Daiwa's View

Warning bell for premature steepening of yield curve

- Will "QE expansion + no change to policy interest rate" be optimal package?

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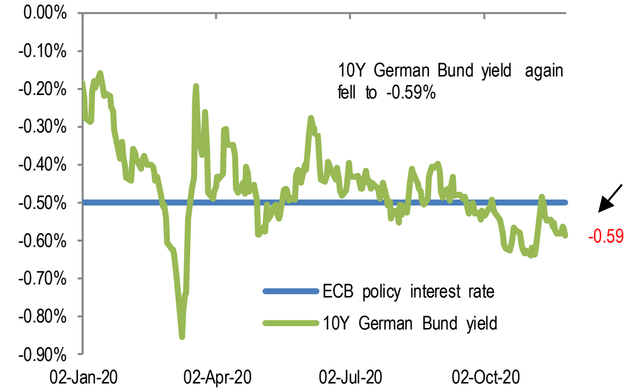
Will "QE expansion + no change to policy interest rate" be optimal package?

Yesterday's major market events in Europe were the release of the account of the ECB's monetary policy meeting, an online speech by ECB executive board member/chief economist Philip Lane, and QE expansion by the Swedish central bank.

Among them, the speech by ECB's Philip Lane was the most influential. Once the remark that "it is essential that the macroeconomic recovery is not derailed by a premature steepening of the yield curve" was reported, flattening pressure was put on German yields, pushing the 10-year German Bund yield down to –0.59% once again. Last night's US Treasury futures price rose to 138-13+ (138.42) in line with moves of European bonds. If the 10-year US yield was traded yesterday, it would have declined to around 0.85%.

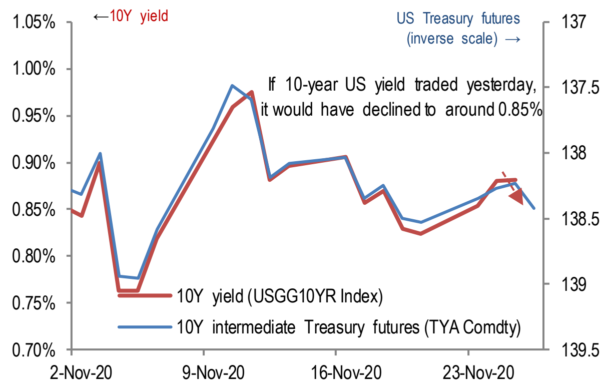
In addition, yesterday's action by the Swedish central bank (albeit a small nation) was suggestive in forecasting monetary policy in other nations. The central bank has decided to expand the size of QE (SEK500bn → 700bn), showing its outlook that the benchmark interest rate would stay at 0% over the next several years. It has adopted a policy of "QE expansion + keeping the policy interest rate unchanged," which is in line with the trend recently preferred by central banks. What is brought about from this combination is naturally a flattening of the yield curve or suppression of a premature steepening.

10Y German Bund Yield



Source: Bloomberg; compiled by Daiwa Securities.

US Treasury Futures, 10Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

In Japan, after yesterday's meetings of JGB Investors and JGB Market Special Participants, the content of MOF officials' briefing for reporters was aired[1]. Although pros and cons were included, the content was largely in line with the current market consensus— "there is room to increase the issuance amounts of 20-year and 40-year JGBs, the issuance of 6-month T-bills is likely to be reduced, and the issuance amount in the YCC-targeted 2-year to 10-year zone is adjustable if the size is a certain amount." The content is unlikely to have an immediate major impact on the yield curve.

That said, necessary revisions (increase or decrease) to finalize the issuance amount depend on the size of COVID-19 pandemic response measures and budget allocation in the FY20 third supplementary budget and FY21 initial budget, as well as the scale of economic measures and estimated tax revenue. We think that calendar-base issuance may remain roughly flat, given FILP bonds that are not issued according to the initial plan. However, this morning's *Nikkei* reported Chairperson of the Research Commission on the Tax System Akira Amari's remarks on a TV program—"if we try to get through the pandemic without issuance of deficit JGBs, we would fail" and "government expenditures of around Y20tn are desirable." The article also said that "if the size is around Y10tn, the government would respond to it without issuing deficit JGBs." Under Mr. Amari's scenario, around Y10tn in the additional issuance size appears to be estimated. We intend to monitor discussions on the supplementary budget.

Media reports on MOF officials' briefing for reporters (excerpts from *Bloomberg* articles)

- Regarding the issuance amount by maturity zone, many participants opined that 20-year JGBs, which have a wide investor base, or 40-year JGBs have room for increased issuance in the case that the issuance amounts are increased or decreased.
- Partly because the intermediate to long-term zone (2-year, 5-year, 10-year JGBs) is currently the target of the BOJ's YCC policy, many had the opinion that either an increase or decrease is basically possible if the change is a certain amount.
- Looking at the supply/demand conditions of 12-month and 6-month T-bills, the conditions for 6-month T-bills are loose. Therefore, some said that 6-month T-bills should be reduced preferentially.

[1] Gist of meeting and minutes to be released on next business day and around one week after meeting, respectively, in Japanese (English text at later date).

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■ Credit Rating Agencies

[Standard & Poor's]

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[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)

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[Fitch]

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

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February 2020

IMPORTANT

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), Daiwa Securities Living Investment Corporation (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 Y10bn. 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.

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