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Global Risk Watch Newsletter

The dark side of the current robust economy, etc.

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

 # The dark side of the current robust economy (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 risk-on trend is regaining momentum in the stock markets of advanced countries, which have once looked losing steam due to political turmoil, rising geopolitical risks and some uncertainty over the U.S. economy. Some factors can be remarked behind this turnaround, including: (1) strength of the real economy and corporate earnings of developed countries, which were once again confirmed, (2) a significant decline of geopolitical risks, mainly in Europe, thanks to the victory of Emmanuel Macron in the French presidential election, and (3) some relief of anxiety over the U.S. government's capability of delivering its policy agenda, as seen in passage of the Obamacare replacement bill at the House of Representatives, and a narrow escape from the government shutdown owing to the budget approval (though a new issue of "Russiagate" is now arising in relation to the dismissal of FBI director).

Indeed, the recent global economy continues to be robust despite the somewhat pessimistic forecast as of last year. In terms of the growth in the 2017 first quarter, among advanced economies, the U.S. was somewhat low at an annualized rate of 0.7%. However, Europe saw 1.8% and Japan 2.2%, both exceeding the potential growth rate. Concerning the U.S., as Federal Reserve Board (FRB) Chair Yellen indicated the slow growth in the first quarter as "transitory," it is likely to have derived from special factors. As evidenced by a little surprising decline in the unemployment rate to as low as 4.4%, the underlying trend of the U.S. economy should be seen as still very positive.

The economic situations in China and emerging economies also remain strong. The April statistics on the Chinese economy show that, although the momentum is dwindling from the first quarter given monetary tightening against the financial bubble, the economic growth still exceeded the annual target rate of 6.5%. As for other emerging economies, many countries went beyond end-last year in their growth rate in the first quarter. This was thanks to numerous tailwinds, including the vibrant economy in advanced countries and China, crude oil prices shifting around USD 50 per barrel as well as the low and stable U.S. long-term interest rates.

The current “too good” global economy might make some fret over the question of its sustainability. Regarding developed countries, concerns on the U.S. economy lie where, in the seventh year of the economic recovery, the unemployment rate has fallen so low that no more jobs can be added to the market. If the tighter labor market brings high inflation through higher wages in the future, monetary tightening may push down the economy. Even if high inflation does not occur, with the growth rate (and eventually corporate earnings) gradually falling due to constraint on the supply side, stock prices driven by expectations may be more likely to adjust themselves substantially. The Japanese economy is in an extremely similar situation to the U.S. To the contrary, unemployment is rather higher in Europe, which leaves more room for future growth though trends in the political uncertainty remain relevant.

Meanwhile, the recent well-being of the Chinese economy heavily relies on reflationary measures. While the bubble expands in the real estate market and the shadow banking system, a vicious spiral where further stimulus causes another increase in distortion is yet to be addressed. Depending on how to contain and diminish the imbalance that is likely to continue swelling by the People’s National Congress in autumn, its influences can end up as hard-landing, or a short-term economic downturn. In either case, this adjustment seems inevitable in the next year or later, not far future. Lastly, emerging economies are largely dependent on the economy of advanced countries and China. The continued low long-term rate in the U.S. will invite foreign exchange and financial stability in those countries, but if this low rate is a result of the flagging U.S. economy, they now could not expect an increase in the U.S. demand, or a vital growth engine for them, which have been suffering from sluggish internal demands.

The above prospects remind us that we cannot blindly embrace that the current vibrancy of the global economy will be warranted in the coming months. A crisis has struck the world every decade, as the Black Monday in 1987, the Asian Financial Crisis in 1997, and the Subprime Mortgage Crisis in 2007. We are now in 2017, or a decade after the Subprime Mortgage Crisis, and might be just seeing the calm before the storm, which is quietly approaching us while picking up its strength.