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# Family Office Service:
# Global Economics, Markets and Tax Newsletter

## A New US President, A New Pivot to Asia?

Q4 2020

### Japan Big Picture

**Economy**

In Q3 2020, Japan's economy rebounded after declining at an annualized rate of 28.8% in Q2 2020, it increased at an annualized rate of 21.4% in Q3. Still, this means that the economy recovered only 56% of what was lost in Q2, rendering real GDP 14% below the level in Q1. It will take some time for the Japanese economy to return to the pre-crisis level.

*Source*: https://www.reuters.com/article/us-japan-economy-poll-idUSKBN27T0F9

Japan's consumer sector remained weak in August 2020. Real (inflation-adjusted) household cash earnings were down 1.4% year-on-year (y/y) which was the fifth consecutive month in which earnings declined. Real household spending (a monthly indicator of consumption) declined 6.9% y/y, indicating consumers were not yet ready to return to a normal level of activity but month-on-month (m/m) spending was up 1.7% in August. September 2020 showed a similar trends with spending down 10.2% y/y but up 3.8% m/m implying consumption is rebounding but record new daily cases of the COVID-19 may see consumers reign back their spending if new measures to restrict the populace's movements are introduced.

*Source*: https://uk.reuters.com/article/us-japan-economy-wages-idUKKBN26T3SC

Japanese exports appear to be heading towards growth which will bode well for Japan's manufacturers. Exports in October 2020 declined only 0.2% y/y following on from a September where exports declined 4.9% y/y and in August they declined 14.8% y/y. The suggestion of stabilization in the data has been driven by exports to China and the US, Japan's largest trading partners. Exports to Europe were still in decline reflecting the return to lockdowns across the continent. Overall, the deceleration of the decline in exports suggests a turning point for a segment of the Japanese economy that has been struggling since 2018. The prospect of strong Chinese economic growth bodes well for Japanese exports and exporting sectors.

*Source*: https://www.reuters.com/article/japan-economy-trade-idINKBN27Y06O

**Key Themes in Japan**

1. Supply Chains

Despite the benefits China's economic growth brings Japan, the Japanese government is worried that Japanese manufacturers are excessively dependent on Chinese supply chains. The disruption of supply chains early in the coronavirus crisis severely hurt Japanese companies and created increased uncertainty. Then, deteriorating trade and political relations between the US and China created additional headwinds. Hence, the Japanese government previously implemented subsidies meant to encourage Japanese companies to transfer resources out of China, into either Japan or Southeast Asia. Now, the Japanese government is intensifying this policy by offering enhanced subsidies to companies that move facilities to Southeast Asia. Specifically, the government pledged to cover up to half of the cost of moving facilities for large companies, and up to two thirds of the cost for smaller companies. The stated goal is not to discriminate against China. Rather, it is to encourage companies to diversify their supply chains, reducing dependency on just one country.

Moreover, it is not simply about diversification. The reality is that manufacturing production wages in much of Southeast Asia are a lot lower than those in China. Countries such as Vietnam and Indonesia have wages that are 60% and 40% below those of China respectively. The subsidies will not only apply to companies that move. They will also apply to companies that boost capacity by investing in Southeast Asia, thereby diversifying their overall footprint. For countries in Southeast Asia, this could be quite lucrative, potentially contributing to a significant increase in manufacturing output and exports. Despite the significance of this program, it remains much smaller than a similar program meant to encourage manufacturing investment in Japan itself.

*Source*: https://asia.nikkei.com/Politics/Japan-expands-China-exit-subsidies-for-moves-to-Southeast-Asia

2. Carbon Neutrality

Around the world, there is increasing governmental interest addressing the issue of climate change. Many governments, especially in Europe, have adhered to the Paris Accord goal of planning to achieve carbon neutrality by 2050. China has pledged to achieve neutrality by 2060. If Joe Biden, as president-elect intends to target 2050 for carbon neutrality. Now, Japan has pledged to achieve neutrality by 2050. By setting this goal, the government will implement new rules that will require energy consuming companies to take action to meet certain goals. This will especially affect companies in heavy industry as well as electric utilities. The government's plan will likely involve major increases in energy production using nuclear, solar, and wind.

