



Global political outlook 2017

A joint Finsbury & Hering Schuppener report

2017



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Dear reader

Recent political shocks have shown that the broad public consensus in favour of the benefits of free trade, market economics, and even the primacy of the rule of law can no longer be taken for granted.

The rift between the perceived winners and losers of globalisation has grown wider over the last few years, and with it the cultural and political divide. Wage stagnation following the financial crisis has made this situation worse. There is a sense that the economy only works for a few at the top of our societies. Many people feel left behind as a result.

On top of that, social media is polarising opinion and there has been a collapse in trust in our institutions. For years, mainstream political parties have staunchly defended free enterprise. But politicians are responding to this new environment by seeking to intervene more, adopt more extreme positions and bypass the mainstream media.

It is more critical than ever that companies – and their leaders – play a more active role as corporate citizens to protect their license to operate. Doing so requires first and foremost a keen understanding of political and social trends. It necessitates demonstrating that businesses add value to the economies and societies in which they operate. And it compels companies to participate fully in the relevant political debates, taking a stance and making their case to all relevant groups who influence their reputation with a research-driven message.

This applies to all businesses, whether local or international, big or growing, established players or disruptors. Supporting companies in achieving this aim, Finsbury and HERING SCHUPPENER have created a global strategic partnership to help clients navigate the global communications, political, and regulatory challenges they face.

In the following report we have collected insights and analysis from across our global offices regarding the political landscape at the beginning of 2017. We hope that you find this report thought-provoking and we would be delighted to discuss the challenges you face.

With our best regards,

Roland Rudd

Chairman of Finsbury

Ralf Hering

Principal Partner &
CEO Hering Schuppener



EUROPE: HOPE AGAINST THE ODDS

While the EU appears to face another year of existential crisis, 2017 could turn out to be a surprisingly positive year for the union.

On the surface of things, the European Union seems to be a patient in intensive care: Brexit; the risk of populist parties disrupting or even dismantling the entire European project; a US administration acting as a cheerleader for EU disintegration; plus the lingering risk of a return of the Euro crisis triggered by Greece and/or even Italy.

Despite these uncomfortable and real risks, there is a strong argument to be made that Europe could actually emerge much stronger from 2017 compared to its state when it entered it.

Reasons for (cautious) optimism

First – and this is the essential precondition for the case for optimism – despite the focus on the risk of a populist victory by Marine Le Pen in France or Geert Wilders in the Netherlands in both countries' upcoming elections, the more likely outcome is that centrist candidates and convinced pro-Europeans will ultimately prevail. In France, victory for Emmanuel Macron would raise the prospect of long-due structural reforms, supporting a much more positive narrative for Europe going forward.

Second, Europe's economy has quietly managed to gather steam. Job creation has been at a new nine-year record in January, with Eurozone growth even outpacing US growth last year. Growth is healthy and increasingly dynamic in a number of member states. With the ECB's loose monetary policy expected to continue for some time sustaining, consumption and (to a lesser degree) investment, the prospects for 2017 are much more positive than headlines would suggest.

Third, Brexit is acting as a unifying force for the remaining EU member states.

While the advancement of the formal negotiations, combined with increasing pressure from the business lobby, will create some tensions between members, there is a strong awareness among governments and industry that unity and focus will protect Europe's most attractive asset: the single market. Seeing its merits more clearly, the EU's remaining member states are likely not only to defend it, but also to advance it in 2017.

Fourth, recent tensions in EU-US relations and the risk of a stronger US detachment from Europe acting as a glue keeping Europe together even more solidly – particularly in the area of defence, where closer cooperation and industry consolidation are on the cards.

Finally, the risk of populist backlash is providing policy-makers from Europe's centrist parties with a greater sense of common purpose, preparing the ground for compromises on issues that would previously have been highly controversial. Take for instance the recapitalisation of Italian banks that saw the European Commission and key member states quietly agree on a compromise solution that didn't strictly abide by the rulebook, but has proved highly effective.

Politics meets policy – key trends in 2017

Against the backdrop of Brexit, the evolving policy agenda of the Trump administration, and European public sentiment, some key trends are likely to shape the EU's economic policy agenda this year.

First, globalisation will face the regionalisation of regulation. Europe has been an essential pillar of global regulatory harmonisation in fora such as the G20 and international regulatory bodies. While EU officials remain convinced of the benefits of a global level playing field in key areas of regulation and standard-setting, there is a growing realisation that this must not come at the expense of European economic interests. Where global minimum standards are no longer achievable, or where they work against EU interests, Europe is willing to leverage the strength of its single market by setting its own regulatory framework accordingly. Good examples of this are initiatives towards creating a European energy union by opening up national renewable support schemes, discussions on imposing steel tariffs, or requirements for non-EU financial firms to establish EU holding companies with their own capitalisation in the area of banking union.

A key area for this has been and will continue to be the digital sector. Here, the emerging regulatory framework has a huge impact on business models and on who will win and who will lose. The coming months will see regulatory interventions such as the Commission's new initiative on taxing the sharing economy, investigations into anti-competitive behaviour in platform economies (e.g. into algorithm-based collusion) or intensified scrutiny of financial technologies. In addition, existing

