Brace for impact

The outlook for the global economy

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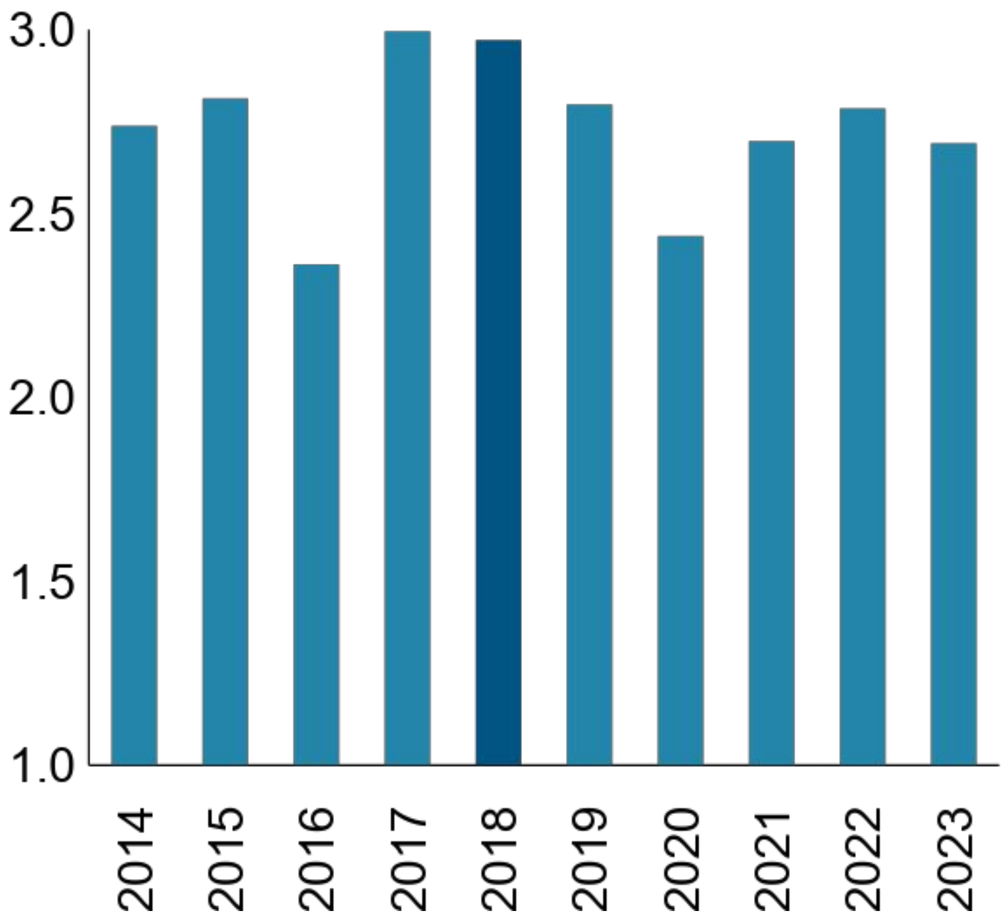
The Economist INTELLIGENCE UNIT

The global economic context

World: Brace for bumps

Trade tensions the top risk

Global GDP growth (%)

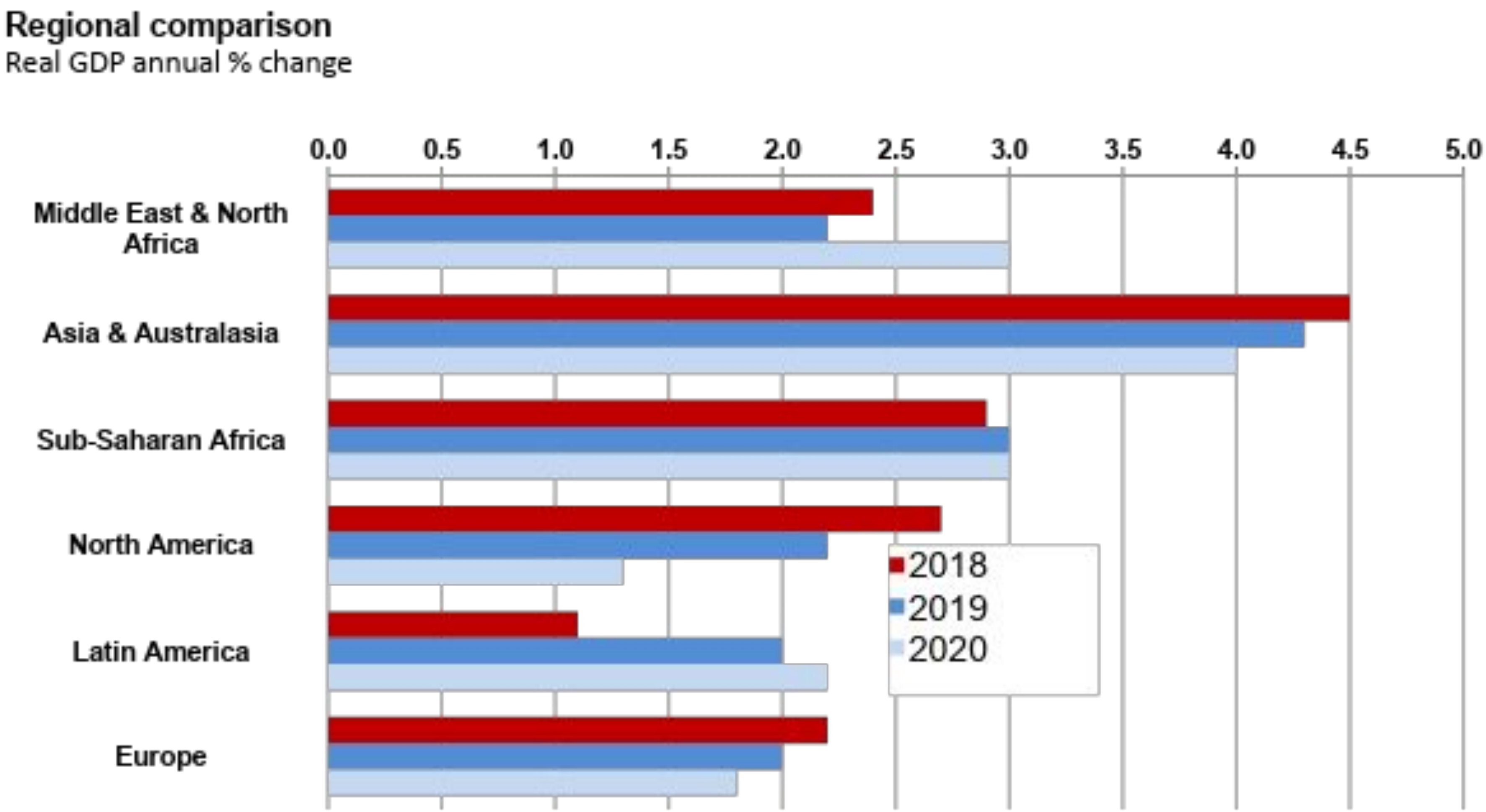


Source: The Economist Intelligence Unit.

- 2018: Another year of fairly strong growth in the US, EU, Japan and China
- Growth will accelerate in MENA and SSA, and remain brisk in Asia, especially ASEAN
- Risk has been building and has begun to weigh on global growth
  - A US-China bilateral trade war is escalating
  - The risks of an EM crisis are growing
  - Tighter global monetary conditions pressuring some emerging markets—Turkey, Argentina, India

World: Emerging markets lead the way

EMs account for 59% of global output (PPP), of 43% two decades ago…



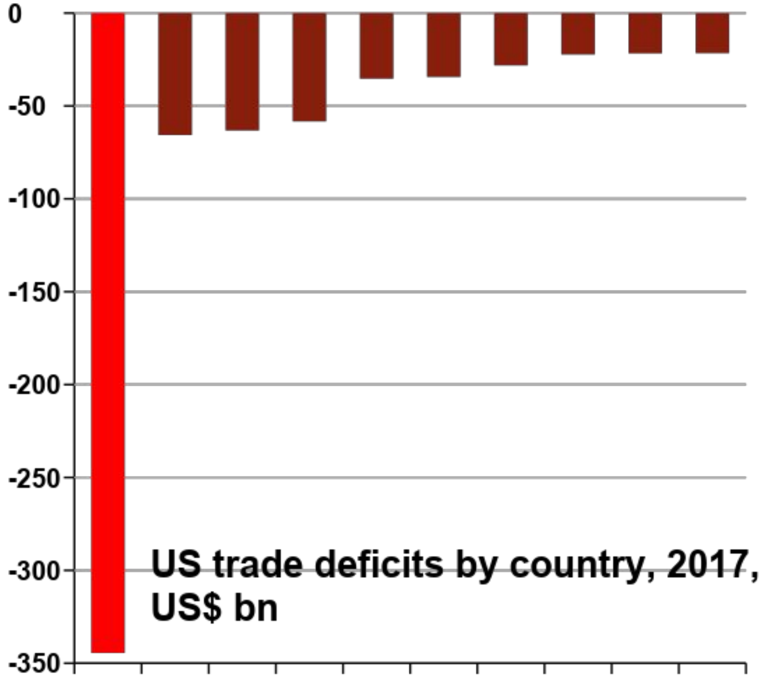
Source: The Economist Intelligence Unit.

