

# Global Risk Watch Newsletter

## Overheating Financial Market Brought on by a 'Fearful' Spate of Stress Events, etc.

Global Risk Watch Vol.16  
29 July 2016

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

#### # Overheating Financial Market Brought on by a 'Fearful' Spate of Stress Events (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The UK referendum held on June 23rd resulted in surprise for the market with the EU-exit camp capturing the majority. Further, as soon as the global market finally began to restore some stability from the financial chaos caused by the referendum result, a large-scale terrorist attack turned up with a truck running into a crowd of people on the Bastille Day celebration in Nice, France, and this was followed by an attempted coup d'état in Turkey. The world has indeed seen a turbulent month.

This series of events has overall brought two major impacts into the world. One is that the global risk-off epicenter has now returned to Europe. Through 2010 to 2012, a tense period concerning Greece EU-exit with a spill-over to southern peripheral markets consequently triggered the European sovereign debt crisis. The world at that time was paying close attention to whether the solidarity of the EU could be maintained. Since then, financial assistance to southern Europe began to yield success (a small turmoil took place again through 2014-2015), and the global risk-off epicenter has shifted to China and emerging economies. However, the result of the UK referendum has once

again recaptured the markets attention towards Europe (as a result, emerging markets are currently enjoying an extremely calm period).

The global stock price plummet, triggered by abrupt fluctuations in exchange rates shortly after the UK referendum, have gradually recovered to previous levels, yet what is left in the aftermath must be carefully observed. For instance, the financial instability in Italy, which was highlighted by Brexit development, has begun to be a big issue with the concern of whether capital injection into fragile banks can be worked out before the release of ECB stress test results. Also, the timing of the UK government to officially notify the EU of their exit, and a new 'form' of trade relationship with EU could become worrisome. Finally, the most critical for the global economy is whether the EU can overcome the 'risk of falling apart', which was also questioned during the 'European sovereign debt crisis' four years ago. In this regard, the re-run of the Austrian presidential election and constitutional referendum in Italy to be held in October this year, as well as upcoming elections in the Netherlands, France, and Germany in next year may reveal results to once again shock the world.

Another major impact is concerned with the stance toward monetary policy in major countries. The US FRB has taken a stronger stance to postpone the interest rate hike, fearing the aftermath of UK referendum result in addition to concerns for its domestic economy. At the same time, central banks including BOE and BOJ are expected to push monetary easing going forward. Monetary easing during a period where the real economy is not necessarily deteriorating, may overheat the risk assets market. In fact, stock prices in the US have already exceeded the previous peak level. Moreover, looking globally, the tightening of credit spread is noticeable. The current state has begun to resemble increasingly the FRB's monetary easing measures after Russian Crisis and LTCM (Long-Term Capital Management) Crisis in 1998, which ultimately brought to us the formation-and-burst of the IT bubble(in 2000).

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