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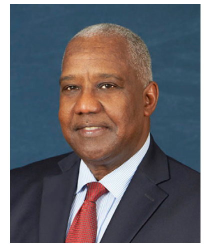

Global Overview

By Byron Shoulton

The International Monetary Fund is predicting 3.5% global GDP growth in 2017. The stronger outlook is the fruit of broad-based recoveries in manufacturing and trade in both developed and emerging markets. While politics in much of the western world is being overwhelmed by the built-up angst from a decade of low growth, the global economy is at its most robust since the end of the financial crisis. While the U.S. economy grew slower in the first quarter of 2017 than it did during the final quarter of 2016, it gained momentum in April.

The Institute of Supply Management's index of factory activity confirmed that while factory activity slipped slightly in the first quarter, it continued to expand at a healthy pace in April for the seventh consecutive month. Separately, construction spending in the U.S. reached its highest levels since 2006 as builders took advantage of warmer weather to put up more houses. Meanwhile, the pace of U.S. job growth bounced back in April from a weaker performance in March, bringing the unemployment rate down to 4.4%, its lowest reading since 2009.

Separately, the U.S. launched a national security investigation into steel imports, which could lead to the imposition of new tariffs. If new tariffs were imposed on steel imports, that would represent a significant act of protectionism and could trigger retaliation from China and the EU. Economic nationalism remains a hotly debated topic in the U.S. and parts of Europe and could become a vital tool used in achieving more favorable trade arrangements between trading partners.

Meanwhile, the U.S. Federal Reserve concluded that the slight slowdown seen in the first quarter was due to temporary factors. The Fed confirmed that it would not be immediately raising interest rates again. In June a meeting of the Fed Open Markets Committee will assess the need for further tightening in 2017, against the background of a strengthening recovery and a question as to how much confidence is attained in the global economy.

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In the ***UK***, Prime Minister Theresa May announced surprise snap general elections for June 2017, which should give her greater national support for the upcoming Brexit negotiations with the EU. The UK's consumer sentiment has managed to remain upbeat so far in 2017. That is despite the many challenges and uncertainties which the country faces as it begins negotiations with the EU to establish future trade, commercial and immigration rules applicable after the UK is no longer a member. Growth in full-time employment and house prices, together with more favorable credit conditions, have supported a robust upturn in consumer sentiment and spending, whereas consumers' purchasing power was boosted by a marked fall in energy costs. A slowdown in private consumption is expected over the coming quarters and especially in 2018-19, as an expected sharp depreciation of sterling following Brexit reduces purchasing power. The labor market is also expected to deteriorate from the second half of 2017 as businesses delay hiring in response to uncertainty about the implications of Brexit.

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Among the many issues of concern is how to reach agreement that preserves the residency and acquired rights of three million citizens of EU nations currently living in the UK. Reciprocal rights would similarly have to be applied to the one million British nationals living in Europe. Both sides are apparently not in agreement. It is said that British voters will find it hard to understand why EU nationals should retain certain rights to recruit family members to join them in Britain even after Brexit. The upcoming negotiations will at best be complicated.

Mexico and ***Canada*** were advised by the Trump Administration that the U.S. will likely not withdraw from NAFTA (as had been previously indicated). Instead, the Administration says it will pursue negotiations to strengthen the trade agreement, such that U.S. interests will not be placed at a disadvantage going forward. This is good news for companies in all three countries which are party to NAFTA. A withdrawal by the U.S. from the trade block would make the 20- year old agreement unviable. Mexico's government can draw comfort from the fact that its turbulent economic history may have prepared it to deal with the upcoming negotiations over NAFTA. A confrontation over Mexican sugar exports to the U.S. is already shaping up - and could turn out to be a dress rehearsal for the implicit haggling over NAFTA.