Trade wars

Trade: US-China friction

Not just a bilateral problem

- 2018—"Trump unleashed"
  - Feeding meat to the base
- IP theft, tech transfer key pressure points—China vulnerable to US pressure, hits Xi's strategic industries
- Trade war: China vulnerable economically, US vulnerable politically
- Supply chains at risk in Asia and globally, companies already shifting operations
- Watch agriculture, tech



Source: National data.

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Trade war to dampen growth

China and the US in disagreement over intellectual property and China's technology transfer practices

US drawing others into the rivalry through the USMCA provision aimed at increasing the trade pressure on China

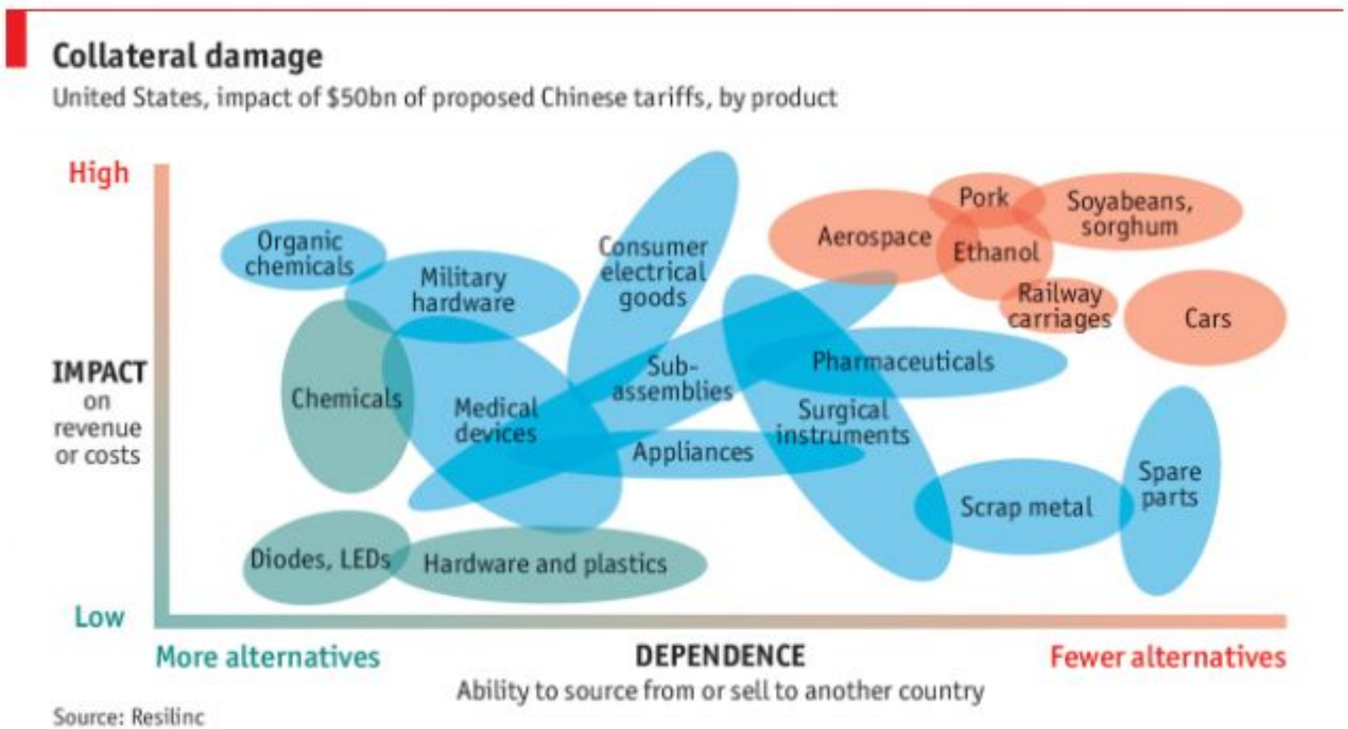
US VP Pence raised allegations of China meddling in US politics ahead of the mid-term elections, also BRI, Made in China 2025 and Taiwan

Global system expected to be characterised by competition between the US and China in the next five years

The support that trade has been giving to China's slowing domestic economy will fade in 2019

- Trade war expected to dampen growth: GDP growth will slow down from 6.6% this year to 6.2% in 2019
- Momentum in both private consumption and investment has weakened
- Disruption expected in a number of provinces that rely heavily on trade

The US is less trade-dependent than China, but sectors like agriculture and cars are suffering

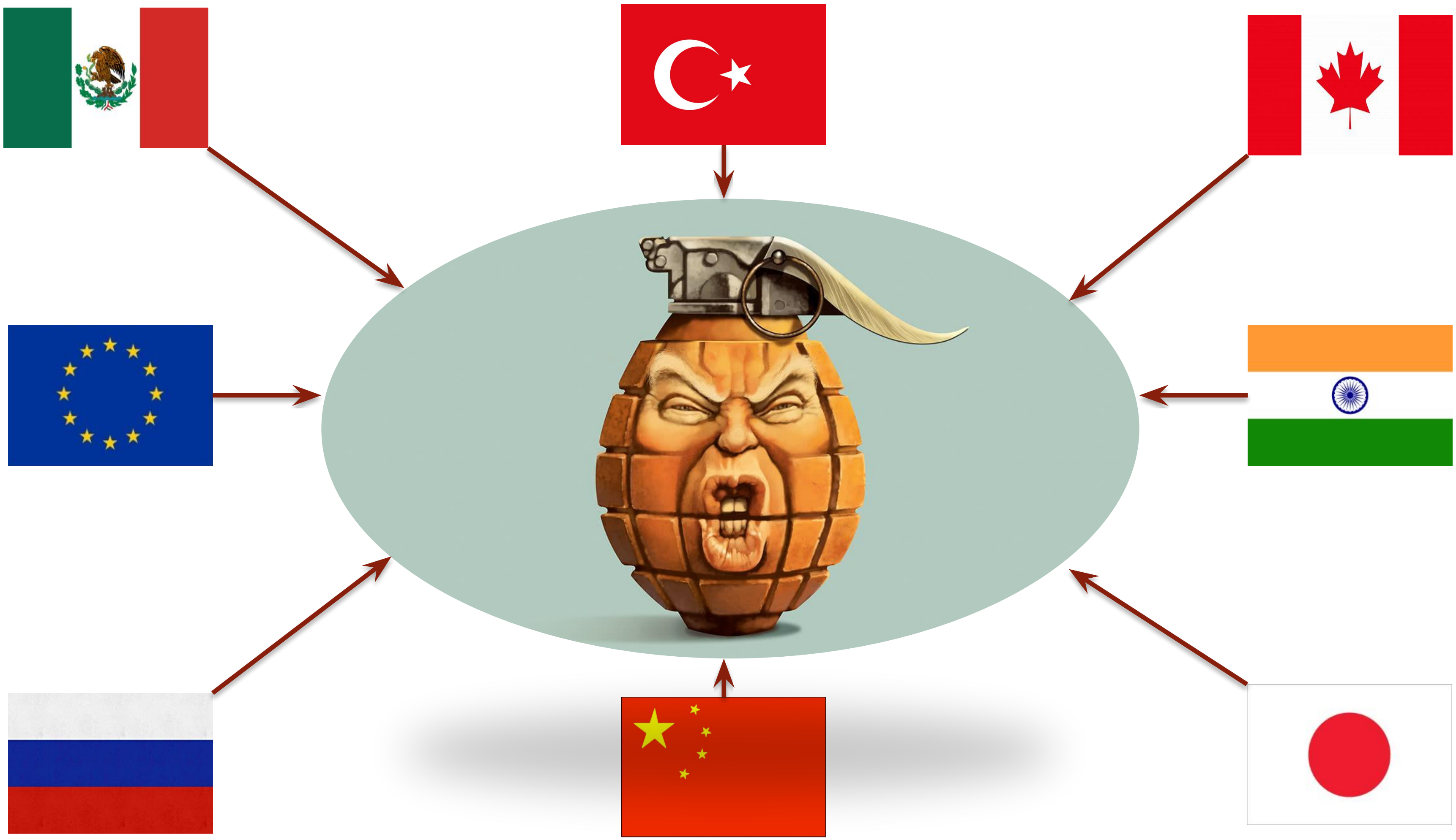


Escalating trade dispute with China coupled with monetary tightening by the Fed will start to weigh on growth in 2019—growth to slow in 2019 to 2.2%

