

# **Overview of the Current Landscape of International Finance**

**Presentation at Asian Capital Markets Roundtable  
Hosted by Nomura Foundation**

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# Challenges to the International Financial System



# Risks and Challenges to the International Financial System

## Five risks

- ① Mounting government debt in most of developed economies
- ② Possible bubble of AI-related stocks and corporate debt
- ③ Rapid expansion of under-regulated private credit
- ④ Increasing debt of developing countries
- ⑤ Questions on stable coin

## More fundamental challenges to the international financial system

- ① Geopolitics and weaponization of the international payment system
- ② Future of the dollar as key currency
- ③ AI and other technologies –jobs, protection of data, privacy, disinformation and misinformation, copy right, cyber-security, competition policies and taxation
- ④ Ways to deal with climate change
- ⑤ Declining and aging demography (stress to pension system, etc.)
- ⑥ Growing divide in societies, soundness of democracy and rule of law

# Asian Financial and Capital Markets (1)

## ○ Roles of financial system in economic growth

- mobilizing and pooling savings
- facilitating payments
- financing trade of goods and services,
- finding new entrepreneurs and value
- diversifying and managing risks
- monitoring investment

## ○ Advantages of banks (especially in early stage of development)

- mobilize large sums of savings from small savers into corporate investment
- monitor investments on behalf of savers based on relation with borrowers
- advise borrower company activities.

## ○ Advantages of bonds and equity markets (capital markets)

- spread risk across large number of investors,
- better finance riskier investments such as technological innovations,
- promote market discipline and corporate governance based on disclosure requirements, price signals, and boards representing equity shareholders

# Asian Financial and Capital Markets (2)

## ○ Purpose of regulations and supervision

- protection of clients (especially deposit holders)
- ensuring integrity (inside-trade, manipulation, mis-reporting and fraud)
- the stability of financial systems (avoiding “runs” and protecting payment systems)

## ○ Economics of regulations and supervision

- fill the gap of information asymmetry between clients and financial institutions
- prevent moral hazard as financial institutions (especially deposit taking banks) are protected by the government due to public goods nature of their activities.

## ○ Increasing importance of capital markets in Asia

- funding large investment and promoting innovation
- providing opportunity for asset management
- regional efforts fostering capital markets including Asian Bond Market Initiative

# Japan's Experience since the 1990's - Challenges to Macroeconomic Policies and Potential -



# Cause of the Bubble in Japan in the Late 1980s

- Aftermath of Plaza Accord of 1985 (expansionary fiscal & monetary policies to tackle rapid appreciation of Yen, possibility of positive wealth effect from stronger purchasing power)
  - Very active financial activities (shift from saving shortage to saving glut, massive lending to real estate sector)
  - Increase of asset prices under the stable CPI (due to strong yen), and their wealth effect on consumption & investment
  - Myth for eternal land price hike, conceit on the strength of Japanese economy and high expectation of its future
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- Yen rate appreciated very rapidly from ¥244/USD in mid-September 1985 to ¥153 in August 1986
  - Nikkei stock index rose from ¥13,113 at the end of 1985 to its peak ¥38,915 at the end of 1989 (increase of total stock value as much as 150% of GDP)
  - Land prices of six urban areas rose by three times from the yearend 1985 to the yearend 1990 (increase of land value by 200% of GDP)

# Reasons for Japan's Long Slump since the 1990s

- Lasting impact of bubble bust - balance sheet adjustment (threat of excess liability) & negative wealth effect (due to declining asset prices)
- Declining & aging population, demographic onus (decline of ratio of productive age population), burden of pension, aged care, & medical cost, loss of vigor of the society
- More-than-expected speedy catchup by Asian emerging economies, failure of keeping pace with digitalization & new technologies, becoming much behind the US
- Risk aversion attitude, over-reliance on government, increase of debt/GDP ratio, Ricardian effect (reducing private sector spending), inefficient resource allocation
- Although per capita growth of productive age population is not that bad, value in terms of price especially in dollar has not increased (low deflator increase & depreciation of yen).

# Potential of Japanese Companies & Economy

- Stable society with limited divide (while challenges to sustainability of super-expansionary fiscal & monetary policies)
- Well-educated & diligent population (importance of directing resources to education, and R&D)
- Unique history & culture different from either China & the West (how to use its positioning )
- Many seeds to be monetized, craftsmanship for perfection, respect for trust, long tradition of market economy from Edo era (1603-1867) through Meiji modernization (starting 1868)
- Frontrunner of aging society, building up tools to manage it (*Economist* article in December 2021)
- Closeness to fast growing Asian countries (need of friendship & deep relations of people, trade, & finance)

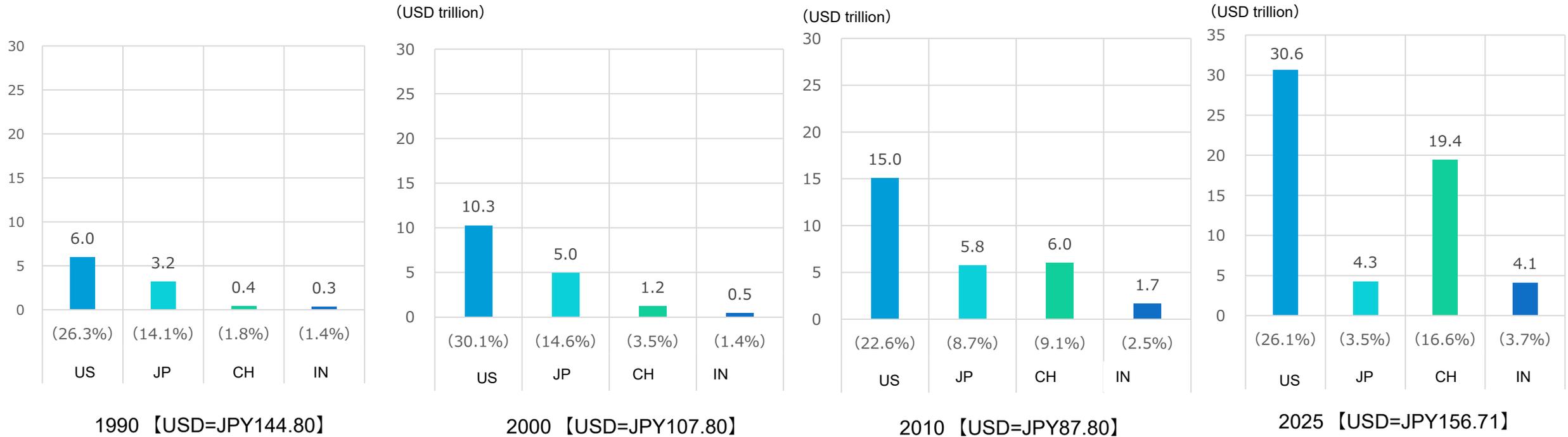
# How to Revitalize the Japanese Economy

