

## Outlook for 5Y JGB Auction

### Bidding at the -0.08 - -0.07% level

- ✓ We expect a certain level of demand for new 5Y JGBs carrying a 0.005%, JS147, from investors, who may want to switch from off-the-run JSs with higher book value to secure profits. The balance between the MOF's issuance and BOJ's purchases would not discourage market participants from buying.
- ✓ In terms of relative value, we think about switching out from the 7Y sector, including positioning vs. JGB futures. It would also be worth considering 5Y/7Y/10Y butterfly trade.

Strategic Memorandum DSTE438  
FICC Research Dept.

Senior JGB Strategist  
**Keiko Onogi**  
+813 5555 8788  
keiko.onogi@daiwa.co.jp  
Daiwa Securities Co. Ltd.

### Auction Details

**Auction Date:** April 8, 2021  
**Issue Date:** April 9, 2021  
**Maturity Date:** March 20, 2026  
**Offering Amount:** About 2.5 trillion yen

\* New 5Y JGBs, JS147, will likely carry a 0.005% coupon.

\*\* On April 7, WI traded at -0.085 - -0.080% (-0.5bp - unch v. previous day's close) and closed at -0.085% (-0.5bp). JS146 traded at -0.095 - -0.090% (-0.5bp - unch) and closed at -0.095% (unch).

### Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### 5Y JGB yield is now at around the middle of the range since the previous auction

The previous 5Y JGB auction went poorly at the -0.070 - -0.065% (+0.5~+1.0bp vs. previous day's close, 100.791-100.815 yen), with the cut-off price of Y100.74 yen. After the auction, the JGB market firmed up partly as some media reported that the BOJ would prepare for deeper negative interest rates, such as revisions to the three-tier structure of current accounts toward the March Monetary Policy Meeting. Then, the 5Y JGB yield momentarily declined to -0.110% during intraday trading on March 24. Last week, when new fiscal year started in Japan, better sellers showed up for intermediate JGBs amid the softness of the JGB market, pushing the yield up to -0.080% at one point. This week, the 5Y JGB yield is moving in the -0.090 - -0.080% range. As of 15:00 today (Apr 7), WI traded at -0.085 - -0.080% (-0.5bp - unch vs. previous day's close) and on-JS146, the on-the-run issue, traded at -0.095 - -0.090% (-0.5bp - unch vs. previous day's close). The yield is at around the middle of the range since the previous auction.

### Even in the near future, the probability of the BOJ to put the short-term policy rate deeper in negative territory appears quite close to zero

We look at the environment surrounding JGBs. On March 31, the Biden administration announced the \$2tn infrastructure rebuilding plan over an eight-year period. In the plan, the expenditures are expected to be covered by a hike in federal corporate taxes. Although the Republican Party is already strongly opposing tax hikes, concerns about a further issuance of US Treasuries would be eased. While caution about the bad kind of interest rate rise (from a worsening of the fiscal balance and an increase in inflation without economic growth) is unlikely to strengthen, expectations for the good kind (from an increase in the

potential growth rate and an even faster economic expansion) are likely to increase. Under the Biden administration, there are strongly rooted expectations of a rise in Treasury yields. In Europe, an uptick in new covid-19 cases and broadening restrictions on economic activity are amplifying concerns over the direction of the economy. In Japan, based on the results of the “assessment” in March, the BOJ introduced the Interest Scheme to Promote Lending to cope with the side effects in the case of a cut in short-term/long-term interest rates in the future. Meanwhile, we saw a series of media reports at the beginning of this week—“the BOJ estimated that profits at financial institutions would decline by several hundred billion yen in the case of deepening of negative interest rates for additional easing.” Reportedly, the BOJ deferred the release of the estimation, although the trial calculation was made as a part of the “assessment.” Reflecting the “assessment” results, the market has more recognized “the scope for deeper negative interest rates,” but many are skeptical about whether the BOJ can actually deepen negative rates. A series of recent media reports have verified that such an action is “easy to say, hard to do.” Even in the near future, the probability of the BOJ to put the short-term policy rate deeper in negative territory appears quite close to zero. In such a situation, we summarize key points to think about the bidding stance at tomorrow’s auction as follows:

