2019 World Economic Outlook

—Toward a Slowdown—

(Original Japanese version put out on December 21, 2018)

Marubeni

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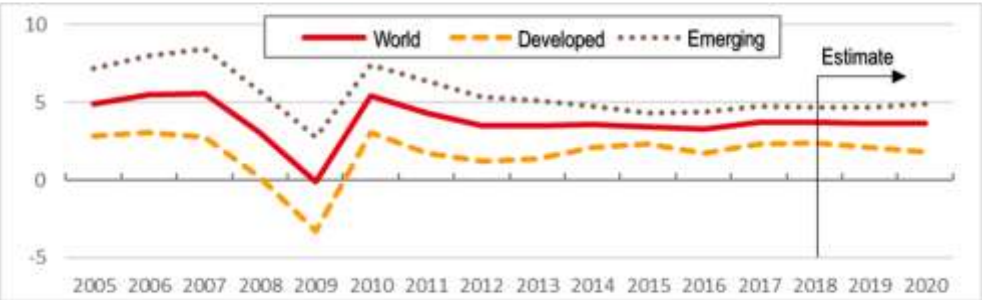
Marubeni Research Institute

1. World Economy
World Economy to Slow, Possible Further Downside Risks

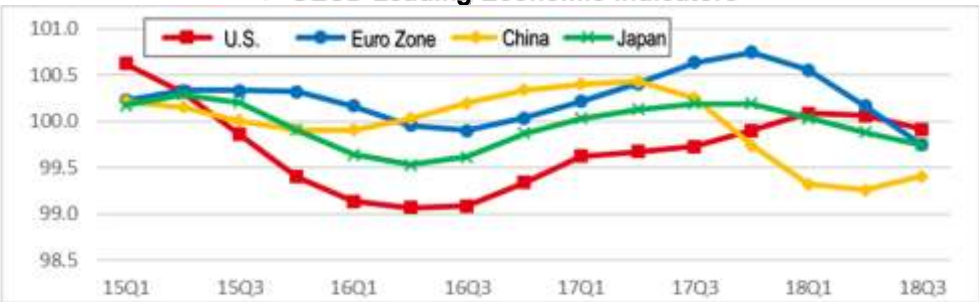
- The world economy should **decelerate** in 2019. Although the U.S. economy is currently buttressing the world economy, the growth rate will begin to decline as the effect of the tax cuts fade and the economy peaks. China's economic growth rate should be maintained on the back of aggressive government stimulus. Without any one economy to pull the world economy along in 2020, economic stagnation could strengthen. The slowing of China's economic growth to around 6%, will have a significant effect on neighboring countries and natural resource and commodity prices.
- Attention should be paid to downside risks .There is concern that if the financial authorities in the developed countries misjudge the degree of economic strength and rush the normalization of monetary policy (exiting ultra-easy monetary policy), an excessively tight international monetary environment could lead to the stagnation of overall economic activity and to asset price corrections. In addition, the Chinese economy could sharply slow as a result of a U.S.-China trade war. There are also risks to the Euro and the EU from Brexit and Italy's fiscal problems.

▽ World Real GDP Growth Rates



Source: IMF "World Economic Outlook" (October2018)

▽ OECD Leading Economic Indicators



Source: OECD

▽ World Growth Rate Outlook (%)

	2017 Share	2017 vs. prior year (actual)	2018 vs. prior year (estimate)	2019 vs. prior year (forecast)	2020 vs. prior year (forecast)
World	100.0	3.7	3.7	3.6	3.5
Advanced Economies	41.3	2.3	2.4	2.1	1.7
US	15.3	2.3	3.1	2.4	1.8
Euro Zone	11.6	2.4	2.1	1.9	1.7
Japan	4.3	1.9	0.9	1.3	0.3
UK	2.3	1.9	1.3	1.2	1.2
Newly Emerging Economies	58.7	4.7	4.7	4.7	4.8
Sub-Saharan Africa	3.0	2.7	3.1	3.8	3.8
Central/Eastern Europe	3.6	6.0	3.8	2.0	2.7
Russia	3.2	1.5	1.7	1.5	1.5
China	18.2	6.9	6.6	6.2	6.0
India	7.4	6.7	7.3	7.4	7.6
ASEAN 5	5.4	5.3	5.3	5.2	5.1
Middle East/North Africa	7.5	2.2	2.4	2.7	2.9
Central/South America	7.7	1.3	1.2	2.2	2.5

Note: Afghanistan and Pakistan are include in thed Middle East/North Africa
Source: World Economic Outlook (October 2018)

2. International Monetary Policy
Risks in Exiting Non-Traditional Monetary Policy

◘ U.S.: Even with worries over a slowdown as a backdrop, the view is that at least 2 rate hikes will take place in 2019

- A fourth rate hike was carried out at the Federal Open Market Committee (FOMC) meeting this past December raising the FF rate from 2.25% to 2.5%. In terms of its policy outlook, the FOMC suggested it may relax its conventional rate hike stance over fears of a stalling economy leading to a sense of disappointment in the market and contributing to a plunge in stock prices.
- Although there has been a reduction in the scale of reinvestment and the corresponding amount of financial assets accompanying the end of quantitative easing, there has also been a gradual acceleration in the downsizing of the Federal Reserve's (FRB) balance sheet. Mitigating the supply and demand for U.S. Treasury bonds and mortgage-backed securities that were the subject of programmed purchases was the primary factor for this (downward pressure on prices).

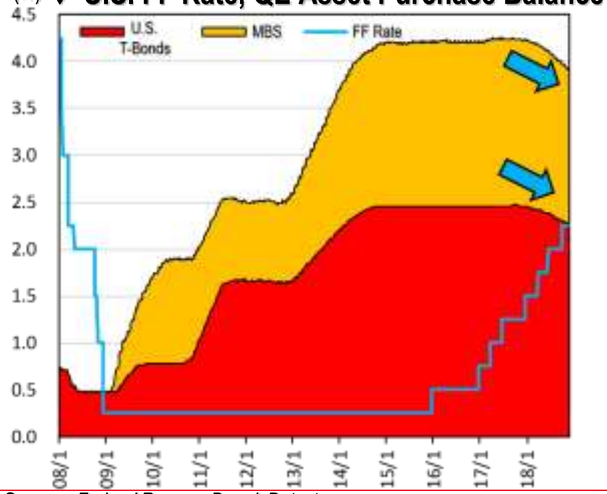
◘ Euro Zone: Following the U.S., the monetary normalization process begins

- The European Central Bank (ECB) maintains the 0% refinancing rate and ceases new purchases of financial assets under the Asset Purchasing Program (APP) at the end of 2018.
- Issuing forward guidance, the ECB says they will maintain current low interest rates until the summer of 2019. With the APP they will maintain a balance by retaining reinvestment corresponding to the amounts to be redeemed.

◘ Japan: Easy (accommodative) monetary policy continues as situation remains unchanged

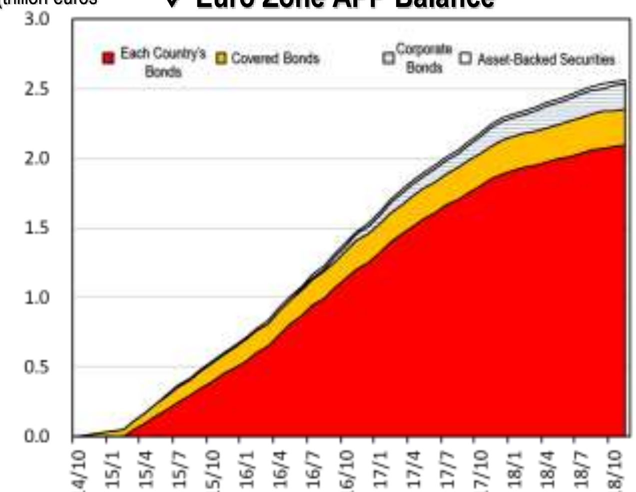
- The Bank of Japan (BOJ) continues its easy monetary policy. However, with the introduction of yield curve control (YCC), their purchase of government bonds decreases. They are looking at the possibility of stealth tapering (hidden normalization).
- In terms of the BOJ's forward guidance, given the current economic and price uncertainties, for the time being there will be no change in the direction of the extremely low short and long-term interest rates.

(%) ▽ **U.S. FF Rate, QE Asset Purchase Balance**



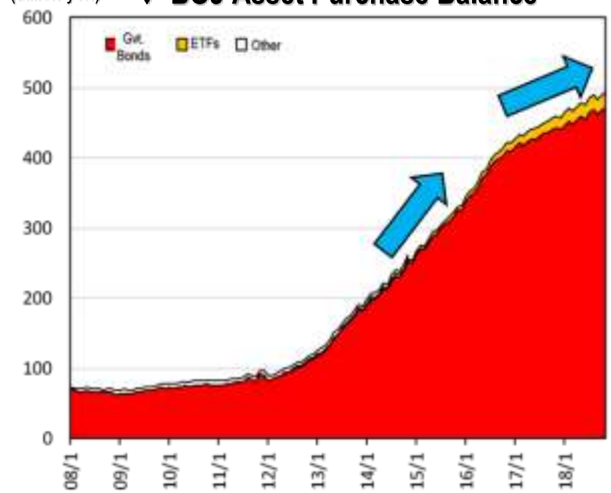
Sources: Federal Reserve Board, Datastream

(trillion euros ▽ **Euro Zone APP Balance**



Source: European Central Bank

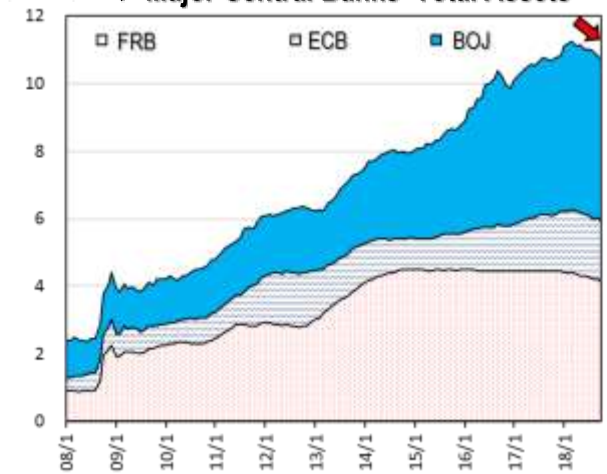
(trillion yen) ▽ **BOJ Asset Purchase Balance**



