2020 Japan-U.S. Symposium on Building the Financial System of the 21st Century
Implications of the COVID-19 Crisis for International Business and Finance
Impacts of COVID-19

• Public health crisis
  – Japan: relatively low incidence, high societal cooperation
  – US: politicization, public mistrust of public health policies; however, good progress on treatment and vaccines
  – Endgame: with vaccines on the way, will pandemic end in 2021?

• Economic effects
  – Lockdowns extremely costly, require large-scale public funding
  – Japan well into recovery, US summer gains in question

• Enormous distributive effects
  – Winners: knowledge workers, big firms, tech, finance
  – Losers: service workers; small firms hospitality, transportation & retail
  – Could be particularly devastating for emerging economies
Managing the Multiple Crises of COVID-19

- **Liquidity crisis** – the crisis that might have been
  - Post-GFC banking and market reforms worked
  - Effective central bank intervention in both US and Japan

- **Insolvency crisis** – the crisis that might arise
  - Key variable is how long the crisis will last
  - If we can return to “normal,” NPLs and defaults should be manageable
  - Vaccine progress offers optimism but “normal” may look very different, especially in sectors like transportation

- **Structural crisis** – the crisis in progress
  - While pandemic is accelerating digitalization and structural reform, they are disruptive for both labor and capital
  - Particular challenge of immobility of labor and capital in Japan
Role of Public Sector

• Monetary and fiscal policy has backstopped economies
  – Monetary authorities have been very proactive and effective
  – Fiscal stimulus worked in both Japan and US
    • But fiscal support in US waning despite 3rd pandemic wave
  – Government support for lending
    • Japan: highly effective in supporting local economies
    • US: PPP successful, but Main Street Lending Program has disappointed
    • Lesson: full government guarantees needed for banks to lend to risky borrowers

• Fiscalization of monetary policy
  – Not just financing of deficits – Main Street relied on Fed risk-taking

• Growing gap between asset prices and real economy
  – Raises macroprudential and distributive concerns

• Challenges of withdrawing government and central bank support
  – When and with what effects on real economy?
  – Who will bear the risks – private sector, banks, governments, central banks?
Financial System Impacts

• Banking system has been resilient due to post-crisis reforms, central bank liquidity injections
  – But is there fragility below the surface?
  – Banks have been taking on significant new risks – if pandemic effects are prolonged, NPLs will rise

• Japanese regional banks
  – Regional banks were already under pressure due to depopulation, economic decline
  – Preexisting concerns about rising risk in portfolios
  – Suga administration initiative to consolidate regional banks – this may be best opportunity to do so
  – Need for new business models – build on reputation and goodwill to market other financial services?

• Digitalization accelerating in financial sector
  – Major banks have been accelerating their efforts, but what is vision of new business models (especially in Japan)?
  – Growing threat from fintechs? Definitely in China, maybe US; but in Japan the big FIs still have reputation and size advantages
  – Central bank digital currencies
    • China is moving ahead quickly - could it threaten role of USD or raise possibility of RMB bloc
    • Or are Chinese efforts primarily a means of increasing control over information?
    • Is there a first mover advantage or is it more important to get design and legal framework right?

• ESG: many feel that post-COVID recovery should be a green recovery
  – Japan: considerable interest in ESG – asset management, Tokyo green bond, govt looking seriously at EU taxonomies; however, still voluntary for the time being
  – US: no federal action, but some at state level; increasingly popular among investors, but with no regulation/standardization
Economic Impacts of US-China Tensions

• US-China tensions have increased markedly
  – On top of existing security and trade frictions, COVID has contributed to US resentment of China
  – US-China relations likely to remain tense under Biden, although some improvements possible
    • Tone is likely to be more diplomatic
    • Some renewed opportunities for cooperation – e.g., climate, health

• US-China competition in global governance
  – China has stepped into void in governance left by US in multilateral trade, health, environmental issues
  – Appetite for US reengagement in global and regional governance among China’s neighbors

• Effects of US-China tensions
  – Japan and others in Asia don’t want to choose between China & US
    • Calls for cooperative institutions and multilateral rules
  – Decoupling unlikely but supply chains may shift to favor resilience over efficiency