OUTSIDERS AND THE WORLD OF FINANCE

MAY 2017

FAUZI ICHSAN

GLOBAL FINANCE SINCE 2008 FINANCIAL CRISIS:
“STRICTLY REGULATED, SEDATED OR BOTH?”

GLOBAL FINANCE FROM A REGULATOR'S ANGLE: POLITICAL PENDULUM HAS SWUNG TO MORE REGULATIONS

- Global financial crisis in 2008 was triggered by US sub-prime crisis, following a decade of loosening regulations for US banks

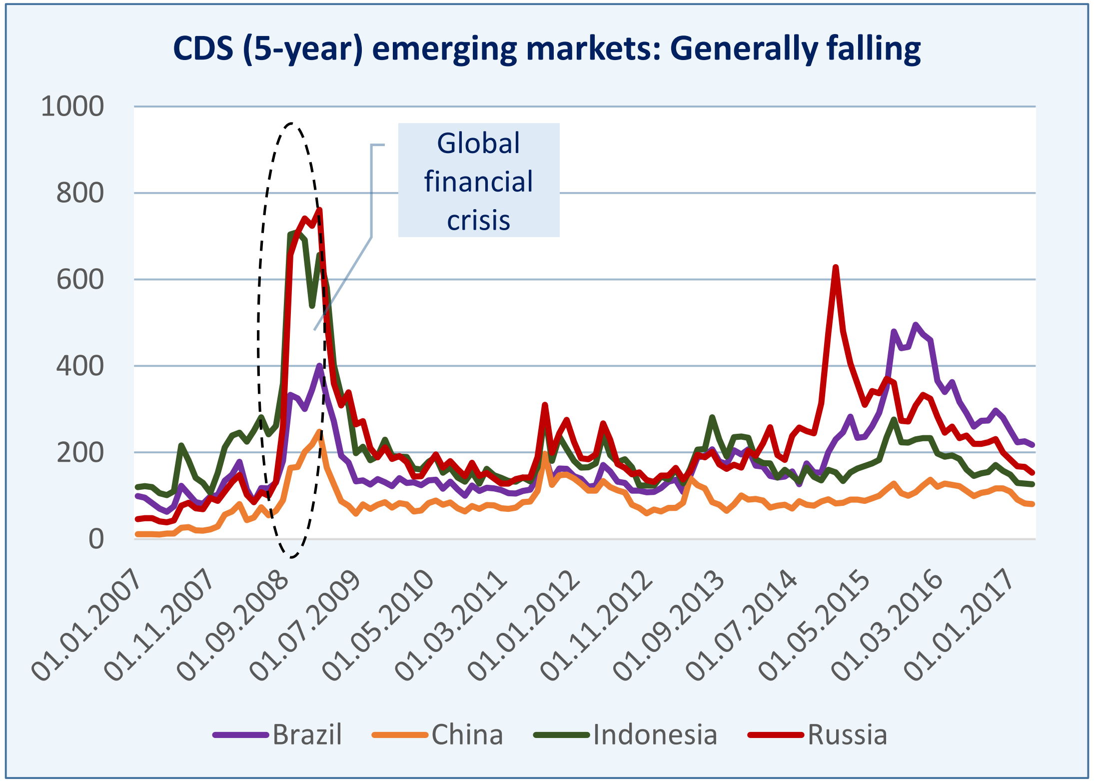
- Global policy makers and financial regulators reacted to the crisis by:
  - Cutting interest rates sharply (to near zero) and injecting liquidity into markets;
  - Bailing out technically bankrupt systemically important banks; and
  - Introduced strict regulations to limit banks' risk-taking abilities

- But these are not permanent solutions
  - Near zero interest rates and expansionary monetary policy have created global asset inflation – as the real economy was not recovering fast enough to utilize freshly injected liquidity
  - Banks complained that strict regulations limit credit growth and investors' appetite to invest in banks – thereby limiting banks' contribution to the real economy

