BANQUE
ERIC STURDZA

GLOBAL ECONOMIC OUTLOOK

"How little time is needed to change everything", Victor Hugo

Bruno Desgardins

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If there is one lesson worth reflecting on regarding 2016, it is that stated in the quotation from ***Victor Hugo*** above. Who could have thought that financial markets would so easily or so rashly absorb such major shocks as Brexit, the election of Donald Trump and the 'No' victory in the Italian referendum? So we approach 2017 tentatively.

For the first time in two or three years, the growth forecasts for the global economy have been revised upward, though admittedly not by much. Although the OECD expects 3.3% in 2017, including 2.3% in the United States, 1.6% in the Eurozone and 1% in Japan, four questions nevertheless arise: Why is growth weak? What accounts for the stagnation of global trade? How can debt be brought under control? What should we think of monetary policies?

- **Why is growth weak?** In 2017, global growth is expected to be higher than in 2016, but even if it is probably underestimated, it remains modest. It is moderate because productivity gains have slowed, populations are growing older, technologies are creating fewer jobs, and the list of reasons could be further added to. Sluggish global growth and the globalization trend are exacerbating inequalities, which could call for corrective policies of redistribution, or even tax measures promoting labour at the expense of capital in companies. Without yielding to the deceptive sirens of protectionism, the advocates of globalization, like the recent winner of the Nobel Prize for Economics, ***Angus Deaton***, recognize that aid, reconversion, education and assistance measures must be adopted.

- **What accounts for the stagnation of global trade?** The stagnation of global trade in volume terms and its decline in value terms are due to two principle reasons: the increased weight of the service sector in the global economy, and less offshoring, or even onshoring driven by progress in robotization. This stagnation could become a decline if protectionist measures are adopted, but we make the assumption that such measures will remain exceptional, and in the meantime, if economic globalization is at a standstill, financial globalization continues. So far, there is nothing to worry about, except for certain emerging countries which have lost some attractiveness and wage competitiveness.

- **How can debt be brought under control?** Since 2007, global debt has increased by more than $60,000 billion in volume terms and by the equivalent of 80% of global GDP in value terms. At $152,000 billion, according to the IMF, the world's debt represents 2.25x global GDP. This debt is higher in developed countries, at 2.8x GDP, with a peak of 4x in Japan, and lower in emerging countries, with one exception, China, at around 2.6x. There are two components to this debt: public and private. Public debt alone is, on average, equivalent to 1x GDP in the developed countries, and slightly less than 50% of GDP in emerging countries. Apart from some rare examples such as Switzerland and Germany, this debt is not being reduced, the low level of interest rates is hardly an incentive to apply discipline, and siren songs calling for fiscal stimulus are likely to increase the burden passed on to future generations.

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- **What should we think of monetary policies?** Monetary policies have led to growth in financial wealth and rising stock markets, but they have not stimulated productive investment and credit. Monetary policies have been able to prevent deflation without stimulating growth.

The United States: “There is no evil from which some good does not spring”, Leibniz

To understand the reasons for the rise in the US stock market after Donald Trump’s election, you have to reason rather like ***Leibniz in the Theodicy*** when he evokes the rape of Lucretia. Many have noted in Trump’s programme just the possible tax cuts, overlooking, rightly or wrongly, the protectionist threat and the pickup in inflation that could result from this, the prospect of a faster rise in interest rates, the consequences of the strengthening dollar, the inexperience of Trump’s chosen team and the risks of diplomatic clashes. After the 20th of January, the first wrong move will almost certainly be punished by the markets, so we prefer to adopt a neutral position in this market.

- ***Donald Trump’s programme and its consequences:*** what is likely, what is worrying, and what is unlikely.

Donald Trump is not Ronald Reagan. He plans a demand-side policy when his predecessor focused on a supply-side policy. The context is also different, because America is at full employment, whereas it was in a severe crisis at the time of Reagan’s appointment. There are numerous contradictions in Trump’s programme, between a liberal stance and protectionist statements, between a Keynesian proposition and the stigmatization of Obamacare. There is a wide gap between both the attempt to reconcile increased income for the disadvantaged and at the same time tax cuts for the wealthiest.

- <u>What is likely</u>: from the fiscal viewpoint, first, a $1,000 billion infrastructure plan, with no details concerning the implementation schedule. The positive effect to be expected of this in 2017 will be moderate, around 0.2 percentage points of added growth. On the tax front, we note the stated intention of reducing the corporate tax rate from 35% to 15% and facilitating the repatriation of the $1,000 to $2,000 billion in cash held by American multinationals abroad, the intention to reduce the maximum personal income tax rate from 39.5% to 35% and to reduce the number of tax brackets from seven to three, 12/25/35%. Regarding the repatriation of profits, it’s worth remembering that Bush wanted to do likewise in 2004 by imposing a 5% tax (Trump mentions a 10% rate), but only $300 billion returned to the US and the consequences for employment were insignificant. Regarding defence, the announcement of a 15% increase in budget, which is currently 3.3% of GDP, represents an additional $80 billion. Finally, there are proposals to increase US energy independence, i.e. to stimulate production of coal and oil.
- <u>What is worrying</u>: the worry concerns financing, because the increase in government spending by around three percentage points of GDP, or $500 billion per year, would be combined with tax cuts that could potentially mean $9,500 billion less in tax revenues on a ten-year horizon.

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- What is unlikely: although the country is not a very open economy, Donald Trump is worrying when he speaks of pulling out of the World Trade Organization, terminating the recent Trans-Pacific Partnership with eleven regional governments, returning to protectionism, imposing very high tariffs (45% on imports of Chinese products and 35% on imports of Mexican products), and replacing Janet Yellen, which could mean a loss of independence for the Fed, not to mention immigration restrictions which would create tension in the labour market and exacerbate wage inflation, because Trump talks of expelling 11 million immigrants. It is irritating when he says he wants to confine NATO to the security of the United States, he wants to allow Japan and South Korea to build a nuclear arsenal to ensure their defence, he wants to make the Europeans pay for American assistance and when he expresses a preference for Saddam Hussein and other autocrats. It may be hoped that, on these various subjects, rashness will give way to moderation. The most sensitive issue will remain the $365 billion US trade deficit with China, and the debate concerning 2.7 million jobs alleged to have been lost; but one should remember that the deindustrialization of the United States and the other developed countries predates China's joining the WTO.