- **Diversity & flexibility**-active participation of women & foreigners, more entry & exit of enterprises, labor mobility, reward based on achievement, strength of individuals
- **Further integration with global economy** -expanding exchange with other economies in investment, HR, technology & knowledge, brand strategy, selling quality product/service at high price
- **Digitalization & green economy**-use of digital technology to create new service & business model beyond efficiency, aiming at zero emission with credible transition
- **Private sector vitality & role of government**-essential role of entrepreneurship, sustainability of fiscal & monetary policies, investment in education & R&D, redistribution
- **Enhancing corporate governance**-reforms not just for compliance but for promoting innovation & risk taking

# Japan's Challenges in Economic Policy Management

- **Fiscal sustainability** – Constant yearly use of big supplementary budget. Non-existence of fiscally conservative political parties. Need for EBPM.
- **Normalizing monetary policies** – Possible negative side effects from sticking to inflation target for too long under deflationary condition (fiscal discipline, weak yen, market function). Risk of disregarding exchange rates.
- **Exchange rates** – A. Factors for weak yen i) difference of monetary policy stance, ii) competitiveness, iii) credibility of the economy. B. Problems of weak yen i) imported inflation, ii) loss of purchasing power (negative to investment and consumption), iii) cheap Japan (goods & services, real estate and companies)
- **Structural policies** – Reforms of labor market, education, medical sector, agriculture, and SME support. But no silver bullets.
- **Policies based on reality of aging and declining population-** Difficulty of reversing demographic trend. Need to adapt policies to the realistic assumption for infrastructure, education, medicine and local communities.

# GDP (in US\$) of the US, Japan, China and India



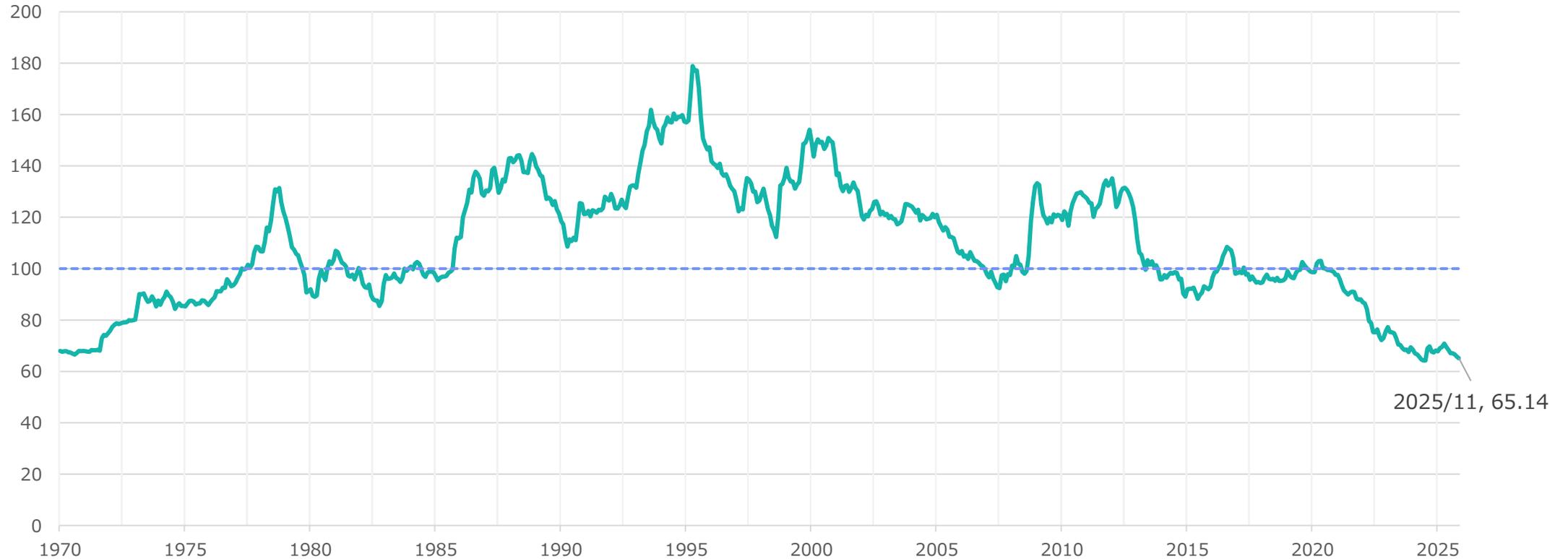
Note: figures in ( ) are share of the world economy. [ ] for each year is the average USD/JPY exchange rate.