Source: https://www.japantimes.co.jp/news/2020/11/09/business/japan-2050-carbon-neutrality-costs/

**Country/Regional Updates**

1. China and the Asia Pacific

China's economy grew very strongly in Q3 2020 at 4.9% y/y. Many analysts had expected growth closer to 6%. The major drivers of growth were investment and exports but consumer spending was weaker than anticipated. Experts now expect China's real GDP in 2020 will increase from 2019. As such, China will be the only major economy to experience positive real GDP growth in 2020. With real GDP now almost back to where it might have been absent the crisis, China is back to normal. However, China faces downside risks such as rising debt, fraught trade relations with the US and Europe, and the continued threat of the virus.

*Source*: https://www.reuters.com/article/china-economy-gdp-idUSB9N2D4018

Global investors have recently taken an interest in Chinese assets. In October 2020 the value of the renminbi surged by the most in 15 years as interest in China gained ground. Possible reasons for the growing strength of the renminbi are the strength of the Chinese economy; the evident weakness of the US economy; and on the increasing expectation that Joe Biden would win the US presidential election. The latter is expected to mean lower US tariffs on China and a less confrontational economic relationship between the US and China and more US fiscal stimulus which, in turn, could boost US demand for Chinese exports.

China's economy declined significantly in Q1 2020 as the Chinese government implemented measures to suppress the spread of COVID-19. Now the economy is in recovery but according to a new study by the Peterson Institute the recovery has consequences. The consequence is the significant increase in non-financial debt, a growing volume of non-performing loans, and the survival of troubled companies (known as zombies) that threaten to undermine productivity growth and use resources that might otherwise go to more productive and innovative enterprises. Prior to COVID-19, underperforming companies were a problem but the necessity of protecting businesses during the pandemic has made the problem worse. During the pandemic, China's government provided small- and medium-sized businesses with tax cuts, subsidized loans, and loan forgiveness in order to prevent a catastrophic rise in unemployment. This was successful in that the unemployment rate remained relatively muted.

However, there has been a sharp rise in debt, with the ratio of non-financial corporate debt to GDP rising 0.11% in the first three months of the crisis alone. The result was a rise in reported non-performing loans (NPLs). It is widely understood that the true volume of NPLs is much larger than reported. In part due to the central bank ordering banks to allow borrowers to delay loan repayment. Also, the bank regulator has asked banks not to classify loans more than 90 days overdue as non-performing (true even before the pandemic). Consequently, banks might have insufficient loan-loss provisions. Absent transparent reporting, it is hard to know the extent of the problem. While 6% of all Chinese companies failed during the first half of 2020, many more have survived but are not necessarily sustainable. Thus, China's recovery masks serious obstacles to sustained economic growth.

*Source*: https://www.piie.com/blogs/china-economic-watch/china-recovers-pandemic-will-zombie-firms-return

2. United States and the Americas

A recent point of discussion among analysts recently has been whether or not the dominant role of the US dollar in the global economy will be lessened in the coming years. Among the factors that might reduce the use of the dollar are the increasing weaponization of the dollar by the US government, thereby encouraging China and/or the Eurozone to do more trading in their respective currencies; the vast increase in the US money supply which has already led to a sharp depreciation of the dollar; the rising external debt of the US, which is likely to necessitate a decline in the value of the dollar; and efforts by the Chinese and Eurozone governments to increase the size and liquidity of their sovereign debt markets. Meanwhile, there are plenty of reasons for the dollar to remain dominant. These include the vast relative size and liquidity of the market for US government debt; the relative transparency of US financial markets and financial regulation; investor confidence in the stability of the US economy; and concerns about stability elsewhere (such as the Eurozone with now central fiscal authority).

