Daiwa's View

Exaggerated inflation expectations, news from those involved in BOJ's March assessment meeting

- I. Steepening of US 10-year/30-year spread appears to have let up

  II. Continuous drop in JGB futures for ten business days is likely to stop

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Steepening of US 10-year/30-year spread appears to have let up

◆ Are inflation expectations exaggerated?

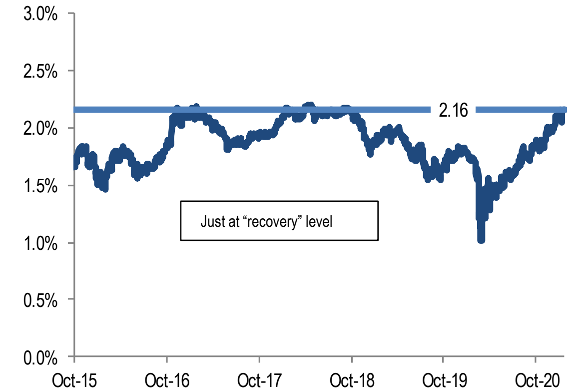
With 10-year and 5-year US inflation expectation rates (breakeven inflation rates) rising to 2.21% and 2.34%, respectively, the market is talking about the reflation trade.

Of course, it is true that inflation expectations have risen to some extent. However, we must note the possibility that the 10-year US breakeven inflation rate (inflation expectations) is slightly exaggerated. Currently, US inflation expectations are inverted (30-year < 10-year < 5-year < 2-year), and 30-year inflation expectations and 5-year forward 5-year inflation expectations, both of which mirror the real long-term strength of the US economy, are staying in the 2.1% level. Although the 2.1% level is also a considerably good figure, it only indicates a recovery to the same level as in 2016 and 2018. This does not show the setting of major record highs for the past several years, unlike short-term/intermediate rates (chart on next page).

This week, the 30-year US yield faced intense short-covering after exceeding 2% at one point. The point here is that this short-covering was triggered when the 20-year forward 10-year yield (2.5%, the level of the median of longer-run projections) exceeded the 30-year yield (2%). This can be interpreted as meaning that the view of an uptrend of longer-run projections is not shared in the market (at least in the current situation).

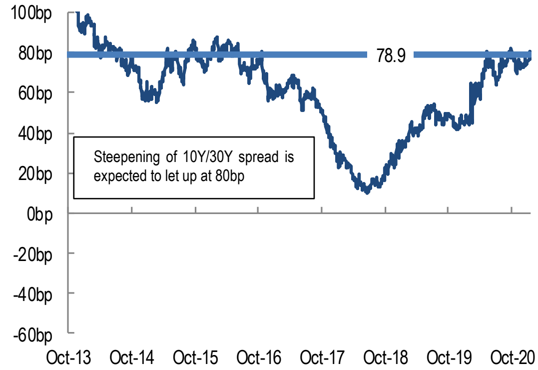
While market participants are confident of temporary overheating of inflation due to base effects, Biden's fiscal policy, and pent-up demand, they probably do not feel sure that inflation will remain overheated over the long term. If the 10-year yield continues to rise under this structure, the 2-year/10-year spread will remain steep. Meanwhile, the upward pace of superlong yields will slow as forward yields are anchored at 2.5%. Accordingly, the 10-year/30-year spread, which now stands at 79bp, is unlikely to steepen that much.

30Y US Breakeven Inflation Rate



Source: Bloomberg; compiled by Daiwa Securities.

10Y/30Y US Yield Spread



Source: Bloomberg; compiled by Daiwa Securities.

Continuous drop in JGB futures for ten business days is likely to stop

◆ Has BOJ started to guide in a dovish direction?

Yesterday, there was news from 'those in the know' for the first time in a long time. According to Bloomberg, several persons who are familiar with the matter said that they are considering measures to make an ETF purchase method more flexible, but it is highly likely that the current purchase target amount will be maintained.

What was the intention of leaking the dovish information that they would be maintaining the ETF purchase target amount when the Nikkei Stock Average hit a 30-year high and topped Y29,500? It was probably not intended to provide further momentum to the Nikkei Stock Average towards Y30,000. Amid a rapid hawkish shift in market expectations regarding the March assessment meeting, we presume that the BOJ intends to correct thinking that is leaning somewhat excessively toward the hawkish side, although this may be reading too much into it.

Since last December's decision on holding the assessment meeting, market sentiment had been somewhat overly dovish. I think that the BOJ corrected this in the hawkish direction by accepting the 15 January Jiji Press report regarding a widening of the 10-year JGB yield trading band. Since then, market thinking has rapidly become hawkish, which is now creating concerns about sharp fluctuations in the prices of holdings due to the assessment results to be announced on 19 March, which is a crucial time immediately before the end of the fiscal year.

That said, I think that the BOJ intended to sway market sentiment from the start. The central bank has to express both hawkish and dovish stances at the March meeting. In our view, taking a preparatory step towards letting the market smoothly digest the results by using a method of first imprinting hawkish information and then imprinting dovish information would lead to less market confusion than the opposite method.

At the very least, the result of the March assessment meeting will supposedly not be tightening. In that sense, I had thought that the leaking of hawkish information would not continue and the BOJ would start to imprint dovish information soon. At exactly the same time as I was thinking this, the latest news by 'those in the know' appeared. Accordingly, we may be able to see this as having certain implications. It is highly likely that the long-lasting drop in JGB futures for ten business days will stop temporarily.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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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 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).

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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.

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