ECONVUE OUTLOOK 2017

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Oil Markets Scenarios for 2017-2018

By Albert Bressand, University of Groningen and Columbia University
December 9, 2016

The core scenario for oil markets in 2017 is a no-brainer: a yoyo in a tunnel with a ceiling at 55/60 dollars per barrel and a floor in the mid- to low- forties. All this predicated not on OPEC, a side-show these days, but on the role of the U.S. Unconventional Gas and Oil industry (U.S. UGO). As we documented, the U.S. UGO (U.S. you go!) is not just adding supply into the pool, it's changing the merit-order that prevailed during the 2004-2014 one-hundred dollar oil decade. 'Tough oil' from the depths of exotic places under equally 'exotic' governance regimes is no longer where the marginal barrel lies. The barrel that sets the price is now a North Dakota/Oklahoma/Texas unconventional barrel. U.S. UGO supply can be ramped up quickly, as has begun since the November 30th OPEC meeting and wishful thinking it triggered on 'market rebalancing'. By mid-2017, the talking-up of prices by OPEC and Russia will be drowned in U.S. oil. Large-scale hedging, however, will help the U.S. UGO survive at least the first part of the coming price downturn. A combination of Trump tax exuberance and of strengthening demand may then trigger the next yoyo upward bounce. Unless a U.S.-China trade war dampens demand and it takes partial hibernation of the U.S. UGO to rebound prices a year later. While timing can vary, the 'yoyo in a 40-60 tunnel' is a robust scenario, which is why OPEC blinked first.

Exploring beyond this scenario could begin with taking stock of some of the analysis still flowing in from the rear-mirror. Its London-witty tone aside, a starting point can be the December 10-16 issue of The Economist. 'OPEC' intervention will not save a flabby industry from the lash of market forces' pontifies the tongue-in-cheek publication. Several oil-market clichés cleverly lumped in that half-pager are invitations for alternative thinking. Oil majors, serious observers know, have lowered costs by a third and have since long opted for dividends over production expansion, which makes The Economist's advice that they should do so flabby on the edges. True, U.S. UGO companies must now pick their plays. But three weeks ago, in a land where oil exploration started back in the 1860s, the U.S. Geological Survey pronounced the Wolfcamp subplay in Texas to hold the largest pool of 'continuous oil' ever found in the U.S. Having to pick from such troves hardly exposes the U.S. UGO to the patronizing remark that 'these firms are egged on by Wall Street… especially under a Trump presidency'. Whether 'wind and solar energy and batteries' will have a stronger impact on oil demand than low oil prices and global demographics is another theme on which thinking beyond clichés might open perspectives. Take the OPEC 'cartel', which The Economist elevates to the rank of successor to the Rockefellers and the Seven Sisters. As we showed, three factors kept OPEC low-cost oil production down, the least important of which were OPEC quotas. Saudi Arabia's self-imposed production-limits had more to do with preserving geopolitical clout through spare capacity and with keeping proven reserves at more than half a century in support of dynastic stability. Meanwhile the rest of OPEC production was limited by a motley set of wars (Iraq-Iran, Gulf I and Gulf II), sanctions (Iran), civil wars (Iraq, Libya), sheer incompetence (Venezuela), poor governance and looting (Nigeria) and unresolved conflicts among resources beneficiaries (Kuwait). Irrespective of U.S. UGO, the gradual resolution of wars and civil wars was going to call the bluff on OPEC quotas. But,

less noticed, the revolution in drilling and field management behind U.S. UGO is also giving Saudi Arabia (and Russia) enough additional reserves to tilt the game in favor of higher production levels if needed. It is no coincidence that Saudi Aramco plans to spend $ 7 billion exploring for tight-hydrocarbons—of which the kingdom has plenty—and has just cracked the one-trillion-cell oil-field management software in Ghawar, the world's largest oil deposit. Add the ongoing certification of Saudi oil reserves as a prelude to the partial IPO of Saudi Aramco and an alternative scenario emerges in which Saudi production would increase by half into the 15-20 mb/range while still respecting the two criteria we mentioned. Oil in the 20-40 dollar range would make it impossible for Iran to protect its own revenues—no tears in Riyadh! It would present the U.S. UGO and oil majors with challenges that 'flabby' analysis by The Economist poorly prepares for.

Link: https://econvue.com/pulse/oil-markets-scenarios-2017-2018

Emerging Markets: Investment of the Year in 2017?

By Marsha Vande Berg December 13, 2016

Strong fundamentals in Asia's emerging markets may tempt outside investors to stay the course when the year turns. But a combination of domestic politics in 2017 and global uncertainties could risk becoming the nemesis of the New Year.

Questions about political continuity at home and support for reforms in Asia's emerging markets hover over these economies' striking potential for growth, including the outlook for strongman leaders in the Philippines, Malaysia and Thailand and Xi Jinping in China and Narendra Modi in India.

At the same time, developed markets are also a cause of uncertainty in Asia's growth economies, notably the rising influence of populist and nationalist tendencies in electorates most recently in the UK and the US and pending in Austria, Italy, France and Germany.

