

The Return of Political Risk

Global outlook for 2017

Robin Bew
Managing Director

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Political risk: on the rise, around the world

Is there a pattern to the latest surge?



Political risk: on the rise, around the world

Is there a pattern to the latest surge?

Anti-establishment



Long running disputes

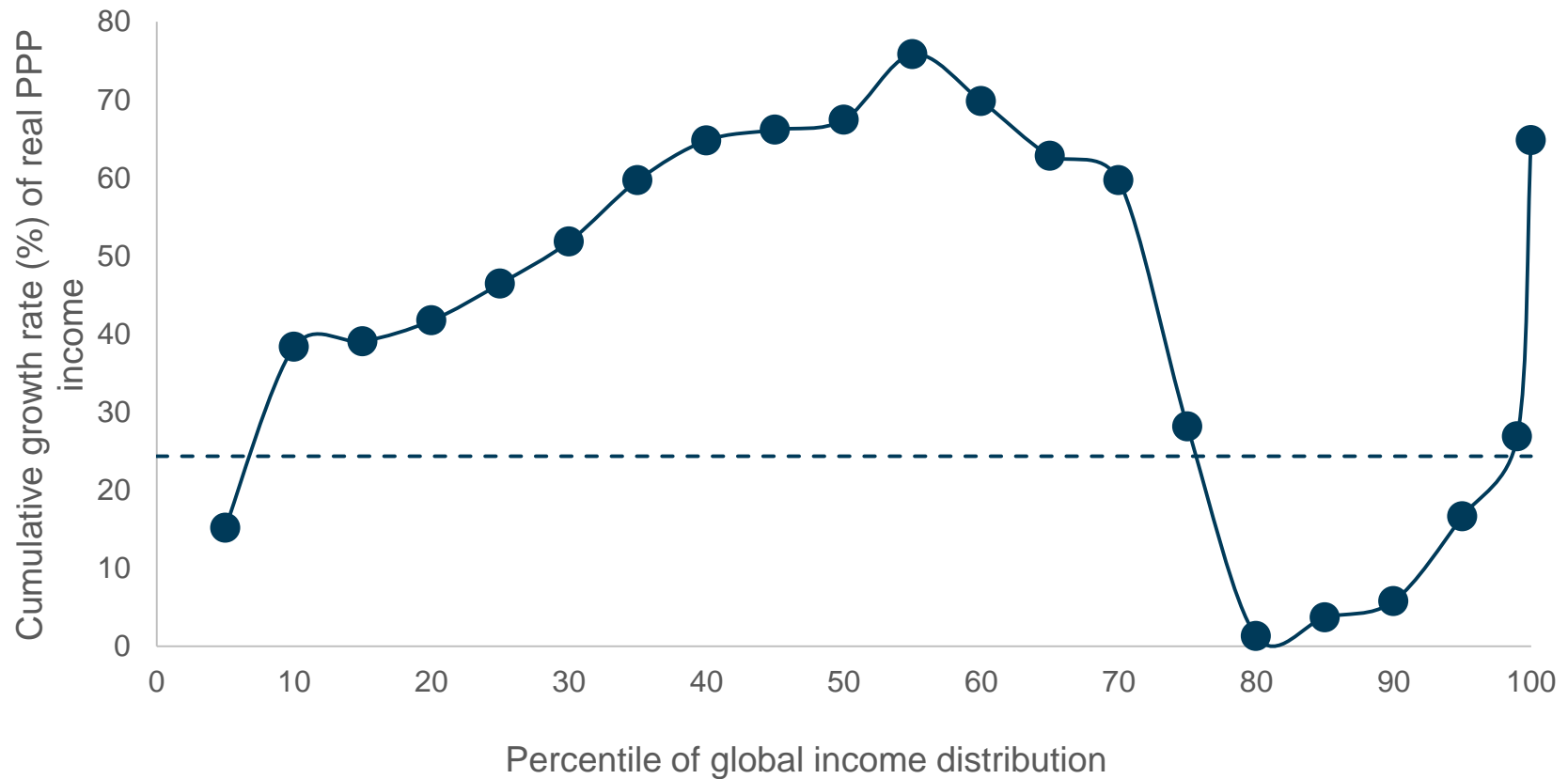


Stagnant incomes?



Winners and losers from globalisation

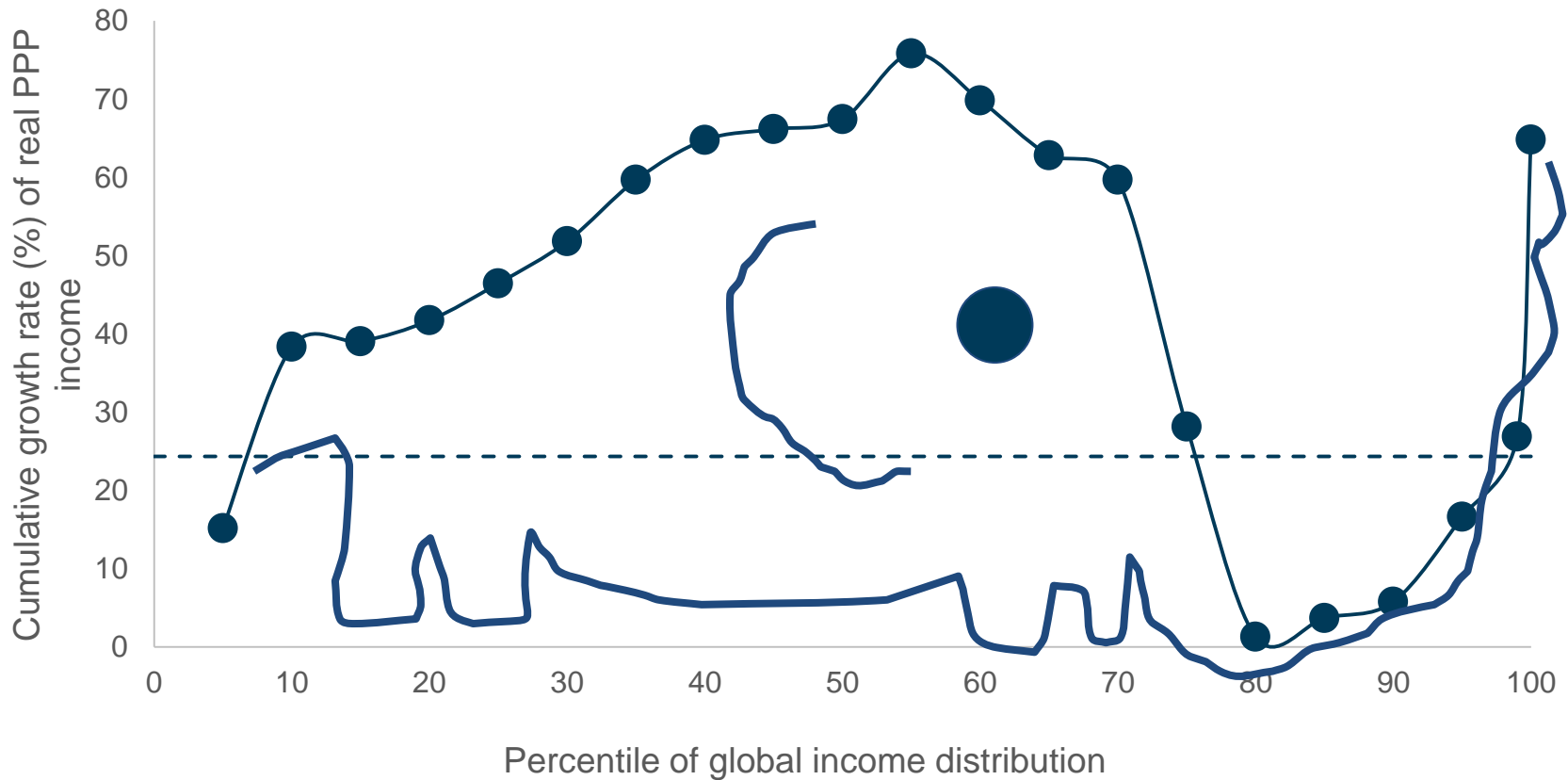
Global growth incidence curve (1988-2008)



Source: Branko Milanovic.

Winners and losers from globalisation

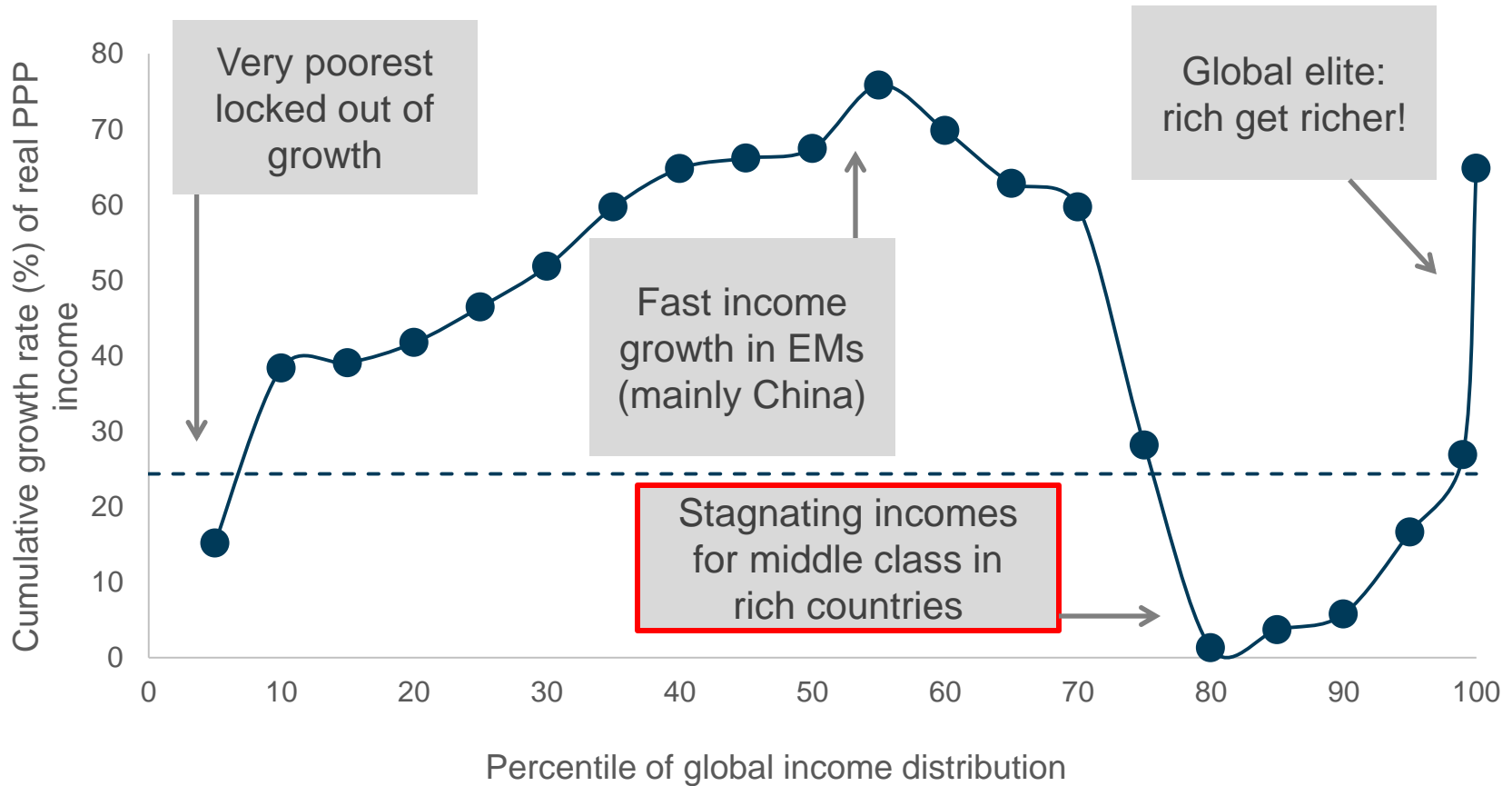
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Source: Branko Milanovic.

