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Shifting US-Japan Geo-Politics, Banking Landscape and Financial Regulations in the Trump Era

(Summary of speech)

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Nomi Prins: President Trump has talked a lot about America First. Over the last 6 months, we have seen that America First means that the United States could also be excluded from the rest of the world's trade policy. For instance, Japan and the European Commission (EC) have recently agreed to an economic partnership agreement (EPA), which could be the largest trade agreement ever. This is an example of the United States being excluded from trade alliances. The new climate in the United States has created opportunities for other countries like Japan.

The shift toward America First and isolationism is not wholly because of President Trump. It is the result of a trend that started approximately 10 years ago. It has much to do with the lack of regulation in the US banking system.

Prior to 1999, the United States regulated banks under the Glass-Steagall Act. This Act required that banks separate their commercial banking operations from their trading, speculation, and securities businesses. That act was repealed in 1999, and the repeal has had a number of consequences.

For one thing, the repeal led to a series of corporate scandals in the United States just a few years later. It also led to the creation of the "Too Big to Fail" concept. It allowed Citigroup, JPMorgan Chase, and Bank of America to become conglomerate banks. It led each bank to increase the risks they hold, and it increased the interdependency of banks throughout the world.

That increased risk and interdependency eventually resulted in the global financial crisis. And yet banks still hold many of the same risky investments they had prior to the crisis, and are still interdependent.

Many in the United States have been talking about reintroducing the Glass-Steagall Act in order to mitigate that risk and interdependency. When President Trump ran for office, he discussed this. It was in the Republican platform as well.

However, since the election, two interesting things have happened. President Trump gave an interview in which he said he still needed to think about Glass-Steagall. Since then, he has not talked much about it. Meanwhile, Secretary of the Treasury Steven Mnuchin has said that President Trump does not intend to bring back the old Glass-Steagall Act, but is rather considering a "21st century Glass-Steagall" that would merely require banks to set aside money for emergencies related to risky investments rather than actually restructure.

I would like to talk more in detail about some of the risks that banks now face in order to highlight why the discussion about regulations like Glass-Steagall is so important.

One emerging risk today is corporate defaults. Thanks to quantitative easing, there is a lot of cheap money available in the market right now. According to S&P Global Ratings, as a result of all the cheap money, corporate debt is expected to climb from $51 trillion today to $75 trillion by 2020. At the same time, the global speculative-grade default rate is now 4.2 percent. This is the highest level since 2009, which was the worst year of the financial crisis. A total of 162 companies defaulted in 2016. This is the second time we have seen annual defaults above 100 since 2009. This has a large impact. When companies default, jobs suffer, research and development suffers, and the market suffers. It reduces confidence, which can catalyze a crisis.

Even with the level of risk we are seeing around corporate defaults today, central banks continue to buy assets, to the tune of $200 billion per month. Will this pace slow in the future? Many are now talking about whether the central banks will change their policies on quantitative easing. The Federal Reserve has been slowly raising interest rates. On the other hand, the Bank of Japan has announced that it will begin an ‘unlimited’ Japanese Government bond buying program.

One issue surrounding quantitative easing is that it is honestly very difficult to tell what the true effect of this policy is. There is no guarantee that when a central bank purchases bonds that it will result in more long-term hires or higher wages, for example. We cannot look at inflation or deflation to see how quantitative easing has impacted the market, because the money from quantitative easing doesn’t go to consumers. It goes to banks and financial speculators. We cannot be certain that any of the money has gone toward jobs or infrastructure. No regulatory requirement even attempted to guarantee that.

That said, there are some who feel that quantitative easing has been successful in revitalizing our economies. In June, Fed Chair Janet Yellen said in a speech, “Would I say there will never, ever be another financial crisis? You know probably that would be going too far, but I do think we are much safer, and I hope that it will not be in our lifetimes and I don’t believe it will be.”
This remark echoes a similar comment made by former Fed Chair Ben Bernanke in 2007 just before the financial crisis. Partly because of that, it is really difficult to accept what she is saying. For instance, the Federal Reserve subjected a number of banks to stress tests this year, and 34 banks passed. However, those tests don’t look at massive

corporate defaults. They don’t look at interdependency. There are risks they don’t consider.

The risks faced by banks in the United States today are greater than even before the financial crisis. The amount of assets that the big six banks hold is about 70% to 80% larger than it was prior to 2008. The amount of deposits they hold is about 40% higher. For these reasons, I think we need to be really careful about the rate at which defaults are increasing, how stocks are supported by share buybacks, and other risks fed by artificial, or conjured money.

Central banks around the world are now pursuing a coordinated zero percent money policy and increasing their assets. The big three central banks in the United States, Europe and Japan now hold assets equivalent to about 17% of global GDP. If this money was liquidated into the real economy instead, it would have a huge positive impact.

In recent years, central banks have used quantitative easing to inject more liquidity ostensibly into the economy. However, as I mentioned, that liquidity hasn’t necessarily reached the real economy. Quantitative easing has failed to produce real sustainable growth. There have been very low increases in wages throughout the world. For many people, even though their country’s economy may be considered stable by generic measures mostly touted by central banks and governments, their personal economies are instable.

