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The World in 2017

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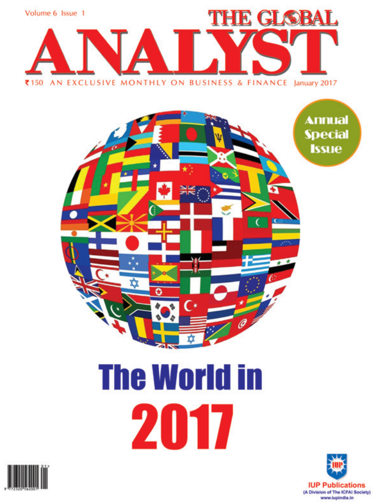

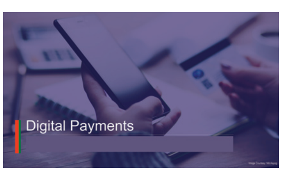

The World in 2017

Curtain Raiser

To say, an eventful year comes to an end, would be an understatement. For, 2016 will be remembered for the developments, both in national as well as international arena, on political and so on economic stage, which could have far ranging, long-term impacts, some unintended consequences included. It all began with China's revelation of a sharp decline in its GDP in 2015. In January, Beijing said, at 6.9%, its GDP growth in 2015 had hit its lowest level in a quarter of a century! The revelation sent shock waves across the globe as the development meant the world's second largest economy won't be importing at the scale it had been doing for the last several decades when it clocked nearly double-digit growth. The subsequent three quarters were no different with economy continuing to grow at sub-7 rate. This has, however, allowed India to reinforce its position as the world's fastest growing major economy. India also remained in the limelight with two of its bold measures. First, it was the passage of the much-awaited GST bill by both the houses of the Parliament, and then came, demonetization, which was announced on the night of November 8. Both these developments could be potential game-changers, if handled properly. Consider the GST, the Goods and Services Tax. Inarguably, the boldest indirect tax reform ever, GST aims to help India usher in "one nation, one tax" regime, which the Prime Minister said, is devoid of 'tax terrorism', and which further strengthens the spirit of one India. Demonetization is another ambitious yet a bold step that aims to transform India, from being essentially a cash-based economy into a less-cash or more appropriately, a digital payment-based one. Both these moves are brave and futuristic, and could deliver significant long-term benefits. At the same time, they also present significant challenges to the government. It'd be imperative the government implements these two measures (GST and digital economy) in such a way so as to cause minimal inconvenience to the common citizen.

On the international scene, two developments, which could shape the direction the world economy takes in 2017 and later, are: Brexit and the victory of Trump in US presidential election. The UK is yet to formally begin the process of its separation from the European Union—a politico-economic union of 28 European nations. Brexit would require UK to renegotiate its trade relationships with other nations, which could further add to an already uncertain global economic environment, post-Trump's win. But the biggest of all the challenges would be how to deal with the challenges that many fear could arise post Trump's coronation slated for January 20, 2017. The whole world would be watching with bated breath as the Trump Administration's first year unravels, his foreign policy measures, his government's stand on America's relationships with its trading partners, particularly Mexico and China, his policy towards immigration that could greatly influence the fortunes of industries, technology (outsourcing) in particular, where advances in robotics, artificial intelligence, etc., are already causing much anxiety for the job markets.

Besides these political and economic developments, actions of central banks in America, Europe, China, Japan and India too could be keenly watched. The US Fed recently raised its key interest rate by a quarter point, from a range of 0.25 to 0.5% to a range of 0.5 to 0.75%. It was the first rate hike (by the Fed) in a year, and only the second since 2008 credit crisis. The move emanates from Fed's growing confidence that the "(US economy) growth is a touch stronger, (and) unemployment is a shade lower." This explains dollar's recent surge, which, however, could be bad news for importers and stock markets everywhere amid growing fears of capital outflows. Oil could be another area where developments could have significant impact on the world. With OPEC keen on production cuts, it appears era of 'low oil' might be nearing its end. But given, dollar is on a roll, it would be interesting to watch how the relationship between dollar, oil, and precious metals, particularly gold, plays out in 2017. The trend in oil prices could also hold key to the fortunes of economies of major oil producing nations such as Russia, Middle East, and Latin America, where falling oil prices of last couple of years have caused severe economic and humanitarian crisis, and have even led to political instability in some like Venezuela and Brazil. Apart from these, geo-political tensions in parts of Asia, Africa and elsewhere could also have a bearing on the global growth.

The special issue brings to you experts' insights into all these issues and many others amidst the anxiety, what's in store in 2017. ■

Amit Singh Sisodiya

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Caution – A Disruptive World Ahead!

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Don't expect the usual while we usher in the New Year. For, the stage seems to be all set for embracing a different world: a disruptive world. Many black swans have already appeared, while others are just lurking around the corner.