These reasons may explain investor's easier attitude towards Chinese finance. Investors are attracted to the relatively high yield on Chinese debt. In addition, China's evident success in quashing the coronavirus, thereby setting the stage for a relatively robust recovery unlike the US. What makes this important is that it potentially sets the stage for Chinese assets to play a bigger role in global finance. If that happens, it could ultimately lead to a bigger role for the renminbi in global trade and capital flows. China's central bank anticipates more foreign central banks and monetary authorities to hold renminbi assets as reserve assets. The use of a currency as a reserve asset is often a prerequisite for global dominance. That is, if the renminbi were widely used as a reserve currency, then traders and investors would feel more comfortable transacting in renminbi.

When a currency dominates global finance, the country can issue foreign debt in its own currency, avoiding exchange rate risk. It can run large external deficits without default and it can exact political concessions from others or impose costs on them – as the US has done. If the renminbi were to become dominant, China could boost living standards by running large external deficits and its geopolitical footprint would be much bigger. It would also mean that the US would lose some of its global standing as well as likely higher borrowing costs and/or a lower valued dollar causing higher import prices and a lower living standard.

*Source*: https://www.brookings.edu/articles/the-renminbi-rises-but-will-not-rival-the-dollar/

**Global Key Themes**

1. Under Joe Biden, will the US pivot back to Asia?
President-elect Biden is signaling that he will make significant changes to trade policy once in office. It will be clear after the two Georgia senate run-offs in January 2021 if Biden will be facing a Republican Senate, making his ability to pass domestic legislation will be somewhat limited. Thus, a focus on external issues, over which a president has more direct institutional power, would be expected. Still, Biden has lately said that his first priority will be to suppress the virus and support the domestic economy so significant changes to trade policy will take time. That being said, the likely path of trade policy in the coming year and even a pro-trade signal can boost sentiment and therefore economic conditions.

The main focus of trade policy will be the relationship between the US and the Asia-Pacific region, in particular China. During the Trump administration, the US has had a two-pronged approach to the region. First, the US has sought to punish China and limit its progress. This has entailed the US imposing tariffs on China and limiting trans-Pacific technology transfers. Second, the US substantially withdrew from engagements in the rest of the region. This has entailed withdrawing from the Trans-Pacific Partnership (TPP) and failing to participate at a high level in key regional economic and defense meetings. This has allowed China to begin to occupy the space left behind by the US. For example The Regional Comprehensive Economic Partnership (RCEP), a regional trade agreement in the Asia Pacific region, will soon be completed. It was conceived by China and is widely seen as part of China's larger effort to dominate trading relations in the region in the years ahead. Most economies in Asia/Asia-Pacific economies have joined RCEP except India. Its members account for roughly one third of global GDP.

Under the administration of President Obama, the TPP was meant to curtail Chinese dominance in Asia and to retain US influence in the region. One of President Trump's first acts was to withdraw the US from the planned TPP. Leading economies in the region, such as Japan and Canada, worried that, absent the TPP, China would come to dominate trading relations in the region. Consequently, they agreed to retain the TPP without the US, renaming it the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Trade has become substantially liberalized across the region and the US is not participating and US businesses are not benefitting.

Now, with Joe Biden about to enter the White House, there is uncertainty as to whether the US will return to the agreement it initiated. For much of his career, Biden was a strong supporter of freer trade and of improved economic relations with China. Biden said that the US will seek to work with other democratic nations to set trading rules, rather than allow China to dominate the process. Doing so would likely entail having the US rejoin the TPP, which had been the planned US-led alternative to the RCEP until the current administration withdrew from the TPP. Yet he will face resistance from many people within his party. Thus, it is not likely he will quickly rejoin.

If the US joins the CPTPP, there will then be two competing trade organizations in the region; one led by the US, the other led by China. RCEP does not substantially address many non-tariff issues that were addressed in the TPP. China has shown less interest in trade in services or in dealing with issues such as protection of intellectual property and government procurement. Also, India's decision to not join the RCEP diminishes the importance of the agreement given India's massive size. Thus, going forward there could be a tug of war between the influence of the RCEP and the CPTPP. Over time, the US will reduce tariffs on China and will seek an understanding with China on issues of concern. Thus, the US will, once again, implement a pivot to Asia, attempting to engage China while, at the same time, limiting China's geopolitical footprint.