The US manufacturing and agricultural sectors, in particular, will be hit by the trade dispute

Trade: A global dispute

US allies and trading partners are retaliating – almost in unison



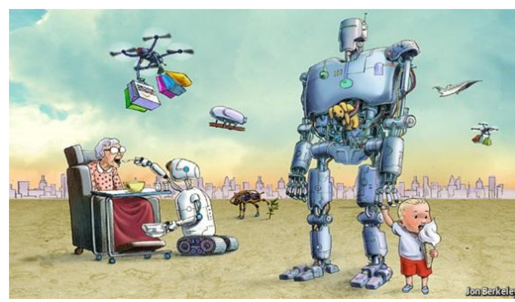
Trade: A proxy for Great Power rivalry

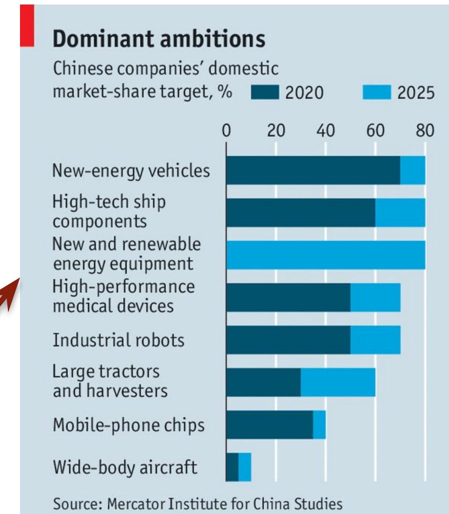
Strategic competition will ensure the trade war will continue past 2019

- The trade dispute represents the race between the US and China to be the world’s leading economy in the medium term

The rules of the game

Leading technologies





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Artificial Intelligence Is Now a Pentagon Priority. Will Silicon Valley Help?

Trade: The winners from US/China tensions

Some Asian exporters are set to benefit

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Garment exporters to benefit from US-China trade war

The imposition of bilateral trade tariffs by the US and China will disturb global trade flows. Prices of goods on the tariff lists will spike in their respective domestic markets, which will provide an opportunity to manufacturers of these goods in other markets to grab a larger market share. The garment industry in the US will be greatly disrupted by tariffs on Chinese goods and we believe that this will benefit major garment-exporting countries in Asia.

Since the start of 2018 trade policy has become the biggest risk to our central forecast for global economic growth. We now expect this risk to materialise in the form of a bilateral trade war between the US and China, with negative consequences for global growth. Nevertheless, the trade war between the world's two largest economies will be beneficial for some garment-exporting countries in Asia. After having already enacted tariffs on US$50bn-worth of Chinese imports, we believe that the administration of Donald Trump, the US president, will move ahead with imposing tariffs on a further US$200bn-worth. Chinese exports to the US totalled US$429.7bn in 2017, including US$42.5bn of textiles and textile-related articles, the majority of which are readymade garments (RMG). The imposition of an additional 25% tariff on these products will create a worldwide opportunity worth US$50bn for other major players in the garment industry to grab a larger market share in the US.

Bangladesh and Vietnam will benefit the most

The most benefit

- Bangladesh—US is second largest export market (after Germany)
- Vietnam—world's 3rd largest exporter of clothing & strong ties the US

Some benefit

- Sri Lanka—industrial base yet to expand sufficiently to be a global supplier
- Pakistan—political tensions with US will curtail the trading opportunities

No benefit

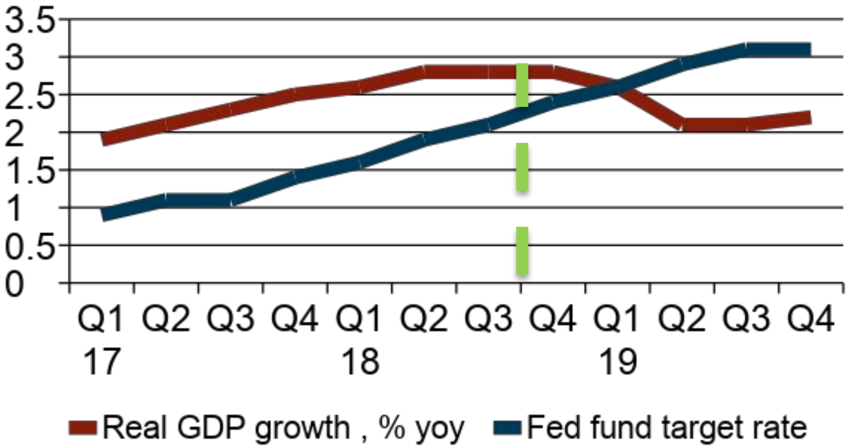
- India—due to relatively higher wages
- Indonesia—due to poor labour productivity

Developed economies
US, Europe, etc.

US: America's economy is at a peak

Although growth will slow, the Fed will have to keep raising interest rates

Trump will resist attempts by senior staff to manage him, so incoherent messaging and ineffective management will continue



Fed to raise interest rates four times (twice more) in 2018 and three times in 2019

- Target rate at 2.4% end-2018, 3.1% end-2019
- Unemployment at new low but inflation – so far – contained, so steady pace of rises to 2020
- Dollar should stay strong to end-2019, but vulnerable to risks

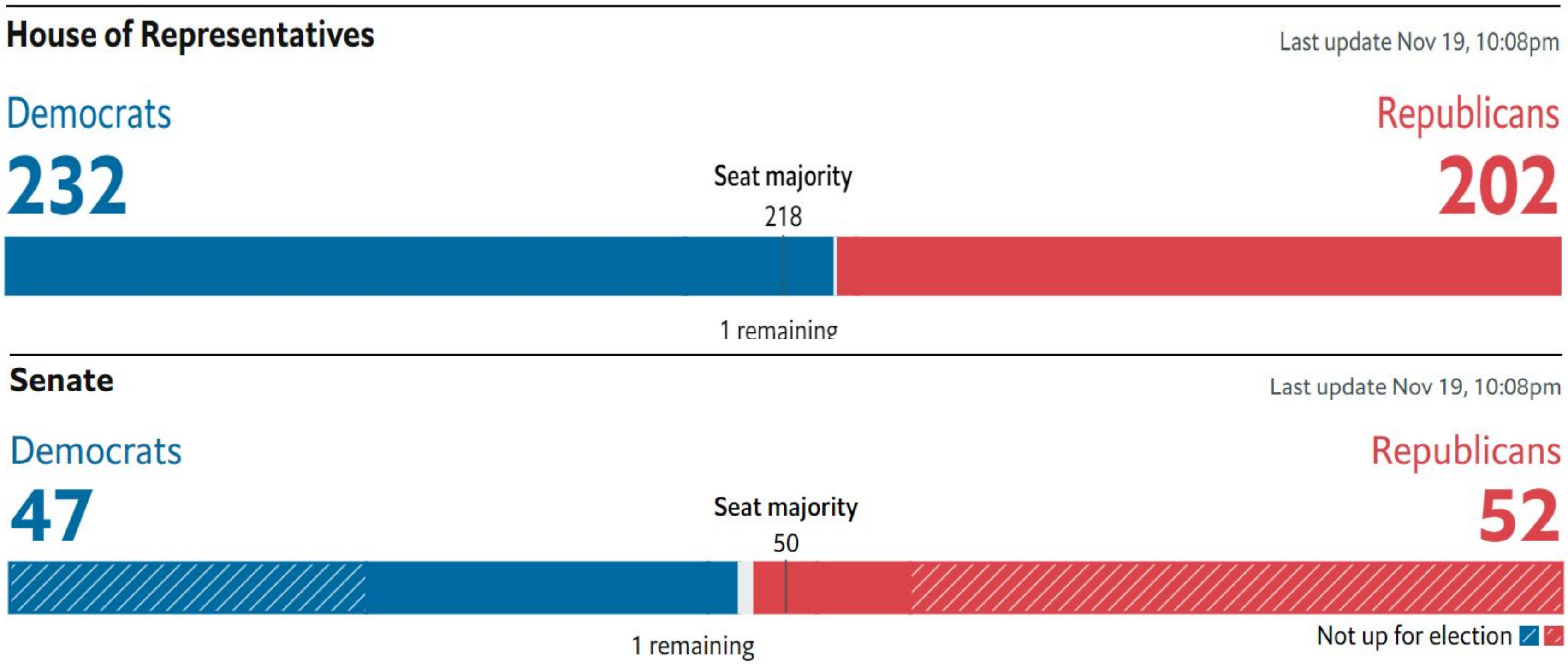
Risk Scenarios	Level of Risk	Level of Impact
Stockmarket crash tips the US into recession	Moderate	High
Deadlock in Congress makes the US ungovernable	High	Moderate
Trump is impeached	Low	Very High
US withdraws from NAFTA	Low	Very High