Winners and losers from globalisation

Global growth incidence curve (1988-2008)

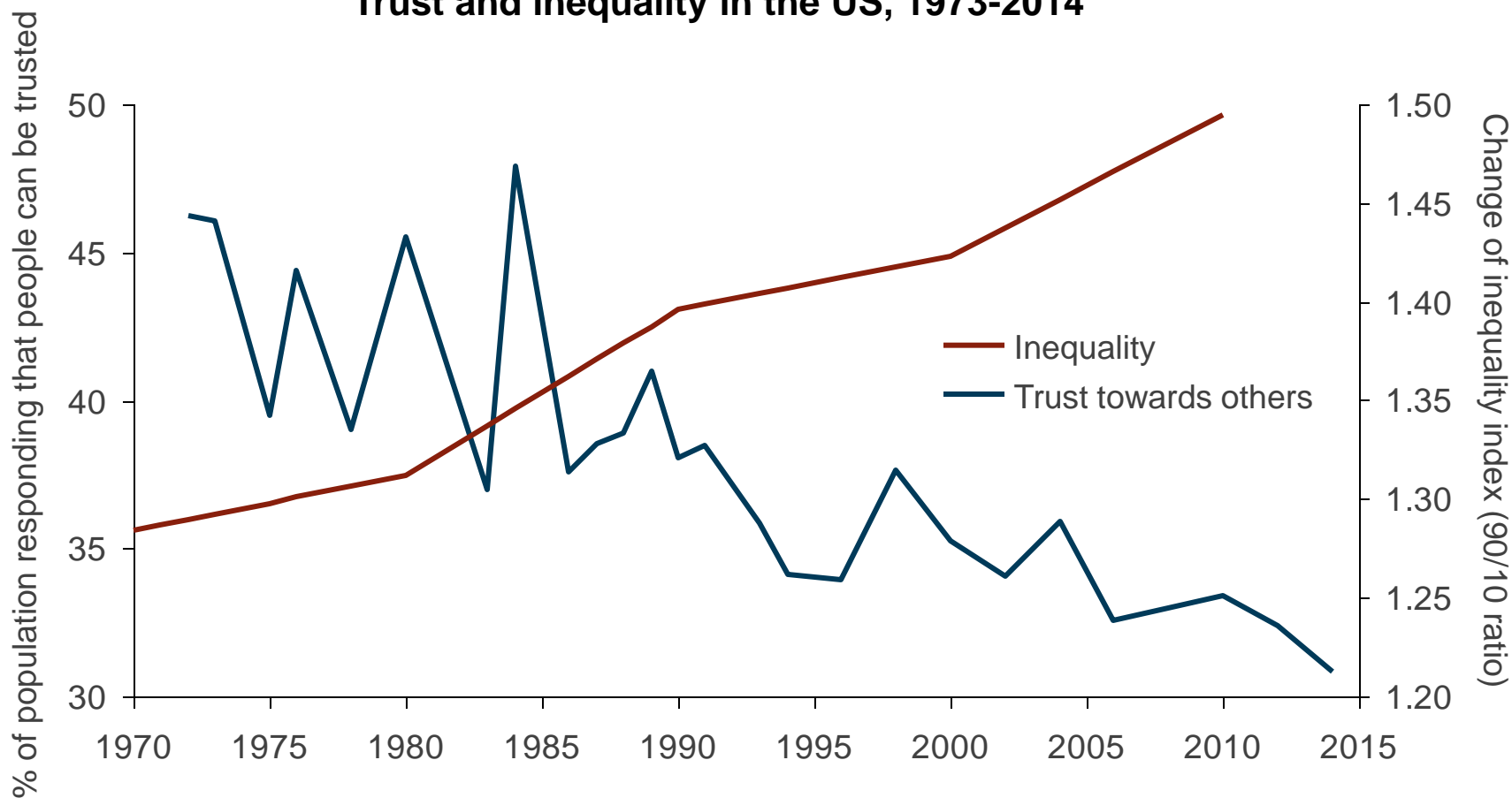


Source: Branko Milanovic.

Income equality and trust

Higher income inequality has reduced trust towards others

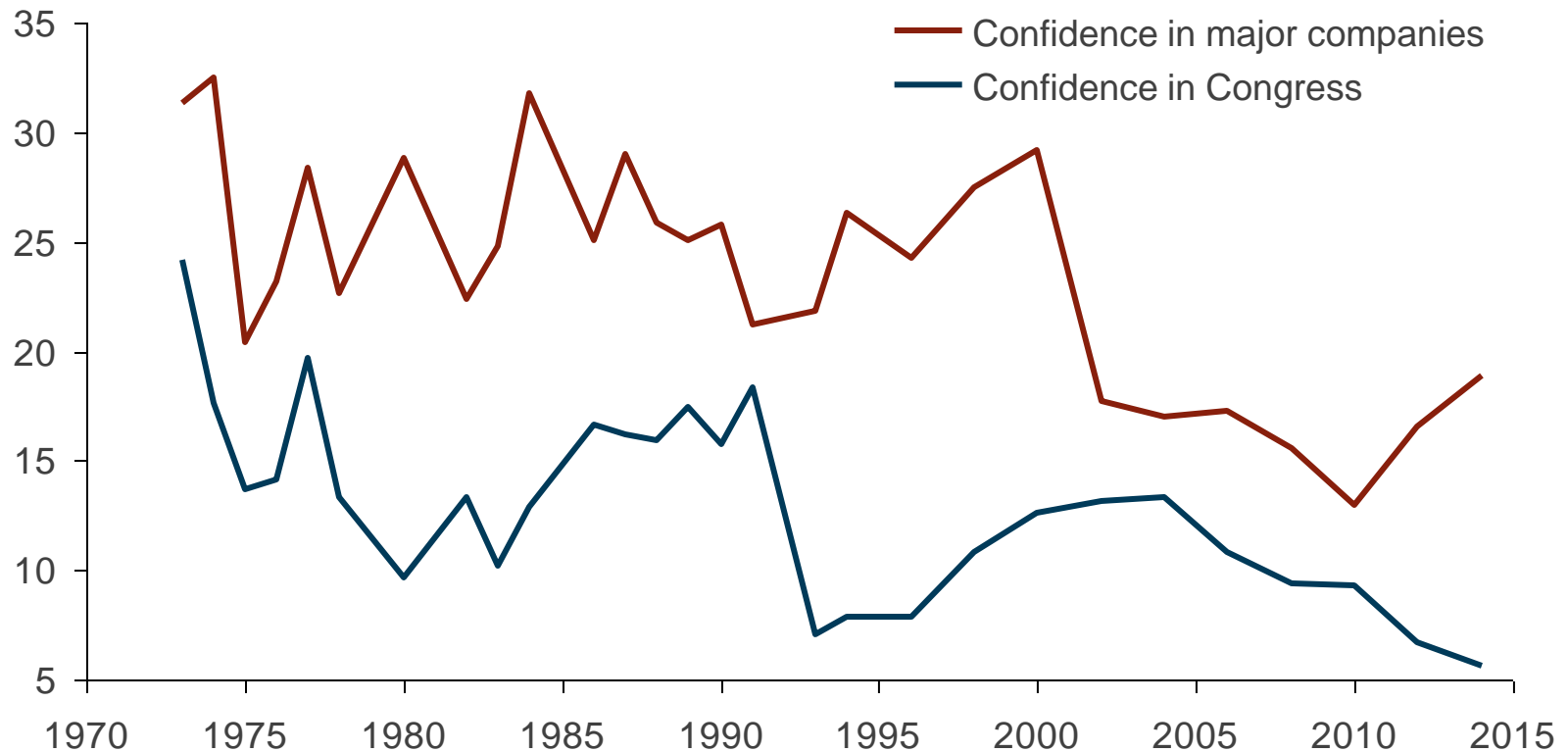
Trust and inequality in the US, 1973-2014



Confidence in government and major companies

Americans' confidence is close to all-time low

% of Americans with high confidence in Congress and major companies, 1973-2014



Source: General social survey (GSS)

Note: The survey asks respondents to choose the extent of their confidence among "a great deal of / only some / hardly any". This graph shows the percentage of Americans with "a great deal of confidence"

The Developed Countries

Brexit: profound consequences

For the UK, and Europe

- UK economy weakens in 2017
- Contagion: boost for anti-establishment and anti-EU parties across Europe
- EU referendums in other countries could trigger euro zone crisis
- Scotland independence, impact on Ireland?



Economist.com

Uncertainty surrounds the UK economy

We expect a domestic demand to stall in 2017, with slower real GDP growth

2016: Uncertainty and market volatility

- Businesses and consumer unsure how to respond. Some spend decisions deferred. But weaker FX provides trade support.
- Bank of England cut interest rates from 0.5% to 0.25%, a new record low
- Early signs on EU stance on exit deal

2017-18: Second-round effects hit domestic economy

- UK-EU negotiations take place while the economy is experiencing higher inflation, rising unemployment and falling investment
- Domestic demand stalls in 2017: real GDP 0.7% y/y
- Unemployment peaks at 6% in 2018

2019-20: The reality of Brexit

- Deal takes shape in 2019
- Shrinking labour force coupled with a decline in services exports
- Domestic demand in gradual recovery
- Structural features mean UK remains an attractive business environment



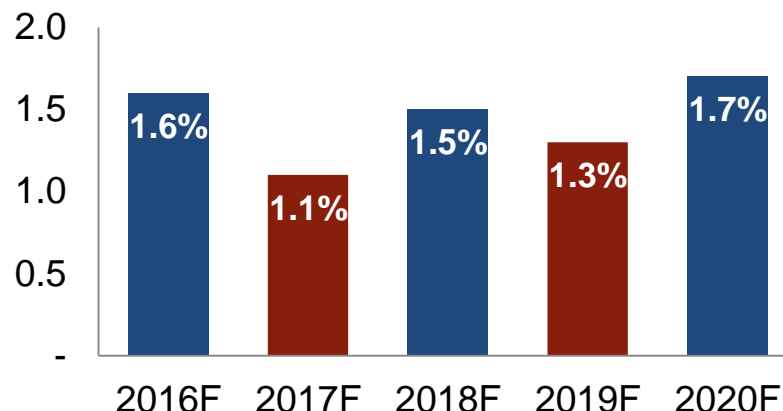
Europe: A year of slowdown in 2017

Recession takes 2017 real GDP growth to 1.1%, recovery expected in 2018

The Brexit vote triggers a crisis of sovereignty, security and identity across the EU

