

Global Brief

Prepared for Client Executive **MAY 2015**

Regional Market Updates

INDIA

Landmark tax bill will end multiplicity of central and state taxes

The goods and services tax bill has been passed by the Indian parliament's lower house. The act subsumes the excise, service, state value-added, entry, and other state and local taxes.

- The tax reform, slated to take effect on April 1, 2016 heralds the economic integration of the Indian goods and services market and is seen as a key prerequisite for long-term sustainable growth.
- Prime Minister Narendra Modi's administration gained the support of all 29 states, which had feared that tax reform would curb their fiscal powers, and he has addressed concerns about implementing and administering the new tax regime.
- The bill amends the Indian constitution and needs the support of two-thirds of the opposition-dominated upper house. The government hopes to gain this during the next parliamentary session in August.

CHINA

China is moving into uncharted economic territory

China's economy is slowing faster than expected and Beijing is moving more aggressively to put a floor under growth and avert a hard landing.

- Recent data point to a continuing weakness in industrial output, construction, real estate, and retailing, but the government is sticking with its target of "around 7%" GDP growth in 2015. The IMF is forecasting 6.8% growth for the year.
- In mid-May, the central bank reduced its benchmark interest rate and the reserve ratio requirement for banks. China's 25 basis point cut to both the one-year loan rate and one-year deposit rate are designed to mitigate an ongoing credit freeze.
- Growth has slowed to a rate not seen in a quarter-century. Given the scale and complexity of its economy and financial system (including fast-growing shadow banking), China is moving into uncharted territory.

BRAZIL

Rousseff's lack of political capital will continue to complicate governance

President Dilma Rousseff is facing her "perfect storm" for governance, as she must push unpopular austerity measures at a time when her political capital is low.

- Rousseff's unpopularity and the recent Petrobras corruption investigation limit her power to lead effectively and to get her base of allies in congress to approve fiscal measures.
- Finance Minister Joaquim Levy's plan to shift from a budget deficit of 0.6% to a surplus of 1.2% was only approved by only a slim margin. Concerns about cutting social security and labor benefits will likely resurface.
- On May 13, the lower house of congress passed legislation increasing benefits for pensioners, further undermining Levy's efforts to cut spending. ▶

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RUSSIA

Time is on Putin's side

Recent high-level US diplomatic overtures to Moscow are intended to put the focus back on the Ukraine crisis and the stumbling ceasefire. Inattention has benefitted Russia and the rebels over the last few months.

- Secretary of State John Kerry's surprise meeting with President Vladimir Putin and foreign minister Sergei Lavrov in Sochi on May 12 was quickly followed up by "working-level" meetings between Assistant Secretary of State Victoria Nuland and Lavrov's deputies.
- The press has played the US's actions as a softening toward Russia, but they are likely part of a larger strategy to bring attention (including galvanizing the Europeans) to a conflict where the passage of time and reduced foreign attention benefits Putin. EU sanctions expire this summer and support for renewing them is ebbing.
- The Ukrainian government continues to falter under a weak and unconsolidated governing structure. The rebels continue to make incremental advances. The BBC reports that the Ukrainians have lost control over 28 towns within eastern Ukraine since the ceasefire was signed in February 2015.

TURKEY

The June 6 parliamentary elections will shape the country's future

The elections can be viewed as a referendum on President Erdogan's efforts to remake the country's governance structure in his favor.

- Erdogan wants to change the constitution to give the presidency substantial new powers, and his ruling AKP party needs to achieve a supermajority in parliament to do so.
- Polling throws this into doubt, as Erdogan's heavy-handed treatment of the opposition and the country's faltering economic outlook have hurt his popularity. The currency fell to record lows in April, and the economy is expected to grow by only 3% in 2015 and 2016.
- If the left-wing People's Democratic Party, which represents ethnic Kurds and other disgruntled groups, fails to achieve 10% of the vote (the threshold required to gain seats in parliament), political instability around the country could intensify.

NIGERIA

A new president should help boost political stability

General Muhammadu Buhari assumes the presidency May 29, and this provides an opportunity to address Nigeria's daunting governance challenges.