Trump is now stronger and more decisive

- Political risk to Trump is the Russia probe
- Fiscal deficit to breach 6% of GDP by 2020
- Trade tensions with China are starting to weigh on agriculture and manufacturing
- Democrats win a Congressional House majority in the mid-terms

US: Democrats take back the House but not Senate

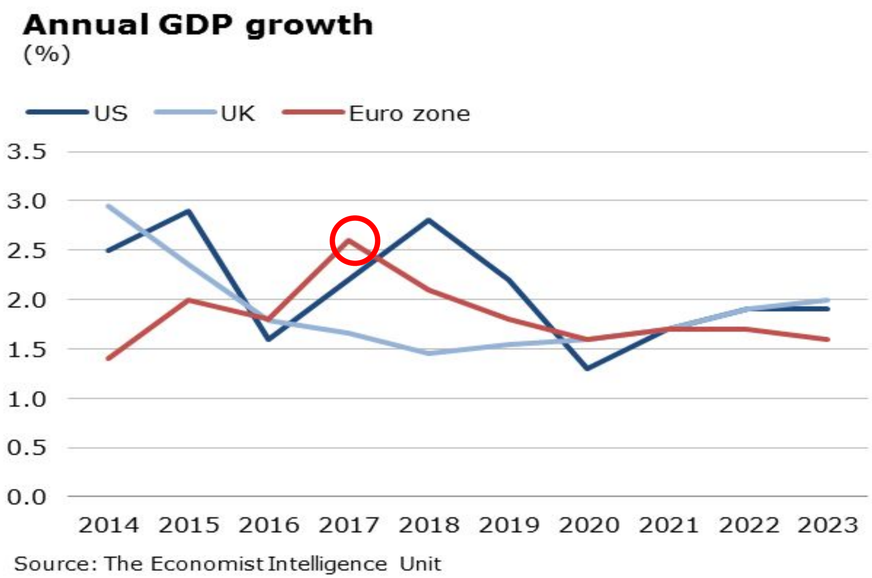
But the 2020 election is still too close to call

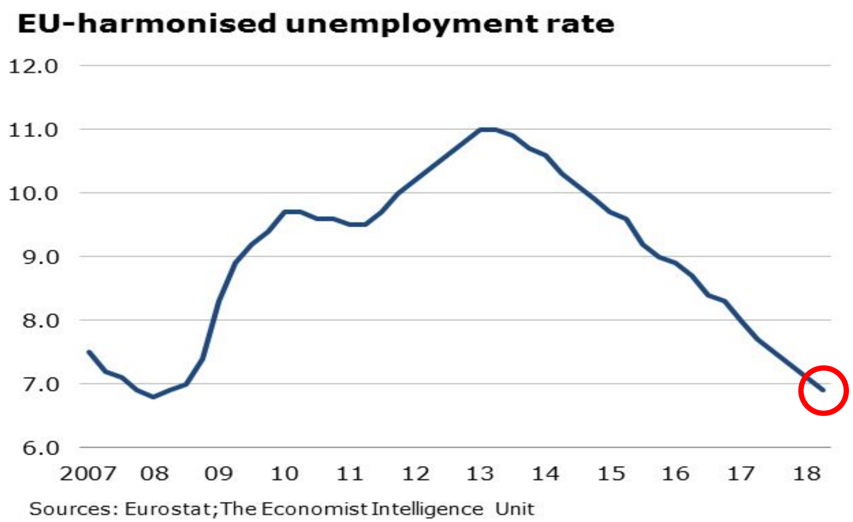


Midterms delivered a blow to the Republicans and Donald Trump

- Congressional oversight of the administration to increase
- Likely to see a number of investigations, particularly into administration officials' use of public funds—and into the president himself, including his tax returns and business ties
- More aggressive oversight is likely to create a number of crises for the White House to manage in the next two years—foreign policy to harden

Euro zone: growth has moderated but will continue





- Economic recovery gained steam in late 2016
- Cyclical upswing has room to expand…

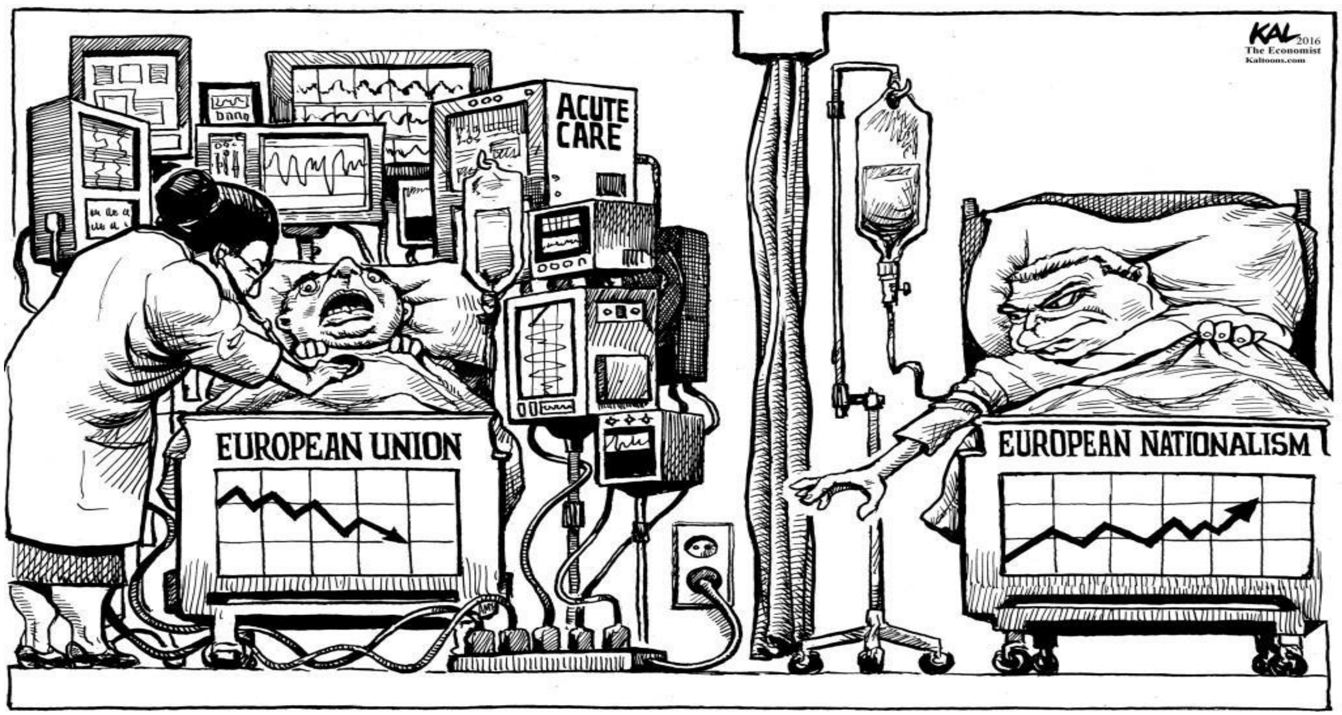
  ….but growth will moderate

  - Higher global energy prices
  - Softer global trade flows
  - Gradual unwinding of accommodative monetary policy
- Intra-bloc disparities will persist

Euro zone: populism and political risk

Political fragmentation is the new normal

- Political fragmentation will be the key obstacle, including in Germany, UK and Italy
- Rise of the radical right is part of a bigger trend: the decline of two-party system and increase in support for parties **at the extremes**
- More significant long-term risk is policy paralysis that affects government effectiveness and potential growth



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UK: Brexit negotiations

Risks are high but the withdrawal agreement will get parliamentary support

- Turmoil after draft withdrawal agreement was released
- Now deal finalised by the EU, vote in UK parliament in early December
- Unhappiness on all sides
- **No plan, no time, no better deal!**

What happens if the agreement is rejected?

Either the existing government under new leadership OR a new government following a snap election would attempt to renegotiate the deal.

This is likely to result in a no-deal Brexit, given the lack of time and willingness from the EU to pursue new negotiations, and a recession!

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UK utterly divided

Remainer camp now probably in majority in UK

- And in Parliament, but cowed by “will of the people”

Soft Brexit camp (and MP remainers) want to maximise economic and political links to UK’s largest partner

- Vassal state?