Source: Bank of Japan

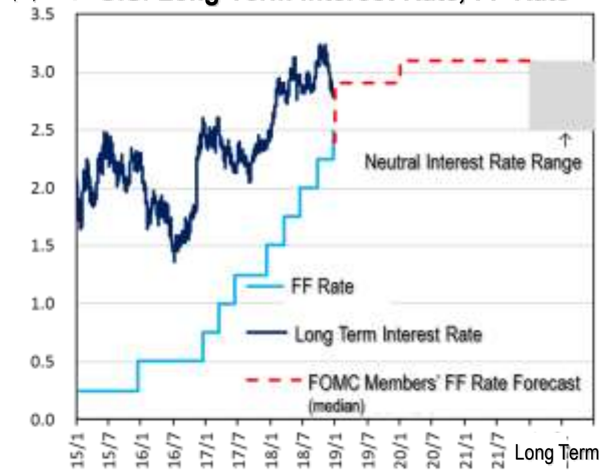
3. Main Points ① Monetary Policy
Monetary Policy Normalization Continues, Credit Climate to Tighten Further

▽ Major Central Banks' Total Assets



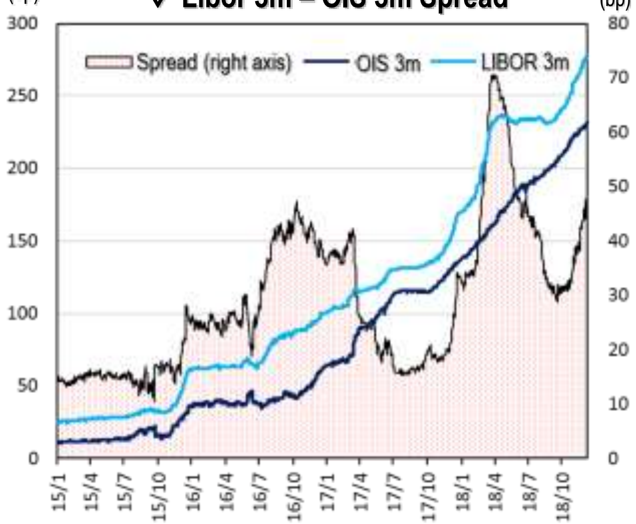
Sources: FRB, ECB, BOJ

▽ U.S. Long Term Interest Rate, FF Rate



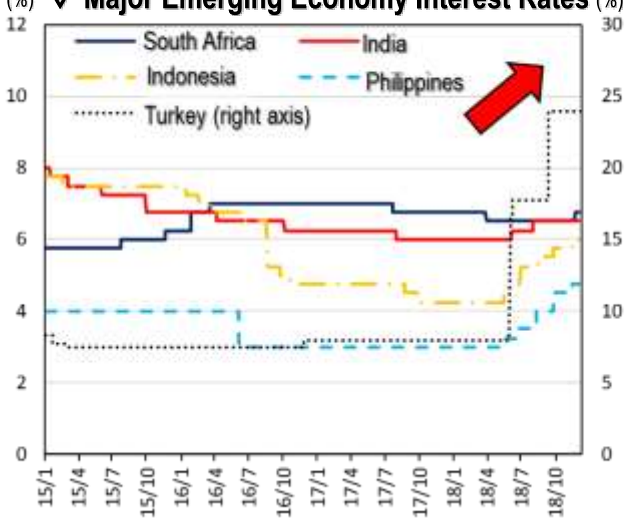
Sources: FRB, Datastream

▽ Libor 3m – OIS 3m Spread



Source: Thomson Reuters

▽ Major Emerging Economy Interest Rates



Source: Datastream

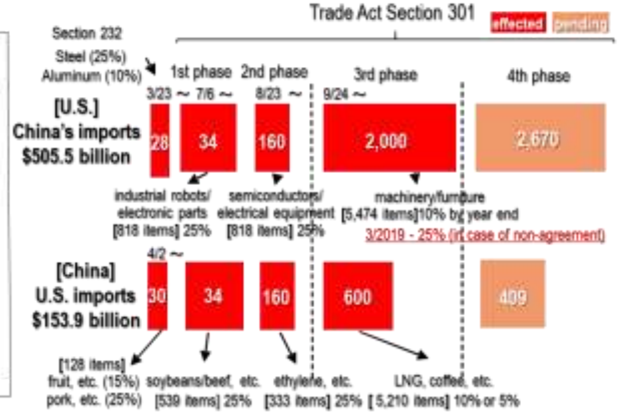
- **Decrease in major central banks' assets accelerates**
  - Assets of the major central banks began to decline in 2018 from their peak of over $11 trillion. This was mainly due to a reduction in reinvestment by the FRB and the shrinking of asset purchases by the ECB. The ECB will no longer make new asset purchases in 2019, so there will be an acceleration in the pace of the reduction of their assets.
- **The U.S. FF rate is nearing the neutral rate of interest level**
  - The FF interest rate is approaching what the FOMC considers the long term neutral or natural rate of interest. If the economy worsens in 2019, the pace of rate hikes will either be slowed or stopped altogether during the year. Also note the reversal in long and short-term interest rates (inverted yield) which has been an indicator of past recessions.
- **Credit climate tightens**
  - The spread between Libor used for inter-bank loans and the risk free interest rate (overnight index swap or OIS) has widened. This suggests that the credit climate in the financial sector is returning to a more normal state. In the U.S., the spread for MBSs (difference with government bond yields), one of the assets purchased under QE, has also widened. This situation is expected to extend to other assets classes in the U.S. as well.
- **Economic downturn in emerging economies due to interest rate hikes**
  - Following monetary normalization in the U.S. and the Turkey currency shock, even the emerging economies cannot avoid some monetary tightening. Although the higher interest rates aim is to subdue import induced inflation and defend against the depreciation of their currencies, higher interest rates in the market will be a burden on their economies.

4. Main Points ② Trade Policy
World Economic Downturn and Other Risks If Protectionism Continues

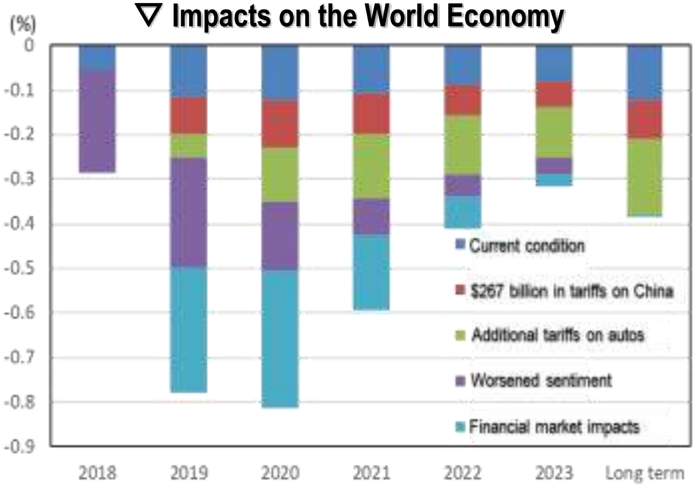
▽ Trade Negotiation Situation

2018	3/23	Additional tariff list of Chinese products released by USTR (2 lists)
	4/3	Steel/aluminum tariffs take effect (applied to some exempt countries on 6/1)
	7/6	$34 billion in tariffs exercised by both countries (1st phase)
	8/23	$160 billion in tariffs exercised by both countries (2nd phase)
	9/24	$200 billion in additional tariffs by U.S. $60 billion by China (3rd phase)
	11/30	New NAFTA (USMCA) signed
	Upcoming	
2019	January	Japan-U.S, Europe-U.S. trade talks start
	February	Survey deadline for additional tariffs on autos
	Feb. end	Grace period ends, tariffs to be raised on 3rd phase of Chinese products (10%→25%)
	May	Deadline for presidential decision on additional tariffs for motor vehicles

▽ Additional U.S. and China Tariffs



▽ Impacts on the World Economy



(Source: IMF

▽ Other Risks From a Trade War

Prices increase with additional tariffs	Prices rise on domestic U.S. products
The battle for supremacy in advanced technology	The establishment of the National Defense Authorization Act strengthened the authority of the Committee on Foreign Investment in the U.S. The Treasury Department is creating detailed rules in preparation for implementation in February of 2020.
	As export regulations are not well developed, the Commerce Department will use the NDAA to establish controls on the export of new technology (newly emerging and basic technology). The Commerce Department will prepare a list of technologies subject to these controls.
	Executives of the Chinese telecommunications giant Huawei were arrested for violating U.S. economic sanctions. Although this move is independent of the Trump administration itself, it has just exacerbated the confrontation with China.

