

Daiwa's View

If financial crisis returns...

- Trigger would be sovereign crises in emerging economies

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Daiwa Securities Co. Ltd.

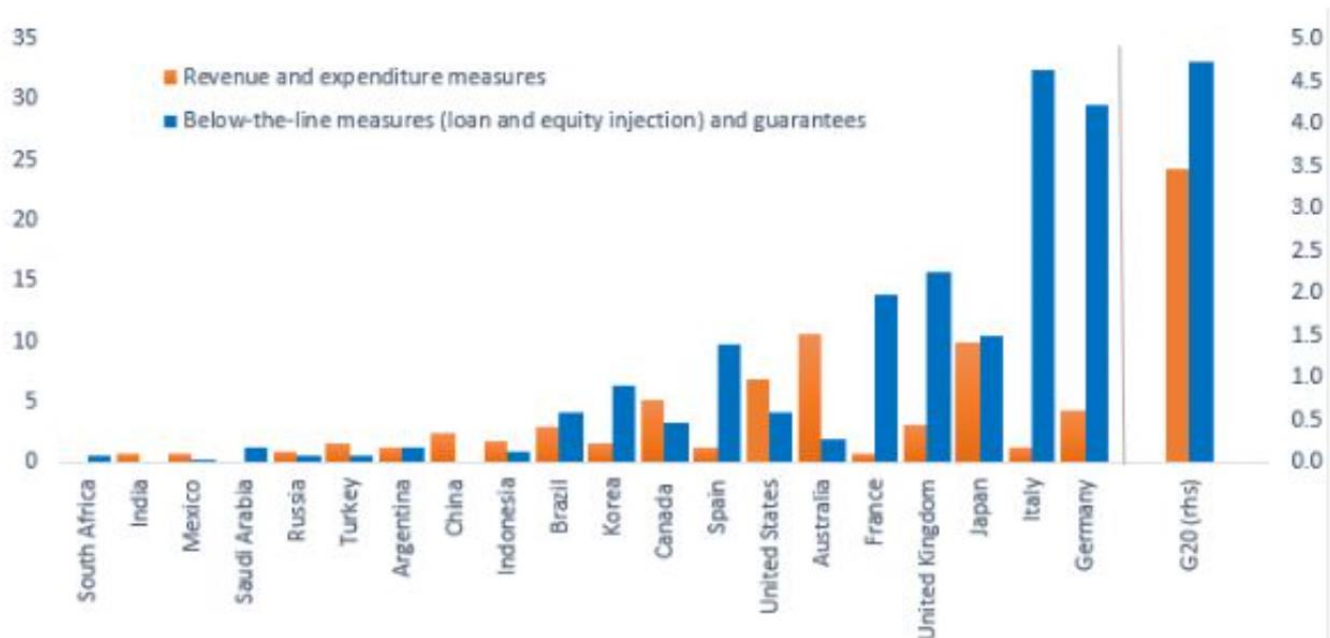
Trigger would be sovereign crises in emerging economies

If financial crisis returns...

Compared to the global financial crisis in 2008, the ongoing COVID-19 crisis is less likely to turn into a financial crisis. This is because a necessary condition for the occurrence of a financial crisis would be "the government's failure." At the time of Japan's financial crisis in 1998 and the global financial crisis in 2008, there was a fatal policy mistake of "delayed government support."¹

However, the current crisis is a "citizens' crisis," meaning that the political hurdle is low for government support. According to [the IMF's estimates](#), G20 economies have already provided fiscal support corresponding to several percentages of their total GDP (chart below). In addition, the culprit of the current crisis is not financial institutions but the COVID-19 outbreak. Under this structure, the policy mistake of "delayed government support," a cause of a financial crisis, would be less likely to occur.

