Deloitte.
Private

Family Office Service:
Global Economics and Markets Newsletter

New wave of Emerging Market debt poses risk to global economy

January 2020

This Month's Big Themes

1. Emerging Market Debt

According to a study published by the World Bank in its latest Global Economic Prospects report, the global economy is experiencing the fourth wave of broad-based debt accumulation in 50 years. There were three historical waves of debt accumulation: 1970-89, 1990-2001, and 2002-09 and each one of these waves ended in a financial crisis across both developed and developing economies. The fourth wave began in 2010. In 2018, global debt reached a record high of about 230% of global GDP with total developing economy debt reaching an all-time high of almost 170% of GDP, an increase of 54% of GDP since 2010. The debt buildup in developing economies debt in this fourth wave has already been larger, faster, and broader-based than in any of the previous three waves.

Debt accumulation can be beneficial to an economy. For example public debt can be used to fund infrastructure investment which can generate jobs and increase productivity. Private sector corporate debt can be used for business and capital investment. Both public and private investment can boost an economy's potential GDP, fostering faster and more sustainable economic growth. Presently, low global interest rates can mitigate some risks, they can also encourage further borrowing at a time when the global economy is slowing. However, both government and business incomes are slowing also which may make it harder to service the debt. Having to service large debts can mean economies are vulnerable to external shocks (more so if debt is in a foreign currency) and it can limit the ability of governments to counter downturns with fiscal stimulus.

The World Bank notes that a growing share of such developing economy debt, particularly private sector debt is being held by non-resident investors. Thus, there is a growing exposure to foreign currency risk. It also notes that the lion's share of the increasing debt to GDP ratio is due to private sector rather than less-secure public debt.

For now, there are two risks that should concern investors. First, if there is a further slowdown in the global economy, perhaps driven by trade tensions, it could exacerbate the difficulty of servicing emerging market debts. Second, if the trade conflicts between major countries worsen, it could hurt the ability of emerging markets to boost exports. That, in turn, would hurt the ability to service foreign currency debt.

Source: https://www.worldbank.org/en/news/feature/2020/01/08/january-2020-global-economic-prospects-slow-growth-policy-challenges

2. US-Chinese after the 'Phase-One' deal

Although the US and China have signed a modest trade agreement that is more of a truce than a trade deal. It requires that the US forego new tariffs, modestly cut some existing tariffs, and remove China from being designated a currency manipulator. In exchange, China pledges to boost purchases of US goods and not manipulate its currency. However, the reality is the agreement leaves in place massive US tariffs on USD 360 billion in imports from China. Furthermore, the average tariffs imposed by each country on the other remain very high relative to recent history. According to the Peterson Institute for International Economics, as of early 2018, the average US tariff placed on Chinese imports was 3.1%. Currently it is 21.0%. With the new agreement, the average tariff will drop to 19.3%. Under the agreement, China

will also slightly reduce tariffs. China's average tariff on US imports was 8.1% at the start of 2018 and is now 21.1%. With the new agreement, that number will drop to 20.9%. Thus, the agreement leaves tariffs historically high and not much reduced from late 2019. The US will continue to impose punitive tariffs on two thirds of all imports from China, including 93% of intermediate inputs, 69% of consumer goods, and 40% of capital goods.

Source: https://www.piie.com/research/piie-charts/us-china-trade-war-tariffs-date-chart

3. Effects of the trade dispute on the US economy

What exactly are the negative effects of the trade dispute? A study conducted by the Atlanta Federal Reserve in conjunction with Stanford University and the University of Chicago offers estimates of the economic impact. The authors of the study conducted a survey of large US corporations.[1] It found that, in the first half of 2019, about 12% of companies said they reduced or postponed capital expenditures. This included 24% of companies that produce goods and only 4% of companies that produce services. In addition, 22% of manufacturing companies said they cut or postponed capital expenditures. The authors estimate that this implied a USD 36 billion reduction in capital expenditures in the first half of 2019, or a decline of 3.8% below what would otherwise have been the case. This is consistent with GDP data showing that business investment declined in the second and third quarters of 2019.

Source: https://macroblog.typepad.com/macroblog/2019/11/new-evidence-points-to-mounting-trade-policy-effects-on-us-business-activity.html

4. Trilateral Trade Talks

Deloitte's global chief economist picked up on a piece of the news that has largely been ignored by the media. Recently "trilateral" talks have been held by the trade negotiators for the US, EU, and Japan. One of the goals was to improve the rules of the World Trade Organization (WTO) regarding subsidies. The phase one deal between the US and China failed to address US grievances about Chinese subsidies, and so now it seems the US is taking a new approach by engaging in multilateral discussions. Actually this is an old approach that had, until lately, been abandoned by the US. In the last three years, the US has been focused on bilateral as opposed to multilateral trade discussions, on the assumption that it has greater leverage in bilateral situations. The latest discussions imply an acknowledgement that there are times when multilateral discussions are useful and impactful. Moreover, the latest discussions suggest an acknowledgement that the US will have greater leverage with China if it cooperates with its traditional allies.