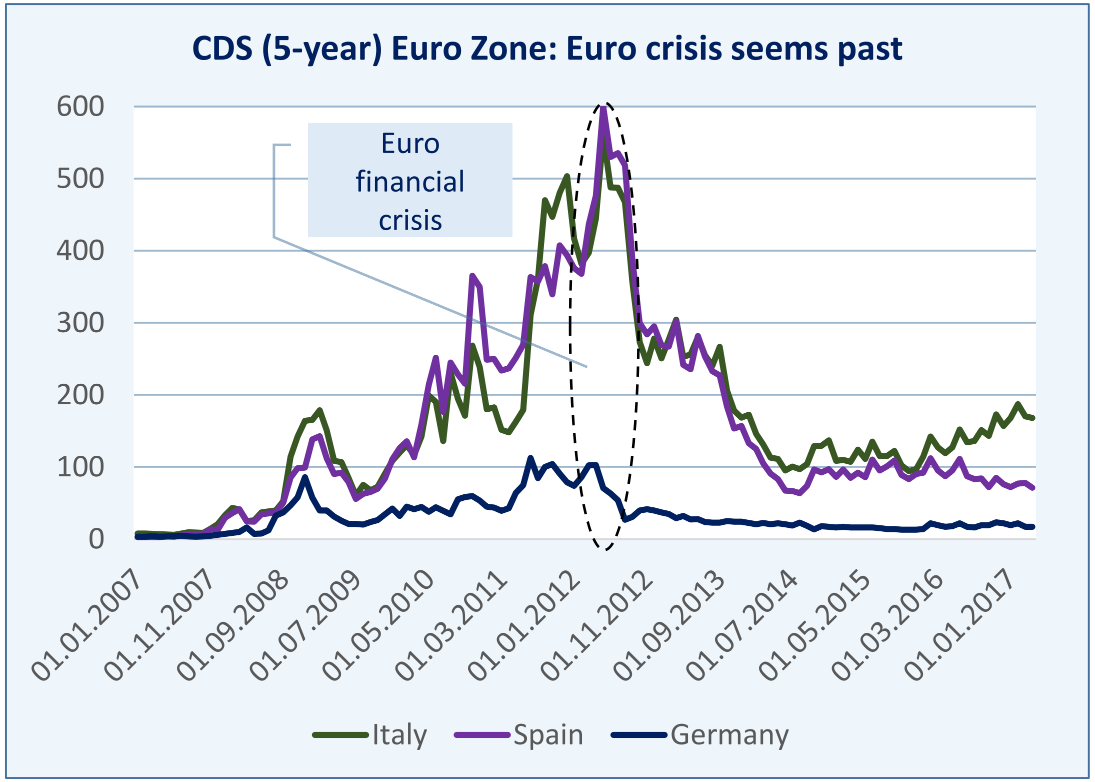
- Policy and regulatory changes are therefore possible (with the election of "outsiders" to powers)

RISK OF GLOBAL FINANCIAL CRISIS: FALLING FOR THE TIME BEING

Credit default swaps (CDS) in emerging markets have stabilized (with exception of specific countries)



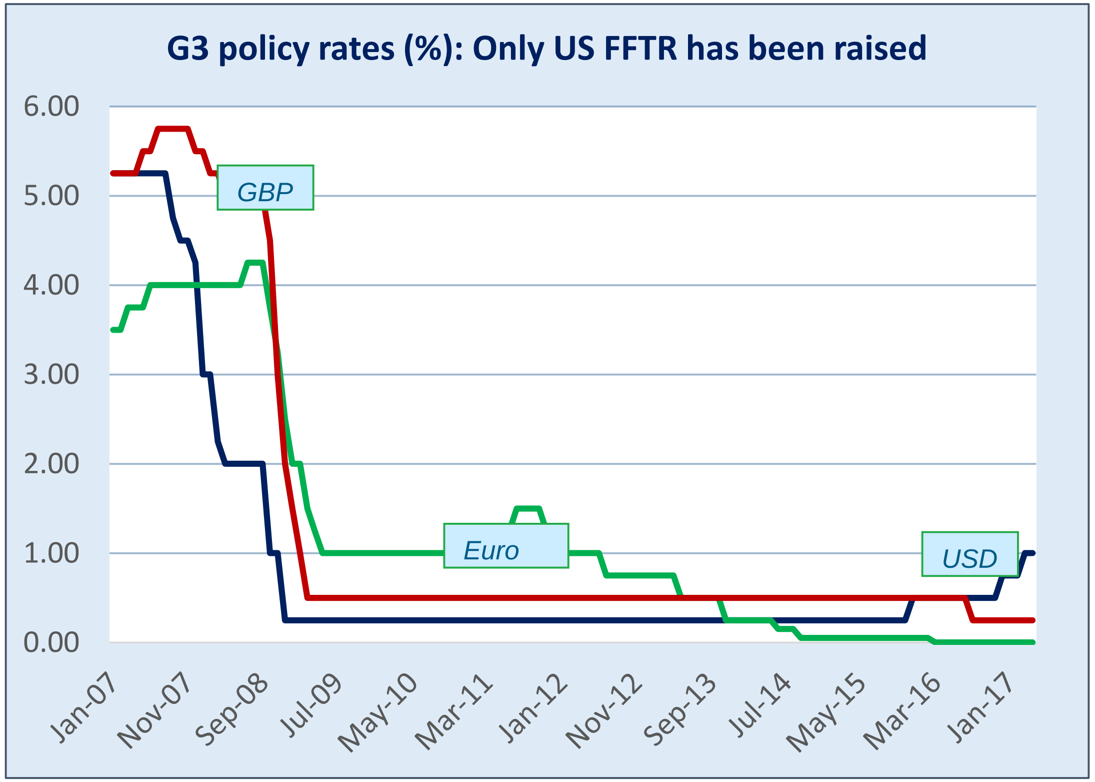
CDS in Euro Zone have not been affected by the Greek crisis, though public debts in some Euro countries bloating