(Source : IMF WEO Oct'25)

# Japan's real effective exchange rate since 1970 (monthly)

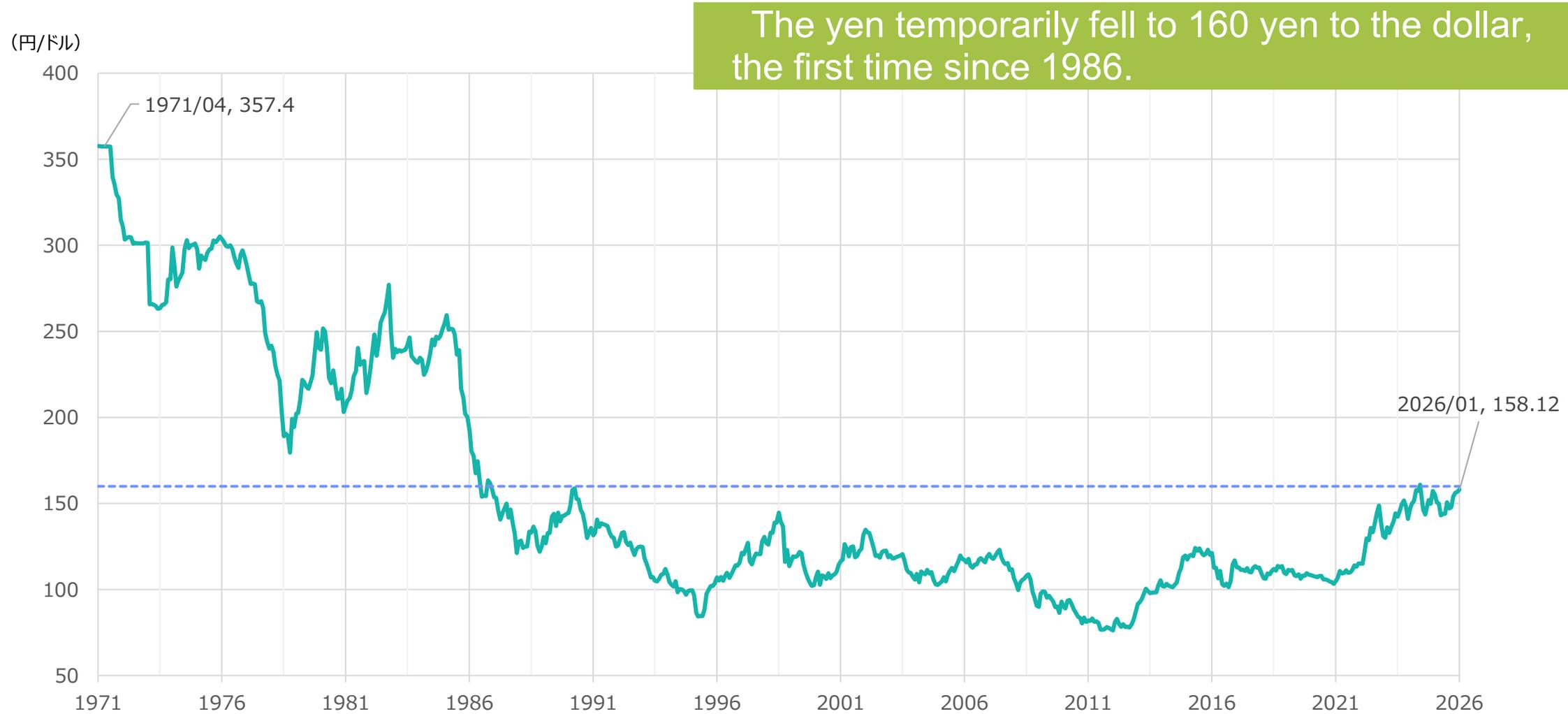
Real Effective Exchange rate of the yen declined to the level not seen since 1970.

(2020年 = 100)



(出所 : BIS \* Narrow Indices)

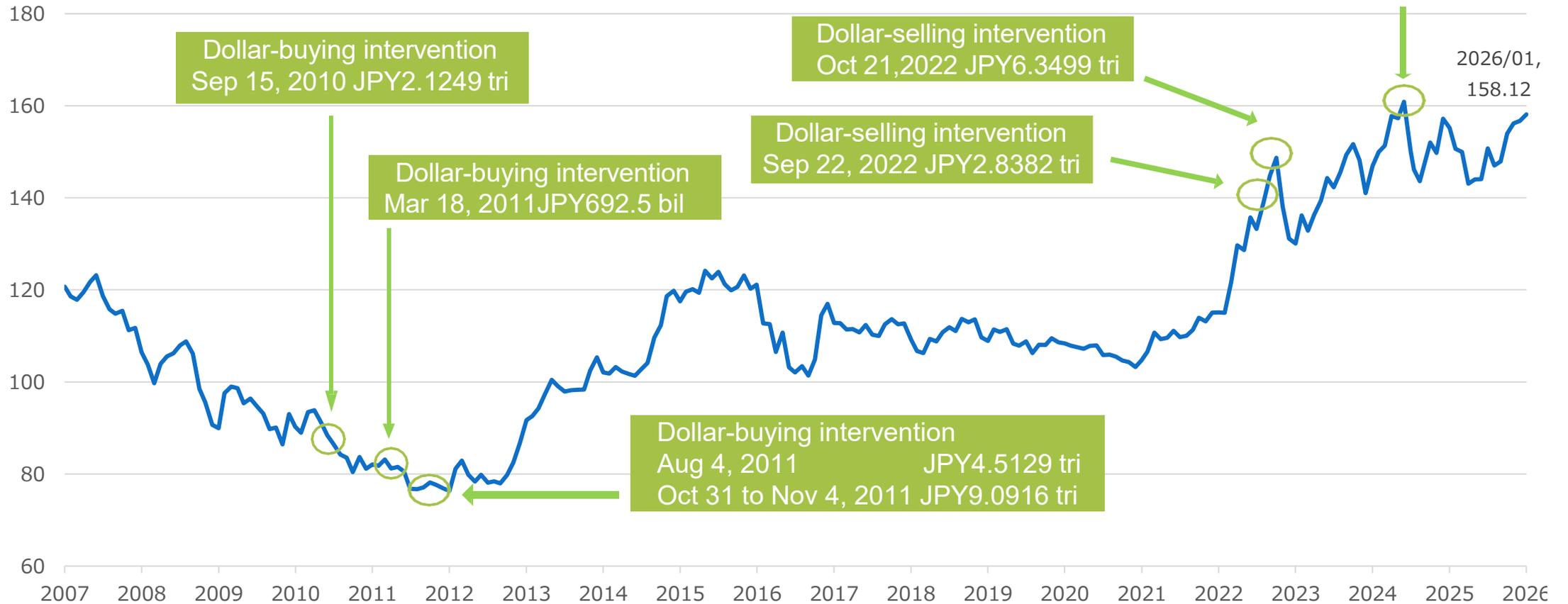
# Trends in the USD/JPY exchange rate since 1970(monthly)