Hard Brexit camp winning the media war

- Have all the best lines
- Smallish group of MPs, but UK has a minority Government

DUP propping up Gov makes things even harder due to Irish border issue

Teresa May has an impossible job

- Battles at home far tougher than with EU

Emerging markets
China, India, and others

China: Economy facing a number of challenges

Debt overhang, ageing population, rising trade conflict with US

Control at the centre is increasing, which should be good for short-term stability but increases the underlying fragility of society

Xi consolidated position and in control, but fundamental economic reform unlikely due to focus on entrenching CCP control and policy support behind SOEs

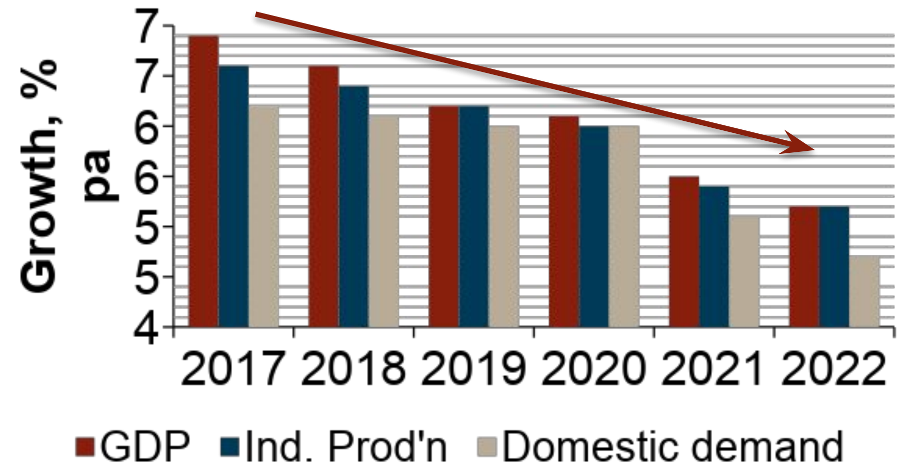
Gov't will support a bit through any trade turndown: lower reserve requirements, cuts to taxes and fees, local gov infrastructure bonds

- Gov't spending to rise faster than private consumption, investment or exports

2016's deleveraging campaign now tightening credit, but financial vulnerabilities only partially addressed and corporate debt weighs on private sector

BRI is big on rhetoric but the reality is more targeted: 60% to ASEAN

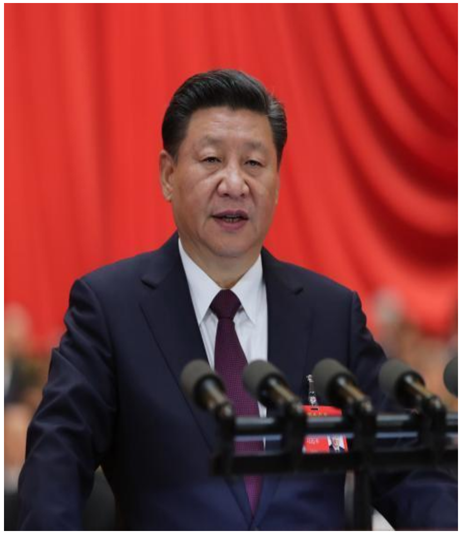
- Debt-financed projects generating pushback



Four old facts about China that are now myths

1. China can't innovate
2. China needs to grow fast to create enough jobs to stop revolution
3. Chinese households are big savers
4. China is a big source of global economic imbalances

China: Xi, the disruptor



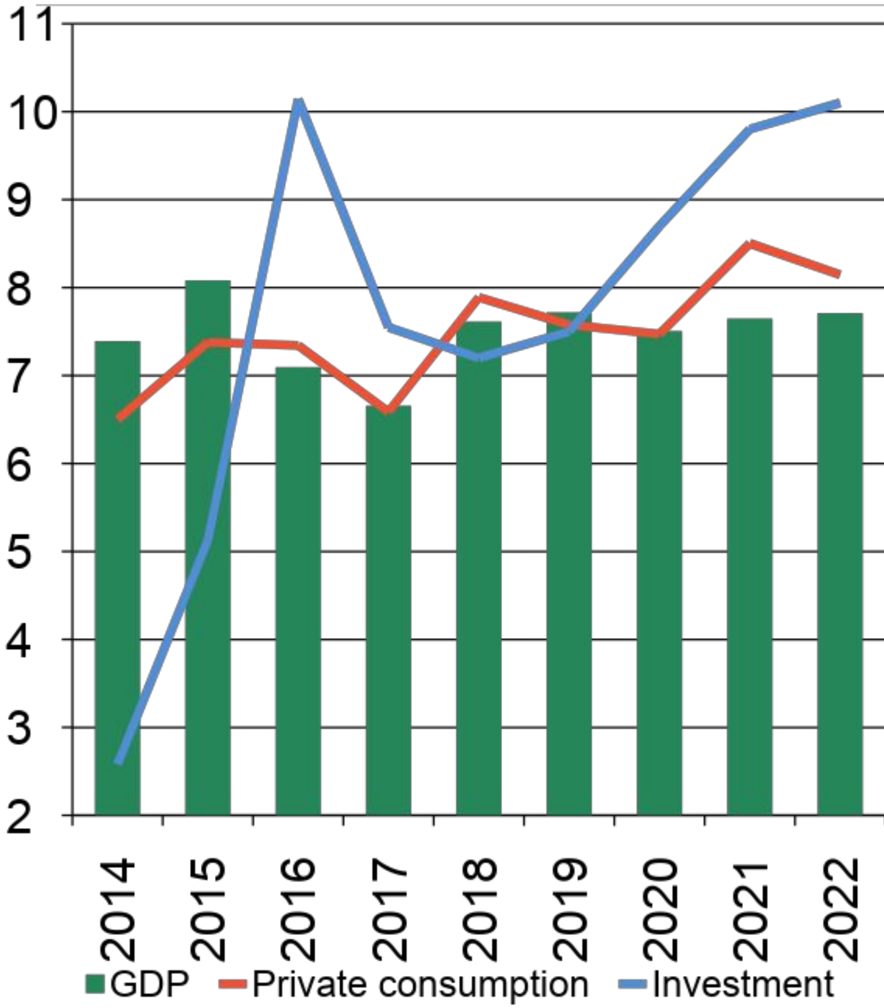
New China
新中国
（1949-76）

Reform & opening
改革开放
（1978-2012）

New era
新时代
（2017 – 2049?)

India: Consumption and investment strength

Real GDP, % change



Source: The Economist Intelligence Unit.

- Economic growth set to accelerate from “low” seen in 2017/18
- Infrastructure investment will continue to be a key driver of economic growth
- Household spending growth also robust: 7.7% rise expected in 2018/19
- Export growth will remain lacklustre: Make in India will fail to reach targets
- India will post faster economic than China throughout 2018-22

Good growth, but a big political year for ASEAN

Slow reforms in Myanmar, no resolution to ethnic tensions

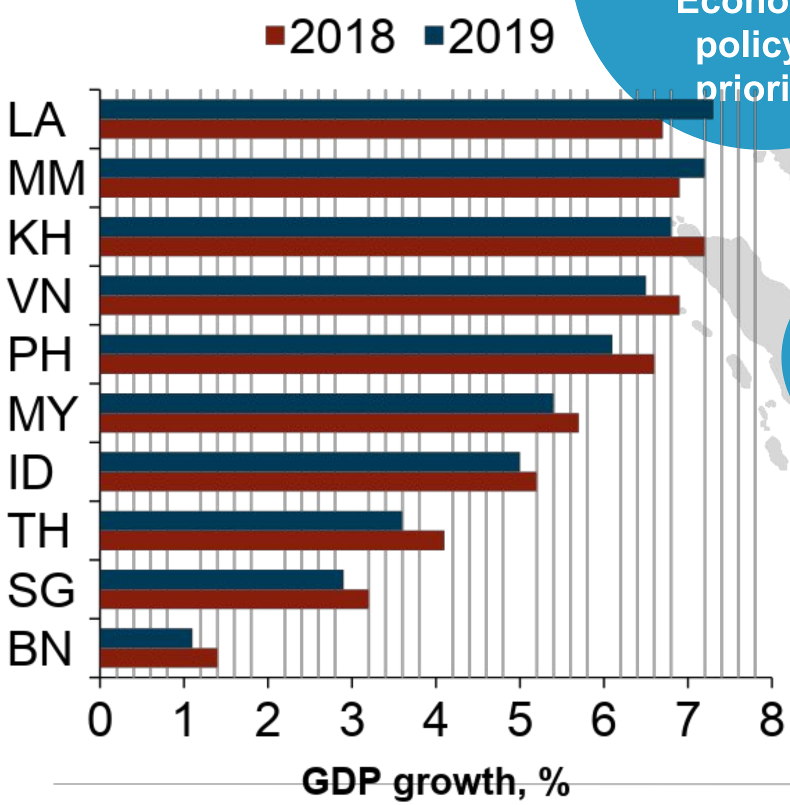
Thailand finally to the polls, as voters get restless. Economic policy a priority.