- ✓ **Expecting a certain level of demand for new 5Y JGBs carrying a 0.005%, JS147, from investors, who may want to switch from off-the-run JSs with higher book value to secure profits:** Since the BOJ released the March “assessment” results, the 5Y JGB yield has been moving at the -0.110 - -0.080% level. We anticipate a certain level of demand from investors for new 5YY JGBs because (1) bidding will likely take place at around the upper limit of the range and (2) new 5Y JGBs, JS147, will belong to a new maturity basket (JS147). Given the current shape of the curve, we can also expect positive carry and positive return from JS147. In addition, investors may want to switch out from off-the-run 5Y JGBs with higher book value to secure profits at the beginning of the fiscal year;
- ✓ **Not attractive in terms of the relative value:** Our analysis based on data since the previous 5Y JGB auction and that over the past three months show that the 5Y sector is neither noticeably overvalued nor undervalued on the curve (Appendix 3). As the 5Y swap spread had been in a widening trend since the previous auction, 5Y cash had become more overvalued against swaps. Recently, as the widening trend is letting up, excessive overvaluation appears to have been corrected (Appendix 6);
- ✓ **Although the BOJ decreased the number of purchase operations and trimmed the monthly purchase amount in the 3-5Y zone, the Bank will likely offer five purchase operations in the zone by the next auction expected in May:** On March 31, the BOJ reduced the number of monthly offers in the 3-5Y zone (from five times in Mar to four in Apr), while it increased the offer amount per auction from Y370bn yen in the last operation in March to 450bn yen. However, it is highly likely that the number of offers in the 3-5Y zone during the period from tomorrow’s auction to the next auction (May 19) will be five times (three times this month and we expect twice in May). If we assume that the current offer amount will be unchanged, the total purchase amount is estimated at around 2.25tn yen (= 450bn yen x five times) vs. tomorrow’s issuance amount of 2.5tn yen. In terms of the balance between the MOF’s issuance and BOJ’s purchases, market participants would have no hesitation to take new 5Y JGBs, JS147, at the auction.

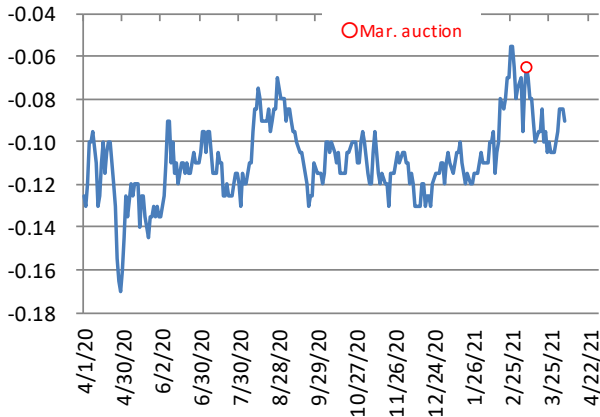
Given all the above points, we would like to think about our bidding stance by carefully watching investor demand at the -0.080 - -0.070% level. In terms of the relative value, we think of switching out from the 7Y sector, including positioning vs. JGB futures. It would also be worth considering the 5Y/7Y/10Y butterfly trade (selling 7Y/buying 5Y and 10Y, Appendix 5) because of the current level and also expected positive carry.