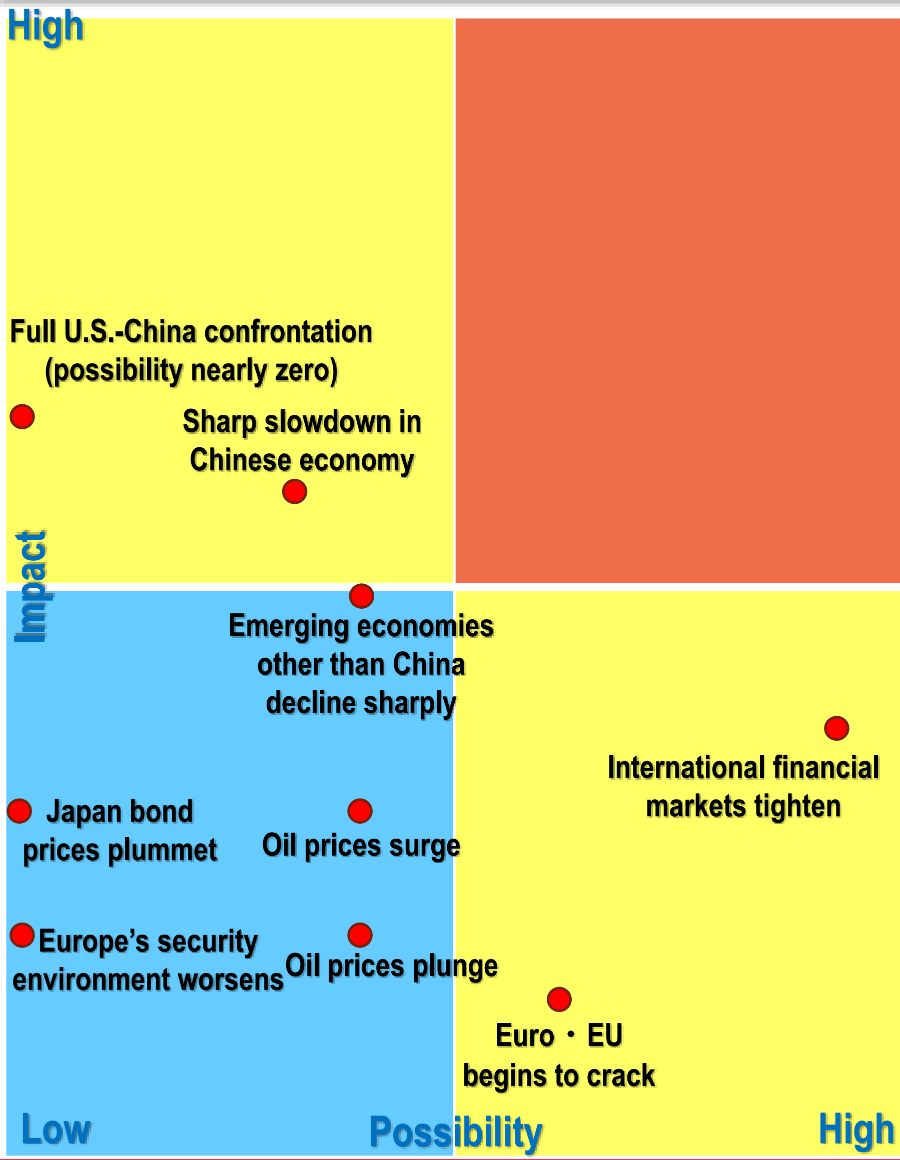
U.S. protectionism continues in 2019

- The Trump administration's trade policy trended toward protectionism in 2018 and there is no sign of a softening in their stance.
- In the 1st half of 2019, a decision by the U.S. will be made on whether to raise tariffs on China or not and trade talks between the U.S. and Japan and the U.S. and Europe are set to begin. In addition, the New NAFTA will be deliberated in the U.S. Congress with a battle looming with the opposition in control of the House.
- The negative effects of U.S. protectionism and retaliatory action on the world economy has dampened investment sentiment and is creating instability in the credit markets with the likely result a 1% drop in the world's GDP growth. The slowing of both the U.S. and Chinese economies is very concerning to say the least.

U.S., China battle for technological supremacy, other possible risks

- The policy of the U.S. engaging China and giving it free access to its economy is over. The U.S. and China are now in a position as contenders for advanced technology supremacy.
- As part of the changing dynamic between the U.S. and China, the U.S. administration and Congress have been discussing or introducing measures aimed at bolstering regulations on Chinese investment, regulating the export of new technology to China and regulating the use of Chinese products by U.S. firms. The U.S. Justice Department has also raised it vigilance of Chinese companies that may be violating U.S. economic sanctions, while in some parts of China boycotts of U.S. products are taking place.
- Japanese companies are also being increasingly affected as they have to rebuild their supply chains and communication systems, as well as reevaluate the increased cost of investing in the U.S. and risks related to U.S. economic sanctions.

5. Downside Risk Factor Scenario
2 Major Risks: Tightening Financial Markets, China Slowdown



Specific Risk Factors

- **International Credit Markets Tighten**
  - FRB rate hikes continue, ECB starts rate hikes
- **Sharp Downturn in China's Economy**
  - China's economic growth rate falls below 6%
- **Euro - EU Begins to Crack**
  - Brexit, Italy's fiscal problem, Germany/France political instability
- **Full U.S. China Confrontation**
  - Confrontation intensifies, moves beyond economy
- **Emerging Economies Other than China Decline Sharply**
  - Currencies plunge, capital outflows, defaults
- **Oil Prices Surge**
  - Oil price rise significantly exceeds assumptions
- **Oil Prices Plunge**
  - Oil price decline significantly exceeds assumptions
- **Japan Bond Prices Plummet**
  - Bond prices plummet, interest rates jump sharply, financial instability
- **Europe's Security Environment Worsens**
  - U.S. withdraws from NATO, Ukraine problem reoccurs

Risk factors in tightening international financial markets

- Relatively strong U.S. economic condition, continued expansion of employment
  ⇒ Excessive monetary tightening by the FRB
- European politics stabilize, economy accelerates
  ⇒ Excessive monetary tightening by the ECB
- Stable Japanese economy
  ⇒ Reduced bond purchases by BOJ, interest rate target raised
- Large scale economic shocks occur
  ⇒ Global demand for funds sharply expands

Risk factors in sharp China slowdown

- Worldwide lock out of Chinese products
  ⇒ China's exports/investment/employment/consumption rapidly deteriorate
  ⇒ Private debt defaults greatly increase
- Future outlook for the Chinese economy sours
  ⇒ China's asset prices (real estate, etc.) dive
- U.S. economic sanctions placed on China
  ⇒ Sharp decline in investment in and lending to China

Risk factors in Euro-EU deterioration

- British parliament does not approve Brexit draft = No Deal
  ⇒ Sudden worsening in UK economy, blow dealt to the EU
- Italian conflict with the EU over fiscal problems
  ⇒ Italy exits EU
- French President Macron resigns, decline of Germany's CDU
  ⇒ Unity in the Euro-EU deteriorates

5. Downside Risk Factor Scenario
Reference: The Impact of a Rapid Deceleration in China's Economy

[China's Imports as a % of Each Country's GDP]

Taiwan	27%
Vietnam	23%
Malaysia	17%
Korea	12%
Singapore	11%
Thailand	9%
Chile	8%
South Africa	7%
Australia	7%
Japan	3%

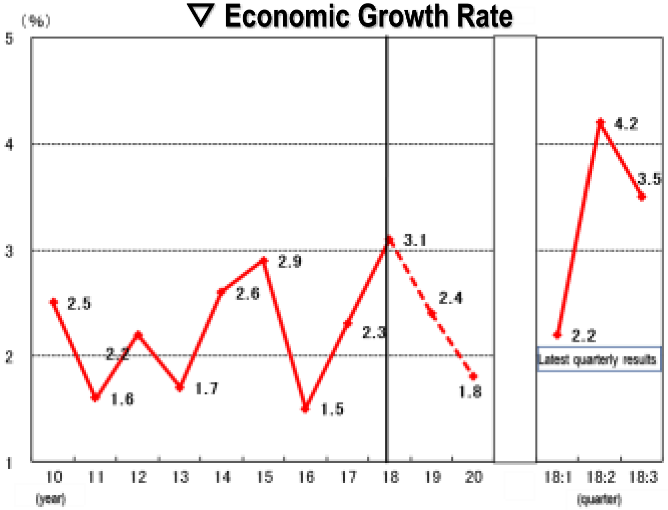
Source: Various official statistics

[China's Imports as a % of World Exports]

Iron Ore	68%
Soybeans	61%
Copper	36%
Crude Oil	19%
Natural Gas	8%
Coal	5%

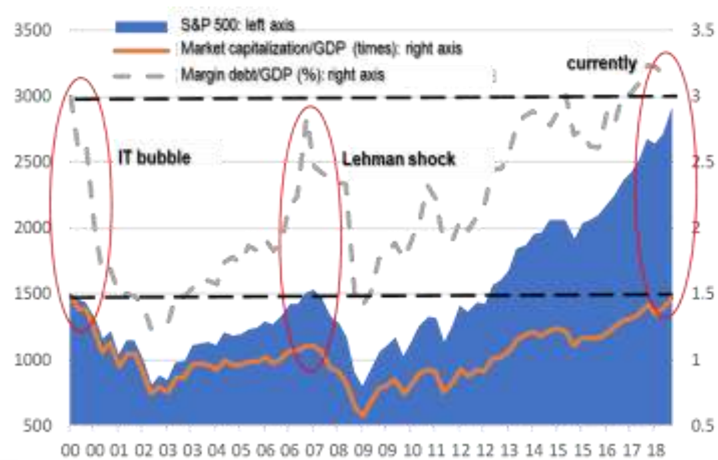
6. U.S.
Economic Slowdown, Stock/Corporate Debt Bubble Warning

▽ Economic Growth Rate



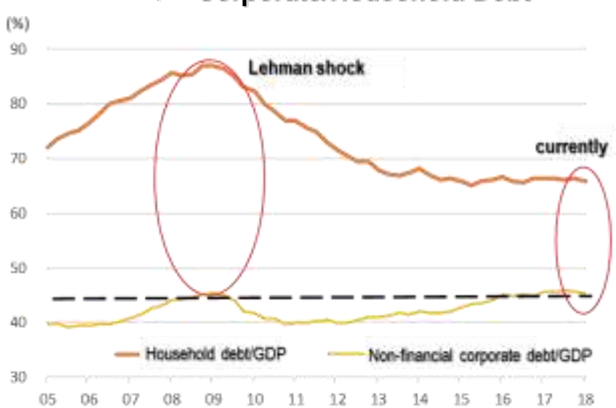
Sources: U.S. Bureau of Economic Analysis (BEA), Congressional Budget Bureau

▽ Stock Price Degree of Over-heating



Sources: S&P, BEA, NYSE, Financial Industry Regulatory Authority

▽ Corporate/Household Debt



Sources: FRB of St. Louis, BEA

▽ Issues Facing the Trump Administration

Economic/ Fiscal	Infrastructure, middle class tax cuts
	Budget battle, debt ceiling restoration (until March 19 deadline), fiscal cliff (compulsory budget reduction unless upper expenditure limit agreed to in 2020)
Trade/ Diplomacy	China-U.S. trade talks, Japan-U.S. trade talks (TAG), Europe-U.S. trade talks, New NAFTA ratification, Russia INF Treaty discussions
	Saudi (reporter's killing problem), Iran, (sanctions grace period ends May 2019), North Korean problem (possible 2nd summit meeting in early 2019)
Domestic Affairs	Russian problem (Mueller investigation, etc.), administration's personnel issues (attorney general, etc.), presidential impeachment
	Healthcare, gun control, 2020 presidential elections and Republican, Democrat actions

▫ U.S. economy slows

- In 2018, growth exceeded the potential growth rate (around 2%) largely due to the effect of tax cuts and fiscal spending. Capital investment did not expand as much as the administration expected, auto and housing sales have already peaked with the economic expansion seemingly having matured.
- Although the current economic expansion will reach ten years in 2019, it should begin to slow as the effect of the tax cuts fade. It will reach a crucial point in 2020.
- External shocks from a trade war in addition to a bursting of domestic bubbles (see below) in the U.S. should lead to an unavoidable downturn in the economy.