Much of the uncertainty can be linked to questions about the effects of "Trump factor" in the US, still the world's largest economy. It's uncertain what impact the President-elect's decision to withdraw from the Transpacific Trade Agreement talks will have on America's self-appointed role as benign hegemon sitting astride the global trading system. Some of this uncertainty surfaced last month when China's leadership said at the APEC summit that Beijing would take the lead in Asian trade in the absence of a US role via TPP.

In addition to the likelihood of interest rate hikes this month and into the New Year, emerging markets must also contend with an unrelentingly strong dollar.

As noted, Donald Trump's election will not be the last time an electorate in the West threatens through plebiscites to undo the liberal order of government that has been the hallmark of the post WWII era. There are unsettling nationalistic influences at play across Europe in particular – a constitutional referendum in Italy and pending national elections in Austria, France and Germany – with implications for the immediate sustainability of the European Union and its monetary system and ramifications globally.

Asia, meanwhile, has its own share of political uncertainty with implications for these growth markets. In the world's second largest economy, a contest over the ambitions of General Secretary Xi Jinping may be playing out inside the black box of Zhongnanhai, the central government's headquarters.

As leaders of China's Communist Party prepare for the 19th Party Congress next October, General Secretary Xi will complete the final year of his first five-year term in office.

While Xi is by all counts in a very strong position, the bigger question is what is the extent of his ambition as China's foremost leader. How will he deal with party precedents if they turn out to be obstacles to getting what he wants particularly the people he wants in place in key positions like the Standing Committee of the Politburo?

Will he attempt to sidestep a longstanding party precedent that says Chinese leaders must retire at age 68, or will he act to ensure his loyalists either retain their positions or move into key slots that strengthen his hand even more. If he does have his way, a key concern is whether the world's second largest economy – soon to be the largest – will be led by an individual who wants to follow in the footsteps of Chairman Mao Zedong, head of China from 1949 to 1976?

It's a volatile cocktail. At the very least, the contest will serve as a distraction from a slowing economy straining under heavy corporate debt and fears of property asset bubbles as well as important initiatives like the pan-Asia infrastructure program, One Belt One Road, not to mention critical financial and capital market reforms.

In India, Modi's BJP party faces challenges in several state elections in 2017, arguably the most important of which are elections in January in the populous Utter Pradesh. A negative outcome for Modi, possibly as a result of the controversial campaign to rid the economy of large rupee notes as part of an anti-corruption campaign, would undercut Modi's political clout as he tries to move India forward with 7-8 percent annual GDP growth.

In Southeast Asia, an easy bull market case among these emerging markets can be made for Indonesia. The government of Joko "Jokowi" Widodo is reform-minded, and his reforms enjoy critical support. The central Bank still has sufficient tools to deal with monetary fluctuations. At the same time, Indonesia, like Malaysia enjoys rather liquid markets so in the event

of a global sell off, equities in liquid markets can be among the first to get disposed.

There's an additional overhang in Malaysia as a result of the as yet unresolved corruption investigation involving the state development fund, IMDB. The office of the Prime Minister Najib Razak and the prime minister himself has been implicated. In Thailand, there is still not a clear course for returning to civilian government while citizens mourn the loss of their bellowed king, Bhumibol Adulyadiji.

In the Philippines' tough-guy president, Rodrigo Duterte, remains a popular figure at home while riling his country's allies with his anti-corruption bombast and threats of sanctioned killings as antidote to drug crimes.

It's a potent mix of possibilities in Asia's growth economies, and challenges seem to lurk at the heart of each. Political volatility will be a factor alongside economic and monetary volatility in 2017. Outcomes will remain unpredictable. The upside may go to those who manage to position themselves to identify which of these growth markets has the strongest oar to navigate difficult domestic and geopolitical shoals.

Link: https://econvue.com/pulse/emerging-markets-investment-year-2017

China's Economic Outlook in 2017

By Sun Xi December 13, 2016

In general, China's gross domestic product (GDP) in 2017 is likely expected to grow similarly as this year's around 6.5%, with the consumer price index (CPI) inflating around 3%. Those officially targets will be confirmed later around 20th December 2016 at China's annual year-end top economic meeting, named the Central Economic Work Conference.

In 2017, China will continue its"supply side structural reform" with the five major tasks of "reducing production capacity, unloading inventory, de-leveraging, lowering cost and filling the short board of the economy", while the government will especially highlight the de-leveraging and preventing financial risks.

Property Market

Many expects China's property bubble will eventually burst in 2017 like what Japan suffered in the past, while others believe the overall risk of Chinese property market is still under control.

That is no question that Chinese housing market has been over-heating in recently years and the house prices in many cities are too overly valued, especially in those tier 1 cities such as Shenzhen, Xiamen, Shanghai, Beijing, Nanjing, Tianjin, Zhengzhou, Hefei, Shijiazhuang, and Fuzhou. Clearly, the recent house prices hike in some of China's big cities is not sustainable. In the future, it is possible to see some regional property crises, but a nation-wide buddle burst is less likely to happen.