- ***Economic disappointment***:

- The Obama presidency is ending well, with 3.2% growth in Q3. Nevertheless, these past few years have been disappointing compared with an average annual growth rate, recessions included, of 3.5% per year between 1948 and 2007. Since 2010, despite $3,000 billion injected by the Fed and $1,000 billion borrowed by the Treasury Department, average annual growth has been only 2.1%. Calculated on a per capita basis, real income growth was five times higher in the Clinton presidency than in the Obama presidency, not to mention the Kennedy presidency when the ratio was ten times higher.
- Some incorrigible optimists will object that, since the trough in the spring of 2009, the cycle has never been as long, with 88 months of expansion, far longer than the average expansion cycles of 58 months recorded since 1945. Others will argue that more than 14 million jobs have been created since 2010, to reach a total of 145 million jobs, that the unemployment rate, at 4.6%, is close to a situation of full employment, and that wages are growing by 2.8% year-on-year.
- The key information is elsewhere:
    - On the one hand, the momentum of productivity gains per hour worked has weakened, from 2.8% per year between 1994 and 2003, to 1.3% until 2010, then 0.4% per year since 2011 and even a decline in recent quarters.
    - Then there is the stagnation, at +0.1% per year between 1973 and 2015, in the inflation-adjusted median hourly wage (Economic Policy Institute), and widening inequalities

which are unfavourable to consumption, because while the poorest 90% have a savings rate of 0, the most affluent 5% post a rate close to 50%. As we have known since ***Keynes***, the marginal propensity to consume declines with income growth, and ***Emmanuel Saez*** provides us with figures which confirm this.

  - Finally, there is the low labour force participation rate, 62.7% compared with 66% in 2007. Two-thirds of the jobs created in recent years have been part-time jobs. 5.8 million workers can find nothing better than part-time work. The actual unemployment rate is therefore 9.5%, close to the European level and well above the low of 7.9% in December 2006.

- Manufacturing job creations of 122,000 in 2009, 310,000 in 2015, and even more in 2016, could have been analysed as an industrial renaissance. The people recruited are now more highly skilled, but manufacturing industry accounts for only 12% of GDP and manufacturing employment 8.5% of total employment. The statistics provided by the Census Bureau showing median income growth of 5.7% in 2015 may seem impressive, but it should be remembered that this figure remains 2.5% lower than the 1999 figure, and unfortunately this is more significant. Never in history has the percentage of those in the 18-34 age group living with their parents (one-third) been as high, and this reveals sluggish income growth.

- ***Many investors consider the market expensive, but this must be viewed in perspective:***

- <u>Six reasons to doubt</u>: the high P/E ratio of more than 17x, the decline in earnings in 2016, share buybacks which are close to $600 billion per year, poor earnings quality (masked by these buybacks which penalize investment and long-term growth), deteriorating corporate debt ratios, and a worsening default rate for speculative bonds (5.5% according to Moody’s, which is more than twice the rate observed in Europe). To this we may add student debt, $1,260 billion, which has more than doubled since 2008 and 11% of which is in default.
- <u>But the US economy is not threatened by imminent recession:</u>
On the domestic level, automotive sales are high, at 17.4 million units (as a reminder, they had fallen to 10.9 million in 2009), and real estate prices, which have regained the highs seen in July 2006, by no means point to a crash, especially since, adjusted for inflation, they are 15% below their peak. This rise in prices is the result of a shortfall in supply and not strong demand. Investment in the housing market represents not even 4% of GDP, versus 6% in 2006. Building permits, at approximately 1.1 million, are only half the level of 2007. Inventories of unsold homes are at their lowest level since the year 2000, while construction needs are estimated at 1.4 million. The percentage of home ownership (63.4%) is far below the peak of 2004 (69.2%), and in fact it is at its lowest level in fifty years. New house sales are unlikely to collapse, as they did between the peak of July 2005 (1.40 million transactions) and the low of February 2011 (270,000). Rents are

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rising by around 4% year-on-year, which means improved returns for landlords. The only threat is the impact of the rise in 30-year mortgage rates, to 4.2% in December 2016 versus 3.5% before the election.

Household debt, at $12,200 billion (including $9,500 billion in real estate), or 110% of gross disposable income, is far below the level of a country such as the United Kingdom (155%), or even the US level in 2007 (134%). Thanks to the rise in stock markets and the property market, wealth, at five times GDP, is at its highest since 1999. Thanks to low interest rates, the cost of household debt servicing is now equivalent to only 10% of disposable income, far below the 13% level seen in 2011. Due to wage growth, demand should remain positive. And the household savings rate of 5.1% is satisfactory in relation to recent averages.

Likewise, although *public debt*, after increasing by $8,300 billion since the start of the Obama presidency, reached a new record at the end of 2016, at $19,150 billion, or 105% of GDP, a higher debt/GDP ratio than in France or Spain, the cost of debt servicing, like elsewhere, is moderate, and the 3.2% budget deficit expected this year, or $590 billion, is on a par with France's deficit.

Similarly, the situation of businesses shows no major risks: the banks are better capitalized than in 2007 and the corporate default rate on loans is low, at 2.1%.

Finally, from a global viewpoint, a recession in China would have less impact on the United States than on other major countries, since US exports to China represent only 1% of GDP, i.e. a percentage half as large as that for Germany or Japan.

- <u>To confirm this optimism, let us take a longer-term view</u>: why is the US market the most resilient when markets plummet? In the past 120 years, the United States has been the leading economy in the world with around one-quarter of global production, and the economy remains very open to innovation. Although China will soon post a larger GDP than the United States, this will remain relatively insignificant, because per capita GDP will still be one-fifth that of the United States, and the US still has strong advantages: demographics, with an expected population of 450 million in 2050, versus 310 million at present and 40 million in 1870; research, with a pre-eminent share of patents filed; and education, with the persistent predominance of American universities on the global stage.

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Europe: “Every power is weak unless it is united”, noted La Fontaine in ‘The Old Man and his Children’.

Two preliminary remarks:

- Brexit was a shock, a mistake by the British and a surprise for many Europeans. This should serve as an electroshock to kick-start reforms, consolidate the EU, and make it more democratic by organizing the election of members of the European executive by universal suffrage and increasing the number of joint policies.

- Let’s not dream, there will be no United States of Europe, because, as Mr Juncker opportunely reminds us, Europeans like diversity and local flavour. We must let time do its work, as Mitterrand would have said. Little does it matter if the Europe of Schengen is not that of the Eurozone, if tomorrow other circles are formed, the main thing is to move forward towards integration. The European Union cannot be built in one day. Europe suffers generally from a lack of consensus, exacerbated by the unanimity rule, rather than from an institutional insufficiency. Europe sometimes gets its priorities wrong, and should, for example, define a common foreign policy before thinking about a common defence policy.

