

Daiwa's View

Major US banks are passive towards risk-taking

- A wider loan-deposit gap is likely to lead to downward pressure on the front end

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Daiwa Securities Co. Ltd.

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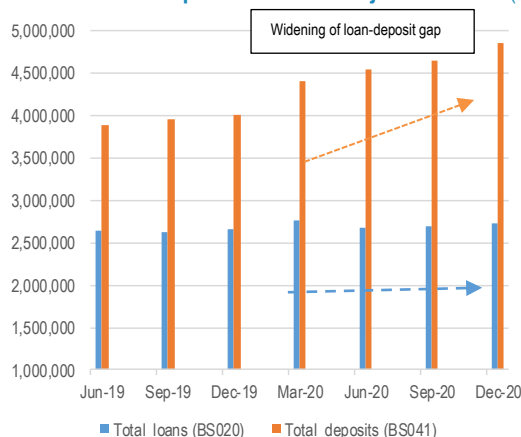
Major US banks are passive towards risk-taking

In [the minutes](#) of the BOJ's December Monetary Policy Meeting (MPM), which was released yesterday, it was pointed out that "future developments in the US credit market warrant attention, since market participants have been actively conducting risk-taking activities." From the viewpoint of bond investment, this was valuable information, as it made known that board members had such discussions regarding the current state of the US credit market.

In fact, in a series of announcements regarding Oct-Dec earnings results at US banks which can control risk in a levelheaded manner, their stance of distancing themselves from risk-taking activities can be seen. Balance sheets at US banks show a clear stance of allocating funds to short-term/long-term investments while accepting a wider loan-deposit gap, as they have not been taking an active stance towards loans, despite a remarkable increase in deposits.

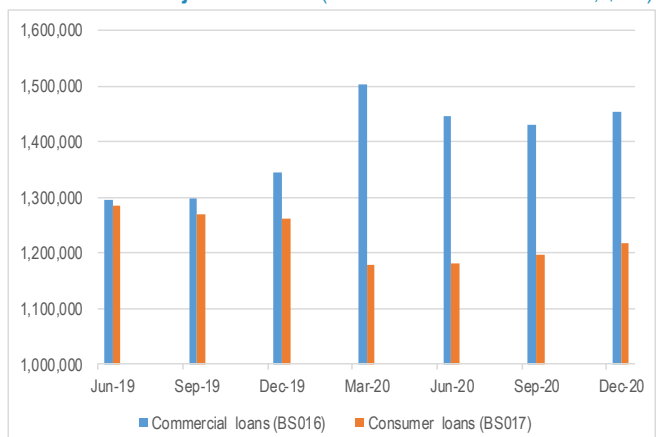
Confirming the aggregate amount of three major US banks (J.P. Morgan, Citi, and Bank of America), total assets and deposits increased by 16% and 21%, respectively, in 2020, while loans increased only 3% (which widened the loan-deposit gap from 34% to 44%). We can point out that one reason behind the low growth rate in loans is a decline in consumer loans due to the impact of cash benefits. However, given the fact that the growth of commercial loans is also less than half of deposit growth, US banks' passive stance towards loans becomes clear.

Total Loans and Deposits at Three Major US Banks (\$mn)



Source: Bloomberg; compiled by Daiwa Securities.

Loans at Three Major US Banks (commercial/consumer loans, \$mn)

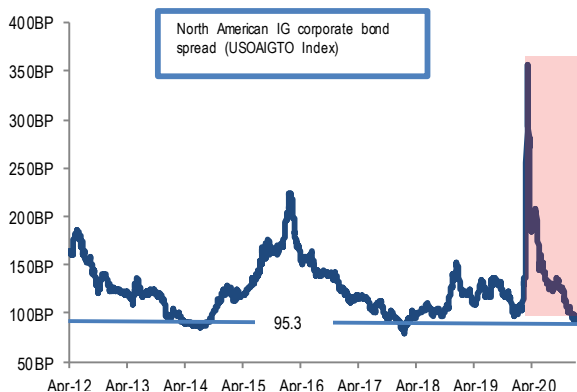


Source: Bloomberg; compiled by Daiwa Securities.

As is well known, credit spreads have been tightening markedly in the US market. The spread level of investment grade corporate bonds (compiled by Bloomberg) is at its tightest level over the past ten years, 95.3bp. Although high-yield corporate bonds had posted a certain degree of correlation with the VIX Index in the past, prices are diverging from the past trend and rising prior to the VIX Index. Amid the continuation of monetary easing, it is natural for investors to adopt a risk-taking stance. However, the stance is beginning to seem a bit over the top.