VN: Economic (not political) liberalisation. Deeper India/Japan ties

PH: Duterte's health questions, but he won't want to cede to the current VP. May elections.

New government in Malaysia. Taxes and infrastructure spend coming down.

SG: Solid growth ~3%



ID presidential election, likely status quo and renewed anti-corruptio n push

ID: Loose fiscal stance, recovery in mining and stable investment. Interest rates up to support Rp.

Eastern Europe – Tensions with the EU

- East European EU member states will clash with Brussels over rule of law issues, migration and access to EU funds
- EU tensions will run high with the nationalist, illiberal and populist governments in Hungary, Poland and Romania
- Euroscepticism is less of an issue in the Czech Republic and Slovakia, but strong opposition to immigration
- Economic growth in East European EU members has been robust in 2017-18, driven by wage growth and an upturn in the euro zone
- We expect a slowdown in 2019-23 owing to tight labour markets, capacity constraints and weaker demand in Western Europe

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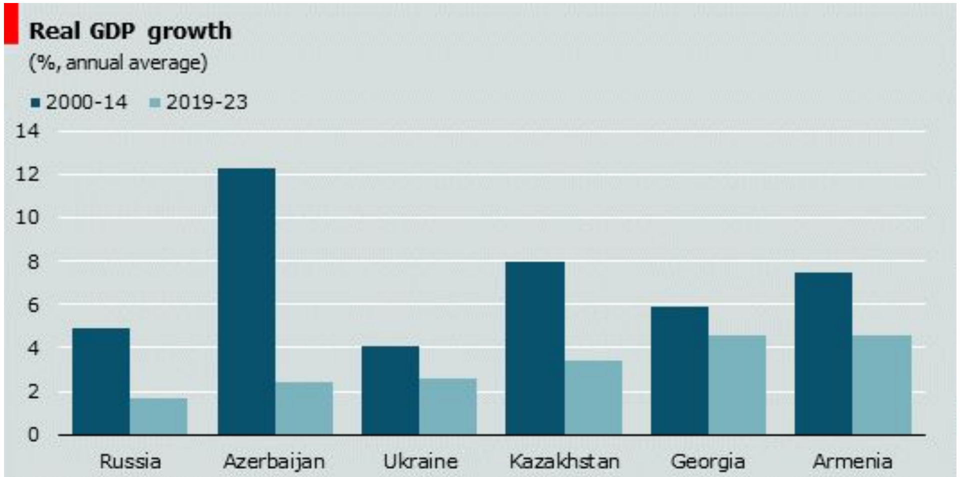
Russia and CIS – Dependence on commodities

- The CIS region remains dependent on hydrocarbon exports and on Russia for trade and remittances
- The economic outlook has worsened since the oil price shock and start of Ukraine conflict in 2014
- Russia-Ukraine tensions have escalated in the Azov Sea region but we do not expect a full-blown military conflict
- We do not expect a resolution of the conflict in eastern Ukraine in 2019-23
- This means that EU and US sanctions on Russia will remain in place

Russia 2019-23 outlook

- Putin will remain in power
- No political renewal
- Real GDP growth will average below 2% annually
- $70/b oil and a conservative fiscal policy will grow foreign reserves and support higher spending on education and healthcare



Source: The Economist Intelligence Unit.

- In Ukraine institutional reforms and economic growth will disappoint
- An oil price shock or a slowdown in China would hurt growth across the CIS
- CIS banking sectors will remain fragile

Bleak long-term economic prospects in CIS

Russia and CIS countries will struggle to achieve high growth rates

Sanctions

- EU and US sanctions against Russia are not going to be lifted any time soon
  - ✓ New US sanctions over the past few months
  - ✓ More US sanctions to come
  - ✓ A rapprochement between Russia and the US is unlikely
- Financing of energy, defence and financial sectors is constrained

Demographics

- Population falling in Western CIS
- ✓ Low birth rates…
- ✓ … and high death rates

Financial sector

- In 2017 the Central Bank of Russia bailed out two big private banks
- Fears of possible contagion effect
- Rouble hit by recent EM crisis

Low investment levels

- Investment is constrained by international financial sanctions…
- … but it has always been structurally low anyway
  - ✓ R&D – 1.1% of GDP
  - ✓ Investment – 20% of GDP
- Weak productivity growth
- State involvement in the economy is high
- No culture of failure
- Little diversification

Russia/CIS will need a better relationship with the West to achieve growth in the long-run

Russia is keen to make a global comeback...

