOF plans to issue
Source: Ministry of Finance, Daiwa Securities.

Appendix 1a: 5Y JGB Yield (%)



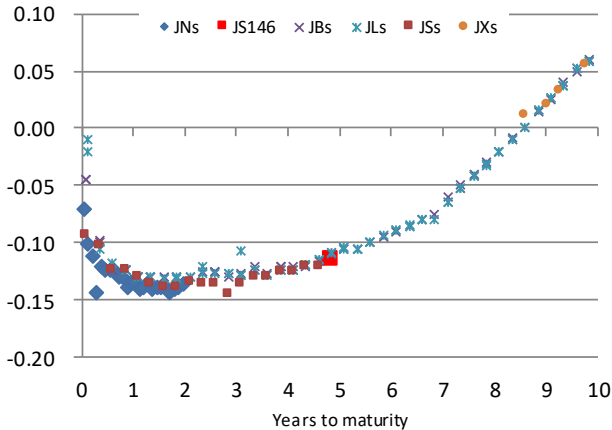
Note: On-the-run issue
Source: Daiwa Securities.

Appendix 1b: Candle of JS146 Yield (%)



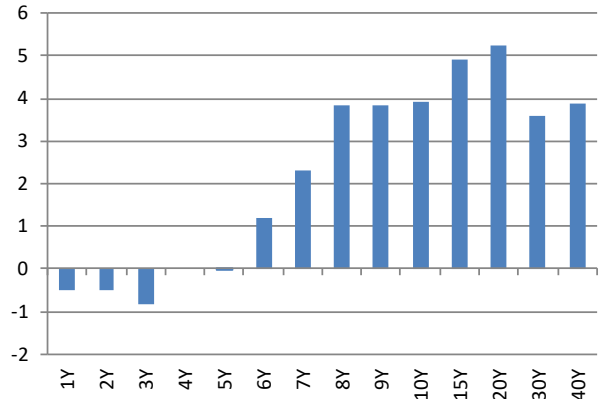
As of 14.30 JST on Feb. 15
Source: Daiwa Securities.

Appendix 2: JGB Yield Curve (% as of Jan. 8)



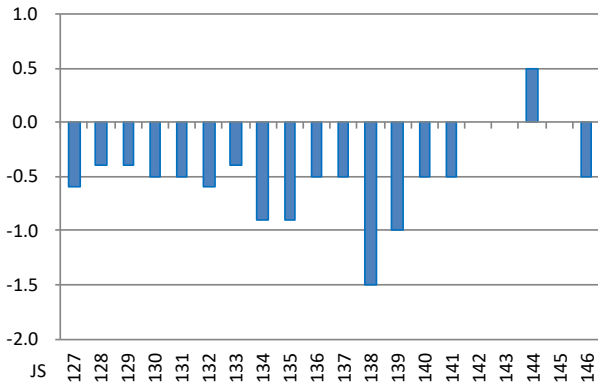
Source: Daiwa Securities.

Appendix 3a: JGB Yield Change (bp): Jan. 13 vs. Feb. 13



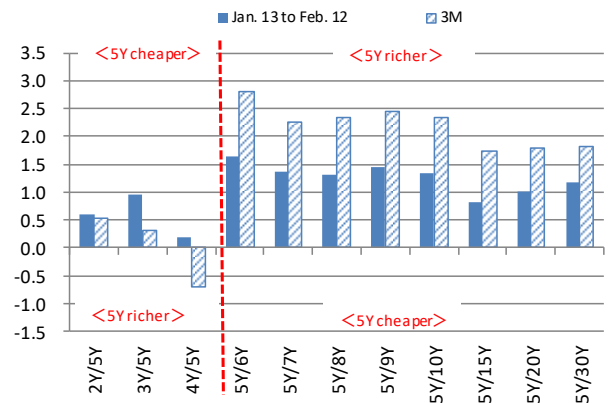
Note: Generic compound yield
Source: Daiwa Securities.