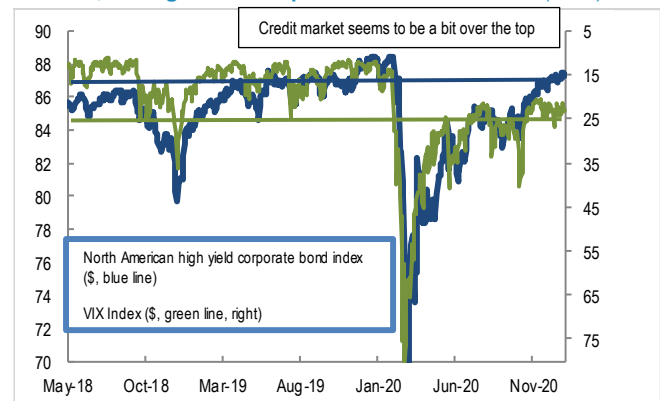
One reason behind the above passive risk-taking stance at US banks may be based on a judgement that this kind of tightening spread does not match risk. If US banks are only making active use of market intermediation without using their own balance sheets, this could be called a sign of overheating.

US Investment Grade Corporate Bond Spread



Source: Bloomberg; compiled by Daiwa Securities.

VIX Index, US High Yield Corporate Bond Price Index (HYG)



Source: Bloomberg; compiled by Daiwa Securities.

Meanwhile, fiscal spending on a macro basis will inevitably increase deposits. In situations with a lack of loan growth, in the US as well, one item that fills the widening gap between loans and deposits is short-term/long-term investments. Last year, this investment item increased as much as 27%, absorbing most of the growth in deposits. This means an emergence of a structure in which larger deposits result in more investment (in government bonds) at US banks, similar to Japanese banks.

If so, additional cash payouts to households (\$1,400/person, which amounts to slightly below Y50tn nationwide) under President Joe Biden's American Rescue Plan announced on 14 January, for example, are likely to have an impact on the bond market via two routes—cash benefits = reflation = higher yields, and cash benefits = larger deposits = more investment in government bonds = lower yields.

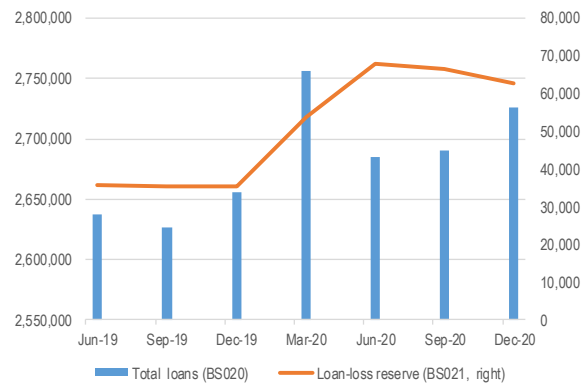
In particular, under [the current situation](#) in which the Treasury General Account is increasing in size on the Fed's balance sheet, the Treasury Department has little need to immediately increase the issuance amount of Treasuries even in the case of additional fiscal spending (funds are raised ahead of spending). In the near term, we thus assume a possibility that more fiscal spending will easily lead to downward pressure on the front-end of the curve through deposit growth at US banks.

Balance Sheet Items at US Banks (total of three majors, \$mn)

	Total assets	Total deposits	Short-term/long-term investment	Total loans	Of which, commercial loans	Of which, consumer loans	Loan-loss reserve
(BBG code)	BS035	BS041	RR704	BS020	BS016	BS017	BS021
30-Jun-19	7,007,275	3,879,659	2,021,873	2,637,921	1,295,513	1,285,870	35,682
30-Sep-19	7,118,296	3,958,679	2,106,579	2,626,553	1,297,977	1,268,785	35,499
31-Dec-19	6,993,044	4,014,497	2,003,447	2,656,371	1,345,404	1,260,743	35,507
31-Mar-20	7,736,365	4,400,257	2,284,456	2,756,862	1,502,291	1,179,719	53,662
30-Jun-20	7,841,722	4,539,782	2,431,018	2,684,659	1,446,190	1,181,420	68,039
30-Sep-20	7,906,865	4,656,875	2,397,075	2,690,982	1,431,385	1,198,176	66,673
31-Dec-20	8,080,471	4,859,731	2,537,956	2,726,126	1,454,759	1,217,403	62,700

Source: Bloomberg; compiled by Daiwa Securities.

Total Loans, Loan-loss Reserves at US Banks (total of three majors, \$mn)



Source: Bloomberg; compiled by Daiwa Securities.

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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.

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- 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.
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■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

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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)

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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.

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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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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))

Assumptions, Significance and Limitations of Credit Ratings

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[Fitch]

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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 ¥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

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- 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