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Mexican President Pena Nieto faces multiplying problems at home that could further undermine his government and hurt the chances of the ruling Institutional Revolutionary Party (PRI) to win the 2018 presidential elections. The challenges include GDP growth of only 1.2% in 2017, the government's inability to tame a spike in violence, ongoing threat from drug gangs, plus corruption scandals among politicians and within the security forces. The series of crises have weakened President Nieto and has fuelled the return of Andres Lopez Obrador, a maverick leftist politician who almost won the presidency in 2006. Mr. Lopez Obrador is increasingly looking like the man to beat in 2018, a prospect that is not welcomed by the private sector due to his anti-business and anti-free trade stance. With that in mind, Mr. Pena Nieto appears keen to wrap up the NAFTA talks with the U.S. as quickly as possible. If the timetable slips, Mr. Lopez Obrador, a foe of most things that Mexico's urbane technocrats stand for, has made clear his own desire to weigh in on the NAFTA renegotiation. That might mark the moment when Mexico's domestic problems serve to undermine its accomplished record of handling international crises and winning good trade deals.

In ***Turkey*** President Erdogan having won the April Referendum aimed at amending the Constitution, has had his powers elevated. Erdogan now enjoys more power than any Turkish leader since Kemal Ataturk, the founder of the Republic of Turkey. The office of the prime minister will now be eliminated and President Erdogan will have greater immunity before the courts. He will be allowed to lead his AKP party even as president and be able to govern Turkey until 2029.

Saudi Arabia confirmed that it expects the agreement by producers to curb crude output and shrink a market glut will be extended into the second half of this year and possibly beyond. The deal between OPEC and its allies to cut output to ease the glut has done little to shrink the flow of crude with lesser sulfur content [which is easier to process into gasoline]. No wonder crude prices have been falling and remain well below $50 per barrel.

Despite the OPEC supply deal, oil prices will remain too low to enable a significant revival in the oil dependent economies of the Middle East and North Africa (MENA). These countries are continuing to cut spending, which in turn is depressing private consumption.

Surging U.S. production has raised concern that OPEC and partners are failing to reduce an oversupply and prop up prices. Oil has surrendered all its gains since the OPEC deal in 2016 to cut output. However, most of the supply produced in the U.S. shale fields, Nigeria and Libya- all of which are exempt from the production cut agreement - are crude of the "sweet" variety. Middle Eastern producers that are shouldering most of the cuts pump mostly "sour" grades that contain more sulfur.

Following a dismal performance in 2016 – when it is estimated that Sub-Saharan Africa's rate of economic growth fell to just 1%, the lowest pace of expansion for at least 20 years – growth is forecast to pick up in 2017. Prices for exported commodities have seen modest improvements this year and weather conditions saw improved rainfall as well.

India

India will be Asia's fastest-growing large economy in 2017-21, expanding at an average annual rate of 7.6%. However, the economy is also going through a painful period. A lending spree earlier this decade has saddled state-owned banks with bad loans. Combined with excess capacity in the steel industry, this will depress corporate lending and investment for some time yet. GDP growth is expected to average 7.2% over the next two years before growth picks-up as the government's major reform program begins to generate greater benefits, especially in infrastructure and policymaking.

Indian exports have been on the rise over the past three months. Exports surged in March, up by 45.3% year-on-year to $39.7 billion for the month. The strength of its export performance is a welcome boost for the government, which has pinned its hopes on expanding shipments. The increase in engineering goods exports is particularly encouraging, as it signals the growing competitiveness of India's manufacturing sector despite a relatively strong rupee. Important to note is that textile exports were also strong and are expected to expand employment in the months ahead. India's exports of agricultural products such as rice, fruits and vegetables, and meat also picked up sharply, which is in-line with seasonal trends in March. However, meat exports could come under pressure in the months ahead as the authorities are stepping up efforts against cattle slaughter, amid a climate of growing social and political intolerance.

Imports of electronic goods rose sharply to $4.8 billion, reflecting India's growing importance as a market for electronics companies. The increase in the import bill was also partly driven by strong demand and higher prices for commodities. On account of seasonal trends and pent-up demand, gold imports surged again, reaching $4.2 billion. The authorities intend to keep a close eye on gold imports as they are the second-largest contributor to the import bill (after petroleum products).

