

# Global Risk Watch Newsletter

## Global Financial Market is in a “lull” before facing a possible “super typhoon”, etc.

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

#### # Global Financial Market is in a “lull” before facing a possible “super typhoon” (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The calm global financial market we discussed in August has continued into September. Of course, it is hard to predict the outcome of the US FRB’s (Federal Reserve Board) FOMC (Federal Open Market Committee) and Bank of Japan’s Monetary Policy Statement which are scheduled for 20th or 21st of September, but if the outcome stays in line with market expectations, it is possible for the “lull” market to continue for a while. The market expectation for FRB is the interest rate hike being postponed to the end of this year. In case of Bank of Japan, the framework of the current easing policy (for example, the inflation target of 2% to be achieved by 2017) is expected to be somewhat loosened, and to come up with further mitigation measures such as additional interest rate easing.

However, the decision of the central bank does not always meet market expectations. For example, in the case of FRB, the last two speeches before the blackout were made by Governor Brainard and Governor Tarullo (who specialize in crisis management and prudential policy, and hold relatively dovish views on monetary policy), and they might push the market into a little dovish-biased sentiment, even though the remarks by Fed governors prior to them

had rather been hawkish. Given that the labor market is closer to a full employment condition and the US economy is likely to continue its strong growth during the second half of this year, it is no wonder even if the FRB judges that the time finally comes to raise interest rates and thereby increase ammunition for future crisis. This decision could be accompanied by another decision of lowering the long-run federal fund rate, which implies that the pace of future rate hikes could be very slow. This additional decision may somewhat mitigate the shock of unexpected rate hike, which could not only affect the asset price in the United States but also will bring huge negative impacts especially to the emerging economies.

On the other hand, the decisions by Bank of Japan can also be seen as disappointing. The fundamentals of the Japanese economy have remained firm in their own way. GDP growth rate in the second quarter was revised upward, and by adjusting for the leap year effect of the first quarter growth rate, the first half of the Japanese economy is growing with the growth rate slightly accelerating from first to second quarter. This growth is actually higher than the potential annual growth rate of around 0.5%. At present, relatively strong numbers in production and capital expenditure are noticeable. The forecast in wages is showing modest but positive growth in real terms which is likely to support consumption in the coming months. Moreover, the positive effects of large-scale supplementary budget are expected to be gradually materialized. Thus, the Japanese economy is likely to keep relatively firm condition in the short-term unless it faces sharp appreciation of Yen or foreign economic crisis.

The question then is whether or not it is necessary for the Bank of Japan to carry out further easing. Inflation is weakening currently; however, even this inflation will likely be somewhat elevated from now on (even though it won't be as rapid as the pace expected by the Bank of Japan) as the constant increase in wages and some recovery in commodity prices in the past months are putting gradual pressures on prices. Under this condition, it is again no wonder even if the Bank of Japan just indicates "zero response" to the market's request of further easing, with only changing the framework of quantitative and qualitative easing. In this case, how the market will react to these decisions is surely a big concern. In terms of timing, it is likely that the FRB's decision will be announced right after Bank of Japan's Monetary Policy Statement. Thus, the impact on the market could be huge depending on the combination of the results which varies from the Bank of Japan's "Zero Response" and FRB's "Rate Hike Postponed" to Bank of Japan's "Bold Easing" and FRB's "Rate Hike".

In any case, the result will be evident by the time this newsletter is published, and by that time, we are hoping the lull market is not attacked by the "super typhoon"...

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