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 (%)	
4/8/21	147	3/20/26	0.005*										
3/9/21	146R	12/20/25	0.1	2.5	3.25	100.78	100.74	0.04	-0.062	-0.054	0.008	18.1264	Poor
2/16/21	146R	12/20/25	0.1	2.5	3.49	100.98	100.96	0.02	-0.101	-0.097	0.004	72.1873	Poor
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

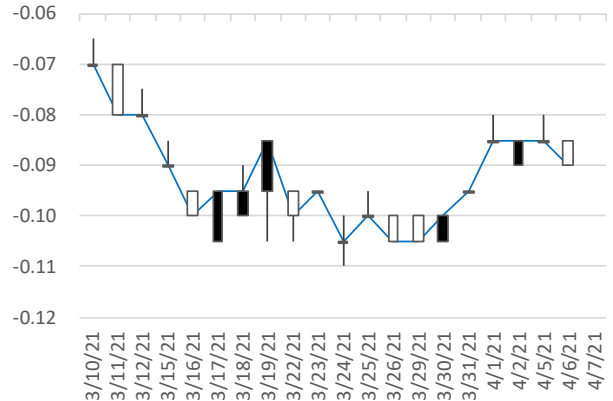
\* Daiwa forecast as of Apr. 7 \*\* Amount the MOF plans to issue  
 Source: Ministry of Finance, Daiwa Securities.

Appendix 1a: 5Y JGB Yield (%)



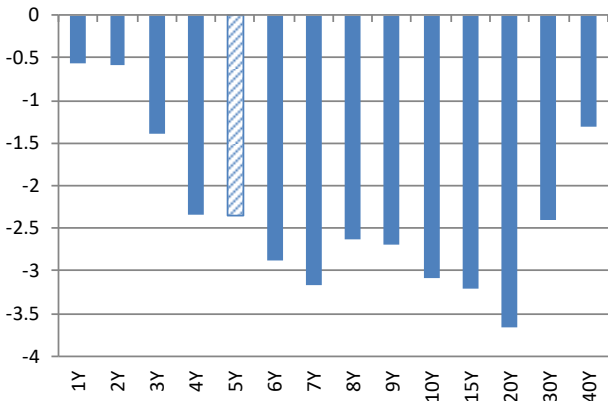
Note: On-the-run issue  
 Source: Daiwa Securities.

Appendix 1b: Candle of JS146 Yield (%)



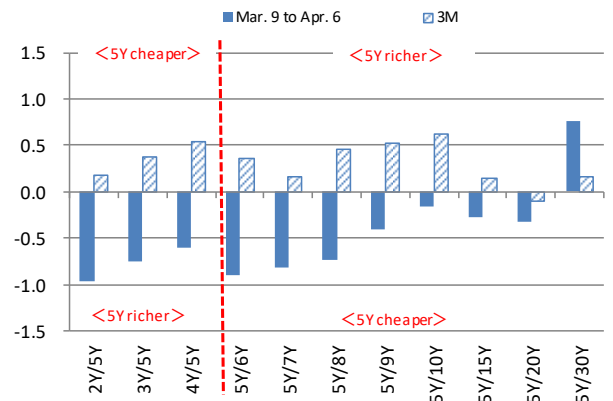
As of 14.30 JST on Feb. 15  
 Source: Daiwa Securities.

Appendix 3: JGB Yield Change (bp): Mar. 9 vs. Apr. 6



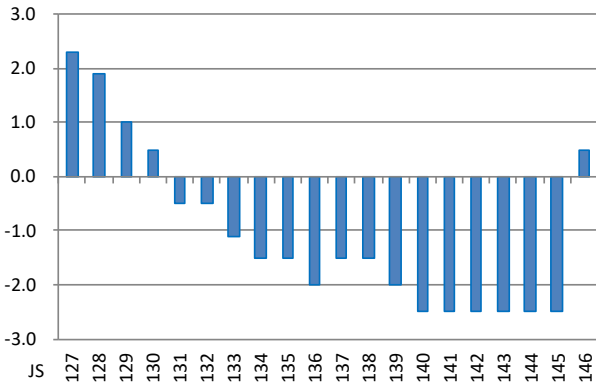
Note: Generic compound yield  
 Source: Daiwa Securities.s.