- Buhari's election platform did not differ substantially from that of outgoing President Goodluck Jonathan, but his law-and-order credentials and promises to hold government accountable won over a frustrated and divided population. ►

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- The new government's challenges are daunting. The fall in oil prices have hit government coffers. Paying public sector salaries is a near-term challenge.
- Over the longer term, rooting out corruption and patronage networks, especially in the oil sector, and addressing unrest around the country will be difficult. However, strong FDI inflows into sectors other than petroleum are likely to increase, due to the perception of increased political stability in the country.

GERMANY

The economy underperformed in the first quarter

The economy surprised on the downside in the first quarter but the government isn't too worried. Exports will continue to drive growth.

- GDP growth in 1Q15 came in at an annualized rate of 1.2% — a notable slowdown from the 2.8% rate achieved in 4Q14. Eurozone growth accelerated in the first quarter to 1.6%, and Germany lagged behind Spain, France, and Italy.
- Exports are a main driver of the German economy and recent weakness in foreign sales (e.g. to China and Russia) contributed to the underperformance. A Eurozone recovery and a weaker euro should help boost German exports, and the IMF in April forecast German growth at 1.6% for the year.
- The IMF also predicts Germany's massive current account surplus will continue growing. To mitigate systemic risks, the IMF has called for new measures in Germany to increase spending on infrastructure, lower barriers to competition in services, and create more flexible labor markets. German officials have resisted this.

CANADA

Parties and companies brace for a political sea change

After a long period of stability, Canadian politics are in the midst of a series of decisive elections, which could potentially bring significant changes to the political landscape.

- Voters are demonstrating willingness to break established party ties, voting for the left-wing New Democratic Party (NDP) in right-wing Alberta and re-electing long-serving Liberals in Ontario and Prince Edward Island.
- Recent polls suggest the October 2015 federal elections will be tightly contested with support presently divided between Canada's three main parties. Liberal leader Justin Trudeau and NDP leader Thomas Mulcair will pose significant challenges to incumbent Conservative Prime Minister Steven Harper
- Canada's economy has suffered due to lower oil prices and a major political scandal has embroiled Harper's office. Trudeau is leading a campaign based on income redistribution and support for the middle class and appears to be gaining ground. ►

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Global Market Themes

GLOBAL GROWTH

The IMF foresees moderate but uneven growth in 2015

In its April report, the IMF projected global growth of 3.5% in 2015 — about the same as last year. Notably, the IMF said fewer downside risks existed to the 2015 outlook than in the 2014 forecast.

- Advanced economies are expected to do better in 2015 and the outlook for Europe in particular has been upgraded since the IMF's January forecast.
- Emerging markets will likely continue to surprise on the downside. EM growth rates in 2015 are expected to be lower than last year and the outlook for many countries has been revised negatively since the January forecast.
- The growth margin between advanced economies and EMs continues to narrow—from 4.5% in 2012 to a forecast 2.1% in 2015, changing what it means to be considered a “growth market.” Significant variation also continues in growth expectations among individual EMs countries.
- Global growth is likely to remain slow for the foreseeable future.

ENERGY

Oil price volatility will continue but the fundamentals are the same

Prices have rebounded from their winter lows, but this doesn't signal a fundamental change in the markets.

- The recent escalation in prices is due to geopolitics (ISIS and Yemen) and downward pressure on the US dollar. Nevertheless, the market remains well supplied: Saudis are unlikely to cut production and US output will continue to grow in the near term.
- Oil price volatility reflects broader uncertainty in the markets thanks to slow global growth, a world awash in liquidity, and questions about the timing and impact of a US interest rate rise.
- Expect prices to bounce around for the next 18 months or so. Issues that could move the needle substantially are geopolitics (especially Iran) and demand from China and the US.

IRAN

A nuclear deal prior to June 30 still looks likely but sanctions will be sticky

Public statements by leaders of the so-called P5+1 countries and Iran signal a continued commitment to reaching a final nuclear deal by the June 30 deadline. The main obstacle remains the schedule for the removal of sanctions.

- While the deal enjoys wide public support in Iran, public figures there continue to call for immediate sanction relief, a position unlikely to be accepted by the US.
- The White House has reached a deal with congressional leaders requiring a two-thirds majority in both the Senate and the House to approve lifting sanctions. Other countries are likely to move faster. ►

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- Early business opportunities from a lifting of sanctions will be in oil production and refining, power generation, and insurance. Top executives from European and US companies, including Chevron, recently participated in an Iran-focused oil industry conference, signaling their willingness to explore the Iranian market if and when sanctions are lifted. ■