

# Global Risk Watch Newsletter

## Government's Governance is Tested in the Emerging Economies, etc.

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

#### # Government's Governance is Tested in the Emerging Economies (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

The global market has continued to react helplessly to various sluggish economic numbers coming out from China. Of particular concern is a robust sell-off of RMB that had been expected to be only stronger before, thereby forcing authorities to intervene in the forex market to buy up RMB against the US dollar. Thus, while capital control has yet to be liberalized in China, the authority is currently struggling to stabilize the nominal exchange rate. This implies the challenges to maintain a controlled economy when it reaches a certain scale. Concurrently, a colossal amount of capital is running away from China, the world's largest foreign exchange reserves holder and an economy with a substantial current account surplus. Considering the potential scale of dollar nominated debt of the Chinese corporate sector, this indicates the magnitude of uncertainties faced by the Chinese economy in the forthcoming future. The Chinese government is now facing the challenges in shifting smoothly from the economy that still heavily depends on involuntary nerve system (or the inherent command economy) to an advanced economy that is equipped with the

high level autonomic nerve system. This is indeed a challenge as the latter system could not necessarily work well with the governance style of the Chinese government, .

Many emerging countries also face a similar situation. This is not simply due to a phenomenon originated from the deteriorating Chinese economy and accompanied commodity cycle, which many emerging economies have resonated with; however it is also indicative of governing dysfunction of the government itself and their ability to cope with a declining economy. For instance, in Brazil, Rousseff's administration is facing a deeper predicament; the economy has officially entered into a recession while its sovereign rating has fallen to junk classes, all the while, the Petrobras corruptions scandal continues to loom over the country. In Malaysia, corruption allegations in relation to state owned enterprises have also shaken the stability of the incumbent government. Moreover, such situations are not limited to resource-rich countries, Turkey as a beneficiary of cheap crude oil prices also face historical currency devaluation due to political turmoil. The China originated risk-off wavelet is gaining momentum on the backdrop of speculation over a US interest rate hike, and seems to target the coast of government with lower governing capabilities as well as being impacted by the cheap price of resources.

In the US, the deciding factor of the timing of an interest rate hike has gradually shifted from short-term factors such as employment figures to the long-term impacts of US economy stagnation as a result of a deceleration in overseas economies. Whether the FRB should decide the timing of a hike under the circumstances of cyclical strength and structural weakness are to be observed (the decision of FOMC should be more clear by the time this newsletter is published). Regardless of rate hike timing, however, in the risk-off environment that has been strongly impacted by the China originated shock, the market may focus only on 'bad' aspects of the FRB's decision.

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