- *The economic attractiveness of Europe*: four points are worth noting

Since mid-2013, the recovery is clear, Eurozone growth has been more than 5.5% in real terms and the unemployment rate has fallen from 12.1% to 9.8%. Europe attracts far more foreign investors than the United States: $245 billion received in 2015 versus $145 billion for the United States. Even without the United Kingdom, Europe’s population is larger than that of the United States. Brexit is not a tragedy, because the United Kingdom was neither a member of the Eurozone nor a member of the Schengen Area. Quite the contrary, the United Kingdom was an obstacle to Europe’s progress. The general idea is that Brexit and Trump’s election are opportunities, if only to move forward on the road to a common European defence system, blocked by the British and pushed towards by Donald Trump’s attitude.

- ***Political trends: migration***

- <u>Immigration</u>: that Europe should attract migrants is not surprising. 70 years of peace can make you dream and forget about lacklustre economic growth. There is indisputably a radical difference between the reception given to immigrants in western and eastern Europe. This can be explained by the fact that, for 45 years, the eastern countries were closed and impervious to a multicultural model. The eastern European countries which do not want to be involved are free to interpret the welcoming of migrants as a way for the West to settle a debt owed to countries that it colonized in

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yesteryear. But the fact that they unashamedly receive aid from the EU representing between 1% and 5% of their GDP may seem shocking to western countries and create a rift.

- The good news is the reinforcement of cooperation through Frontex, the increase in its budget from €250 million to €350 million and the increase in the number of its personnel from 350 to 1,000.
- Internal migration: unlike the United States, where migration from the distressed manufacturing regions of the Great Lakes to Texas and California is frequent, in Europe there is an obvious language barrier. Nevertheless, in the past seven years, 1 million young people, often with university degrees, have left Southern Europe, frequently heading for Germany.

- *Cyclical economic trends*: encouraging figures

GDP growth in the Eurozone is expected to reach 1.7% this year, despite subdued credit growth of 1.2% in October, employment growth is 1.5% year-on-year, and the sentiment indicators are positive.

- Germany:
  Two outstanding strengths and two manifest weaknesses can be identified. On the one hand, consolidation of the public finances and an improvement in competitiveness, and on the other hand the fragility of the banking system, which signals the failure of the bank-industry concept, and population ageing. The decline in the public debt/GDP ratio, from 81% of GDP in 2010 to 68% in 2016, helped by negative interest rates and budget surpluses, will make it possible to reduce taxes by €7 billion next year. The country should still increase wages to stimulate consumption.
- Spain:
  The growth outlook has been revised upward to 3.2% in 2016, the trade deficit has been erased, unit production costs have been reduced, the unemployment rate has fallen from 27% at the peak of the crisis in early 2013 to 18.9%, the minimum wage was recently increased by 8% to €825, and the good news is that the restructuring of the banking sector has apparently been successful.
  However, the budget deficit is still high, at 4.6% in 2016, and public debt has reached 100% of GDP, or €1,100 billion, a ratio far exceeding the 40% level noted in 2008. The recovery of the real estate sector reveals many contrasts, with an upturn in Barcelona, stagnation in Madrid and prices still falling in many other regions. Worse still, demographic factors (the low birth rate and youth emigration) are costing the country several percentage points of GDP and stifling its long-term growth prospects.
- France:
  The figures are unexciting. The competitiveness handicap relative to Germany widened between 2000 and 2008, when the wage cost differential increased by more than fifteen percentage points compared with Germany. Today, Germany has 350,000 exporting firms and France only 125,000, Germany exports 47% of its GDP each year, and France 29%. German exports, at €1,000 billion, are almost 2.5x France's total. But this dramatic figure should be put into perspective. While

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Germany has always given priority to exports, French firms have given priority to external growth abroad.

We may add to France's weaknesses the competitive shortcomings in services, insufficient research spending, the inadequate size of many firms and the shortcomings of the education system. Government spending, at more than 55% of GDP (of which 13% for civil service payroll), is higher than elsewhere but, unlike in Switzerland, for example, pension spending is part of government spending, and 80% of government spending is in fact transfer payments. The public debt is increasing, and is now €2,170 billion, but thanks to the fall in interest rates, interest charges on the debt, at €45 billion, are identical to those ten years ago when the debt was half the present size.

On the negative side, note that industrial production is still 8% below the 2008 level, tourism, which accounts for 8% of GDP, has been adversely affected by terrorism, the unemployment rate remains very high, especially for the unskilled, and one-third of part-time workers (i.e. 1.6 million employees) would like to work more.

On the positive side, there has been a sharp increase in corporate profitability, growth in investment in new technologies, the corporate tax rate is set to be reduced from 33% to 28%, and the inpatriate worker tax scheme has been extended up to eight years.

- Greece:

  The origins of the crisis date from the period between the creation of the euro and the year 2008. Civil servants' pay had increased by around 120%, compared with only 20% in Germany. An adjustment was bound to be required sooner or later, and competitiveness and the public finances had to be restored.

  The effects of the crisis: in seven years, purchasing power declined by about 30%, and wages and pensions by between 20% and 40%. Private creditors have lost more than half of their loans, but the situation is still chaotic, with a public debt ratio which, despite debt relief, is still 1.8x GDP. Some criticize the bailout plans for aiming to facilitate the clean-up of banks' balance sheets and leaving only 5% for the Greek budget. There is some truth in this; tax revenues are insufficient and shortages are adversely affecting the functioning of hospitals and the public transport system. Reforms are continuing, in particular the harmonization of the 930 pension schemes and the management of pension costs, which account for 11% of GDP.

  Persisting doubts: there are doubts because, while growth could be as high as 2.5%, it has remained low, at 0.1%. Doubts because, although the trade balance is headed towards equilibrium, when exports remain stable, this is exclusively due to a cyclical decline in imports. It is therefore to be feared that a recovery might mean a worsening of the trade deficit. Doubts because, although the budget deficit has declined sharply, although the primary surplus, at 1.1% of GDP, exceeds the 0.75% target, financing of the welfare state is problematic, as attested by the difficulty faced by Alexis Tsipras in having Brussels endorse an increase in pensions in favour of the poorest. Doubts because, while there are fewer job losses, and although the unemployment rate has declined

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slightly, from 26.1% to 24.6%, since the start of the crisis almost 430,000 young people have left the country (a figure which would be equivalent to 3.5 million in France).