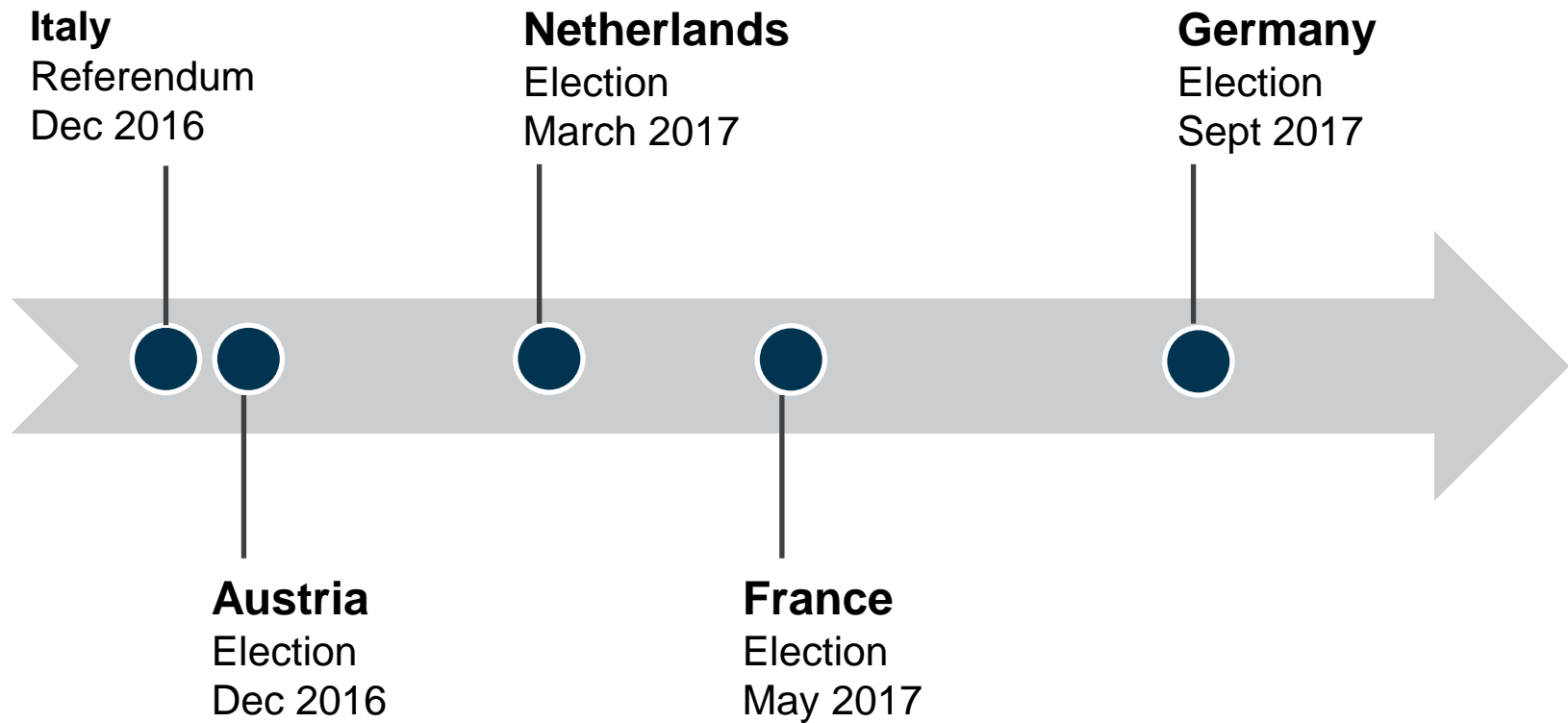
- Baseline forecast: deal that sees the UK exiting - migration control vs. services trade with the EU
- Questions about the future: struggle to negotiate Brexit, the risk of Grexit (60% probability), weak labour market and the migrant crisis
- Brexit vote puts heat on Italian banks - €360bn burden of non-performing loans
- State of emergency in Turkey (failed coup)
- ECB's exceptionally loose monetary policy:
 - Key interest rates at or below zero
 - €80bn per month QE programme
 - longer-term refinancing options aimed at pushing banks to lend more money
- The euro has shown resilience following the Brexit (2017 average US\$1.09:€1.00)

EU (Real GDP change %)



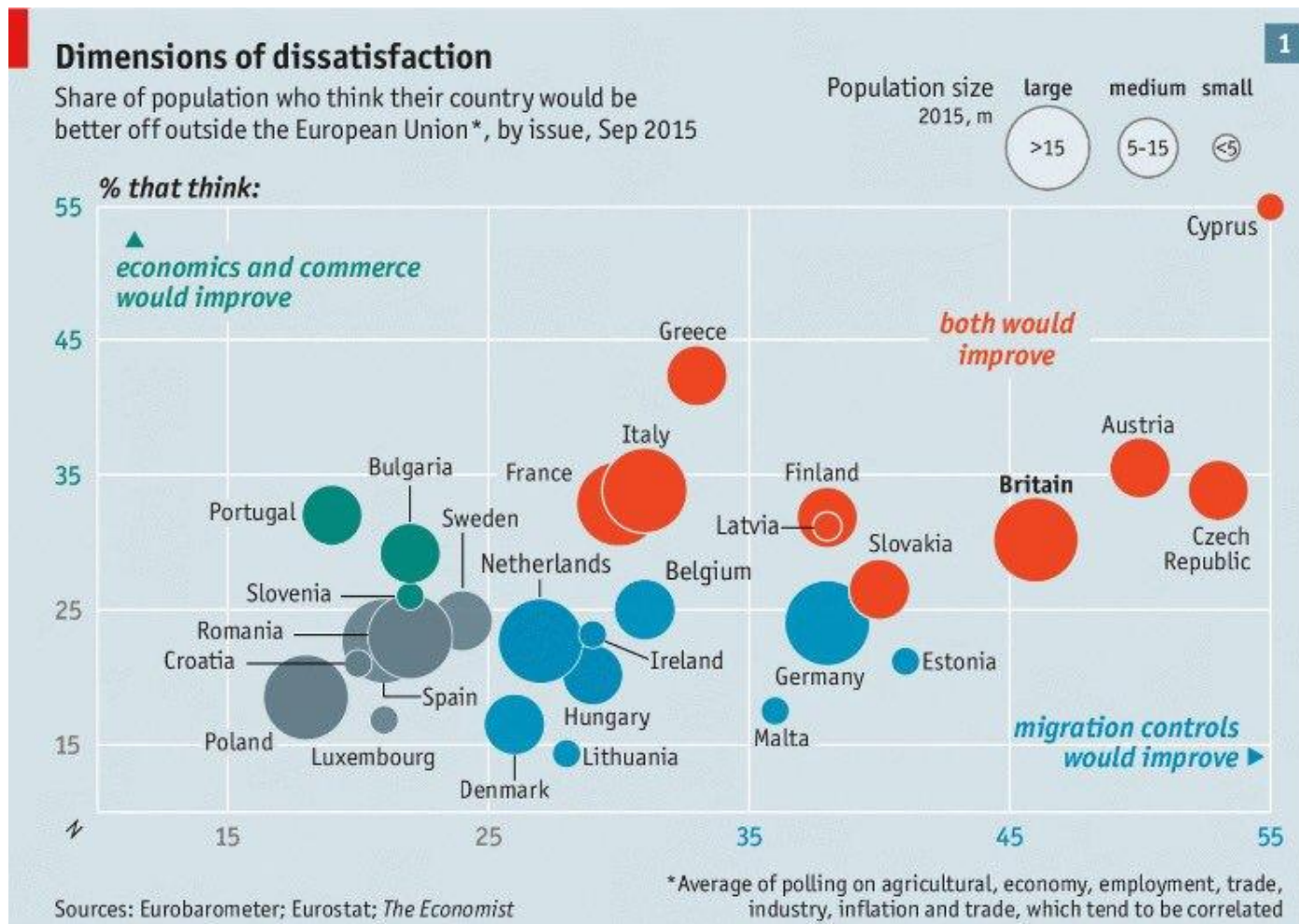
European Union: a road to nowhere?

Busy electoral calendar poses existential risks



Europe: on the brink?

Remarkably few contented countries

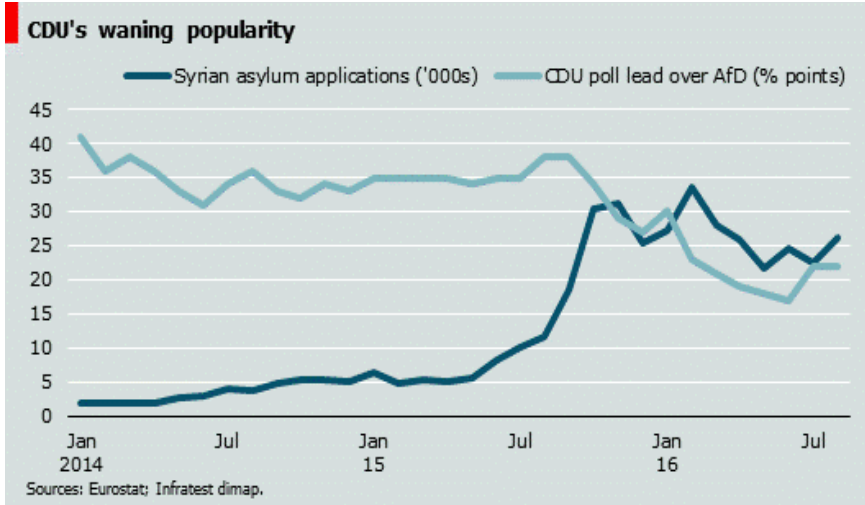


A test for Germany and France in 2017

The far-right will gain in both countries, but fall short of taking power

Germany

- 1.1m immigrants in 2015: >1% of total pop
- Merkel out of step with public opinion
- CDU/CSU coalition to win 2017 election and Merkel continues as chancellor
- Alternative for Germany (AfD) will pass 5% threshold and enter parliament for first time



France

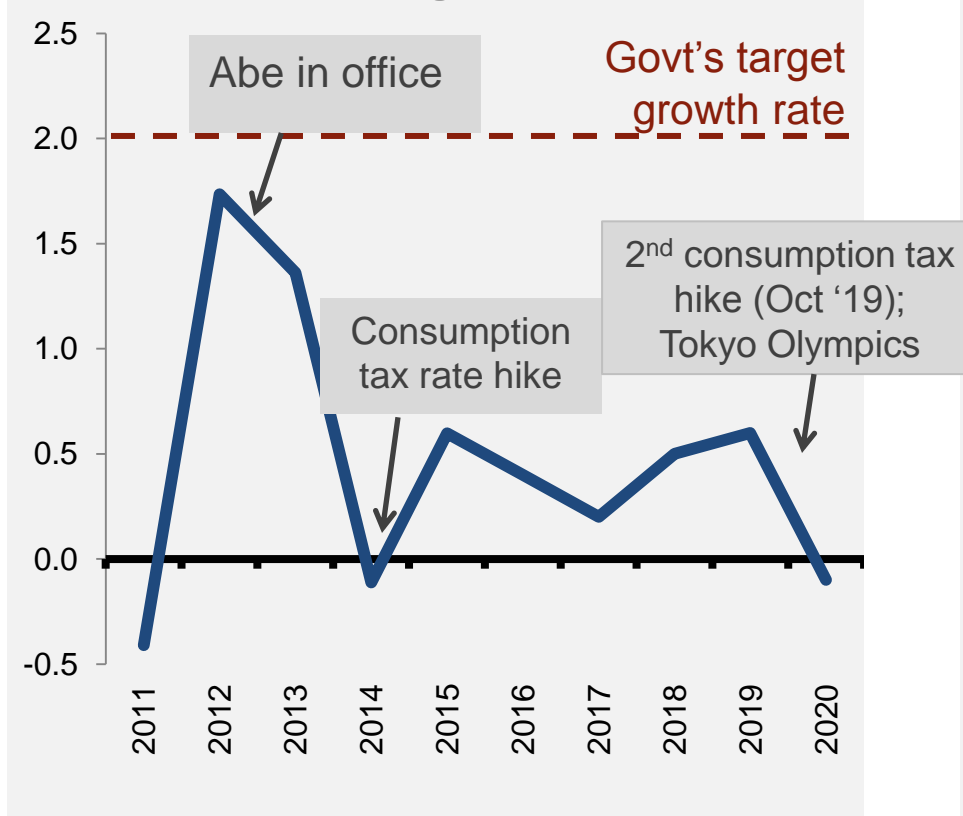
- Ignominy for Hollande, as Parti Socialiste (PS) conducts a primary
- Fillon for Les Républicains
- Le Pen for Front Nationale (FN)
- FN beats PS in first round
- PS voters support Fillon in 2nd round