Stock Market

The Shenzhen-Hong Kong Stock Connect was just launched on 5th December 2016, after a similar link between the Shanghai and Hong Kong bourses was launched in 2014. Most analyses have expressed positive views on Chinese stock markets in 2017. It is highly possible for China's A-shares to be included into the MSCI Emerging Markets Index in 2017, after the first rejection in 2016.

Chinese RMB

In 2016, the exchange rate between Chinese renminbi (RMB) and the US dollar has fallen nearly 7.7% since the beginning of this year and recently reached an eight-year low as 6.9. As a stronger US dollar is expected to strengthen further, the exchange rate may reach 7 in 2017, and the outflows of Chinese capital will likely continue. However, the further significant and dramatic depreciation of RMB is less possible, because the fundamentals of the Chinese economy are sound and the internationalization of RMB has been in firm progress.

Notably, the uncertainty of US President-elect Trump's policies towards China such as alleged trade war will definitely further complex China's economic outlook and trend, so we should keep our eyes open and adjusted our expectations accordingly.

Link: https://econvue.com/pulse/chinas-economy-outlook-2017

Healthcare's Forecast for 2017

By David W. Johnson December 13, 2016

President-Elect Donald Trump ran his campaign on a promise to repeal and replace Obamacare. His recent appointment of Rep. Tom Price, author of the "Empowering Patients First Act"[1], as HHS secretary indicates that he is serious.[2] Price's proposal is a market-based approach that reduces government spending, narrows the range of care that insurers

are mandated to cover, offsets premium increases for older, sicker patients with tax credits, caps the employer-tax exclusion, and reverses Medicaid expansion.

While the full implications of "repeal and replace" remain to be worked out, the Trump administration has an opportunity to foster a dynamic healthcare market aligned with patient and customer needs.

Where Process Trumps Outcomes: The Stage Has Been Set

The current U.S. healthcare system is centrally-administered, complex and runs on reimbursement formularies that have not changed in the past 50 years. This has given private market incumbents the opportunity to exploit the system for their own economic benefit. Patients navigate a system of artificial economics that optimizes revenue, drains resources and curtails national productivity at the expense of health and well-being.

For the first time since 2009, the U.S. will have a unified government with all three branches of government under one party’s control. Under a Trump administration and unified Republican Congress, there is potential for significant U.S. healthcare reform legislation.

The Republican Party agrees that serious legislative measures need to be taken to ensure lower premiums and more choice for consumers. There is an opportunity for a new plan to see that healthcare pricing and regularity policies facilitate better resource allocation.

Until We Know More

In the short-run, before the new HHS secretary proposes and implements major legislative changes, we can expect to see healthcare expenditures run at higher levels than inflation and consume a greater percentage of GDP as incumbents continue to pursue historically successful business practices that optimize revenue. This, of course, creates opportunities for new market entrants to offer more value in the form of lower-cost, consumer-oriented solutions.

Over time, these twin forces of incumbent pursuit of perverse incentives built into the current reimbursement system and new business models responding to market demands for better, cheaper and more convenient options will shape healthcare’s supply-demand relationships. In the long run, market-driven reform trumps inefficiency, but not without an epic fight.

In this sense, healthcare reform distills to a debate about government’s role in healthcare provision. The battle will be waged in both the marketplace and legislative chambers.

Conclusion: Employ Raging Pragmatism to Fix American Healthcare

America does not need to spend 18% of its economy to provide superior healthcare to everyone in the country. Perverse payment incentives have created a fragmented, cruel and bloated system that harms far too many Americans. Despite massive investment in healthcare, Americans are sicker than ever. More of the same will drain national resources, stifle innovation, accelerate income inequality, and curtail national productivity. A centrist and pragmatic approach offers the best opportunity to deliver better healthcare for less money and free up enormous resources to fund other pressing needs and invest in more productive industries.

During his campaign, President-Elect Trump made big promises to deliver better care to all Americans. All Americans wants better, cheaper, more convenient and compassionate healthcare. As he oversees legislative changes to the ACA, Populist Donald Trump should heed those concerns and take into account how healthcare touches the lives of every individual and community while also ensuring that outcomes matter, customers count and value rules.

Links: https://econvue.com/pulse/healthcare's-forecast-2017

(1) http://tomprice.house.gov/sites/tomprice.house.gov/files/HR%202300%20Empowering%20Patients%20First%20Act%202015.pdf
(2) http://www.modernhealthcare.com/article/20161128/NEWS/161129932?utm_source=modernhealthcare&utm_medium=email&utm_content=20161128-NEWS-161129932&utm_campaign=am

Four Takeaways from the FOMC Meeting

By Michael Lewis December 16, 2016

1. FOMC turns more hawkish, finally. From the moment Janet Yellen took the helm in January 2014, the FOMC has been growing steadily more dovish. Until this week, that is. The FOMC raised the funds target another +25BP, as expected, but the accompanying “dot plot” increased projected future tightening for the first time in more than four years.

The FOMC did raise the funds target in December 2015, but that was far later and far less than had been envisioned when Yellen was sworn in or while she served as vice-chair under Bernanke for that matter. Yellen’s dovish retreat is readily apparent in the quarterly “dot plots.” In September 2014, when the dot plot was extended to 2017, the members projected that the funds target would end that year at 3.75%. Every quarterly edition of the dot plot since then reduced that 2017 endpoint, sometimes by as much as half a point; the 2017 plan bottomed out at just 1.125% this past September. After this week’s meeting, the funds target projection for 17Q4 is up to 1.375%.