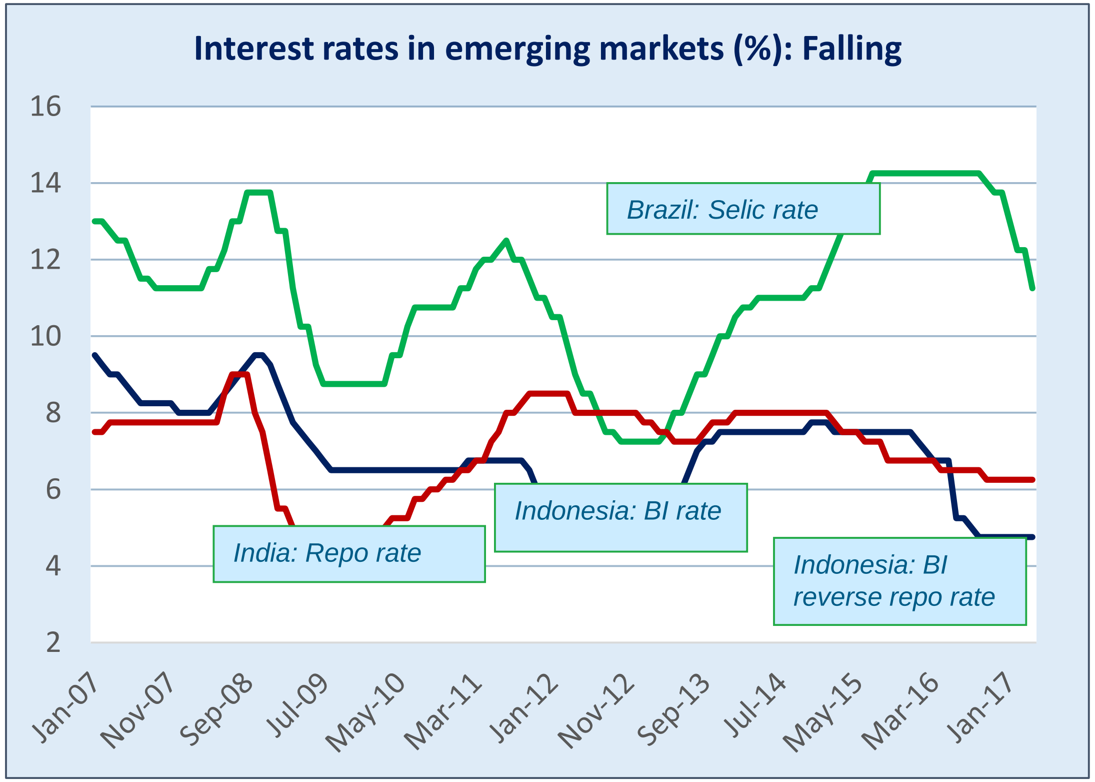
Source: Bloomberg

GLOBAL INTEREST RATES:
MARKETS DO NOT EXPECT SHARP HIKES IN US RATES (ESPECIALLY TO PRE-2008 LEVELS)

As monetary policy of ECB, BOJ and BOE has been expansionary, monetary policy of the US Fed has relatively tightened even if US interest rates were not raised