Trump

Some may harbor the idea that much of Trump's more extreme ideas are just electioneering rhetoric. America's robust democratic institutions will act as an effective safeguard. But with the GOP controlling both the House and the Senate, the new President will be much less hamstrung. What is more, besides character and brand, his macho nationalism plays to wide constituencies of angry blue-collar workers who voted him into the White House in the first place.

Trump remains highly flexible, if not totally unpredictable (which can be a useful ploy for negotiating deals). Nevertheless, there seems little doubt which way he is heading by looking at some initial picks for his top team.

Choice for Chief Strategist and Senior Adviser is Steve Brannon, CEO of Trump's final campaign, former Goldman Sachs, and chairman of Breitbart News, a well-known national platform for the extreme 'alt-right'. General James Mattis, nick-named "Mad Dog" and known hater of Iran and political Islam, is named

Defence Secretary, along with retired general Mike Flynn, who is opposed to the Iran nuclear deal. Jeff Sessions, the most anti-immigration voice in the Senate, is named Attorney General. There is also an array of savvy, top business executives, including ExxonMobil CEO Rex Tillerson, named Secretary of State; former Goldman Sachs partner and hedge funder Steven Mnuchin as Treasury Secretary; billionaire private-equity investor and "King of Bankruptcies" Wilbur Ross as Commerce Secretary; Goldman Sachs President and former Goldman commodities trader Gary Cohn, as National Economic Council Director; fast-food chain owner Andrew Puzder as Secretary of Labor; and Linda McMahon as Head of Small Business Administration, who is co-founder and former CEO of wrestling franchise WWE, a $650 mn listed company, and a fifth billionaire to join the wealthiest White House in modern history. If there is any doubt about Trump's priorities, Scott Pruitt is named Head of the Environmental Protection Agency. He is a well-known Climate Change denier, currently suing the EPA as Attorney General of Oklahoma.

On the positive side for the United States economy, there is a $2.5 tn treasure trove of American overseas investments. Bringing a substantial proportion back will boost economic growth and jobs, as will his avowed investment of $1 tn in re-building America's crumbling infrastructure. His massive tax cuts to 15% for corporate tax, drastically streamlining the 74,608-page tax code to just one-page for the small guys, abolition of inheritance tax, and removing constraints on the fossil energy sector are set to boost the stock market and headline numbers for the US economy. The greenback is likely to continue its upsurge.

However, on geopolitics and the world order, never before in post-war history has an American president-elect caused so much uncertainty and consternation, adversaries and allies alike. Is America abandoning globalization and its role as global policeman? Is Trump's presidency going to upend rules which have defined international trade for the past 70 years? Will he start a trade war with China and others deemed to hurt American jobs? Is "America First" going to mean that even strategic allies may not get a fair share except through American lens? Will he "bomb the hell of ISIS" while Islamic terrorism may shift elsewhere? Will he abandon the Paris Agreement on Climate Change and double-down on "Drill, baby, drill" even as OPEC has capped oil production? What happens to promised American financial contribution to help developing countries cope with Climate Change as its very validity is denied? Is Trump cozying up to Russia because of Arctic resources? Is any bilateral or multilateral commitment, such as the "One China Policy", only a commodity to be traded as and when the price is right? What will happen to the Western liberal world order underpinned by America's example as a shining city on a hill?

All these remain to be seen after Trump assumes the presidency. But signs are that he is unlikely to change his spots. And the whole world needs to adapt to this new reality, not least China.

Brexit and the future of Europe

With Brexit, the United Kingdom is now between a rock and a hard place. Triggering Article 50 under the Lisbon Treaty to start negotiations to leave the European Union will drop a slow-motion guillotine. Even if no deal is reached at the end of two years, the UK will be cut off under the Treaty, which is designed in the first place to prevent Member States from breaking apart. But unless Article 50 is triggered, no meaningful negotiations can start. Also, why should the EU give better terms to the UK if it means encouraging others to leave. All this is seriously rocking the boat, and the British pound has been falling.

Similarly, nationalistic anti-immigration political parties are gaining strength all over Europe. The Five Star Movement in Italy, the National Front in France, the Party for Freedom in the Netherlands, the Danish People's Party, and a new Alliance for Progress and Renewal Party in Germany, to mention but a few. All these parties are gaining ground while the ongoing Brexit momentum is fueling calls across Europe for similar referendum on leaving the EU. In particular, 2017 will see a presidential election in France and key elections in Germany and the Netherlands. The outcome may signal the beginning of the end of the Euro and the European Union as viable institutions.

China

Political development

2017 is also a decisive year for China, not just because of Trump.

The defining moment is the leadership transition scheduled to take place at the 19th National Congress of the Communist Party of China in the autumn. A great deal of political jockeying and infighting is already taking place behind the scene.

The prize is elevation to the 400 members or alternate members of the Central Committee, from which are selected the 25 members of the Politburo. Most members have a meritorious track record with at least two provincial leadership posts and a ministerial position before making it to the Politburo.

