A New Chapter: US-Japan

Nomi Prins

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.
- 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.
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 reflationalory 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.”

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.”

Reuters/Hannah McKay
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

Source: DB Global Markets Research
$13.3 Trillion Total in QE, by Q1 2017: USA, Europe, Japan

Total Assets of Major Central Banks
FED QE : US Treasuries

US Treasuries & Agencies Held by Central Banks

Source: Federal Reserve Board, Table H.4.1.
BOJ QE: Japanese Government Bonds

JAPAN: RESERVE BALANCES AT BOJ
(trillion yen, reserve adjusted)

Z = Zero Interest Rate Policy.
Note: Blue shade is Quantitative Easing Policy.
Source: Bank of Japan.
PBOC QE: China
Relationship Shift: USA - Japan

- Obama Era (State to State).
- Trump Era (Personal Relationships, Single “Deal” Focus).
- 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.
- 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.
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?