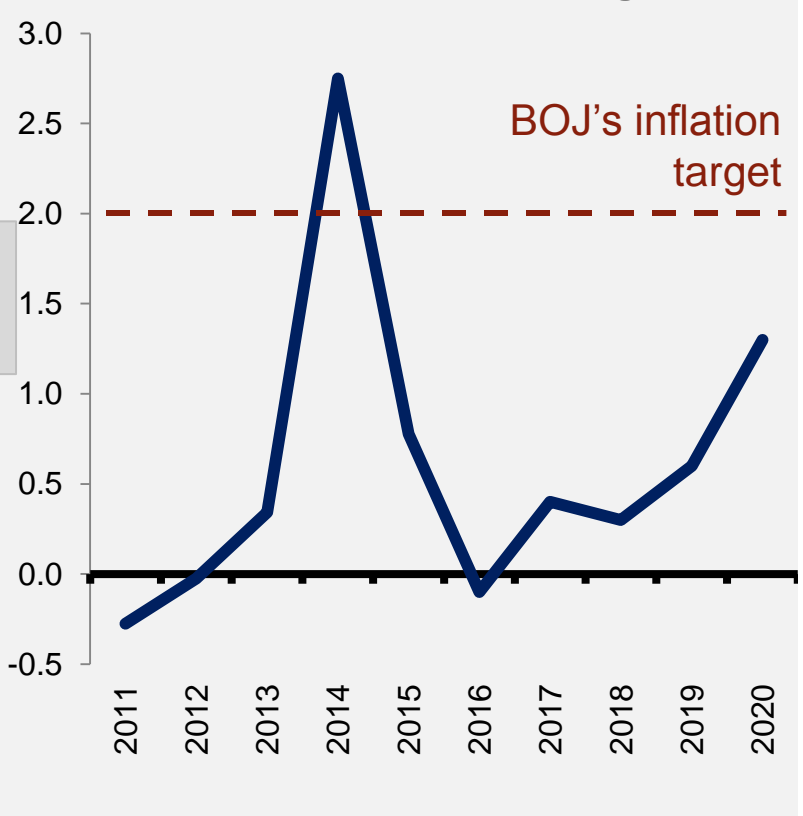
Japan: Abenomics will not achieve its objectives

We forecast real GDP growth will average 0.3% per year over next 5 years

Real GDP (% change)



Consumer prices (% change)



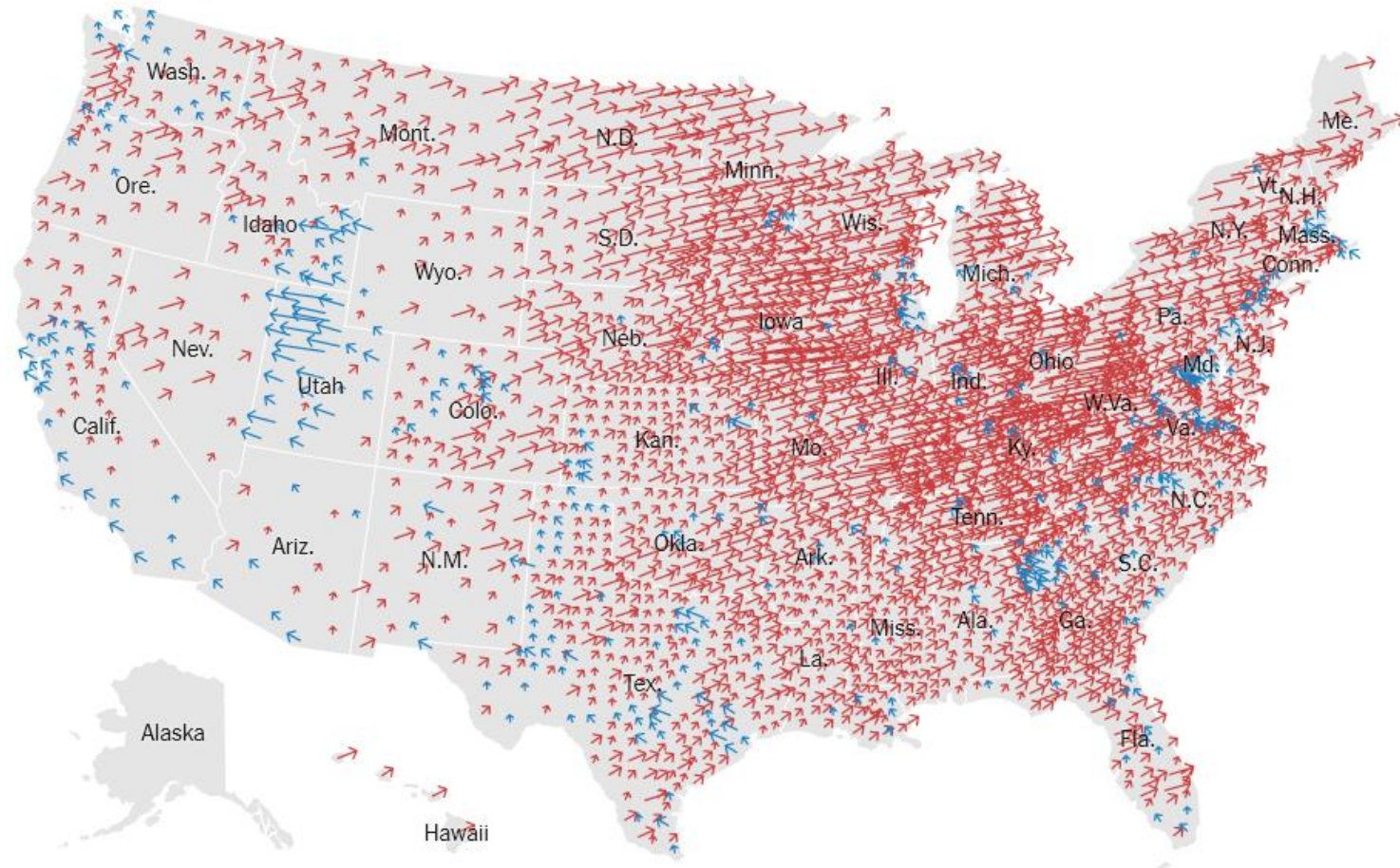
Source: The Economist Intelligence Unit.

Trumped!



The new electoral map

The Rust Belt swings

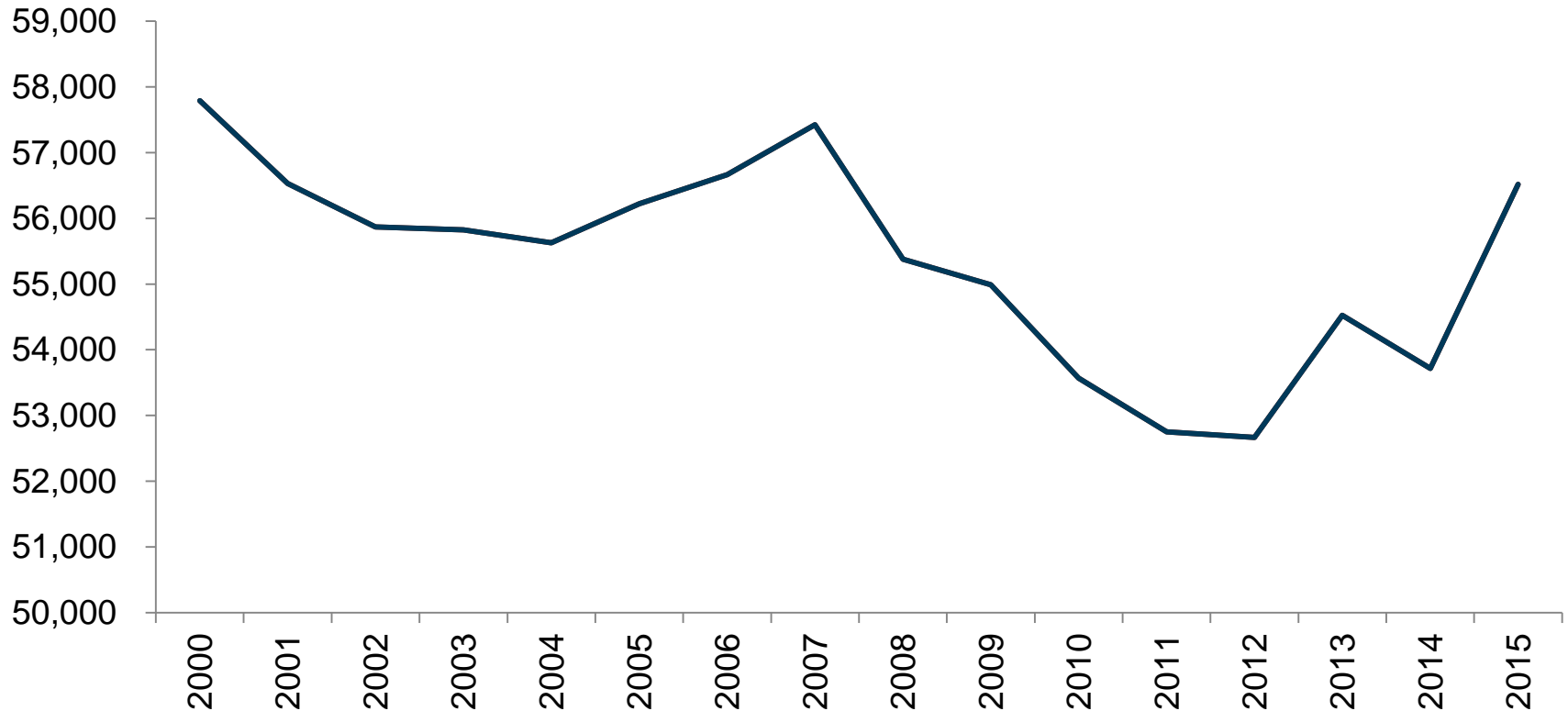


Source: The New York Times.

