

Daiwa's View

Taking notice of possibility of change in stance

- Are *Bond Market Survey* and LCH-JSCC spread signs of change in stance?

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Daiwa Securities Co. Ltd.

Are *Bond Market Survey* and LCH-JSCC spread signs of change in stance?

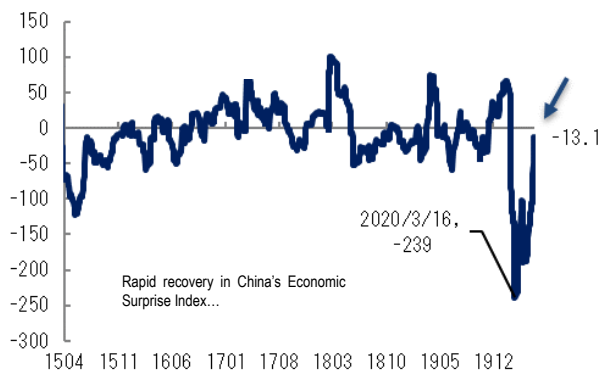
Taking notice of possibility of change in stance

Risk-on mode continued yesterday, as shown by a gain of the DJIA to 25,742 pt and the ongoing bear steepening of the yield curve. As [a change in the market trends](#) is determined by tightening of credit spreads and the bottoming-out of business sentiment shown by improvement in the Economic Surprise Index, risk appetite is recovering solidly.

Of course, the level of economic indicators itself is still low. However, the important point in the market is not the absolute level of indicators but a change in the consensus and its direction. In this respect, China's Economic Surprise Index¹ has now recovered to a normal level of -13.1, after hitting a bottom at -239 on 16 March. Meanwhile, the US Economic Surprise Index now stands at -54.7, hitting a bottom at -144.6 on 30 April. If we assume that the US will recover at the same pace with China, its economic indicators are likely to start to largely match with market forecasts in around mid-July.

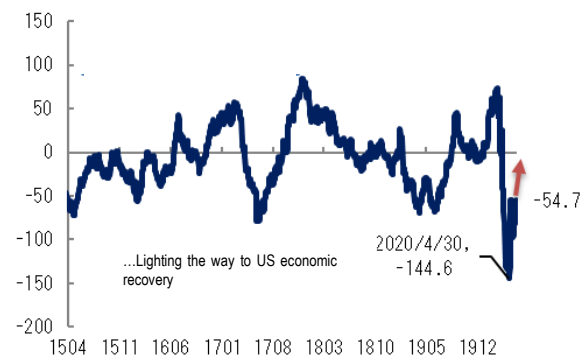
Some point out the divergence between indicators and the market. However, as the market reflects the outlook, what we are watching now is probably the landscape in the future.

Chart: Citigroup's Economic Surprise Index (China)



Source: Bloomberg; compiled by Daiwa Securities.

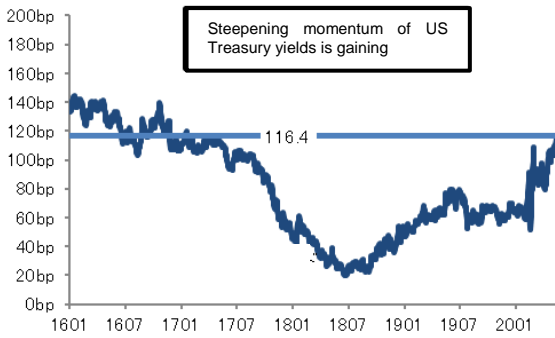
Chart: Citigroup's Economic Surprise Index (US)



Source: Bloomberg; compiled by Daiwa Securities.