It is believed that India's relatively healthy economic outlook, combined with the central's banks high levels of foreign exchange reserves, will limit the risk of exchange-rate volatility.

The increase in the trade deficit to $10.4 billion (compared to $4.4 billion in March 2016) is in line with projections. The expectation is that a wider merchandise trade deficit will result in a growing current-account shortfall for 2017. However, at the equivalent of 0.9% of GDP, this will still be relatively low and pose little risk to macroeconomic stability. The data also serve to underscore that the economy has firmly left behind the sluggishness witnessed after the demonetization campaign was introduced in November 2016.

The currency has had a strong start so far in 2017. It is expected to depreciate only modestly (from Rs.64.8:U.S.$1 in the first quarter of 2017 to RS68.3:U.S.$1 by year-end]. The strength of India's merchandise exports will also reduce the pressure from export-oriented companies on the monetary authorities to allow the currency to weaken in 2017. It is believed that India's relatively healthy economic outlook, combined with the central's banks high levels of foreign exchange reserves, will limit the risk of exchange-rate volatility. The central bank will meet its inflation target of 2-6% throughout 2017-2021. It will set monetary policy with a view to reducing inflationary pressures during this period.

The current account is expected to remain in the red for the next few years, albeit to a lesser extent than in the past, averaging 1.5% of GDP in 2017-21. The fact that the deficit will remain contained is, to a large extent, the result of commodity price trends. Oil prices, for example, will remain significantly lower than at their peak in 2012, limiting India's energy import bill. The global oil market glut is helping India's biggest crude processor, Indian Oil Corporation, to become nimble. In the past the company bought 80% of its crude via long-term contracts. It managed to cut that share to 10-12% over the past three years. Being able to take advantage of the flexible prices on the spot market for crude supplies creates major savings.

India's competition with China for influence in South Asia will remain one of several obstacles to improve Sino-Indian ties, along with China's deepening ties with Pakistan (India's longtime adversary).

Meanwhile, India is under pressure to spend more to upgrade its highway and agricultural infrastructure and to create a more reliable power grid. Failure to do so would mean that India's status as the fastest-growing major country will not be sustained. The country seeks to build closer ties with Japan and Vietnam, partly with a view to containing China's influence in the region. India's competition with China for influence in South Asia will remain one of several obstacles to improve Sino-Indian ties, along with China's deepening ties with Pakistan (India's longtime adversary).

Vietnam

GDP growth of 6.7% is projected for 2017 and 2018 [up from 6.4% in 2016]. Nonetheless, growth during the first quarter disappointed somewhat, advancing by 5.1% (its weakest start since 2014). The slower pace was the result of government policy, as it sought to refocus the economy away from the natural resource sector. As such, it will not take long for headline economic growth to bounce back, with the government having directed the state-owned oil company PetroVietnam to increase oil extraction in the aftermath of the weak first quarter data.

The increasing amount of intermediate goods that Vietnam's booming export sector needs to keep running will continue to exert upward pressure on the country's import bill. For example, $11.3 billion in machinery, equipment, tools and related spare parts were imported in January-April 2017, representing an annual increase of 40%. The rapid pace of import growth is also indicative of robust domestic demand. Based on the latest data available, retail sales rose to a near two-year high of 13.5% in April. The value of Vietnam's merchandise exports continues to rise in 2017 [following growth of 8.3% in 2016]. The U.S. is Vietnam's primary export market followed by China, Japan, South Korea and Hong Kong. The EU accounted for 19% of total exports while ASEAN countries accounted for 10%. China is the main source of imports, followed by South Korea, Japan, Taiwan and Thailand. ASEAN countries account for about 14% of Vietnam's total imports, while the EU accounts for half that amount.

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One leading rating agency has warned that Vietnam's banking sector will likely face capital shortfalls over the next 12-18 months and that this will continue to represent a credit burden for the sector. Rapid loan growth will widen the capital gap for the banks as the economy continues to expand at a fast clip. According to Moody's an expected loan growth of 26% in 2017 and 2018 (similar to the pace set in 2016) will lead to a total capital gap of $9.4 billion (or 4.6% of GDP). This is the amount of external capital needed for the banking system to replenish their Tier 1 ratios back to 8%, after they have utilized their reserves to absorb potential losses on non-performing loans.