▫ Stock/corporate debt at past bubble levels

- In the U.S. stock market, the level of market capitalization and margin debt (margin transaction obligations) vs. GDP have reached the levels from before the 2000 IT bubble collapse and the 2008 Lehman shock. The cyclically adjusted price-to-earnings ratio is 30 times, the same level it was right before the Great Depression of the 1930s.
- Corporate debt is now over $9 trillion and its ratio to GDP exceeds that from right before the Lehman shock. On the other hand, household debt has not reached the level that preceded the Lehman shock. However, instead of financial institutions where regulations have been strengthened, household lending from non-bank finance, where the ability to raise funds is low, has risen, which has increased apprehension over the credit situation in the case of interest rate hikes.

▫ Bumpy road ahead for the administration

- With the Democratic Party having captured the House, the Trump administration is in for a tough time over budget deliberations and various scandals

7. Europe
Gradual Slowdown Starting With Exports, Italy's Fiscal Issue, Brexit

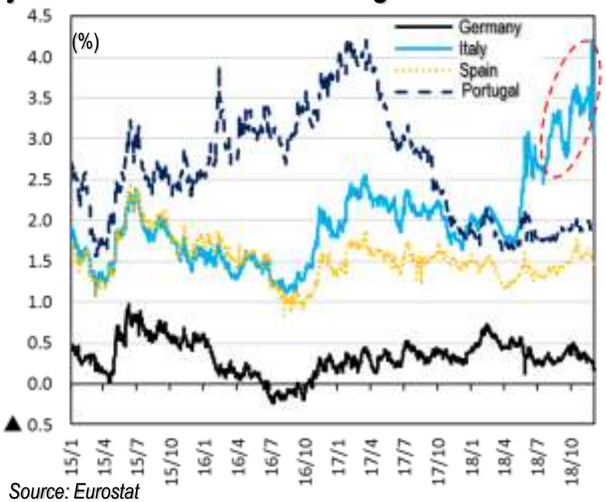
▽ Main Economic Indicators

(vs. prior year, %)

	2015	2016	2017	2018 estimate	2019 forecast	2020 forecast
Euro Zone GDP Growth Rate	2.1	1.8	2.4	2.1	1.9	1.7
Private Expenditure	1.8	2.0	1.7	1.6	1.8	1.6
Inflation Rate	0.0	0.2	1.5	1.8	1.8	1.6
Germany GDP Growth Rate	1.7	1.9	2.2	1.7	1.8	1.7
France GDP Growth Rate	1.1	1.2	1.8	1.7	1.6	1.6
Italy GDP Growth Rate	1.0	0.9	1.5	1.1	1.2	1.3
Spain GDP Growth Rate	3.4	3.3	3.1	2.6	2.2	2.0
UK GDP Growth	2.4	1.9	1.9	1.3	1.2	1.2
Private Expenditure	2.6	2.9	1.7	1.4	1.3	1.3
Inflation Rate	0.0	0.7	2.7	2.6	2.0	1.9

Source: European Commission

▽ Major Euro Zone Countries' Long-Term Interest Rates



Source: Eurostat

▽ Italy's Fiscal Debt (forecast included)

(Sources: European Commission, Italy's Ministry of Economy and Finance

▽ Major Political Trends/Issues in Europe

Country/ Region	Trends/ Issues
Germany	Chancellor Merkel steps down as head of the CDU after the party suffers setbacks in parliamentary elections in the states of Bavaria and Hesse in October. Ms. Kramp-Karrenbauer, a moderate centrist, was elected as her successor. There is a need for an early recovery in the CDU's support rate due to the upcoming European Parliament elections and elections in 3 former East German states.
France	Dissatisfaction also surfaces over President Macron's wealth and corporate tax cuts as demonstrations break-out over fuel tax hikes. Macron's approval rating fell into the 20% range, and as with the previous Hollande administration there are fears over falling into lame duck status. Some are predicting that France's far right populist party will become the majority in the upcoming state legislative elections.
UK/EU	The European Court of Justice ruled that the UK government could revoke its Brexit decision without the approval of the EU member states. While PM May survived a no confidence vote in parliament, approval of a withdrawal agreement will prove difficult.
EU	There is uncertainty over reform (Euro Zone common budget, etc.) led by Germany and France due to possible expansion of populism in the European Parliamentary election and opposition from some Northern European countries and the 3 Baltic nations.

◘ Slowdown from trade war, Italy's fiscal problems, etc.

- For the time being , personal consumption and investment expected to remain strong. However, the European economy should gradually slow due to lower exports caused by a U.S.-China trade war, Italy's fiscal problems and Brexit.
- The ECB's easy monetary policy will shift in 2019. Attention will be focused on disruption in the bond markets in Euro Zone countries as government bond purchases end and on the timing and speed of interest rate hikes.

◘ Expanding populism in Europe

- In the conflict between the EU and Italy over Italy's 2019 draft budget, the Italian government agreed to a revised budget plan which helped calm long term interest rates. However, conflict continues between the EU and the populist administration of the 5 Star Movement political alliance.
- European parliamentary elections will be held in May 2019 and it is expected that populist parties in Germany and some Eastern Europe countries will expand their power. This election is very important in that in October of 2019 both the President of the European Commission and the President of the ECB will be replaced with repercussions for the future.
- Populist movements are threatening existing parties even in Germany and France. Chancellor Merkel of Germany has been forced to step down as party chair, while in France, President Macron has faced stiff demonstrations against such measures as a fuel tax hike and to demand raising the minimum wage.
- A vote on a Brexit withdrawal plan by the UK parliament was postponed until mid-January. (Note: It failed.)

8. China
A Slowdown and Avoiding Further Deterioration

▽ Main Economic Indicators

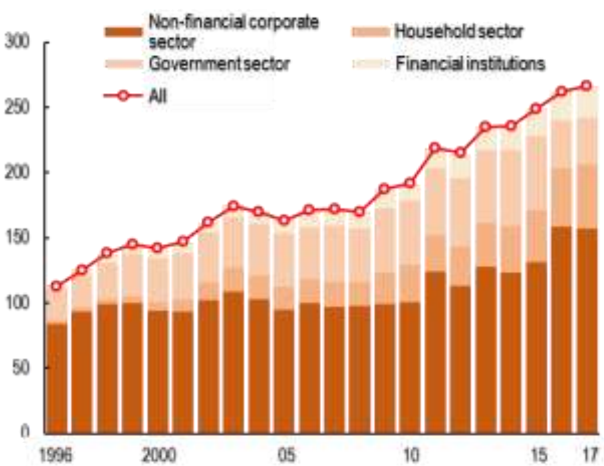
(vs. previous year, %)		2015	2016	2017	2018	2019	2020
GDP		**6.9**	**6.7**	**6.9**	**6.6**	**6.2**	**6.0**
Production	Industrial Production	6.1	6.0	6.6	6.4	6.2	6.0
Demand Items	Retail Sales	10.7	10.4	10.2	9.0	8.0	8.0
	Fixed Asset Investment	10.0	8.1	7.2	5.0	7.0	8.0
	Exports	-2.9	-7.7	7.9	10.0	-5.0	-5.0
	Imports	-14.3	-5.5	16.7	17.0	-5.0	-5.0
Monetary/Fiscal	New Loans	19.8	7.9	7.0	15.0	18.0	18.0
	Fiscal Deficit Ratio	-2.4	-2.9	-2.9	-2.6	-3.5	-4.0
Industry	Vehicle Sales (million)	28.0	29.0	29.0	27.0	26.0	25.0
	New Housing Starts (total area)	6.9	22.4	5.3	3.0	5.0	4.0
	Crude Steel Production	-2.2	0.5	2.9	9.0	-2.5	-2.0
Commodity Imports	Crude Oil	8.8	13.6	10.2	8.0	5.0	3.0
	Iron Ore	2.2	7.5	4.9	-1.0	-4.9	-4.0
	Soybeans	14.5	1.8	14.8	-4.3	-10.0	-10.0

Source: Marubeni Research Institute (2018: Estimate 2019-20: Forecast)

▽ China's External Demand Dependency (vs. GDP)

(Sources: China National Bureau of Statistics, China General Administration of Customs

▽ China's Debt by Sector (vs. GDP, %)



Sources: People's Bank of China, China National Bureau of Statistics
Note: Parts estimated from unofficial data

▽ "Made in China 2025" Priority Fields/Core Companies

10 Priority Fields	Core Firms		
① Next generation communications		Core Firms	Secondary Firms
② Industrial machinery/robots			
③ Aviation	1st List (1/17/2017	54	50
④ Marine resources/Ships			
⑤ Mass transportation			
⑥ Efficient/New energy vehicles	2nd List (12/14/2017)	71	20
⑦ Electric power			
⑧ Agricultural machinery			
⑨ Advanced materials	3rd List (11/1/2018)	68	26
⑩Bio-pharma/Medical equipment			

Sources: China's State Council, Ministry of Industry and Information Technology, All China Federation of Industry and Commerce

◘ Seek to prop up growth through full use of fiscal stimulus

- Stagnant fixed asset investment, sluggish real estate and auto sales, and falling imports of iron ore, soybeans and other commodities are creating growing concern of a downturn in the Chinese economy.
- Export orders by the U.S. at the fall 2018 China Import and Export Fair held in Guangzhou were down 30% from the previous year, a very large drop given total export orders at the fair were down only 1%. So, it is expected that overall exports to the U.S. will fall in 2019 .
- Although the Chinese economy's reliance on external demand has declined in recent years, if the U.S.-China confrontation escalates there is fear of a hard landing. In order to make up for a fall in external demand, such economic measures to boost the economy as VAT rebates on exports, easing of real estate regulations, reduction in the sales tax on autos, public investment and others are being considered.
- The government's debt ratio is now 260%, about double what it was after the Lehman shock 10 years ago. This suggests there may be a huge amount of potential bad debt and might limit the government's ability to respond to shocks.