The new electoral map

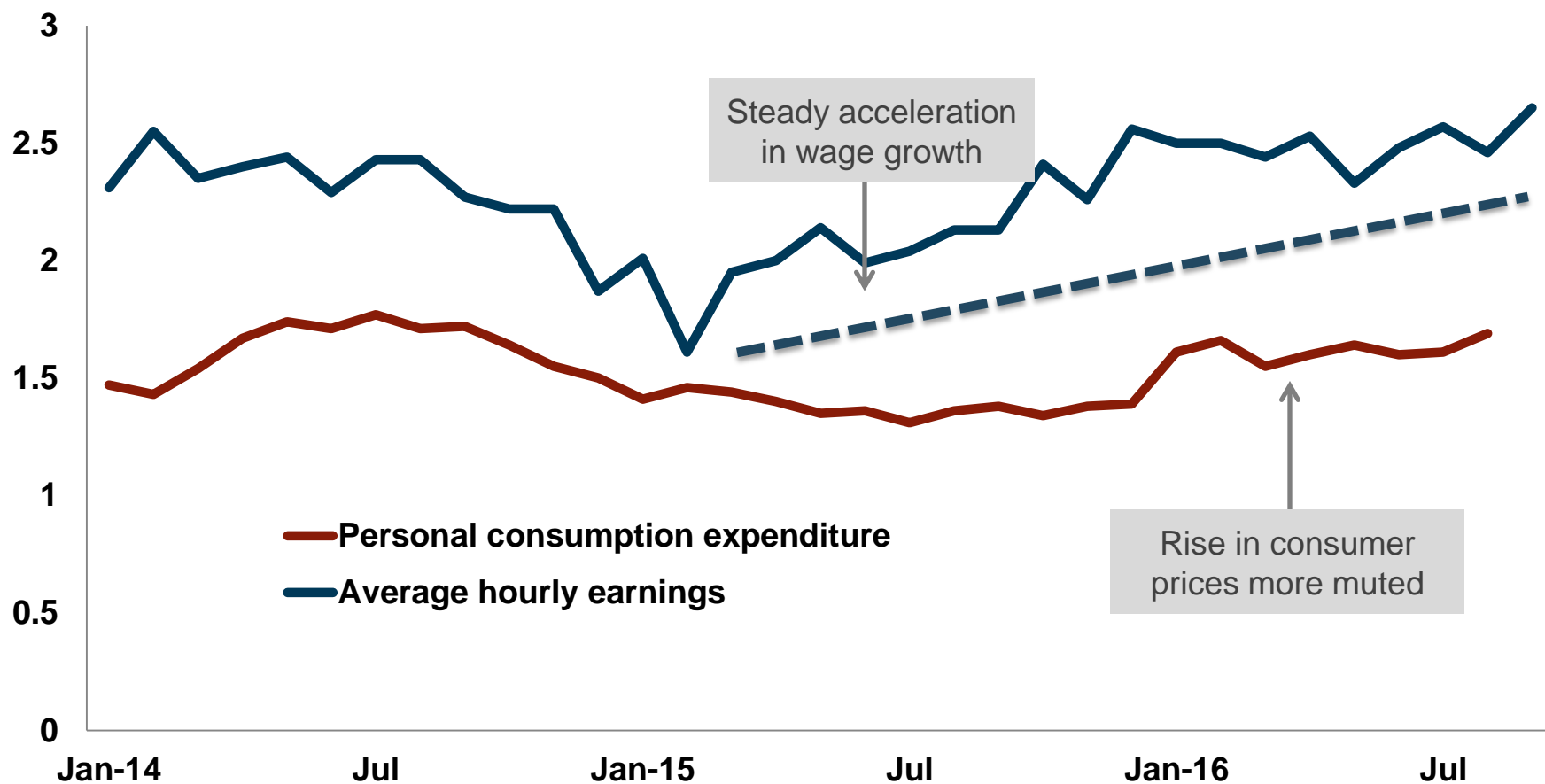
How rich do you feel?

Median household income (US\$)



Power to the people

Accelerating wage growth is delivering a big increase in real incomes



Source: Bureau of Labor Statistics.

Everything is negotiable in the age of Trump

What he said he would do, versus what he will...



What he promised:

- **Trade:** 'better deal' for US; tariffs up to 45% on Chinese imports; renegotiate NAFTA; TPP dead
- **Immigration:** border wall with Mexico; 11m undocumented immigrants deported; visa suspensions; end to DAPA/DACA; refugee intake cut
- **Energy:** withdrawal from climate change agreements; support for fossil fuels industry; Keystone XL approved

What he will deliver:

- **Trade:** symbolic tariffs on Chinese/Mexican goods; TPP dead; little economic impact
- **Immigration:** Small extension to existing border fence; some increase in deportations; visa suspensions; DAPA/DACA gone; fewer refugees accepted
- **Energy:** no support for CPP; withdrawal from Paris deal; EPA gutted; Keystone approved; new drilling on public land

The Trump administration

What he said he would do, versus what he will...



What he promised:

- **Fiscal policy:** huge infrastructure plan; big corporation and personal tax cuts; creation of thousands of new jobs
- **Healthcare:** Obamacare repealed, replaced with 'much less expensive', 'better' deal

What he will deliver:

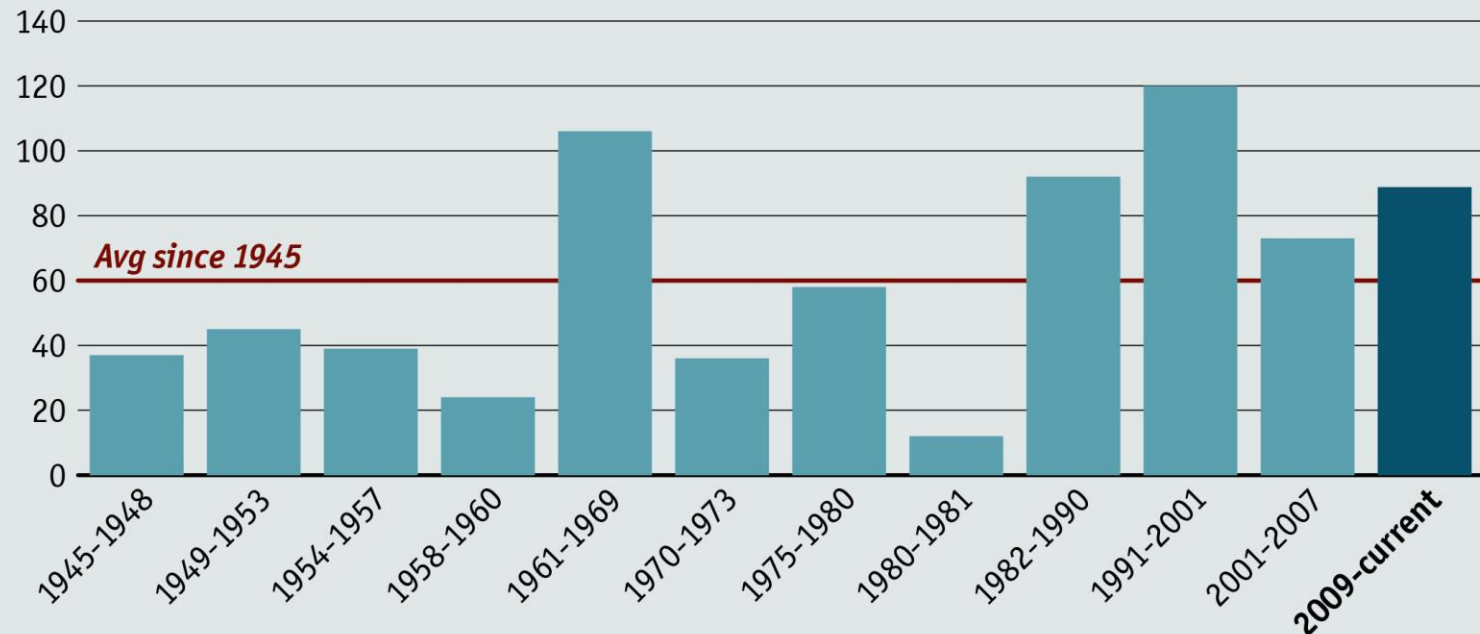
- **Fiscal policy:** Smaller infrastructure plan; corporate tax cuts; rationalisation of personal taxes and rates
- **Healthcare:** key planks removed to weaken Obamacare but some architecture survives

Likely to deliver a growth boost

But not much slack in economy, so next recession sooner rather than later

US business cycle expansions

(number of months, trough to peak)

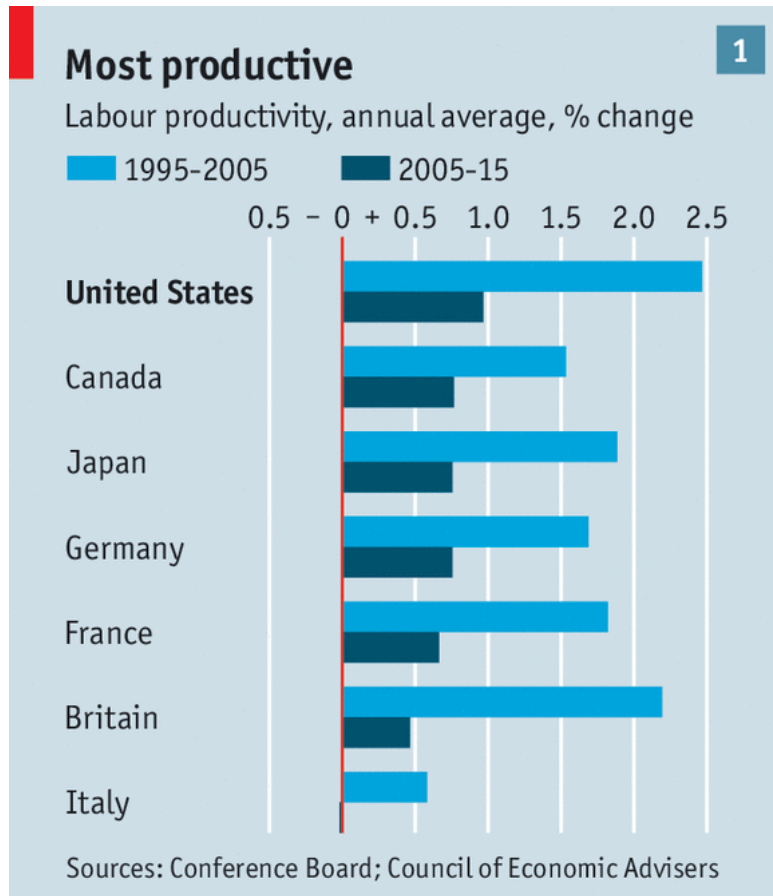


Note: The NBER defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.

Source: National Bureau of Economic Research (NBER).

The enduring constraint

The US has a productivity problem; just like everywhere else



Economist.com



Barack Obama's prescription:

- Higher public/private investment
- End to anti-tax, anti-deficit ideology
- Improving education standards
- Ongoing push for free trade

We would add:

- More flexibility in labour market, esp for parents and carers
- Simplifying business taxes and regulations

What will Trump do?

A long, straight road stretches into the distance under a blue sky, with mountains in the background. The road is flanked by sparse vegetation and utility poles. The overall scene is desolate and open, symbolizing a path forward.

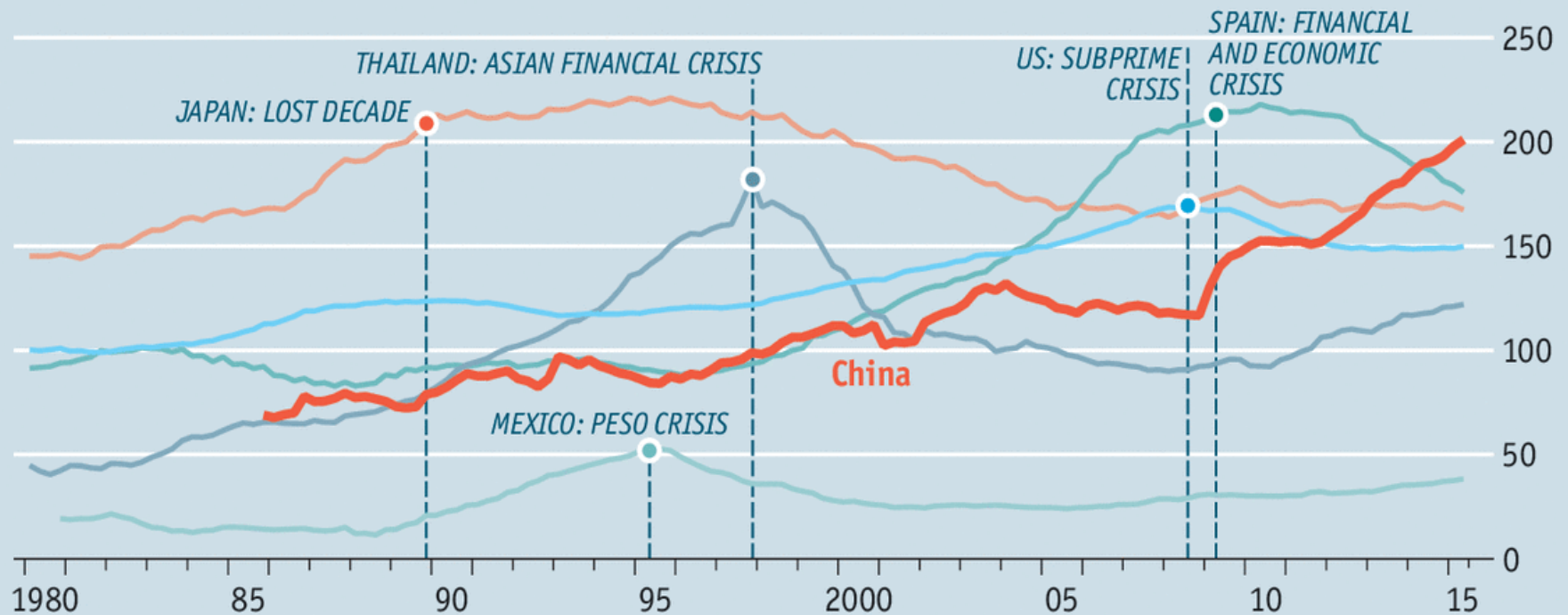
The Emerging Countries

China: pace of economic growth is not sustainable

Real GDP growth of 6.2% in 2017 will slow to 4.2% in 2018: hard landing!