Italy*:*

Contrasting short-term trends: the unemployment rate remains high, at 11.7%, far higher than the low of 5.7% in 2007, and only slightly below the peak of 13% in 2013. Economic growth is zero, but the Job Act passed in March 2015 and the exemption from social security contributions during three years for each fixed-term work contract converted into a permanent work contract have allowed the creation of 585,000 new jobs during the Renzi government's term.

Fragility of the banking sector: this is one of Renzi's unresolved problems, because banks' non-performing loans amount to €85 billion. In 2014, nine of the 15 major Italian banks failed the ECB's stress test, and since then there has been no progress. Possible solutions include a recapitalization of about €40 billion, which would represent two percentage points of Italy's public debt or, eventually, the creation of a European "bad bank". At the same time, the banks have continued to stock up on Italian sovereign bonds. They held 12% of outstanding bonds in 2007, and they now have 21%, or approximately €400 billion.

Long-term trends: factors for concern are the stagnation of GDP since the year 2000 at around €1,760 billion, an ageing population, a decline in the country's population, and the hijacking of 70% of welfare spending by pensions. More reassuring factors include manufacturing employment, still 20% of the total, a percentage similar to that of Germany, low private debt and the primary budget surplus, since the estimated 2.4% deficit in 2016 corresponds to interest on the debt.

Ireland: ongoing improvement.

GDP growth remains high, at close to 4%, and it is more balanced than in 2007. The construction sector accounts for only 7% to 8% of GDP, whereas around 2007 it accounted for 23%. The outlook is positive, because the inflow of foreign investment requires a pickup in construction.

Portugal: a slowdown.

The recovery is losing momentum despite a certain fiscal laxness, the current-account surplus is decreasing and recent upward pressure on interest rates has increased the cost of servicing a large public debt of 1.3x GDP, and private debt of 1.8x.

- ***The outlook***:

- A doubling of the Juncker Plan: for want of growth, sluggish markets are an obstacle to private investment, and for want of tax revenues, public investment is constrained. The Juncker Plan, worth €315 billion, soon to be doubled, has in one year been able to release €115 billion for infrastructure investment and for the financing of SMEs, and should contribute to a pickup in investment.
- A possible economic war with the United States: Europe would have everything to gain from adopting a united stance. On top of the financial penalties imposed by the US authorities on Deutsche Bank and others could come trade sanctions imposed by the WTO on Airbus, accused of having received illegal subsidies.

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- A harmonization of corporation tax: the corporate tax rate, currently 12.5% in Ireland but 34.4% in France, 19% in Poland but 31% in Italy, and 22% in Sweden but 30% in Germany, diverges greatly from one country to another, and there is a wish for convergence. But even more than this, the idea is to standardize the calculation base, to calculate a European profit and, finally, redistribute the revenues to each of the European States in which the company has created part of its wealth.
- Consolidation of the Eurozone: in light of the amounts of gross external debts outstanding, there is little risk of seeing the Eurozone implode. Quite the contrary, the banking union, the action of the ECB and the determination of governments should consolidate the zone.

The United Kingdom: the choices for Theresa May.

- ***Political policy***: the net immigration balance for 2015 was 333,000 - too much for Teresa May, who apparently prioritises sovereignty and immigration control over preservation of the single market. She will therefore not be able to negotiate a status similar to that of Norway, which accepts the free movement of persons.
- ***Economic policy***: Theresa May is breaking away from the free-market practice of the most recent Conservative governments. While she confirms the choice of a corporate tax rate of 17%, the lowest in the G20, she shows a will for greater State intervention to maintain certain industries, guide housing policy, regulate temporary work, initiate employee representation on boards of directors and develop infrastructure. Even if this means allowing the budget deficit, already 4.5% in 2015, to get worse. A budget supplement of £100 billion over five years, or 1% of GDP, has been decided on accordingly. Anxious to prevent the offshoring of factories, she is open to concessions, and this explains Nissan's continuing presence in the United Kingdom.
- ***What should we think of the job market***? Flexibility or insecurity, it depends on your viewpoint. Flexibility might be used regarding students looking for casual jobs, unemployment benefits amounting to only €400 for 26 weeks, compared with potentially €6,000 for up to 24 months in France, and an average duration of unemployment of 28 weeks compared with 68 weeks in France.

Insecurity might be better suited to define the situation of persons without skills who find only unskilled types of jobs. "Zero hour" work contracts enable a company to employ a worker with no guarantee of hours worked and without health insurance. The number of such contracts (0.9 million, i.e. almost 3% of employees) may seem moderate, but in a country where the unemployment rate is so low (4.9%) and where the participation rate (75% of people of working age) is extremely high, this is surprising.

- ***The short-term trend***: a downturn is expected.

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Following the vote in favour of Brexit, the Sterling fell 18% in value, inflationary pressures arising from imports are starting to be seen, the employment indicators and investment intentions are deteriorating, the growth prospects for 2017 have been revised downward from 2.1% to 1.4% (figures of the Chancellor of the Exchequer), the budget deficit (4% in 2016) is expected to stay at a high level of 3.5% in 2017, and public debt will remain substantial, at 90% of GDP.

The United Kingdom will probably lose the manna provided by the European Investment Bank (EIB), i.e. €7.8 billion in 2015. Japan, after the United States, has warned the British authorities of the possible relocation of Japanese assets currently in the United Kingdom.

Japan:

- ***What choices***?
    - Undeniably, Prime Minister Shinzo Abe recently scored a success in the senatorial elections. He enjoys a two-thirds majority there, but what will he do? Elected since 2012, he has made numerous announcements and often retreated, as in the case of the second sales tax hike, from 8% to 10%, which has been put off until 2019.
    - <u>What will he do</u>? Step up military spending, bearing in mind that he already has a navy larger than the British Navy? Undertake structural reforms, which have often been mentioned, and often delayed? Use fiscal policy over and above the recent $265 billion fiscal stimulus package, which was modest in practice, because new expenditures were hardly more than one-quarter of the stated amount, and even then they have been spread over two years? For example, $93 billion has been allocated to those on low wages, sums have been budgeted to facilitate childminding in order to encourage childbearing, and to finance the new 500kph train linking Tokyo to Nagoya.
- ***Worrying economic results***:
  In 1990 Japan accounted for 17% of global industrial production, but this percentage has fallen to less than 11%. GDP growth was only 0.4% in 2015, to $4,600 billion, and will not be any higher this year. The consumer price index is negative by 0.5%, despite all the Bank of Japan's efforts since 2012 to reach 2%. The producer price index has declined 3.6% year-on-year. Industrial production is no higher than in 2012. Wage growth has been disappointing and retail sales are declining. The trade balance has become positive again, but exports fell for the eighth month running, pointing to a shortfall in domestic demand. The unemployment rate was only 3% in July, the lowest level since 1995, but greater labour market flexibility has resulted in a decline in the share of wages in value added, or even a fall in nominal wages. And now, out of the 41 OECD member countries, Japan ranks 34th for those with the greatest inequalities.
- ***On the global level, Japan is declining***:

