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Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

# Global Risk Watch Newsletter

## Premonition of 'Inflation', etc.

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

#### # Premonition of 'Inflation' (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy (CRMS) at Deloitte Touche Tohmatsu LLC/Deloitte Asia Pacific Risk and Capital Management Leader)

The "Trump rally" is still going on in the markets where the US dollar has been further strengthened, stock prices have been further boosted and bond prices have been further down in advanced nations. Actually, the US stocks have recently renewed its new historical peaks and also Japanese stocks have reached a high for the year in the midst of the plummet of the Yen value against the US dollar. On the other hand, long-term interest rates are rising steadily in major countries, even including Japan where the BOJ caps the 10 year rate at around 0%.

Under these circumstances, on December 14, the FRB (Federal Reserve Bank of America) decided to raise the interest rate for the first time in a year at the FOMC. The rate hike itself was almost fully anticipated in the market in advance, but the market was somewhat surprised when FOMC members assumed the average number of interest rate increases next year will be three times compared to twice in the last meeting. A factor behind this surprise is that this somewhat hawkish stance was indicated despite the fact that the FRB itself admits the high uncertainties concerning the actual policy implementation of Trump (in particular, the expansionary fiscal policy), or assuming almost neutral effects of Trump policy at this moment. In addition, on December 8, before the Fed made the decision, the ECB (European Central Bank) also made a decision to reduce the quantitative easing programme beginning next April. Similarly, the BOJ (Bank of Japan) which had already decided the change of policy framework shifting its focus from quantity to price in September, is likely not to decide the further easing at the policy meeting in late December.

In fact, looking at the macro-economy of major advanced countries, they have already shown a steady growth even before the beginning of "Trump rally". The US economy is likely to continue to keep high growth rate of higher than 2% or potential growth rate in the fourth quarter, where the unemployment rate has already fell far below the full-employment threshold of 5%. On the European economy, a steady economy continued in tandem with rising inflation, whereas the uncertainty regarding Brexit of a while ago is almost seen as a negligent event. The Japanese economy has also continued to grow with the speed of higher than its potential growth rate, with the extremely tight labor market. Which has already seen the highest job offer-to-applicant ratio since the 1990s. Those changes in macroeconomic environment, from a looming deflationary pressure which had forced the central banks a defensive-battle to a steadfast economic improvement with a turning point of inflation from the latter half of this year, have now ultimately brought the central banks "more rooms" in terms of policy manoeuvrability.

If a new economic stimulus package will be successfully implemented by the new Trump administration and thereby adding more pressures on the economy, however, that may bring a completely different world from the one which we had long been so accustomed to. This is the world of "inflation" in a "high pressure economy". For example, considering the situation in Japan, hourly wages has already risen at a very fast pace, reflecting the tightening labor market, and as a result shifts in employment from non-permanent to permanent workers are progressing. Under such circumstances, exchange rates and crude oil price, which are other major variables of the price function, will also change significantly in the direction of boosting prices. Henceforward, should the "Trump rally" escape the unwinding risk by executing a smooth policy implementation, then this situation will almost certainly lift up the inflation rate in Japan next year (perhaps even to a level which many people did not even imagine).

In Japan, a nomination for buzzword of the year includes "negative interest rate" (though it was not selected). Admitting that it may be too early, still I cannot resist the attractions of expecting that "Exit" might appear as a candidate for buzzword next year.

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