Monthly Economic Report

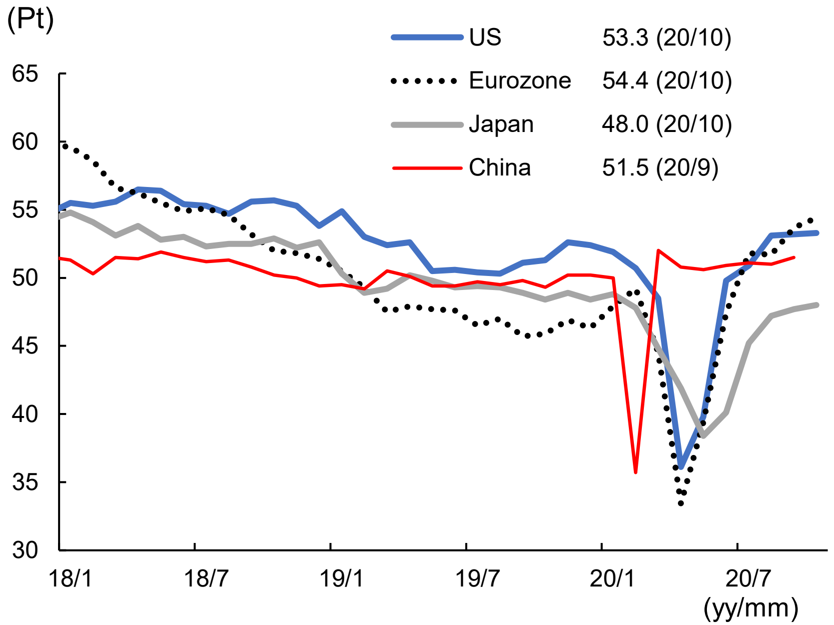
October 29, 2020

Mizuho Research Institute

1. Current state of the global economy: the impact of the resurgence of Covid-19 infections expanding among the non-manufacturing industry in Europe

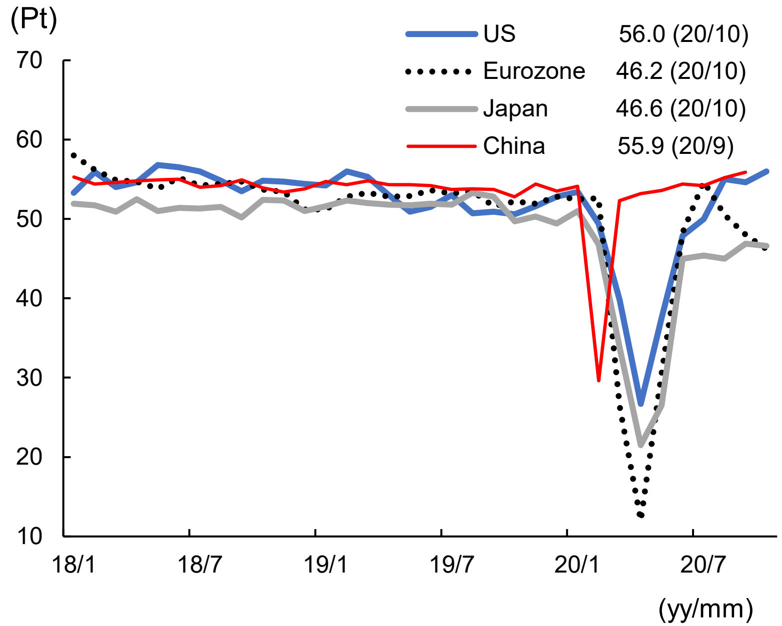
- Overall, the global economy is on a recovery.
  - The manufacturing PMI stayed above 50 in the US, the Eurozone and China. The non-manufacturing PMI also remained firm, above 50 in the US and China.
- The impact of the Covid-19 pandemic has been spreading in the Eurozone.
  - France and Spain have re-imposed night curfews and business restrictions on bars and restaurants. The Eurozone non-manufacturing PMI, which has remained below 50 since September, fell further in October. Likewise in England (London), inter-household mixing in indoor settings has become prohibited. Furthermore, there are concerns regarding the contraction of the Eurozone economy due to stay-at-home orders in France from the end of October, and the scheduled reinforcement of Covid-19-related behavioural restrictions in Germany, France, and Italy.

Manufacturing PMI



Note: The Purchasing Managers' Index (PMI) is an index calculated by weighting indexes such as new orders, output, order backlogs, prices, employment, and quantity of purchases. The reading of 50 in the PMI is the "expansion-contraction" threshold.
Source: Made by MHRI based upon the National Bureau of Statistics of China, Markit Economics

Non-manufacturing PMI



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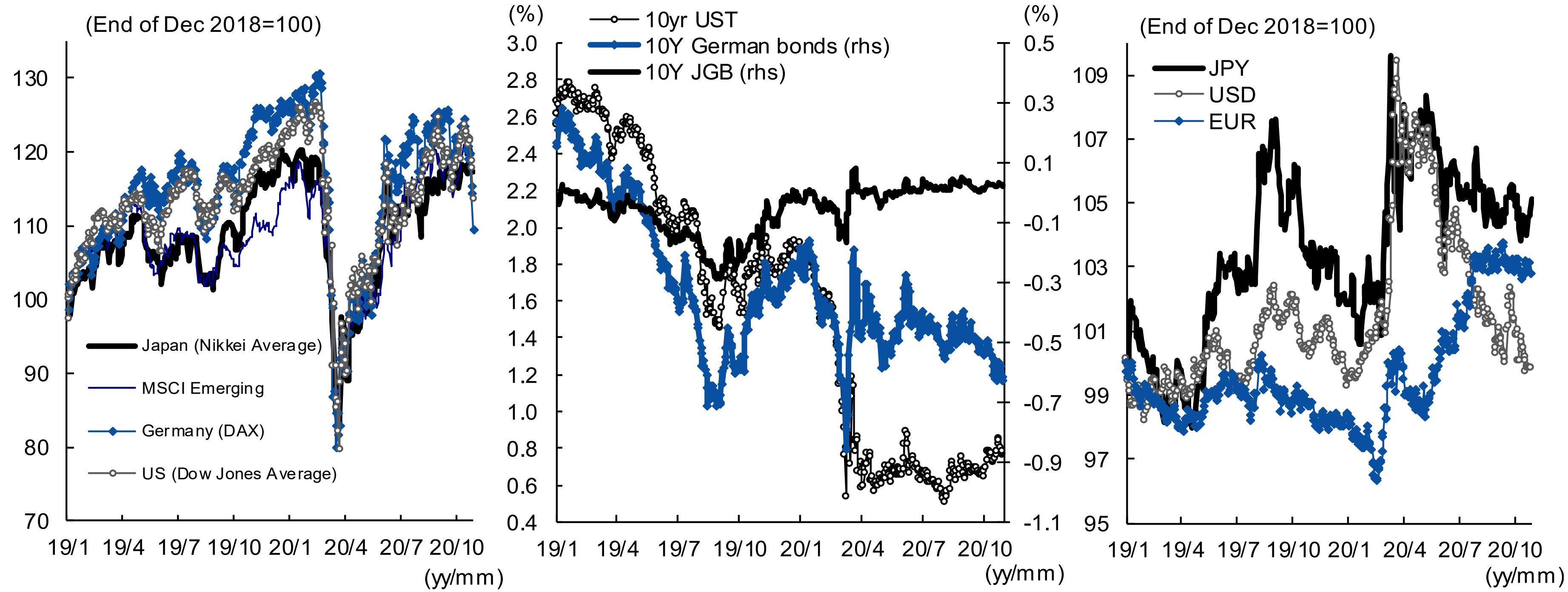
Source: Made by MHRI based upon the National Bureau of Statistics of China, Markit Economics

Overview of financial markets: mounting concerns over the resurgence of Covid-19 infections

- While the financial markets factored in Joe Biden's lead in the US presidential election, there were rising concerns regarding the spread of Covid-19 cases. Both US and Japan stocks fell. 10yr UST yields rose slightly, factoring the rise of expenditures following Joe Biden's victory. Turning to currencies, the Japanese yen traded around JPY104 level to the US dollar, while the appreciation of the euro took a breather, given factors such as the resurgence of Covid-19 infections in Europe.

Major market trends

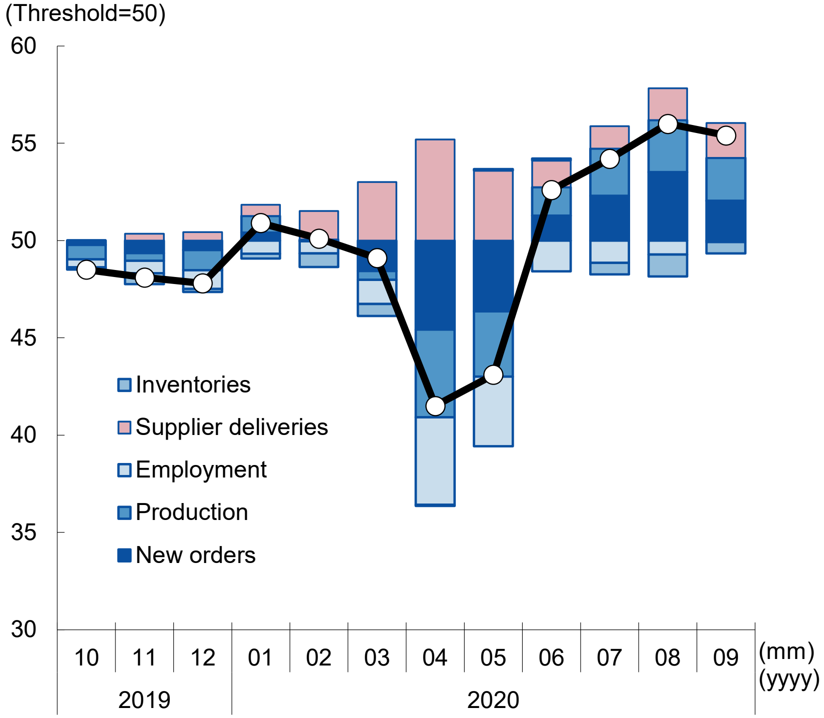


Note: Currency exchange rates are based upon the nominal effective exchange rates as released by the authorities of each country.
Source: Made by MHRI based upon Bloomberg

2. (1) US economy: corporate business conditions continue to improve, as with motivations to invest

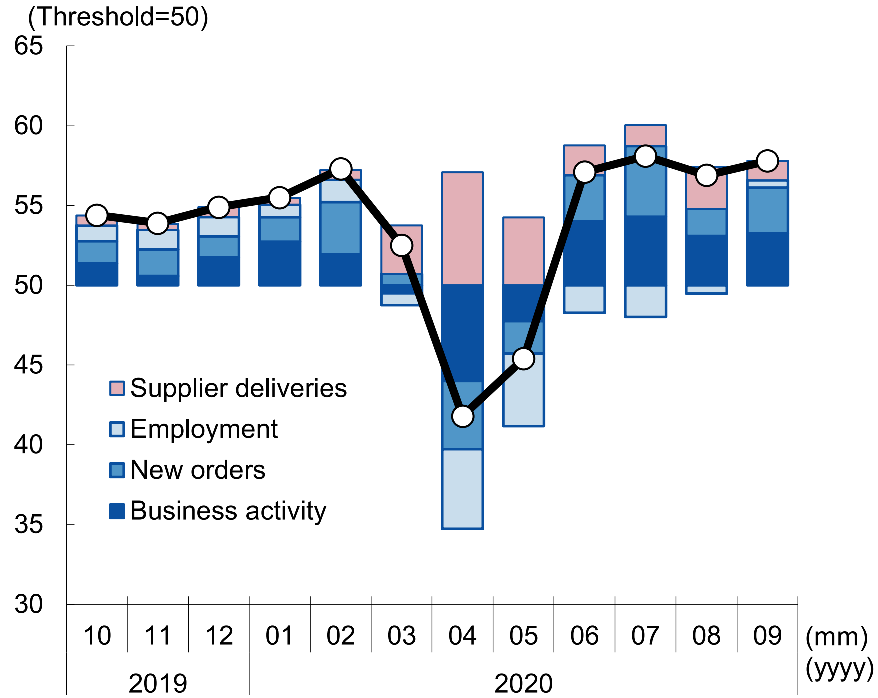
- Both the manufacturing and non-manufacturing ISM indexes followed an uptrend in September, standing at 55.4 and 57.8 respectively.
  - The employment index, which had been following a downward trend, finally reversed course in the non-manufacturing sector. The index also rose in the manufacturing industry, reaching close to the 50 threshold.
- According to the Fed's Beige Book, the capital investment outlook is continuing to improve.
  - Despite high future uncertainties such as the state of Covid-19 infections, the expansion of investment related to measures to address the Covid-19 pandemic (e.g. air-conditioning equipment, communication equipment) may be contributing to the improvement of the willingness to investment.