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- A country caught in a stranglehold between indebtedness and an ageing population: Japan is the most heavily indebted country, with overall debt of more than 4x GDP, a worrying percentage even if the cost does not exceed 2% of GDP. The population has been decreasing by 200,000 per year since 2010 and is expected to decline by around twenty million people by 2040. The number of children per female remains desperately insufficient at 1.4x, when 2.1x would be needed merely to maintain the population level, and for the first time since statistics started to be collected, more than a century ago, the number of births per year has fallen below one million. Already, the over-65 age group, which represents 16% of the population, continues to work in 22% of cases, versus 18% in the United States, but this is not sufficient. The percentage of the elderly poor is getting constantly worse; from 20% in 2009, it has increased to 26%. The country rejects immigration, the number of foreign workers does not exceed 900,000, and therefore productivity will decline further.
- The confidence of economic agents is low: all these poor figures explain why more than half of the $17,000 billion of Japanese savings are in liquid assets, and they help to understand why, since the crisis of the 1990s, the banks have never regained the will to take risks and encourage lending.
- The country still has strengths: however, to avoid ending on an excessively negative note, bear in mind the quality of the Japanese education system, the country's advance in robotization, and the upmarket specialization of industry. We may add that growth is probably badly measured, because the contribution of the new technologies and their influence on productivity are probably poorly assessed. After accounting adjustments, the Bank of Japan assesses growth for 2014 at +2.4%, and not -0.9%. This estimate is fairly consistent with the low rate of unemployment and with corporate profits which have never been as high as a percentage of GDP.

China: ***"It's better to light a candle than to curse the darkness", Chinese proverb.***

For some years now, China has apparently been applying this proverb to the letter, adopting numerous stimulus measures to ward off the risks and negative implications of a slowdown. But this means disregarding other risks such as overcapacity, pollution and over-indebtedness, on which we shall endeavour to shed more light.

- ***Exceptionally rapid development:***
- China covers an area similar to that of the United States, with a population over four times larger. Attitudes affected by around thirty years of Maoism and a rural population which in 1978

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accounted for more than 70% of the total population, this was the challenge facing Deng Xiao Ping at the time.

- The success has been incomparable: while the United Kingdom doubled its GDP in 58 years between 1780 and 1838, from 1978 on China took just 27 years to increase its GDP sixfold, although it still ranks only 80th in the world in terms of per capita GDP.
- The changes: in just over three decades, China has risen from the low-income group of countries to the medium-income group; China took more than 300 million peasants from rural areas to employ them mainly in industry, and accessorily in services, without any major social unrest. China, formerly a rural country and now 55% urbanized, has managed to avoid exponential growth of slum areas on the outskirts of the cities, despite ten million migrants every year. The government recently agreed to offer *hukou* (household registration) rights to 100 million non-native residents, as an aid to these rural migrants. China has managed to combine party planning with the emergence of an entrepreneurial class. It accounts for more than 20% of global industrial production versus 7% in 2000 and 3.5% in 1990, but recently there have also been numerous relocations in the country's hinterland, where wages are 30% lower, and also a lot of effort to increase product sophistication.

  China was formerly a closed country but has succeeded, by creating special economic areas near about fifteen coastal cities, in attracting a large quantity of foreign capital and creating numerous jobs, 13 million in 2015 on a minimum wage of between $1.15 and $2.50 per hour, far below the $7.25 official minimum wage in the United States.

  Chinese exports increased by more than 20% per year in the early 2000s, and even by more than 25% per year in 2005 and 2006, thus making it possible to increase its export market share from less than 5% in 2000 to around 17% in 2012.

  This success contrasts with developments in Russia. While Russia made an abrupt and ill-prepared entry into the capitalist system, China preferred gradual reform, kept control of capital flows and delayed the convertibility of the renminbi.
- ***Skidding out of control?***
- Personal power: in recent decades, the balance of power within the diarchy of the president and prime minister seems to be shifting in favour of President Xi Jinping, aged 64, son of a revolutionary hero, who has asserted himself against the prime minister, Li Kequiang, despite the latter's support from former president Hu Jintao. Xi is likely to hold onto power beyond the scheduled ten-year period, despite the rule providing for retirement before age 67.
- Ambitions on the global stage: China has a greater economic presence in foreign markets, but it is harder for Western firms to invest in Chinese companies. China is taking advantage of its plentiful foreign exchange reserves, due to the accumulation of trade surpluses (e.g. $600 billion in 2015) to acquire foreign companies. In 2015, foreign investment by Chinese companies, at $145 billion, exceeded foreign investment in China of $135 billion, and this trend will probably continue.

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A power long renowned for its isolationism, in recent years China has showed surprising ambitions in the China Sea, even defying a recent international court ruling, and not hesitating to boost its official military budget to $140 billion, a level which worries its neighbours, because it is almost three times the Japanese defence budget. One possible reason for this expansionism is the importance of the China Sea for trade, as the route taken by one-quarter of global trade and most of China's trade.