... as recent events in the Sea of Azov exemplify – potential to destabilise CIS

Preventing a rapprochement between CIS countries and Western institutions

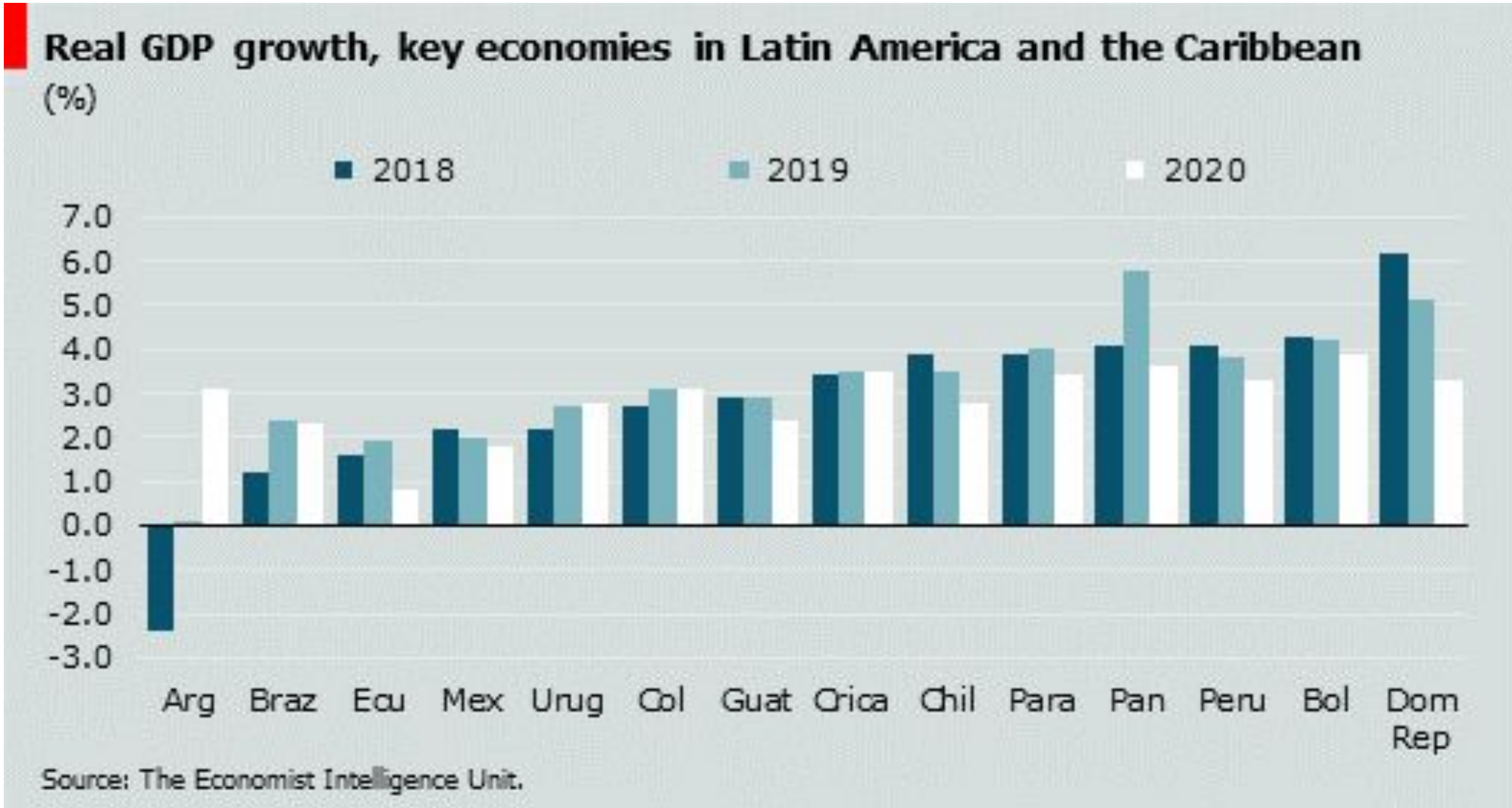
- Explains Russia's actions in Ukraine

Cementing Russia's global role

- If possible on a par with the US
- Explains Russia's growing role in UN

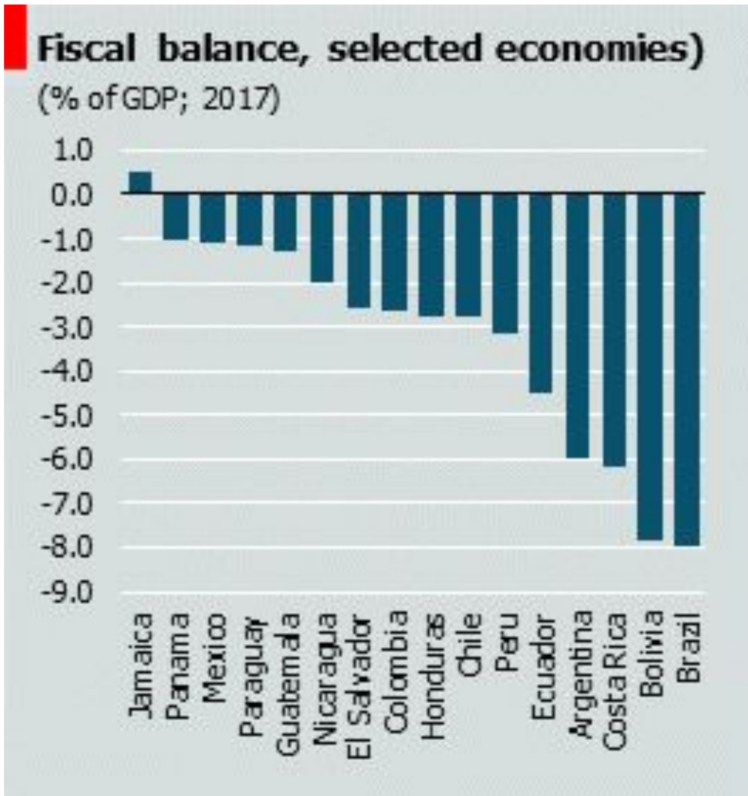
Latin America: choose wisely

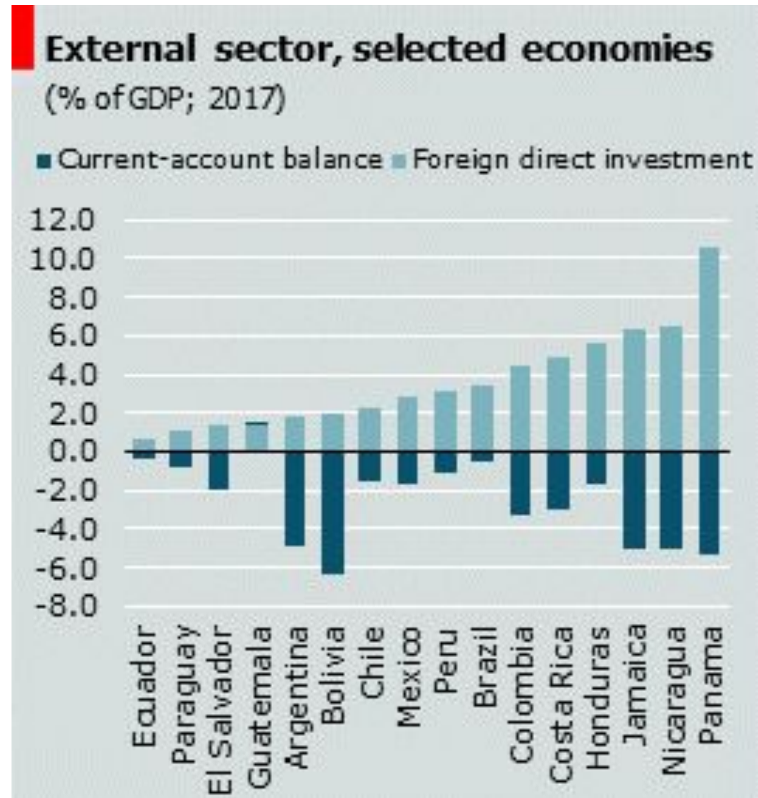
Variation in growth rates, but most economies will face global headwinds



Vulnerable to tightening global credit conditions?

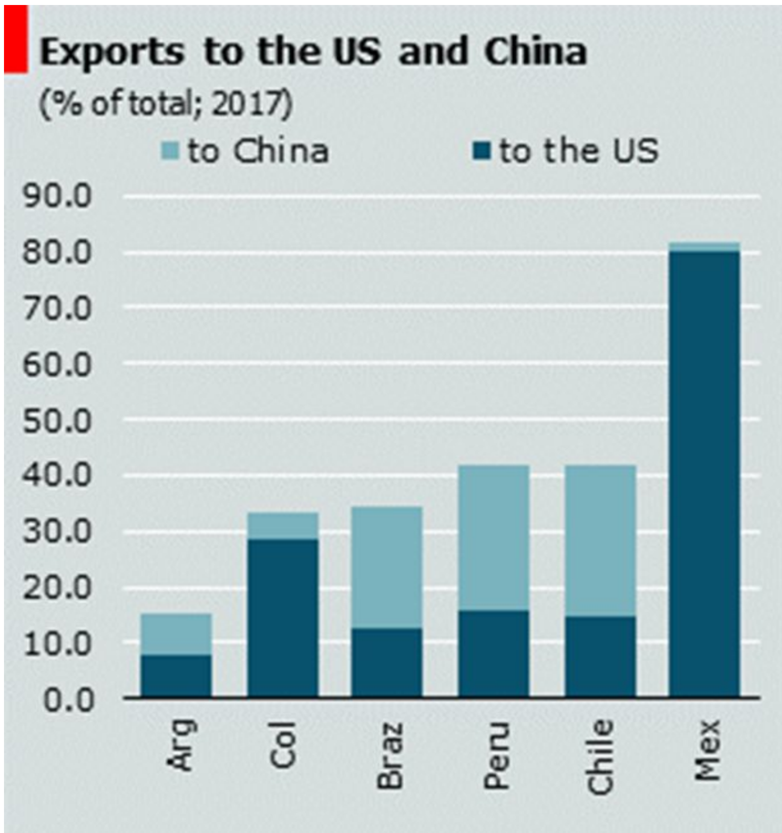
Only a few countries with large twin deficits – Argentina and Boliva are ones to watch





US-China trade war looms large

A potential trigger for more Latam currency stress, economic weakness



- For most large Latam economies, the US and China are of primary importance as trade and investment partners
- There are some niche opportunities from trade war to capture market share
- But to extent that the trade war hits commodity prices, US interest rates, and global growth, Latam will clearly suffer

Middle East Outlook

Geopolitical tensions will remain elevated in 2019-23 – risking investor sentiment

The Yemen war – increase international pressure to revive peace efforts are likely to bear little fruit

- fighting involves multiple groups, making negotiations very difficult

GCC Crisis – we expect the boycott of Qatar by some of the GCC to endure, presenting an ongoing source of tension

Khashoggi killing – has put a strain on relations with the US but we expect the impact to be short-lived

- at most, we anticipate possible sanctions on individuals, but will need to watch House Democrats to see if they attempt to curtail the financial relationship with the Kingdom

- limited domestic impact in KSA but may dampen inward investment in the short run

Stronger growth, but high risks

Real growth will continue to rise in 2019

- Driven mainly by Egypt and UAE as well as return to growth in Saudi Arabia. Iran having a tough time under renewed sanctions

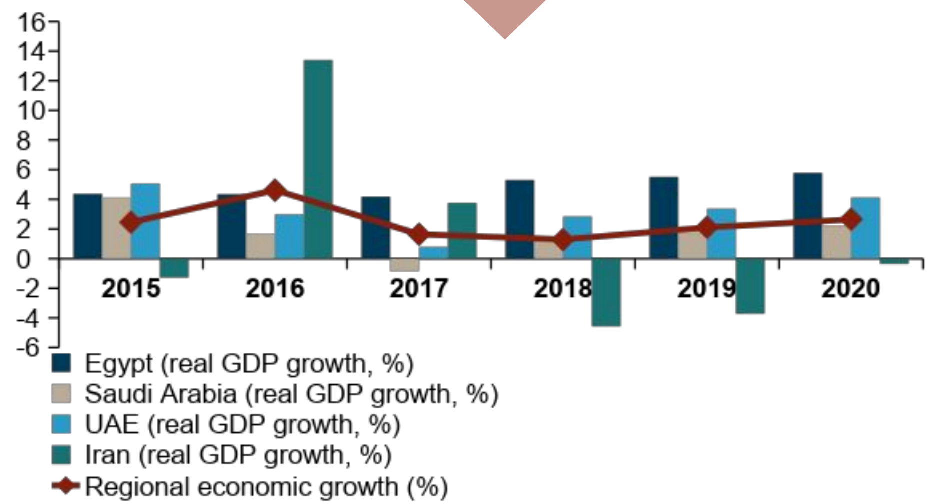
Downside risks to regional growth:

1. Security-political turmoil
2. Oil supply shock
3. US Fed & ECB tightening impact on capital flows

Consolidating growth momentum
- Oil price uptick
- International tensions linked to political repression could briefly hinder investment in non-oil sector
- Mishandling of corruption fight could trigger capital flight & reserves decline

Improving business sentiment
- Macroeconomic outlook stabilising
- FDI less responsive despite new incentives (red tape/corruption still a problem—albeit easing)
- Potential risk to FX reserves from portfolio outflows

Oil-driven growth
- Growth mainly fuelled by crude exports
- Return to high spending on infrastructure and economic stimulus
- Rebound in non-oil economy and services



Polarisation persists amid anti-extremism efforts

Rising geopolitical tension in the GCC has crystalised opposing alliances

- <u>Saudi-UAE-Egypt</u> cooperation to counter <u>Iran-Turkey-Qatar</u> axis
- Regimes finally aware that status quo is unsustainable
- Corporate risk management requires addressing political risk and contingency plans for distribution and transportation channels

Saudi-Iranian arms race

Qatar blockade threatens GCC unity

Fragile four in 2018
(most vulnerable to social unrest)

Sudan
Algeria
Iran
Iraq

Turkey: Heading towards a financial crisis?

