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Jean-Claude TRICHET

Now I will take Akinari. You have the floor.

Akinari HORII

Thank you, Monsieur le Président. I would like to discuss three things, spending one minute on each. One is prospects for global economic growth, the second is inflation and deflation, and the third is financial systems. Regarding the first one, growth prospects, economists on average are very gloomy about the global economic growth next year. However, I am somewhat more optimistic, because at the moment, there are three main elements which put downward pressures on the economic growth of the world.

One is US-China trade disputes. They are not only reducing trade volume between the US and China but also putting a damper on business investment here and there. China and its trading partners have elevated uncertainty over business prospects. However, regarding what was agreed by the US and China yesterday or two days ago, the US and China will strike a deal. I would not call it a permanent peace treaty or anything. It is a temporary truce, but I am pretty sure Mr. Trump understands the implications of these issues for economic growth in the US, and there will be the presidential election. This element will ease in my view. I might be too optimistic, but this is the first element.

The second element is a rapid slowdown in China's economic growth, which is attributable in my view to deleveraging there. Due to huge debt accumulated there, the Chinese authorities are smart enough to curb that trend. This is a good thing for the sustainability of China's economic growth long term, but it puts a damper on it in the short term. Again, the Chinese authorities seem a little concerned about excessive downward pressure, so in recent months monetary policy has been eased. State controls on state-owned enterprises have been eased, too. These two negative elements will tend to become a little bit weaker.

The third element is most important for cyclical developments. Manufacturing in the world economy is in large part influenced by the so-called silicon cycle. The production of IT goods and machines is governed by cyclical forces of inventory stocking and destocking. These cycles typically consist of two years up and two years down. The most recent expansionary phase began in early 2016 and peaked in early 2018. If the two-year rule continues to hold good, then it will be early 2020 or around the turn of the year, when the cycle hits the bottom and begins to recover.

This is a good element. If 5G and IoT development accelerates, then the economic bottom will come sooner and the ensuing recovery will gain momentum. This concerns economic growth prospects. Regarding low inflation, I did discuss this issue two years ago. Painful memories of GFCs still rankle in the minds of businessmen and workers. Despite good economic performance during the past few years, workers still have some sense of job insecurity. Corporate businessmen are feeling that some sort of liquidity shortage might break out anytime. I also discussed how global competition put a downward pressure on prices, as did the IT/AI revolution.

As I did discuss two years ago, this momentum is not being lost, but it is slowing down. China's influence in global deflation is coming to an end in my view, because of high wage increases in China. Also, the US-China disputes will perhaps limit the Chinese influence of prices on the US and elsewhere. Regarding the IT revolution, this is the sort of thing that depends on regulations. One footnote to this is that inflation historically flared up when inflation psychology picked up. It is very difficult to analyze the psychology of people, but in this regard, the 2020 presidential election may change the whole dynamics. This is so if the election ends with a progressive president. We are all familiar with how radically US politics changed in the past, from Jimmy Carter to Reagan and that sort of thing.

If the 2020 US presidential election proves to be that way, then the new president will formulate left-wing policies, including universal health insurance coverage. This is a good thing for American people, but it may change the psychology of American people. To be more specific, the psyche may become more inflation prone, like an episode in the mid-1960s, when the Johnson administration advocated a guns-and butter-policy of introducing Medicare and Medicaid in 1965. This led to a spike in the prices of medical products, triggering inflation psychology then. That is about inflation.

Regarding financial systems, this is the greatest concern of mine. To be specific, a huge debt has been accumulated in the global market, carrying negative interest rate, including Japanese JGBs and European debts. Negative rates are not just short-term papers but long-term government bonds and mid-term corporate bonds. Negative interest rates are counterintuitive to me, although macroeconomists attribute them to deflationary expectations. Are they serious?

I know no survey that supports the negative inflation expectations over 10 years or longer. In addition, you have to bear in mind that holding fixed-income assets carries risks, not only of inflation and deflation but also many others. These include price volatility that is unrelated to inflation. Debtors may default, and liquidity premiums should be paid there. Also, holders may die before maturity. Negative interest rates or negative yields defy these risks in my view.

Investors simply hold long-term debts carrying negative interest rates for arbitrage gain. They hope to earn long before maturity, wishing that they could escape scot free from possible spikes interest rates. Such decision making, based on a beauty contest, creates a bubble. If it bursts, then a number of institutional investors will go under. They may entail a systemic run on the asset-management industry.

This is because once investors run on bond sales, some asset managers will face a shortage of liquidity in bond markets, which makes it difficult for them to execute the sale orders. This results in a cash shortage. Remember, some or more than a few asset-management companies hold assets under management for trillions of dollars. It is a difficult problem. Viewed from a different angle, I had discussed this two years ago, too.

Jean-Claude TRICHET

Akinari, may I ask you this? Am I right or wrong when I say this? One, on global growth, you are relatively optimistic, a little bit more optimistic than the mainstream.

Akinari HORII

Indeed.

Jean-Claude TRICHET

Second, on getting out of the very low inflation regime, you are reasonably optimistic. The bet is that the new president in the US will change things a little bit, turn the tables if I may say so. However, taking all this into account, you see the situation as very different from the very low inflation that we have today, which is driving the central banks to be incredibly accommodating.

Akinari HORII

This is what I meant.

Jean-Claude TRICHET

It is what I understand from the second message. Paradoxically, on the third message, you are very pessimistic, as are a number of us, and you see a dramatic crisis looming.

Akinari HORII

This is what I am getting at. Regarding recent low Japanese interest rates, negative interest rates, who are the main investors? They are dollar-based investors, particularly American investors, buying JGBs at negative interest rates. Why? It is because of a big spread between LIBOR and OIS. There is a liquidity shortage in the market. Why is that? It is because major banks are reluctant to do market making activities.

This is because they fear that doing arbitrage on LIBOR and OIS, they have to expand their balance sheets, which requires huge capital and huge liquidity. As I said two years ago, Basel III and Dodd-Frank require too much of this kind of thing. Therefore, LIBOR spread is wide there. From the viewpoint of American investors, on a swap basis, buying JGBs will give them profits over US Treasury holdings. That is why and that is part of the reason that American investors buy JGBs with negative interest rates.

Jean-Claude TRICHET

I take your point, Akinari. It is very interesting, the element of speculation that you have in your market. We have a lot of American citizens here and we would very much like to hear their own sentiment about what is going on in the JGB market. It is very stimulating, but could you conclude now?

Akinari HORII

Yes. Regarding these kinds of distorted regulations, on the one hand there are tight regulations on banks and much fewer regulations on shadow banks, including asset-management companies. These make imbalances that are already there even worse. Since short-sighted speculations are so widespread, it would unwind someday, and possibly create a fiasco in the system. That is my major concern.

Jean-Claude TRICHET

What you said is very important. I am afraid we will find other pockets in the world, pockets of finance and pockets of markets, where we have also speculative behavior, abnormal behavior and bubbles. However, yours is gigantic and very impressive.

Akinari HORII

Behind this, too much emphasis is given by the central banks to anti-deflation policy.

Jean-Claude TRICHET

The central banks are the only game in town now in many countries, including Japan. It is very abnormal, a very abnormal situation, and we will discuss it.