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CFO Summer Seminar & Reception

Economic and Political Outlook



Deloitte Touche Tohmatsu LLC

Making another half century of **Impact**

デロイト トーマツ 50周年 次の50年へ

50th
Deloitte Tohmatsu

Tonight's agenda

Welcome remark and survey results introduction

19:00

Tom Hewitt, director of CFO Program international

Seminar

Mr. Tsuyoshi Oyama, Center for Risk Management Strategy (CRMS) of Deloitte Tohmatsu

Stress scenarios: Trade War, No-deal Brexit, and The Failure of Abenomics

19:05-19:30

Discussion by table

19:30-19:40

Sharing discussion points

19:40-19:50

A break

19:50-20:00

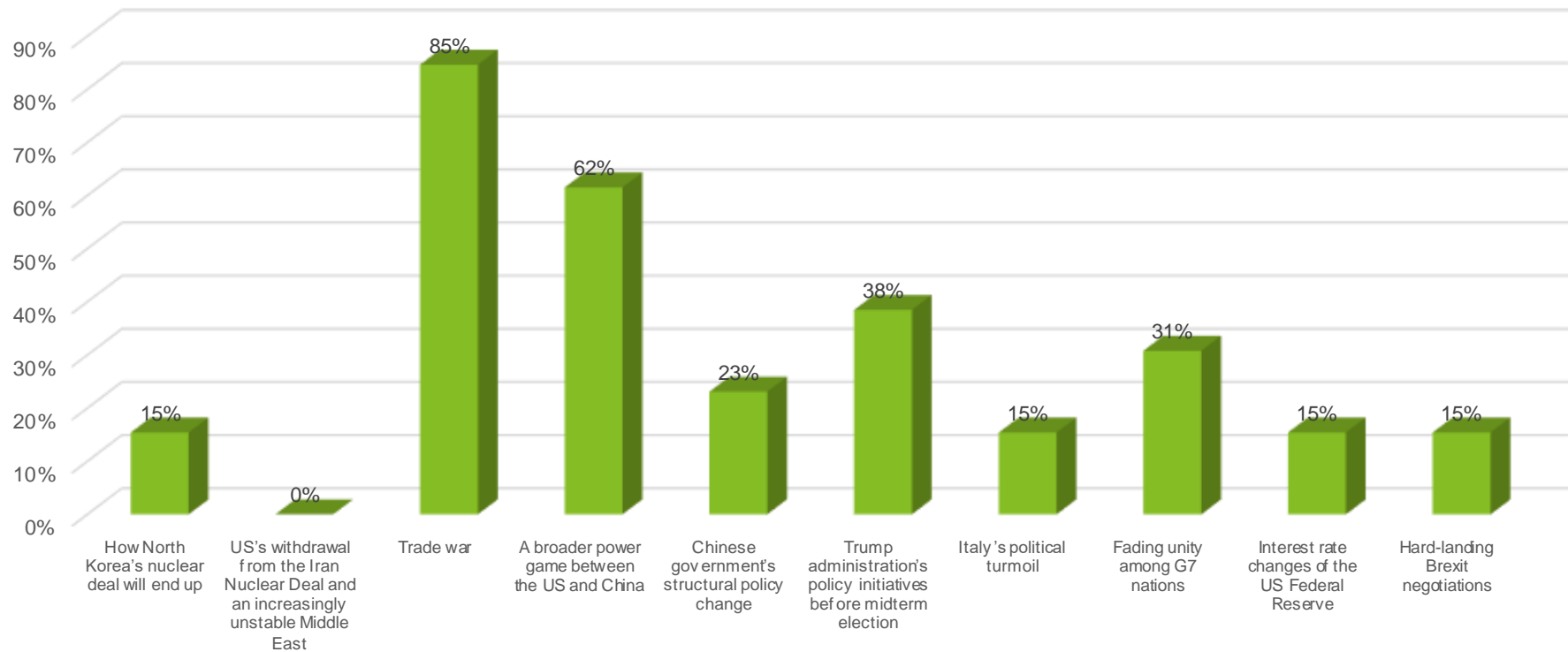
Reception

20:00-22:00

Pre-event survey results

Trade War and US-China rivalry are most concerned amongst issues

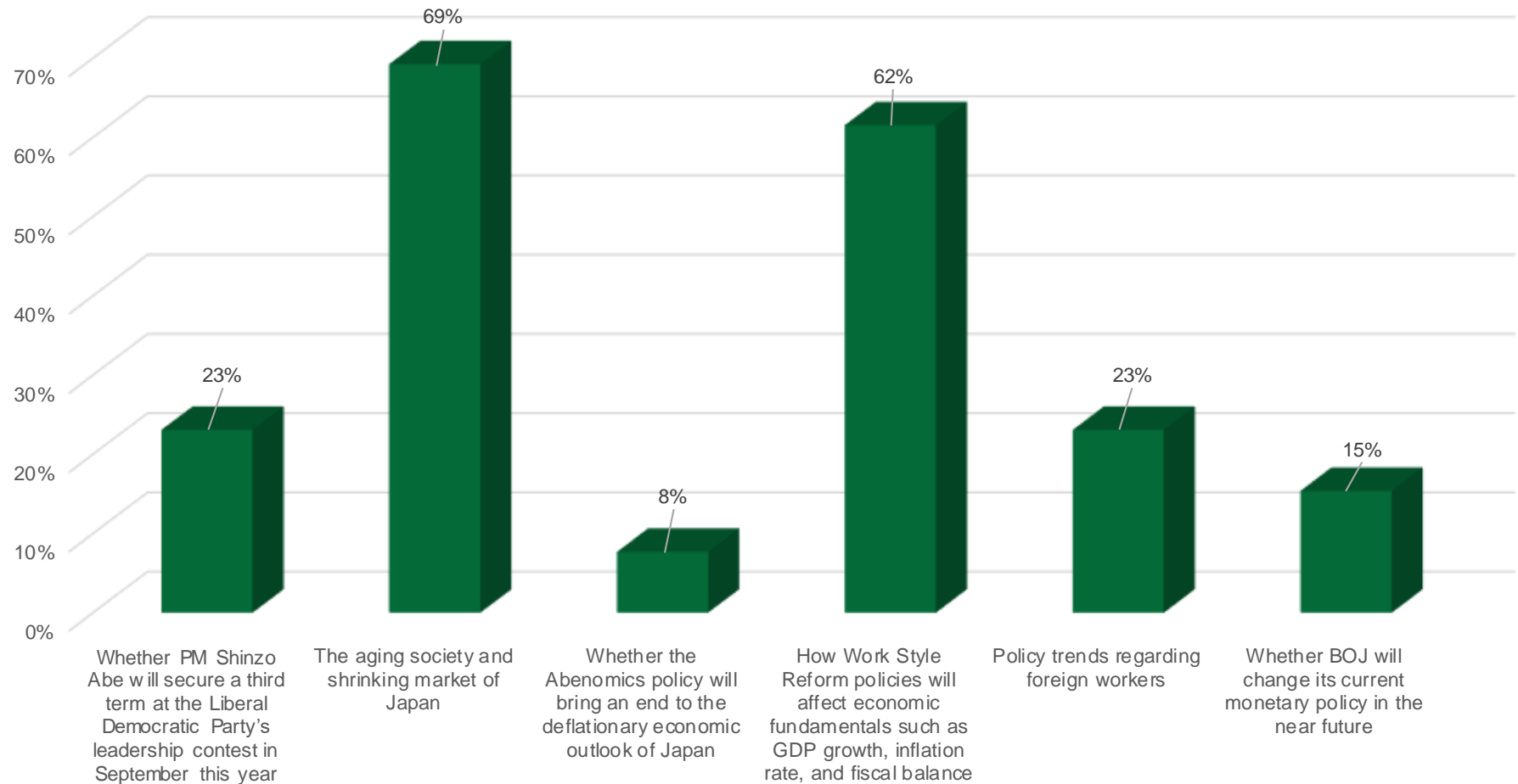
What are urgent Global political and/ or economic concerns, in your mind? (%)