- Multiple factors behind lira's plunge

- The government could have halted the market fallout, but was not willing…

…or measures were not radical enough

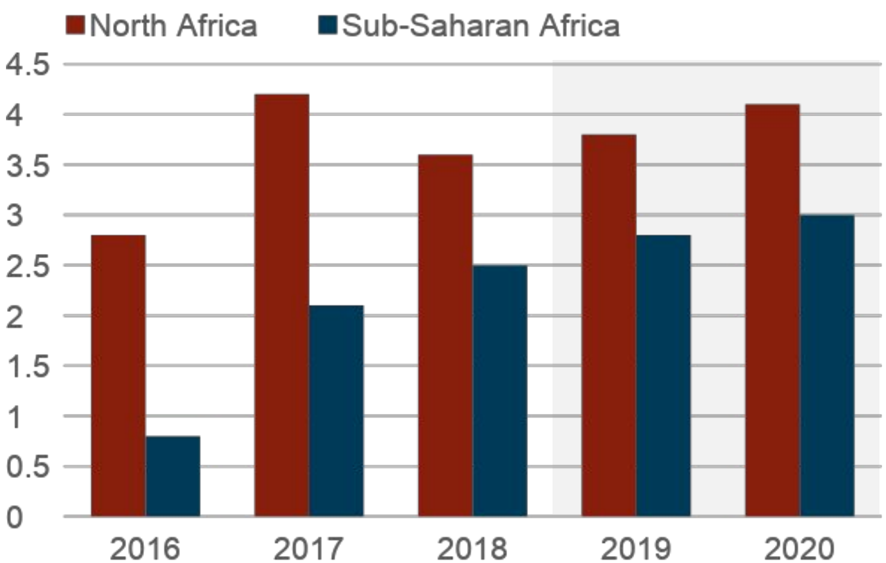
- Inflation to average around 15% in 2018-19

- Erdogan is not going anywhere

Africa accelerates in 2019-20

Regional growth gains momentum but major vulnerabilities remain

Real GDP (% change) picks up …



Risks weighed to the downside…

Acceleration in economic growth (2019-20)

- ➢ Access to affordable external finance
- ➢ Buoyant commodity demand and prices
- ➢ Dynamic (non-resource) regional traders
- ➢ Shift from consolidation to stimulus
- ➢ Credit expansion and consumer spending

Major risk factors cloud the outlook

- ➢ Financial vulnerabilities persist
- ➢ Tighter global credit and contagion
- ➢ Fall-out from global trade tension
- ➢ Destabilising election cycle
- ➢ Unresolved security concerns

Source: The Economist Intelligence Unit

International firms attracted by reforms and incentives

Pro-business and investment reforms are high on the policy agenda

Business sector reform process

- Greater market access and regulatory certainty
- Strong focus on trade facilitation
- Slowly addressing corruption and patronage
- Financial and non-financial incentives target FDI

Support for expanding consumer markets

- Growing cities and middle class
- Improving access to financial services
- Evolving supply chains and distribution channels
- Major threat from informal trade and fake goods!

Leveraging strategic natural resources

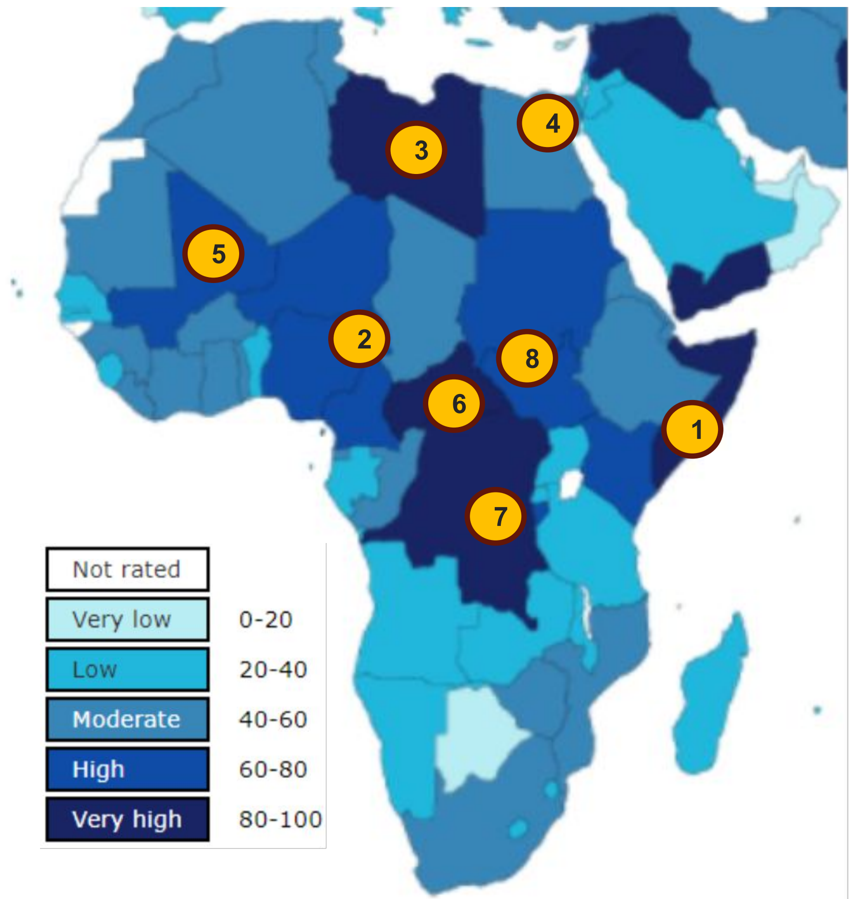
- Extensive under-used farmland
- Water and power supplies
- Energy sector potential
- Solid mineral production and processing
- Power sector liberalisation and investment

Africa will suffer from various hotspots of insecurity

…disrupting trade and investment, displacing populations and raising risk premiums.

1. **Somalia:** Africa's most violent state plagued by conflict involving Al Shabaab (spill-over in Kenya).
2. **Nigeria:** Ethnic rivalries, resource conflict (Delta region) and Islamist militants (Boko Haram) – spilling over into Niger, Chas and Cameroon.
3. **Libya:** Multiple, competing militia groups jostling for power and influence.
4. **Egypt:** Religious and politically motivated violence and demonstrations.
5. **Mali:** Armed insurgency continues to affect northern parts of the country.
6. **Central African Republic**: Rebels and militias continue to fight for control.
7. **DR Congo**: Political instability fuels provincial conflict and mass displacement.
8. **Sudan / South Sudan**: State oppression, insurgencies and inter-communal violence.

Security risk map



Source: Economist Intelligence Unit

Conclusion

The tide turns

The trade war is causing growth to recede from its 2018 peak

Growth will be a bit slower

- Rising tariffs and protectionism causing a drag on the global – and US - economy
- Weaknesses in China’s domestic economy
- Turbulence in Argentina and Turkey
- Still some good growth stories: India, Pacific Alliance, bits of the Middle East

Monetary policy still tightening

- US unemployment low so rates will rise, with the inflationary effect of tariffs making this a little faster than it would otherwise be
- Impact of partial China tightening, deleveraging campaign, shadow banking crackdown becoming apparent
- Some emerging markets looking vulnerable

Alliances in flux

- US tensions with traditional allies, transactional approach to trade
- Recipient countries waking up to the risks in Belt and Road, as are non-China powers
- Supply chains looking to diversify to be more robust to trade barriers
- Middle East tensions complex and deepening, risk to energy markets