

RELEASE IN FULL

From: Sullivan, Jacob J <SullivanJJ@state.gov>
Sent: Thursday, March 24, 2011 7:32 PM
To: H
Subject: FW: Japan econ initial thinking & timeline

Worth taking a look at the below. Jen is very good.

From: Harris, Jennifer M
Sent: Thursday, March 24, 2011 5:32 PM
To: 'kcampbell@state.gov'
Cc: Sullivan, Jacob J
Subject: Japan econ initial thinking & timeline

Hi Kurt,

I've talked to some markets people up in NY to get a more useful sense of what we're up against and what might be done. The baseline view is far more positive than you'd think—maybe even too much so, as speculators are moving in now that the markets' worst-case no longer involves white smoke clouds or Tokyo.

I'll have a 3ish pager for you, hopefully tomorrow, that will be heavy on ideas you can take or leave. The immediate highlights:

- **Primary concern here is the stock mrkt.** And here, Nikkei is stabilizing. Toshiba up 10%. If you want to ferret out speculation, watch the carry trades from the retail investors (esp in the Toshin funds). In terms of currency hedges, Brazil and Australia are the most likely trades, so tend to be useful indicators...
- **Need to be prophylactic in impressing upon markets the ways in which this is NOT Kobe:** In 1995 with Kobe, several banks went under bc they lost physical assets in the quake, and these losses were exacerbated by the RISK OFF associated with the serin gas attacks only a few months later (as a general matter, Japanese banks tend to hold more in equity and real assets than do US banks).
- **GDP hit wont be that badly.** This is true in large part bc the destruction occurred in a region that accounts for only 4% of Japan's GDP. And assuming a reasonably swift clean-up and reconstruction effort, the stimulus effects from reconstruction spending should kick in by late this year such that
- **Public debt picture is pretty rosy.** Although gross public debt represents 226 percent of GDP, and net debt (accounting for foreign exchange reserves and debt held by other public agencies) is a far more reasonable 121 percent of GDP, and the Japanese government is still able to borrow at some of the world's lowest interest rates. This reflects, in part, the fact that nearly all of Japan's government debt is held domestically (95%, I think) and Japan's public and pension funds appear disinterested in shifting away from Japanese government bonds on account of a national disaster and, say, a \$100bn supplementary budget. That would be kind of like PIMCO dumping t-bills after Katrina and associated clean up costs— just not going to happen.
- **What I'm worried about that so far no one seems to be watching: *Rice and refinery repair season.*** Rice was the initial spark that ignited the 2008 food – fuel price spikes. And the fact that rice prices have not increased amid this ongoing bout of spikes is one of the happy distinguishing features between this and the 2008 food spikes. There are some worrying early signs of hoarding and chatter about export restrictions in the region, and so anything we can do to fend this back would be extremely helpful.

Second, most all of the world's refineries are offline for another few weeks for post-winter repairs. Once these come back and we fully price in ME oil disruptions, Japan could feel the energy market shocks in a big, unhelpful way. Would suggest readying some kind of 3 month emergency fuel plus up and putting this fact in the papers. Ideas below

Some Early Recommendations:

1. **Move rice to Japan off-market** (I believe the USG has a considerable rice stock in storage, so maybe a few off market shipments of rice, "Courtesy of USAID or the US Government" -- helpful both for our STRATCOM goals, and for stabilizing the rice market. Second, secure public commitments from Japan's neighbors to refrain from export bans. Third, get out in front of inevitable price increases by conveying clear signals to markets that we expect rice to rise as a general function of inflation.
2. **Get ahead of energy markets.** The strongest such signal we could send here is some statement that we (the USG and /or the GOJ) are prepared to tap into our SPR(s) to stabilize energy markets, short-term and if needed. Hopefully this message will alone be sufficient and moot any actual need to tap the SPR. Apart from this, again some signal that GoJ is readying a plan to address energy strains / shortfalls -- particularly as refineries come back online to boost oil prices--would be a good thing.
3. **Swap lines.** Get the Fed to resurrect the lines it set up in 2008, "just in case." This falls on the more ambitious side of the spectrum. Terry Checki at the NY Fed would be the guy to speak with here... If you haven't already spoken with him, you and he might actually find a 10 minute call useful across the board.