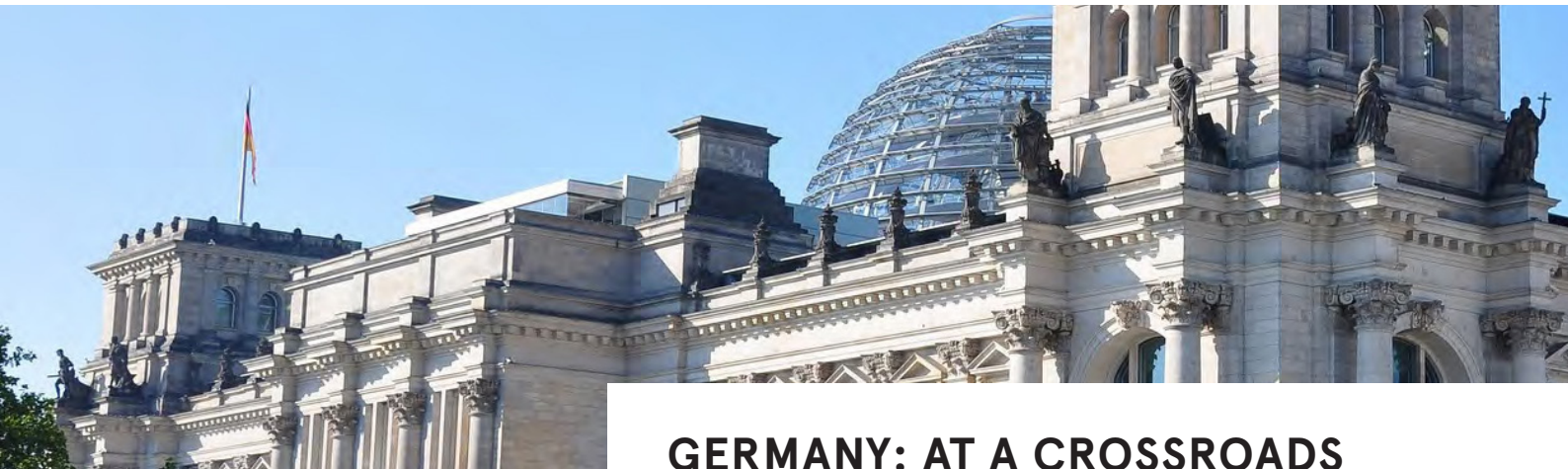
regulatory instruments such as the EU Merger Regulation are being adapted with a view to bringing companies that have a high valuation but little actual revenue into the ambit of DG Competition. These processes can still go both ways for the affected businesses: regulators' decision on which path to take will come down to businesses' ability to explain – ideally early on in the process – the value-add of their service for the economy and society at large. If positioned well, data-based businesses stand a good chance of gaining exemptions from strict data protection, social or even competition rules.

Finally, Europe will be at the forefront of the fight against perceived excesses of globalisation – not least because the Commission is keen to counter the impression that the single market only benefits big business. To do so, the EU will continue to use the full range of its instruments at hand. Businesses should expect more antitrust investigations into corporate tax practices, potentially followed by legislative proposals. Another example of activism is the focus on the potential anti-competitive effect that institutional investors have on markets via their cross-shareholdings, especially if those asset managers are increasingly perceived as too-big-to-fail.

Impact for businesses

Where do these developments leave businesses? The interplay of politics and business takes place in a public policy game that is more politicised than ever: dispelling antitrust concerns, activating/shielding from trade defence, setting and/or shaping the regulatory agenda comes down to having the right strategy, with the right timing to engage with politics in Europe. Beyond that, businesses have to put their cards on the table and communicate – not only their interests, but also their positions on the bigger picture. Companies have to speak up and play their part in making sure that Europe emerges stronger than ever from 2017. Only if they are partners of politics, will politics be a partner to their business.

Dr. Nikolaus Tacke – Managing Director at HERING SCHUPPENER, Brussels
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GERMANY: AT A CROSSROADS

As Germany heads into a crucial election year, Europe's economic powerhouse is facing new challenges.

For the last decade, Germany has been one of the bright spots among the world's economies, achieving consistent growth, low unemployment and a strong fiscal balance sheet, earning the country a reputation as Europe's economic and political centre of stability. However, as the country warms up for September's Federal elections, the question is how much it must adapt to stay ahead in the face of a changing global environment.

Export-based business model looks increasingly vulnerable

Germany's business model for the last twenty years has been to maximise the potential benefits from open trade and global economic integration. The share of exports to GDP has continuously risen over that period and amounts to almost 50 per cent today, with one in four jobs tied to exports. However, as the risks of protectionist tendencies and regulatory fragmentation emerge, this business model suddenly seems vulnerable. This is particularly due to the fact that Germany has faced criticism over its substantial trade and current account surplus and the underlying economic and fiscal policy course it has advocated over the last decade. While conservative German policymakers and central bankers have long rejected these criticisms, international pressure is mounting for the country to rebalance its economy towards greater domestic investment and demand.

These discussions are spilling over into the domestic policy discourse. There is a growing debate about whether the Federal government's focus on fiscal consolidation is too narrow-minded and ignores the long-term challenges Germany's economy faces: Germany's infrastructure is ageing and the investment level is well below the

OECD average (measures to upgrade its digital infrastructure have been particularly insufficient); energy policy has been patchwork and is proving increasingly costly for consumers and businesses; and the approach to regulatory change in light of technological innovation and changing markets has been piecemeal and at times under-ambitious. What is more, Germany's education system has serious weaknesses ranging from high inequality to lack of talent development in science and IT.

So far this has not affected growth, but there is growing concern that the country is slowly losing its competitive edge and must do more to prepare for increasing global competition, digital disruption, demographic change, and potentially a less open global trading environment. The next government therefore faces the task of addressing these looming challenges.

Federal elections

Germany's federal elections will not take place until September, leaving a long period for events to influence the dynamics of the race.

Although the media and pundits are focussing on the prospect of the right-wing populist Alternative for Deutschland (AfD) entering parliament as a sign of a populist backlash in Germany, mainstream parties are still amassing a solid share of 75–85% in opinion polls, manifesting Germany's reputation as Europe's anchor of stability. The biggest potential game-changers during the German campaign would be a victory for Marine Le Pen in France, or Geert Wilders in the Netherlands, putting the future of the European Union and the Eurozone in jeopardy, Berlin in crisis mode and the legacy of Angela Merkel's chancellorship under different spotlight.