No boom without a bust

Private non-financial sector credit as % of GDP

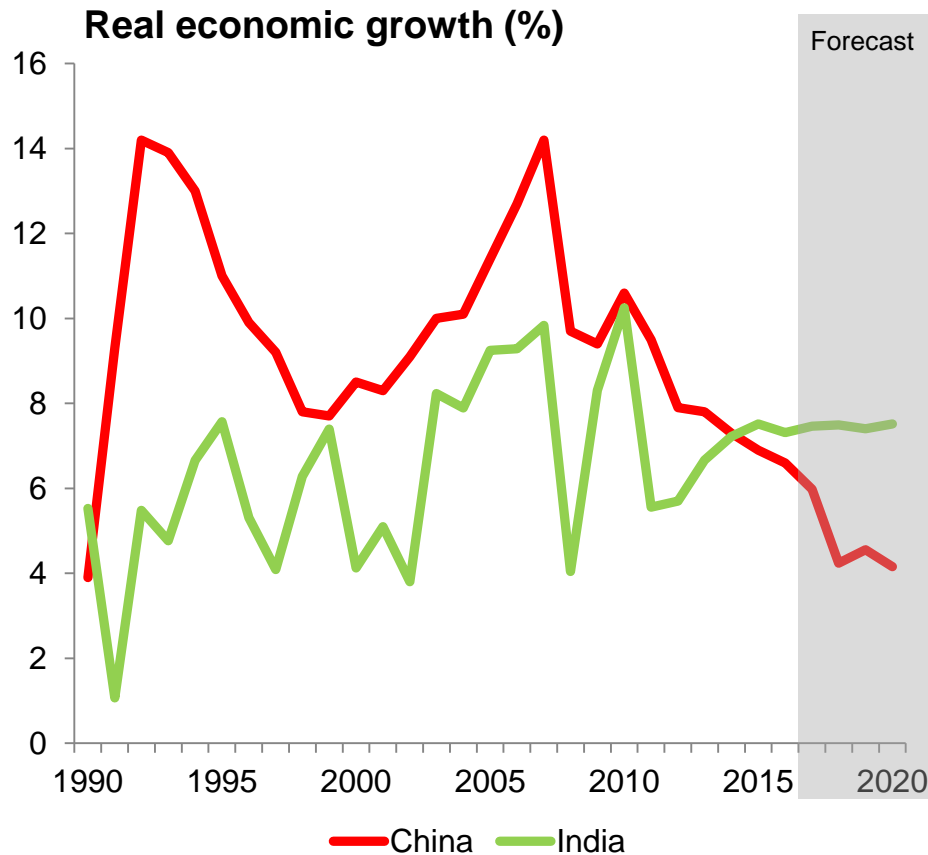


Source: BIS

Economist.com

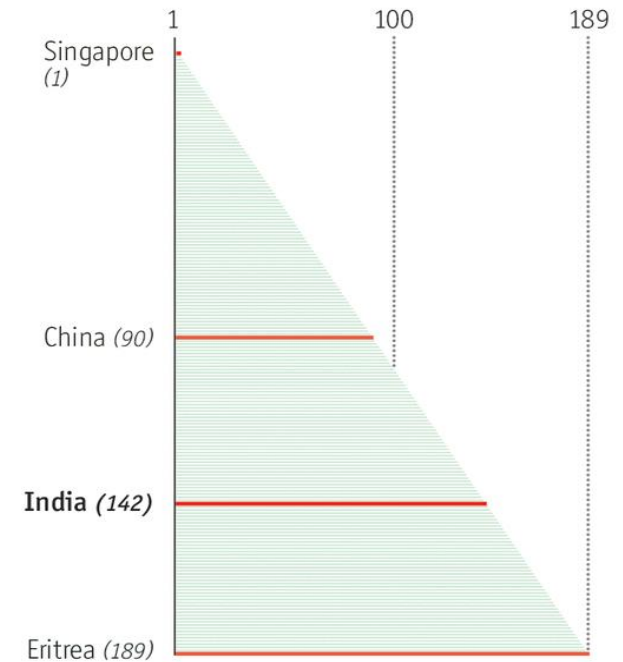
India: catching up?

India has overtaken China as the fastest growing large emerging market



Needing a lift

"Ease of doing business" ranking
2014, (1=best)



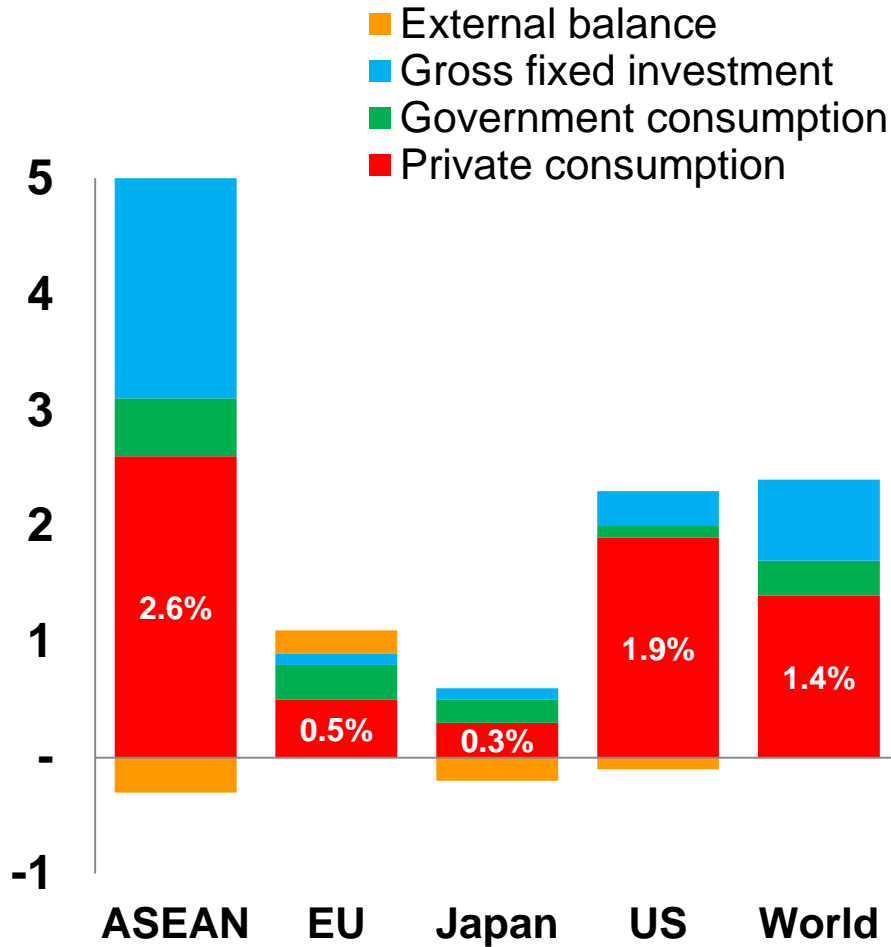
Source: World Bank

Economist.com

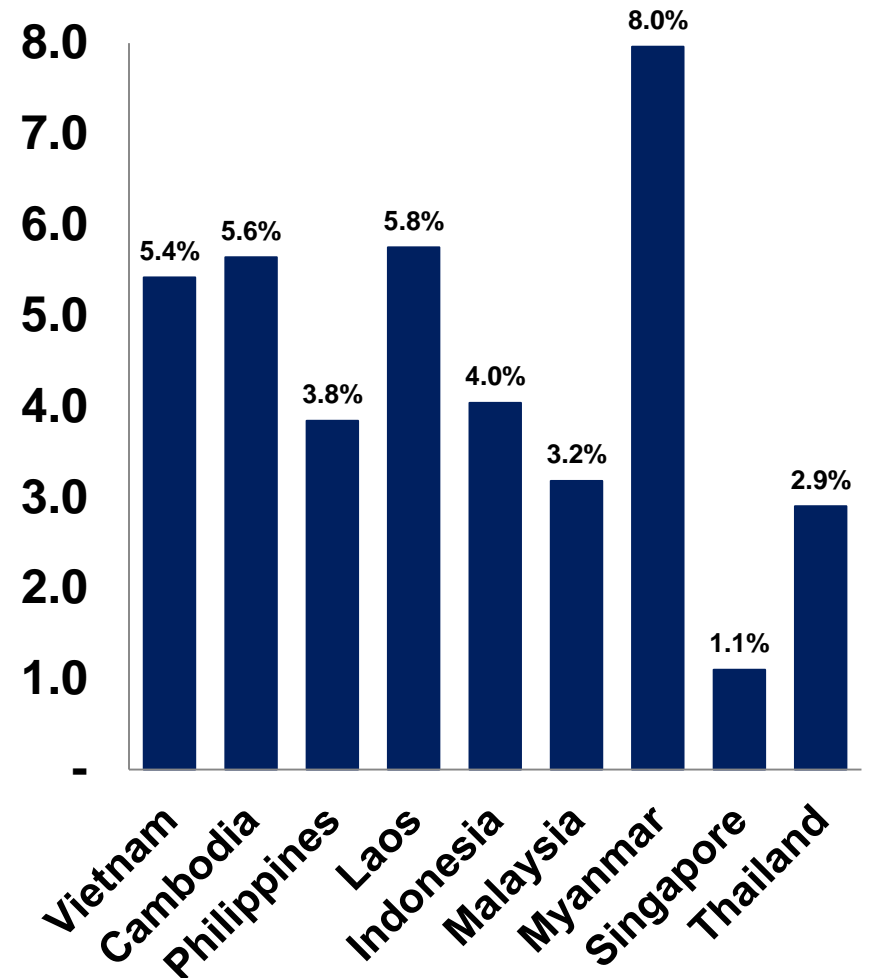
Source: The Economist Intelligence Unit.