In any event, the three participants want to add four new categories to the list of subsidies that are banned by the WTO. These are unlimited guarantees; subsidies to insolvent businesses that lack a restructuring plan; subsidies to companies that cannot obtain private sector funding and that suffer from excess capacity; and subsidies that are effectively a form of debt forgiveness. All of these clearly apply to many Chinese state-owned enterprises (SOEs). The trilateral group sees such subsidies as creating an uneven playing field for global companies that want to compete in China. Moreover, enforcement of these new guidelines would actually benefit China in that they would compel Chinese SOEs to reform or die.

Source: https://www.reuters.com/article/us-usa-trade-eu-japan/u-s-japan-eu-to-meet-on-china-ahead-of-wednesday-trade-deal-signing-ustr-idUSKBN1ZD01N

Country/Regional Updates

1. Japan

Genuine concerns for the Japanese economy will start to arise now after the December Services PMI slipped below 50 for a second time in Q4 2019. The November PMI print was 50.3, which suggests growth, albeit very moderate, this follows from an October print of 49.7. In December the print of 49.4, points to a very moderate contraction. However, the print of 49.4 does represent the lowest level since September 2016. The manufacturing PMI recorded a value of less than 50 in 10 of the 12 months in 2019. With the lowest prints coming in both October and December 2019 with a value of 48.4. Combined with the weakness in Q4 2019 service PMI numbers, the composite PMI recorded prints below 50 in each month of the fourth quarter. Investors and analysts have feared the Japanese economy may begin contracting in Q4 2019 and the PMI would certainly reinforce that bias.

Source: https://tradingeconomics.com/japan/composite-pmi

---

[1] Please see the Global Economics and Markets Newsletter December 2019 regarding a description of a new dataset that measures business expectations and uncertainty. The survey used to create the aforementioned data series was used to create this piece of analysis.

Real wages, (wages adjusted for the effects of inflation) declined in November 2019, suggesting additional stress on the economy following October's consumption tax increase as well as the general weakness in industrial and services data.

Real wages fell 0.9% y/y in November 2019, the biggest drop since July 2019. This follows a decline of 0.4% y/y in October 2019. Although the government was quick to dispel the decline as a result of the consumption tax increase, nominal total cash earnings fell 0.2% y/y in November 2019, following no change in October 2019. It is clear the wages are in a period of decline which is often the case when economies enter a period of economic slowdown. This is reinforced by overtime pay, which is considered to be an indicator of corporate activity declined 1.9% y/y in November 2019 after a 0.1% y/y fall in October.

Source: https://tradingeconomics.com/japan/composite-pmi

The latest forecasts from Oxford Economics, a leading economic consultancy, suggest Japan's economy will slow to 0.3% y/y in 2020 following its estimate the Japanese economy expanded 1% y/y in 2019. The drivers for the slowdown include a continuing weaker external environment as well as weak wage growth and weaker household consumption due to a loss of purchasing power from higher tax and falling wages.

2. United States

Housing starts in the United States soared in December 2019, reaching the largest number of starts since December 2006, just prior to the collapse of the US housing market. The number of starts in December was up 16.9% m/m and up 40.8% y/y. The increase was across the board, encompassing both single family homes and multi-unit residences; and encompassing all regions of the United States. There are three factors that would explain such a large increase. First, housing data is highly seasonal, and the numbers reported by the government are adjusted to account for that seasonality. Normally, starts fall in December due to cold and disruptive weather but December 2019 was unusually warm. Thus, starts were likely higher than normal because of good weather. Second, the US Federal Reserve cut interest rates three times in 2019 and, with tame expectations of inflation, bond yields remained low. Thus, borrowing costs for builders were very favorable. Finally, a strong job market with solid job growth and low unemployment, boosting consumer confidence. This led to increased sales of homes and contributed to greater confidence on the part of builders. All these factors led builders to start construction in anticipation of strong demand.