Angela Merkel's CDU is centring their election campaign around the chancellor's reputation as a respected leader and guarantor of stability in turbulent times, seeking to tap into Germans' preference for stability. While Merkel's course during the migration crisis has hurt her popularity ratings somewhat, this has not yet translated into a widespread voter sentiment for a change of government. That said, it is her election to lose, as all other parties will seek to feed into the lingering discontent with her political leadership.

The nomination of European Parliament president Martin Schulz as the Social Democrat's chancellor candidate has reshuffled the cards, as illustrated by the strong surge for the SPD in the polls. While the party will have to run a strong campaign in order to secure a viable governing option, Schulz is positioning himself as a credible alternative to Merkel. Well known as straight talker with working class roots, he is campaigning on a platform of societal fairness, pro-growth and investment measures, and is strongly pro-European.

However, while Angela Merkel and the CDU (bolstered by its Bavarian sister party CSU) are still in a favourite position to come out first, her governing options are likely to be more difficult. The next parliament will be more fragmented with the expected re-entry of the liberal party and the addition of right-wing AfD, making coalition-building a daunting challenge. That said, continuation of the grand coalition of CDU/CSU and SPD is likely only if the coalition maths offers no other option, as both parties are worried that they will lose acceptance among fringe voters.

In terms of policy, a CDU led government would seek tax reliefs for the middle classes and increase spending on domestic security, whereas a SPD led government would prioritise infrastructure investment and additional resources in education. Coalition scenarios make the Green party's involvement in the next coalition likely, which would result in a stronger focus on reforms to shift the automotive sector towards clean energy and the agriculture and food sector towards a more sustainable model.

Impact for businesses

Given Germany's dependence on open trade and a rule-based order, the country is expected to continue to defend that order and take on even more global responsibility. Its current G20 presidency that will culminate in the summit in Hamburg in July is a key priority in 2017. In addition, the German government has already assumed a leading role in aligning the EU's Brexit strategy, which will be a mammoth task for the next Federal government. Equally, the next government is expected to develop a long-term plan for the future of European integration – ideally reviving the Franco-German alliance.

At the same time, in light of growing disenchantment with globalisation among German citizens, German policy-makers will continue to pursue policies that aim at reigning in the perceived excesses of global capitalism. Whether caps on bonuses for management boards, pushing for a reform of the global corporate tax regime, or strengthening protection of workers in the digital economy, the next government is likely to come up with a range of new proposals.

One particular area of increased political sensitivity concerns the M&A market. Transaction success for cross-border mergers or acquisitions is more dependent than ever on the involved parties' ability to reflect societal, political, and regulatory interests in their plans. A proposed reform that would empower the German government to block foreign acquisitions if they run counter to national interests (i.e. they pose risks not only to public security, but also to the protection of key technology) is just the most visible symptom of the growing clout of policy-makers and regulators in M&A transactions.

Finally, the next German government will be instrumental in driving the debate on regulatory change in response to digitisation both in Germany and in Europe – affecting business models dependent on the free access to and use of data, and raising disputes over IP rights, data proprietorship, as well as liability and insurance cover and taxes for autonomous machines. Understanding regulatory risks and opportunities early on and successfully feeding into the incoming government’s approach will be vital, both for established players or disruptive challengers.

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UK: THE DAYS OF PASSIVE GOVERNMENT ARE OVER

As the national wounds caused by the Referendum continue to bleed, Prime Minister May must prepare the country for Brexit negotiations with the EU.

The United Kingdom has, for much of its recent history, sought to have a disproportionate impact on the world. On 23 June 2016 it inadvertently got its wish, with its decision to leave the European Union.

The implications of this seismic event have not merely been felt within the UK. The success of the Leave campaign, especially via its infamous leading light Nigel Farage, gave encouragement to that other populist political outsider, Donald Trump, and has caused severe anxiety amongst leading EU leaders who fear hard-right uprisings at home.

The next twelve months for the UK economy will be dominated by how its political leaders balance the immediate needs of delivering a successful programme of government with the short to medium term economic and social challenges triggered by its decision to divorce from the EU.

The national wounds caused by the Referendum will take many years to heal, if at all. However, one of the few developments with which most people tend to agree is that Theresa May was the best (or the least worst) option as Prime Minister to have emerged from the aftermath of the unseemly and bitter campaign.

The new Iron Lady or Theresa Maybe?

May is a political survivor and a shrewd operator, who survived an entire parliamentary term as Home Secretary, often the most precarious job in government. Her approach has tended to be risk-averse, relatively unspun (at least in comparison to Blair and Cameron) and with a steely moral code, as befits the daughter of a vicar.

She has gone to great lengths to be seen to do things differently. For the first time since Thatcher, the UK has a Chancellor of the Exchequer whose job is simply to fulfil that role rather than to be the de facto second in command/groomed successor, which has made this the most dominant Number 10 in living memory. She has also taken counterintuitive positions towards business, by challenging bad corporate behaviour; scrapping Cameron's Business Advisory Group; criticising excessive pay; and highlighting the lack of female representation in boardrooms. Although in some instances she has already rowed back from her original strident positions, the general principle has remained the same, namely that this is a government which will intervene and on its own terms.

The much-anticipated Industrial Strategy was published in January, outlining the economic interventionism which May promised – most notably in the form of spending money in the UK regions that predominantly voted for Brexit. It had been expected that she would also provide clarity on which strategically important sectors would be protected, with particular companies no longer necessarily up for sale to the highest bidder. However, this has proven to be more complex than first anticipated and a separate consultation is being developed for publication later in the year.

Although the acquisition of ARM Holdings by the Japanese company SoftBank was permitted to proceed back in the summer, it only received a public endorsement from the PM and Chancellor once the acquirers had made legally binding pledges on maintaining the existing HQ and increasing employee numbers. This sends a strong signal that any foreign company seeking to buy up a British asset must put political engagement at the heart of its strategy because the days of passive government are over.