ISM manufacturing index



Source: Made by MHRI based upon Institute for Supply Management

ISM non-manufacturing index

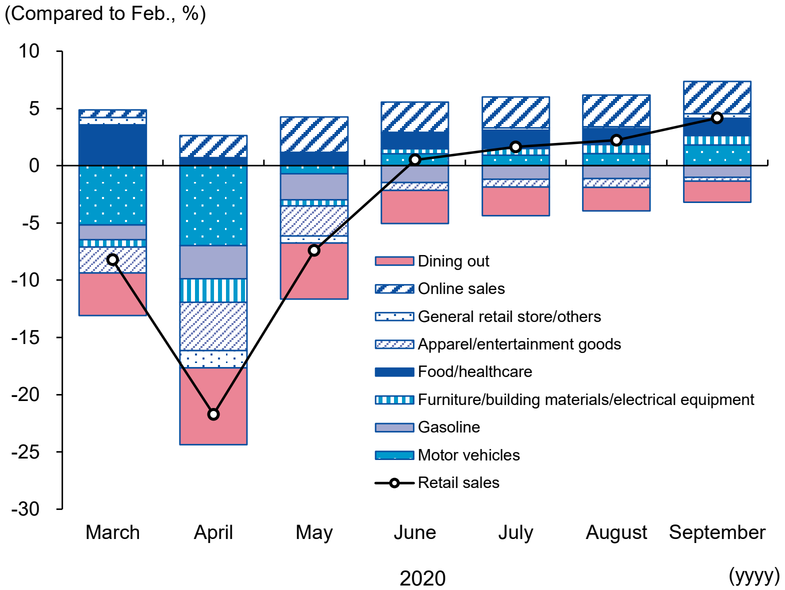


Source: Made by MHRI based upon Institute for Supply Management

Goods consumption is firm and services consumption is also continuing to recover. Even so, the improvement of consumer sentiment is muted

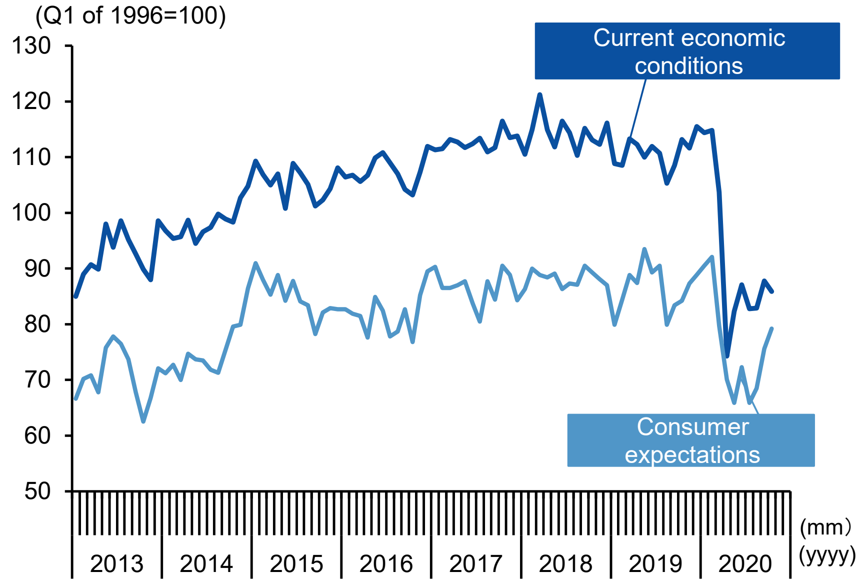
- September retail sales rose a strong +1.9% m-o-m, serving as evidence of the strength of goods consumption and ongoing recovery of service consumption.
  - Spending on motor vehicles and apparel/entertainment goods rose dramatically. The rise of savings due to existing income support measures and the shift in demand from service consumption served as underpinnings.
  - Even though restaurant service remains below the pre-corona pandemic level, it is still following a recovery, reflecting the easing of mobility restrictions.
    - Amid the approaching winter season, restaurant services are expected to trend low, given the difficulty to operate outdoor services which has thus far served as a factor attracting customers.
- The Consumer Sentiment Index rose slightly to 81.2 in October (September: 80.4). Even though future expectations are serving as the driver, sentiment on current economic conditions remain flat.
- The University of Michigan indicates that the slowdown in recovery of employment, the resurgence of Covid-19 infections, and the delay in passage of additional economic stimulus measures are serving as restraints on the improvement of sentiment on current conditions.

Retail sales



Source: Made by MHRI based upon the US Department of Commerce

Index of consumer expectations

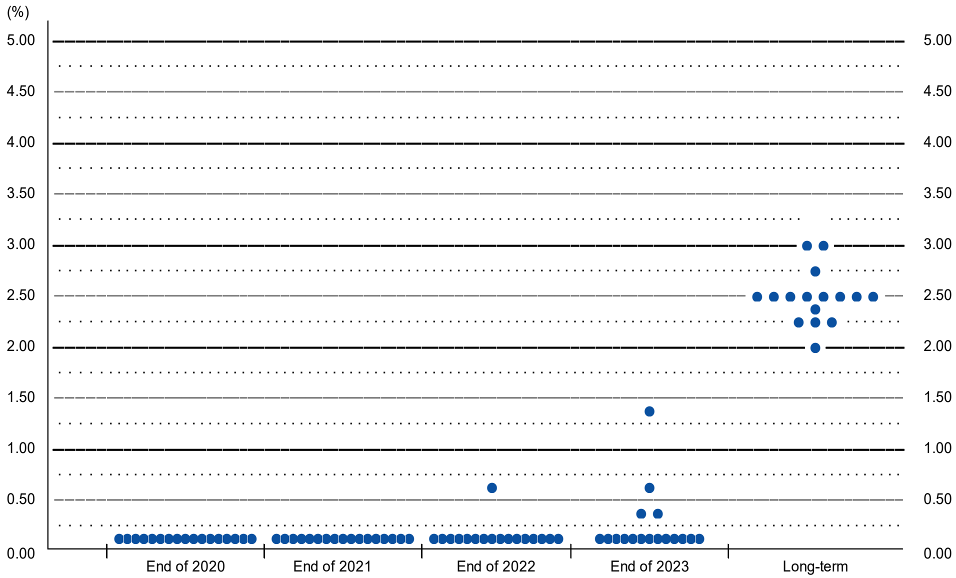


Source: Made by MHRI based upon University of Michigan

(2) US monetary policy: FOMC expected to keep policy rate unchanged at least until end-2023

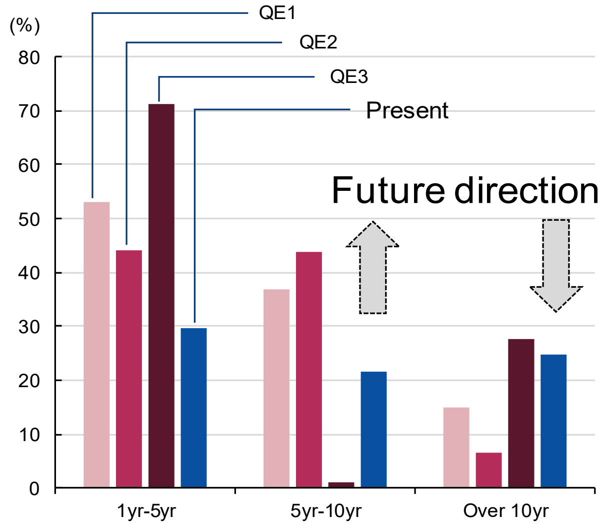
- At its meeting in September, the FOMC set “maximum employment,” “inflation at the rate of 2%” and “inflation moderately above 2% for some time” as the new conditions for a change in monetary policy.
  - According to the economic outlook among FOMC participants, the third condition of the foregoing conditions remains unaccomplished (forecasting that “for some time” will be “at least for one year or more” , and more specifically “between 1.5 years and two years”).
  - On the outlook on monetary policy, the majority of FOMC participants projected that the federal funds rate will be kept unchanged until the end of 2023.
- The FOMC statement set forth explicitly that the role of the Fed’s purchases of Treasury securities and agency MBS is to “help foster accommodative financial conditions” in addition to “sustain smooth market functioning.”
  - At the FOMC meeting in July, many participants noted the credit easing effect of Treasury securities purchases, as a precursor to further easing ahead (expanding the pace of securities purchases and changing the composition of maturities).

Outlook on the economy and monetary policy among FOMC participants



Note: The economic outlook indicates the median rate for the Oct-Dec quarter of each year.
Source: Made by MHRI based upon FRB

Component ratios of maturities by US Treasury securities purchase programs

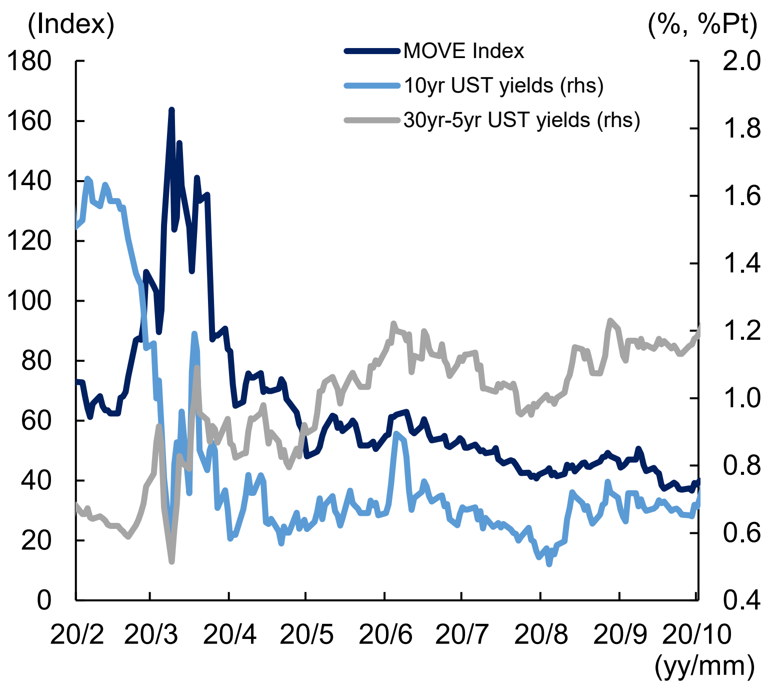


Note: The average balance of holdings of US Treasury securities (m-o-m difference) for each program of US Treasury securities purchases. Holdings of securities with maturities of less than one year are excluded from the graph.
Source: Made by MHRI based upon FRB