Whether this truly marks a change in direction/attitude or whether Yellen & Co. can even follow through on the current far-from-hawkish intention remains to be seen. It is a start.

2. The markets and the FOMC are aligned, finally. During Yellen's tenure (and before), fed futures consistently scoffed at the FOMC's resolve to tighten policy. The markets were right to price in only very limited tightening. After this week's meeting, however, the FOMC and markets are on the same page. The median FOMC dot plot shows three more +25BP rate hikes in 2017, and fed futures are pricing in +60BP of tightening, or about 2.5 rate hikes, next year.

Has Yellen restored the Fed's credibility? Perhaps, though FMI thinks the futures market share our view that higher inflation will give the FOMC no other choice. If it takes longer for inflation to perk up, Yellen will likely balk again.

3. FOMC is lying shading the truth about inflation. While the FOMC shifted in a more hawkish direction, the members' economic forecast was virtually unchanged -- the same okay +2% real growth and stable jobless rate near 4.6% over the three-year forecast horizon. Of special note, the FOMC continued to argue that core inflation would remain just barely below their +2% target through 2019. FMI disagrees, and we suspect that the FOMC is far from convinced.

Granted, inflation has been under +2% for a long time. Yet, prolonged ultra-easy policy inevitably generates inflation pressures. There is ample evidence, in wages (data which Yellen particularly follows), housing prices and elsewhere that such pressures are building.

By insisting that inflation will not breach the target, FOMC members put off uncomfortable questions about why policy remains so accommodative when dual mandate goals have been met. We believe that members want to raise the inflation target to foster their strategic goals, namely a steeper, more normal yield curve and hence higher long rates. Once inflation does start trending above +2% -- which we believe will occur by mid-2017 -- the FOMC will have to abandon their magical thinking by either raising the inflation target or by agreeing to tolerate higher inflation "for a while."

4. The surge in long rates enabled FOMC's hawkish turn. Between the September and December FOMC meetings, the FOMC economic and inflation forecasts were unchanged; neither the data nor the outlook provided reasons for the FOMC to step up projected future tightening. Trump did win the election, which we doubt Yellen expected. That, however, is likely only a minor factor (any successes Trump has in stimulating the economy or failures threatening it will take a while to manifest).

The big difference from September and the main motivation for the FOMC's new more hawkish stance was the surge in long rates, e.g., the +80BP increase in the 10-year yield.

This, we believe, was what the FOMC wanted, though it is undoubtedly more of an increase than they had expected at this point. FMI has argued that the FOMC's emerging strategy is to steepen the yield curve to more 'normal' levels. This would alleviate stresses on the financial system and, they believe, give them more time to return to a neutral policy. To that end, the FOMC would encourage higher long rates by promoting/tolerating higher inflation, even exceeding the official +2% target. (The Bank of Japan, we note, has already begun to pursue a similar strategy; other central banks will likely follow).

The increase in long rates is not a problem -- rates are still not high enough to impede economic activity. Consequently, the FOMC saw a free pass to squeeze in a bit more projected tightening, and they took it.

Link: https://econvue.com/pulse/four-takeaways-fomc-meeting

The Thrust of Economic Policy vs The Force of Demography

By Saul Eslake December 13, 2016

2017 could be the year in which the thrust of economic policy collides with the force of demography.

For the past six or so years, economic policy-makers in 'advanced' economies have been frustrated by their apparent inability to engineer a return to the growth rates of the period between the recessions of the early 1990s and the onset of the global financial crisis. From its post-crisis low in the first quarter of 2009, OECD area real GDP growth has averaged 1.9% at an annual rate, down from an average of 2.6% between the previous trough in the fourth quarter of 1990 and the peak in the first quarter of 2008.

Yet despite such an apparently sub-par rate of GDP growth, the unemployment rate across the OECD area has fallen from a peak of 8.1% at the end of 2012 to 6.3% as of late 2016, which is less than a percentage point above the lowest it has ever been since 1980. Over the last three years, the OECD area unemployment rate has fallen faster than over any other three-year interval in the last four decades. In the four largest OECD economies (the United States, Japan, Germany and the United Kingdom) the unemployment rate is at or below levels traditionally regarded as implying 'full employment': and, with the exception of the United States, this has been accomplished in the face of workforce participation rates rising to decade-or-more highs.

This apparent paradox – of apparently sub-par GDP growth nonetheless being sufficient to generate rapid (by historical

standards) declines in unemployment – is largely explained by demography. Beginning in 2011, when the first of the post-war baby-boomers began turning 65, the growth rate of the OECD area's working-age population – defined here not, as labour force statistics typically do, as the population aged 15 and over, but instead more realistically, given 'norms' about retirement ages, as the population aged between 15 and 64 – has decelerated much more markedly than it had done over the previous three decades. From an average of 0.7% pa over the decade to 2010, the growth rate of the 15-64 year old population in OECD member countries slowed to just 0.3% pa over the five years to 2015, and according to UN forecasts will slow to just 0.1% pa over the five years to 2020.

