Daiwa Securities

Daiwa's View

Coordinated easing vs. anxiety

- US yield curve back to normal, but market remains confused

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp

Daiwa Securities Co. Ltd.

Coordinated easing vs. anxiety

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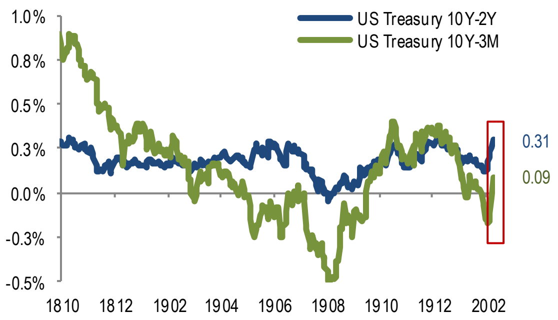
Last night, a 50bp rate cut was unanimously determined at an emergency FOMC meeting. The latest statement still maintains the phrase "act as appropriate," indicating the high possibility of an additional rate cut at the next FOMC meeting. Yesterday, the Australian central bank implemented a 25bp rate cut. Today, the Bank of Canada is expected to join the rate cut. As yesterday's G7 statement does not include a coordinated rate cut itself, we are aware of the possibility that the next move by the ECB/BOJ will not be a rate cut. However, some sort of coordinated easing (≠ coordinated rate cuts) will be probably implemented.

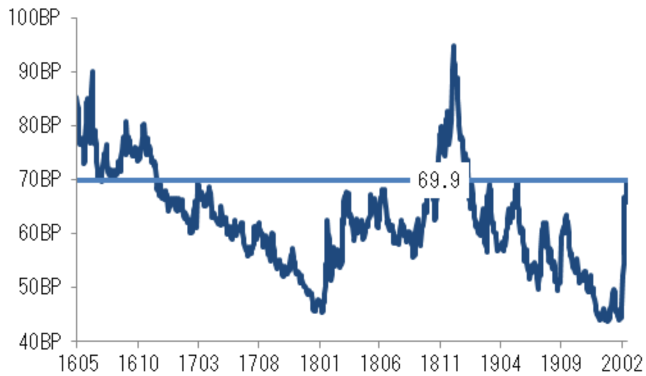
After the emergency rate cut, the US long-term interest rate slid to a record-low 0.9% at one point. However, it recovered to the 1% level (at same time, S&P 500 Index also rebounded to 3,000 points). Due to bull steepening of the yield curve in line with the rate cut, the US yield curve temporarily reverted back to normal. Last night, we saw other favorable movements—the 3-month/10-year US spread surfaced to positive territory, and the 2-year/10-year US spread has steepened further (from 26bp to 31bp). On the other hand, the market remains unstable, as witnessed by the North American CDS Index widening to around 70bp and the VIX Index again rising to around 40bp. Although we positively view the change of the shape of the yield curve caused by the rate cut, of course all the issues will not be resolved by the cut alone.

Chart: US Long-term/Short-term Yield Spread



Source: Bloomberg; compiled by Daiwa Securities.

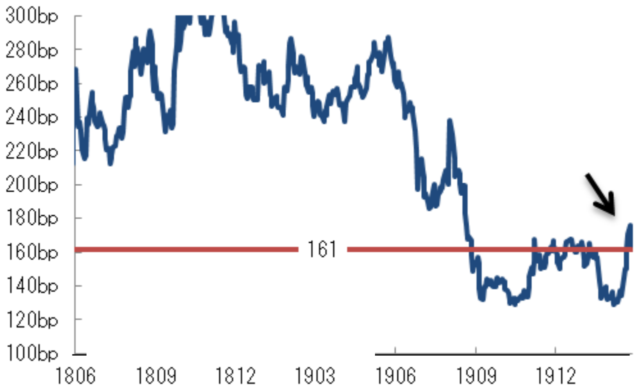
Chart: North American CDS Index (CDX NA. IG 5Y)



Source: Bloomberg; compiled by Daiwa Securities.

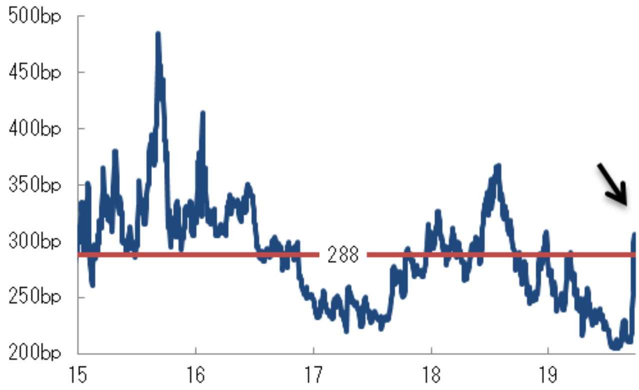
Regarding the ECB, there is a possibility that the central bank will embark on a rate cut at the Governing Council meeting to be held on 12 March. Meanwhile, we note yesterday's remark by Austria's central bank governor Robert Holzmann on TLTRO that "This is definitely an area that will be under consideration." In the current situation where peripheral nations' yield spreads vs. German bonds have widened due to the COVID-19 virus outbreak, it is difficult to deliver benefits from rate cuts to marginal areas of the EU economic zone. Therefore, what is currently required is not a rate cut but the tightening of spreads vs. German bonds. In order to achieve it, TLTRO will probably be the best tool. Yesterday, credit spreads improved in Europe (incl. Italy) across the board, which might have positively reflected an anticipated step by the ECB.

Chart: Italy vs. German Gov't Bond Yield Spread (10Y)



Source: Bloomberg; compiled by Daiwa Securities.

Chart: European CDS Index (iTraxx Europe XOVER)



Source: Bloomberg; compiled by Daiwa Securities.

Under the circumstances, the BOJ's next move is also garnering attention. Our chief economist Mari Iwashita currently assumes a small possibility of the BOJ's speed-before-quality decision to deepen negative rates, given the USD/JPY rate staying at the Y107 level despite the emergency rate cut. If stock prices continue to decline, the BOJ is likely to cope with it by increasing the ETF purchase amount for the time being. Regarding the key factor of a rate cut, the BOJ is likely to watch carefully whether the ECB will embark on the deepening of negative rates on 12 March.

In my opinion, what is currently required in Japan is credit support for SMEs. Given the cost, the benefit of the deepening of negative rates, to which such SMEs are unable to access, is not high. However, if the ECB deepens negative rates and the yen sharply strengthens close to Y100/$, the possibility of the BOJ's rate cut would finally increase in order to abate economic downward pressure via the exchange rate. If the BOJ deepens negative rates, it is likely to take sufficient measures to address side effects at financial institutions, such as an addition of the YCC target maturity (not shortening to 5-year JGB yield but addition of 5-year yield) and expansion of the universe for the IOER.

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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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February 2020

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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 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%.

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* 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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