(3) US bond market: 10yr UST yields are forecast to move around 0.7% to 0.9%

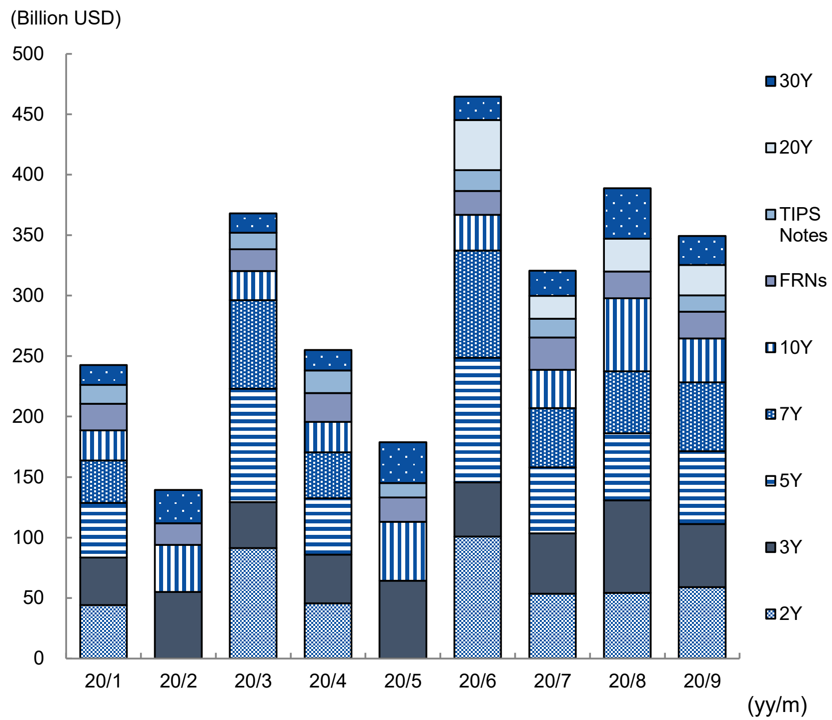
- Given the rise of views on Joe Biden's lead, reflecting the outcome of the US presidential debate (September 29), 10yr UST yields moved around the upper half of the 0.7%-range, due to risk preference driven by expectations toward a partial agreement on stimulus measures.
  - The MOVE index is trending at historical lows.
  - Given the increase of US government bond issues along with the rise of fiscal spending, the market will tend to focus upon the risk of deteriorating bond demand-supply balance.
- Since the rise in probability of a Biden/Democratic Party victory in the presidential/congressional election gives rise to an environment conducive of the passage of economic stimulus measures, thus serving to raise the market's focus upon upward pressures on interest rates, we expect that the 10-yr UST yield will move around 0.7% to 0.9%.

Trends in the MOVE index



Note: The MOVE index refers to the volatility index in the US bond market.
Source: Made by MHRI based upon Bloomberg

Changes in the amount of UST issued by maturity



Source: Made by MHRI based upon sifma

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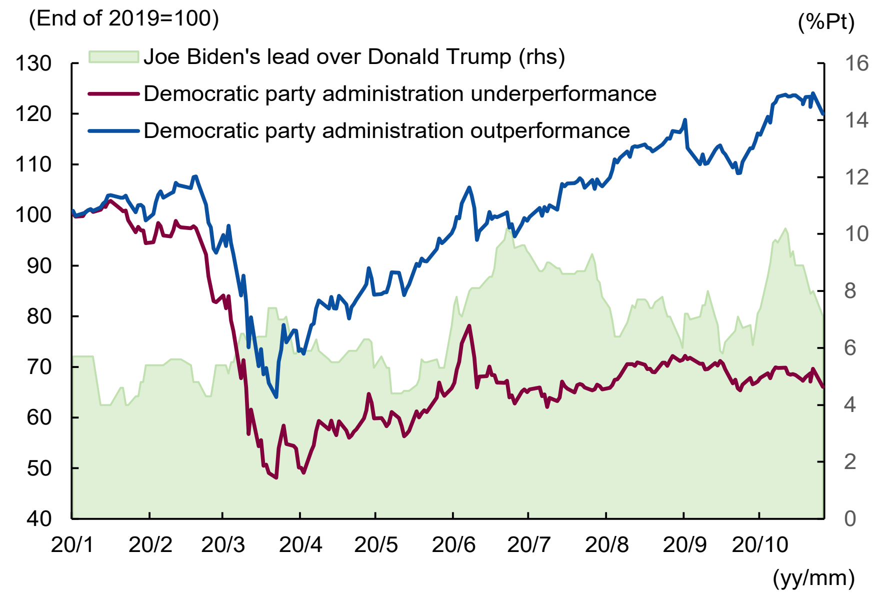
(4) US stock market: the spread of Covid-19 in Europe and the US is serving as a drag, leading to weak market conditions ahead

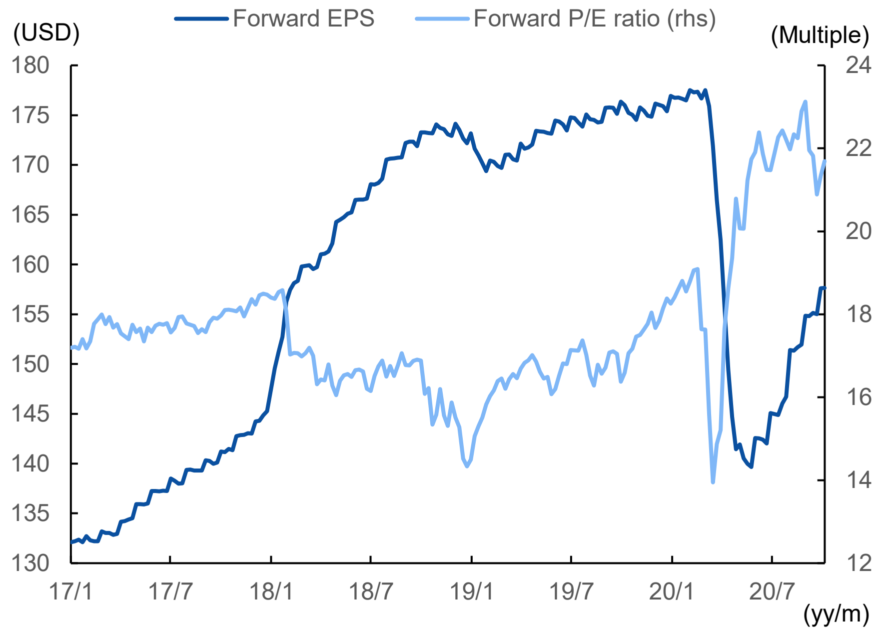
- Even though the Dow Jones average temporarily rose on views of Joe Biden's lead in the US presidential election, stock prices subsequently fell to the lowest level since the end of July, due to the ebb of expectations toward additional economic stimulus measures and resurgence of Covid-19 cases in the US and Europe.
  - The Democratic Party administration outperformance index has risen sharply since the end of September. Expectations toward economic stimulus measures by the Democratic Party administration contributed to the upward pressure upon the stock market.
- Given expectations toward the recovery of corporate earnings results in 2021, the forward P/E ratio is following a gradual downward trend.
  - There is a strong sense of overvaluation even in consideration of the low interest rate environment, leading to our view that the downtrend will persist.
- The market should remain weak going forward, due to high uncertainties stemming from the delay in presidential election results and the resurgence of Covid-19 cases.

The Democratic Party administration outperformance index



Note: The Democratic Party administration outperformance (underperformance) are indexes published by JP Morgan, comprised of groups of companies which will be subject to positive (negative) effects due to the change of administration.
Source: Made by MHRI based upon Bloomberg, and Real Clear Politics

S&P 500 Index forward P/E ratio and forward EPS



Note: The forward EPS and forward P/E ratio are on a 12-month forward basis.
Source: Made by MHRI based upon Refinitiv.

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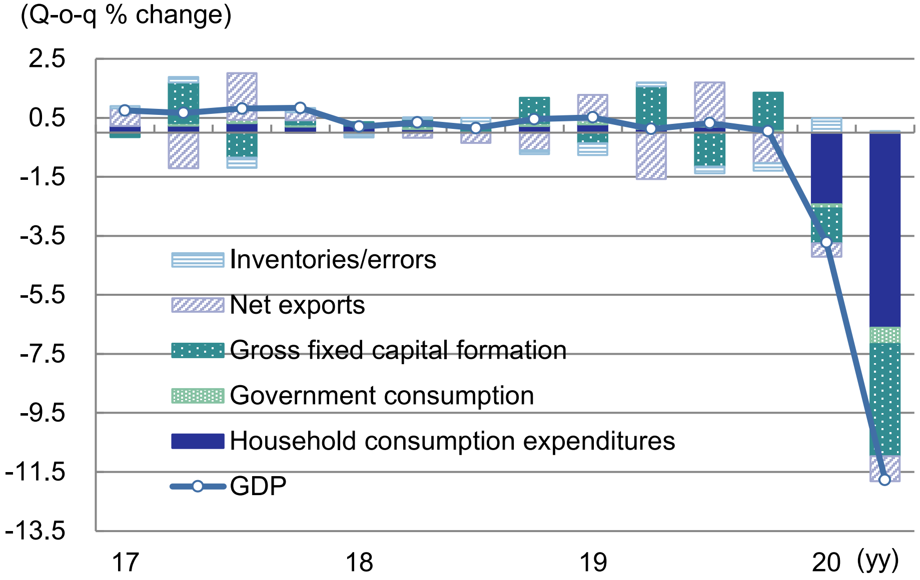
3. (1) The Eurozone economy: the recovery pace is expected to slow down along with the resurgence of Covid-19 infections toward the year-end

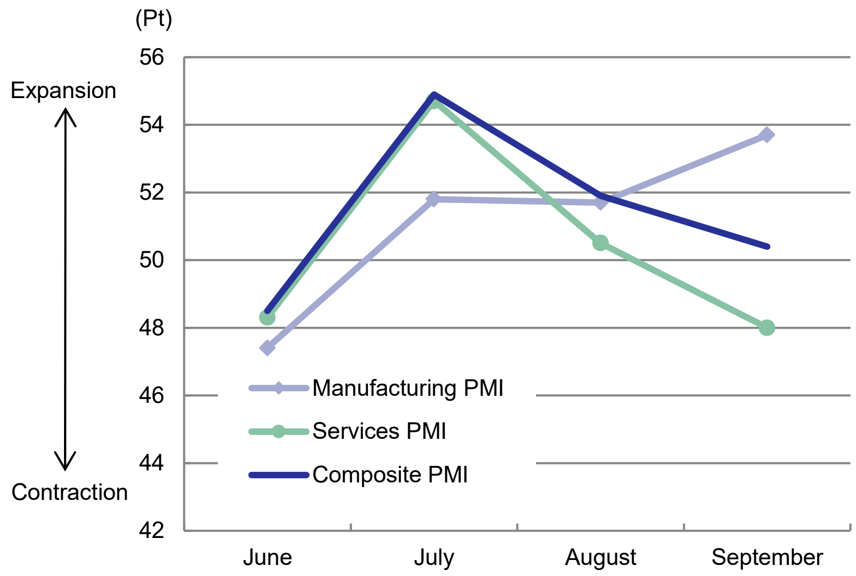
- Eurozone real GDP growth stood at -11.8% q-o-q in the Apr-Jun quarter, marking a historical downturn.
  - In addition to household consumption (-6.6% q-o-q), gross fixed capital formation (-3.8% q-o-q) served as a drag upon economic growth. Among the background factors are limitations upon production activity such as motor vehicle production, in addition to limitations on consumption of services along with the lockdown.
- The Eurozone Purchasing Managers' Index (composite PMI) in September, having a high correlation with GDP, stood at 50.4, falling closer to the expansion/contraction threshold of 50.
  - Among the background factors is the increasingly cautious stance toward the consumption of services along with the resurgence of Covid-19 cases.
  - In Spain and France which are subject to the resurgence of Covid-19 infections, the composite PMI fell for the second month in a row. The composite PMI fell to the 40s in both countries in September.

