

Daiwa's View

Rapidly increasing money stock

- Supporting stock prices and inflation expectations

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Daiwa Securities Co. Ltd.

Supporting stock prices and inflation expectations

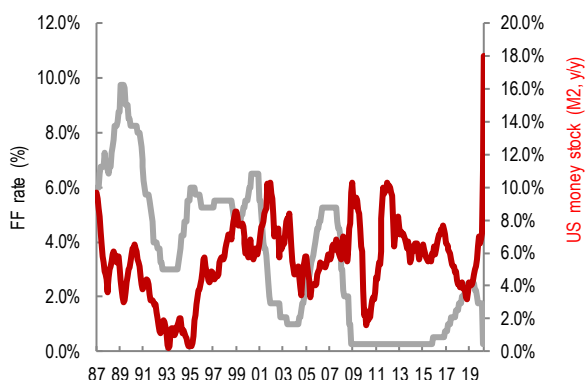
Rapidly increasing money stock

Yesterday, the market saw the Nikkei Stock Average gain by 353 (up 1.73%) to 20,741 and the German DAX Index advance by 317pt (up 2.87%) to 11,391pt. Overnight, the Nikkei Stock Average Futures rose to around 20,970. (The US market was closed due to Memorial Day.) Individual factors were pointed out, but we have the impression that the gain was large compared to the change in factors. (Although the lifting of the state of emergency in the Tokyo metropolitan area had a strong impact, this was not yesterday's flash report.) Amid [a change in market trends](#), the market appears to be continuously unwinding positions accumulated based on a pessimistic outlook.

Has there been an impact from the huge scale of money from monetary easing? Perhaps. The recent surge in the US money supply (money stock/money supply) is impressive. Although the growth rate of core M1 is also high, an increase in M2 driven by a surge in saving deposits at commercial banks is noteworthy. In the US, M2 increased rapidly from \$15.30tn as of end-2019 to \$17.17tn as of end-April 2020 (see chart below).

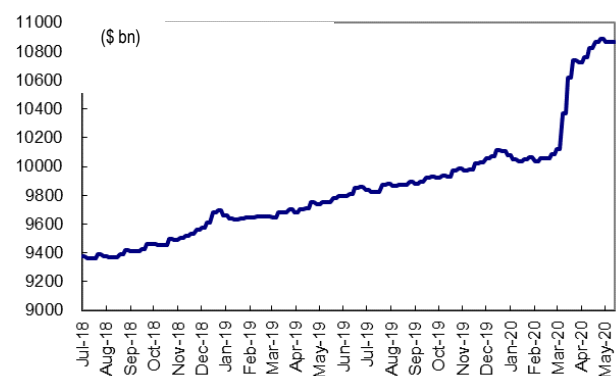
Of course, as one of the factors behind this surge, we can point out the fact that many entities have increased cash on hand in the face of the COVID-19 pandemic. The amount of outstanding US bank loans and leases has shown a historical surge. However, we should not miss the role played by the Fed's monetary easing as a factor behind this credit expansion. Either way, history has shown whether the market remains pessimistic about the future in an economic situation in which the credit creation function is working and the money supply is increasing.

Chart: FF Rate and Change in US Money Stock (M2)



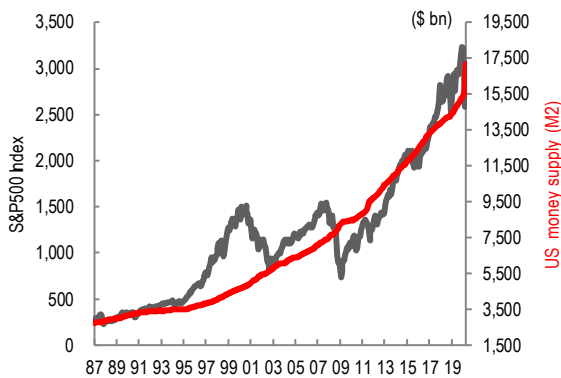
Source: Bloomberg; compiled by Daiwa Securities.

Chart: Outstanding Amounts of US Loans and Leases (bank credit)



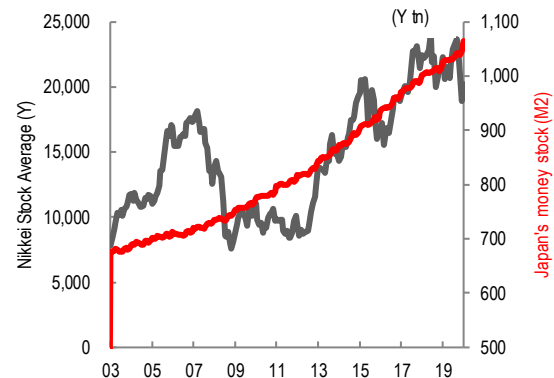
Source: Bloomberg; compiled by Daiwa Securities.

