

A New Chapter: US-Japan Nomi Prins



The Canon Institute for Global Studies

Shifting Power Alliances, Central Bank Collusion and the Trump Era

Geo-Politics and Economics in the Trump Era

- ▶ President Trump's Washington:
 - ▶ America First or Last?
 - ▶ From multilateral to bilateral trade agreements.
 - ▶ Leaves TPP – Jan. 23, Paris Climate Accord – June 2.
 - ▶ NAFTA vs. “Wall” – Trump vs. Mexican President Pena Nieto at G20
- ▶ Ongoing power shift from West to East, from Developed to Developing Geo-political Alliances.
- ▶ Japan in the crossroads of change.
- ▶ U.S banking, regulatory and financial landscape impact.
- ▶ Central Bank Collusion and QE Policy: G7 vs rest of G20.

Low Growth Despite QE / Average G7 Interest Rates at Zero Percent

Japan

- ▶ **GDP growth forecast up 1.4% in 2017**
- ▶ **Stronger trade based on pan-Asian activity / fiscal stimulus.**
- ▶ **BOJ Governor Kuroda continues QE.**
- ▶ **BOJ holds 500 (\$4.5) trillion yen of assets (amount = 93% of GDP.)**

USA

- ▶ **IMF cut US GDP forecast to 2.1% in 2017 from 2.3% in April**
- ▶ **Further interest rate hikes? (up 1% from Dec. 2015)**
- ▶ **Trump Administration to cut corporate taxes/regulations**
- ▶ **FED holds \$4.5 trillion of assets (amount = 23% of GDP.)**

Financial Factors to Consider for Japan

- ▶ **OECD: “Only a small improvement is in prospect for 2018, taking global GDP growth to 3.6%” (Most growth in non-G7)**
- ▶ **Economic shift to infrastructure vs. speculation capital use?**
- ▶ **Global threat from China’s financial system: Estimated \$9 trillion in shadow banking “assets.”**
- ▶ **According to the Bank for International Settlements assets denominated in dollars on the books of Japanese banks surged \$3.5 trillion by the end of 2016.**
- ▶ **Risk of *Too Big To Fail* banks in US greater than in 2008, despite recent passing of Federal Reserve Stress Tests.**
- ▶ **US bank share buybacks – another form of QE? (taking place of plateauing corporate buybacks).**

Danger of Corporate Defaults in 2017

- ▶ **By 2020, business debt likely will climb to \$75 trillion from its current \$51 trillion level, according to S&P Global Ratings**
- ▶ **At the end of December 2016, the global speculative-grade default rate rose to 4.2% (highest level since 2009)**
- ▶ **Corporate defaults up to 162 for 2016 -- second consecutive year since 2009 with >100 defaults. Defaulted issuers accounted for \$239.8 billion in debt (double the \$110.3 billion total for 2015)**
- ▶ **US accounted for the majority of defaults globally in 2016 at 64.8%**
- ▶ **Globally, Central Banks continue to subsidize banks and markets; acquiring \$1.5 trillion in assets through first five months of 2017.**
- ▶ **Asset bubbles everywhere.**

To QE or Not to QE, That is the Central Bank Question

► Bank of Japan Governor Haruhiko Kuroda June 21, 2017:

"Our economy is on firmer footing, but we are still distant from our 2 percent inflation target... It is appropriate to keep monetary conditions easy with our current market operations framework."

Began "Unlimited" 10 year JGB buying program on July 6 and increased 5-10 year JGB purchases by 50 billion yen.

► ECB President, Mario Draghi at the ECB Forum June 27, 2017:

"All the signs now point to a strengthening and broadening recovery in the euro area. Deflationary forces have been replaced by reflationary ones."

Central Banks, Crisis and Judgment

Janet Yellen, British Academy
in London, June 28 2017:

“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.”