Appendix 3: Z-scores of JGB Yield Spreads



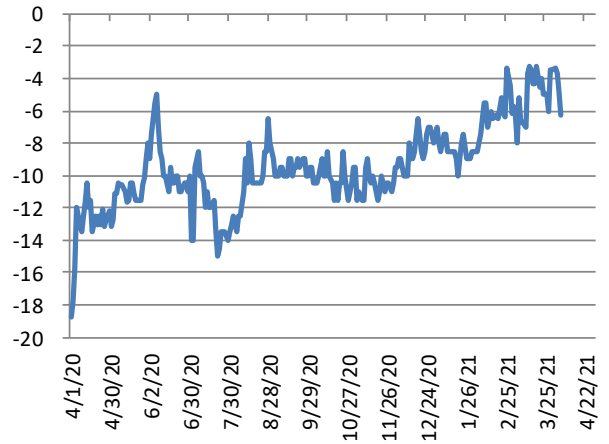
Note: Generic compound yield  
 Source: Daiwa Securities.

Appendix 4: JS Yield Change (bp): Mar. 9 vs. Apr. 6



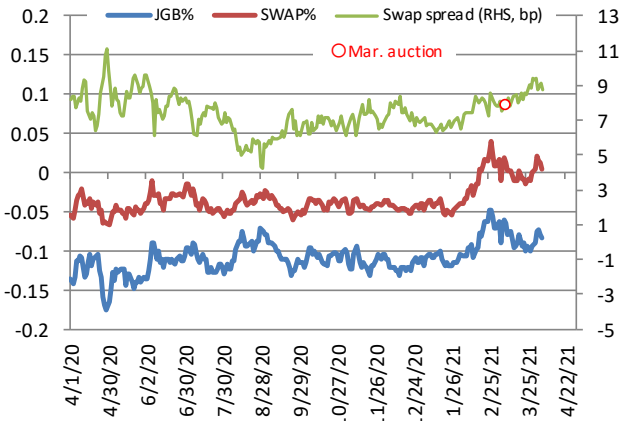
Source: Daiwa Securities.

Appendix 5: JGB 5Y/7Y/10Y Butterfly Spread (bp)



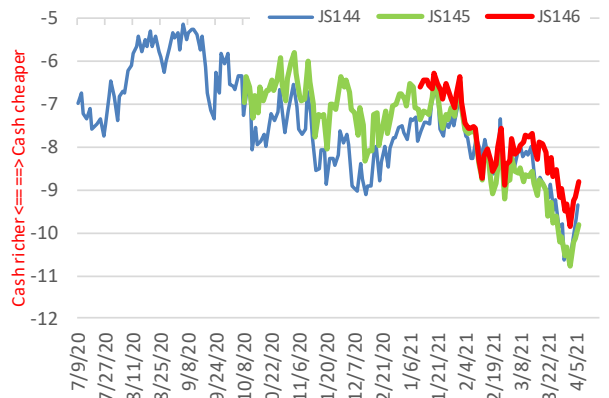
Note: On-the-run issues and CTD basis  
Source: Daiwa Securities.

Appendix 6a: 5Y Swap Spread (bp)



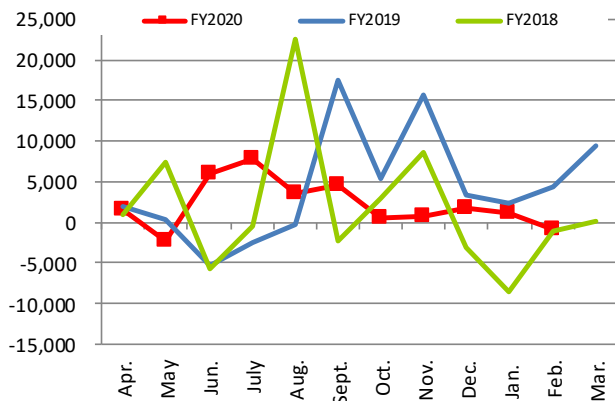
Source: Daiwa Securities.

