

Global Risk Watch Newsletter

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

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3.Highlight of Indicator for this Month

After the Brexit, Conflicting Signals of Uncertainties in Stock and Bond Markets (Yasuhiro Sobue, Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Despite the severe turmoil in financial markets since the Brexit referendum in the UK held on June 23rd (Japan time June 24th), recent market figures indicated that stock market is gradually recovering. The VIX (Volatility Index) fell to 12.82 (latest data as this article is written on July 14th), and US stocks (Dow Jones Industrial Average) also reached back up to a 14 months high level.

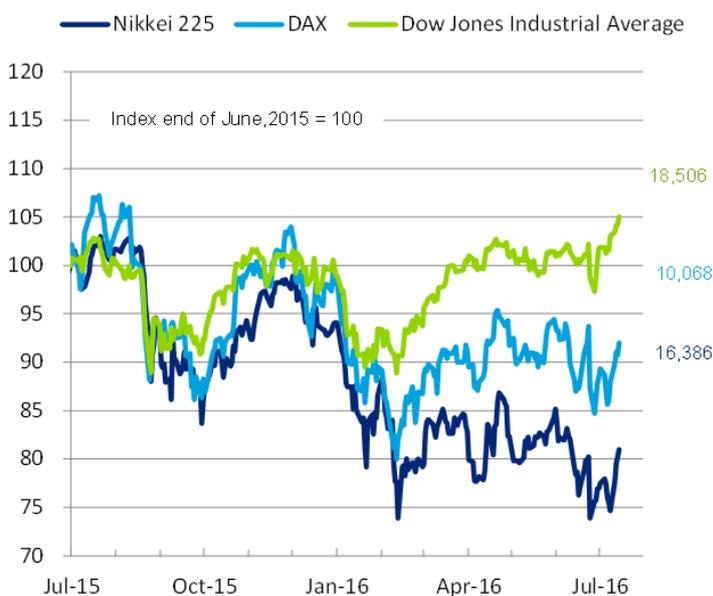
On the other hand, long-term interest rates have remained on a downward trend. The main factors for the long-term interest rates decline are; (1) anticipation of increasing monetary easing policy globally (delaying interest rate hike in the case of US) due to increased uncertainties after the Brexit, (2) concerns of shrinking economic activities as the results of Brexit, thereby inducing downward pressures on the economic growth in the mid-and long term.

Regarding (1), expansion of the liquidity supply by the central banks is believed to stimulate the demand for financial assets. Hence creating a higher stock and bond prices (interest rate decline) environment (so-called liquidity driven market).

We note, (2) suggests the expected growth of the global economy declines in the mid-and long term, as a result of lower stock and higher bond prices (interest rate decline). However, the impact of (2) will not materialize immediately, while policy makers mainly in the UK and Europe will lay out various measures to avoid these adverse impacts, thus stock market may have priced with speculation of economic recovery underpinned by these policy support. As described above, there are different views on the economic growth outlook in the stock/bond markets. At this moment, although it is difficult to make to conclusion as for which one is right or wrong, but there is no doubt that uncertainties for the macro economy have increased compared to pre-Brexit period.

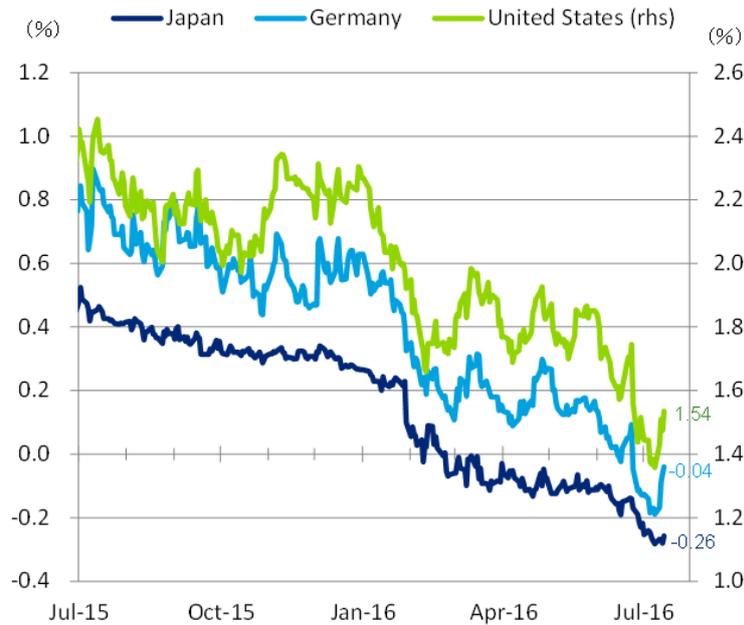
Given these circumstances, the significance of risk management is about to reach another critical stage. Particularly Brexit, as the root cause of these uncertainties, can have mid-and-long term impact; a forward-looking view of risk management will be in more demand.

Chart 1. Stock prices of Japan, United States, and Germany



Source: Bloomberg

Chart 2. Long term interest rates of Japan, United States, and Germany



Source: Bloomberg

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