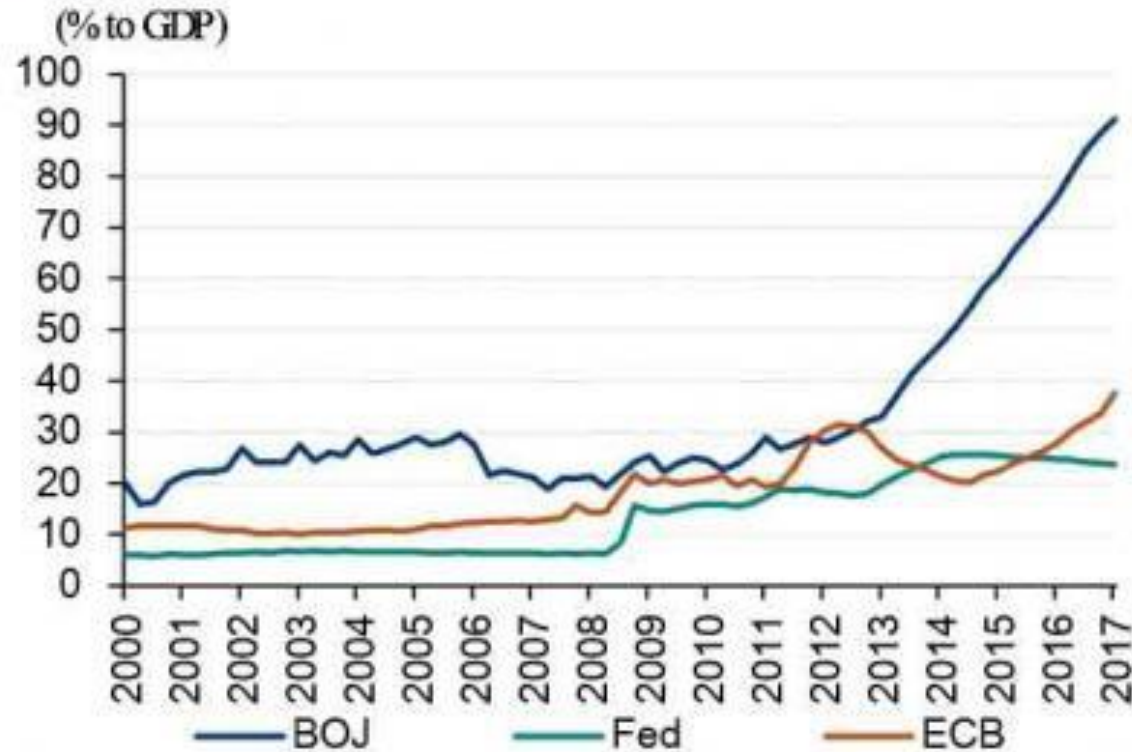
Reuters/Hannah McKay

Ben Bernanke, Federal
Reserve Bank of Chicago,
May 17, 2007:

“All that said, given the
fundamental factors in place
that should support the demand
for housing, we believe the
effect of the troubles in the
subprime sector on the broader
housing market will likely be
limited, **and we do not expect
significant spillovers from
the subprime market to the
rest of the economy or to the
financial system.**”

G3 Central Banks Divergent Assets vs. GDP since 2013

Chart 1: Central banks' total asset to GDP ratio (BoJ, Fed and ECB)



