

Daiwa's View

Yield declines led by inflation expectations

- Investors regaining a sense of calm

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Daiwa Securities Co. Ltd.

Investors regaining a sense of calm

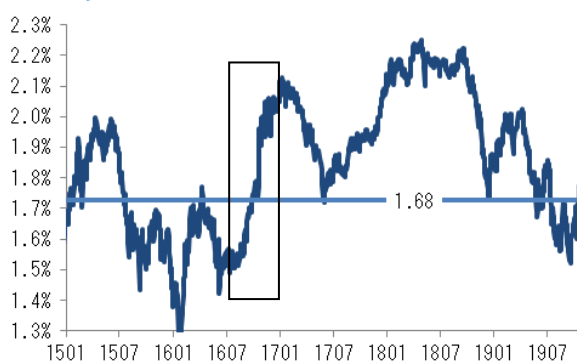
Yield declines led by inflation expectations

Yesterday, the US long-term interest rate fell by 5bp to 1.87%, around 10bp lower than the 1.97% logged on 8 November on an intraday basis. One point to note is that the rate drop was led by inflation expectations. Yesterday, the 10-year US breakeven inflation rate fell by 5bp amid the announcement of slowing US core CPI in October (actual reading of 2.3% vs. market consensus of 2.4%, with Sep figure being 2.4%). The entire decline in yesterday's US rates can be explained by a drop in inflation expectations. It is premature to draw a conclusion based solely on the movements of a single day, but it is possible market participants have realized that the end of low inflation will not be as simple a matter as the bottoming out of the economy resulting in inflation.

In fact, the possibility is increasing that inflation will remain weak. For example, checking the China PPI, which has a strong impact on the global inflation rate, in 2016 the PPI index recovered by as much as 10% from its bottom, pushing up US import prices and facilitating inflation. Although this supported a surge in yields, the PPI in October 2019 fell to below zero, at -1.6%, and is now putting deflation pressure on the global economy. This makes it difficult to expect the degree of yield uptrend in the current market to match that seen in 2016, despite the fact that the current market's rising interest rates led by the term premium resemble those in 2016.

Assuming the market has gained a levelheaded awareness of these fundamentals, 'investor panic' may have been calmed. JGBs have continued to surge over the past several weeks, ignoring US yield trends and inflation expectations, but yesterday's logical movements by US Treasuries may help to restore a sense of calm to investors.

Chart: 10-year US Breakeven Inflation Rate



Source: Bloomberg; compiled by Daiwa Securities.

Chart: China PPI and US Import Prices



Source: Bloomberg; compiled by Daiwa Securities.

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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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- 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 and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group is to acquire up to 5.01% of Credit Saison's total common shares outstanding (as of 31 Jul 2019), while Credit Saison is to purchase up to ¥2bn worth of Daiwa Securities Group's common stock.
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- 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.

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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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