Pre-event survey results

Aging society and work style reform are regarded as most important issues

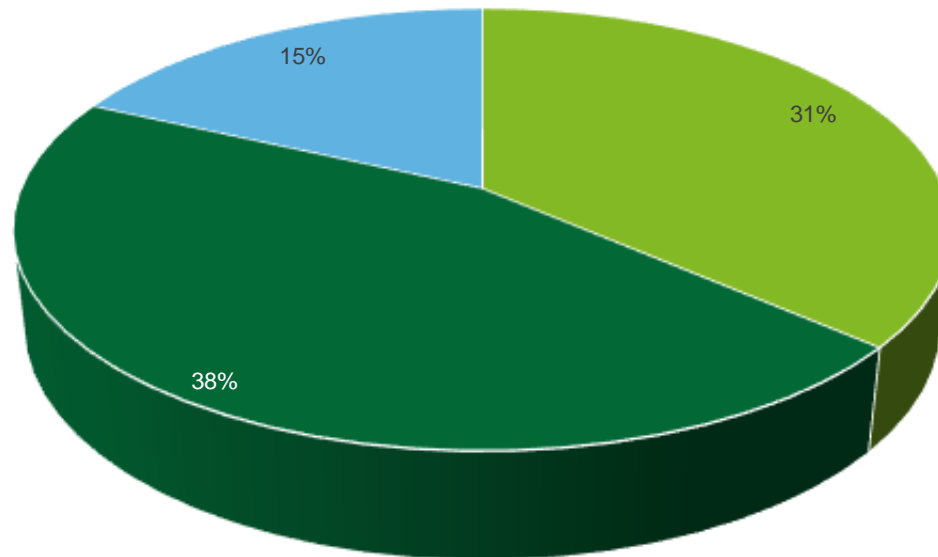
What are urgent political and/or economic concerns for Japan, in your mind?



Pre-event survey results

Business prospects are mostly optimistic or moderately optimistic

How would you rate the level of optimism in your business?



■ Optimistic ■ Moderate ■ Very optimistic



Stress scenarios:

Trade War, No-deal Brexit, and The Failure of Abenomics

How will you meet the coming politico-economic challenges?

July, 2018

Tsuyoshi Oyama

Deloitte Touche Tohmatsu LLC

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1. Intensifying Trade War Scenario

Intensifying Trade War Scenario

Scenario story

- The Trump administration carries out its aggressive trade policy as promised and goes so far as to implement increased tariffs on Chinese exports (raising the duty rate to 25% against 1,102 items, mainly industrial products but excluding some important consumer goods, amounting to USD 50 billion in imports from China). This invites Chinese retaliation (raising the duty rate to 25% against 659 items, mainly agricultural products and automobiles, amounting to USD 50 billion in imports from the US)
- The US strengthens the power of the CFIUS (Committee on Foreign Investment in the US) and thereby strongly restricts Chinese companies' investments into the US - mainly in advanced/high technology industries
- In reaction to American tariff hikes on steel and aluminum imports from Europe, the EU implements retaliatory tariff hikes, which in turn invites American retaliatory tariff hikes on car imports from the EU
- The US government and the newly elected Mexican president dash hopes for agreement on a new NAFTA deal, leading to the end of NAFTA
- The US government implements tariff hikes on automobile imports including from Japan, pushing Japan to make a deal to further open its agricultural market to the US