The UK economy

In terms of the economic outlook, it is difficult to know whom to trust. Significant damage was caused by the perceived scaremongering made by several forecasting bodies (who were regarded as having supported the Remain campaign) in the run up to the Referendum poll. The catastrophic mistake made by Chancellor George Osborne was to create the impression that in the event of a Brexit vote, the economy would instantaneously collapse leading to a swift recession. This simply did not happen and the UK economy has thus far bucked each and every gloomy forecast.

The subsequent relative health of the economy has only further emboldened the Brexiteers, many of whom now have significant roles in the Cabinet. However, the principal Brexit shocks have barely begun to be felt and a number of major challenges lie ahead, such as a spike in inflation which may overpower the moderate increase in wages, and the implications of the record-breaking levels of personal debt of UK citizens. Low interest rates have helped to keep people in their homes, but millions of people are barely managing (a group targeted by the PM's policy team) and any sudden economic shock in the global financial system could be economically, socially and politically disastrous.

Brexit

Despite all the usual challenges of managing a major economy, the Prime Minister has to prepare the country for Brexit negotiations with the EU. Despite the legal challenges mounted against the government, and the subsequent need to get parliamentary approval, May is still likely to trigger Article 50 in March. To suggest the current administration is not ideally tooled up for what comes next is perhaps the political understatement of the decade. No country of this economic size and influence has ever attempted what the UK is now undertaking, and with fundamentalists on both sides calling for seriously conflicting outcomes, Theresa May is unlikely to keep everyone (perhaps anyone) happy.

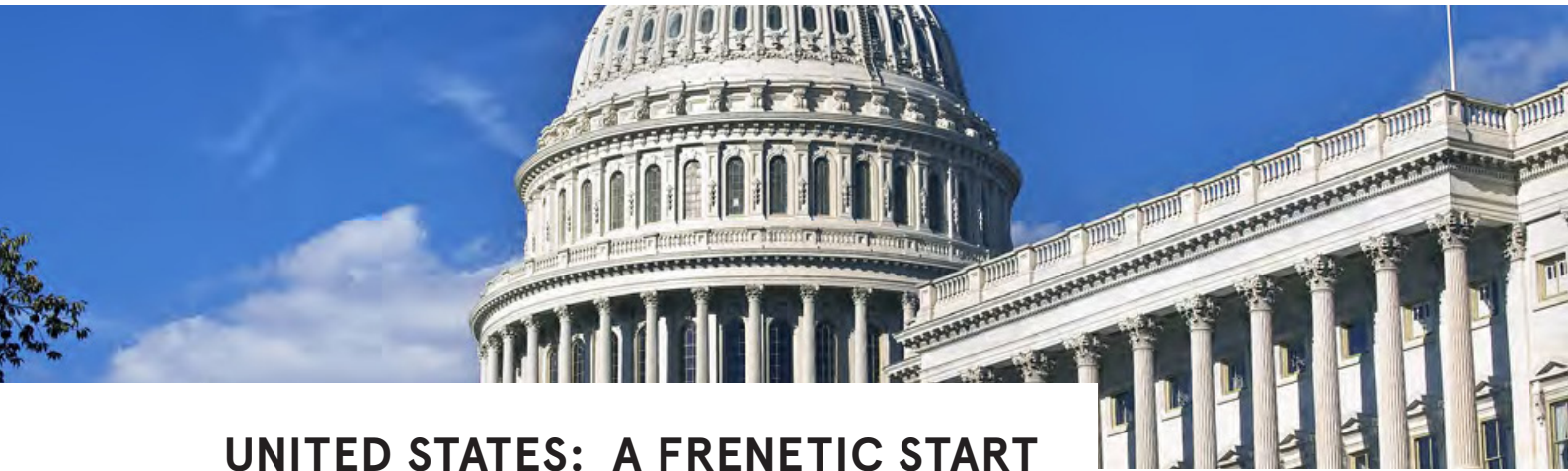
The options for withdrawal are on a spectrum ranging from falling back on a World Trade Organisation (WTO) relationship with the EU, to remaining part of the single market with no real substantive change. There are many potential deals in between these two positions, but privately Number 10 believes it can negotiate an agreement where the UK formally leaves the single market and then pays for significant access.

Impact for businesses

Despite the tough talk on business, the government needs to demonstrate that, despite Brexit uncertainties, Britain remains open for business and that the country has a bright economic future. That means the government is still prepared to bend over backwards to accommodate the wishes of internationally mobile firms. This creates a window of opportunity in the first half of 2017 to approach the government with a wish list of key asks to ensure that they are incentivised to remain committed to the UK.

Additionally, companies cannot overestimate the value of providing solutions for the government, rather than just highlighting the problems businesses are facing. Unless we see a dramatic change in British politics (unlikely in the short to medium term given the absence of an effective Opposition), Brexit will happen, and given that the government is apparently making up its response on a day to day basis, all companies will need a clear and effective strategy to navigate through these unprecedented times.

Scott Colvin – Partner at Finsbury, London



UNITED STATES: A FRENETIC START

As power struggles heighten at the White House and several thousand political posts remain unfilled, President Trump continues to tick off a long list of policy goals in rapid-fire succession.