Chart: S&P 500 Index and M2 Balance in US



Source: Bloomberg; compiled by Daiwa Securities.

Reference: Nikkei Stock Average and M2 Balance in Japan



Source: Bloomberg; compiled by Daiwa Securities.

Some argue that this money will remain idle as dead storage—i.e., the pandemic will cause US companies to suffer from “borrowing phobia” and keep cash idle, similar to Japanese firms. If companies keep deposits in their bank accounts and the speed at which money circulates¹ declines, money is unlikely to flow into the real economy.

If the US stock market views companies with idle cash positively, this will become a trend. On the other hand, if the stock market judges such corporate management as inefficient and negatively assesses its stock prices, top management that takes such corporate action may be eliminated from the market.

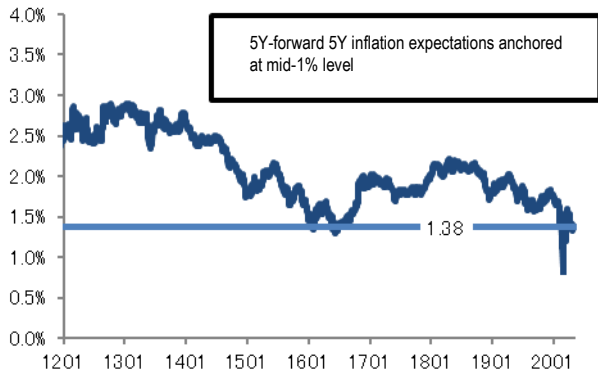
Looking back on Japanese corporate action of the past, we can point out the reluctance of banks to lend money seen during the financial crisis—i.e., deep-rooted caution about “dysfunctional indirect financing”—as one factor behind excessively conservative corporate action. Although Japan’s economy relies mainly on indirect financing, indirect financing has been dysfunctional over the long term due to a delay in public fund injections—a failure of the government sector. Since Japanese companies have experienced such a situation, their corporate action, which is apparently excessively conservative, is rational.

On the other hand, the Fed and US government have calmed the financing crisis caused by the pandemic relatively early via [expeditious and bold measures](#). The positive results of these measures may have increased trust in the government sector and left US companies less traumatized than Japanese firms. It is possible that US corporate action will not be as conservative as in Japan because the US relies mainly on direct financing and has highly reliable authorities, which take quick action to restore the market function in the case of a liquidity crisis.

In other words, US companies might not keep cash idle to the same extent as Japanese firms. Therefore, it is possible that an increase in money stock will bring about growth in nominal GDP (although slower than before). If the Fed has the option of controlling the output gap via this channel, deflation (if it occurs) is unlikely to be prolonged and inflation expectations will likely be anchored easily relative to other central banks. This is probably one factor behind the fact that the 5-year forward 5-year inflation expectations, which is carefully checked by the Fed, has been anchored at the mid-1% level. Although more market participants forecast that US yields will follow a path of Japanification, it would be premature to conclude that the 10-year US yield will decline to 0%, like Japan.

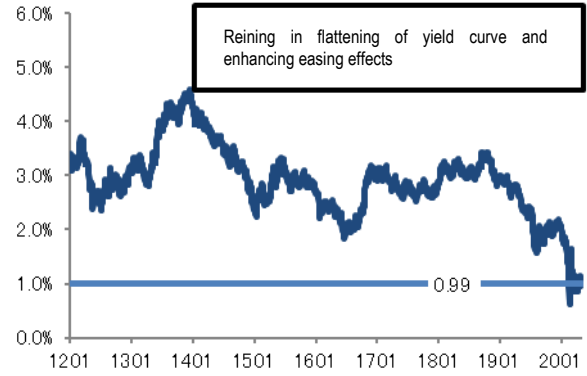
¹ Nominal GDP = Money stock X Velocity of circulation

Chart: US 5Y-forward 5Y Inflation Expectations



Source: Bloomberg; compiled by Daiwa Securities.

Chart: US 5Y-forward 5Y Interest Rate



Source: Bloomberg; compiled by Daiwa Securities.

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[Standard & Poor's]

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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%.
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- 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

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