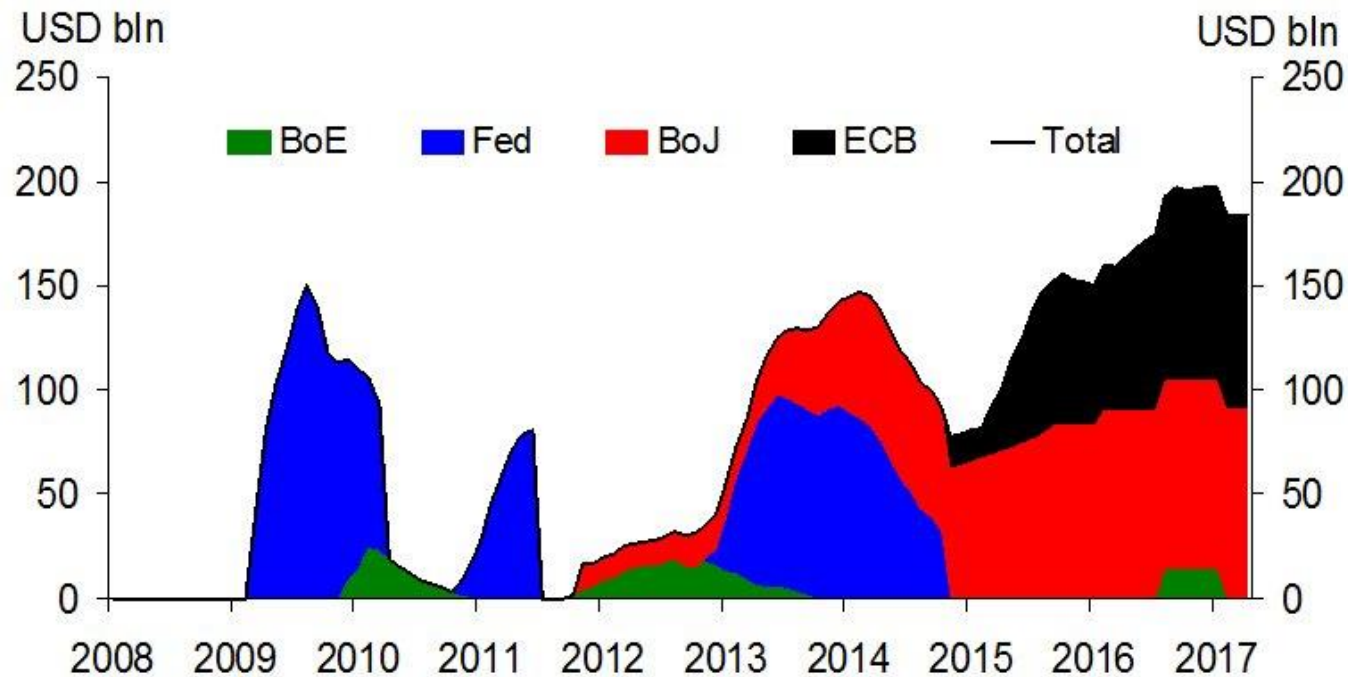
Source: Haver, Bloomberg, BofA Merrill Lynch Global Research

G3 Central Bank QE: “Conjuring Money”

Still plenty of liquidity being added to markets:
ECB, BoJ, and BoE buying a combined \$200bn every month



Monthly Fed, ECB, BoE, and BoJ asset purchases



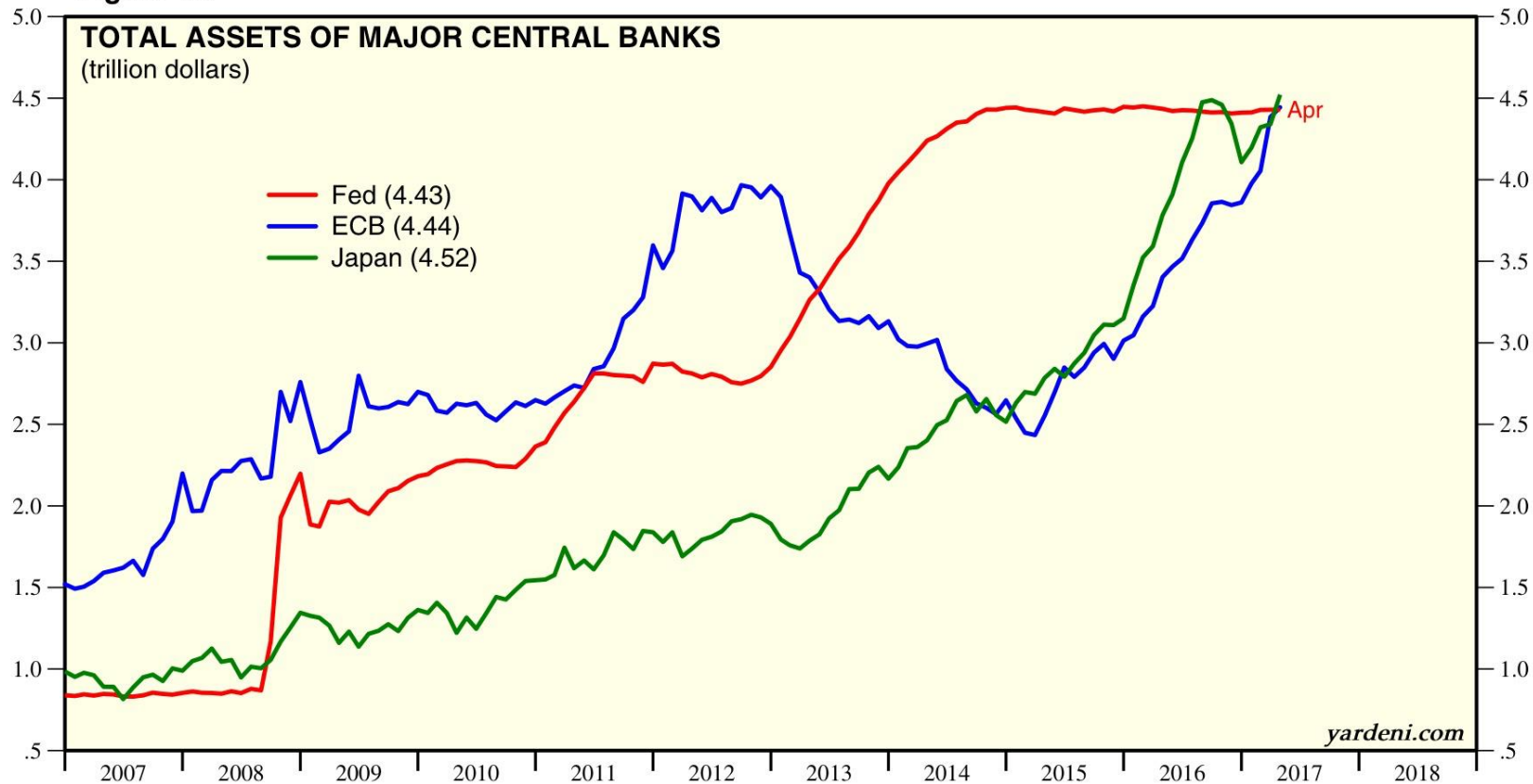
Note: 12m moving average.