Appendix 3b: JS Yield Change (bp): Jan. 13 vs. Feb. 13



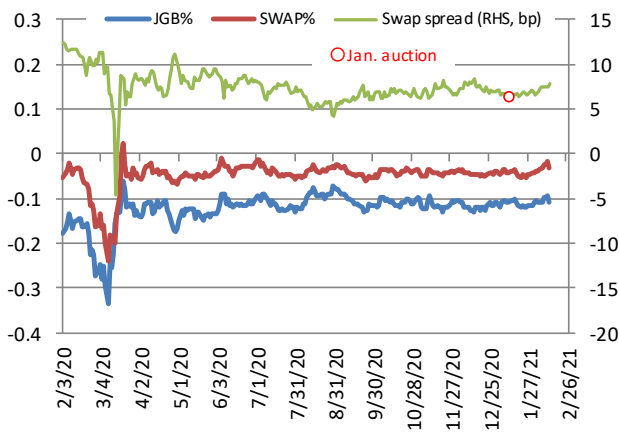
Source: Daiwa Securities.

Appendix 4: Z-scores of JGB Yield Spreads



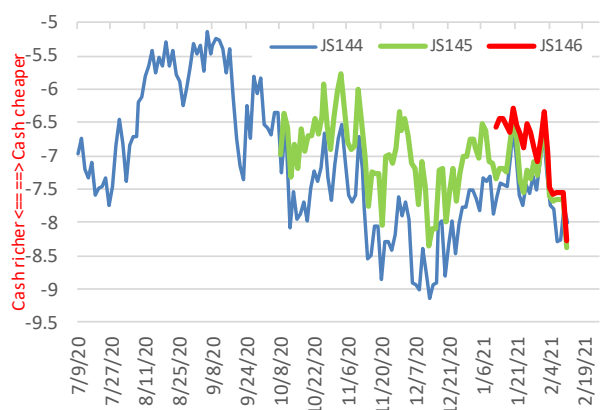
Note: Generic compound yield
Source: Daiwa Securities.

Appendix 5a: 5Y Swap Spread (bp)



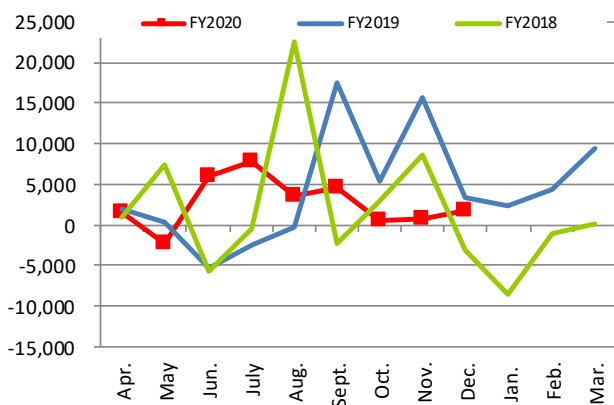
Source: Daiwa Securities.

Appendix 5b: JS Asset Swap (bp)



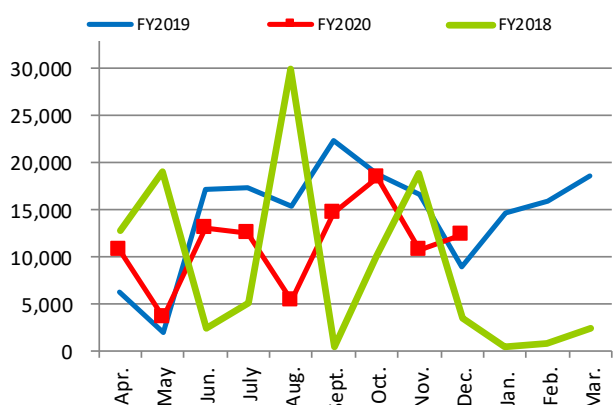
Note: Yen-Libor basis
Source: Daiwa Securities.

