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### Feature Articles

This month's focus: **Economic Policy Uncertainty and Capital Markets**

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The US Trump Administration has imposed additional tariffs on almost half of US imports from China in three rounds and has indicated its intention to raise tariffs on all imports from China in a fourth, which has induced retaliation by China and a consequent US-China trade war. Intensification of the bilateral trade war will likely have a serious impact not only on the two economies but also the world economy as a whole, including Japanese and other Asian economies, because it will make trade inefficient by disrupting supply chains and constrain corporate investment by increasing business uncertainty and risk premiums on international operations.

<b>Political Uncertainty and Impact on European Financial Markets</b> .....	<i>Sayuri Ito</i>	24
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Political uncertainty in Europe has deepened since the end of the euro zone's debt crisis. Market players have been cautious about Italy where two euro-sceptic parties have formed a coalition government. However, financial contagion across the euro zone, a striking feature of the euro zone's previous debt crisis, has not been observed so far. Not only differences in market environment and macroeconomic policies but also progress of structural reforms and improvement of the institutional framework for the euro are background factors behind current limited contagion from Italy.

Global market reaction to the unexpected UK referendum results was fierce but financial contagion from Brexit to other countries was seen for only a very short period of time. Even the sterling pound exchange rate has become less responsive to Brexit-related factors over time.

While it seems political uncertainty in Europe will not be the trigger for a global financial crisis, Europe might continue to be vulnerable to external shocks because a divided political situation could be an obstacle to completion of the European project and, also, Brexit-related uncertainty will persist.

<b>Using Newspaper Text to Measure Policy Uncertainty in the US and Japan</b>	<i>Arata Ito</i>	34
<p>.....</p> <p>This paper provides a detailed description of newspaper-based economic policy uncertainty (EPU) indices in the US and Japan. The US EPU index spiked shortly after the terrorist attacks in 2001, the global financial crisis in 2008, the 2011 debt ceiling dispute, Trump’s election in 2016, and the 2019 government shutdown. The Japanese EPU index rises when there are changes in prime minister and when the Diet becomes divided, with the ruling party having a majority in the lower house but not the upper house. It also went up during the 1997-98 Asian financial crisis and in reaction to the failure of Lehman Brothers in 2008, the 2011 debt ceiling dispute in the US, the decision in 2016 to defer a consumption tax hike in Japan, and the UK’s EU referendum in 2016.</p>		
<b>Effects of Economic Policy Uncertainty on Asset Prices</b>	<i>Masao Kumamoto</i>	45
<p>.....</p> <p>The aim of this paper is to investigate the effects of economic policy uncertainty (EPU) on stock returns. In the theoretical investigation, we point out that EPU reflects long-run economic uncertainty which is related to the possible change in economic fundamentals in the future, and therefore we can apply the long-run risk model proposed by Bansal and Yaron (2004) to explain the effects of EPU on stock returns. In empirical analysis, we employ the ARDL and GARCH models, and show that EPU has a negative impact on stock returns both in the short and long term, and has a positive impact on stock return volatilities.</p>		
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