As a matter of arithmetic, the slowdown in the growth rate of the OECD area working-age population 'explains' about three-quarters of the 'shortfall' in OECD area real GDP growth since the end of the financial crisis, compared with the era before it. And it also largely explains why this 'below-trend' growth rate has nonetheless been sufficient to allow a significant decline in unemployment across the OECD area.

The rapid deceleration in the growth rate of working-age populations in 'advanced' economies (and in some 'developing' economies as well) has co-incided with the aftermath of the financial crisis, rather than being in any way a consequence of the financial crisis. Yet economic policy-makers appear to have ignored it, in calibrating their expectations for what constitutes an appropriate or desirable rate of economic growth.

The slow-down in the growth-rate of working-age populations, combined with the apparent slow-down in productivity growth in 'advanced' economies (which may be, in part, a legacy of the financial crisis) has resulted in a significant slowdown in potential growth rates – from about 2% pa in the years immediately before the financial crisis to less than 1½% pa in 2017 and 2018, according to OECD estimates.

When unemployment is high, aiming for real GDP growth above its potential rate makes sense, since reducing unemployment requires above-potential economic growth, by definition. But once an economy has reached full employment, continuing to push for above-potential real GDP growth is bound to lead, eventually, to higher inflation.

Incoming US President Donald Trump wants to use fiscal policy to engineer a faster rate of growth in the US economy, in much the same way that some interpretations of economic history hold that the Reagan Administration did in the 1980s (although those versions of history ignore the impact of the sharp fall in interest rates that occurred then, which cannot be replicated now, and the substantially lower growth rate of the US working-age population now than then). The Trump Administration also wants to redistribute economic and employment growth from other countries back to the United States through various trade policy measures – measures which may well provoke retaliation from countries adversely affected by them.

This prospect increases the prospect that, after more than five years of worrying about the risks of falling into deflation – a very unpalatable prospect, to be sure – 2017 may be a year in which both investors and policy-makers start to grapple with the opposite concerns.

Link: https://econvue.com/pulse/thrust-economic-policy-vs-force-demography

What's Next Under the Trump Administration?

By Robert Shapiro December 13, 2016

The United States is poised to enter a more typical economic cycle than we've seen since the 1990s. The Trump administration's outsized tax cuts and plans to increase defense spending, and the virtual certainty that the GOP Congress will eagerly go along, will swell the US budget deficit and jumpstart faster growth.

Stronger growth will be counterbalanced by two other forces. First, productivity growth has stalled, and the Trump agenda will do little to revive it. Second, the Federal Reserve is likely to respond large deficit and faster growth, especially in an environment of low unemployment, by initiating a period of conventional phased-in interest rate increase. Based on past cycles, this will include 14 to 17 rate increases over three years; and under this scenario, the expansion will end by 2019.

Beyond this, most of the risks are on the downside. Most troubling, of course, are the growing stresses on the EU; and the odds of the EU breaking down are not insignificant.

Link: https://econvue.com/pulse/whats-next-under-trump-administration

Trumpism and the Global Economy

By Karim Pakravan December 13, 2016

In contrast to President Obama, who came to power in an unprecedented global financial crisis and with an economy close to collapse, President-elect Trump is a lucky man. He inherits an economy in its seventh year of expansion, with a stock market which has tripled in value since the dark days of 2009. Over eight million jobs have been created since the trough of the 2009-2010 Great Recession, unemployment has dropped by more than half, wages are rising and the budget deficit has shrunk to under 3%. At the same time, the global economy, which seemed in a precarious position a

few months ago, has stabilized. Finally, the U.S economy shows signs of perking up, with economic growth climbing out of its recent 2.0% growth rut. The most immediate elements of Trumps economic program are likely to provide further stimulus in the next few quarters to an already strong economy, growing at close to potential, at the expense of fiscal rectitude.

However, despite a recent stabilization, the global economy remains fragile and vulnerable to shocks, and the Trump factor could introduce major new risks, as well as amplify existing ones. These risks to the global economy could backfire on the U.S. economic performance. At this stage, we can identify four sets of risks: the impact of a President Trump's aggressive nationalism; another down cycle on emerging market currencies, with the potential for another round of currency wars; undermining the global financial architecture; and unresolved sovereign debt and banking problems in the Eurozone. I will focus on the first two risk factors.

We have seen a sharp slowdown in global trade in the past few years. Ove the past few decades, global trade had expanded at a faster pace than global output (an annual average of 6.1% vs 3.5%for GDP over 1980-2007). However, following the Great Recession, global trade volume growth has declined sharply, (an annual average of 3.6% vs. 3.4% for GDP over 2011-2016), actually falling below GDP growth in 2015-16. While there are some structural elements in play, trade still plays a major role in global economic growth. Trade "unfairness" was a major part of candidate Trump's message, and we should take him at his word. A Trump presidency raises the specter of major trade tensions at the very least, and a trade war at the worse, with a significant negative feedback loop effects on U.S corporations.