Balanced growth in ASEAN

Contribution to real GDP growth in 2017
(% points)

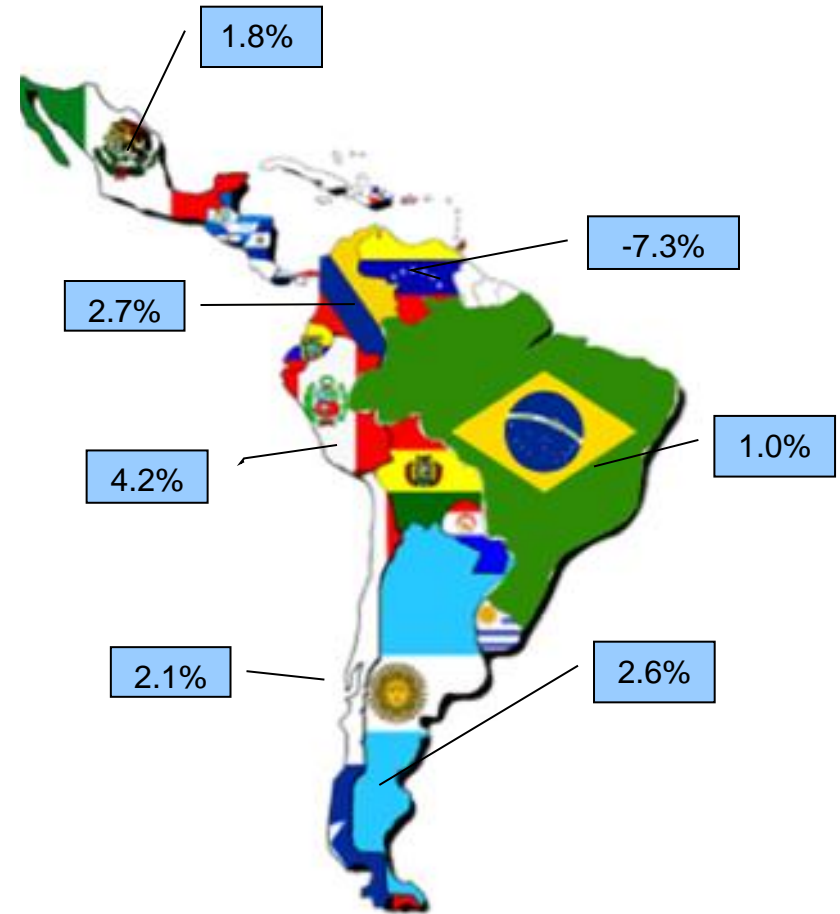


Growth of real GDP per head, 2016-20
(% change pa; avg)



The Latam outlook: mapping growth in 2017

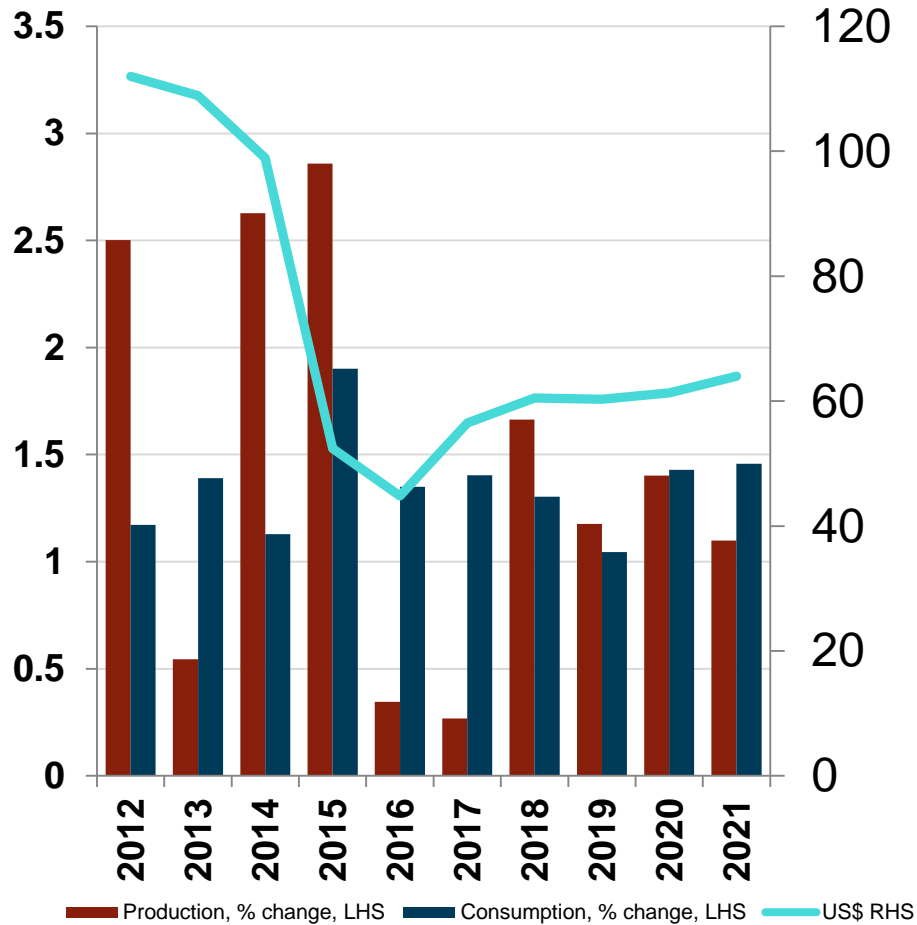
- Latin America is expected to grow at 1.8% in 2017 after shrinking by 0.5% in 2016
- Growth will be dragged down by performance of Brazil and Venezuela
- Peru and Colombia remain among top performers, but growth slower than in previous years
- Argentina's economy finally picks up
- Mexico outlook clouded by uncertainty over US policy



Source: Economist Intelligence Unit, CountryData.

Modest oil price relief will help Gulf

But high downside risk

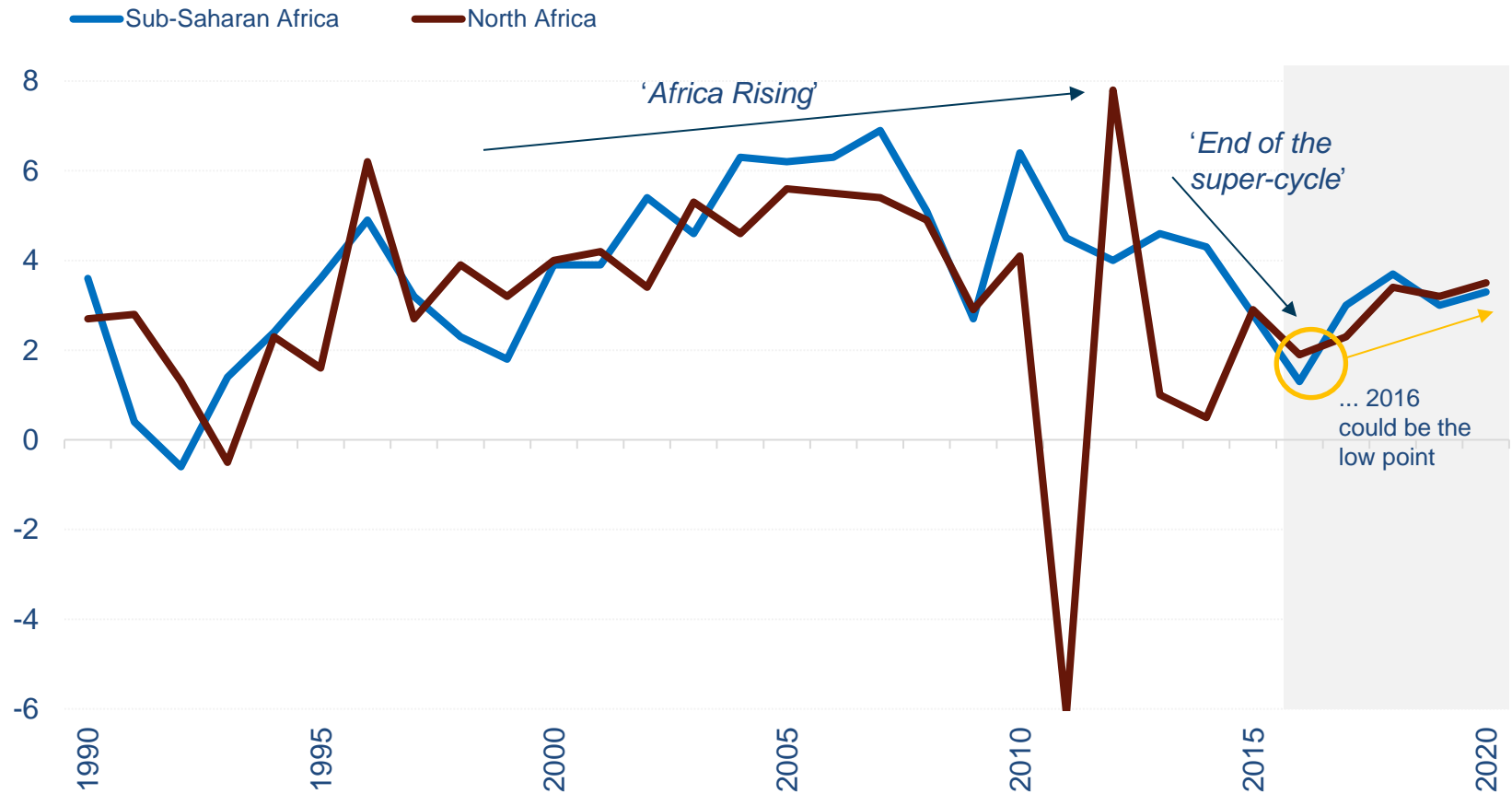


- Oil production/demand broadly in balance in 2018-21
- No return to sky-high oil prices
- GCC public finances will continue to be pressured as a result—big budget deficits for all in 2017
- OPEC market control proposals too modest to have an impact. Russia unlikely to curtail production
- Shale has been resilient. Any price increase will quickly trigger shale production increase

Source: The Economist Intelligence Unit.

African slowdown is coming to end

African Economic Growth
(Real GDP annual % change)



Source: EIU

From 'Africa rising' to 'Africa diverging'

Excelling

- Rapid growth (>5%)*
- Non-resource dependent
- Pursuing reform agendas
- Trade and competitiveness
- Private-sector investment

Cote d'Ivoire, Ethiopia, Ghana, Kenya, Rwanda, Senegal and Tanzania.

Holding

- Reasonable growth (3-5%)*
- Important vulnerabilities
- Industrial development
- Sleeping giants
- Strong potential

Botswana, Cameroon, DR Congo, Egypt, Gabon, Mauritius, Mozambique, Morocco, Sudan, Uganda and Zambia.

Lagging

- Slow growth (<3%)*
- Sizable economies
- Structural issues
- Resource dependent
- Fragile states and conflict

Algeria, Angola, Libya, Nigeria, Rep. Congo, South Africa, Tunisia, Zambia and Zimbabwe.

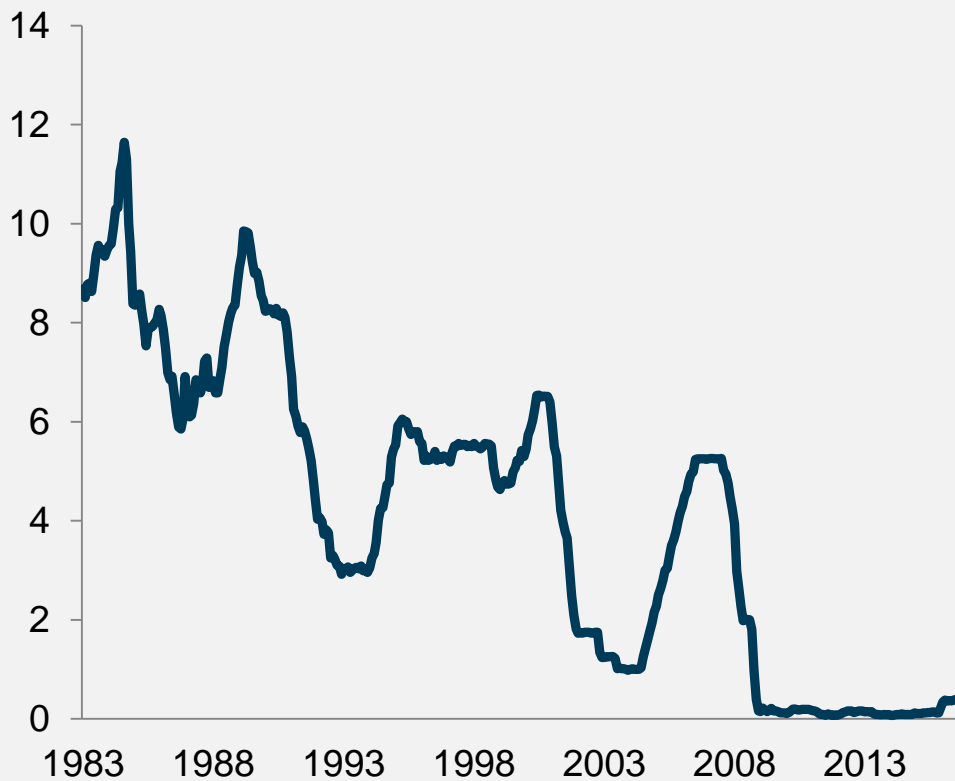
* Average annual real GDP growth in 2016-20

Global issues to watch

Monetary policy in a new normal

Central banks are unprepared for the next recession

US federal funds rate (%)



Source: The Economist Intelligence Unit.