Discussion points

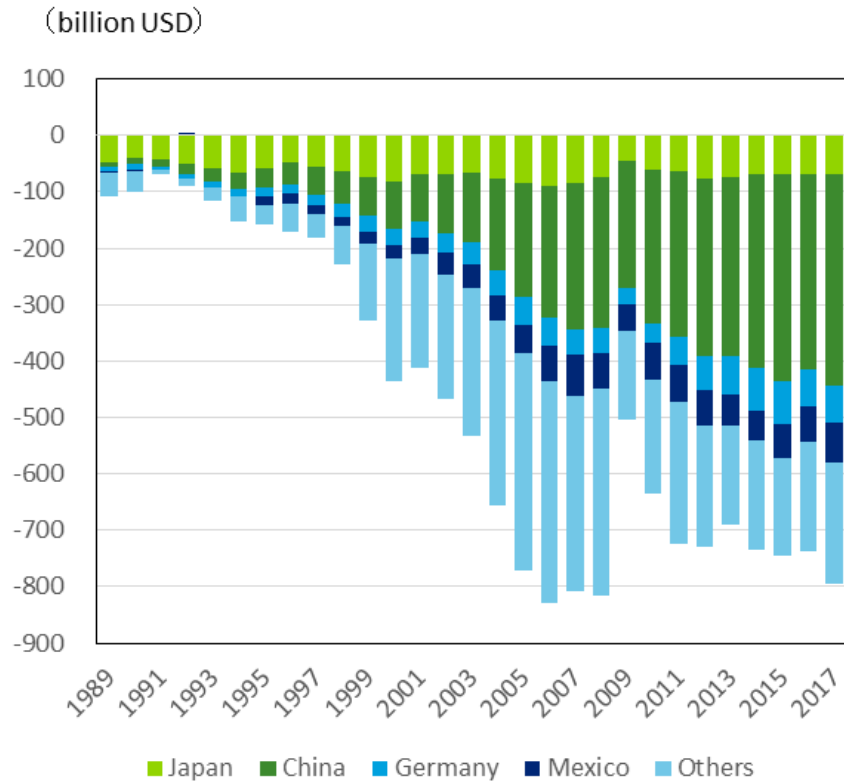
Three questions to deepen our discussion

- Is this scenario plausible?
 - Yes, the Trump administration has been successfully carrying out the trade war in order to improve their polls in the run-up to the mid-term elections and has no reason to stop
 - No, the Trump administration understands the possible negative impacts on voters once the trade war begins to affect the prices of consumer goods and employment. Thus, the administration seeks to make deals before starting the trade war in earnest

- What are the possible impacts on the important players' economies in this scenario?
 - Huge, particularly for the US
 - Huge, particularly for China, Europe, Japan, Canada, Mexico and others
 - Negligible, as indicated by several estimates
 - Better to distinguish short-term impacts from mid or long-term impacts

- What are your responses to mitigate possible negative impacts?

US Trade Balance Development



Source: US census Bureau

Effects of Unilateral US Import Tariffs

Import tariffs of 25% on cars and car parts, as well as of 25% and 10% on steel and aluminium products