Other trade policy initiatives could include restoring US participation in international organizations, including the World Trade Organization (WTO). For the duration of the Trump administration, the US refused to approve the appointment of new members of a dispute resolution body of the WTO. This had the effect of making the WTO powerless to adjudicate trade disputes, thereby leaving member states free to engage in protectionist actions with impunity. A return of active US membership will likely be quite impactful. For example, the US currently has in place tariffs on European aluminum and steel. These likely violate WTO rules. If WTO power is restored, it will likely mean pressure on the US to remove the tariffs. While Biden might not remove them immediately, he will have an excuse to do so in the longer term wishing to avoid "a dangerous slide toward protectionism."

*Source*: https://www2.deloitte.com/us/en/insights/economy/global-economic-outlook/weekly-update.html

2. Surveys

The latest Deloitte Survey of European CFO's (1,550 respondents) and the Oxford Economics Global Risk Survey (142 businesses from across the world) tell similar stories: although there are improvements in revenues and economic conditions, risks to future revenue and economic growth remain to the downside The fact remains in many countries, especially in Europe, the US and some Asian countries, new daily COVID-19 cases are higher than in the first wave is weighing on sentiment. Since the publication of the Deloitte survey, many European countries, have imposed new lockdowns. This will be particularly detrimental to the real estate assets, particularly retail, as well as the retailers themselves and also office real estate as the future state of demand for office space is still yet unknown. With non-essential workers, having to remain at home, factories and retail outlets will remain closed, or with significantly shorter working hours which will result in higher unemployment.

*Source*: https://www2.deloitte.com/global/en/pages/finance/articles/european-cfo-survey.html?id=gb:2bl:3bl:4ecfo20A:5awa:6fin:ik1

*Source*: https://resources.oxfordeconomics.com/hubfs/-Recovery-running-out-of-steam-.pdf

**Tax Update**

1. Australia

**Corporate tax residency definition to be amended**

The Australian government has accepted the recommendations of the Board of Taxation following its review and consultation into the corporate tax residency rules as they apply to foreign incorporated companies. The government stated that it will make technical amendments to the central management and control (CMAC) test to clarify that a non-Australian incorporated company will be treated as an Australian tax resident if it has a "sufficient economic connection to Australia."

*Source:* https://www.taxathand.com/article/15439/Australia/2020/Corporate-tax-residency-definition-to-be-amended

2. Japan

**Can Japan attract international financial firms and their high-earning executives?**

The Japanese government is considering implementing business and tax measures aimed at attracting foreign financial firms and their high-earning employees to boost Japan's standing as a global financial center. On 31 August 2020, Japan's Financial Service Agency (JFSA) released its annual policy guidance for the year, and among the goals is the desire to make Japan's financial and capital markets more sophisticated to enhance its role in Asia and the rest of the world.

*Source:* https://www.taxathand.com/article/15582/Japan/2020/Can-Japan-attract-international-financial-firms-and-their-high-earning-executives

3. United States

**New Jersey increases Millionaire Tax**

New Jersey's Governor Phil Murphy announced an increase in tax for millionaires in New Jersey's 2021 fiscal year Budget (FY2021). The revised FY2021 Budget raises the state's gross income tax from 8.97% to 10.75% for every dollar earned between USD 1 million and USD 5 million annually. Previously the 10.75% bracket was reserved for income earned above USD 5 million annually.

*Source*: United States - New Jersey Increases Millionaire Tax (02 Oct. 2020), News IBFD

**IRS to Relaunch its Non-Resident Rental Income Compliance Campaign**

The US Internal Revenue Service (IRS) Large Business and International Compliance Division (LB&I) has announced the launch of a compliance campaign addressing the US taxation of non-resident foreign individuals' rental income from US-based real property. The goal of the LB&I campaign is to improve return selection, identify issues representing a risk of non-compliance and make the greatest use of limited resources.