President Donald Trump has had a whirlwind beginning to his term, signing executive orders and issuing public policy pronouncements in rapid-fire succession. Although many of his actions have been greeted with concern, including by some Republicans in Congress, many steps have been consistent with his campaign pledges. He withdrew the United States from the Trans-Pacific Partnership (TPP) trade deal. He signed an order directing federal agencies to eliminate two regulations for every one regulation adopted. Another directive ordered the construction of a wall along the U.S. border with Mexico and to speed up deportation of undocumented immigrants. He helped clear the way for the Dakota Access pipeline and Keystone XL pipeline to be approved. He also nominated a conservative judge to the Supreme Court, Neil Gorsuch, to fill the vacancy left by the death of Antonin Scalia. Now, as Vice President Mike Pence, Secretary of State Rex Tillerson and Secretary of Defense Jim Mattis head to Europe for high-level meetings, their counterparts are likely to ask them about Trump's views on critical economic and security issues and his leadership style.

Trump's most controversial executive order has been the one following through on his pledge of "extreme vetting" in an effort to reduce the risk of domestic terrorism by halting the entry of people into the United States from seven majority-Muslim countries in the Middle East. This move has had global repercussions, generated protests at airports across the country, and led over 100 U.S. companies to oppose the ban. Handing Trump his first legal setback as president, a federal judge issued a ruling blocking the order, which was upheld by a three-judge panel of a U.S. appeals court, drawing criticism from Trump. Global businesses that have employees who were affected by the ban have breathed a sigh of relief, but the situation is far from clear.

While Trump rode a wave of populism to win the election, he has since aligned himself more closely with Wall Street, tapping several current and former Goldman Sachs executives to serve in his administration, as well as other deal-makers. The president has taken steps aimed at rolling back financial regulations from the Obama era, drawing praise from Wall Street but also raising questions from the populist wing of his supporters. A memorandum he signed opens the door to reversing the fiduciary rule that requires financial advisors to act in their clients' best interests when providing retirement advice, instead of pursuing the highest profits for themselves. If the Labor Department finds the rule is having an adverse impact on investors' ability to get advice, the order allows the agency to revise or rescind it. Opponents of the rule complain it would create significant costs that they would have to pass onto investors, while supporters of the rule argue it is necessary to protect consumers.

A number of Trump's conversations with foreign leaders have raised eyebrows by creating tensions with traditional allies and questioning longstanding policies. A meeting with Mexican President Enrique Peña Nieto was cancelled after a Tweetstorm over who would pay for the border wall that Trump wants to build. A call with Australian Prime Minister Malcolm Turnbull went badly after he asked Trump to honor a refugee agreement that had been reached with President Obama. During a call with French President Francois Hollande, Trump vented that the United States was being taken advantage of by China and international bodies like NATO. On a more reassuring note, his early visits with counterparts – British Prime Minister Theresa May, Japanese Prime Minister Shinzo Abe and Canadian Prime Minister Justin Trudeau – appeared to go well. And last week he signalled to Israel that expanding settlements was not conducive to finding a solution to the Arab-Israeli conflict, and told Chinese President Xi Jinping that he would maintain the longstanding U.S. policy of "One China." In addition, he has affirmed the importance of NATO while asking all allies to shoulder a fair share of the costs.

The reality of governing

As can often be the case, especially at the beginning of an administration, power struggles are underway inside the White House. The more conservative wing is led by chief strategist Steve Bannon while more mainstream Republicans are led by White House Chief of Staff Reince Priebus. With help from Jared Kushner, the president's son-in-law, all three players are trying to figure out a path toward achieving the president's goals of cutting taxes, rebalancing trade, ramping up defense and infrastructure spending, and curtailing government healthcare programmes.

Amid these power struggles, the administration is still trying to fill several thousand political appointments in the federal government. Trump will also now have to deal with the fallout from the abrupt resignation of National Security Advisor Michael Flynn, and try to instill greater trust in the White House and his national security apparatus.

The president has staunchly defended his Cabinet post picks. His choice for the Labor Department, Andrew Puzder, has withdrawn but so far the rest have won confirmation, even his controversial pick for the Education Department, Betsy DeVos. A number of his picks, such as Secretary Mattis, Secretary Tillerson and Secretary of Homeland Security James Kelly, are viewed as pragmatists who can work with both Democrats and their foreign counterparts. While Trump has complained that it is taking too long to get his team through the Senate, it took until late April 2009 for Obama to have his full Cabinet in place.

The list of policy goals Trump hopes to achieve is long. While some of them can be realised through agency action, his most important ones – tax reform, repealing and replacing the Affordable Care Act (also called “Obamacare”), and overhauling trade policies and agreements – will require cooperation with and action by Congress. While Trump and the Republicans control the executive and legislative branches, Democrats have made it clear that they will not go quietly along with policy choices they do not support. Senate Democrats hold enough seats to block most controversial legislation, due to the 60-vote supermajority required to end filibusters. While Republicans only need a simple majority to undo key budget parts of the Affordable Care Act, they need Democrats on board to replace it. House Speaker Paul Ryan said he hopes to complete repeal and replace efforts this year, but that timeframe does not appear realistic as congressional Republicans have yet to coalesce around a replacement strategy. It remains to be seen whether the White House will start to try to drive a legislative agenda and proposal on this and other priorities, or let Ryan and Senate Majority Leader Mitch McConnell take the lead.

One of the most complex issues that may divide traditional Republicans from the president are changes to U.S. trade policy. In addition to withdrawing from the TPP, President Trump has vowed to renegotiate NAFTA and to put a higher priority on bilateral trade deals than regional and multilateral agreements. Prospects for U.S.-EU negotiations to forge a Transatlantic Trade & Investment Partnership (TTIP) remain unclear. During May’s recent visit, she and Trump discussed the possibility of a future bilateral trade deal once the United Kingdom completes Brexit. After his meetings with Abe, Trump said Japan and the United States would launch a high-level dialogue on trade issues.

The business community has aggressively defended NAFTA but is divided over a border adjustment tax that would tax the cost of imports but make revenue from exports tax exempt. This Republican proposal is an attempt to boost U.S. exports and pay for a substantial corporate tax rate cut, but – like the tariffs Trump has threatened against Mexico and China – it could lead to higher prices for consumers, retaliation by foreign governments, and legal action at the World Trade Organization (WTO).