◘ Technology driven country the new growth engine

- To respond to upgraded domestic consumption and more sophisticated demand and to boost export competitiveness, China came out in 2015 with a national policy termed "Made in China 2025" with the aim of creating a high technology nation.
- 10 fields have been prioritized including next generation telecommunications like 5G, industrial robots, new energy vehicles, advanced materials and bio-pharmaceuticals, among others. China will try to foster selected core companies that can become top global players. However, this aim has put China on a collision course with the U.S. that is having an effect on trade negotiations.

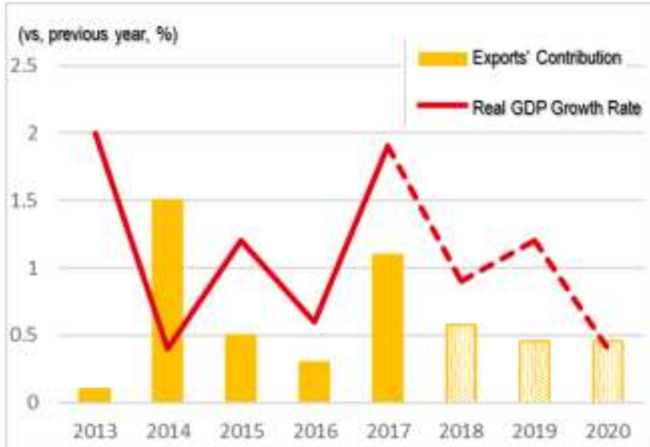
9. Japan
Economic Expansion Continues, Not Much Velocity

▽ Main Economic Indicators

		Actual 2017	Estimate 2018	Forecast 2019	Forecast 2020
Real GDP (%)		1.9	0.9	1.3	0.3
		(1.9)	(1.0)	(0.8)	(0.7)
	Private Expenditure (%)	1.1	0.5	1.2	0.0
		(1.0)	(0.8)	(0.7)	(0.6)
	Private Capital Investment (%)	3.9	3.9	2.8	1.2
		(4.6)	(3.8)	(2.1)	(1.2)
	Exports (%)	6.8	3.4	2.6	1.2
		(6.4)	(2.5)	(2.7)	(2.7)
Industrial Production (%)		3.1	1	2.3	1.2
Job Offer to Applicant Ratio (times)		1.54	1.63	1.65	1.66
Consumer Price Index (%)		0.5	0.9	1.2	1.7

Source: Nikkei Center Note: Figures in parentheses are fiscal year. The CPI excludes fresh foods and accounts for future consumption tax hike.

▽ Real GDP Growth Rate/Exports' Contribution

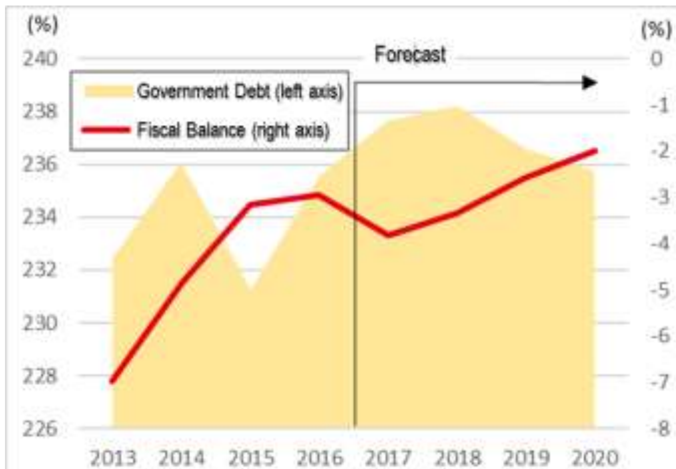


(Sources: Cabinet Office, Nikkei Center

▽ Personal Consumption

Sources: Cabinet Office, Nikkei Center
Shade area marks planned consumption tax increase date

▽ Government Debt and Fiscal Balance as % of GDP



(Sources: Cabinet Office, Nikkei Center

◘ Economic expansion phase longest but also slowest since WWII

- The economic expansion will reach 74 months in January 2019, the longest since WWII. Although the expansion continues, it is sluggish. A series of natural disasters has affected it in its current stage.
- Regarding personal consumption, demand will be boosted in 2019 in anticipation of a consumption tax hike. However, following the tax hike demand will decline with growth going into 2020 looking to be somewhat stagnant.
- Exports have also been affected by the natural disasters and given the likelihood of a slowdown in overseas economies, the pace of export growth will be moderate.
- Given that capital investment is to be supported by labor saving investments and corporate performance has been good it should modestly rise.

◘ Downside to consumption tax hike less than last increase in 2014

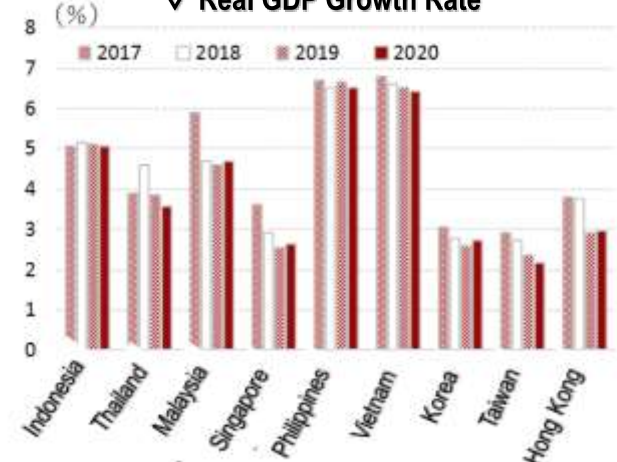
- Compared with the consumption tax hike in 2014 this one will have a weaker impact due to the fact that is a little smaller and mitigating policies are being put in place.
- Also, labor supply and demand is tight, especially in the construction and service industries which are suffering shortages. However, as the elderly and women increasingly enter the labor market, wages will remain sluggish, so this very slight growth in overall income will not boost consumption.

◘ BOJ's easy monetary policy headed for long-term battle

- Prices are set for only slight rises, so the BOJ will not meet its 2% inflation target. Considering the secondary effects from the fine tuning of their relaxation measures, the BOF is in for a long-term battle.

10. Other Asia
Stable Domestic Demand, Concern Over External Environment

▽ Real GDP Growth Rate



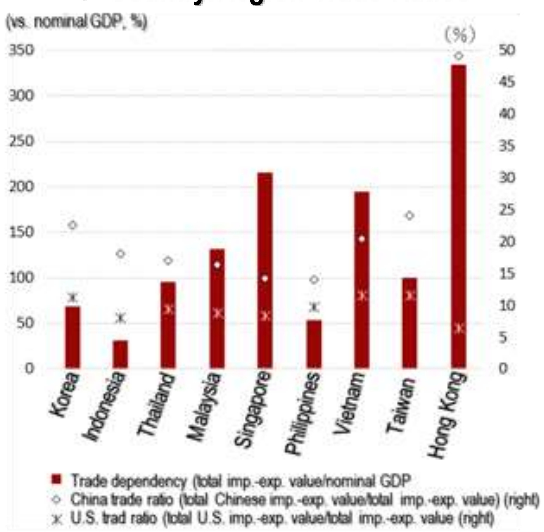
Source: Marubeni Research Institute

▽ Fundamental Indicators

	Current Account Balance (vs. nominal GDP, %)		Fiscal Balance (vs. nominal GDP, %)		Government Debt (vs. nominal GDP, %)		Consumer Price Index (%)	
	2019	2020	2019	2020	2019	2020	2019	2020
Indonesia	-2.4	-2.3	-1.8	-1.8	29.9	29.7	3.8	3.8
Thailand	8.1	6.9	-1.8	-1.8	41.3	41.2	0.9	1.1
Malaysia	2.3	2.1	-2.6	-2.5	54.3	52.9	2.3	2.6
Singapore	18.3	17.8	1.6	1.6	114.3	115.0	1.4	1.4
Philippines	-1.5	-1.4	-1.4	-1.4	39.2	38.6	4.0	3.3
Vietnam	2.0	1.7	-0.5	-0.9	57.4	57.1	4.0	4.0
Korea	4.7	4.4	1.5	0.9	40.4	41.1	1.8	2.0
Taiwan	13.6	12.8	-1.9	-1.9	33.1	32.2	1.3	1.5
Hong Kong	3.1	3.2	2.0	1.8	0.0	0.0	2.1	2.2

Source: IMF

▽ Country/Region Trade Ratios



Sources: IMF, CEIC Note: Re-export values included

▽ Currency Fluctuations

Source: Thomson Reuters

◘ Slowdown in world economy a risk

- The economies of most Asian countries have been solid both externally and internally on the back of world economic growth led by the U.S. and China.
- 2019 should see continued sound growth as incomes rise and investment in infrastructure continues.
- On the other hand, in the case of a slowing world economy due to sluggish demand in the U.S., China and other developed countries caused by the fallout from a U.S.-China trade war, stagnant external demand could hit many ASEAN countries and drag down their economic growth rates somewhat.
- However, if supply chain shifts from China accelerate, investment in the ASEAN countries could increase and help bolster their economies.
- Attention should be paid to the upcoming April presidential election in Indonesia and the possible promotion of populist policies. In Thailand, there is potential for instability in the upcoming elections (set for February) as they try to shift back to civilian rule.

◘ Possibility of capital outflows

- The currencies of many Asian countries depreciated following the Turkey shock in the summer of 2018.
- Countries like the Philippines and Indonesia, with weak fundamentals, are susceptible to rises in external interest rates which could lead to capital flight and a further weakening of currencies.