Eurozone: real GDP



Note: Y-o-y growth rate of real GDP and contribution ratio by demand item
Source: Made by MHRI based upon Eurostat

Eurozone: PMI



Note: PMI at 50 is the expansion/contraction threshold
Source: Made by MHRI based upon HIS Markit

(2) Eurozone monetary policy: an extension of the PEPP is likely at the ECB Governing Council in December

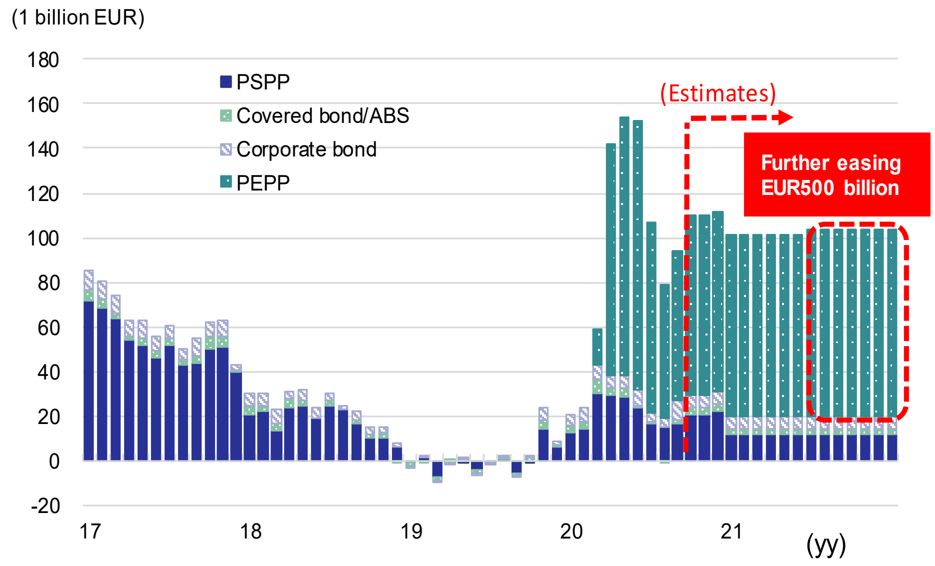
- We expect that monetary policy will remain unchanged at the ECB Governing Council meeting on October 29.
  - Given the re-imposition of partial lockdowns among the countries of Europe, there are rising uncertainties regarding the future course of the Eurozone economy. Even so, since the re-imposition of lockdowns have just started, its impact upon mobility etc. is yet to be detected.
- We expect that the ECB will indicate the possibility of further monetary easing (re-extension of the PEPP) at the next Governing Council meeting in December.
  - The ECB will most likely wait for the ECB staff macroeconomic projections to make a final decision on monetary easing. However, we expect that the ECB will make an indication of further monetary easing in December through its statement or the ECB president's comments, in view of the need for some sort of message to address the current spread of Covid-19 cases.
  - We forecast a six-month extension of asset purchases (PEPP) until the end of 2021 and an increase of EUR500 billion. The ECB will most likely forego measures to push interest rates deeper into negative territory.

Recent remarks by ECB President Lagarde and Executive Board member Philip R. Lane

Christine Lagarde, President of the ECB	Oct. 7, 2020 (Interview with Harvard International Review)	[But] inflation is still very distant from levels in line with our inflation aim. So we need to maintain an ample monetary policy stimulus to reach our objective.
	Oct. 6, 2020 (Comments made ahead of the WSJ CEO Council)	Ms. Lagarde warned that Europe's economic recovery looks "a little bit more shaky" amid a second wave of infections […] We are prepared to use all the tools that will produce the most effective, efficient, and proportionate outcome.
Philip R. Lane, Member of the Executive Board of the ECB (Chief Economist)	2020/10/6 (Speech at the NABE Annual Meeting)	[Meanwhile] the resurgence in infection rates (and the associated public health measures) is posing renewed challenges, especially for those sectors most affected by social distancing. Reflecting this, the momentum in the services sector has been slowing down since August.
	2020/9/24 (Twitter Q&A)	(Answering the question regarding his assessment on the economic outlook evolved over the last few weeks given the sharp increase in new COVID cases) Our baseline allows for some periodic resurgence of the virus until a full-scale medical solution is found.

Source: Made by MHRI based upon ECB

ECB's purchase of assets so far and outlook

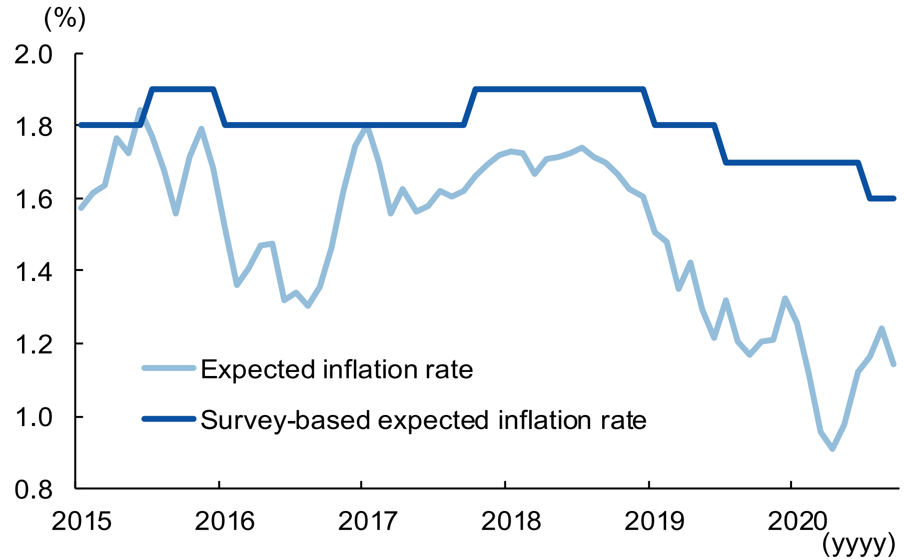


Note: Figures up to September 2020 show actual results, while those after October are estimates and forecasts based on the past performance.
Source: Made by MHRI based upon ECB

(3) Eurozone bond market: 10yr German government bond yield expected to trend around -0.7% to -0.5%

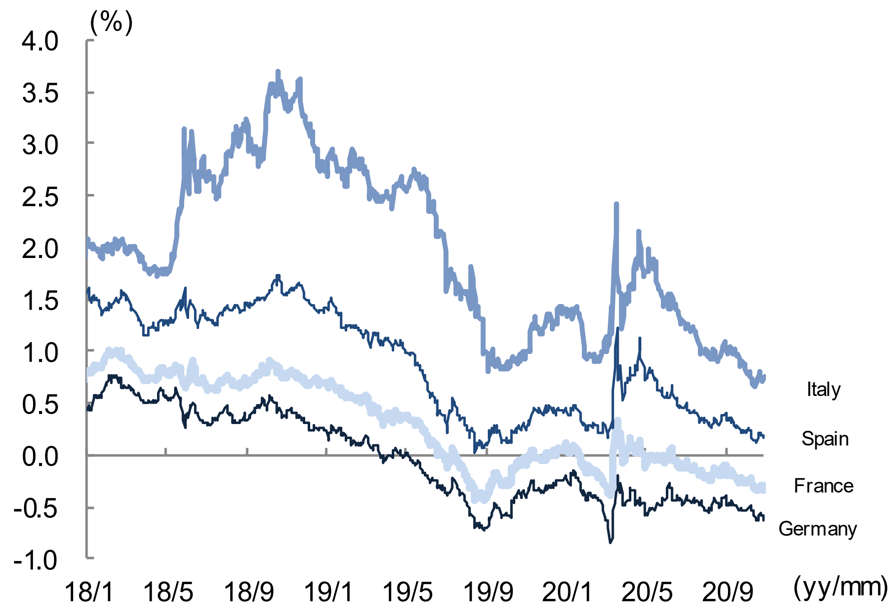
- ECB President Christine Lagarde indicated the possibility of examining a strategy tolerating the rise of inflation above the target. (September 30).
  - Given the decline of both the expected inflation rate and the survey-based expected inflation rate below 2%, the odds are high that monetary easing will persist for a prolonged period.
  - The ECB Governing Council may decide upon additional monetary easing (extension and increase in the amount of the Pandemic Emergency Purchase Programme (PEPP)) at its meeting in December.
- Amid the resurgence of Covid-19 infections across Europe, the 10yr Italian government bond yield temporarily fell to a historical low at the 0.6%-level. As restrictions on outings and business activities due to the spread of Covid-19 infections may continue for several months, interest rates are expected to trend at a low level. The yield on 10yr German government bonds is expected to trend around -0.7% to -0.5%.

Eurozone expected inflation rate



Note: Expected inflation rate refers to the 5-year forward 5-year inflation swap, while the survey-based expected inflation rate is the 5-year forward long-term inflation forecast by the ECB Survey of Professional Forecasters (SPF).
Source: Made by MHRI based upon Bloomberg and ECB

The 10yr UST yield

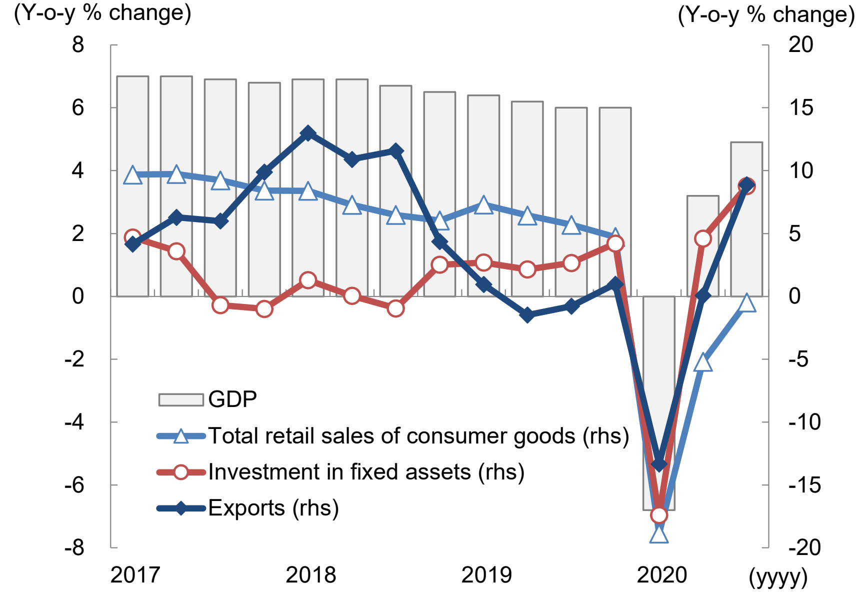


Source: Made by MHRI based upon Bloomberg

4. (1) The Chinese economy: growth accelerated in the Jul-Sep quarter, driven by real estate investment and electronic equipment exports

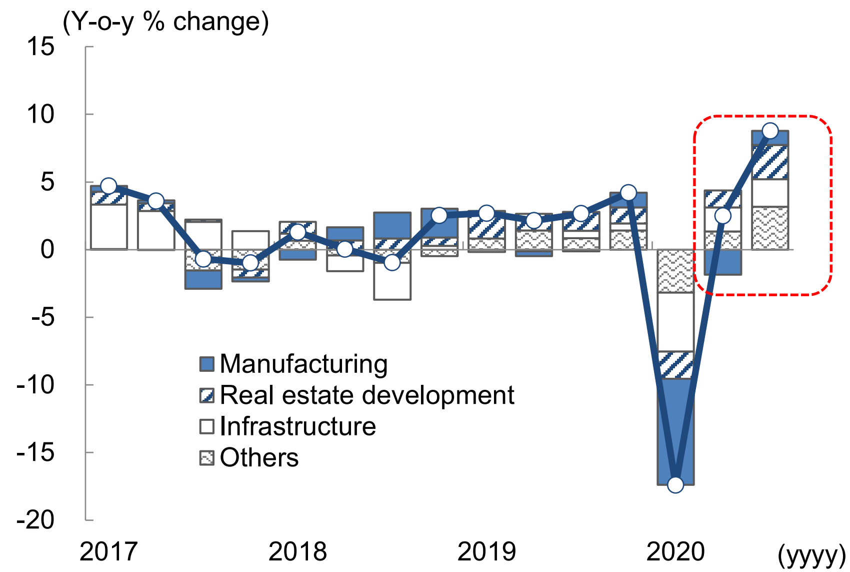
- In the Jul-Sep quarter, China's real GDP grew at a faster pace of +4.9% (Apr-Jun quarter: +3.2% q-o-q).
  - Regarding investment in fixed assets, infrastructure investment was firm, in addition to the expansion of real estate development investment. Manufacturing investment also picked up.
  - Turning to exports, exports bound for the US and ASEAN expanded, given strong exports of PC and electronic equipment reflecting firm demand related to remote working.
  - In retail sales, the breadth of decline narrowed from the previous quarter. In addition to the strength of motor vehicle sales reflecting policy support measures, the improvement of the employment and income environment, and successful control over the spread of Covid-19 infections contributed to the recovery of consumption.
- Looking forward, the fading of exports related to one-off demand and slowdown of real estate investment due to measures to suppress the property bubble may serve as a drag upon the Chinese economy. Even so, the recovery should continue, supported by infrastructure investment and the improvement of the employment and income environment.