(出所 : Bloomberg)

# USD/JPY exchange rate and Japanese government currency intervention

(円/ドル)



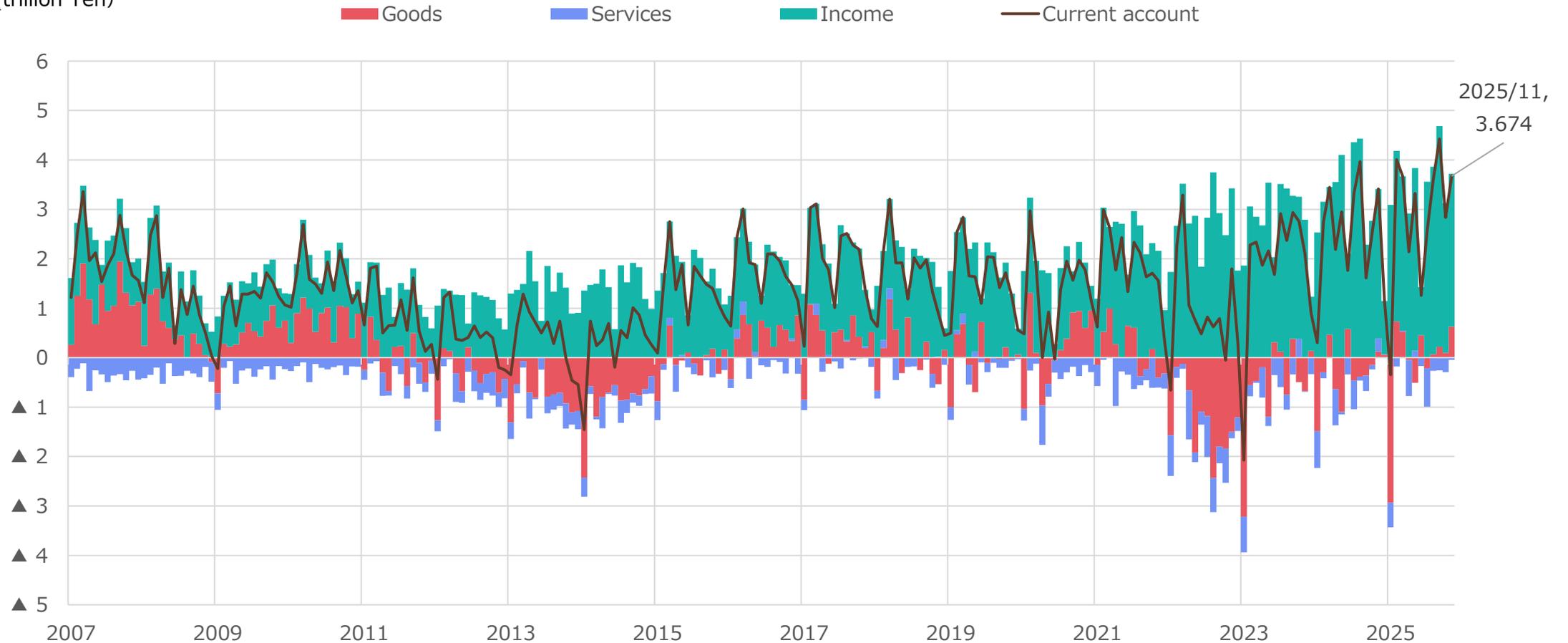
Note: The dollar buying interventions in the summer and fall of 2011 purchased a total of USD 172.2 billion at JPY13.6045 trillion. The average exchange rate was JPY 79 to the dollar.

(出所：財務省、Bloomberg)

# Japan's current account balance (monthly)

Current account surpluses are large based on investment income from abroad.

(trillion Yen)

