

Daiwa's View

“Crocodile’s mouth” with dislocated jaw

- Background of deep-rooted steepening pressure

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Daiwa Securities Co. Ltd.

Background of deep-rooted steepening pressure

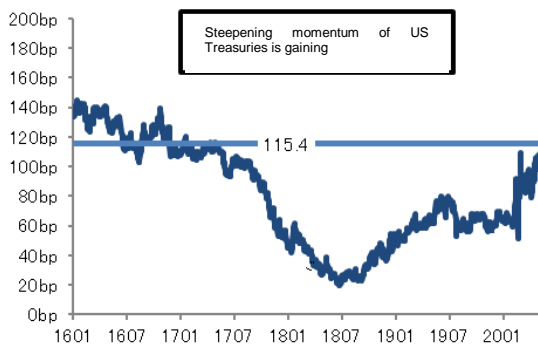
“Crocodile’s mouth” with dislocated jaw

Risk-on mode also continued yesterday—global stock prices advanced and yields posted bear steepening. In particular, we have the impression that a rise in superlong yields was marked. Yesterday, the US 5-year/30-year yield spread came close to its peak in 2017, widening from 110bp to 115bp (left-hand chart below). The European 5-year/30-year yield spread also widened from 65bp to 71bp. Regarding JGBs as well, the 30-year JGB yield rose to 0.515% yesterday, easily topping a dip-buying guideline of 0.5% thus far. This move is consistent with the structure of global steepening, as witnessed by the bottoming-out of the Economic Surprise Index, an extraordinary level of additional issuance of government bonds, and suppression of the short end of the yield curve due to monetary easing. Therefore, this is leading to less dip-buying than before.

In such a situation, the fiscal system subcommittee of the Fiscal System Council submitted a handout entitled *Responses related to the coronavirus infection* yesterday. The handout includes a chart on the difference between expenditures and tax revenues in the general account (≈ issuance amount of JGBs), which has been called a “crocodile’s mouth” However, the expected shape for FY20 substantially differs from the crocodile’s mouth¹ (see chart on next page). If we continue to use the expression “crocodile’s mouth,” its jaw is dislocated. The background for the recent steepening is the existence of such an extremely wide difference between revenues and expenditures.

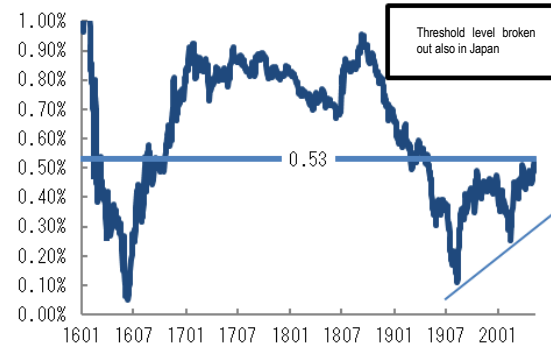
The rise in yields is being suppressed by monetary easing, but it is inevitable to put the weight of suppression mainly on the short-term/intermediate zone (10-year sector also in Japan). In that sense, we should not underestimate the steepening pressure that is intensifying globally. That said, the current steepening level relative to ballooned expenditures is within the level of sound phenomena of market functions. Therefore, this is not an issue that should be immediately forced out by the central bank.

Chart: 5-year/30-year US Treasury Yield Spread



Source: Bloomberg; compiled by Daiwa Securities.

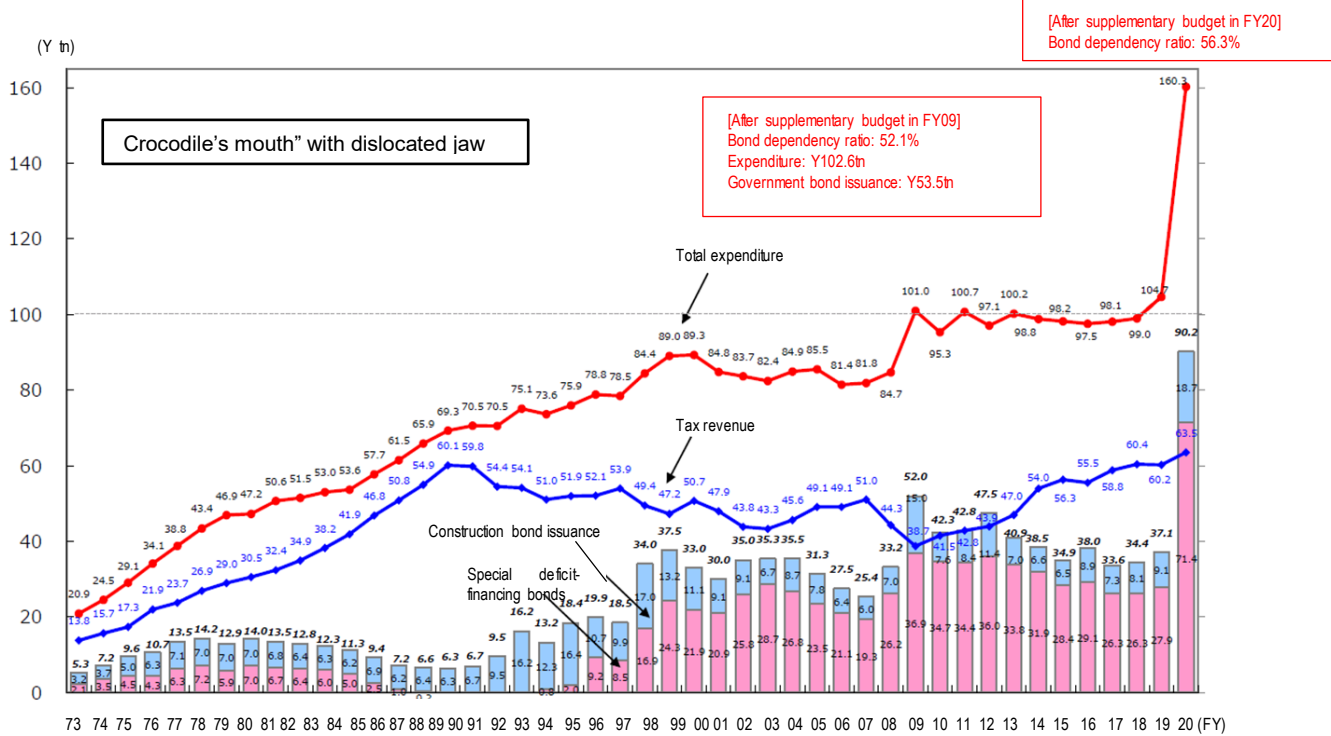
Chart: 30Y JGB Yield



Source: Bloomberg; compiled by Daiwa Securities.

¹ As tax revenue forecast not updated in this chart, shape likely to worsen eventually.

Chart: Expenditures and Revenues in General Account (crocodile's mouth)



Source: MOF; compiled by Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

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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), 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%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).
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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- 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.

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.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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