Real GDP and main indicators



Note: Fixed asset investment is converted into real terms by PPI (construction materials), and total retail sales of consumer goods are converted into real terms by the retail price index. Exports are in nominal terms denominated in USD.
Source: Made by MHRI based upon the National Bureau of Statistics of China and the General Administration of Customs of China

Fixed asset investment

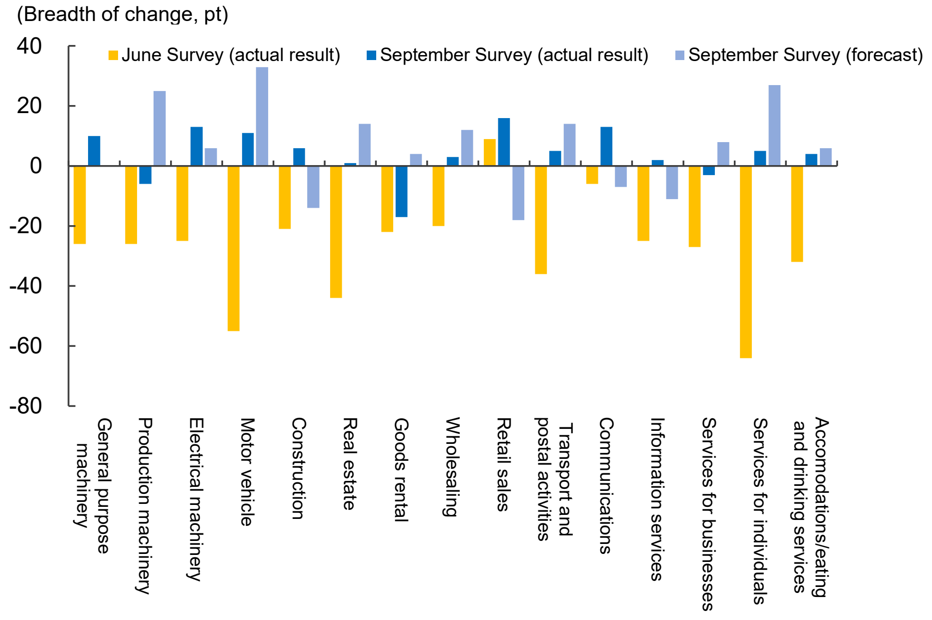


Note: Converted into real terms by PPI (construction materials)
Source: Made by MHRI based upon the National Bureau of Statistics of China

5. The Japanese economy: slow recovery of business confidence

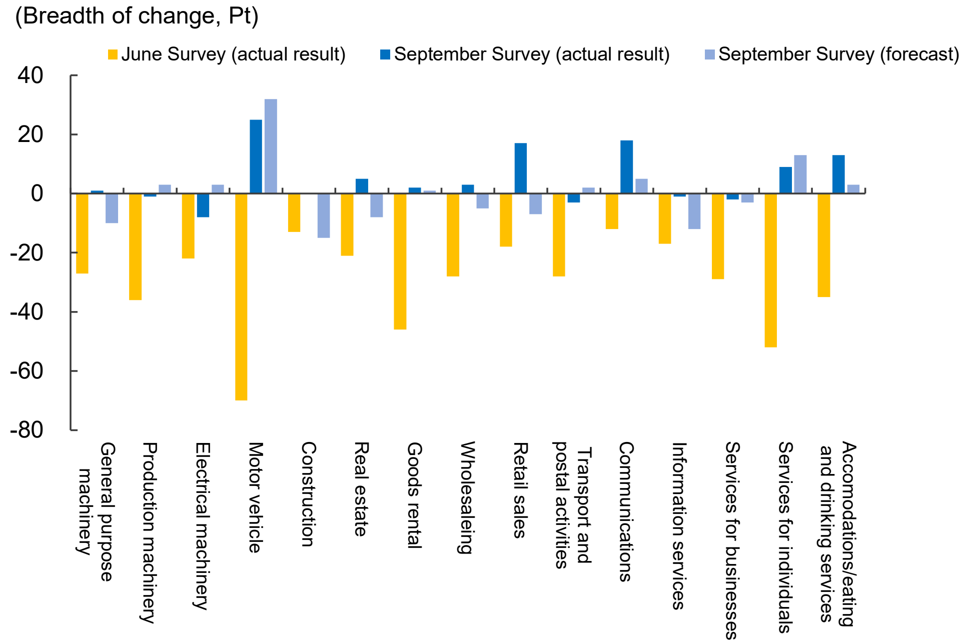
- The business conditions DI of the *Short-Term Economic Survey of Enterprises in Japan* (*Tankan*) (September 2020 survey) revealed improvements among large manufacturers (-27% (June survey: -34%)) and large non-manufacturers (-12% (June survey: -17%)). Even so, the breadth of improvement was small in comparison in light of the fall in the June survey (the upturn was slightly less than 30% and 20% in the manufacturing and non-manufacturing sectors respectively).
  - ■ The percentage of “favorable” did not increase, and instead, shifted from “unfavorable” to “not so favorable.” This is more of as an “emergence out of the worst,” rather than a “recovery.”
- As for outlooks on business, the DIs in the manufacturing sector (-17%) and non-manufacturing sector (-11%) indicate that the breadth of improvement is weak mainly among non-manufacturers due to the concerns regarding the resurgence of Covid-19 infections.
  - ■ While the outlook with respect to motor vehicles is improving, the rebound of demand is expected to remain weak mainly among medium-sized and small non-manufacturers in the second half of the fiscal year.

Change in the business conditions DI (large enterprises)



Source: Made by MHRI based upon Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan (Tankan)*

Change in the business conditions DI (small enterprises)

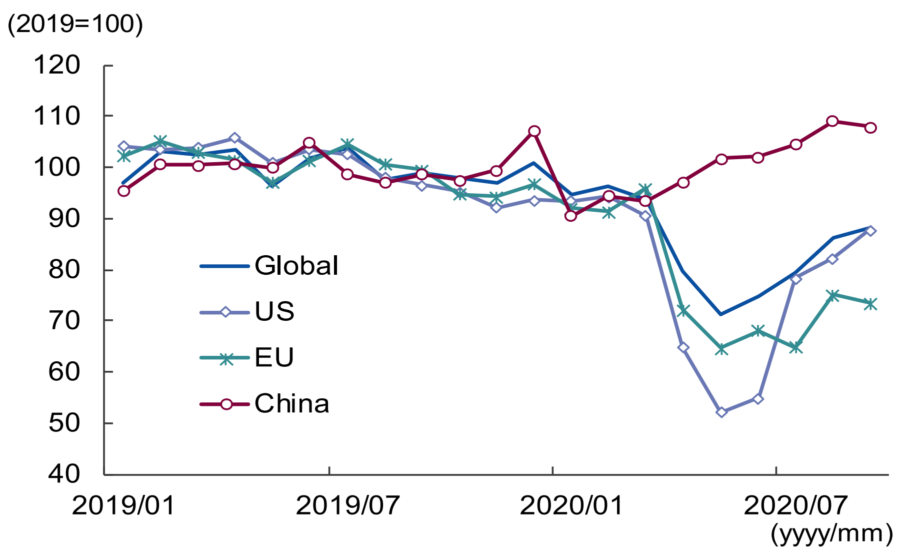


Source: Made by MHRI based upon Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan (Tankan)*

Exports (mainly motor vehicle exports) increased, while imports levelled off

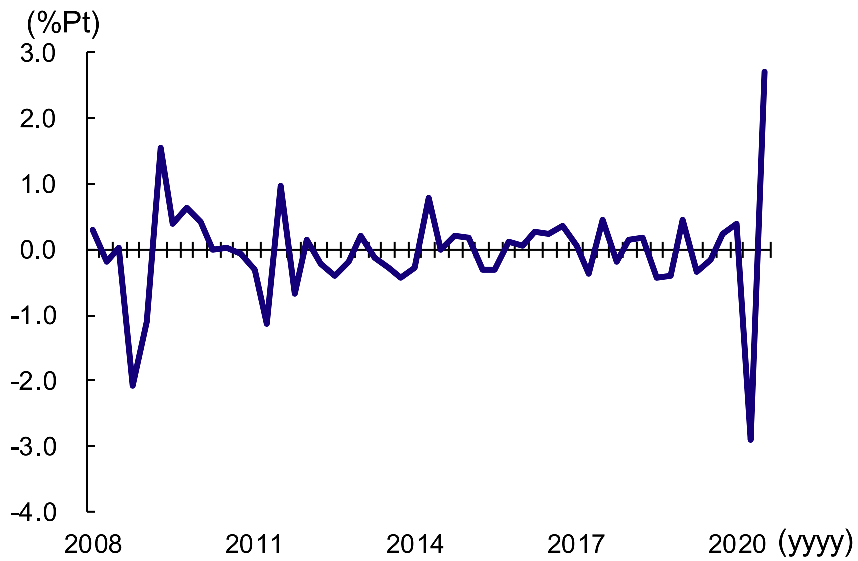
- The September export volume index rose mainly in motor vehicles. In contrast, imports levelled off.
  - In September, the export volume index stood at +2.5% m-o-m (August: +8.7% m-o-m), rising for four consecutive months. Exports have recovered to approximately 90% of the pre-Covid-19 pandemic level (2019 average). Motor vehicle exports increased reflecting the recovery of demand, serving as a driver of the overall recovery.
  - The September import volume index turned out to be more or less flat at +0.6% m-o-m (August: -0.2% m-o-m). Even though imports of materials increased reflecting the normalization of economic activities, there has been a lull in the increase in imports of masks and PCs as compared to the Apr-Jun period, serving as a background factor for the sluggish of imports.

Export volume index by region



Note: Seasonally adjusted by MHRI
Source: Made by MHRI based upon Ministry of Finance, *Trade Statistics*

Contribution by external demand to q-o-q change in real GDP

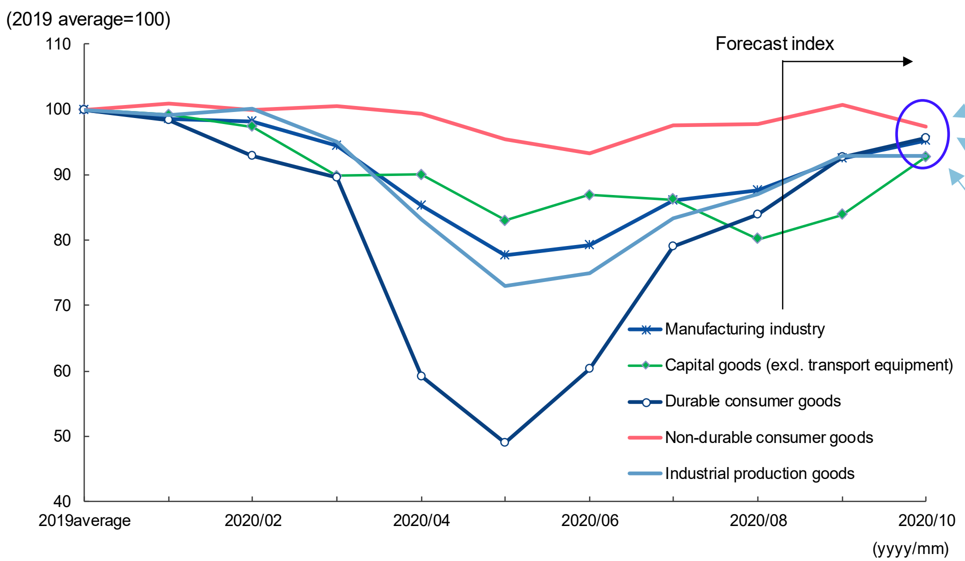


Source: Made by MHRI based upon Bank of Japan, *Developments in Real Exports and Real Imports*

Even though production of motor vehicles continued to recover, the odds are high that capital goods will remain sluggish

- Industrial production stood at +1.7% m-o-m in August (July: +8.7% m-o-m), increasing for three consecutive months.
  - The motor vehicle industry (+8.9% m-o-m) led the recovery, and production in a wide range of industries such as electronic components and materials also increased.
- Industrial production is projected to recover to about 95% of the pre-pandemic level (2019 average) as of October.
  - Looking at the data by goods, durable consumer goods should recover to 96% of the pre-pandemic level, reflecting the recovery of goods consumption such as motor vehicles.
  - Meanwhile, despite projections of a recovery of capital goods to approximately 93% of the pre-pandemic level in October, the odds are high that production in September and October will fall below the projected recovery. We forecast a delay in recovery of capital goods, given the postponement of capital investment in machinery both domestically and overseas along with the decline in corporate profits.