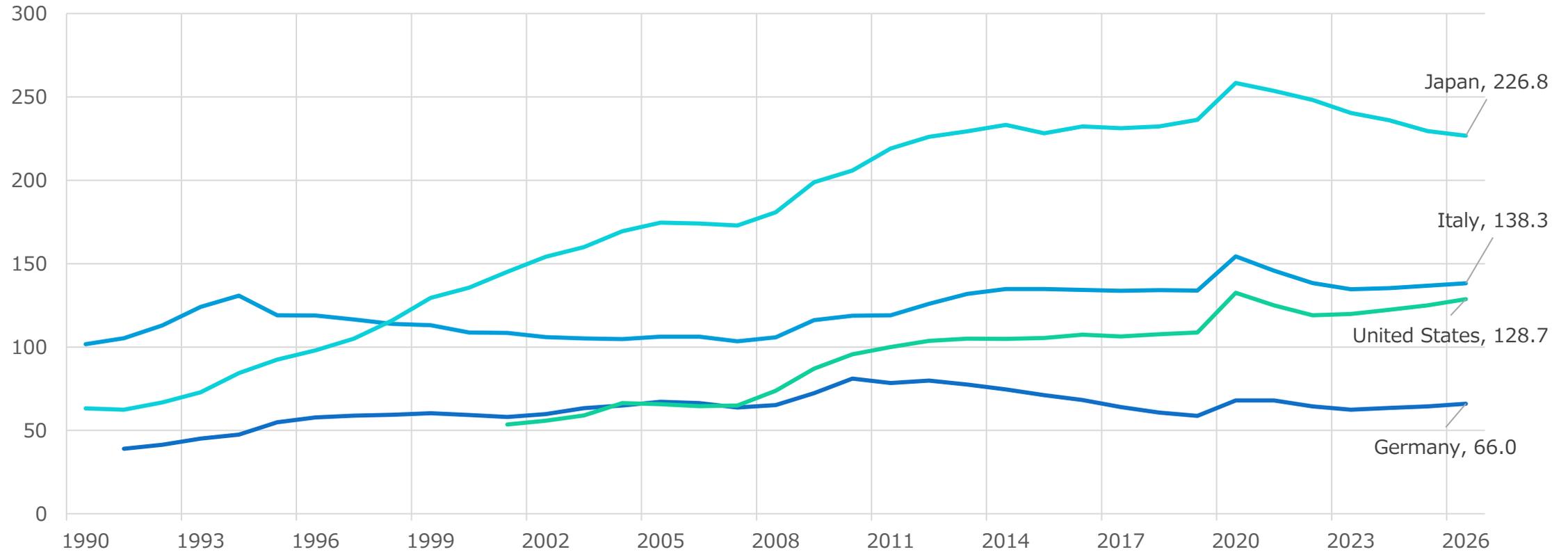


(出所：財務省)

# International comparison of public debt (general government basis)

Japan's outstanding government debt is over 225% of GDP.  
Largest among major developed countries.

(% of GDP)

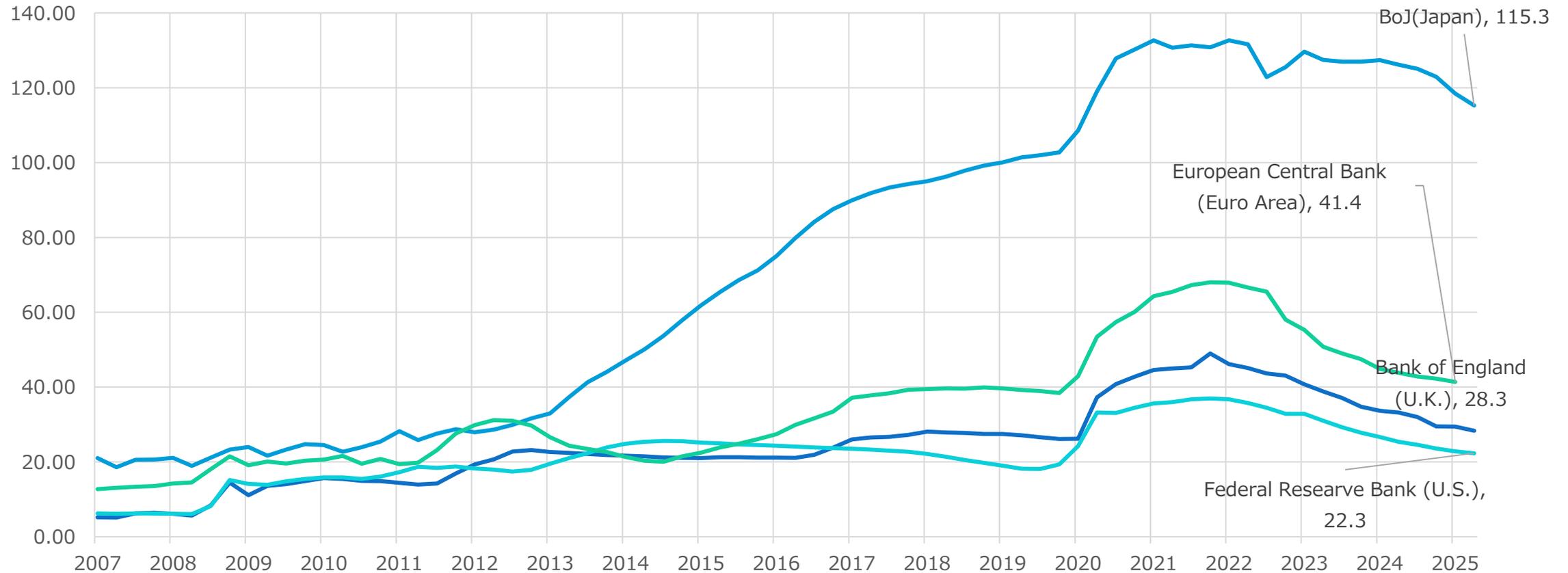


(出所 : IMF WEO Oct'25 )