Source: https://www.census.gov/construction/nrc/pdf/newresconst.pdf

3. China

China's government reported that the Chinese economy grew 6.1% in 2019, the slowest rate of growth in 29 years – but remaining within the government's growth target of between 6.0 and 6.5%. In the fourth quarter of 2019, the economy was up 6% y/y, the slowest pace of quarterly growth since 1992. China is currently facing a number of challenges that are acting as a headwind to growth such as the trade conflict with the US, slower growth in multiple markets around the world, a high level of debt, excess capacity in industry which has stifled investment, cautious behavior on the part of consumers, and a declining working age population. Moreover, the latter demographic problem is likely to intensify over time. The government reported that the birth rate in 2019 was the lowest since records began despite the government ending the one child policy. The demographic problem is a structural problem that will be a headwind to growth in the future whereas the other headwinds to growth are more short-term in nature.

Source: http://www.stats.gov.cn/english/PressRelease/202001/t20200117_1723398.html

Global equity prices rose in the early part of January 2020 as the People's Bank of China (PBOC), substantially reduced the required reserve ratio (RRR) for commercial banks by 50 basis points. The effect will be to release roughly USD 115 billion into the economy. The new RRR for large banks is 12.5% and the rate for small and medium sized banks is 10.5%. Since early 2018 the RRR has been cut eight time in an effort to stimulate credit market activity at a time when the economy has been slowing. In addition, the government indicated concern that there will be an increase in the demand for cash for the Lunar New Year holiday. The PBOC's actions may suggest the government is not expecting any significantly positive economic impact following the implementation of the phase one trade deal with the United States.

Source: https://www.reuters.com/article/us-china-capex/china-capex-growth-hits-three-year-low-as-weak-economy-trade-war-drag-idUSKBN1Y809F

4. Eurozone

In the Eurozone, December 2019's service PMI reach a four-month high of 52.8, up from November's 51.9 in November to 52.8. For now, the growth of services is offsetting the dismal performance of manufacturing, thus allowing the Eurozone economy to continue growing – albeit very slowly. The composite PMI rose to 50.9 in December 2019, up from 50.6 in October and November. The lowest print was 50.1 in September 2019. The strongest growth of services took place in Spain and Ireland. In Germany, which has the worst performing manufacturing sector in the Eurozone, the services PMI rose from 51.7 in November to 52.9 in December, a four-month high. Although new orders for services in the Eurozone accelerated, export orders for services continued to decline. Among service industries, the strongest growth was in tourism and hospitality as well as telecoms services.

The manufacturing sector of the Eurozone, especially Germany, remains very weak. The PMI declined from 46.9 in November 2019 to 46.3 in December. This is a level reflecting a sharp decline in activity. The PMI has been below 50 for eleven consecutive months. Germany continued to have the lowest PMI in the region at 43.7, a level indicating a very sharp decline in activity. Meanwhile, the PMIs prints for the Netherlands of 48.3 and Italy of 46.2 fell to an 80-month low. Spain's PMI was also low at 47.4. Among the major Eurozone economies, only France had a favorable PMI at 50.4. For the region, the sub-index for output fell at a rate not exceeded in seven years. New orders fell at one of the fastest rates in seven years. Thus, Markit concludes that "a return to growth remains a long way off." Markit also noted that "only households provided any source of improved demand in December, underscoring how the consumer sector has helped keep the economy out of recession in recent months." This may explain the relative strength of French manufacturing which is disproportionately dependent on the production of consumer goods. Germany's weakness reflects the troubles in Europe's capital goods sector. That, in turn, is largely due to trade concerns and weakness in the global economy.

Source: https://www.markiteconomics.com/Public/Home/PressRelease/39dc7f18e8f04b16b790298e7dbbd06e

Germany industrial woes continued in November 2019 when industrial orders fell 1.3% month-on-month and 6.5% y/y following weak external demand linked to various trade disputes around the world and Brexit. Foreign demand fell 3.1%, the biggest drop since February, whereas domestic orders rose 1.6%. The reading for October was revised up to a rise of 0.2% from a previously reported fall of 0.4%.

Source: https://www.reuters.com/article/us-germany-economy-industrial-orders/german-misery-continues-as-industrial-orders-fall-unexpectedly-idUSKBN1Z70W3

According to first statistical release, German real GDP grew 0.6% 2019 y/y. This means the German economy has grown for ten years in a row: the longest period of growth in a united Germany. However, growth lost momentum in 2019. In the previous two years, real GDP grew much more strongly (by 2.5% in 2017 and by 1.5% in 2018). Compared with the average of the last ten years (+1.3%), the German economic growth in 2019 was lower. Despite this weak growth, unemployment remains low at 3.1%, also a record during a unified Germany and wage growth remains moderate at 1.9% y/y in September 2019, but this is an increase on 1.2% in July and 1.3% in August. Germany's problems are linked to the slowdown in its aforementioned industrial sector.