	Steel, Alu		Cars		Steel, Alu & Cars	
	Mio. €	% of GDP	Mio. €	% of GDP	Mio. €	% of GDP
EU28	509	0.00	8528	0.06	9037	0.06
Germany	-37	0.00	-5043	-0.16	-5080	-0.16
Japan	-153	0.00	-4256	-0.10	-4409	-0.10
Mexico	-991	-0.10	-3685	-0.39	-4676	-0.49
Canada	-2881	-0.21	-3230	-0.23	-6110	-0.44
South Korea	-77	-0.01	-2262	-0.18	-2338	-0.18
China	-237	0.00	-1679	-0.02	-1917	-0.02
United Kingdom	-198	-0.01	-586	-0.02	-784	-0.03
Italy	-6	0.00	-579	-0.03	-585	-0.03
Netherlands	-107	-0.02	-547	-0.08	-655	-0.09
Ireland	-23	-0.01	-463	-0.17	-485	-0.18
Hungary	9	0.01	-213	-0.19	-203	-0.18
Sweden	-48	-0.01	-211	-0.05	-259	-0.06
Spain	39	0.00	-206	-0.02	-168	-0.02
Belgium	-67	-0.02	-201	-0.05	-268	-0.06
Austria	-46	-0.01	-192	-0.05	-239	-0.07
Poland	13	0.00	-152	-0.04	-139	-0.03
Czech Republic	-26	-0.01	-150	-0.09	-176	-0.10
France	-74	0.00	-133	-0.01	-207	-0.01
Australia	-147	-0.01	-119	-0.01	-266	-0.02
Turkey	-215	-0.03	-111	-0.01	-326	-0.04
Slovakia	3	0.00	-100	-0.12	-96	-0.12
Luxembourg	-31	-0.06	-94	-0.18	-125	-0.24
Norway	-116	-0.03	-90	-0.03	-206	-0.06
Brazil	-268	-0.02	-79	0.00	-347	-0.02
India	-203	-0.01	-72	0.00	-275	-0.01
Russia	-414	-0.04	-46	0.00	-460	-0.04
Indonesia	-53	-0.01	-39	0.00	-92	-0.01
Romania	3	0.00	-36	-0.02	-34	-0.02
Denmark	10	0.00	-18	-0.01	-8	0.00
Finland	-15	-0.01	-15	-0.01	-30	-0.01
Slovenia	-2	0.00	-10	-0.02	-11	-0.03
Malta	0	0.00	-1	-0.01	-1	-0.01
Estonia	-1	0.00	1	0.01	0	0.00
Latvia	0	0.00	3	0.01	2	0.01
Lithuania	2	0.00	3	0.01	5	0.01
Cyprus	0	0.00	4	0.02	4	0.02
Bulgaria	-4	-0.01	6	0.01	2	0.00
Croatia	-11	-0.02	8	0.02	-3	-0.01
Portugal	-5	0.00	15	0.01	10	0.01
Switzerland	10	0.00	31	0.01	41	0.01
Greece	-11	-0.01	32	0.02	20	0.01
USA	2878	0.02	5739	0.03	8617	0.05

Source: ifo Institute, May 2018.

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Source: IFO institute, May 2018

2: No Deal Brexit and a Destabilizing EU Scenario

No-deal Brexit and a Destabilizing EU Scenario

Scenario story

- The May government cannot form a consensus within the Conservative party on whether or not the UK should remain in the customs union so as to address the issue of the Northern Ireland border. Consequently the UK fails to reach an agreement with the EU on the Brexit treaty by this October
- As a result, the UK is not allocated a transitional period to prepare a trade agreement with EU by the end of 2020. They will instead leave the EU by the end of March 2019 without any deals in place with the EU
- In this environment, the UK could meet with the various challenges shown on page 8
- Meanwhile, the EU itself also faces its own crises triggered by the aggressive stance of the Italian government on immigration and its fiscal deficit. As well, by the destabilizing German coalition government which is deeply divided on its own immigration policy
- The above hinders German-led EU initiatives to help avoid a hard break in the UK-EU relationship
- In the latter half of 2019, the UK economy seriously suffers from huge drops in trade and capital expenditures, as well as high inflation caused by another round of GBP depreciation
- Italian and other weak economies also suffer from capital outflows, rises in interest rates, and consequent banking crises – they are not financially rescued by Germany or the EU

Discussion points

Three questions to deepen our discussion

- Is this scenario plausible?
 - Yes on a no-deal Brexit, given that the UK government is currently in a kind of limbo it is very difficult to imagine that they will be able to make any deals with EU in the near future
 - Yes on a destabilizing EU, as even Germany is now inclined towards restricting immigration
 - No, the EU and the UK have always found solutions for stopping the crises in the past

- What are the possible impacts on the economies in this scenario?
 - Huge, particularly on the UK economy
 - Huge, particularly on the Italian economy
 - Negligible, as the UK anyway finds a way to enhance its economic relationship with non-EU economies, and the strong German and French economies pull others out of economic downfalls