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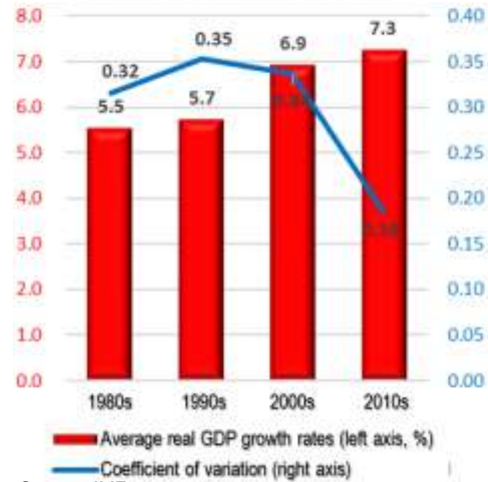
11. India
High Growth in a Closed Economy Rare

▽ Stable Growth in the Short-Term

	2015	2016	2017	2018	2019	2020
Real GDP (vs. prior year, %)	8.2	7.1	6.7	7.3	7.4	7.6
Consumer Price Index (vs. prior year, %)	4.9	4.5	3.6	4.7	4.9	4.6
Government Fiscal Balance (vs. GDP, %)	-7.2	-7.2	-7.2	-6.6	-6.5	-6.3
Government Debt (vs. GDP, %)	70.0	69.5	71.2	69.6	68.1	66.5
Current Account Balance (vs. GDP, %)	-1.1	-0.6	-1.9	-3.0	-2.5	-2.4
Inward Direct Investment (vs. GDP, %)	360.0	356.0	303.0	387.0	471.0	520.0
Foreign Exchange Reserves (months of imports)	8.9	7.6	7.5	6.8	6.5	6.3
External Debt (vs. GDP, %)	23.1	20.8	19.8	20.2	20.0	19.9
Short Term (vs. GDP, %)	9.1	9.1	8.4	9.0	9.2	9.4

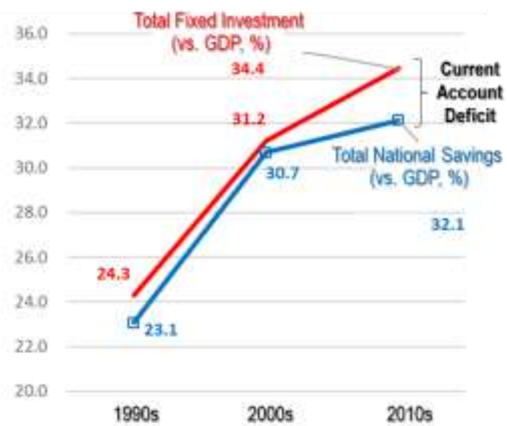
Source: IMF

▽ Accelerated/Stable Indian Economic Growth



Source: IMF

▽ Increased Savings Needed for Fiscal Health



Source: IMF

▽ Improving Auto/Pharmaceuticals Competitiveness (Competitiveness, Exports Share > 1)

Fiscal 2017				Fiscal 2018			
HS	Item	Export Share	Trade Specialization Coefficent	HS	Item	Export Share	Trade Specialization Coefficent
61.0	Articles of apparel and clothing accessories, knitted or crocheted	2.8	1.0	2.0	Meat and edible meat offal	1.5	1.0
62.0	Articles of apparel and clothing accessories, not knitted or crocheted	3.6	1.0	3.0	Fish and crustaceans, mollusks and other aquatic invertebrates	2.3	1.0
3.0	Fish and crustaceans, mollusks and other aquatic invertebrates	1.1	1.0	61.0	Articles of apparel and clothing accessories, knitted or crocheted	2.8	0.9
63.0	Other made-up textile articles; sets; worn clothing and worn textile articles; rags	1.6	0.9	62.0	Articles of apparel and clothing accessories, not knitted or crocheted	3.0	0.9
23.0	Residues and waste from the food industries; prepared animal fodder	1.1	0.9	63.0	Other made-up textile articles; sets; worn clothing and worn textile articles; rags	1.7	0.8
52.0	Cotton and cotton fabrics	3.0	0.8	30.0	Pharmaceutical products	4.4	0.8
30.0	Pharmaceutical products	2.6	0.7	52.0	Cotton and cotton fabrics	2.3	0.7
87.0	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	2.8	0.4	10.0	Cereals	2.5	0.7
10.0	Cereals	1.9	0.4	9.0	Coffee, tea, mate and spices	1.1	0.6
74.0	Copper and articles thereof	2.0	0.4	87.0	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	5.5	0.5

Source: International Trade Centre (A trade specialization coefficient of 1 or near 1 means high competitiveness.)

◘ High growth success, rare for a closed economy

- India will continue to maintain high growth in the 7% range in fiscal 2019/2020 driven by consumption and investment.
- In addition to high economic growth, the fluctuation in its annual growth has been shrinking (coefficient of variation is lower) making it **the last survivor among BRICs**.
- India's fundamentals are stable and interest rate hikes limited.

◘ Gradual but steadily progressing economic reform

- Due to accelerated growth and rising consumer prices the **government is focusing on supply side reform**. Infrastructure investment has been strong, however, there are worries over fiscal resources (current expenditures account for 90% of the annual budget, so there is not much left for other types of expenditure).
- In 2017, the long-awaited **goods and services tax (GST) was introduced**. In addition to increasing revenue, it is also providing domestic market unification
- India's **"twin balance sheet problem" (companies and banks) has been eliminated**. So there are many borrowers with problem loans especially in the infrastructure and steel sectors.

◘ Risks: Government finance and general election

- Possibility of decreased tax revenue due to confusion over the GST, interest rate hikes and a drop on bond prices, perplexity among government bond holders.
- Risks related the scheduled May 2019 general election (shady politicking before election, **monetary policy intervention**, retreat on reforms)
- Oil price rise, geopolitical risks (China/Pakistan), turn to the right (Hindu supremacy)

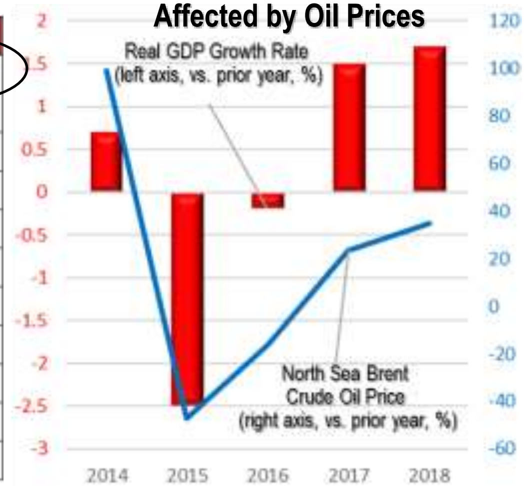
12. Russia
If Oil Prices Remain Steady, Potential Growth Rate Reached

▽ Steady Oil Price = Potential Growth Rate

	2015	2016	2017	2018	2019	2020
Real GDP (vs. prior year, %)	-2.5	-0.2	1.5	1.7	1.5	1.5
Personal Consumption (vs. prior year, %)	-7.8	-1.9	2.6	1.8	1.4	1.4
Total Fixed Investment (vs. prior year, %)	-12.3	-1.9	7.4	2.1	1.0	1.0
Consumer Price Index (vs. prior year, %)	15.5	7.1	3.7	2.9	4.0	4.0
Unemployment Rate (%)	5.6	5.5	5.2	5.5	5.5	5.5
Fiscal Balance (vs. GDP, %)	-3.4	-3.6	-1.5	2.2	2.9	2.4
Government Debt (vs. GDP, %)	16.3	16.1	15.5	16.1	15.6	15.5
Current Account Balance (vs. GDP, %)	4.9	1.9	2.2	6.1	5.7	4.9
Foreign Exchange Reserves (months of imports)	15.7	17.0	15.9	17.0	18.5	19.8
External Debt (vs. GDP, %)	37.9	39.8	32.9	32.3	32.8	34.1
North Sea Brent Crude Oil Prices ($pb)	52.4	44.0	54.4	73.3	72.5	68.7

Source: IMF

▽ Economic Structure Strongly Affected by Oil Prices

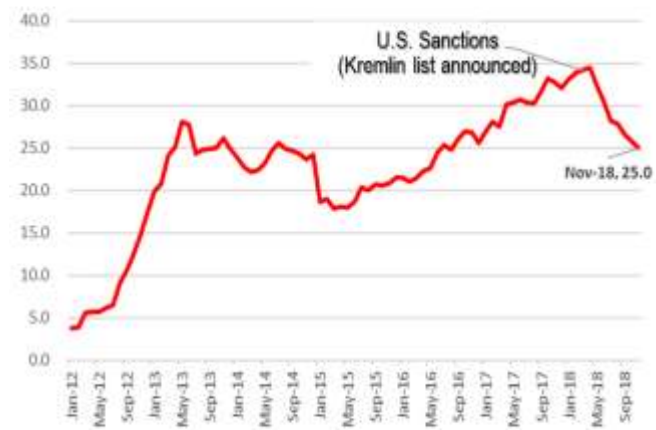


Source: IMF

▽ Labor Shortage in the Economy
(number employed, million persons)

Source: *Russian Federal State Statistics Service*

▽ Foreigners and Sanctions
(share of non-resident Russians holding Russian bonds, %)



Source: Central bank of the Russian Federation

◘ If oil prices are stable in 2019/2020, Russia should reach potential growth rate

- In 2019 the VAT will be increased and the pension age raised. Consumer prices are expected to rise and if interest rates go up domestic demand may slow.
- The growth driver will shift from internal demand to external demand. However, there are concerns over a global economic slowdown, lower oil prices and cooperation with OPEC to reduce oil production.
- In preparation for such shocks, the government is carrying out painful fiscal consolidation and implementing measures aimed at reducing the economy's external dependence (buffers).