- Inequalities: despite a tripling of wages in ten years, which has adversely affected corporate competitiveness, a regime in which equality was supposed to be the cardinal virtue has been replaced by one of the most inegalitarian societies in the world. There are around 1 billion poor people, a middle class of 300 million, and a few hundred thousand rich people. Growth is also unequal from one region to another. Yesterday, the coastal provinces were growing, and the centre lagged behind. Today, relocation due to labour cost differentials is favourable to western China (Tibet and Xinjiang) and central China (Henan, Hubei and Jiangxi), and penalizes the northern regions specialized in mining and heavy industry (Shanxi).
- Slackening growth: on a per capita GDP basis, China still ranks only 80th in the world, a level comparable to that of Brazil or Turkey, and the question is whether this catch-up will continue, because growth is weakening and the population is ageing rapidly. In the 1960s, the number of children per female exceeded 6, while since 1995 it has fallen to 1.5 and the population will reach a maximum of 1,420 million around 2030 before declining rapidly. In 2050, assuming a constant retirement age, the working-age population (865 million in 2012) will have declined by 250 million. In 2009, China launched a $600 billion stimulus plan which had immediate positive effects, but with subsequent harmful consequences: overcapacity, bad debts, etc. In the early 2000s, $1 worth of stimulus generated $1 of GDP, while now $6 of stimulus is needed for $1 of GDP. This gives a measure of the loss of effectiveness of stimulus plans. In 2007, the current-account surplus amounted to 10% of GDP, while now, due to the loss of competitiveness, it has fallen to 3%.
- Recent stimulus measures: in 2015 and 2016, under the 13th five-year plan, the Chinese authorities endeavoured to counter the structural slowdown, allowing the budget deficit to increase to 4% of GDP, or €300 billion, and they initiated new infrastructure projects (10,000 km of motorways added by 2020 to the existing 20,000 km, new railway tracks), but without any great success and with the same harmful effects as in 2009. McKinsey gives an opportune reminder that China already has 32 times more roads per km² and three times more railway tracks than Brazil.
- ***A worry for the world:***
- Worries about growth: in the past few years, China has had a wonderful stimulating effect on global growth. According to the IMF, in 2016 China's GDP accounts for 17% of global GDP measured on a purchasing power parity basis and, even if it slows down, Chinese growth will contribute approximately 35/40% of global growth. The global slowdown is both a (partial) cause and a (definite) consequence of China's slowdown. China's imports (-19% in 2015) and its exports (-

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11%) are both declining. Growth in industrial production is no longer 20% as in 2010, but 6%, the capacity utilization rate has fallen, there has been a stagnation of private investment (60% of the total) and the budget deficit is worsening, whereas there was a surplus before 2007. Despite these factors, there is still capacity for stimulus, because the base rate of 4.3% is still high, as is the corporate credit rate, still at 6%.

The country most exposed to a Chinese slowdown is Taiwan, because its exports to China account for 18% of GDP. South Korea is also sensitive, with exports to China which amount to 10% of GDP.

- <u>Worries about overcapacity in numerous sectors</u>: headline inflation is low, at 1.3% in August, but reflecting overcapacity, producer prices (the PPI) decreased without interruption from 2012 until August 2016 (a 3% rise in November), and this increases companies' cost of debt servicing. The sectors most impacted by overcapacity are steel, cement, aluminium, refined products, paper and glass.

  In the case of steel, production was multiplied by twelve between 1990 and 2014, and half of the capacity operates at a loss. China has a capacity of 1.2 billion tonnes, it produces half of the world's steel and, as is emphasized by the European Chamber of Commerce in Beijing, it produces more than twice as much as the United States, Japan, India and Russia combined! The decision has been taken to merge the main groups and shut down 100 to 150 million tonnes of capacity by 2020, but that will not be sufficient.

  Regarding cement, in two years, 2011 and 2012, China produced more cement than the United States in the whole 20th century, so there is abundant overcapacity, but fortunately China lacks the port capacity for exports. In these various sectors, between 25% and 30% of State-owned enterprises post losses and, to focus on mining, it has been announced that there will be 1.8 million job layoffs by 2020 and a €14 billion fund will be made available to facilitate occupational redeployment of the employees. In fact, some estimates even expect 10 million jobs to be destroyed out of about 100 million urban factory jobs. This rather frightens the Chinese, and on the provincial level there has been a reluctance to decide on plant shutdowns, but we should remember that in the 1990s, about 30 million civil servants were made redundant.

  These various subjects are watched closely by the Western companies in these sectors, because they are being hit hard by the disposal of this excess production. For example, steel giant ArcelorMittal lost $7.9 billion in 2015.

- <u>Worries about debt</u>: the debt burden amounts to around $28,000 billion, or 2.5x GDP, compared with 1.5x in 2008. The spiralling growth of debt reflects a marginal decline in the return on capital invested. Ever more debt for less growth. Officially limited to 40% at the end of 2015, the public debt ratio led Moody's to place China on negative watch, noting that the State will have to recapitalize numerous companies and banks, or even provinces.

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Corporate debt, at 1x GDP in 2008 and almost 1.6x at present (0.9x for State-owned enterprises alone, which account for only 20% of production), is undermining many companies and requiring corporate mergers.

Banks' non-performing loans are estimated at $2,250 billion, or around 20% (15% according to the IMF) of outstanding commercial loans.

However, to temper this pessimism, note that two-thirds of the debt has been taken on by State-owned enterprises and is owed to State-owned banks. It may be assumed that the banks will convert part of the loans into equity. Also, the loans represent only a fraction of deposits (about 70%) and gross savings amounted to $5,200bn in 2015, far larger than the $3,400 billion recorded in the United States, or around 50% of GDP. Lastly, the risk of international contagion is moderate, because China is still a major creditor of the rest of the world ($3,050 billion in foreign exchange reserves) and because corporate debt in foreign currencies represents hardly 5%.

- Worries about "shadow banking": this is a more sensitive issue than in other countries, because it is more significant, at 80% of GDP according to Moody's, and more opaque. However, it is very domestic, and therefore there is less risk of contagion.
- Worries about real estate operations in 2017: mortgage lending was encouraged to boost the country's growth and, in one year, such loans increased by more than 70%, and drove real estate prices up 10%.

  For a long time the provinces have derived significant revenues from the sale of land for property development, but due to overcapacity the manna is running out and their debts represent the equivalent of 40% of GDP.

  In 2017, a contraction of about 20% in property sales can be feared, because many cities have started to rein in the sector in order to limit overcapacity and lower the level of stocks. This is an important matter, because real estate represents half of household wealth, one-third of the revenues of local and regional governments, and over half of banks' exposure, so it is a key variable for the economy. As a percentage of GDP, in 2015 mortgages represented only 20%, far less than the 100% ratio in the United States.

Emerging countries:

Emerging countries, including China, account for 38% of global GDP in nominal terms but 52% on a PPP basis, and they now generate more than 50% of global growth. Compared with the developed countries, emerging countries still have advantages, potential for lowering interest rates and a debt level which is not yet problematic, but many of them have exhausted the catch-up effect with developed countries and are still faced with skills, productivity and infrastructure shortcomings.

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Furthermore, the situation is one of contrasts between countries such as Brazil and South Africa which depend on commodity prices, very export-oriented countries which are penalized by sluggish growth in Western countries, and Asian countries, from Vietnam to India, which are still posting growth in excess of 5%.