Actual production and forecast index by key goods



○ **Consumer Goods**
Production is expected to increase against the backdrop of a shift of consumption from services to goods, and a recovery in automobile demand.

○ **Producer Goods**
Recovery due to increased output of steel materials for motor vehicles and increase of semiconductor output reflecting the rise in demand for 5G and teleworking.

○ **Capital Goods (excluding transport equipment)**
Although semiconductor manufacturing equipment is expected to remain firm, forecasts that the postponement of capital investment will start to emerge both domestically and overseas along with the decline in corporate profits, the odds are high that capital goods will fall short of projections. The recovery is expected to take longer in comparison to other goods.

Note: Indexed as pre-Covid-19 pandemic (2019 average) = 100. September and October are extrapolated on the assumption of production projections.
Source: Made by MHRI based upon Ministry of Economy, Trade and Industry, *Indices of Industrial Production*

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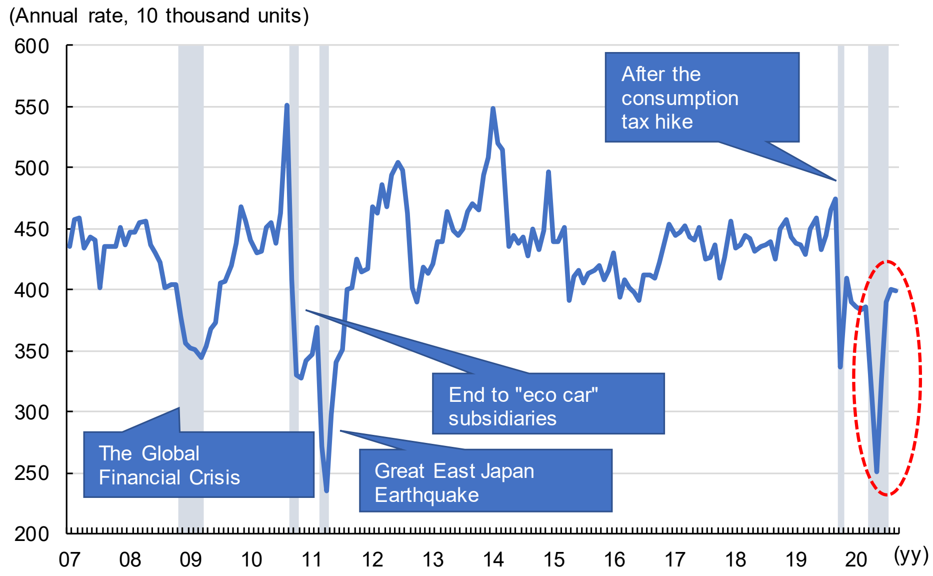
The recovery of motor vehicle consumption slowed, while consumption of services increased due to the “Go To Travel” campaign

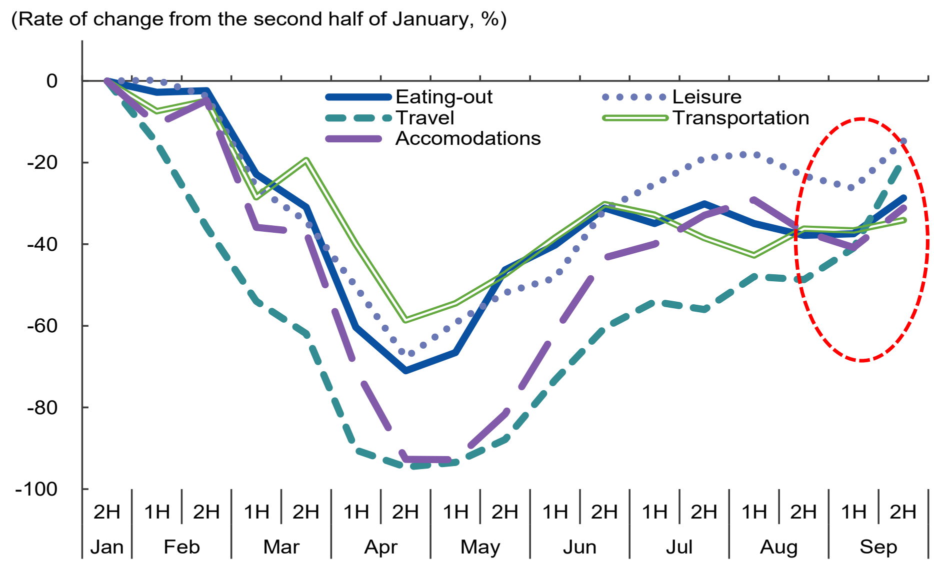
- In September, new motor vehicle sales (passenger vehicles including light motor vehicles) turned out to be more or less flat at -0.4% m-o-m (August: +2.8% m-o-m). Sales, which has continued to follow an uptrend since June, is slowing down.
  - While sales of regular passenger motor vehicles increased, sales of light motor vehicles fell in a backlash to the increase up to September. Looking forward, while the launch of new models from the autumn onward will have a positive impact, the odds are high that the pace of recovery will be sluggish since the deterioration of the employment and income environment will serve as a drag.
- Consumption of services in the second-half of September increased dramatically due to several factors such as the pause in spread of Covid-19 infections, the “Go To Travel” campaign, and the four-day weekend.
  - Travel, leisure, accommodations, and eating-out are following a recovery path. Likewise in October, consumption of services is expected to increase due to the addition of Tokyo to the “Go To Travel” campaign. Even so, the level of consumption is still below the pre-pandemic level, and concerns regarding the resurgence of Covid-19 infections remains unabated.

Motor vehicle sales (seasonally-adjusted)



Note: Passenger vehicle based (including light motor vehicles), seasonally-adjusted by MHRI
Source: Made by MHRI based upon Japan Automobile Dealers Association, Japan Light Motor Vehicle and Motorcycle Association

Consumption indicators by industry

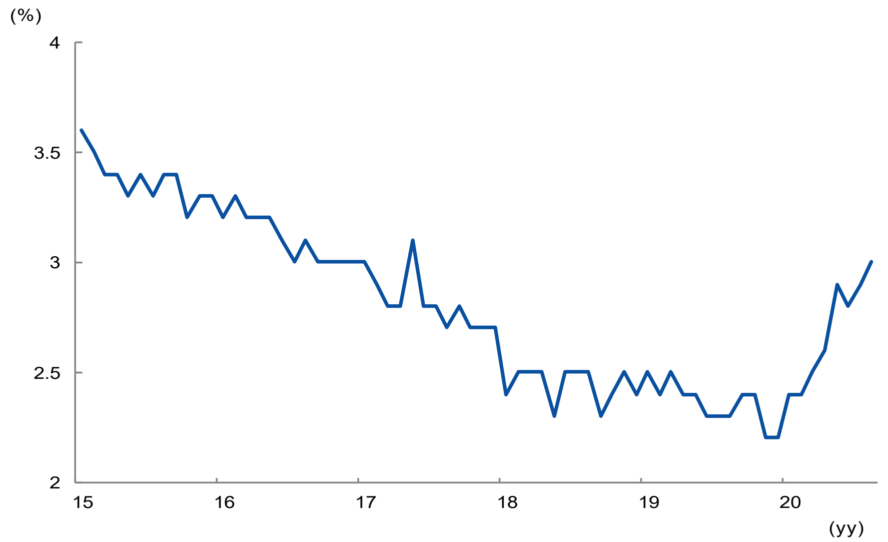


Note: Reference data
Source: Made by MHRI based upon JCB and Nowcast, *JCB Consumption NOW*

Rise of unemployment rate and decline of active job openings-to-applicants ratio. Despite the resumption of job seeking, the recovery of job openings remains slow

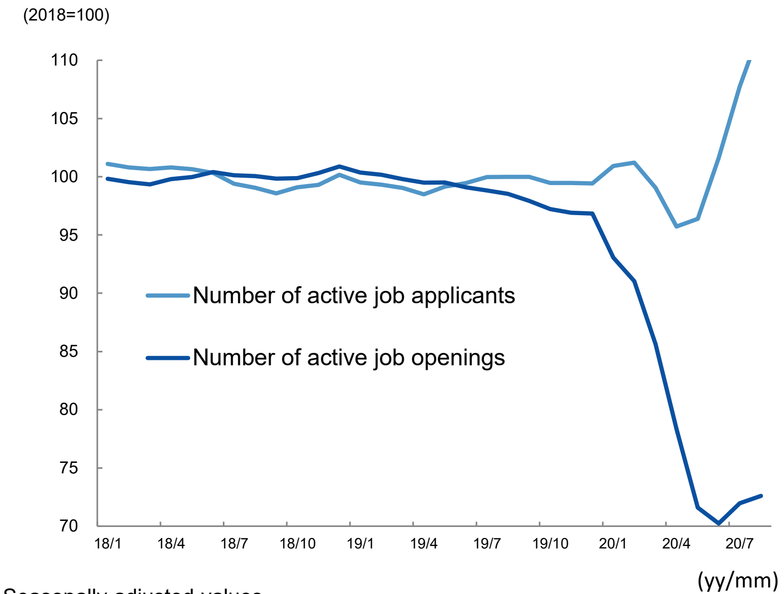
- The unemployment rate edged up to 3.0% in August 2.9% in the previous month. The resumption of job seeking by those who left the labor market contributed to pushing up the unemployment rate.
  - The increase in number of “new job seekers” contributed to the rise in number of unemployed persons. Both the number of employed persons and the number of employees are picking up, and the population not in the labor force is declining.
- The active job openings-to-applicants ratio stood at 1.04x in August (July: 1.08x), falling from the previous month (-0.04pt). The increase in number of job applicants surpasses the increase in number of job openings.
  - However, amid uncertainties regarding the future course of the economy, corporate enterprises are not necessarily motived to hire, leading to a relatively slow pace of recovery in job openings.
- The number of people who were temporarily absent from the work force has returned to the level on par with the previous year, and job-seeking activities have resumed, leading to the view that the labor market is bottoming out.
  - Despite prospects that labor market participation will continue to progress, we expect that the unemployment rate will rise slightly from September onward amid the slow recovery of companies’ willingness to hire.