Source : DB Global Markets Research

\$13.3 Trillion Total in QE, by Q1 2017: USA, Europe, Japan

Total Assets of Major Central Banks

Figure 10.

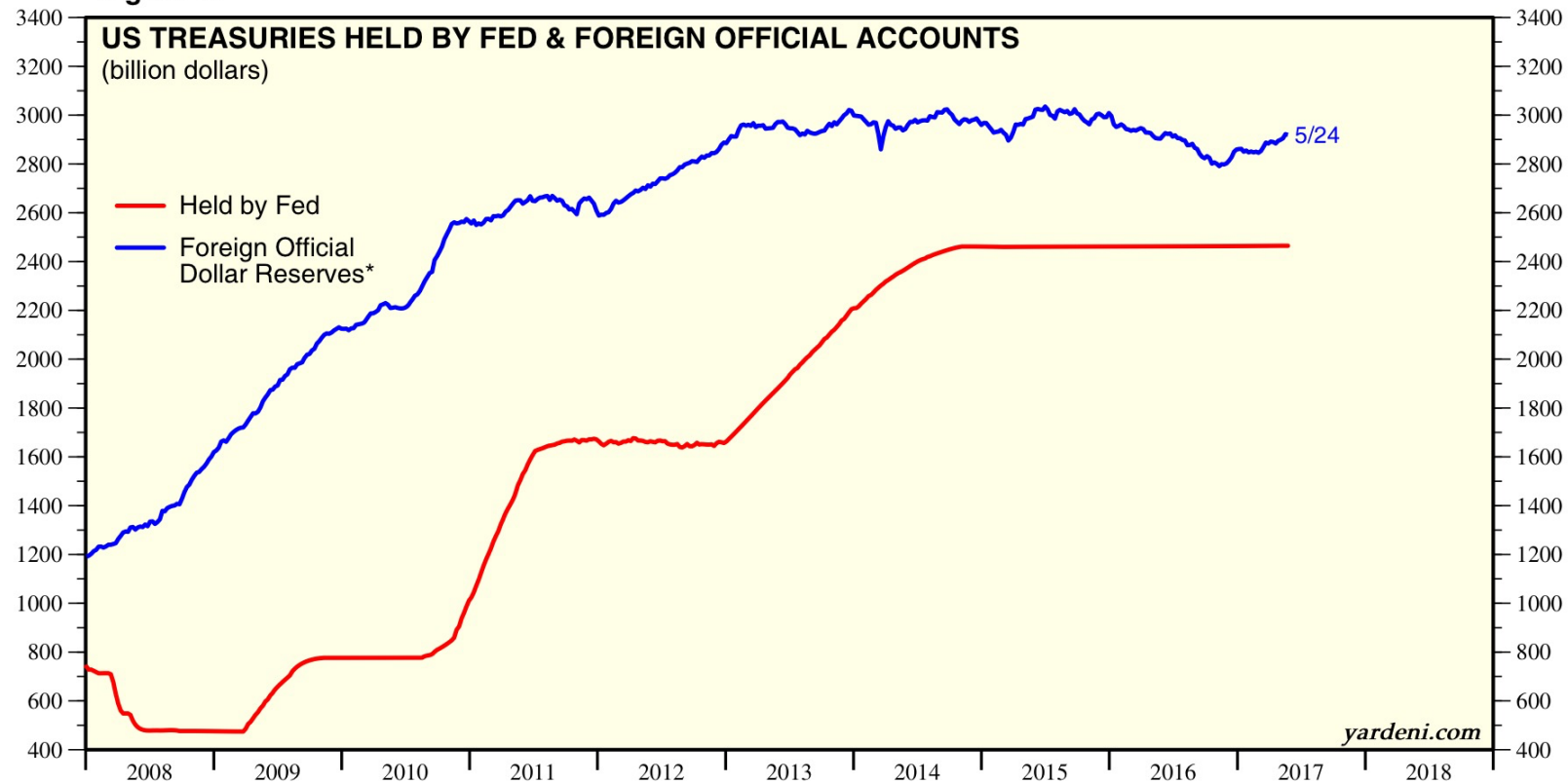


Source: Haver Analytics.

FED QE : US Treasuries

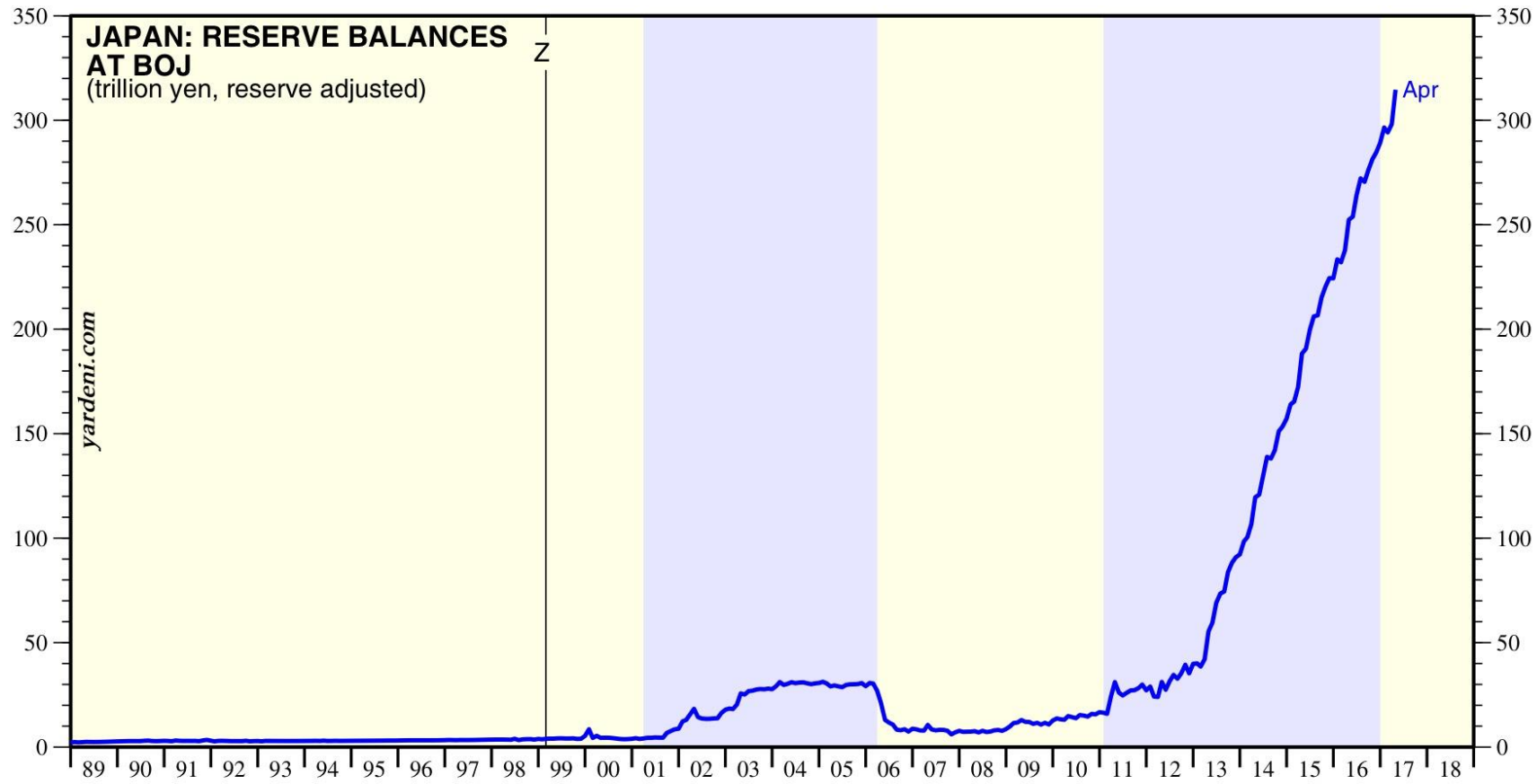
US Treasuries & Agencies Held by Central Banks