The central bank is expected to allow the currency to weaken in 2017, albeit only gradually. The foreign exchange reserves have recovered since deteriorating in 2015. However, these are not sufficient to support the defense of the currency over an extended period of time.

In order to sustain the current growth momentum policymakers in Vietnam cannot wholly rely on fiscal policy and the activities of state-owned enterprises. The government's budget deficit remains quite wide and the public debt-to-GDP ratio is well above that of comparable countries, limiting the potential for prolonged fiscal stimulus. The gross public debt-to-GDP ratio of 58.2% is well above the emerging market median of 47.3%.

Brazil

Brazil's emergence from a 2-year recession will help to lift aggregate growth in Latin America back into positive territory this year. However, Brazil's growth will be weak at just 0.5% for the year. After an accumulated fall in real GDP of 7.3% in 2015-16, Brazil's economy is forecast to pick up gradually in 2017 and to gather momentum thereafter. By the fourth quarter of 2017 GDP is projected to be growing at a rate of over 2% year-on-year. Brazil's economic upturn could subsequently be capped by a potential hard landing in China in 2018 and a slowdown in the U.S. in 2019.

Real GDP will likely only just return to pre-recession levels by 2021, and will take longer in per-capita terms. It will take longer for the economy to pick up speed, not least because of the imperative of fiscal adjustments, but also because private consumption will be weak. Social security reforms will affect consumption. High unemployment (12-13% currently) will remain throughout 2017, easing only gradually in 2018. Interest rate cuts will ease household indebtedness and companies' battered balance sheets, but credit growth will be much weaker than during Brazil's 2004-11 period of boom.

President Temer will likely see out the remainder of his term in office (which ends in December 2018), while continuing to press for economic reforms. The expectation is that whoever emerges as president in January 2019 will likely continue to pursue and secure many of the reforms now being put in place by the current government. The sitting interim government has pursued orthodox, business-friendly policies necessary to regain investor and creditor confidence in Brazil's medium term outlook.

As Brazil has a trade deficit with the U.S. and is not markedly integrated into global manufacturing chains, it is much less likely to be affected by protectionist policies that may be implemented by the new U.S. Administration, compared to Mexico or China.

Foreign policy will prioritize trade deals with partners in the region and overseas. Brazil is keen to revamp Mercosul (the Southern Cone customs union) comprising Argentina, Brazil, Paraguay and Uruguay. In December Mercosul suspended Venezuela, reflecting a hardening of the union's stance against the leftist regime there. The EU and Mercosul have exchanged proposals for a long-delayed free-trade agreement.

As Brazil has a trade deficit with the U.S. and is not markedly integrated into global manufacturing chains, it is much less likely to be affected by protectionist policies that may be implemented by the new U.S. Administration, compared to Mexico or China. The current account is expected to widen to 3% of GDP by 2020 as economic recovery lifts imports. Although prices for Brazil's commodity exports are rising from 2014-15 lows, the country will not enjoy terms of trade as favorable as those seen during the 2004-11 boom. China's loss of demand will hurt Brazil's terms of trade in 2018, before an anticipated modest recovery ensues thereafter.

Policymakers have addressed price distortions that caused double-digit inflation in the recent past, easing inflation to 4.6% in mid-March. The central bank is now fully committed to achieving the 4.5% central inflation target; and it is expected that this target will be reduced over the next few years, contributing to lower inflation. This year's abundant agricultural harvest affecting most crops is expected to dampen price pressures.

The currency, the real, is likely to follow a gradual weakening path, reflecting a narrowing of interest-rate differentials with the U.S. Although there is a risk of additional currency weakening (if the global economy suffered a hit or if there is greater U.S. monetary tightening than currently expected), the real should find some support as GDP gradually recovers and assuming the fiscal reform agenda is not derailed

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