Trends of the unemployment rate



Note: Seasonally adjusted values
Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Labour Force Survey*

Trends of active job openings and active job applicants



Note: Seasonally adjusted values
Source: Made by MHRI based upon Ministry of Health, Labour and Welfare, *Employment Referrals for General Workers*

(2) BOJ monetary policy: BOJ's *Outlook Report* revised down its outlook on FY2020 economic growth

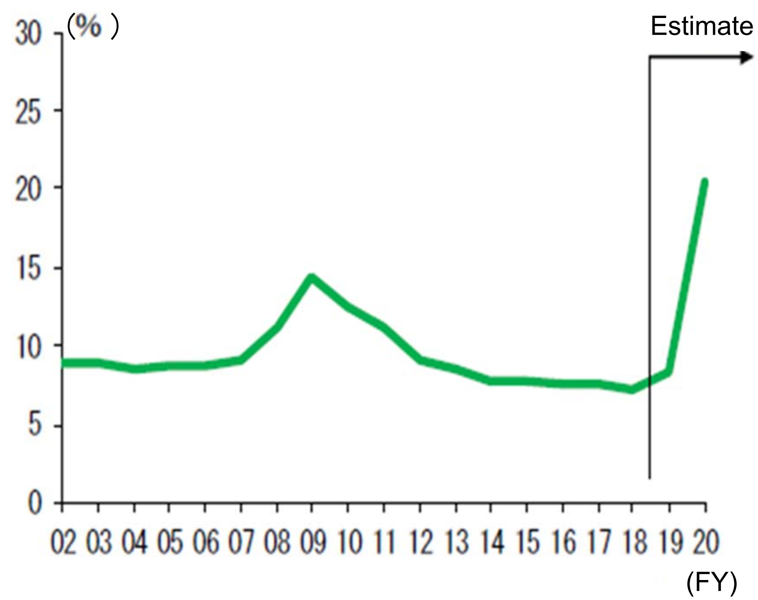
- The Bank of Japan (BOJ) left monetary policy unchanged at its Monetary Policy Meeting in October. In its *Outlook for Economic Activity and Prices* (the "*Outlook Report*"), the BOJ made a downward revision of its outlook on growth for FY2020.
  - ■ The BOJ will monitor closely the decline of medium- to long-term growth expectations among companies and households, and the effect on the financial system due to the prolonged impact of Covid-19 infections.
- According to the *Financial System Report,* assuming that no corporate financial support measures were implemented, the proportion of companies with short-term fund shortages which are unable to cover the negative operating CF using cash on hand during FY2020 remains more or less unchanged with respect to large companies. On the other hand, this proportion increases to about 20% for small and medium-sized enterprises (SMEs), leading to our analysis that there will be a greater stress than at the time of the Global Financial Crisis. We expect that the BOJ will extend the financial support measures for companies by six months from the end of March 31, 2021, at a meeting held by the end of this year.

BOJ *Outlook Report* (October 2020)

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hike and policies concerning the provision of free education
Fiscal 2020	−5.6 to −5.3 (−5.5)	−0.7 to −0.5 (−0.6)	−0.8 to −0.6 (−0.7)
Forecast made in July 2020	−5.7 to −4.5 (−4.7)	−0.6 to −0.4 (−0.5)	−0.7 to −0.5 (−0.6)
Fiscal 2021	+3.0 -+3.8 (+3.6)	+0.2 -+0.6 (+0.4)	
Forecast made in July 2020	+3.0 -+4.0 (+3.3)	+0.2 -+0.5 (+0.3)	
Fiscal 2022	+1.5 -+1.8 (+1.6)	+0.4 -+0.7 (+0.7)	
Forecast made in July 2020	+1.3 -+1.6 (+1.5)	+0.5 -+0.8 (+0.7)	

Note: Majority outlook of the Policy Board members. Figures in brackets indicate the medians of the Policy Board members' forecasts.
Source: Made by MHRI based upon the Bank of Japan

Percentage of SMEs facing short-term fund shortages



Source: Made by MHRI based upon the Bank of Japan, *Financial System Report*

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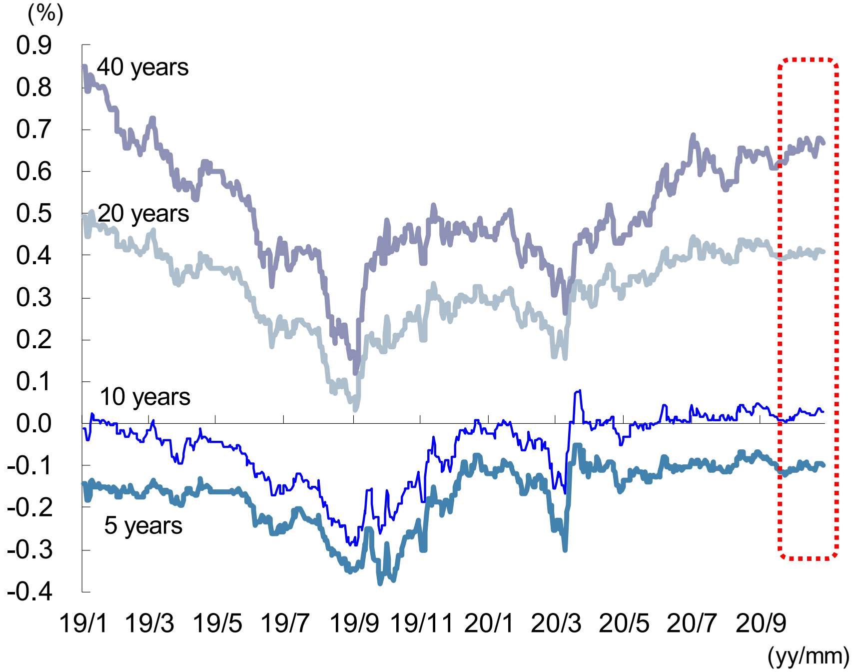
(3) Japanese bond market: 10yr JGB yield forecast to trend around 0%

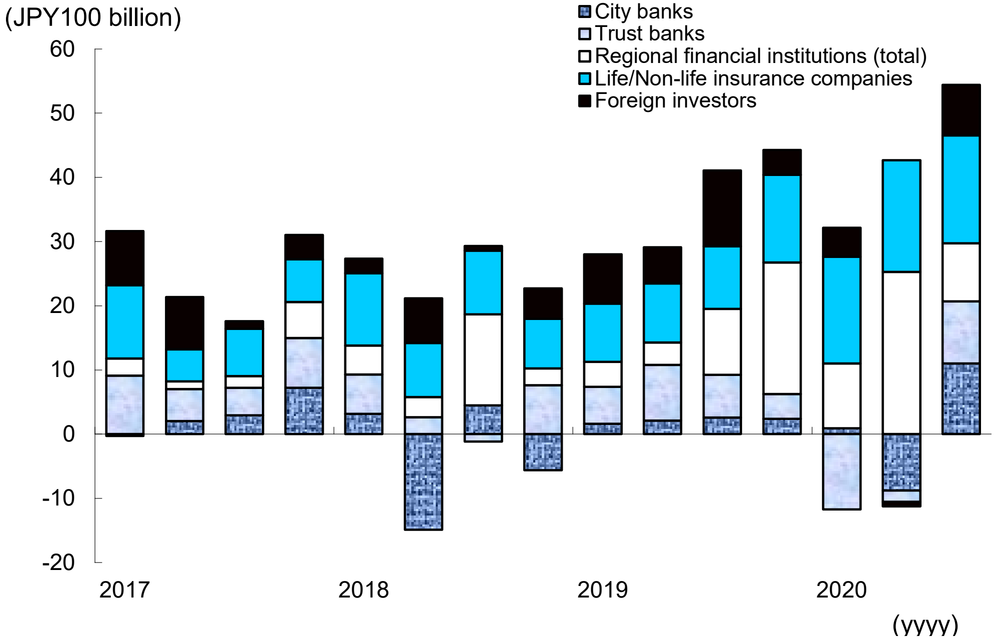
- The 10yr JGB yield remained steady around 0% even amid difficulties in US bipartisan economic stimulus negotiations. As the first meeting (September 23) between BOJ Governor Haruhiko Kuroda and Prime Minister Yoshihide Suga confirmed the maintenance of monetary policy, the 10yr JBG yield is expected to move around 0% for the time being.
- Japanese domestic banks' deposit-loan gap reached a historical high on October 12. Given the attractiveness of super long-term bonds such as 20-year bonds as investment options to secure positive yields, we expect the persistence of stable demand for super long-term bonds.
  - According to trading trends in the Jul-Sep quarter for super long-term bonds(by investor), city banks' long positions intensified, in addition to stable demand among life insurance and non-life insurance companies.
  - The fading attractiveness of foreign bond investment due to the low interest rate environment also served to boost investment in domestic super long-term bonds.

JGB yields



Source: Made by MHRI based upon Bloomberg

Trading volume in super long-term JGBs by type of investor (quarterly)



Source: Made by MHRI based upon Japan Securities Dealers Association

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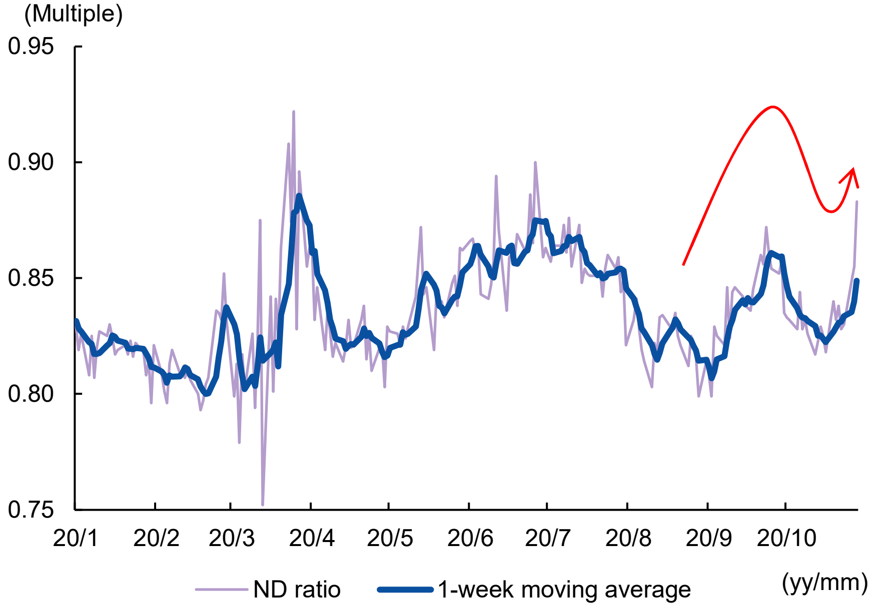
(4) Japanese stock market: Japanese stocks follow firm footing. Looking forward, there will be a focus of attention on announcement of earnings results

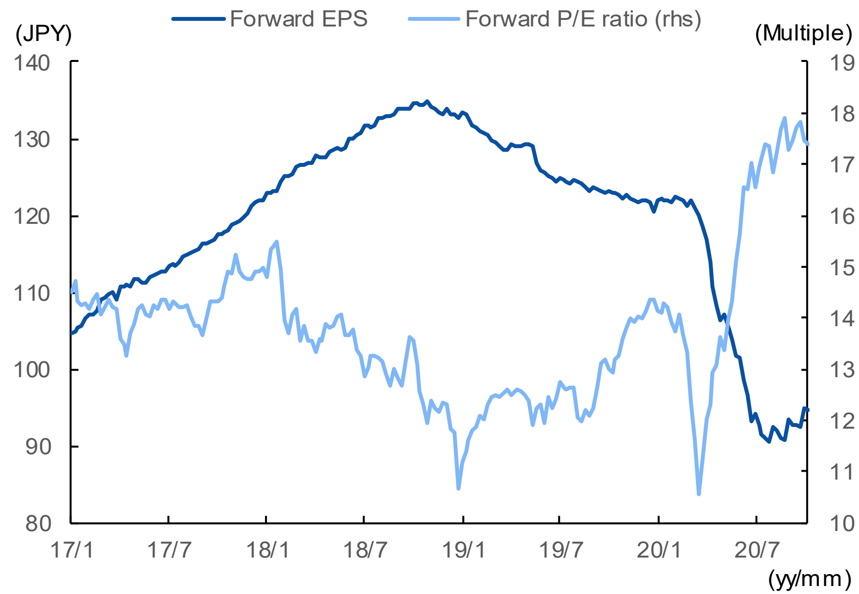
- The Nikkei Stock Average is following firm footing at the JPY23,000-level. The market is taking a wait-and-see stance ahead of the announcement of corporate earnings results and the US presidential election.
- Even though Japanese stocks were underperformers against US stocks, it is currently following firm footing even amid the fall of overseas stocks.
  - Given the resurgence of Covid-19 infections mainly in the US and Europe, there might have been an inflow of funds to Japan, which has a relatively small number of infections.
- The recovery of corporate performance is extremely sluggish. The forward P/E ratio at 17 indicates a strong sense of overvaluation, making a further rise unlikely.
- Since the recovery of corporate earnings is indispensable for the rise of Japanese stocks, market attention will focus upon the announcement of corporate earnings results.