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<u>India</u>:

- In 1900, India had the fourth-largest railway network in the world, but at the end of the 1940s, India's leaders, like the Chinese authorities, chose development within their own borders, Socialist and democratic in India, Communist and authoritarian in China. Gandhi, assassinated in January 1948, was an inspiration for a short time, while Mao, in power from 1949 until his death in 1976, was an organizer for a long time. India maintained intellectual contact with the Western world, while China became isolated. Both declined on the global stage.
- <u>Potential and challenges</u>: with the seventh largest economy in the world in terms of GDP, behind the United Kingdom at No. 6 and France at No. 5, India has a per capita GDP equivalent to 1/10th of that in the United States, while in China the proportion is one-quarter. India posted a 7.1% growth rate in Q2, higher than that of China. India is similar to the United States regarding consumption as a percentage of GDP, at 64% versus 70% in the United States, compared with 57% in Japan, 54% in the European Union and 38% in China.

  The population continues to grow, posing a huge challenge, and India will have to create 90 million jobs between now and 2025. This represents 10 million jobs each year for young people entering the market, which is not easy in a country where the manufacturing sector accounts for only 16% of GDP, compared with 34% in China. In 2030, India's population will exceed that of China, and the 20-24 age group is already larger than in China, at 116 million versus 98 million in 2013.
- <u>Handicaps</u>: Mr Modi cannot govern the federal State of India as he ruled Gujarat, with a population of only 60 million, between 2001 and 2014. He has little room for manoeuvre, because the Upper House of parliament is hostile to him. He is faced with difficulties in the areas of tax reform, land purchases, the labour market, the reduction of unproductive subsidies, and the restructuring and privatization of State-owned enterprises.

  In the near term, the percentage of non-performing loans is an especially serious obstacle to credit since the public-sector banks are under-capitalized and hence not very inclined to make loans. There is still significant potential for interest-rate cuts, but this process is slowed by an inflation rate which is still 5%.

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More fundamentally, India is poor in capital, with a savings rate of 32% compared with 45% in China, and must create the conditions to attract international investors. In 2015, the amount of savings was almost $40 billion, but that is too little to finance the country's infrastructure needs, and the 3.5% budget deficit is an obstacle to any stimulus. Other obstacles to development include shortcomings in infrastructure, insufficient skilled personnel in certain sectors, chronic electricity shortages, the terrible sanitation system, social rigidities meaning there are still 16% of "Untouchables", and excessively frequent attacks on religious minorities.
The sluggish growth of industry is a barrier to development.
The capacity utilization rate is only 70%, and as low as 50% in steel and paper production.
After the United States, India is the country which has the largest land area under cultivation, but much of this land is in semi-arid regions which lack water and where it is impossible to sow high-yielding seeds, or in regions that experience frequent flooding. While the agricultural population has fallen to 24%, two-thirds of the population live in rural areas where services account for 50% of activity.

Brazil:

- Politically, fragmentation is a constant feature. There are around 25 parties, and Lula ruled a coalition of about twenty political formations. Today the situation is worse, because the Conservative Mr Temer, replacing Dilma Rousseff, has little legitimacy and will face difficulties in forcing through retirement at age 65, starting to launch privatizations of infrastructure (ports, airports, sewerage and water treatment), attracting foreign capital or freezing government spending for a long time, even though he has taken the decision to increase welfare allowances (the '*Bolsa*') by 12% for 14 million disadvantaged citizens.
- Economically, to stimulate the economy, the Central Bank recently decided, for the first time in four years, to lower its policy rate by 0.25% to 13.75%, but the country is in recession, with negative growth of -3.8% in 2015 and -3.5% in 2016. GDP has fallen to the level of 2010 and per capita GDP has even declined by almost 10% since the onset of the recession. Retail sales have declined 18% since the peak of 2012, consumer credit is weak, at only +1%, the unemployment rate is high, at 11.8%, and inflation, at 8.4% in September, is still excessive. Brazil posts a primary deficit of 2.3% of GDP, worsening the public debt ratio, which is now 70% of GDP versus 51% in 2012. We may add the loss of competitiveness, due, in recent years, to the high exchange rate of the Brazilian real and wage growth, so that the trade surplus, $47 billion in 2016, is a misleading figure resulting merely from the decline of imports.
- Fundamentally, the country still has some shortcomings. Firstly, public investment in infrastructure, for example, which does not exceed 2% of GDP, when in China it is frequently 6% of GDP. Next, the total investment rate, which fell by 23% in 2013 to 18% of GDP (compared with a rate of

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around 25% in Russia and 35% in India), which, for want of sufficient savings, is more than two times less than in China.

Russia:

- Politically, Putin has run the country, directly or indirectly, for the past 16 years and will probably win the presidential election in 2018. Defence spending has increased sharply in recent years, to $90 billion, equivalent to the combined spending of France, the United Kingdom and Germany, but this may seem excessive for a country whose GDP is on a par with that of Italy. His foreign policy strengthens Putin's image, and the intervention in Syria, a first outside the former Soviet Union since the war in Afghanistan in 1979, may be motivated by the presence of 20 million Muslims in the Caucasus, equivalent to 15% of the country's population, but the country has no real ally. At the UN General Assembly, only ten countries, including Syria and Venezuela, supported Russia on the bombing of Aleppo.
- Fundamentally, Russia, currently 9th in the world by its population, will only rank in 15th place in about fifteen years' time, on a par with Turkey, because its population is declining, and its working population is shrinking by around 200,000 people per year. The country's other weaknesses are its legal system, which is not sufficiently protective to attract foreign capital, insufficient public investment which will adversely affect the country's long-term growth and hinder productivity gains, the weak diversification of industry and the reliance on oil and gas which has not decreased in the past twenty years. Admittedly, Russia accounts for 18% of global gas production (No. 2 after the United States) and has 17% of global gas and coal reserves, but 70% of the oil, 92% of the gas and 80% of the coal are in Siberia, which lacks infrastructure to facilitate production. Sensitivity to oil price fluctuations remains high, with a 10% variation in the oil price representing a 1 percentage point variation in GDP growth, even though the fall of the rouble, which moves in step with oil prices, offsets the decline in revenues.
- Short-term, the country still has large foreign exchange reserves of close to $370 billion, but the low level of commodity prices, the impact of international economic sanctions, and a budget deficit exceeding 3% of GDP have obliged the country to dip deeply into two sovereign funds which represented a reserve larger than 6% of GDP, and it is essential to keep watch on its gross external debt, currently 51% of GDP, because more than 80% of the public debt is denominated in US dollars and in euros.
- Household income declined by 10% in 2015, and the number of poor people increased by 3 million, to 19 million, although far from the level of 50 million reached at the end of the 1990s.
  Recently the situation has improved, and the recession, with -0.5% expected in 2016, is milder than in 2015 (-3.7%), although retail sales have declined by 4.4% year-on-year. Other positive aspects are the low unemployment rate of 5.5%, crude production which is at a record level of 11m bpd, favourable cereal harvests and the rising proportion of exports to China, 9% of the total.