The second downside risk comes on the currency front. The immediate impact of the Trump victory has been a dollar surge and a sharp steepening of the yield curve. U.S inflation had been steadily rising in the past few months, getting close to the 2% Fed target. However, the prospects of a sharp rise in the U.S deficits has led to a steepening of the yield curve. In combination with the expected divergence in monetary policies of the major central banks, this has increased tensions in an already nervous currency market. In particular, emerging market currencies face the prospect of a lengthy period of weakness. Currency market turmoil could also worsen if President Trump accuses the Chinese of currency manipulation. Bottom line, be on the lookout for political risks.

Link: https://econvue.com/pulse/trumpism-and-global-economy

Regulatory Guidance – the Differences in Approach to Fintech Regulation in the United States, the United Kingdom, and the European Union

By Collin Canright December 13, 2016

Financial technology evolves into its next stage of maturity in 2017. Where venture investments going to FinTech firms marked progress to date, in the coming year regulatory interest will come to the fore.

Business awareness and consumer adoption will remain will pick up in FinTech as well, but after a year of study and interest, regulators are starting to make their rules. This became particularly important in the United States during the first days of December 2016 when both the Office of the Comptroller of the Currency and the Federal Reserve Board of Governors weighed in on FinTech.

Meanwhile, regulations in the United Kingdom and Europe are moving apace as well, with support for competition in the U.K. and for consumer choice in the Eurozone. These and a number of other initiatives fall under the my tagline "The Empire Strikes," one of my FinTech trends to watch in 2016. Given the recent activity as 2016 draws to a close, the development of FinTech regulatory regimes will become the most critical trend in 2017.

Regulatory approaches to innovation

Regulators rightly walk a fine line between supporting innovation and protecting consumers. Several sessions at the Money20/20 FinTech conference held Oct. 23 – 26 highlighted the different approaches regulators can take to keeping a regulatory balance. The regulators have the hardest job, to help innovation happen and block harm," said Jo Ann Barefoot, a former regulator who heads the Barefoot Innovation Group. She held a fireside chat with CFPB director Richard Cordray at Money20/20.

Three different approaches to regulation emerged:
1. A paternalistic approach to consumer protection first and foremost exemplified by the U.S. CFPB and OCC.
2. An entrepreneurial approach to increasing competition in financial services taken by the United Kingdom's Financial Conduct Authority (FCA).
3. A public-interest approach concerned about making financial institutions into utilities characteristic of some regulation from the European Union.

The U.K.'s Financial Conduct Authority (FCA) started Project Innovate to make the regulatory system more innovation

friendly. The FCA provides unofficial advice to FinTech startups and runs Project Innovate to provide a “regulatory sandbox” in which FinTech firms can test their products within a regulatory framework. Interest was so high in the initial FCA class that it had to expand the number of companies supported and accepted 24 in its first class.

“The bottom line here is not innovation,” said Bob Ferguson, who heads Project Innovate for the FCA, speaking at Money20/20. “The bottom line here is competition with innovation as a means to that end.” The approach appears to work, given that London remains the world center of FinTech innovation, even with some slowdown in the wake of the Brexit vote.

In contrast, the CFBP and other U.S. agencies clearly put priority on innovations that expand financial inclusion, whether that means providing services to people without bank accounts, expanding their access to reasonably priced credit, or reducing the costs of financial services to consumers. The CFBP runs Project Catalyst to encourage innovations that are “safe and beneficial for consumers.”

Open data

In the European Union, the move for banks to connect using APIs in order to give consumers the ability to grant other parties to access their accounts is causing a great deal of anxiety. The Directive on Payment Services (PSD2) requires banks to enable merchants and other third parties that obtain permission from consumers to access funds in their bank accounts.

A merchant, for instance, will be able to make a realtime debit of a consumers account. This effectively eliminates banks as intermediaries and turns them into public utilities, complete with regulated fees.

But PSD2 goes beyond payments to bring dramatic changes to banking. The underlying premise endorsed in the U.K. and under study by the CFPB is that the account data do not belong to the bank; they belong to the consumer.

Technically this translates in the U.K. into a proposal to require banks to adopt an “open API” technology stance. Whether that encourages or stifles innovation remains to be seen and depends on your point of view. The products of many FinTech firms either rely on or would benefit from bank account and data access.

APIs or application programming interfaces are software connection for passing data from one program or service to another and are critical to the future of FinTech and financial services, and investors are taking note. Open API and other connectivity technologies will play increasingly important roles as FinTech develops in the year to come.

Link: https://econvue.com/pulse/regulatory-guidance-differences-approach-fintech-regulation-united-states-united-kingdom-and

2017 Global Economic Outlook

By Nikolai Tagarov December 19, 2016

In 2017, China will manage to avert a banking crisis despite rising debt levels in both firms and households. China has started spinning off bad debts into separate asset management companies. This will help avoid a crisis but will come at the cost of slower growth than 2016. High RE prices in first-tier cities will also act as a factor for slower growth as they crowd out and make unprofitable the operation of many SMEs. However, since households are now overburdened with unprecedentedly high debt levels as well (a great proportion of which is due to existing mortgages), sales of new RE assets even in tier one cities will slow down – which may lead to stabilizing and even falling RE prices. At the same time, China will continue with its “going out” strategy of investing abroad, particularly along the New Silk Road. However, in order to avoid sharp depreciations of the currency, outflows will be tightly controlled and SOEs will benefit disproportionally as they receive more outward investment quotas. However, due to the slowing economy, in the second half of 2017 we will likely see some attempts to reform (e.g. allow to go bankrupt and privatize) loss-making SOEs.