# International comparison of central bank assets

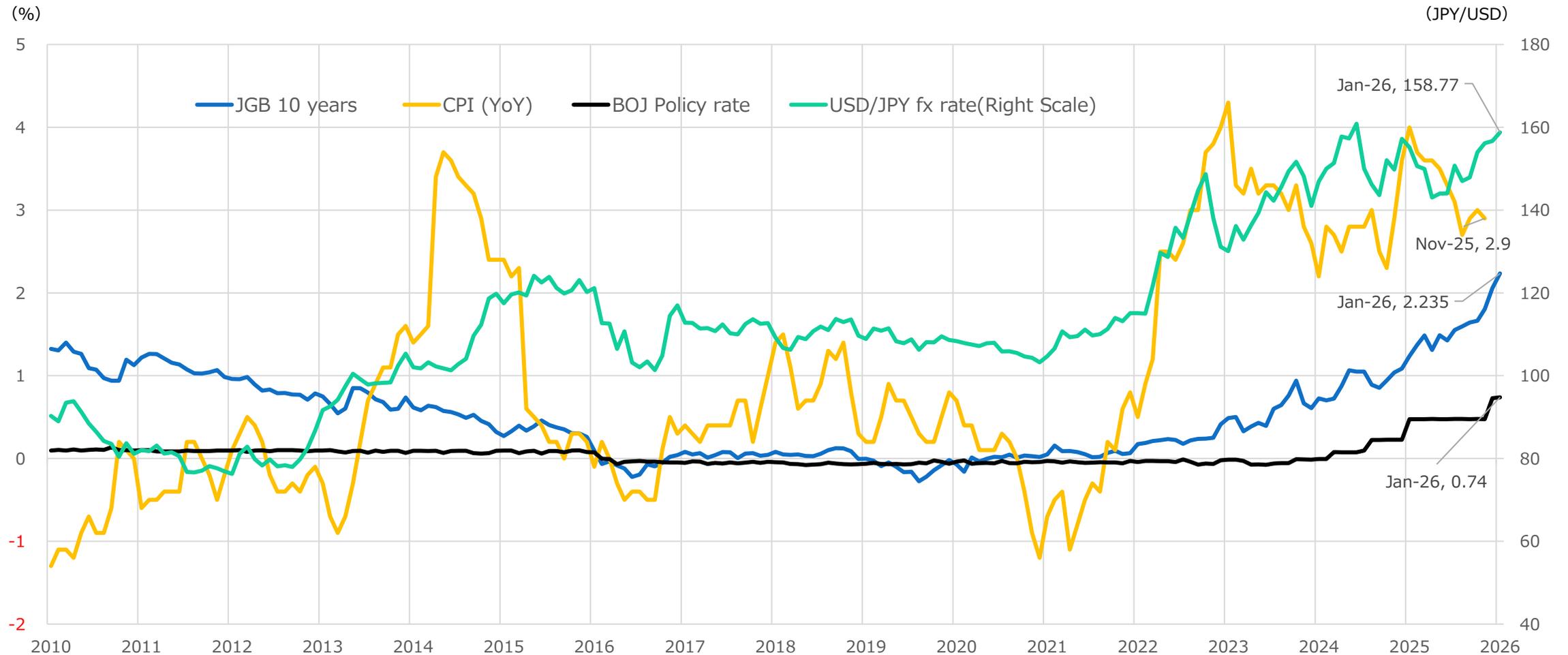
The BOJ's balance sheet expanded rapidly through asset purchases.

(% of GDP)



(出所 : BIS)

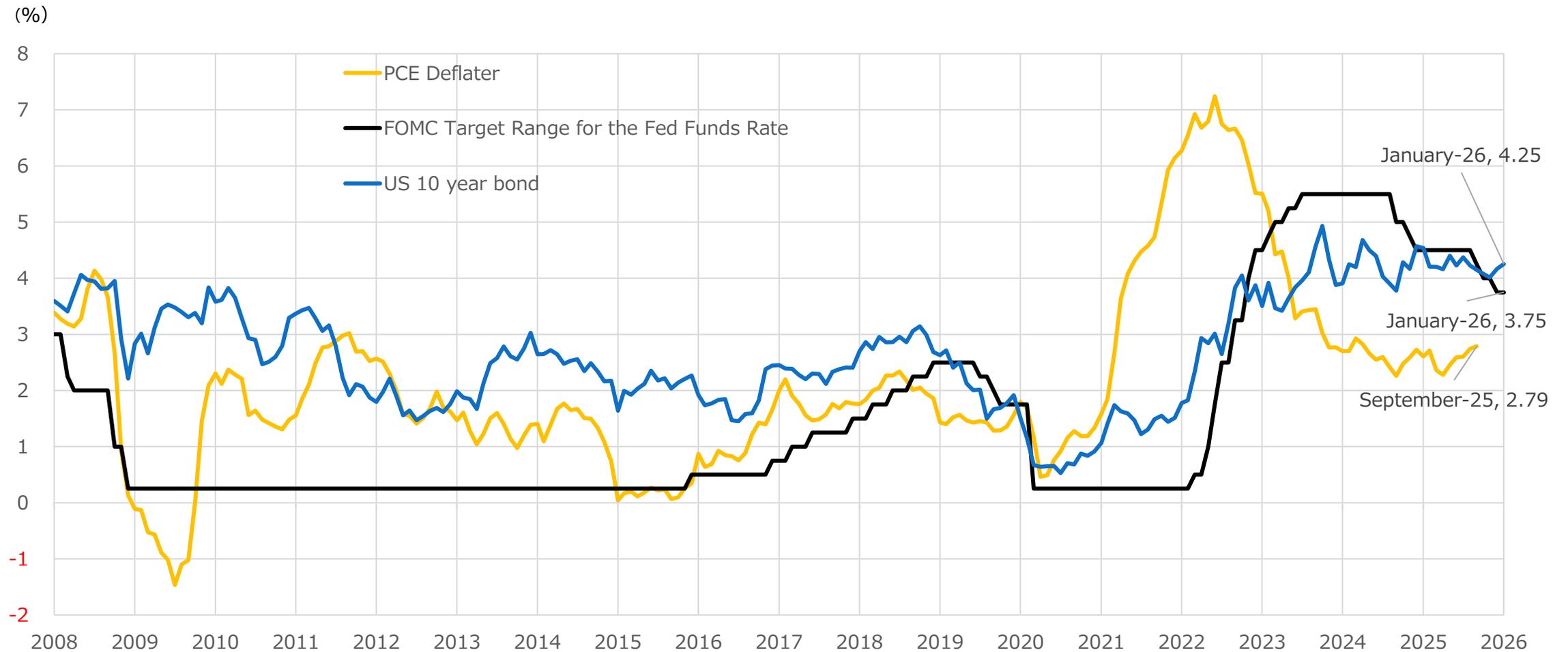
# Japanese long and short term interest rates, CPI, and USD/JPY exchange Rate



(Note: All data are as of the end of the month, except for the latest data which are the most recently published figures.)