Appendix 6b: JS Asset Swap (bp)



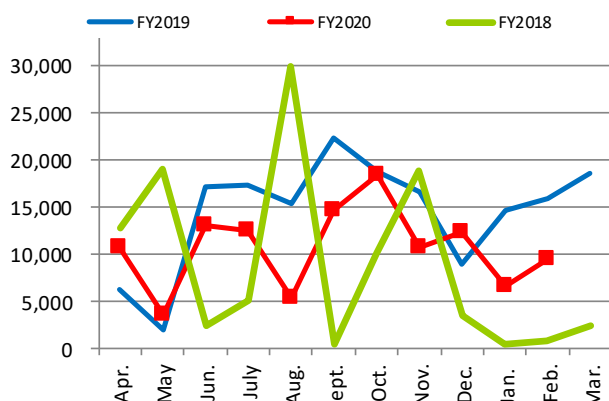
Note: Yen-Libor basis  
Source: Daiwa Securities.

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



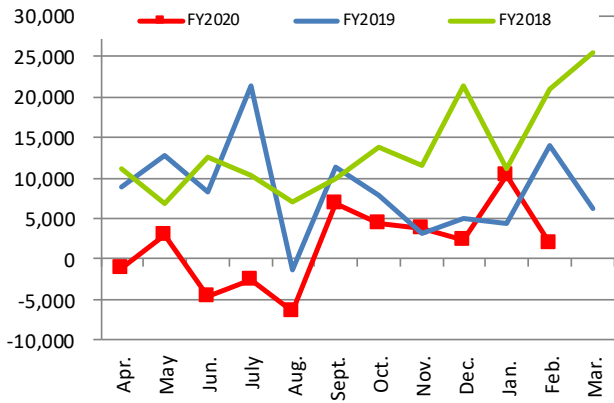
Source: JSDA

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



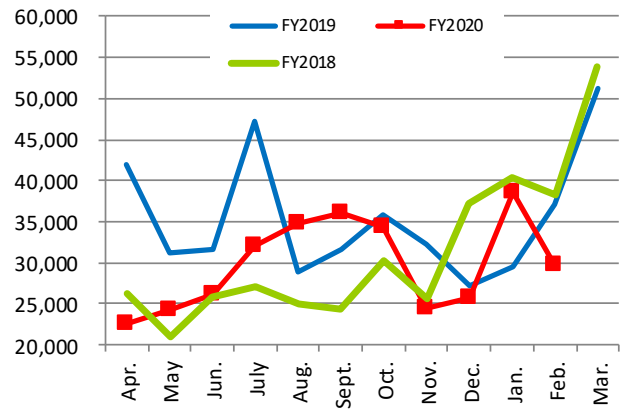
Source: JSDA

**Appendix 8a: Net Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



Source: JSDA

**Appendix 8b: Gross Purchase of Intermediate-term JGBs by Overseas Accounts (Yen 100 millions)**



Source: JSDA

## Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

### ■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:

- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

In addition to the above, Registered Credit Rating Agencies are subject to the supervision of the Financial Services Agency ("FSA"), and as such may be ordered to produce reports, be subject to on-site inspection, and be ordered to improve business operations, whereas unregistered Credit Rating Agencies are free from such regulations and supervision.

### ■ Credit Rating Agencies

#### [Standard & Poor's]

##### The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

##### Assumptions, Significance and Limitations of Credit Ratings

Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of March 7th, 2017, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

#### [Moody's]

##### The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website ([https://www.moody.com/pages/default\\_ja.aspx](https://www.moody.com/pages/default_ja.aspx)))

##### Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16<sup>th</sup>, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. ([https://www.moody.com/pages/default\\_ja.aspx](https://www.moody.com/pages/default_ja.aspx))

#### [Fitch]

##### The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

##### How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.com/site/japan>)

##### Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of September 27th, 2019, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (<https://www.fitchratings.com/site/japan>)

February 2020

## **IMPORTANT**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

**Conflicts of Interest:** Daiwa Securities Co. Ltd. may currently provide or may intend to provide investment banking services or other services to the company referred to in this report. In such cases, said services could give rise to conflicts of interest for Daiwa Securities Co. Ltd.

**Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.:** Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

### Other Disclosures Concerning Individual Issues:

- 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).

### Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- 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