One outcome of that is that people are starting to question the ability of their governments to understand the economy. When that happens, people tend to vote out whoever is in power. This is one of the things that I think contributed to Trump’s victory in the United States. In turn, the economic situation globally has affected political decisions domestically, and those decisions are affecting our international alliances.

The shift in our policies toward international alliances might again have an impact on the global economy. It’s a circle. President Trump seems to be shying away from multilateral agreements and toward more isolationist ideas. The last time the United States did that was in the 1920s. In fact, isolationist policies were one of the reasons there was such a speculative mood in the United States in the 1920s, and that speculation led to the financial crash of 1929.

It looks like, for the time being, the United States will continue to act in a more isolationist manner. That is good and bad. It is bad from the standpoint of general global connectedness. It is good for other countries, including Japan. It gives other countries the opportunity to take on a stronger role in the international community. Japan is already moving to do that, as we can see with the Japan-EU EPA.

Ever since President Trump came into office, alliances excluding the United States have been completed much more rapidly. These alliances were already being planned and executed before he came into office, mostly since the financial crisis to be sure and apprehension about the current dollar-based monetary system, but he seems to have accelerated them. This is happening all over the world. China is getting involved in more alliances. Japan is as well.

I was in Mexico a couple of weeks ago and I spoke with people there about the North American Free Trade Agreement (NAFTA) and trade alliances. Since President Trump has come into power, he has been talking about how to get Mexico to pay for the wall he wants to build between the United States and Mexico. He has also made a number of negative comments about Mexico and about NAFTA. Furthermore, President Trump has also pulled out of the Trans-Pacific Partnership (TPP). Prime Minister Abe seems to be trying to save the TPP. He will not be able to move forward with the United States, but with all that has happened, we now have countries like Mexico that are looking at the situation with the United States and actively wanting the TPP to continue without the United States. Japan could thus, take a larger leadership role regarding the TPP..

With President Trump continuing to push his wall idea, US-Mexico relations are deteriorating. This presents a very good opportunity for China to develop its alliance with Mexico. When I spoke in Mexico, a trade delegation from China was there at the same time. These sorts of things are already happening more frequently. There has been movement on the part of other countries to create alliances outside of the partnerships with the United States ever since the financial crisis. With the election of President Trump, these movements are only accelerating.

The Japan-EU EPA is a major agreement that has impacted that movement. Japan is a part of the shift that we are seeing as power in the international community moves slightly away from the United States. To a large extent, Japan can greatly influence how this shift plays out. Japan is already also involved in a number of other large trade deals, such as the TPP or the Regional Comprehensive Economic Partnership (RCEP). These deals could create a large amount of trade, and Japan is playing a leadership role in their negotiations. These deals are being worked out in opposition to US policies. Unless US policies change soon, they will move forward.

And as the rest of the world moves forward with its own deals, the situation in the United States today is one in which the financial crisis and the concept of “Too Big to Fail” has led many to question whether we don’t need more regulation in the banking sector to avoid another crisis. However, many of the senior people in the Trump administration seem to be not very interested in bringing back something like the Glass-Steagall Act, so not enough is happening. There is action taking place around military spending. Although the new budget hasn’t passed yet, the draft does include a large boost for the military. We have a lot of people now working in Congress to figure out how the new budget will work, whether they can cut corporate taxes, or cut social spending, and so on.

The latest draft budget will increase defense spending by approximately $53 billion. It earmarks an extra $2.8 billion for spending on homeland security. To make that budget balanced, President Trump is cutting from social insurance programs and institutions related to international alliances. President Trump’s isolationist tendencies are not supported just by the things he says; if the budget is passed, that isolationism will be carried out through budget cuts.

Meanwhile, he is doing no meaningful work on his campaign promise to bring back the Glass-Steagall Act. In fact, there is movement in his ranks toward further deregulation. A recent bill passed in the House of Representatives, dubbed “The Financial Choice Act” called for the loosening of banking regulations. If this new legislation is passed, it will likely just require that banks hold onto more money for emergencies, in reserves, rather than actually separate deposits and lending activities from speculative ones.

I think the lesson here is that there is a lot of inconsistency in what President Trump has said and what his administration is doing, and I think that people around the world understand this and that it is catalyzing the shifts in power and new economic alliances that we are seeing globally. The Trump presidency is accelerating the movement of world currencies away from the United States dollar.

Alongside all of that is the problem of whether or not the markets are sustainable at their current level. They are not. There is a lot of risk in the economy right now. There seems to be a large disconnect between how people in the financial sector feel about the economy and how the normal people outside of the financial sector feel about it. There is a disconnect between what is happening in elections and what is happening with our economic policies.

A lot of people have asked me if all of this will somehow lead to the impeachment of President Trump. I don’t think so. Each time there is a scandal it creates a lot of news and confusion in the world, but nevertheless, we have a Republican Congress in the United States. At the state level as well, many state legislatures are controlled by Republicans. Even with the recent coverage around the Trump presidency, we aren’t seeing a shift yet away from the Republicans.

I think that President Trump will continue to be in office for the remainder of his term, heath permitting. He might not make it back for a second term though. In the meantime, regardless of what the executive branch does, right now, we are seeing more and more people at the congressional level and lower that are working to create better regulations and more stability, and I think and hope we will continue to see that happen.