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Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

Jittery Emerging Economies Await a Season of Politics, etc.

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1. Overview Macroeconomic and Financial Risks (Trends & Topics)

Jittery Emerging Economies Await a Season of Politics (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy (CRMS) at Deloitte Touche Tohmatsu LLC/Deloitte Asia Pacific Risk and Capital Management Leader)

The perfect conditions that advanced economies have enjoyed may see a hint of cloud; the US, EU, and Japan have slightly felt a shift towards economic growth deceleration. The countries may, sooner rather than later, run up against a wall that limits their economic growth. Evidence of this can be seen in the US, where signs, however small, have appeared to show that wages and prices are creeping up once more. Meanwhile, in the midst of the Trump administration's escalating protectionist trade policy and the growing political and social backlash against the tech industry, intermittent risk-off trends have been getting stronger. In this environment, the probability of realization for the two scenarios facing the US and global economies (with opposite directions) have risen concurrently: The scenario of overheating economies and rising wage/prices, and the scenario of reversal of equity market rally by risk-off political and geopolitical events. In other words, the situation has become much more uncertain than before.

Concerning emerging economies (which could strongly be influenced by the US), most remain strong. Though there are some countries where uncertainty about intensifying trade friction and domestic political worries has translated to a mild worsening of the business sentiment. What is instead more worrisome is the rising tide of populist policies and strengthening authoritarianism in many emerging economies in the run up to the wave of elections that will happen in the second half of 2018 and into early 2019. Important countries with elections this year are Malaysia, Turkey, Mexico, and Brazil, while India, Indonesia, and Thailand etc. will go to the polls in 2019.

In presidential elections underway in Mexico and Brazil, support for far-right or far-left candidates has grown while concerns have sprung up that they will abandon their efforts in market liberalization and fiscal discipline. In preparation for their own elections, the growing trend in many Asia countries is towards budgetary excess. We can see examples of this largess in cash provisions for civil servants and pensioners in Malaysia, revival of fuel subsidies in Indonesia, as well as expanded infrastructure investments and debt bail-out for the agricultural sector in India. Also, it is very likely that we will see continued expansive government spending to keep the current business momentum in both Thailand and Turkey. As a result of this spending signs are popping up that both the budget and current accounts deficits (which they had worked to improve over the years) will once again expand for most countries. Democracy has also been in retreat in countries that established democratic governments in the 1990s. While the political and social influence of the US can still be felt, the similar growth in Chinese influence also forms a backdrop for the rising reliance of developing countries on China both economically and as a source of capital.

All the above situations warrant our careful attention to the impact of a sudden rise in US interest rates or a sudden rise in risk-off sentiment precipitated by political or geopolitical events on emerging economies. If countries are in distress because of capital outflows, they could see a helping hand in China, and China may see a way to expand its influence further in emerging economies. Conversely, if capital leaves China as well as emerging economies and China rushes to collect on its loans to emerging economies (whose loans may be an important source of foreign exchange reserve for China), they may after all have to rely on the help from the US or the IMF and lose their confidence in China.

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