By far the most important factor that will likely greatly influence the global economy next year is the Italian referendum, which PM Renzi just lost. It is very likely that the ensuing instability, whether a stable coalition of regionalist parties (Lega Nord) and the anti-establishment Five Star movement can be formed or not following elections, will lead to a banking crisis in Italy. Such a (more likely than not) scenario poses far more existential threats to the Euro and the EU than Brexit; the concurrence of the two may prove exceedingly dangerous.

The origins of the Italian crisis really lie in the fact that the Eurozone is not an “optimum currency area”; Italy has been losing competitiveness vis-à-vis Germany yet due to having the same currency cannot resolve this problem by devaluing its currency. Ultimately, there are only two ways that this can be resolved. Either Italy must leave the Eurozone to regain competitiveness, or the EU must move decisively in the direction of fiscal union. In the context of rising xenophobic sentiments in Europe, such solidarity even among Europeans will be highly unlikely. A drawn-out string of half-measures as in the case of Greece is probably not going to be an option to postpone effective decision-making for an economy as large and important for Europe as Italy.

Eastern Europe will probably continue on a path of divergence from “Old Europe” on a range of matters, and will be increasingly assertive with its claims that its voice should be heard, particularly via the use of semi-formal coalitions such

as the Visegrad Group around specific issues such as immigration. However, buoyed by increasing levels of Chinese investments while (in most cases) being able to pursue relatively independent monetary policy, Eastern Europe will remain one of the regions with higher than average GDP growth.

Given the recent developments in Italy, the events to watch out most carefully are election results across Europe (both West and East). If anti-establishment parties come to the fore, this will make it very challenging to mitigate and deal with the negative effects of Brexit and the potential banking crisis and instability in Italy. As for the US, concerns about the contagion effects of the above will probably make it very difficult for President-Elect Trump to fulfill his promise to raise interest rates.

Link: https://econvue.com/pulse/2017-global-economic-outlook

The Future of Compliance Under Trump

By Carole Basri December 19, 2016

General counsels and compliance officers should be aware that with a new Trump administration there is a potential for a change in several areas including the following:

1. There will probably be a simplification of existing regulations.

2. The Dodd Frank Act's sweeping reforms may be rolled back but the likelihood is that it will remain largely intact due to corporate comfort with the Act as is; however, enforcement will be less rigorous by the Justice Department and the Securities and Exchange Commission. Even the opportunity to roll back the whistleblower protections and awards will not be pushed by corporate America because many corporations have learned to live with it so long as a requirement is added that the whistleblowers receiving a bounty must first report the incident on the company hotline.

3. Interestingly, large American corporations will generally champion keeping the reforms in place under the Dodd Frank Act since they have already created the compliance structure to support the reforms. I do not think banks will want to roll it back since they will feel the next administration will just want it back and that the infrastructure is already there so it is better to just leave it alone.

4. Compliance departments will continue to grow internationally as developing (BRIC) and underdeveloped countries strive to fight corruption.

5. We are already seeing the following anti-corruption efforts in the BRIC countries:

In Brazil, with the Petrobras and the impeachment of President Dilma;

In India, with the demonetization campaign of Prime Minister Modi; and

In China, with the second five year plan to fight corruption, the installation of compliance officers in all large Chinese companies, and the decline in the luxury goods market.

6. While Russia remains an outlier on the fight against corruption at this time, this will probably change soon. Under a Trump administration, some or all of the sanctions will probably be lifted against Russian banks and other entities. As Russia, joins in the larger international market, it will need more compliance with anti-money laundering, anti-bribery, sanctions and boycott laws and regulations. This will lead to larger
compliance departments for Russian companies and in particular, financial services companies.

7. Underdeveloped countries will also have a need for their companies to expand compliance departments if they are to fight corruption and become greater players in the global economy. This will be most apparent in Africa.

8. Compliance departments will probably expand globally since it is at its heart self regulation rather than government regulation. By this I mean that there will be more industry (like FINRA) and governmental oversight of existing compliance programs in companies. The mandate for expansion will not be to increase regulators but to increase the responsibility for effective compliance programs within each industry and company. This is the essence of self regulation.

9. In house legal departments and compliance departments will be professionalized with more certification and degree programs like the LLM in Compliance at Fordham Law School. There will be an increased demand for trained in house lawyers and compliance professionals.