Appendix 6a: Net Purchase of Intermediate-term JGBs by Major Banks (Yen 100 millions)



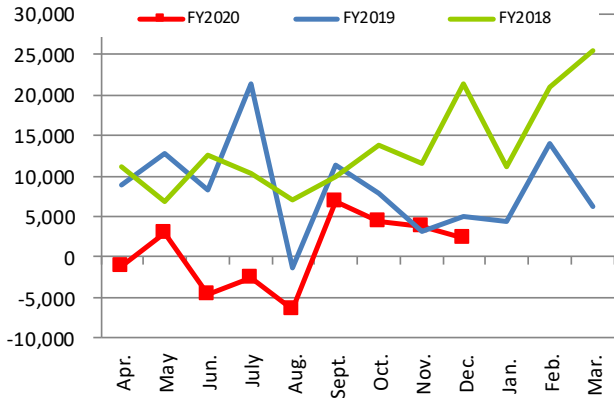
Source: JSDA

Appendix 6b: Gross Purchase of Intermediate-term JGBs by Major Banks (Yen 100 millions)



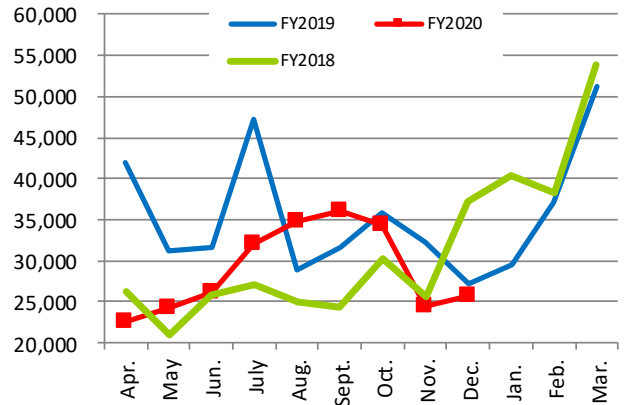
Source: JSDA

Appendix 7a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)



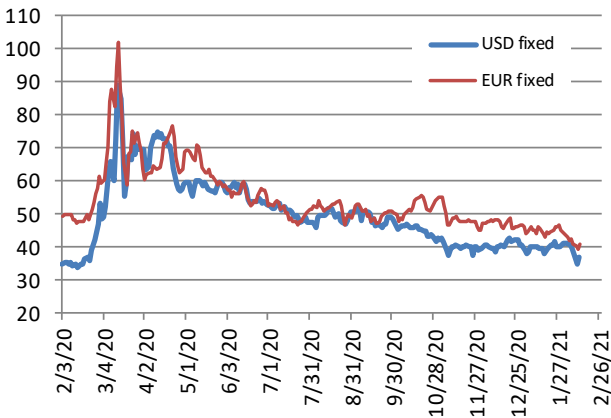
Source: JSDA

Appendix 7b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)



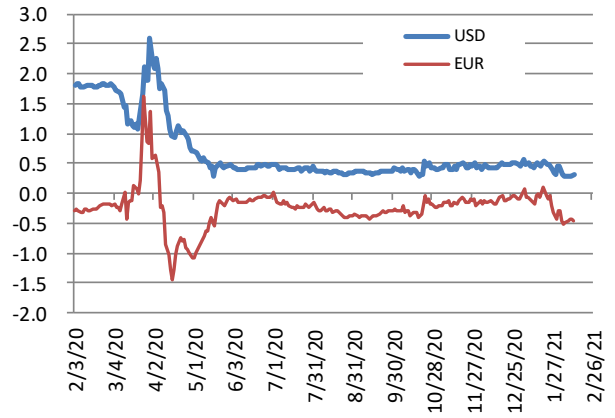
Source: JSDA

Appendix 8a: 5Y JGB Benchmark Spreads (bp)



Note: against 5Y UST and 5Y OBL
Source: Daiwa Securities

Appendix 8b: 5Y Hedged JGB Return (%)



Source: Daiwa Securities

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[Standard & Poor's]

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[Moody's]

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February 2020

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- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 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.
- 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.

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