

# Daiwa's View

## If inflation concerns are becoming a topic in the market

- JGB sensitivity to overseas yields could remain low for the time being

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Daiwa Securities Co. Ltd.

### JGB sensitivity to overseas yields could remain low for the time being

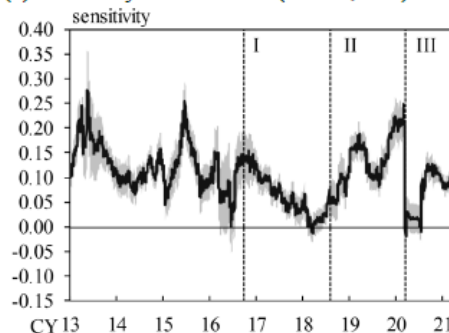
#### If inflation concerns are becoming a topic in the market

Yesterday, inflation concerns were [a topic](#) in the market. A noteworthy point was the difference in performance by region/asset. While the rate of decline in stock price indices followed the pattern Japan > Europe > US, the extent of yield increases followed the pattern Europe > US > Japan, clearly reflecting a difference in fundamentals by nation/region.

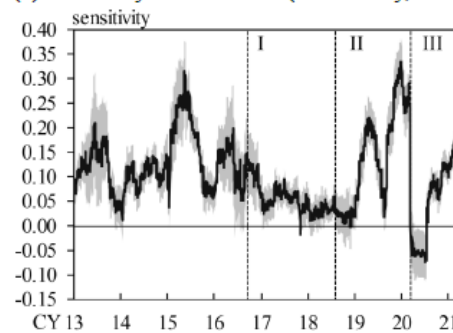
If you include a view of the 10-year JGB yield's sensitivity (beta) to 10-year European and US government bond yields, the most notable moves yesterday may have been seen in the Japanese market. It may have only been a single day's movement, but yesterday the 10-year JGB yield declined, heading in the opposite direction of 10-year European and US government bond yields. The sensitivity of JGB yields to US/European yields, of course, becomes significantly positive when calculated for a certain period. However, observing the sensitivity on a rolling basis, we found that periods of high sensitivity and those of low sensitivity are mixed. Therefore, it is true that sensitivity to overseas yields is not as stable as market participants typically presume.

#### 10Y JGB Yields' Sensitivity to 10Y US/European Yields

(5) Sensitivity of JGB Yields (to U.S., 10Y)



(6) Sensitivity of JGB Yields (to Germany, 10Y)



Source: Extracted from BOJ's "[Assessment for Further Effective and Sustainable Monetary Easing: The Background.](#)"

Notes (1) I: Introduction of QQE with Yield Curve Control (Sept. 2016), II: Strengthening the Framework for Continuous Powerful Monetary Easing (July 2018), III: Enhancement of Monetary Easing in Light of the Impact of the Outbreak of the Novel Coronavirus (COVID-19) (Mar. 2020).

(2) Rolling regression estimates for 90-day windows. The shaded areas represent  $\pm 1$  standard errors.

Currently, market sentiment tends to be focused on inflation expectations as a global market factor. Due to differences in economic conditions between the US/Europe and Japan, a rise in Japanese inflation expectations seems unlikely. If differences in fundamentals between the US/Europe and Japan were partially reflected in yesterday's decline in the JGB yields' sensitivity to overseas yields, the beta may remain low for the time being, considering that the fundamental structure is unlikely to change in the short term.

Meanwhile, the region that posted the largest yield gains yesterday was Europe, where positive surprises are continuing in terms of economic indicators. The 10-year German Bund yield rose to  $-0.16\%$ . Following the US, the economic outlook in Europe is also facing an “inflection point,” in the words of ECB executive board member Philip Lane. Under the circumstances, the 5-year forward 5-year inflation swap rose to  $1.6\%$ . Moreover, the rise in vaccination rate is making it easier to generate positive surprises with respect to the ECB’s exit strategy.

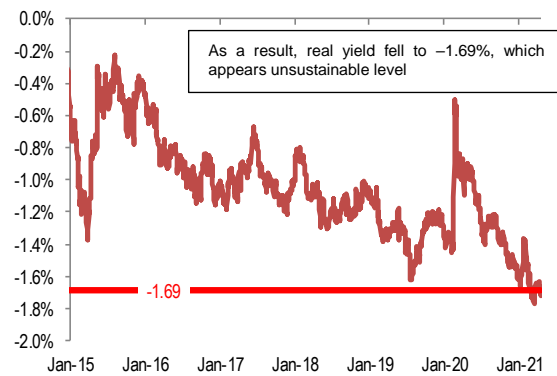
Compared to the sharp rise in inflation expectations, the rise in nominal yields remained small, resulting in the decline of the 10-year German real yield to  $-1.69\%$ . This appears to have reached an unsustainable level. If inflation expectations continue to rise, upside potential for German Bund yields (nominal yields) would be accepted.

**10Y German Bund Yield, Inflation Expectations**



Source: Bloomberg; compiled by Daiwa Securities.

**10Y German Bund Real Yield**



Source: Bloomberg; compiled by Daiwa Securities.

Regarding the US, the extent of yesterday’s yield increases was relatively small, and that of stock price declines was also small. That said, the Fed-focused 5-year forward 5-year BEI rose to  $2.38\%$  yesterday, giving the impression that the potential for future yield increases is increasing.

The rise in US yields appears to be currently contained by the following factors: (1) yields have risen ahead of other nations, (2) the Fed changed its message on the exit strategy to a slightly cautious tone, reflecting the April jobs report, and (3) economic surprises are peaking out. However, with inflation expectations edging up, it is becoming increasingly difficult to tell what will happen.

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#### [Moody's]

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- 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).

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- 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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Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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