Link: https://econvue.com/pulse/future-compliance-under-trump

Protectionism, Geopolitics, and Populist Nationalism Could Accelerate “Peak Globalization”

By Banning Garrett December 20, 2016

The global economy in 2017 could be extremely uncertain and volatile, battered by political and geopolitical instability that aggravates other economic challenges. The United States under the Trump administration may be the most uncertain global factor, even if it backs off some of the more draconian protectionist measures advocated by Donald Trump during the campaign. The Trump victory has provided the biggest boost yet to populist nationalism sweeping the developed world with its anti-globalization and protectionist themes. The European Union, already reeling from Brexit, could begin be further destabilized by political shifts in France, the Netherlands, and Austria even if extreme right parties do not come to power. Terrorists attacks in Europe linked to ISIS or Al Qaeda - and immigration -- will likely enhance xenophobic fears and support for nativist politics and "strongman" rule. We are not yet in the 1930s, but it could get pretty ugly over the next 2-3 years.

The US administration, if it pursues Trump's "America First" sentiment (it is hard to call it a "strategy") may accelerate a global trend toward zero-sum geopolitics that currently is being led by Russia and China, while undermining global cooperation, including international efforts to climate change, and the US alliance system. Moreover, the already fragile international order could face a number of geopolitical crises, especially in Eurasia and the Middle East, that may be poorly handled by the Trump administration and further unsettle global markets. At the same time, the problems of inequality and regional economic distress within the US are not likely to be effectively addressed by the policies advocated Trump's cabinet appointments nor will they lead toward sustainable long-term growth despite Wall Street's initial enthusiasm for his proposed tax cuts, deregulation and infrastructure investment. Moreover, despite Presidential jawboning, it is not likely that a significant number of manufacturing jobs will be "brought back" to the United States as they have been lost not to China but to technology. Additionally, at a time of accelerating technological change that requires forward-thinking policies, it seems so far that the Trump administration is likely to look backwards for solutions to structural economic challenges, which may produce short-term gains while jeopardizing long-term economic readjustment and growth.

Such developments in the US, which would likely significantly affect the global economy, could actually accelerate another long-term trend that is now only a "weak signal." That trend, which might be called "Peak Globalization," could lead to restructuring the global economy over the coming decades. By "Peak Globalization," I mean a point in time when the amount physical material moving around the world - in the form of liquid fuels, container ships, food, etc. - peaks and begins to decline. New technology is making possible moving toward local economies (both at the national and urban levels) based on "just in time production at the point of consumption" of energy, food, and products. New technology coupled with concern about economic and environmental sustainability as well as reduction of carbon emissions has already spurred interest and development of these technologies, from renewable energy to vertical farms to 3D printing and other advanced manufacturing technologies to bring production of goods to local communities. Any shift toward greater protectionism and uncertainty about international trade could increase support for taking steps, however limited

initially, to further develop and deploy technologies that reduce economic and political risk by beginning to decouple from the global economy.

The Trump administration's belligerence and transactional approach to asserting "America First" and its hostility to climate change agreements and environmental regulations while doubling down on fossil fuels, may, ironically, accelerate moves toward a more economically and environmental global economy. We may look back on 2017 as an historic turning point in a direction quite unanticipated by both Donald Trump and Wall Street.

Link: https://econvue.com/pulse/protectionism-geopolitics-and-populist-nationalism-could-accelerate-"peak-globalization"

China's Second Policy Paper on Latin America and the Caribbean: Indications of Chinese Intentions, and Recommendation for the U.S. Response

By R. Evan Ellis December 13, 2016

On November 21, 2016, the People's Republic of China (PRC) published its second white paper on its policy toward Latin America and the Caribbean. Although the document received very little attention in either the U.S. or region, it serves as a valuable indicator of China's intentions toward the region, both through what it says on its face, and how it may be read "between the lines."

China's engagement in Latin America and the Caribbean increasingly impacts the region, and by extension, the economic and security environment of the U.S. As such, China's new document on its approach toward the region is important for policymakers, analysts and businessmen with an interest in that relationship.

Among those details, the document notes the PRC desire to use its relationship with Latin America to "consolidate multilateral trading systems." This may be understood as its plan to attempt to move beyond the bilateral free trade agreements already negotiated with Chile, Peru, and Costa Rica, in order to advance its Free Trade Area of the Asia-Pacific (FTAAP), building on the framework of the Regional Comprehensive Economic Partnership (RCEP) which it has established in Asia, to create a multilateral trade regime across the Pacific with rules favorable to China, taking advantage of the likely U.S. withdrawal from the Trans Pacific Partnership.

In a similar fashion, China's professed desire to leverage its relationship with Latin America to advance "global governance reform" (mentioned in two separate parts of the document) arguably reflects its ongoing campaign to use its

expanding weight in international trade, investment and finance to reshape the Post World War II "Bretton Woods" system of international economic institutions more to its advantage, including the International Monetary Fund's inclusion of the Chinese RMB as one of its reserve currencies in 2016.

China's new policy white paper on Latin America and the Caribbean contains important insights into where the PRC wishes to take its relationship with the region under the leadership of President Xi Jinping, and how. As such, it should be carefully studied by government, as well as business analysts for insights. While the PRC may undertake activities other than those explicitly mentioned in the document, and while it may not achieve everything that it has announced that it aspires to do, decisionmakers should at least plan on the basis that the PRC will attempt to do, what it says it wishes to do in Latin America and the Caribbean.

Link: https://econvue.com/pulse/china-latin-america-and-caribbean-us-sphere-influence

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