Chart: Announced Fiscal Measures in G20 Economies (% of GDP)

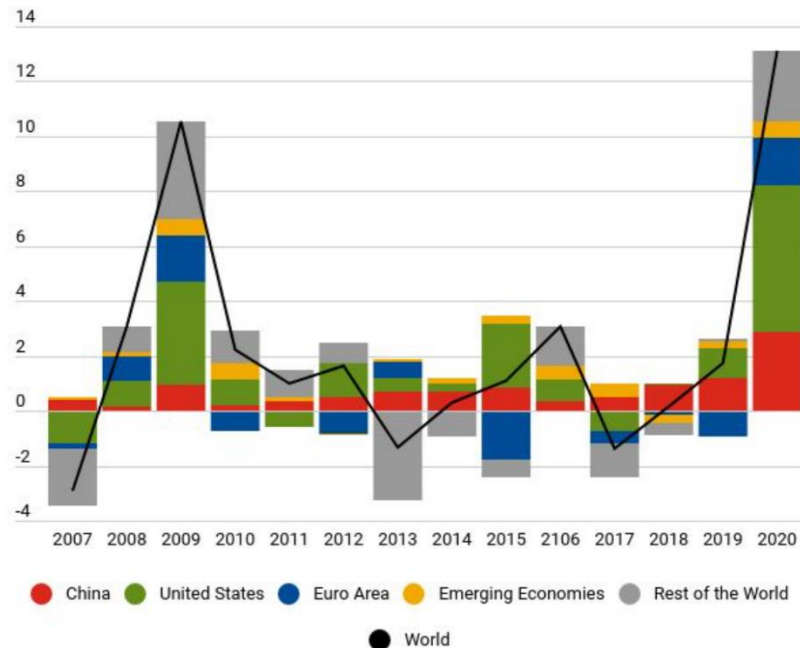


Source: Extracted from IMF; compiled by Daiwa Securities.

¹ Background factor was deep-rooted backlash from citizens against bailout of high-salary employees at financial institutions.

That said, the fact that early-stage, large-scale fiscal spending tends to obtain approval means that fiscal deterioration (solvency crisis) would be more likely to occur. In addition, the amount of fiscal support would increase if major nations (pressed by near-term large-scale economic cost) fail to normalize economic activity levels due to “speed-before-quality” measures for the reopening of the economy. On the other hand, the prolongation of a downturn in GDP entails a risk that “debt dynamics” will fall into a negative spiral.

Chart: Contribution to Change in Global Government Debt Change (2007-20, % of GDP)



Source: Extracted from IMF; compiled by Daiwa Securities.

If this “dynamics deterioration” causes downgrades of sovereign ratings, ratings of financial institutions could be lowered across the board. If so, [the Achilles heel of the COVID-19 crisis](#) would lie in the risk of downgrades to sovereign ratings. Therefore, the contagion channel would be “solvency crisis → sovereign crisis → financial crisis.” If a financial crisis happens under the current situation, it is highly possible that it would be caused by a national solvency crisis.

Which areas are facing such a high risk? Advanced nations are probably in a relatively strong position. The starting point of their ratings is high, and ample private-sector capital accumulation enables them to finance fiscal spending with government bonds denominated in local currencies. In this case, an increase in the issuance of government bonds causes a rise in local interest rates and crowding out, while the central bank’s purchases of government bonds to contain them create concerns about currency depreciation. That said, nagging concerns in advanced nations have been currency appreciation and yield declines thus far, and there is thus considerable time until the opposite phenomena would bring about a crisis.

Meanwhile, higher yields and currency depreciation in emerging economies could quickly shift to a solvency crisis as capital accumulation is low and the ratio of foreign currency procurement is high. After the financial crisis, companies in emerging economies rapidly accumulated external debt, leading to record-high levels of outstanding of dollar-denominated debt. Currently, as these portions are facing a rapid outflow of funds, the IMF and G7 have started to provide support such as debt repayment. Whether the COVID-19 pandemic will shift to a financial crisis via solvency crises in emerging nations is one major dividing point of the current crisis.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

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1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.

As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).

3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
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- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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Corporate Name: Daiwa Securities Co. Ltd.

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