On top of the apparatchiks are the currently seven-member Politburo Standing Committee (PSC), China's top leadership cabinet, including President Xi Jinping, Premier Li Keqiang, and President Xi's right-hand man, Wang Qishan, the anti-corruption czar. Apart from the certainty that President Xi will be able to secure another term of five years as President from 2017, there are many imponderables as to the final makeup.

Since the 16th Party Congress in 2002, PSC members who were 68 or older at the time of a Party Congress have retired without exception. This is known as the rule of *qi-shang, ba-xia* (literally meaning "seven up, eight down"), referring to the convention that if a PSC member is 68 or older at the time of a party congress, he must retire, but if he is 67 or younger, he may still enter the committee.

Both President Xi and Premier Li are well within the retiring age limit. Four other members of the PSC will exceed the age limit and are expected to step down. Uncertain is the future of Wang Qishan, who will have reached 68 by the time of the party congress. As he has been instrumental in the Party's anti-corruption campaign which is entering deep waters, it is speculated that the conventional retiring age may be exceptionally relaxed to accommodate his retention, if not even promotion as Premier.

Additionally, any fresh blood making it to the Politburo and its Standing Committee as replacements will be rising stars of exceptional ability. These are set to drive the Party, including an eventual successor to President Xi after he finally retires.

Needless to say, the party politics involved are intertwined and extremely complex. At the time of writing, it is still too early to tell. In any event, the final outcome will dictate the course of China's development trajectory for decades, and by definition, the shape and dynamics of the vast country's economy.

Economic growth

China's Five Year Plan (2016-2020) seeks to double 2010 GDP and the per capita income of both urban and rural residents by 2020. The aim is to achieve a moderately well-off country by 2021, the 100th anniversary of the Communist Party of China (CPC).

According to a statement by President Xi, for this to be realized, annual growth for the 2016-2020 period must be at least 6.5%. According to a Reuters report of October 17, China's 2016 growth rate is expected to average 6.6%, within the range set by the government. While the economy slowed considerably in the course of various periods, growth has since somewhat stabilized, thanks to better-than-expected recovery and a host of accommodating measures, including relaxation of banks' Required Reserve Ratios (RRR).

However, growth in 2017 is expected to slow to 6.5% or worse, so the People's Bank of China is now on its toes to provide easing support if and when required.

Structural reforms

China's economic slowdown is due to a number of structural factors, including demographics and shift of resource-intensive exports to services, consumption and value-added growth. To sustain long-term growth, supply-side structural reform is essential. Nowhere else is such reform more critical than in China's mammoth state-owned enterprises relying on various forms of policy support or monopoly for survival.

During the March 2016, "Two Sessions" in Beijing where 3,000 provincial administrators, top businessmen and Chinese Communist Party (CCP) bigwigs met to discuss the Five Year Plan, Premier Li Keqiang spoke of using "mergers, reorganizations, debt restructuring and bankruptcy liquidations" to deal with "zombie enterprises" and added that the government will spend $15.3 bn to help those laid-off as a result.

> For most of the world, China in particular, 2017 is set to be a key milestone year, for better or worse!

What is more, a great deal of lending by China's massive state-owned banks is to state-owned enterprises where the marginal productivity of capital leaves much to be desired. This is part and parcel of China's immature system of 'financial repression' which mandates low bank-deposit interest rates. The Chinese people have few other safer options for their hard-earned cash. These big banks prefer to lend to cozy state-owned enterprises rather than much-more productive small-and-medium enterprises. Bank lending has pushed up corporate debt above 150% of GDP by early 2016. What is more, many of these state-owned enterprises are in the resource sector, resulting in massive excess capacity, e.g., in the steel industry. Much of the money has ended up in excessive property development, evidenced by rows and rows of empty buildings.

Thanks to these innate problems, China remains wary of opening up the country's capital account, which in turn hampers the exchange-rate flexibility of the renminbi, the Chinese currency. Absent such flexibility, full convertibility and status as an international reserve currency will continue to be beyond China's grasp.

The problem of the renminbi is now compounded by the rising strength of the greenback, to which the Chinese currency is informally linked. The expectant further weakening of the renminbi has prompted huge currency outflow through various proxy channels, exacerbating the currency's fall, despite the People's Bank of China's intervention to prop it up. With the coming Trump Presidency, this is likely to fuel accusations, however unjustified, of currency manipulation to drive down the renminbi to gain unfair trading advantage.

So much is at stake that a nationwide campaign is mounted to eliminate excess capacity, surplus housing stock, and financial leveraging, to lower costs, and to address various deficiencies including loss of employment due to restructuring. To boost long-term productivity, a "Made in China 2025" government initiative has been incorporated in the latest five-year plan to transform the country's manufacturing industries into "Ten Trillion Yuan" pillars in digital technology, biotechnology, green and low-carbon economy, high-end equipment and materials, as well as creative businesses.

Whether China succeeds in these restructuring challenges will determine whether she can overcome the classic "middle-income trap" to rise to the next level of development.

So for most of the world, China in particular, 2017 is set to be a key milestone year, for better or worse! ■

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