2018 Economic outlook from the Economist Intelligence Unit

On the January 2018 KPMG/NACD Quarterly Audit Committee Webcast, Leo Abruzzese, Global Forecasting Director for the Economist Intelligence Unit (EIU), painted the picture of a global economy operating with a significant tailwind: coordinated growth across major developed economies, a return to a more normal interest-rate environment in the United States, and maturation and reform taking hold in certain developing economies.

However, as Abruzzese told Jose Rodriguez, Executive Director and Partner-in-Charge of the KPMG Audit Committee Institute, the U.S. political climate has become a determining factor for the length and strength of the current global economic expansion.

“Right now, we’re in the sweet spot,” said Abruzzese, “but I don’t think this has many more years to run.”

Wavering U.S. policy could dampen existing trade relationships and sour some reliable partners. Directors and executives who tuned in the for the Webcast appeared to agree with his observations—39 percent of Webcast attendees surveyed cited geopolitical instability or uncertainty as the greatest risk to the health of the U.S. economy over the next few years.

In your view, what is the greatest risk to the health of the U.S. economy over the next 2–3 years?*

Geopolitical uncertainty/instability	39%
Reaching peak of normal business growth cycle	18%
Failure to address deficit	18%
Stagnant wages	6%
Financial systemic risk	5%
Climate severity	4%
Global competition	4%
Other	5%

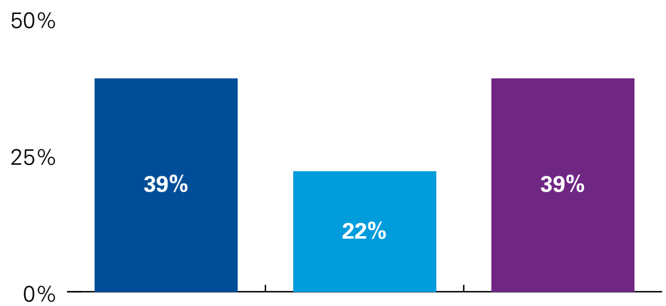
**Of 962 corporate directors and senior executives surveyed during the Jan. 18 webcast.*

The global stance of the current U.S. administration is shifting political and economic influence around the world, with China finding its voice on the world stage and Russia reemerging as a geopolitical force, said Abruzzese. How will Japan and India respond? What could cause China to falter?

United States

While 39 percent of directors and executives surveyed during the Webcast said that the recently enacted U.S. tax cuts will make their companies more competitive over the long term, Abruzzese said the consensus view is that the tax cuts will only marginally enhance U.S. growth in 2018 and are expected to have less impact after that. “We were looking at 2.1 percent or 2.2 percent U.S. GDP growth in 2018—with the tax cuts, it could be closer to 2.3 percent,” he said.

Will the recently enacted U.S. tax cuts make your company more competitive over the long-term?*



Consumer confidence is strong and businesses are investing, but wage growth is not significant. Abruzzese added that, “The U.S. recovery is complete,” as indicated by a 7 percent increase in total U.S. jobs since the beginning of the recession and 87 consecutive months of U.S. job growth. “The unemployment rate is down to 4.1 percent and could get to as low as 3.7 percent.”

Consumer sentiment is high and consumer balance sheets are less leveraged. Business investment has responded to demand over the past several years, and Abruzzese believes that higher profits from corporate tax cuts will be returned to investors. On the horizon, however, is the potential for as many as seven interest rate hikes over the next two years by the Federal Open Markets Committee, which could help bring an end to the current expansion in 2020.

Global outlook

In the **Euro zone**, the multiyear recovery is now "stronger and broader," while Brexit-related issues and negotiations have contributed to slower U.K. growth—"it's a protracted process." Political risk remains "a source of vulnerability, but the contagion threat is limited," said Abruzzese.

The 19th Party Congress in October "confirmed President Xi Jinping as most powerful leader of **China** since Mao Zedong," said Abruzzese. "Xi has centralized power, ousted rivals, and tightened controls. We're used to viewing China as an economic force, but now it's emerging as a political force as well," said Abruzzese. By not identifying an heir apparent, Xi may try to extend his presidency beyond 2022. China's private nonfinancial sector debt is expected to rise to more than 250 percent of GDP by 2022, above peak indebtedness that precipitated several modern credit crises around the globe, but Xi remains committed to 6.5 percent growth in 2018. In response to a question from Rodriguez about the impact of China's declining purchases of U.S. government debt, Abruzzese said that with rising rates, "a bond buyer such as China may be less interested in buying."

Growth in **India** is expected to accelerate to nearly 8 percent in 2018 as the services sector expands and domestic consumption fuels growth.

Latin America's largest economies, specifically **Brazil** and **Colombia**, are expected to grow faster in 2018, though the pace of growth in **Mexico** is not expected to move, said Abruzzese, who believes that the "business community wants NAFTA" and that "it will change, but not disappear."

In **Saudi Arabia**, the recent anti-corruption initiatives of Deputy Crown Prince Muhammad bin Salman have drawn "broad support" while the country prepares for the eventual public listing of state oil company Aramco this year. And African economies are diverging as growth slows among the continent's largest countries, including **Nigeria** and **South Africa**, while reform-focused, less resource-dependent countries such as **Ghana, Kenya,** and **Tanzania** experience rapid growth.

Even as challenges emerge, global GDP growth of 2.9 percent is expected, according to an EIU aggregate analysis. Yet, for 2018 and beyond, the EIU enumerates five key economic risks for companies and boards to consider:

1. **Interest rates and bond yields, key indicators of the cost of capital, are increasing in most markets. How will investors react?**
2. **Easy money policies from central banks compelled investors to look for alternate sources of return, driving up asset prices, particularly real property and equity.**
3. **Capacity constraints in the U.S. and China, in particular, raise the specter of inflation.**
4. **Unwinding central bank balance sheets of assets acquired following the financial crisis is unprecedented and fraught with challenges.**
5. **China's ability to manage its own debt could develop into its own crisis.**

For the full replay and other highlights, visit kpmg.com/aciwebcast.

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