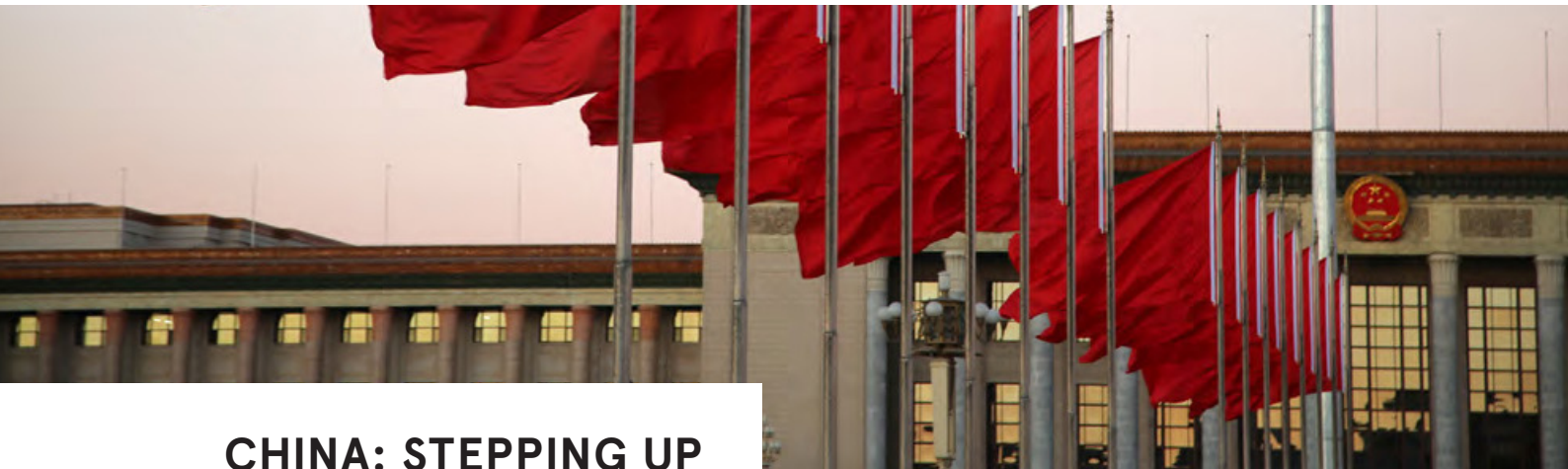
Impact for businesses

The frenzy of the first few weeks has made it difficult to predict the president's next move, or how strongly he will stick to previous positions. This is disconcerting for U.S. and global companies that thrive on certainty, but they are learning to be more flexible and focus on the advantages of clear and consistent messaging. Some are supporting Trump on certain issues – such as job creation – while opposing him on others – such as immigration.

Recent polls show Trump's approval rating has turned negative, which is unusual for the opening weeks of an administration. Republicans are starting to feel some pressure from constituents who have flooded town hall meetings to express concerns, especially over the prospect of losing health insurance. There is also bipartisan worry about how Trump and his team will handle rising global tensions, whether they be from Iranian missile tests, additional provocations by North Korea, or the myriad of challenges posed by Russia in Eastern Europe and the Middle East. The new administration is still getting its feet wet, and it is possible that a new National Security Advisor can help it move towards a firmer footing.

The change in administrations creates significant opportunities and risks for U.S. and global companies. To stay ahead of the curve, businesses and organisations must be nimble and responsive to the fast-moving developments in Washington. They must reassure their investors, customers, employees, and other stakeholders with effective internal and external communications that show they understand these shifts. They need to forge relationships with a broad range of key players as well as be ready to defend their reputations. A number of companies have already come under political fire, while others are successfully navigating this new environment. While uncertainties remain, it is clear that the new administration has reshaped the political landscape, requiring companies and institutions to take pro-active steps to be ready to respond strategically and protect their interests.

Ambassador Miriam Sapiro – Partner at Finsbury, Washington D.C.
Jeremy Pelofsky – SVP at Finsbury, Washington D.C.



CHINA: STEPPING UP

Following his much noticed defence of globalisation at Davos, President Xi is seeking to reconcile China's domestic economic agenda with its international trade interests.

How times change. In 2016, China found itself caught in a highly politicised diplomatic wrangle about whether it would be granted market economy status fifteen years after its accession to the WTO. At the beginning of this year, China's president Xi used his visit to the WEF in Davos to deliver a rigorous defence of free trade and globalisation, raising at-tendees' hopes that China would step up to become a defender of the world's open trade system at a time of growing protectionist threat. The speech was welcomed at home and internationally, but also raised questions on exactly which concrete measures Beijing is will-ing to undertake in 2017.

A sustainable economy

China's GDP grew by 6.7 per cent for the full year, which is well within the target range of 6.5-7 per cent set by the government.

Via the "Belt and Road" programme and the Asian Infrastructure Investment Bank initiative, Beijing is undertaking significant investments in and beyond China. Equally, China's economy is seeing rapid growth in high-tech, consumer and the services sectors.

At the WEF, President Xi acknowledged that financial risks, lack of internal growth drivers and the excess industrial capacity remain the key challenges for China in the coming year.

Although the discussion agenda is yet to be disclosed for the Fifth Session of the 12th National People's Congress and the Fifth Session of the 12th Chinese People's Political Consultative Conference in March this year, China is expected to continue to push forward its economic development transition, namely the supply side reforms aimed at increasing the efficiency and competitiveness of major industrial sectors. This is to be achieved by driving innovation, with a view to adjusting overcapacity in the manufacturing sectors, while also considering and studying the needs of consumers in order to boost domestic spending and the growth of the services sector. This applies both to inward efforts to attract quality foreign investment to China and the outward efforts of encouraging the Chinese companies to go global.