*Note*: Non-resident aliens are subject to a 30% US withholding tax on rental income from real property, unless an election is made to treat the income as effectively connected to a US trade or business under section 871(d) of the US Internal Revenue Code (IRC). IRC section 871(d) allows non-resident foreign individuals to elect to treat income from US real property as effectively connected to the conduct of a US trade or business and to offset their rental income with expenses related to the rental activity. US federal income tax is then paid on a net income basis at the progressive US income tax rates.

*Source*: United States - IRS to Relaunch its Non-Resident Rental Income Compliance Campaign (09 Oct. 2020), News IBFD

**US Treasury Issues Final Regulations on Certain Foreign Partnership Distributions**

The US Treasury Department (Treasury) finalized regulations on certain sales of partnership interests by foreign partners. Specifically, the final regulations detail withholding and information reporting requirements for foreign partners that recognize gain or loss from the disposition of an interest in a partnership that is engaged in a trade or business within the United States. The final regulations also affect partnerships that, directly or indirectly, have foreign persons as partners.

*Source*: United States - US Treasury Issues Final Regulations on Certain Foreign Partnership Dispositions (13 Oct. 2020), News IBFD

**A change in course: Tax policy implications of a Joe Biden presidency**

Joe Biden appears to be headed to the White House and will assume responsibility for US fiscal policy beginning in January of 2021. His tax agenda calls for, among other things, increasing rates on large corporations and upper-income individuals and limiting or eliminating some of the incentives currently available to these taxpayers. "A change in course", (7 November 2020 / PDF), published by Deloitte Tax LLP, looks at Biden's tax policy proposals, how they compare with current law, and how economic and political factors may influence what he can get enacted in the near term.

*Source:* https://www.taxathand.com/article/15629/United-States/2020/A-change-in-course-Tax-policy-implications-of-a-Joe-Biden-presidency

## Useful Resources

| Investing | Economic Data | Economic Analysis |
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| • investing.com | • United States: Bureau of Economic Analysis | • Deloitte Insights: Economics |
| • MarketWatch | • United States: Bureau of Labor Statistics | • Deloitte Weekly Global Economic Update |
| • Yahoo! Finance | • Cabinet Office of Japan | • International Monetary Fund |
| **Central Banks** | • European Commission: Eurostat | • Project Syndicate |
| • Federal Reserve Board | • United Kingdom: Office for National Statistics | • Organization of Economic Cooperation and Development |
| • Bank of Japan | • National Bureau of Statistics of China | • Central Intelligence Agency: The World Factbook |
| • European Central Bank | • Federal Reserve Economic Database | • Aon: Political Risk Heatmap |
| • Bank of England | **News** | |
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| • Deloitte Tohmatsu Japan Inbound Tax & Legal Newsletter | • United States Department of Treasury | • International Bureau of Fiscal Documentation (IBFD) |
| • Deloitte tax@hand | • Internal Revenue Service (IRS) | • Australian taxation Office (ATO) |
| | • Japan Financial Services Agency | • National Tax Agency (NTA) |

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To this end Family Consulting offers four services directly to families who own and manage business and family assets:

- Family governance;
- Contingency planning;
- Family successor training service;
- Family office services.

For more information, visit our website at: www.deloitte.com/jp/family-consulting-en

The Family Consulting team eliminates the question "I don't know who to ask..." by acting as the relationship manager of our clients, supporting the prosperity of their families through a unified contact point for inquiries, no matter how complicated the matter may be and to do this Family Consulting works closely with our colleagues across Deloitte Private domestically and globally to assist families and their businesses with:

- Income tax advisory and compliance services;
- Owner and family wealth planning;
- International tax and estate consulting;
- Family enterprise consulting;
- Succession Advisory Services
- Cross-border Succession and Reorganization Support
- Family Governance and Council Support for Owner Family

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