Figure 8.



* Held by foreign official institutions at the Fed. Average of week ending Wednesday.
Source: Federal Reserve Board, Table H.4.1.

BOJ QE: Japanese Government Bonds



Z = Zero Interest Rate Policy.

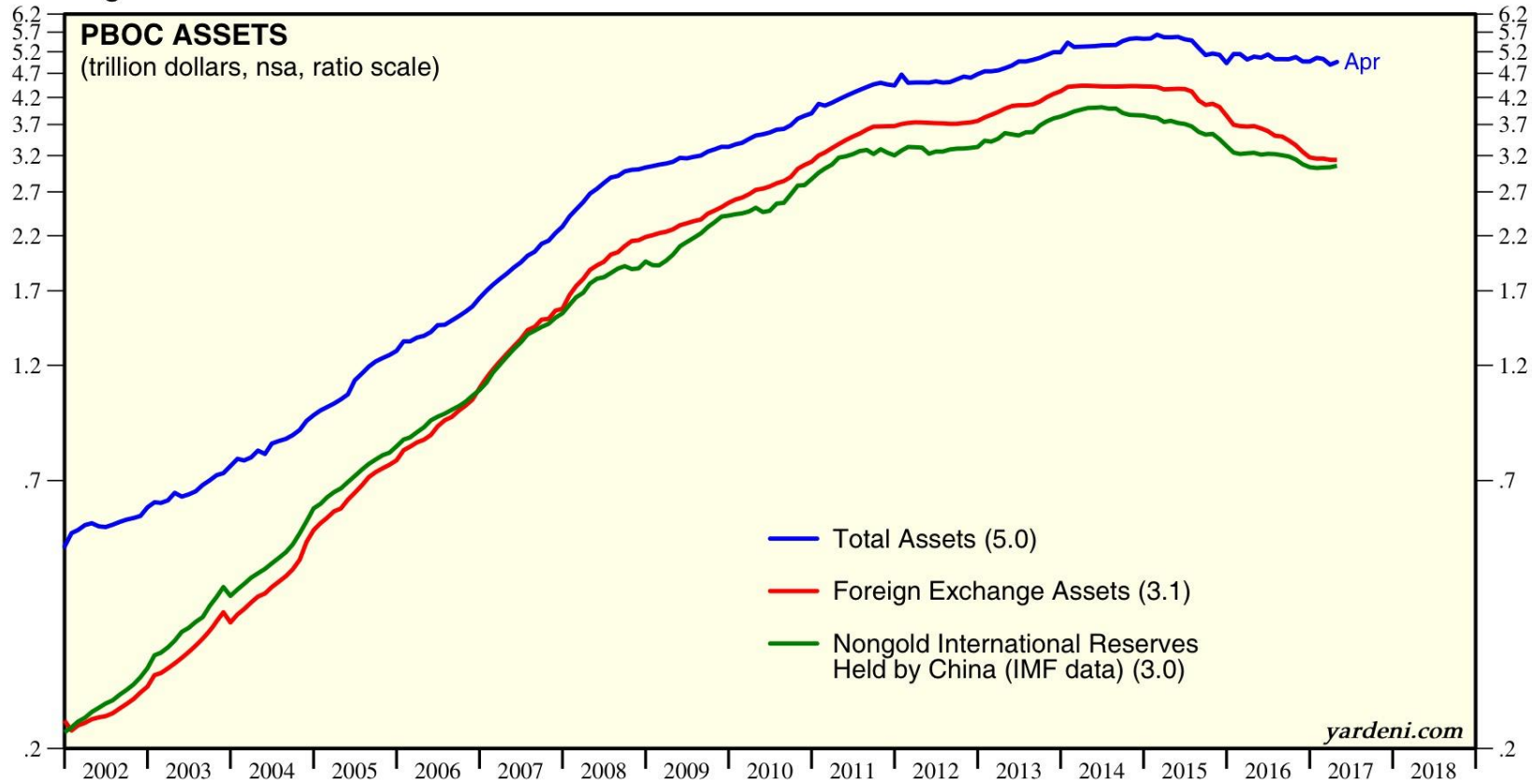
Note: Blue shade is Quantitative Easing Policy.