In December 2016, new government regulations indicated the trend towards stricter scrutiny of outbound M&A deals in the real estate, hotel, entertainment and sports business sectors, mega investment in non-core business, and any investment which is considered as nonstrategic. As a result of this, although China outbound M&A in 2017 might not see a surge in volume, the total value of future deals may remain unaffected as China is looking for both domestic and external oriented development through more strategic investment, to acquire advanced technology and industry know how, expand market share, and hedge against currency impact. Deals of strategic value are still encouraged where the acquisition of the targets can be integrated into the existing core business. However, in response to the new regulations, currency exchange approval might take time and some of the M&A activities might be directed back to domestic and Asian markets which are on the "Belt and Road" map.

This all points to the fact that China has realised that, in many areas, it has lacked sufficient funding, professional expertise, and adequate competition. It also acknowledges the role of the non-public sector, of which foreign investment is a vital part, as an important component of China's economy.

Tentative steps towards encouraging foreign investment

An important aspect of China's economic policy – especially following the Davos speech – concerns China's new openness for investment. While this has been an issue of much complaint for foreign companies in the past, the Chinese government's most recent decisions give reason for optimism. Last December, the National Development and Reform Commission and the Ministry of Commerce jointly announced the seventh proposed update to the Catalogue for the Guidance of Foreign Investment Industries (the Catalogue), cutting the number of restricted measures for foreign investment from 93 to 62.

As China is currently trying to stop capital flight, it is hoped that by removing sectors from the restricted list, foreign capital will come in again and drive economic development. To maintain the stable investment environment, the Catalogue

continues to encourage foreign investment in modern agriculture, advanced manufacturing, the high-tech sectors, energy-saving and environmental technology, and the modern services industry.

Furthermore, according to the statement issued on 16 December 2016 after the Central Economic Work Conference, which sketched out the guiding economic policies and priorities for the next year, China will take substantial steps in mixed-ownership reform in the electricity, oil, natural gas, railway, civil aviation, telecommunications and military industry sectors. The statement also highlights that mixed-ownership reform is where state-owned enterprise reform can make breakthroughs.

Political stability

On the political side, aggressively countering corruption at all levels remains one of the key priorities. While the policy is not universally popular, it is believed to be key to ensuring the legitimacy of the Communist party going forward. During the four-day meeting of the Sixth Plenary Session of the 18th CPC Central Committee held in October 2016, the party leaders approved documents on the discipline of the Party. Comprehensive and strict governance in the Party is the focus of the Sixth Plenum.

All Party members were asked to “resolutely improve” Party governance and enhance government service standards. The message was clear: do more for the wealth of the people, do less for your personal gain.

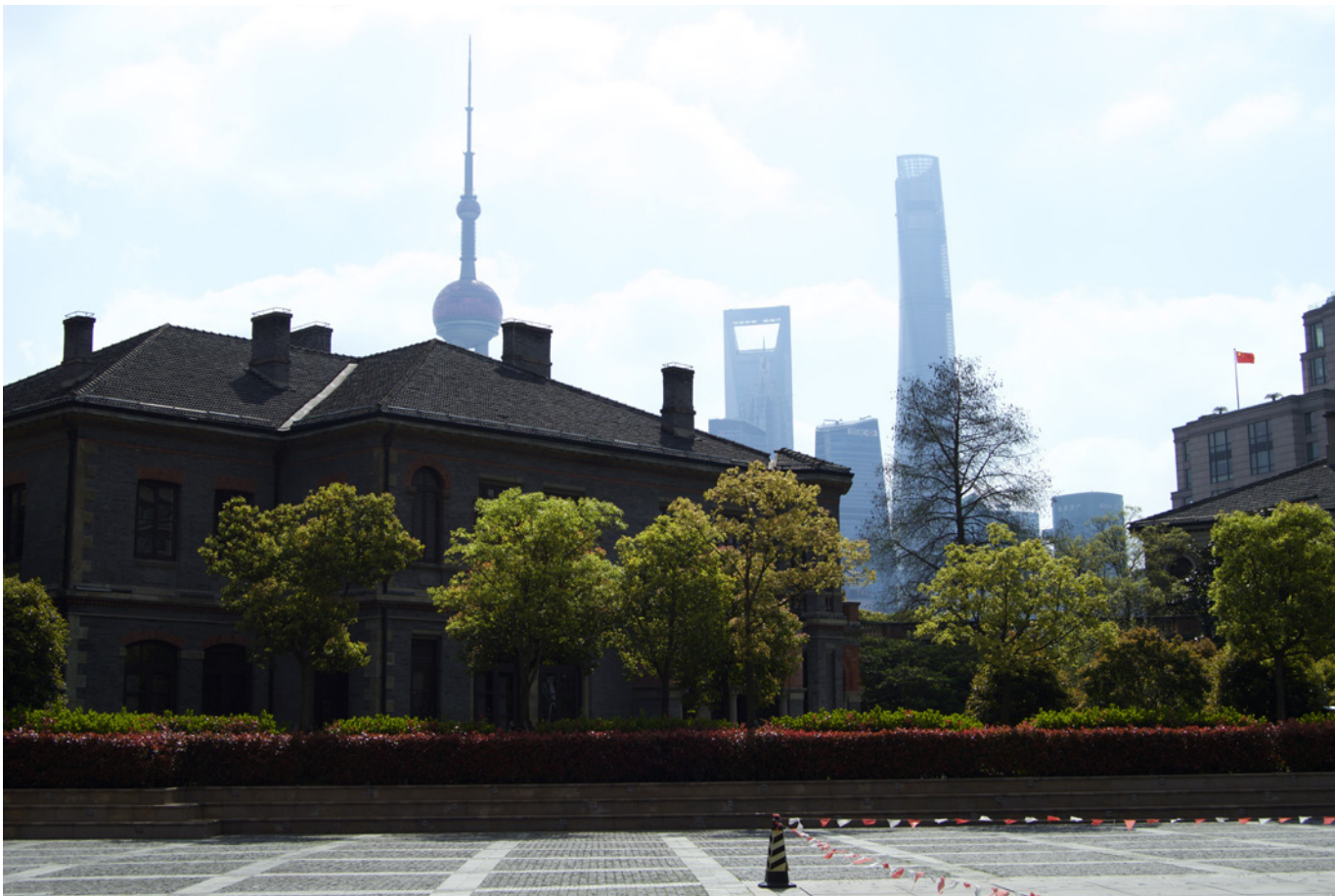
The policy has also bolstered the increasingly strong political position of President Xi himself, who is due to start his second five-year term as leader of Communist Party, especially after he was designated as “core” of the Communist Party’s Central Committee at the Sixth Plenum, an honorific title that has been bestowed on only a few of China’s leaders.