Trends of ND ratio



Note: ND ratio = Nikkei Stock Average/Dow Jones Average
Source: Made by MHRI based upon Refinitiv

TOPIX forward EPS and forward P/E ratio

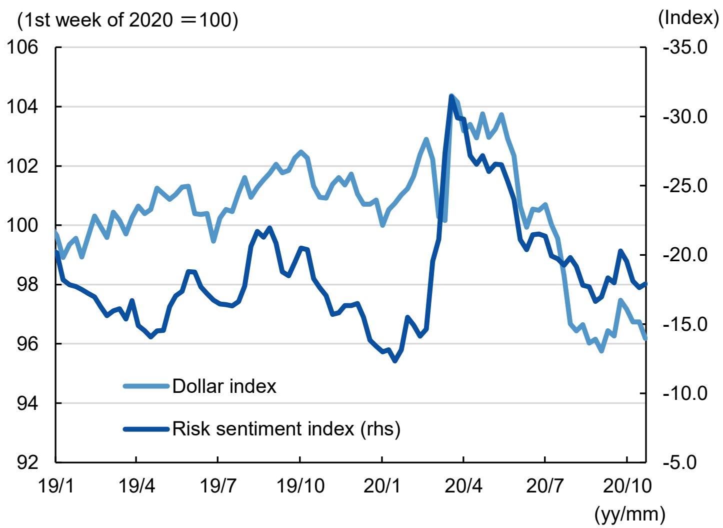


Note: The forward EPS and forward P/E ratio are on a 12 months ahead forecast basis.
Source: Made by MHRI based upon Refinitiv

6. Forex market: despite dollar weakness in a risk-on market due to Joe Biden's election victory, the downside of the USD/JPY should be firm

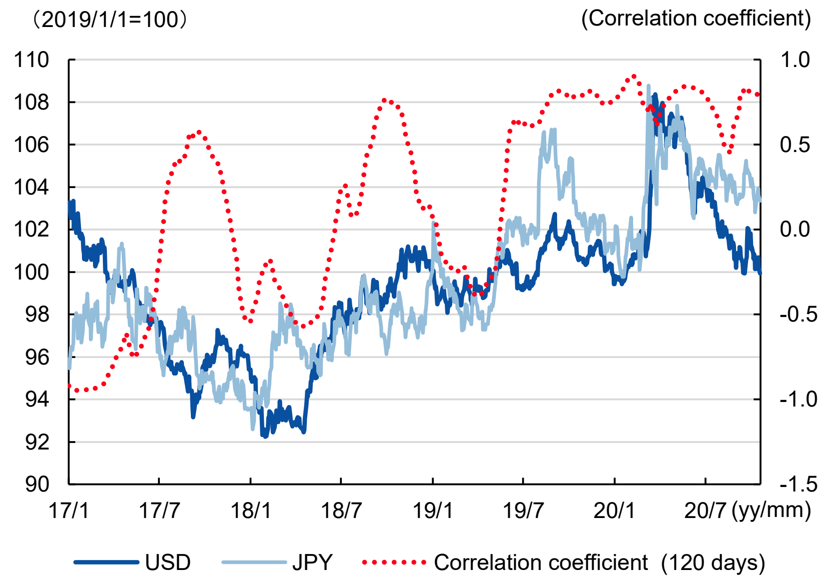
- The USD/JPY exchange rate traded without a clear direction around the mid-JPY105 level, reflecting market speculation on additional US stimulus.
  - Even though the USD/JPY exchange rate rose at one point above JPY106 for the first time in three weeks, reflecting expectations toward additional US stimulus, it subsequently reversed course to the lower half of the JPY105 level along with the rise of concerns regarding difficulties in passage of the stimulus measures.
- Joe Biden's presidential election victory and the Democratic Party control of both the House and Senate will serve as slightly risk-on dollar-weakening pressures.
  - Regardless of the administration in power, monetary policy will remain accommodative. The topside of the dollar will remain heavy, given limited leeway for interest rates to move higher.
  - In recent years, the dollar has tended to weaken when risk sentiment improves. Risk-on market sentiment may accelerate in the event of the facilitation of smooth policy management by the resolution of the division in Congress.
- Even so, since there is still a high correlation between the USD and JPY, both currencies will come under selling pressures in a risk-on market. We expect the USD/JPY currency pair to remain firm and move around JPY105-107 to the USD.

Risk sentiment index



Note: The graph shows the degree of correlation in the global financial markets based on 14 indicators such as stocks, interest rates, government bonds, and commodities. Cumulative change value based on the end of 2005. Estimates by MHRI.
Source: Made by MHRI based upon Bloomberg

Nominal effective exchange rate of the USD and JPY

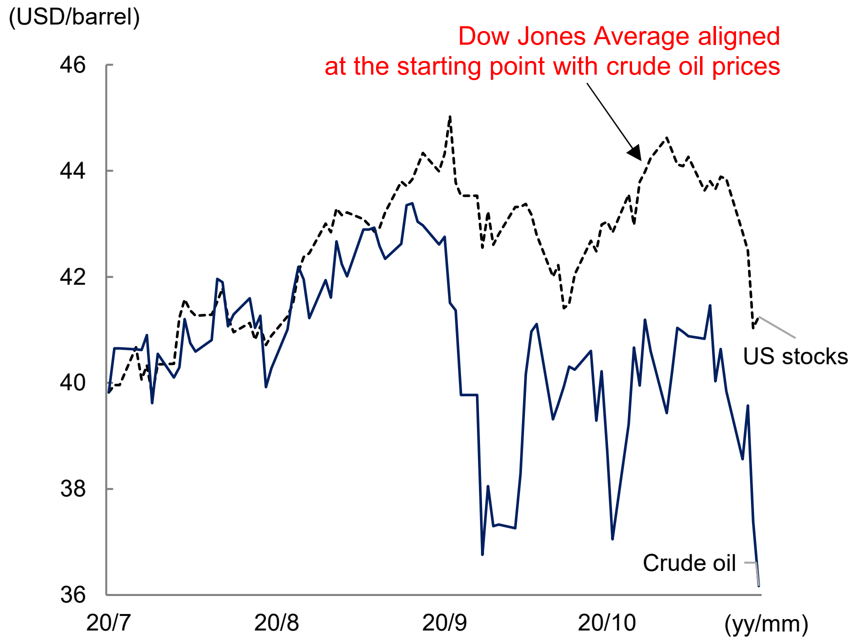


Note: Nominal effective exchange rate is based on the BIS Broad.
Source: Made by MHRI based upon US Department of Treasury

7. Crude oil market: the WTI fell below USD40 again due to the Covid-19 pandemic

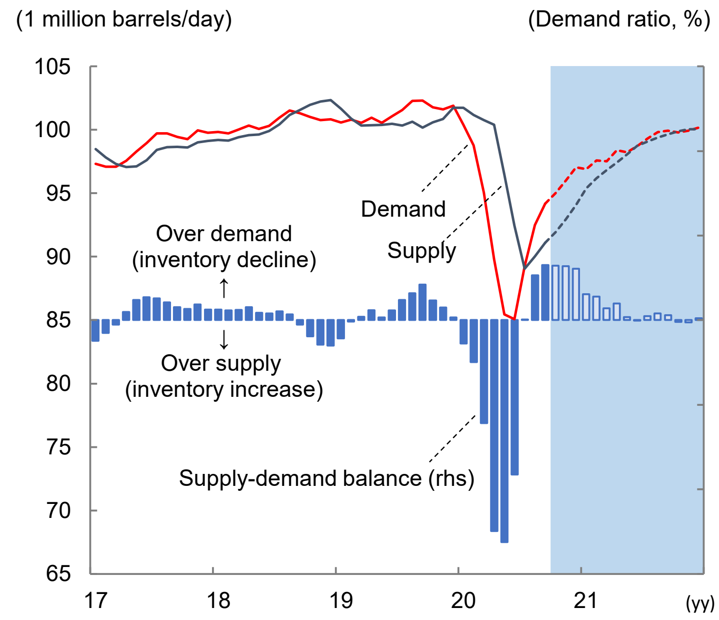
- Crude oil prices fell sharply along with stock prices reflecting the increase in the number of Covid-19 cases in the US and Europe.
  - Following restrictions on behaviour in Italy and Spain, a month-long stay-at-home restriction was implemented from the end of October in France. Germany also implemented bans on certain business activities such as restaurants and entertainment facilities from November. The spread of Covid-19 infections in Europe is leading to the rise of concerns regarding the future course of the global economy. It is also serving to escalate concerns that the sluggish demand for crude oil will persist.
- We expect that the topside of the WTI will be around USD40, given concerns that the stagnant demand for crude oil will persist. In the Oct-Dec quarter, the WTI should move around an average level of around USD40.
  - In addition to sluggish demand, output hikes in Libya is also serving to hamper the recovery of the crude oil market. The slow recovery of demand also affects the pace of reduction of excessive crude oil inventories.
  - In the US, two-thirds of oil production in the Gulf of Mexico has stopped due to hurricane Zeta. Even so, its impact should be temporary.

Crude oil prices and stock prices



Note: The trend (rates of change) of "US stocks" in the figure equals to the trend (rates of change) of the Dow Jones Average.
Source: Made by MHRI based upon Refinitiv

Crude oil supply-demand balance



Note: Figures after October 2020 are the forecasts by EIA.
Source: Made by MHRI based upon EIA

8. Outlook on the financial markets

		○Main scenario					○Sub-scenario 1				○Sub-scenario 2			
		2020/ Jul-Sep	Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep	2020/ Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep	2020/ Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep
US	Federal funds rate (End-of-quarter, %)	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00-0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25	0.00–0.25
	10-yr UST bond yield (%)	0.63	0.75	0.75	0.80	0.85	0.85	0.95	0.95	0.95	0.75	0.45	0.65	0.70
	Dow-Jones Average (USD)	27,314	27,100	26,800	26,900	27,000	28,600	29,100	29,700	29,700	27,100	20,700	21,300	22,000
Japan	Euroyen TIBOR (3-mo, %)	-0.06	-0.07	-0.07	-0.07	-0.07	-0.06	-0.05	-0.05	-0.05	-0.07	-0.07	-0.07	-0.07
	10-yr JGB yield (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.05	0.05	0.00	-0.10	-0.05	-0.05
	Nikkei Stock Average (JPY)	22,913	23,100	22,600	22,600	22,800	23,700	24,200	24,500	24,500	23,100	16,500	17,200	18,100
Europe	ECB deposit facility rate (End of quarter, %)	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
	10-yr government bond yield (German government bonds, %)	-0.49	-0.50	-0.45	-0.40	-0.35	-0.40	-0.35	-0.30	-0.30	-0.50	-0.70	-0.60	-0.50
Forex	USD/JPY rate (USD/JPY)	106	106	107	107	108	108	109	109	109	106	103	105	107
	EUR/USD rate (EUR/USD)	1.17	1.16	1.15	1.15	1.14	1.15	1.14	1.14	1.14	1.16	1.10	1.10	1.11

- Sub-scenario 1 (upside scenario)
  - Early containment of the Covid-19 pandemic. The absence of a resurgence of infections leads to an upturn of the global economy. Long-term interest rates and stock prices rise. The dollar strengthens against the yen.
- Sub-scenario 2 (downside scenario)
  - Despite a temporary global economic recovery due to the reopening of economic activities around the world, a second wave of Covid-19 infections arises in the Jan-Mar quarter of 2021. Measures to prevent the spread of Covid-19 infections lead to a global economic slowdown. Both long-term interest rates and stock prices fall. The dollar continues to weaken against the yen.