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- By mid-August, the Russian market was at an all-time peak, the rouble was down sharply from 34 to the dollar in mid-2014 to 61, and interest rates remained high and attractive, at 9%. Markets continue to rate Russia poorly, because 10-year bonds offer far higher yields than the bonds of countries such as Spain or Italy, even though the latter are far more heavily indebted.

Other large emerging countries:

Asia:

- Growth remains sustained, e.g. 5.2% in Indonesia and around 7% in the Philippines. In several countries, however, such as Thailand, Malaysia and South Korea, consumption is based on a sharp increase in consumer lending, and this ultimately represents a factor of vulnerability.
- The geopolitical scene is changing, and the Philippines, a country of 103 million inhabitants, is breaking free of US influence and seeking to acquire military hardware from China and Russia.
- **Turkey**: this year, Turkey experienced its fifth coup d'état since 1960 (after 1960, 1971, 1980 and 1998) and remains rather isolated on the diplomatic stage, although it is trying to move closer to Russia and is planning the construction of a common gas pipeline with Israel to transport Israeli gas to Europe.
  The currency has fallen by around 17% since the coup d'état. Growth has slowed drastically, and GDP declined in Q3, which is a first since 2009, prompting the country to launch a plan worth several billion dollars to finance infrastructure development and stimulate growth. But gross debt in foreign currencies has increased, to 60% of GDP, and the current-account deficit is high because of insufficient savings. Also, exports have a high import content and energy accounts for a large proportion of imports. But what is most worrying is the sharp growth in private-sector credit since the early 2000s; from 10% of GDP, it has increased to 70%.

Africa:

- From 17% of the world's population in 1500, Africa had fallen to 7% in 1900. Today, the population is growing rapidly, and in 2050 the continent will again have 17% of the population of the planet, i.e. 2.5 billion people at that time. By then, China's population will be 1.3 billion, stable compared with the present day, while India will have a population of 1.7 billion.
  Over-optimistic analyses of Africa are excessive. Admittedly, growth is expected to be as high as 4.5% in 2016, and some countries such as Ethiopia, Mozambique and the Ivory Coast are doing

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even better, but it will be difficult to provide jobs for the 25 million young people who enter the market each year.

We should stress the weakness of many of the 51 states and the significance of internal migration on the continent, a cause of disorder, especially since the 8,000 km of the Sahara Desert are no longer a barrier.

We can add the rapid growth in the debt burden of these states, by 10 percentage points in five years, to reach 44% of GDP, and the abundance of natural resources but weakness of manufacturing centres, often concentrated on the coast (the large ports of Durban, Lagos/Abidjan, Dar es Salaam, and Ethiopia).

Nigeria, the leading economy in Africa, has gone into recession, and is struggling to overcome inflation officially at 17% and to attract foreign capital, which is much needed for its infrastructure financing.

In **South Africa**, the second largest economy on the continent, the economic situation is difficult. A decline in GDP and consumption in Q2, an unemployment rate of 25%, losses reported in half of the mines, a worsening foreign-currency debt at 47% of GDP, a budget deficit that is out of control, at 3.9% of GDP, a very large trade deficit amounting to 4.9% of GDP, a BBB- credit rating assigned by Fitch, and a 10-year interest rate exceeding 9% are all factors of concern.

In **Niger**, the government's legitimacy is challenged, and it remains vulnerable to terrorist attacks. This French-speaking country has only 17 million inhabitants in an area twice as big as France, but only 10% of the inhabitants have access to electricity. The number of children per woman of childbearing age exceeds seven. Accordingly, the population could be as much as 70 million in 2050, and emigration could become a major issue.

Ethiopia is often mentioned as an example of a country enjoying strong growth, of 7% to 10% per year, but one-third of the population still has less than $2 per day to live on, and the country, which lacks capital, has a current-account deficit of 7% of GDP.

<u>Latin America</u>:

- In **Mexico**, the situation is contrasting.

  Regarding demographics, the number of children per female has fallen from 5.4 in the 1970s to 2.3 recently, but 30% of the population is aged under 15.

  Regarding the economy, from 1994 to 2012 economic growth was weak and the per capita GDP gap with the United States widened. Oil accounts for 40% of tax revenues, and the recent fall in crude oil production from 3m bpd in 2008 to 2.5m bpd, and the low oil price, have forced the country to slash welfare spending, even though this is a small budget item. More worrying is the accumulation of gross debt in foreign currencies, at 30% of GDP, at a time when the currency has been devalued by 16% year-on-year. And even more disturbing is the anxiety perceptible following Donald Trump's election, because 75% of Mexican exports are destined for the United States and

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Canada and because, of the three million cars produced, many are exported. On the positive side, fortunately, there are job creations (+3.6% year-on-year), a low unemployment rate (3.9%), and hence sustained retail sales.

- In **Argentina**, recession prevails (-2% expected), with rising poverty and an inflation rate of more than 30%, partly attributable to a 30% fall in the value of the currency and the removal of numerous subsidies for the poorest, for water, gas and electricity. Mauricio Macri wants to open the markets to competition, but SMEs are not ready and one notes, for example, a 30% fall in local shoe production.

Conclusion:

- To provide a link with our investment strategy note which will follow in a few days' time, based on the previous pages we adopt a neutral weighting on the United States and Japan, an overweight position in Europe, and an underweight position in emerging countries except China in which we have a neutral position.
- Against this backdrop of moderate growth, there are numerous social and political challenges:
- Political challenges, because democracy, which seemed to have won definitively in 1990, is now being undermined by blossoming populist movements and the dissatisfaction of Western populations, faced with stagnation and a decline in their purchasing power.
- Demographic challenges, with the prospect of a doubling of the African population by 2050, and elsewhere the costs of population ageing.
- Geopolitical challenges, because although the demise of the Soviet bloc lent credibility to the idea of an end to war, that this is not at all the case. In addition to the resentment of a Russia whose population is declining and whose economic weight is diminishing, there are China's ambitions in Asia, the incapacity of Middle Eastern countries to make peace, and about fifty conflicts, mainly domestic.
- But at the start of this new year, we shall choose to conclude with ***Nietzsche*** by recalling that ***"Optimists love the uncertainty surrounding the future"***, which, when you think about it carefully, is what indeed characterizes the current stock market.

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