

Daiwa's View

Target achieved, or is there concern about overshoot?

- (1) Inflation indicators to continue to attract attention for now
- (2) Difference in performance of Japanese, overseas bank shares

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Daiwa Securities Co. Ltd.

Target achieved, or is there concern about overshoot?

◆ Inflation indicators to continue to attract attention for now

(1) Inflation indicators to continue to attract attention for now

It is hard to overestimate the fact that the University of Michigan's 5- to 10-year inflation expectation surged to 3.1%. As this indicator is correlated with the Fed-focused 5-year forward 5-year breakeven inflation rate (BEI), the overshoot of this indicator could have a significant impact on the Fed's thinking on inflation.

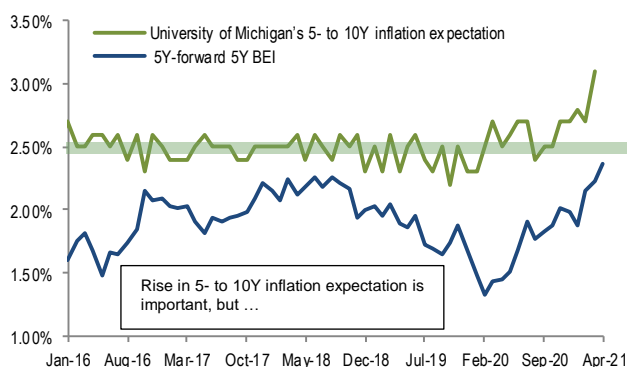
(2) Difference in performance of Japanese, overseas bank shares

That said, we are unable to say that the indicator is perfect. In the first place, it is natural that a rise in prices of daily necessities creates an upward bias to consumer replies to the questionnaire. Given the fact that 1-year inflation expectation jumped to the historically high level of 4.6% in this questionnaire, we may be able to interpret that the adhesive nature of inflation expectation among US public was shown by the 5- to 10-year inflation expectation coming in at only 3.1% (right-hand chart below).

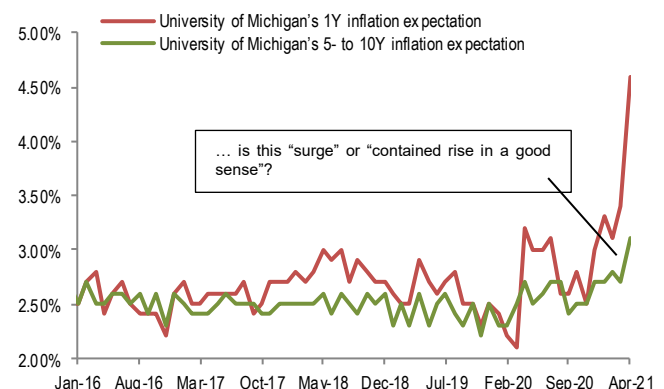
The 5-year forward 5-year BEI is still moving at the 2.3% level after peaking out at 2.4%. The 2.3% level of the BEI, which is based on the CPI, is equivalent to the 2% level of the PCE, the Fed's target. Therefore, we can say that inflation indicators have finally factored in the Fed's target. In this light, rising inflation expectations to this point are not a worrisome factor. Rather, this is a minimum level for the Fed to avoid facing difficulties.

That said, inflation expectation has already reached the target level. If it rises further from now, it would enter the overshoot zone. Therefore, it is true that the market has entered [the stage](#) where it is more sensitive to a rise in inflation. In this light, market attention to inflation indicators is unlikely to recede in the near term.

University of Michigan's Inflation Expectation, 5Y-forward 5Y BEI



Source: Bloomberg; compiled by Daiwa Securities.

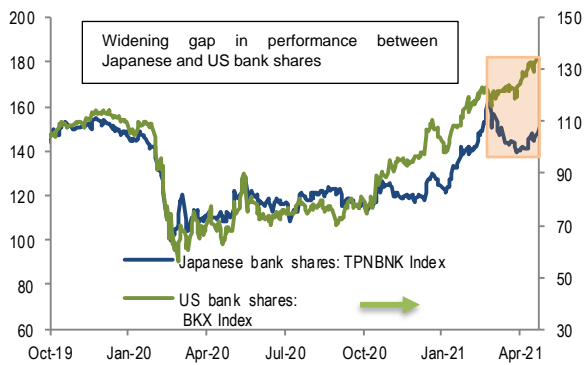


Source: Bloomberg; compiled by Daiwa Securities.

◆ **Difference in performance of Japanese, overseas bank shares**

Amid increasing attention to inflation, we are again seeing a wider difference in performance between Japanese and US bank shares, which follows the pattern Japan < US. Of course, as bank shares partially reflect the interest rate trends, it is true that the aspect of the “chicken-and-egg debate” is included. Generally, however, bank earnings serve as a mirror of the macro economy and tend to reflect overall fundamentals, including private-sector loan demand and bankruptcies (credit cost).

Banking Share Indices in Japan, US, Europe (pt)



Source: Bloomberg; compiled by Daiwa Securities.



Source: Bloomberg; compiled by Daiwa Securities.

[In our previous report](#), we pointed out that the correlation between Japanese and US long-term yields has been declining since inflation concerns became a market topic. This trend may be reflecting an element (= fundamentals) that is also assumed to be a cause of the performance gap between Japanese and overseas bank shares. If so, compared to Europe and the US, where inflation unease is a topic of concern, yield volatility is unlikely to rise in Japan. For the time being, the correlation between Japanese and US yields is expected to continue to decline.

Even in the case that JGB's volatility does not heighten compared to Europe and the US, it would be difficult to assume that the BOJ will artificially raise volatility as before. Since the March assessment meeting, operations have become more transparent due to the disclosure of the schedule and amounts. In addition to setting a high hurdle for a change within the month, BOJ governor Haruhiko Kuroda also stated at the press conference on 27 April that “we will not intentionally fluctuate long-term yields.” In the near term, volatility of JGBs is unlikely to heighten, and thus preference for carry and roll-down trade will likely remain strong.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

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[Fitch]

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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:

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).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- 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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