(Source : Bloomberg, Ministry of Internal Affairs and Communications)

# US policy rate, long term interest rate and PCE deflater



(Note: All data are as of the end of the month. the US, stats are delayed due to the government shutdown. The latest data are the most recently published figures.)

(Source : Bloomberg, BEA)

# Asia's Achievement of Development & Its Key Messages



# Asia's Journey to Prosperity

- Policy, Market, and Technology over 50 Years -  
Published by ADB in January 2020 (Available on ADB HP)

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1. 50 years of Asian development
2. The role of markets, the state, and institutions
3. Dynamics of structural transformation
4. Modernizing agriculture and rural development
5. Technological progress as key driver
6. Education, health and demographic change
7. Investment, savings, and finance
8. Infrastructure development
9. Trade, foreign direct investment, and openness
10. Pursuing macroeconomic stability
11. Poverty reduction and income distribution
12. Gender and development
13. Environmental sustainability and climate change
14. The role of bilateral and multilateral development finance
15. Strengthening regional cooperation and integration in Asia

## Developing Asia's Growth over 50 Years (1960 to 2018)

- developing Asia's per capita GDP (in constant 2010 US dollars) grew 15-fold from \$330 to \$4900
- developing Asia's share of global GDP rose from 4% to 24%
- poverty reduction, and improvement in health and education
- absolute poverty (\$1.90 a day) reduced to 7% in 2015 (from 68% in 1981)
- life expectancy at birth increased from 45 years to 72 years (water, nutrition, shelter, antibiotics and other medicine, vaccination, birth assistance, access to health facilities, sanitation)
- average years of schooling (aged 20-24) from 3.5 years to 8.9 years (In Bangladesh, for boys from 1.5 years to 8.1 years and for girls from 0.2 years to 8.6 years)