◘ If the current situation maintained, economy should continue to hover around the potential growth rate in the mid-term

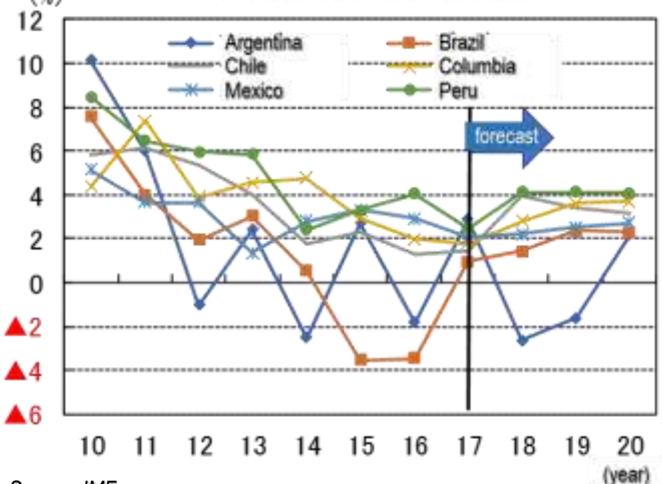
- A labor shortage has become apparent, with employment having peaked. So, even with improved productivity the margin of growth will be limited.
- Economic sanctions and an insufficient economic structure could suppress growth.

◘ Risks: Sharp oil price drop, economic sanctions

- Sharp drop in oil prices.
- Strengthening of U.S. economic sanctions. 2nd round of sanctions over the UK Skripal poisoning incident have not been implemented yet.
- Tightening in the international monetary environment. If the FRB/ECB raise interest rates, the Russian central bank will be pressed to raise rates to defend the ruble.
- Indirect impact of a trade war. China is Russia's largest export destination.

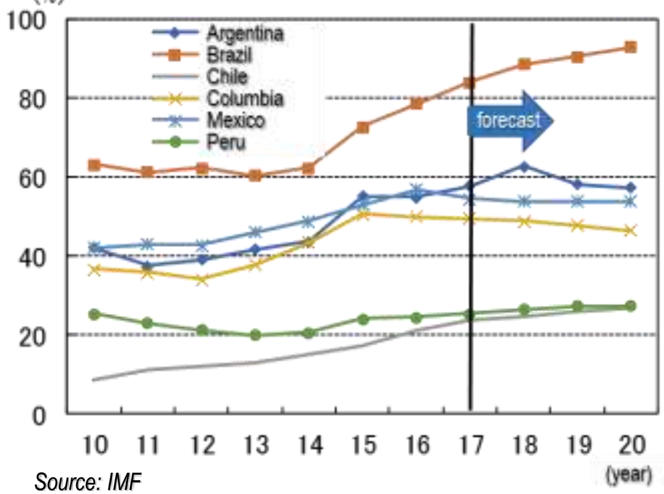
13. Latin America
Economies Flat, Attention on the Argentine Election

▽ Real GDP Growth Rate



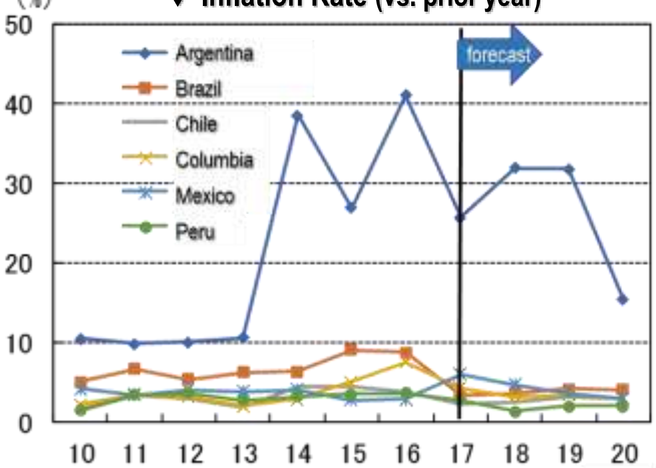
Source: IMF

▽ Government Debt to GDP Ratio



Source: IMF

▽ Inflation Rate (vs. prior year)



Sources: IMF, Buenos Aires City

▽ 2019 Election/Political Schedule

January 1	Brazil Bolsonaro Government Inauguration
February 3	El Salvador Presidential Election
October 27	Argentina General Election (president, legislature)
October	Uruguay General Election
October	Bolivia General Election
Pending	BRICs Summit, Brazil

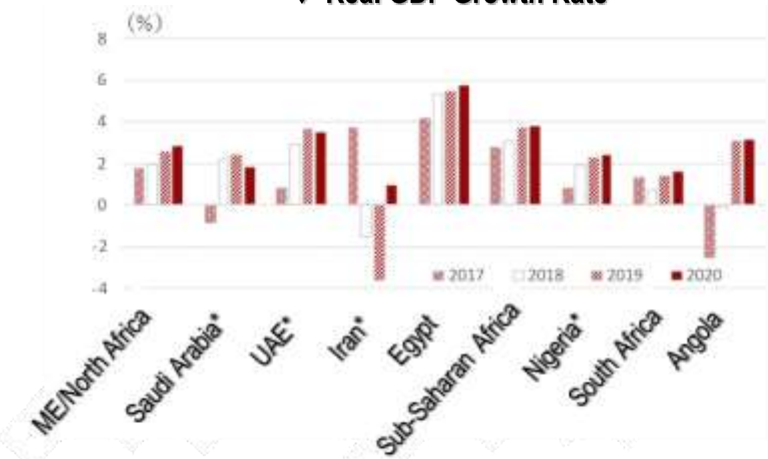
Sources: Various media reports

Main country economies are flat

- Brazil has been recovering from an economic downturn, however, the pace has been moderate. Government debt is expected to rise to the same level as GDP (100%), so depending on how the fiscal reforms to be launched by the right wing Bolsonaro administration in 2019 play out, there will be some country risk concerns..
- In Mexico the new administration of Lopez Oblador has quickly implemented such left wing oriented policies as cancelling construction of the new Mexico City airport and freezing bidding on new oil blocks. The markets are sending warning signals with the fall in stock prices and the peso continuing to depreciate.
- There has been high uncertainty in the Argentine economy, however, with IMF support and changes in fiscal and monetary policies the economic confusion has ceased for now. Still, unless the support rate for the Macri administration recovers before the October 2019 elections, Argentina may see the return of a leftist regime possibly inviting economic turmoil.
- Despite the launch of a new currency and currency denominations in Venezuela, hyper-inflation has not cooled-off. By the end of 2019 it may reach 10,000,000%. The decline in crude oil production continues and is 1.3 million bpd below Nigeria. Foreign exchange reserves will continue to remain below the $9 billion level. On the other hand, China and Russia are lending support to Venezuela, which may mean a relapse into an East-West confrontation over the country.
- As in Europe and the U.S., populism in Latin America against the existing political order is rising. The biggest risk is not just the social divisions in single countries, but the risk to stability of the entire region's economy.

14. Middle East/Africa
Another Possible Slowdown Due to Sluggish Resource Prices

▽ Real GDP Growth Rate



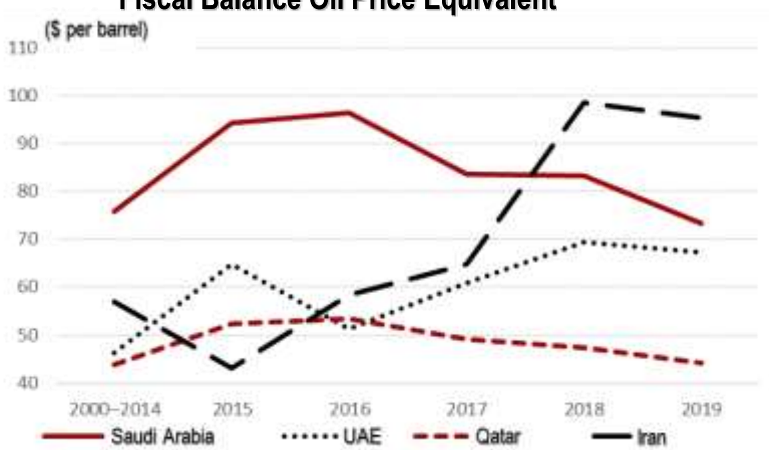
Source: Marubeni Research Institute
*Note: *Asterisk denotes IMF classified crude oil exporting countries*

▽ CPI and Current Account Balance

	Consumer Price Index (%)			Current Account Balance (vs. nominal GDP, %)		
	2018	2019	2020	2018	2019	2020
Saudi Arabia*	2.6	2.0	2.3	64.7	70.0	62.2
UAE*	3.5	1.9	2.2	31.2	34.0	27.1
Iran*	29.6	34.1	24.2	5.8	0.9	-3.7
Egypt	20.9	14.0	10.9	-6.4	-7.3	-7.6
Nigeria*	12.4	13.5	13.0	8.1	4.5	3.7
South Africa	4.8	5.3	5.4	-12.1	-13.5	-14.1
Angola*	20.5	15.8	10.9	-2.5	-2.1	-0.4

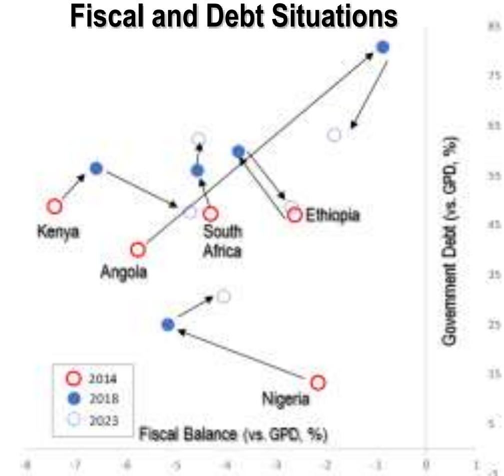
Source: IMF
Note: 2018/2019 assumes a Dubai crude oil price of between $67-$70 per barrel.

▽ Various Middle East Countries Fiscal Balance Oil Price Equivalent



Source: IMF .

▽ Various African Countries Fiscal and Debt Situations



Source: IMF .

◘ Sluggish oil prices a factor toward downturn (Middle East)

- With introduction of a VAT in some ME countries (Saudi Arabia, UAE, etc.) with aim of fiscal consolidation along with a recovery in oil prices, signs of a recovery in the economic and fiscal situations in oil producing countries emerged in 2018.
- However, soon after, oil prices once again dropped and worries over a slowdown due to a decline in oil-related revenues was rekindled.
- Such trends as U.S sanctions on Iran, a change in U.S.-Saudi relations (Khashoggi problem), Qatar's de-coupling from the GCC, Israel's relations with the Arab countries and other diplomatic and geopolitical uncertainties persist in the region and will likely weigh heavily on their economies.