“ I know you think you understand what you thought I said but I'm not sure you realise that what you heard is not what I meant”



Policy options

Quantitative easing ✓

Forward guidance ✓

Negative interest rates ?

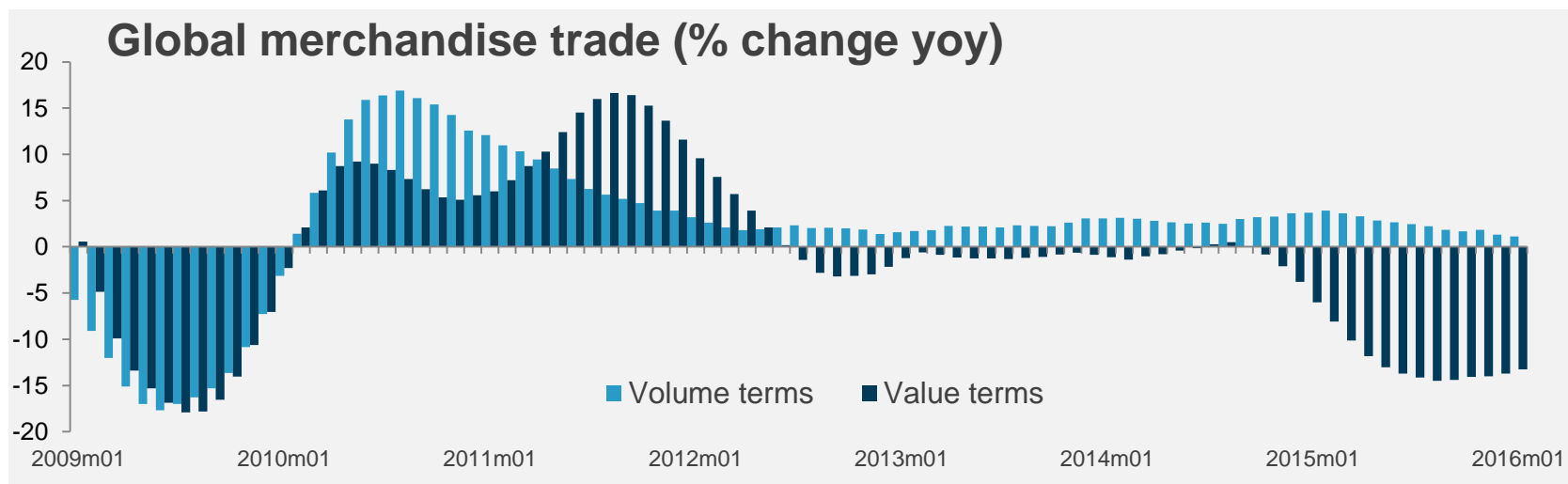
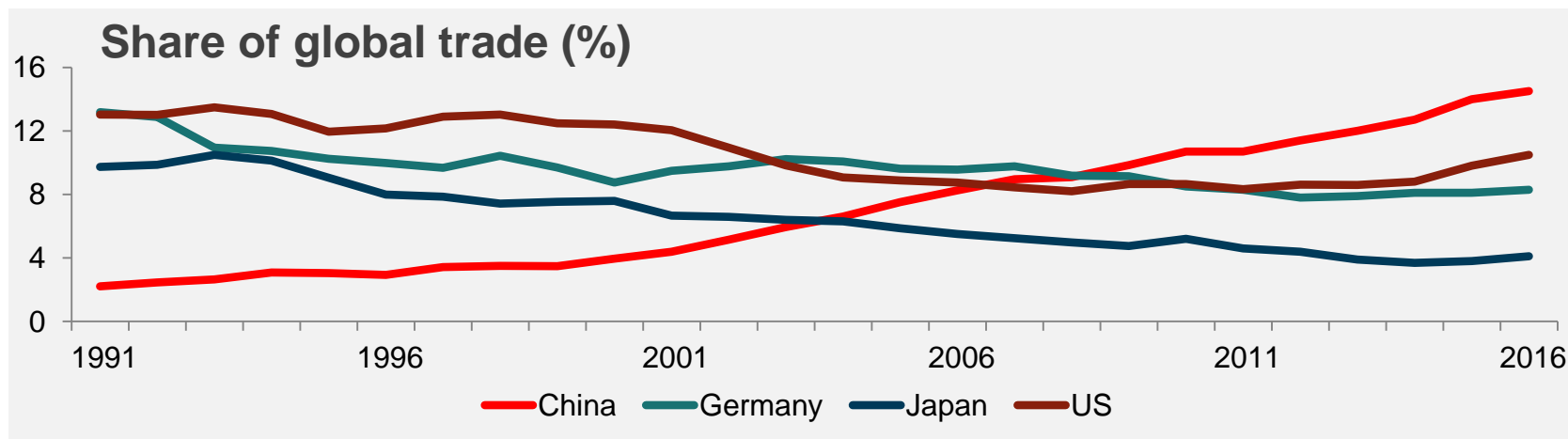
Higher inflation target ?

Target nominal GDP ?

Helicopter money ?

Trade, a secular decline

Global trade having its worst year since 2009, will improve modestly in 2017



And the answer is....?

Key economic themes in 2017

Global economic growth quickens from 2.2% in 2016 to 2.5% in 2017

Low interest rates

- Cheap money remains key support for global economy
- Central banks reaching limit of capabilities
- Interest rates will remain unchanged in Eurozone and Japan in 2017-20
- We expect only one Fed rate rise in 2017

US to drive OECD growth

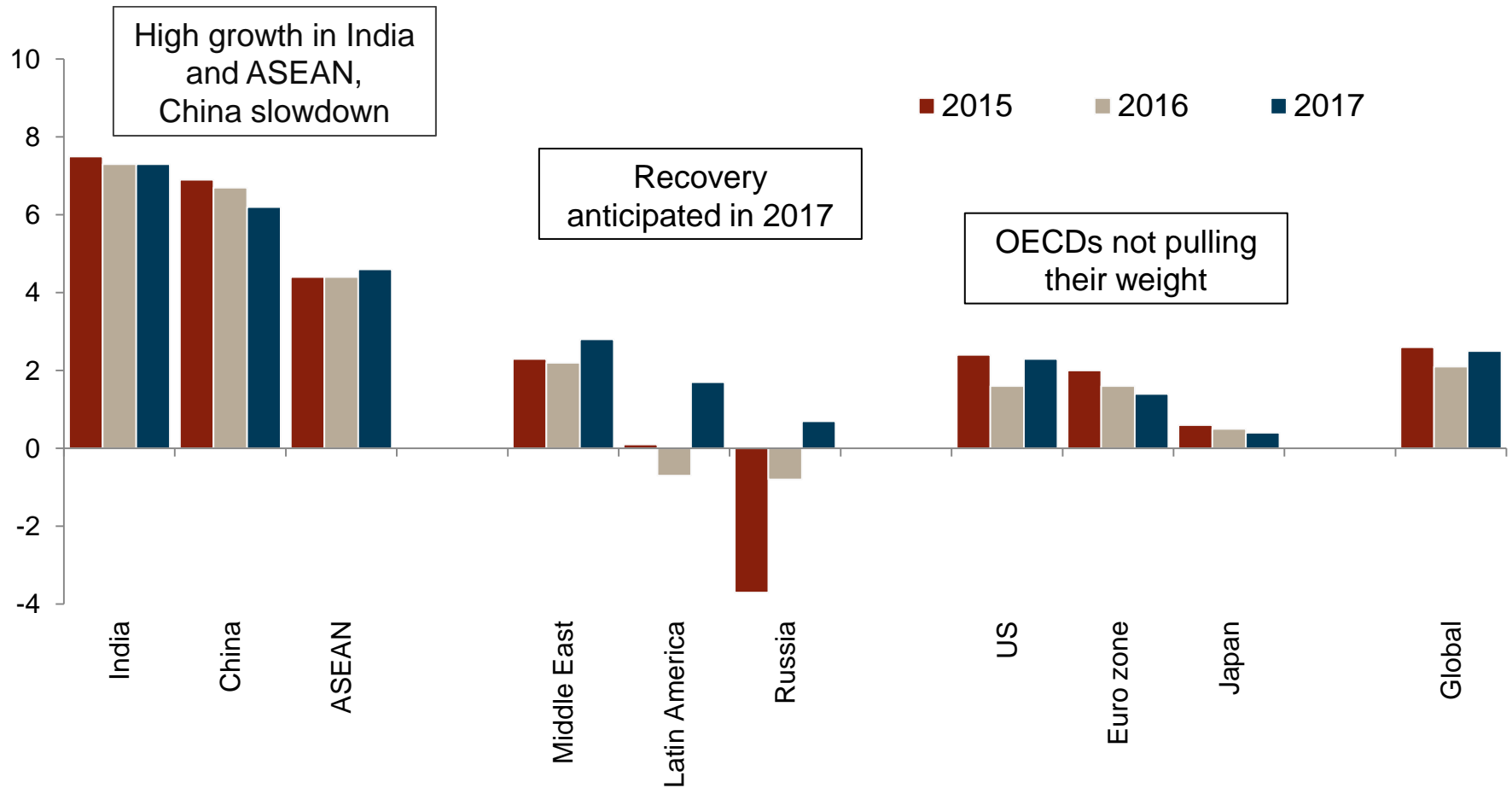
- Rich world governments are not pulling their weight
- US will remain engine of growth in the OECD – until 2019
- Sluggish economic growth of around 2% is new normal for the US
- Eurozone weighed down by political issues

Emerging markets improve

- China keeps credit taps switched on as Party Congress approaches
- Low bond yields fuel demand for risky EM assets
- Brazil and Russia return to growth after contracting for two years
- Commodity markets start to rebalance

Where is the growth?

Higher commodity prices support EMs in 2017: last hurrah of the decade



Real GDP growth; % change, year on year.
As of September 2016. Source: The Economist Intelligence Unit.

What does it mean for you?

The impact on UK education

UK and Brexit

- Unwelcoming narrative for foreign students
- Immigration controls seem to be trumping desire to deal with UK productivity gap
 - Hence poor outcome from PM India visit
 - Productivity to be addressed via infrastructure?
- Weaker pound makes UK courses more affordable
- EU students rush to get in while they still can?
 - Fees for them will reset in 2019?

Net effect could be final hurrah before marked deterioration?

Overseas conditions

- US narrative very unwelcoming
 - Australia too?
- US becoming more expensive due to dollar
- Better economic performance in some key markets
 - Latin America
 - Africa
 - South East Asia

Net effect supportive of UK institutions?

Questions?