Source: Bank of Japan.

PBOC QE: China

PBOC

Figure 6.



Source: People's Bank of China and IMF.

Relationship Shift: USA - Japan

- ▶ Obama Era (State to State).
- ▶ Trump Era (Personal Relationships, Single “Deal” Focus).
- ▶ PM Abe official US visits in November 2016, February 2017.
- ▶ G20 Meeting: Japan + US bilateral ? ==> Japan + EU FTA/EPA
- ▶ Potential Trump visit to Japan November, 2017?



Evolving Alliances – Trump Era

- ▶ Japan + EU
- ▶ Germany + China
- ▶ Russia + China
- ▶ Mexico + China
- ▶ Japan + India
- ▶ Japan + South East Asia
- ▶ Japan + China + South Korea



Trade Agreements Impacting Japan

▶ **Trans Pacific Partnership (TPP)**

Signed Feb. 2016 (US OUT) → Regional Opportunity for Mexico/Japan / Asia post US exit

▶ **Regional Comprehensive Economic Partnership (RCEP)**

Drafted Nov. 2012, Expected Finalization in 2017 → Regional Opportunity for East

▶ **Pacific Alliance** Established June 2012 → Regional Opportunity for Asia in Latin America

▶ **Association of Southeast Asian Nations (ASEAN)** Established Dec. 2008 → Expanded Opportunity for Japan and non-SE Asian States

▶ **European Union –Japan Free Trade Agreement** 4 Years of Talks → EU + Japan > one-third of Global GDP, will be about same size as NAFTA (Japan is EU's second largest trade partner after China)

Trade Agreements Impacting Japan

- ▶ EU-Japan FTA / EPA, Signed at G20, Hamburg
- ▶ Japan PM Shinzo Abe:
 - ▶ “The birth of the world’s largest free advanced industrialized economic zone.”
 - ▶ “Japan and the European Union will hoist the flag of free trade high amidst protectionist trends.”
- ▶ Jean-Claude Juncker, president of the European Commission: “shows that closing ourselves off from the world is not good for business, nor for the global economy, nor for workers. As far as we are concerned, there is no protection in protectionism.”

Trump Doctrine Outlook

- ▶ Increase Defense Spending / Cut Corporate Tax and Social Insurance.
- ▶ Loosen Banking / Financial Regulations: US Banks Passed Stress Tests.
- ▶ Ongoing Monetary Policy fueling Speculation.
- ▶ Bi-Lateral vs. Multi-Lateral Trade Agreements.
- ▶ Emphasis on “Deal Specific” Agreements (High Speed Railway with Japan).
- ▶ Further Instigating Power Shift from West to East.
- ▶ U.K, Germany, France, Australia, Mexico, Canada: Old Alliances Reconsidered?
- ▶ Latin America, Africa, Caribbean. Pivotal Diplomatic Regions Ignored?
- ▶ Inconsistencies: Message, Tone, Diplomacy and Reliability.

Pivotal Issues: Japan, China, USA

- ▶ Asian Leadership: From Regional to Global Influencers
- ▶ Infrastructure Development vs. Military Spending
- ▶ Asset Bubbles, Shifting QE, Growing Bank and Systemic Risk.
- ▶ Central Bank Leadership or Strategy Changes?
Kuroda April, 2018? Yellen February, 2018?
- ▶ Chinese Elections: October's National People's Congress in China
- ▶ U.S Recession?
- ▶ Global Corporate Credit Crisis?
- ▶ Trump Scandal?