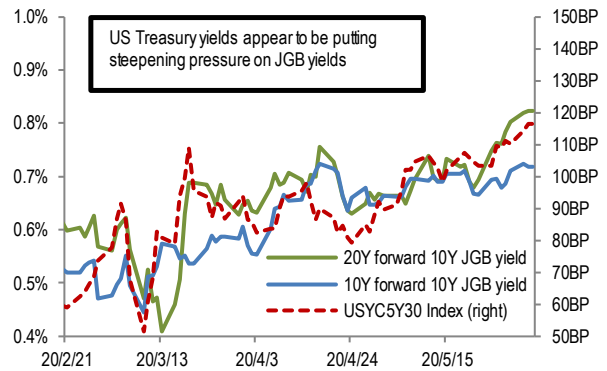
¹ Deterioration in Economic Surprise Index indicates worsening of economic indicators beyond market forecasts, while improvement in index indicates recovery of economic indicators better than market forecasts.

Chart: 5Y/30Y US Treasury Yield Spread



Source: Bloomberg; compiled by Daiwa Securities.

Chart: 5Y/30Y US Yield Spread and Forward 10Y JGB Yields



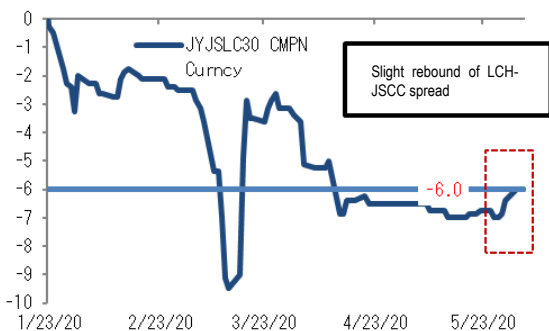
Source: Bloomberg; compiled by Daiwa Securities.

Anyway, steepening pressure is strong globally. Yesterday, the US 5-year/30-year yield spread continued to widen (115bp → 116.4bp, left-hand chart above). Since March 2020 when the market became definite about the Fed's policy rate cut, this spread and forward 10-year JGB yields have started to show a close correlation. This trend is still observed. In particular, the correlation between the US spread and the 20-year forward 10-year JGB yield is high, which may be one cause of the rise in JGB superlong yields.

We are now taking notice of two factors for the future. One is substantial deterioration in the results of [the Bond Market Survey](#) by the BOJ (DI for degree of bond market functioning: -27 → -45). Although the BOJ has enhanced monetary easing since the coronavirus crisis, a decline in market functioning was confirmed as a result of aggressive JGB purchases prior to further issuance of JGBs from July. As prices of risk assets such as stocks have started to recover, the BOJ now must have room to pay attention to market functioning. Therefore, it may change its stance, accepting yield changes more than before. Of course, such a change will likely be seen after the central bank confirms the market trends following the increase in JGB issuance from July. However, we should be aware of the possibility that this survey will trigger a more flexible stance at the BOJ.

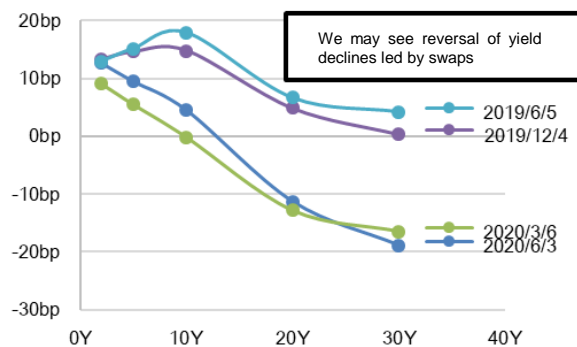
Another is the recent rise in the LCH-JSCC spread (tightening in negative territory). The LCH-JSCC spread shows the difference in preference for long interest rate positions between Japanese and overseas investors. Since the beginning of this year, the LCH-JSCC spread has been deepening in negative territory. It appears that interest rate long positions by overseas investors drove a decline in swap interest rates, but recently the 30-year LCH-JSCC spread has tightened slightly in negative territory from -7 to -6. Although we need to confirm whether the spread will post a full-fledged reversal toward positive territory, this is a sign of the possibility that overseas investors have started to change the recognition on superlong yields, which needs to be watched carefully.

Chart: JSCC-LCH Spread (30Y)



Source: Bloomberg; compiled by Daiwa Securities.

Chart: JPY Swap Spread



Source: Bloomberg; compiled by Daiwa Securities.

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[Standard & Poor's]

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[Moody's]

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- 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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- 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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