Source:
https://www.destatis.de/EN/Press/2020/01/PE20_018_811.html;jsessionid=2C3341BFA4ACAEF4C94BCA54683FB166.internet732

5. United Kingdom

The results of the Q4 2019 survey of British CFOs conducted by Deloitte demonstrates the positive impact the results of the December 2019 general election had on business sentiment. The survey results are clearly indicative that it was the impact of political uncertainty that was the driver of weaker business uncertainty over the past few years, leading to a decline in business investment in the wider economy. CFOs reported the biggest-ever increase in optimism in the 11-year history of the survey, taking it to its highest-ever level. The scale of the improvement eclipses previous surges in confidence following interest rate cuts during the financial crisis in 2009 and the European Central Bank president's pledge to "do whatever it takes" to save the euro area in early 2012. The uncertainty that has beset the UK since the EU referendum in 2016 now appears to be lifting. CFO perceptions of external uncertainty have fallen from one of the highest ever readings to near-average levels. The topic of Brexit has been at the top CFOs' worry list since the EU referendum but has dropped to third place in Q4 2019. The top two risks are now 'weak demand in the UK' and 'rising geopolitical risks worldwide'.

Clarity on the nature and timing of the UK's formal exit from the EU, if not future trading arrangements, seems to have bolstered CFO spirits. The election of a political party with a commanding parliamentary majority, and an end to the

immediate possibility of a radical Labour government, have further reduced political uncertainty. Brexit is no longer the top concern for CFOs, who expect UK corporates to increase capex for the first time in four years.

Source: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/finance/deloitte-uk-cfo-survey-2019-q4-report.pdf

Recent Bank of England research, drawing on CFO Survey data, testifies to the toxic effect of uncertainty on investment. With reduced uncertainty has come a strong rebound in CFO expectations for business investment. Whether this translates into greater corporate activity this year will depend on a continuing positive trend in sentiment and uncertainty. But all things considered, CFOs go into 2020 with sentiment at levels that would have been unimaginable at any time in the last three years.

Source: https://www.bankofengland.co.uk/speech/2019/michael-saunders-speech-at-barnsley-and-rotherham-chamber-of-commerce

6. Singapore

The Singaporean economy grew 0.7% y/y in 2019 (real GDP), following growth of 3.1% in 2018 and 3.7% in 2017. On a quarterly basis, Q4 GDP grew 0.8% y/y in Q4 2019, up from 0.7% in Q3 and 0.2% in Q2. With total trade exceeding more than 300% of GDP, Singapore's economy is at the mercy of the global economy and with global trade, manufacturing and investment slowing, Singapore's economy feel's the full effects. In Q2 2019, on a q/q basis, the economy contracted 2.6%. Although the quarterly y/y figures point to improving growth profile, the q/q figures point to an economy barely growing, in Q4 2019, the GDP grew 0.1% q/q.

Source: https://www.singstat.gov.sg/-/media/files/news/advgdp4q2019.pdf

Capital Markets

Following the US government assassination of General Qassem Soleimani, considered to be the second most powerful man in Iran, the initial response from global financial markets was very volatile, with oil future prices rising to their highest levels since September, following the drone attack on the Saudi Arabian oil facilities, as did other commodities, especially gold, given its safe-haven properties. Equity prices and bond yields fell in response except for the share prices in oil producers and defense-related companies.

1. Equities

After Iran 'retaliated' by firing missiles at two US military bases in Iraq On January 8, 2020, but immediately afterwards both sides looked to de-escalate the situation. President Trump did not order a counter-attack and Iranian officials had apparently said they do not desire an escalation. The result of the de-escalation was to send both the NASDAQ and the S&P 500 equity indexes to record highs.

Source: https://www.reuters.com/article/usa-stocks/us-stocks-sp-500-nasdaq-hit-record-highs-as-us-iran-escalation-fears-fade-idUSL4N29D3WV

Alphabet, the parent company of Google, on Thursday 16th of January 2020 the fourth US company to reach a market capitalization in excess of USD 1 trillion. The other US companies to reach such a feat are Apple, Amazon.com and Microsoft.