◘ Possibility of a sluggish recovery (sub-Saharan Africa)

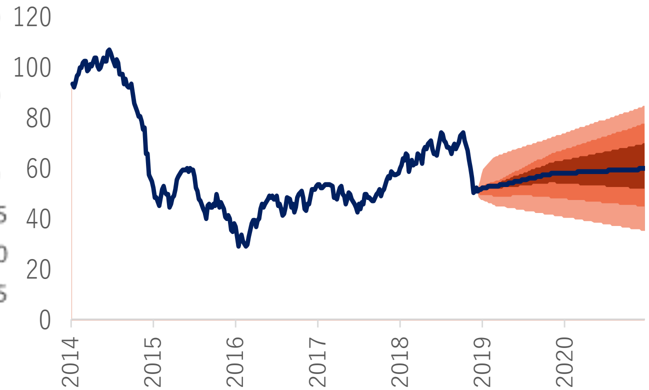
- Overall the major economies of sub-Saharan Africa have picked up since the 2016 recession and this is expected to continue. However, the commodity market has turned sluggish again, so a tailwind from natural resources is not expected.
- Countries that expanded their debt on the back of low worldwide interest rates are at risk of higher payments on interest if interest rates rise and a worsening fund procurement environment which will place a heavy burden on their economies

15. Crude Oil Price Outlook
Increasing Global Uncertainty Will Weigh Heavily on Rebounding Prices

▽ **Global Supply/Demand Balance** (million bpd)

Source: EIA "Short Term Outlook December 2018"

▽ **WTI Price Outlook** (US$/barrel)



Sources: Thomson Reuters, Marubeni Research Institute

Main Price Rise Causes	
OPEC Plus* production cuts exceed expectations −Fiscal deterioration in oil producing countries (especially Saudi Arabia) U.S. shale oil production sluggish −Insufficient pipeline capacity, production lowered due to price decline Non-OPEC Plus countries intentionally adjust their production	U.S. strengthens Iran sanctions (full oil export ban, etc.) Venezuelan production less than expected Investment lacking in upstream energy industry Geopolitical risk in the Middle East rises
Main Price Fall Causes	
OPEC Plus* production cuts less than expected −Saudi Arabia lowers its production cuts due to U.S. pressure −Compliance rate in production reduction nations declines (i.e. Nigeria) −Increased production in non-reduction countries (Iran, Libya, Venezuela) − Unexpected recovery in production in Mexico and Angola Demand falls as global economy slows further U.S. shale oil production is higher than anticipated	U.S. sanctions on Iran are eased OPEC's influence declines −Russia's influence grows −57 year member Qatar withdraws from OPEC −Conflict between Saudi Arabia and Iran U.S. dollar's strength progresses, continues Protectionism warning signals led by the U.S.

∗OPEC Plus = Mixture of OPEC countries and non-OPEC countries that will reduce oil production

- Oil prices should rebound to around $60 per barrel, but global uncertainty may pull them back down.

−OPEC Plus reducing production in reaction to plummeting prices from excess supply. The most likely price scenario is that oil prices will rebound to about $60 around early May in anticipation of the U.S. strengthening sanctions on Iran.

−The upper price scenario is that sanctions on Iran are fully reinstated and decreased supply due to production cuts exceeds expectations. The lower price case is that OPEC production cuts don't go as planned and a slowdown in the world economy accelerates.

- Although excess supply was expected for 2019, it may fluctuate due to all the uncertainties

➢ Questions over OPEC Plus production cuts

Production cuts of 1.2 million barrels per day starting from Jan. 1, 2019 were agreed to at the OPEC Plus ministerial meeting in Dec. 2018 .

−How far can Saudi Arabia go in ignoring the U.S. Trump administration's calls for production hikes?

−There has been no precise announcement on the production cuts of each country and the non-OPEC oil producing countries reduction targets are voluntary.

➢ Uncertainties in the U.S.

−U.S. shale oil production is expected to rise by 1 million bpd in 2019, however low oil prices could result in production adjustments.

−To what degree will Iranian oil be affected and what will be the impact on the 8 major importing countries and regions with renewed economic sanctions on Iran as the grace period ends early May 2019?

➢ Demand uncertainty due to a slowing global economy

16. Industry Related Points
Turning Points for Various Industries

Global Value Chain Transformation

- Following the intensification of the U.S. China trade war, many companies began to look at moving their bases out of China to ASEAN and other countries which means it is possible we may see an acceleration in the rebuilding of global value chains (GVC) in the near future. While we may not be able to predict whether the trade war will end soon or not, companies may need to look at transforming their global supply chains from a mid to long-term perspective.
- The idea of separation from the current U.S.-China interdependent relationship, called decoupling, has been gaining some steam in the U.S. If the Trump administration were to seriously move forward on this it would cause serious damage to both sides, with fears of the chaos it would cause spreading worldwide.
- The U.S. is now trying to separate the Chinese links in its advanced technology and defense industry GVCs in the name of security with the U.S. National Defense Authorization Act now prohibiting the government and government agencies from using equipment from 5 Chinese companies, including Huawei. Other countries are also starting to make similar moves

Data Application Trends Rapidly Expanding

- With the recognition that data application and utilization is a source of value-added, regulations on its illegal and unauthorized use are being strengthened (personal information protection, GDPR, etc.) and data transaction markets and transaction standards being formed. The main thing is to establish data sovereignty by determining who the data actually belongs to and then be able to freely carry out transactions in a reliable and trustworthy trading environment.
- For example, in Germany Industry 4.0 is being promoted in parallel with the trend toward advancing the "industrial data space" model for secure data exchange, and currently, through EU policies, is partnering with the U.S. Industrial Internet Consortium to create global standards for this.
- Japan too has been implementing various laws related to government data disclosure and has revised the personal information protection law. It is also looking to improve the data access environment by forming certified data banks where individual data can be accessed by business as well as create data mechanisms for the wide distribution and utilization of data from such various industry sectors as medical, transportation, energy, etc., and is being pushed heavily by industry, government and academia.

Increased Uncertainty Around Energy Supply and Demand

- Uncertainty over energy supply and demand has greatly increased even in the mid to long-term. According to the International Energy Agency's (IEA) future outlook main scenario, dependence on fossil fuels is expected to fall from 81% in 2017 to 74% in 2040, only a 7% decrease, while in the low carbon society scenario it drops to 60%. Note that fossil fuels will make up more than half the energy mix even if the low carbon scenario is realized
- The future composition of energy and supply and demand growth will be entangled with the progress made toward a low carbon society and the many variables that it entails likely restraining energy investment due to the high level of uncertainty. As a result, oil field development and so on will be stagnant, with the possibility of future energy shortages.
- Decarbonization will progress globally, however, in the emerging economies a certain amount of reliance on coal, etc., will continue for economical reasons. Although the use of natural gas as an alternative to coal will expand, the pace will depend to a large degree on how far renewable energy spreads. Renewable energy still has many technological and systematic hurdles to overcome to advance to the next stage. However, if technological innovation and cost reductions progress further, it is possible that it could expand quickly. The use of electric vehicles are expected to continue to increase, but there are still various uncertain factors that are affecting the pace of expansion. Also, the carbon policies of each country must be taken into consideration.

17. 2019 Major Political and Economic Event Schedule
Elections Led by Emerging Economies
Japan Era Change/Consumption Tax Hike

▽ Country/Region

Date	Region	Event
Jan. 14-17, 30-31	Europe/CIS	European Parliament Plenary Session
Feb. 4-10	China	Chinese new year holiday
February	**Japan**	**Japan-EU EPA goes into effect**
February	**Africa**	**Nigeria presidential elections**
February	**Asia**	**Thailand general election**
March	**Europe/CIS**	**UK's scheduled withdrawal from the EU**
March	China	National People's Congress
April	**Japan**	**Unified local elections**
April	**Asia**	**Indonesia presidential and general elections**
May	**Japan**	**New emperor's enthronement, new era name**
May	**Europe/CIS**	**European parliamentary elections**
May	**Asia**	**India general election**
July	China	Communist Party Central Politburo Meeting
Summer	**Japan**	**Upper House election**
October	**Japan**	**Consumption tax hike (8%→10%)**
October	**N. America**	**Canada general election**
October	**S. America**	**Argentina presidential election 1st vote (November: Final vote)**
November	**Middle East**	**Israel general election**
Mid-Dec.	China	Central Economic Work Conference

Note: Black letters are annual or bi-annual events, Bold red letters are other than that

▽ International Meetings, Summits, etc.

Date	Region	Event
Jan. 22-25		World Economic Forum, Davos, Switzerland
March 28-31		Inter-American Development Bank Annual Meeting, China
April 22-23	Asia	34th ASEAN Summit, Thailand
April 12-14		IMF/World Bank Bi-Annual Meeting, Washington D.C.
April	Asia	Boao Asia Forum
May 2-5	Asia	2nd Annual Asian Development Bank Meeting, Fiji
May 8-9	Europe/CIS	28th Annual European Bank for Reconstruction and Development Meeting, Sarajevo, Bosnia and Herzegovina
May	Africa	54th Annual African Development Bank Meeting, Equatorial Guinea
June 28-29		G20 Summit, Osaka, Japan
June	Asia	Asia Infrastructure Investment Bank Annual Meeting
June	Asia	One Belt, One Road Summit
June	Europe/CIS	CIS Summit
June	Asia	Shanghai Cooperation Organization Summit
August		**Executive Director of the IEA's term expires, (Fatih Birol, Turkey)**
Aug. 24-26		G7 Summit, Biarritz, France
Sept. 17-30		74th Session of the UN General Assembly
September	Europe/CIS	Eastern Economic Forum, Russia
Oct. of Nov.	Asia	35th ASEAN Summit, Thailand
October	**Europe**	**ECB President Mario Draghi's term expires**
Nov. 11-22		25th Conference of the Parties to the UN Framework Convention on Climate Change (COP25)
Nov. 17		APEC Summit, Chile

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