Interest rates are falling in emerging markets, even in countries with current account deficits – as cross-border capital flows from developed markets to EM accelerated



Source: Bloomberg

GLOBAL INTEREST RATE FORECASTS:
ONLY US RATES ARE EXPECTED TO RISE

- Only US Fed Funds rate is expected to rise – albeit slowly
- With most other global central banks maintaining loose monetary policy, the Feds are unlikely to hike aggressively
- With markets predicting long-term US inflation below 2,5%, FFTR in the long-run is assumed to remain below 3,0%
- Any risk of another global crisis (however remote) is likely to keep global interest rates low
- "Potential shock to the financial system" may be political in nature

	Currently	Q2-17	Q3	Q4	Q1-18	Q2
USD (FFTR)	1,00%	1,25%	1,50%	1,75%	2,00%	2,00%
USD (UST, 10-yr)	2,25%	2,48%	2,64%	2,80%	2,90%	3,04%
EUR (Refi)	0.00%	0.00%	0.00%	0.00%	0.00%	0,00%
GBP (Base rate)	0,25%	0,25%	0,25%	0,25%	0,25%	0,25%
AUD (RBA call)	1,50%	1,50%	1,50%	1,50%	1,50%	1,50%
CNY (1-yr)	4,35%	4,35%	4,35%	4,35%	4,35%	4,35%
IDR (BI reverse repo)	4,75%	4,75%	4,75%	4,75%	4,75%	4,75%

Source: Bloomberg survey, median figures

GLOBAL GROWTH FORECASTS:
MARKETS ARE NOT PESSIMISTIC

- Despite China's slowdown, markets still believe global economic growth is slowly rising

Pertumbuhan ekonomi, %

	2014	2015	2016	2017F	2018F
United States	2,4	2,6	1,6	2,2	2,3
Euro Zone	1,2	2,0	1,8	1,7	1,6
Japan	0,3	1,1	1,0	1,3	1,0
China	7,3	6,9	6,7	6,6	6,3
India (fiscal year)	6,5	7,2	7,9	7,0	7,3
Brazil	0,5	-3,8	-3,6	0,6	2,3
South Korea	3,3	2,8	2,8	2,6	2,6
Indonesia	5,0	4,9	5,2	5,4	5,4
World	3,5	3,4	3,1	3,3	3,4

Source: Bloomberg survey

ADDRESSING THE TOPICS OF THE DISCUSSION:
POLITICAL FACTORS MAY OUTWEIGH ECONOMIC FACTORS

- Should/could the international monetary system be reformed to restore financial trust?

  "Accommodative monetary policy and tighter regulations following the global financial crisis have somewhat satisfied the public. However, tighter regulations are now often blamed for limited contribution of banks to the real economy. In global markets, the USD and US treasury bonds are likely to remain dominant for decades to come".

- Did cataclysmic regulation help reign in speculative excesses and financialization of the economy?

  "Tighter regulations are limiting excess risks in the banking sector but banks continually lobby for regulatory relaxation – which may gain momentum with the election of President Trump. Meanwhile, record low global interest rates have increased more leverage and may risk creating "bubbles" in financial assets and real estates".

- Outsiders and the financial system: Confrontation, collaboration or absorption?

  "The demise of the "anti Wall Street" movement and the softer stance of parliaments towards financial institutions in many countries indicate that outsiders have limited lasting influence on the financial system – unless perhaps there is a fundamental change in the political system"

ADDRESSING THE TOPICS OF THE DISCUSSION: ABSENT A GLOBAL RECESSION, THE WORLD'S FINANCIAL SYSTEM IS LIKELY TO PREVAIL

- Is President Trump friend or enemy of "finance"?

  "Donald Trump's real estate business has been helped by banks with financial leverage. As president, he is pushing for corporate tax cuts and the re-introduction of Glass-Steagall Act in the US, which will be good for finance. However, he may see the contributions to the economy between commercial/ investment banks versus non-bank financial investors (hedge funds and real money funds) differently".

- After the Outsiders' electoral victory, did "Wall Street" lose its power?

  "If the global economy continually creates savings and wealth, absent a global recession, it is difficult to imagine "Wall Street" or any financial system losing its power. One may see more regulatory scrutiny and protection of customers, but without weakening the financial system – the system may indeed become fairer".

EXPRESSION OF GRATITUDE