Source: https://www.reuters.com/article/us-usa-funds-google/which-company-just-hit-1-trillion-google-it-idUSKBN1ZF2SH

2. Commodities

Oil prices also responded to the de-escalation of tensions, falling 5% on January 8th. WTI the U.S. crude benchmark, settled down USD 3.09, or 5%, at USD 59.61. It was WTI's first slump beneath USD 60 since mid-December. Just earlier on Wednesday, it hit an April 2019 high of USD 65.65 as news of the Iran attack on two U.S.-Iraqi airbases sent oil rallying in Asian trading hours. Brent, the global benchmark for crude, lost USD 2.47, or 3.6%, by 3:30 PM ET (20:30 GMT) to trade at USD 65.80. It fell to USD 64.94 earlier, cracking the USD 65 support. Brent had peaked at USD 71.28 on Wednesday on news of the Iran missile attacks.

Source: https://www.investing.com/news/commodities-news/oil-slumps-5-as-trump-stands-down-on-iran-us-inventories-shock-2055049

Useful Resources

Investing	Economic Data	Economic Analysis
・ investing.com	・ United States: Bureau of Economic Analysis	・ Deloitte Insights: Economics
・ MarketWatch	・ United States: Bureau of Labor Statistics	・ Deloitte Weekly Global Economic Update
・ Yahoo! Finance	・ Cabinet Office of Japan	・ International Monetary Fund
Central Banks	・ European Commission: Eurostat	・ Project Syndicate
・ Federal Reserve Board	・ United Kingdom: Office for National Statistics	・ Organization of Economic Cooperation and Development
・ Bank of Japan	・ National Bureau of Statistics of China	・ Central Intelligence Agency: The World Factbook
・ European Central Bank	・ Federal Reserve Economic Database	・ Aon: Political Risk Heatmap
・ Bank of England	**News**	
・ People' Bank of China	・ Reuters	

All of resources presented above are publically available. The inclusion of these resources is not an endorsement, nor a guarantee of their accuracy made by Deloitte Touche Tohmatsu Limited.

About Deloitte Private Japan and Family Consulting

Deloitte helps private companies, their owners, and individuals with substantial assets apart from businesses they operate to understand, plan and execute effective business and tax strategies — adjusting course when needed to respond appropriately to potential tax consequences of new legislation and evolving market conditions.

To this end Family Consulting offers four services directly to families who own and manage business and family assets:

- Family governance;
- Contingency planning;
- Family successor training service;
- Family office services.

For more information on the Family Consulting service, visit our website at:
www.deloitte.com/jp/family-consulting-en

The Family Consulting team eliminates the question "I don't know who to ask..." by acting as the relationship manager of our clients, supporting the prosperity of their families through a unified contact point for inquiries, no matter how complicated the matter may be and to do this Family Consulting works closely with our colleagues across Deloitte Private domestically and globally to assist families and their businesses with:

- Income tax advisory and compliance services;
- Owner and family wealth planning;
- International tax and estate consulting;
- Family enterprise consulting;
- Succession Advisory Services
- Cross-border Succession and Reorganization Support
- Family Governance and Council Support for Owner Family

Newsletter Archives

This is a free newsletter. To see past issue, please visit our website.
www.deloitte.com/jp/family-consulting-en

Deloitte Tohmatsu Tax Co.
Family Consulting, Deloitte Private
Emi Kono, Partner
Marunouchi Nijubashi Building, 3-2-3 Marunouchi, Chiyoda-ku, Tokyo 100-8362, Japan
Tel +81 3 6213 3800
email tax.cs@tohmatsu.co.jp
Corporate Info. www.deloitte.com/jp/en/tax
Tax Services www.deloitte.com/jp/tax/s/en
Family Consulting Services: www.deloitte.com/jp/family-consulting-en

Deloitte Tohmatsu Group (Deloitte Japan) is a collective term that refers to Deloitte Tohmatsu LLC, which is the Member of Deloitte Asia Pacific Limited and of the Deloitte Network in Japan, and firms affiliated with Deloitte Tohmatsu LLC that include Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and Deloitte Tohmatsu Corporate Solutions LLC. Deloitte Tohmatsu Group is known as one of the largest professional services groups in Japan. Through the firms in the Group, Deloitte Tohmatsu Group provides audit & assurance, risk advisory, consulting, financial advisory, tax, legal and related services in accordance with applicable laws and regulations. With about more than 10,000 professionals in nearly 40 cities throughout Japan, Deloitte Tohmatsu Group serves a number of clients including multinational enterprises and major Japanese businesses. For more information, please visit the Group's website at www.deloitte.com/jp/en.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms and their affiliated entities are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Shanghai, Singapore, Sydney, Taipei and Tokyo.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500®companies. Learn how Deloitte's approximately 286,000 people make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

Member of
Deloitte Touche Tohmatsu Limited

© 2020. For information, contact Deloitte Tohmatsu Tax Co.

IS 669126 / ISO 27001