

Global Risk Watch Newsletter

A Holiday for Global Risk-Off, etc.

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1. Overview Macroeconomic and Financial Risks (Trends & Topics)

A Holiday for Global Risk-Off (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The risk-off sentiment that rocked the global markets since the start of the year has finally begun to ease off - thanks to a series of strong US economic indicators which corrected a prevailing pessimistic view, a stronger stance taken by Chinese authorities towards stabilizing their economy, and bottoming out of crude oil prices. Also, some policy measures including 1) the increasing anticipation of FRB (Federal Reserve Bank) holding its interest rate in March, 2) negative interest rate policies launched by the BOJ (Bank of Japan) and ECB (European Central Bank) which have rather ironically emphasized the limits of monetary policy and instead increased the expectations for fiscal stimulus, and 2) Chinese government's decision to move into a full-scale fiscal stimulus that had said to be the last forbidden option, help set the market turmoil on a break for once. Using the 'hay fever symptom' analogy I described in last month's edition, we can say that the doctor has finally administered and increased the dosage of stronger side-effect medicines that s/he once hesitated in order to stave off the worsening allergic symptoms, and this decision has worked so far.

However, the 'worsening allergic constitution' itself, which is the liquidity decline in the global financial market has not been halted. Moreover, the global economy remains unstable, meaning that there are still much pollen (uncertainty

over the future) to be remained in the air ready to trigger allergic symptoms. In particular, economic uncertainties driven by political turmoil have surged recently. For example, Europe continues to face turmoil over migration problem, increasing likelihood of Brexit, and emerging austerity fatigues among peripheral countries in the south. In the US, Donald Trump continues to lead the Republican Party presidential primaries despite his repeated extremely controversial remarks. Hence, a growing risk of 'ego' to be exposed in each country, while riding on the flow of populism momentum. Another vigilant concern is a larger number of countries adopting the negative interest rate policy. This phenomenon indicates a 'decline in basic physical fitness' of the global economy, or a condition of unstoppable decline of productivities that is often dubbed as "secular stagnation". A big question is whether it is appropriate to prescribe medicines with strong side effect to cope with this decline in basic physical fitness. Expansion of negative interest rate will induce instability in the financial system through downward pressure on earnings of financial institutions. Moreover, further strengthening of fiscal policy could ultimately encourage accumulation of another unworkable capital stocks, and is likely to widen the imbalances to be corrected. The orthodox policy measures which are normally expected to tackle with declining productivities are structural reforms; however, introducing painful policy measures will be more and more difficult under current rising populism in many countries. In this environment, the fierce battle between the allergic symptoms (global risk-off trends) that are stimulated by uncertainties, and doctors (policy makers) who try to prescribe the medicine with strong side effects should continue for some time. We might better brace for this global risk-off holiday be unexpectedly cut short.

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