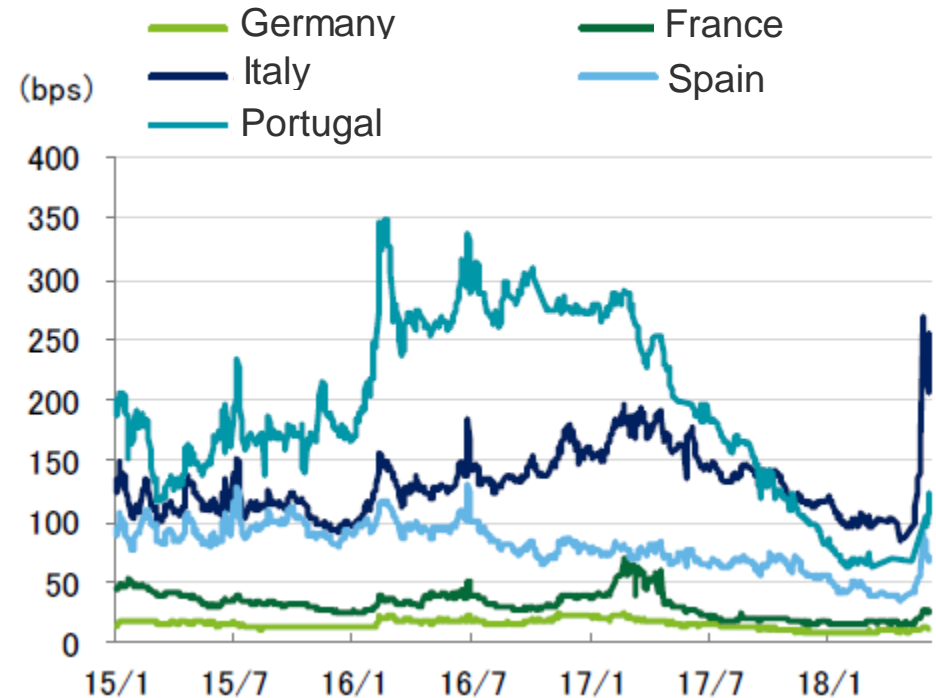
- What are your responses to mitigate possible negative impacts?

Top 5 consequences of “no deal”:

1. Rising costs for consumers and businesses
 - The increase in tariff costs would be between £4.5-6 billion per year for UK exporters. Meanwhile, the cost of tariffs paid by UK consumers and businesses on imported goods could be more than double this, between £11bn-£13bn (around 0.6% to 0.7% of GDP, with an average tariff rate of almost 6%).
2. Disruption at ports and airports
3. Confusion over everything from contracts to chemicals regulation
4. Uncertainty for 4 million citizens
5. Cross-border services in disarray

Source: CBI “Top five consequence of “No deal ” Brexit. October, 2017

Sovereign CDS spread



Source: Bloomberg

3. The Failure of Abenomics Scenario

The Failure of Abenomics Scenario

Scenario story

- Intensifying trade war with the US causes JPY appreciation and forces the Abe government to make a deal to protect the Japanese automobile industry by opening up the Japanese agricultural market
- In this environment, PM Abe barely wins the LDP leadership election in September with only very weak support from regional LDP members, consequently weakening PM Abe's power base in the LDP
- The above situation pushes foreign investors to sell Japanese equity and buy JPY, reversing the positive results of Abenomics over the last 6 years
- The BOJ is forced to fire a bazooka to stimulate the Japanese economy by further lowering the negative policy rate and showing commitment to holding JGB for a long, long time (hinting at an introduction of a helicopter money policy)
- This monetary policy invites a mini-banking crisis, in which many regional banks face a bank-run that further pushes down the Japanese economic condition

