Deloitte.
デロイト トーマツ

トーマツ.

'This newsletter is translated from the Japanese edition distributed on October 21st
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

Narrower Paths for Major Central Banks Now Face the Risk of Being Clogged by Another European Shock, etc.

Global Risk Watch Vol.19
28 October 2016

==

≪index≫

==

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

 # Narrower Paths for Major Central Banks Now Face the Risk of Being Clogged by Another European Shock (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The global market has seen some turbulence but generally remained stable as the Bank of Japan's announcement of "new framework" of its monetary easing and the US FRB's (Federal Reserve Board) decision to delay the rate hike were more or less in line with market expectations. Especially, the market was relieved by the US FRB's delay on the rate hike. Despite the US economy itself being generally stable, by the FRB choosing to take a cautious approach not to surprise the market, the FRB must have been aware of the "Pax Americana" situation in the global scene where the "peace" of global economy is upheld by US' monetary easing policy. However, fatigue of "taking care of markets" also seems to become evident, where several FRB top rank officials' statements after the decision are seen rather hawkish, implying "we have put up with the inaction this time, so be prepared for the next meeting".

On the other hand, the Bank of Japan (BOJ) was successful in blinding the market to its decisions to delay further deepening of negative interest rate and switching from "quantity" to "interest rate" emphasis – or a kind of "tapering" announce beforehand, by using new measures with powerful nuance on wording such as "yield curve control" and "inflation-overshooting commitment". With this, the Bank of Japan also seems to have conveyed its message (especially to banks) that "this time, we have delayed further deepening of negative interest rate so be prepared for the next meeting". As the BOJ managed to prolong the "life expectancy" of the current monetary easing policy that faces the limitations on "quantitative" easing, by keeping the possibility of further deepening negative interest rate, the BOJ must continue to keep up such attitude toward banks.

Both central banks (and the European Central Bank:ECB also) coincidentally chose to "not move" this time while strongly hinting that "they will take actions next time". The problem is whether these central banks can actually take actions as they intend. Recently in Europe, series of events are shaking the situation, such as the concerns over Italy's financial system and Germany's leading bank. Emerging stress events have been managed to be settled in the past, however there are still chances of problems such as the possible "bail-in" or "bail-out" of an Italy's major financial institution after the re-evaluation of its non-performing loans towards the end of the year. Also in the beginning of December, the constitutional referendum is awaiting in Italy, which can risk Italian Prime Minister's political career. If his proposal of revising the Constitution will be rejected, the politics will fall into turmoil, and if additionally the major bank's "bail-in" or "bail-out" is to be required, the sovereign debt crisis of Europe's third biggest economy can actually face the reality. In addition, UK Prime Minister May's political stance on pushing hard Brexit can stir up such concerns.

If such events happen, would the US FRB be able to raise interest rates or would the BOJ be able to further deepen negative interest rates (which could imply another financial system instability).... Contrary to their intentions, the major central banks may be freezed for a while to taka their alarming actions.
