

## Daiwa's View

## Themes that changed during Golden Week

- Risk sentiment stable as a whole, but supply served as steepening pressure

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Daiwa Securities Co. Ltd.

**Risk sentiment stable as a whole, but supply served as steepening pressure**

## Themes that changed during Golden Week

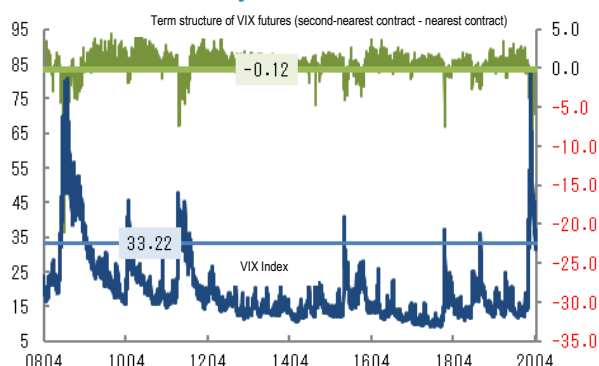
In the global market during Japan's Golden Week holiday, long-term interest rates and crude oil prices rose, but other rates and prices were largely stable. We will check the themes that changed during the holiday.

- (1) COVID-19: Due to wider optimism about easing of lockdowns, expectations increased for bottoming-out of economic indicators. This triggered a 20% surge in the WTI crude oil futures price to \$24 compared to the pre-holiday level. The VIX Index also declined.
- (2) Europe: Germany's constitutional court pointed out concerns about the partial legality of the ECB's QE program, judging that the Bundesbank may not be able to participate in asset purchases from now on. Due to this, the spread of Italian government bonds vs. German government bonds has widened by 13bp compared to the pre-holiday level.
- (3) US-China: US President Trump indicated that he would impose retaliatory tariffs against China for its handling of COVID-19, which raised caution about the resurgence of the US-China trade friction.

However, market risk sentiment against these factors is almost balanced. With respect to the Europe and US-China factors, the market appears to have just taken them as initial warnings at this moment.

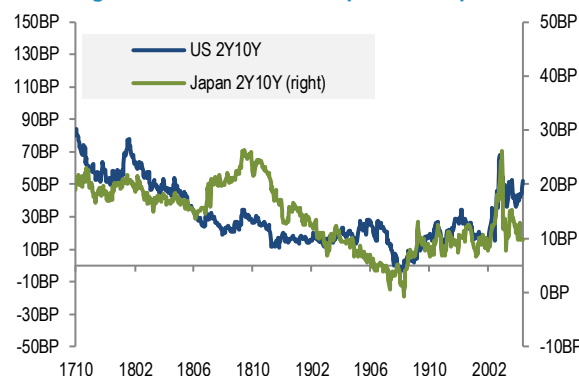
In contrast to the stable risk sentiment, there were more substantial moves in bond prices. Due to the announcement of the quarterly refunding plan by the US Treasury Department, US long-term and superlong sectors substantially softened. Fiscal spending to cope with the COVID-19 pandemic was initially funded by T-bills, and the step of refinancing such T-bills with coupon-bearing bonds is within expectations. However, the market appears to have reacted to a higher-than-expected weighting of long-term and superlong zones.

Chart: US Stock Volatility Indices



Source: Bloomberg; compiled by Daiwa Securities.

Chart: Long-term/short-term Yield Spread in Japan and US



Source: Bloomberg; compiled by Daiwa Securities.

**Chart: Change in US Yield Level (%)**

	2Y	3Y	5Y	10Y	30Y
01-May-20	0.19	0.24	0.35	0.61	1.25
07-May-20	0.18	0.24	0.37	0.7	1.39
Change	-0.01	0.01	0.02	0.09	0.15

Source: Bloomberg; compiled by Daiwa Securities.

Specifically, it was announced that the total supply of quarterly refunding scheduled for next week would amount to record-high \$96bn (incl. \$39bn in new cash). By maturity, the offering of 3-year bonds stands at \$42bn, while the supply amount of long-term and superlong bonds is higher than the estimates, as shown by \$32bn (previous estimate of \$29bn) in 10-year bonds and \$22bn (\$21bn) in 30-year bonds.

Moreover, the department announced that it would issue 20-year Treasury bonds on 20 May for the first time in about 34 years. The \$20bn size of the issue also exceeded the upper limit of the market estimate. The higher weight of long-term and superlong zones in the supply plan as a whole shows the US Treasury Department's stance of taking advantage of the current low interest rate environment.

Actions to address the COVID-19 pandemic have an impact on the shape of the yield curve in three phases: lockdowns → fiscal spending (short-term government bonds) → refinancing of short-term government bonds to long-term government bonds. In the US, where the pandemic and lockdowns spread prior to Japan, the supply of coupon-bearing government bonds has increased and steepening has been observed in this timing. This is suggestive also for JGB yields.

While easing of lockdowns progressed in Europe and the US, Japan's state of emergency was extended during the holiday and additional fiscal spending is presumed going forward. This spending is likely to be eventually refinanced with coupon-bearing JGBs, similarly to the US. Given the above-mentioned process and fiscal spending as well as the timing of refinancing, the full impact of increased supply of long-term JGBs on the Japanese market is expected to be in around 2H.

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### ■ Credit Rating Agencies

#### [Standard & Poor'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%.

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