Discussion points

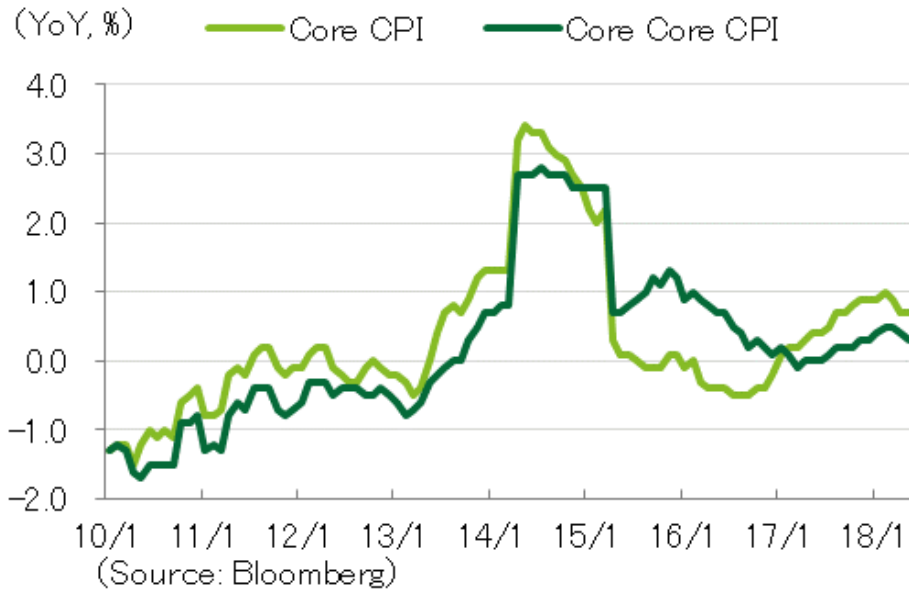
Three questions to deepen our discussion

- Is this scenario plausible?
 - Yes, the Japanese people are becoming tired of the current government and the LDP is likely to reshuffle its top positions to win next year's upper house election. But, this triggers a negative reaction among foreign investors' who assume the end of Abenomics
 - No, PM Abe is still strong enough to win a third term as LDP leader by a large margin and finally embarks on the third arrow policies that include labor market reforms and acceptance of foreign workers

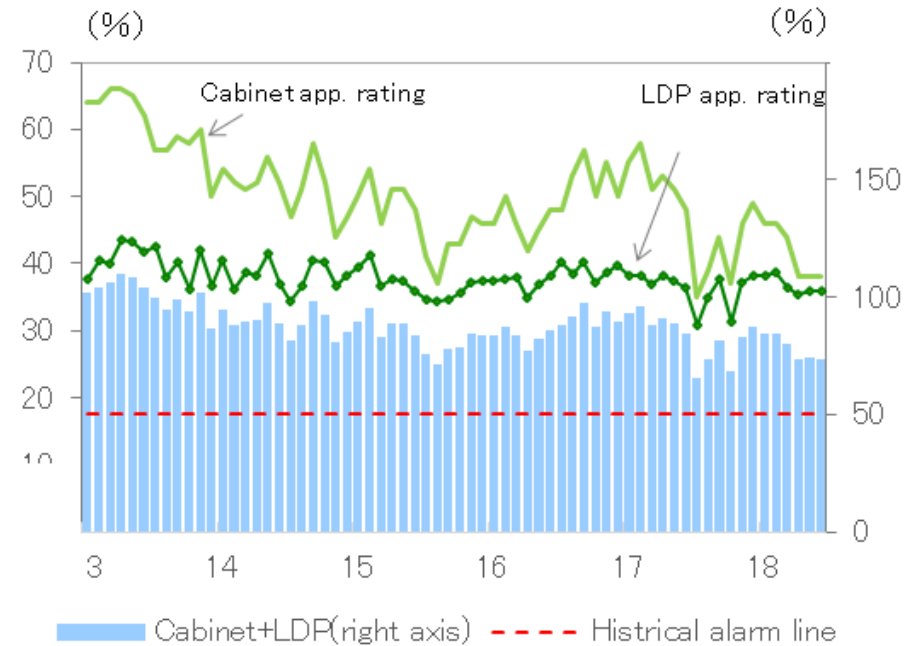
- What are the possible impacts on the economies of this scenario?
 - Huge, as Abenomics is the last hope for the Japanese economy
 - Negligible, as Japanese industries have now become strong enough to keep high profitability regardless of the Japanese economic condition including its exchange rate

- What are your responses to mitigate possible negative impacts?

CPI inflation



Abe government and LDP: Approval ratings



(Source: NHK Broadcasting Culture Research Institute
"Monthly Report of Political Awareness", DTT analysis)

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