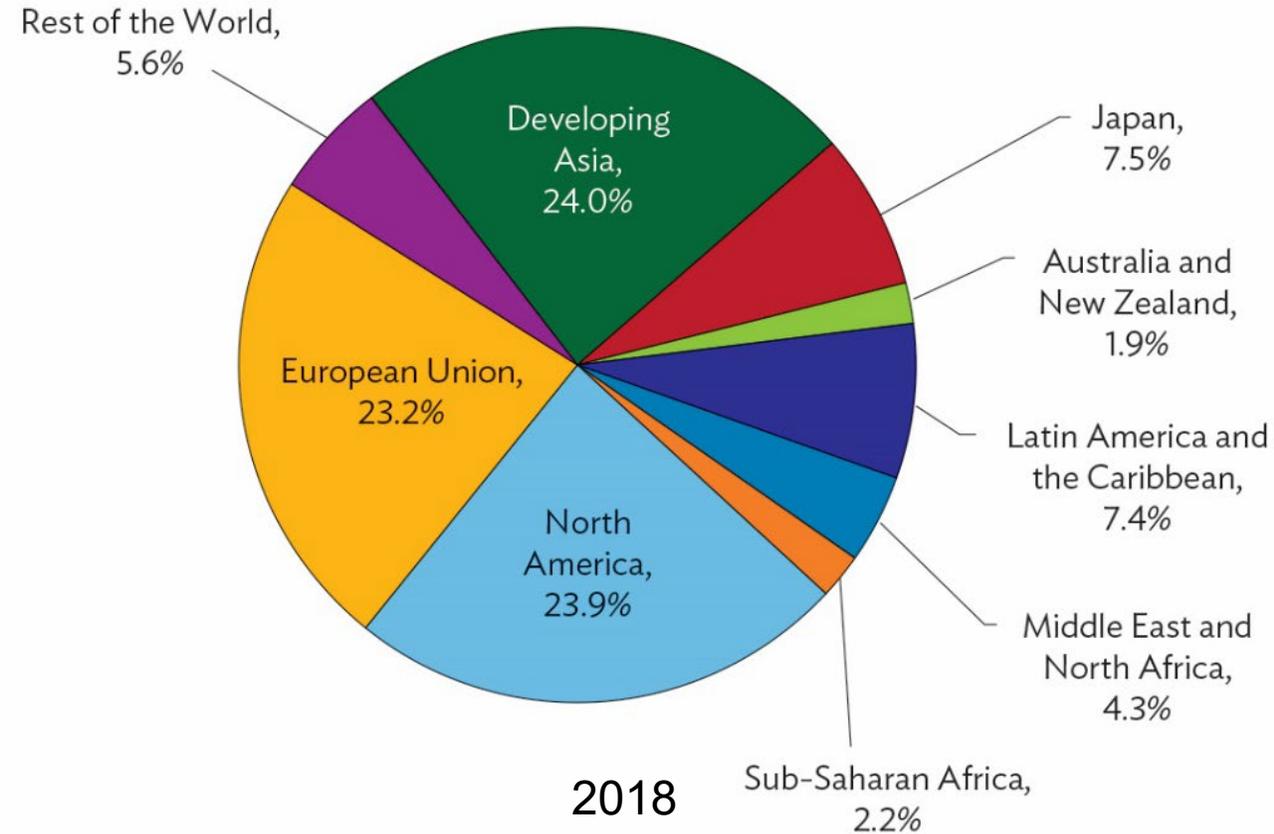
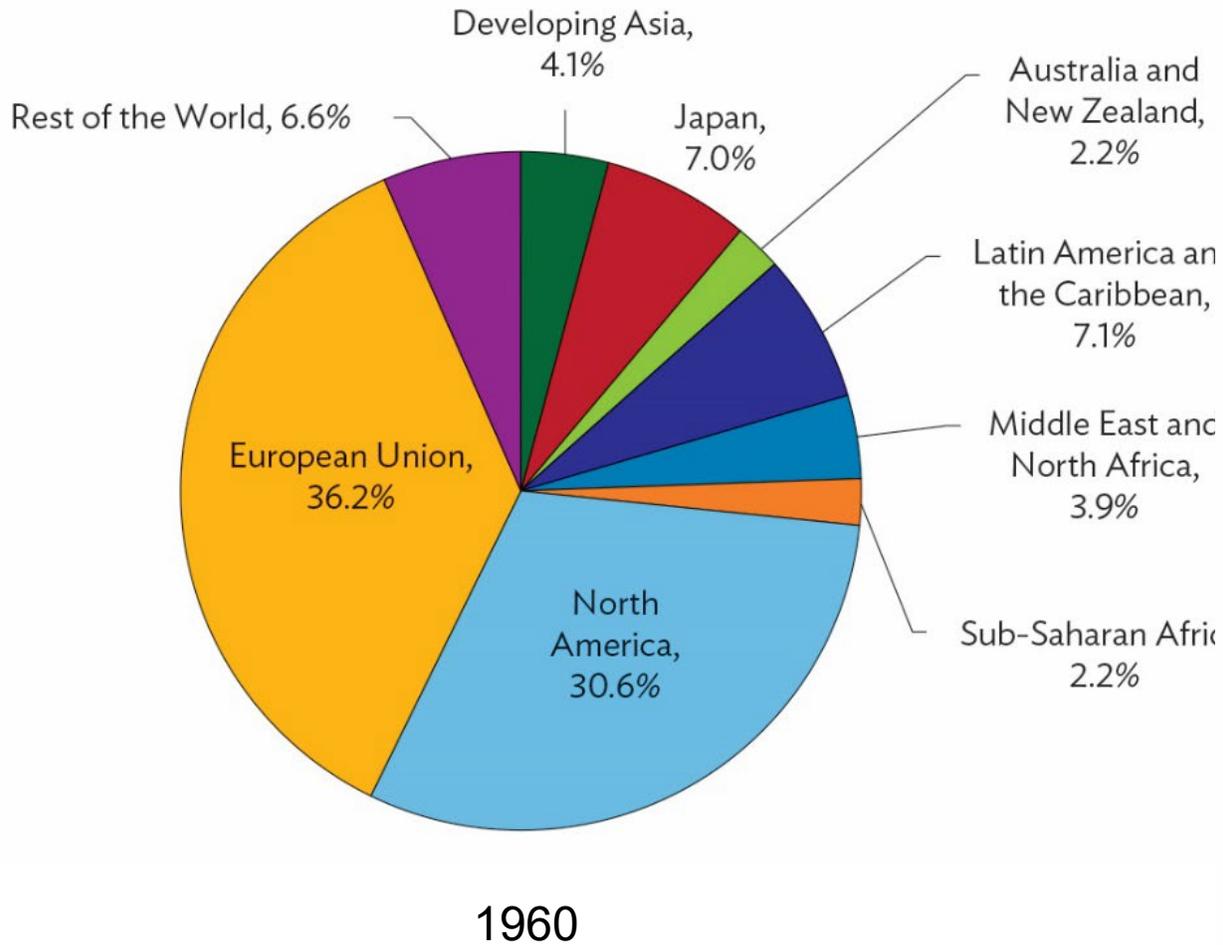
# Key Message from Asia's Development History (1)

- 1) Markets and the private sector are crucial. Japan's development since the Meiji era and China's reform and opening-up policy exemplify this. The government also plays a significant role, particularly in institution building.
- 2) Export-led growth has been overemphasized. It should rather be called outward-oriented policy. Failed import substitution in Latin America and others was influenced by socialism, anti-colonialism, and the Center-Peripheral Theory (Prebisch, 1962 paper). From Flying Geese to Global Value Chains.
- 3) There is no such thing as an "Asian Consensus." Success stems from realism, gradualism, and a willingness to learn. The role of visionary leaders and bureaucrats.
- 4) Not fundamentally different from standard economic theory. "Industrial policy" is not always successful but useful in the early stages. R&D support is crucial.
- 5) Industrial structure transformation (production and employment). The role of agriculture productivity. The significance of manufacturing. Is leapfrogging from farming to service, skipping manufacturing possible? The expansion and importance of the service sector.

## Key Message from Asia's Development History (2)

- 6) The importance of technology in Asia's development. Krugman's 1994 critique that Asia's growth was not based on TFP (Total Factor Productivity) and would face the same limits as the Soviet Union was mistaken.
- 7) High savings lead to high investment. The role of the banking sector and capital markets. Capital markets are also growing in importance.
- 8) Macroeconomic stability is fundamental (especially compared to Latin America). Lessons from the Asian currency crisis and global financial crisis. Fiscal discipline, central bank independence, and financial sector strength. Emphasis on macroprudential policy.
- 9) Poverty reduction has progressed, but income distribution has worsened in many countries. Japan's high-growth period saw equitable growth.
- 10) It's too early to celebrate "Asian- -Century." There are remaining challenges (climate change, infrastructure, income disparities, gender issues, etc.). Efforts to maintain peace, and enhance soft power.

# Global GDP Shares, 1960 and 2018



Sources: Asian Development Bank. Key Indicators Database. <https://kidb.adb.org/kidb> (accessed 2 August 2019); and World Bank. World Development Indicators. <https://data.worldbank.org> (accessed 2 August 2019).