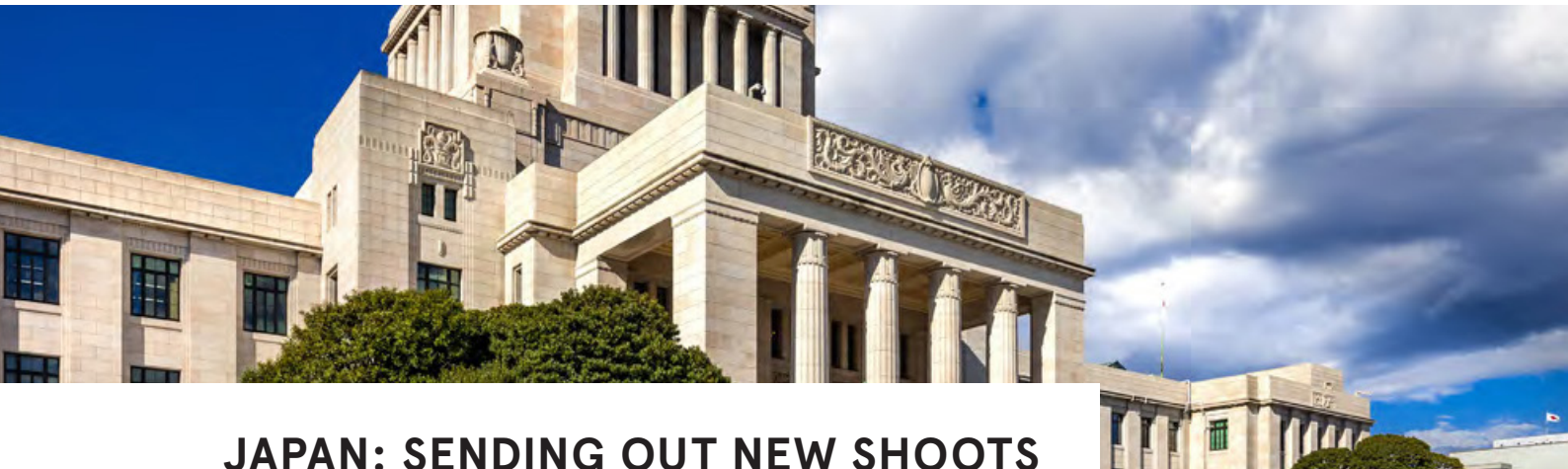
Impact for businesses

With this as the backdrop, 2017 is set to see more sharing of technology, IP and best practices by foreign companies as China actively courts overseas investment, advances structural reform to create more space for growth and sustain its momentum, and seizes opportunities presented by the new round of industrial revolution and digital economy.

Corporations, for their part, need to be mindful of three key points. They need to be fully prepared for the political and operational risks that the anti-graft campaign poses; they must be willing to explore new and innovative ways of working with government agencies to ensure investment opportunities; and they must accept the fact that they will be expected to help put the nation back on the fast-growth track it seeks.

Agnes Zhao – Head of Finsbury Beijing





JAPAN: SENDING OUT NEW SHOOTS

Amid the uncertainties and geopolitical risks at the beginning of 2017, Japan is emerging as an unlikely bright spot.

Prime Minister Shinzo Abe's successful visit to US president Trump, at which Abe managed to persuade Trump to reconfirm the close security relationship and raise hopes for a positive trade agenda, is the latest sign of Japan's growing international visibility which Abe hopes will reach its climax at the 2020 Olympic Games in Tokyo. 2017 will be a critical year for him, as he will have to showcase the success of his reform agenda before his governing Liberal Democratic Party of Japan (LDP) decide next year on whether to confirm him as their party president, thus permitting him to exceed the two-term limit hitherto stipulated by party rules. Realising that personal dream will depend on his 2017 record, so we can expect to see Abe-san raise the stakes this year in his efforts to showcase a vibrant and resurgent Japan.

Signs of growth – signs of hope

Embers of growing economic hope are now appearing in several data, showing a tightening labour market, strengthened domestic consumption and increased business investment, leading to an uptick in annual GDP growth from 0.7% in 2016 to approximately 1.0% anticipated for 2017. Indeed, after more than twenty years of deflation, there is currently a modest but at least positive inflation rate of 0.2%.

The first two of the Prime Minister's 'Abenomics' arrows have stabilised an economy that was in the doldrums in late 2012, driving a recovery in asset prices and investment activity while achieving a normalised exchange rate that has allowed corporate Japan to generate significant improvements in profitability. However, these successes are underpinned by monetary and fiscal policies that beg the question as to how long they can be sustained without meaningful structural reforms, the third of Abenomics' three arrows.

Fattening wallets, changing minds

Last autumn, Abe articulated his reform plans, targeting labour productivity and income, and pledging to reform the structure of Japanese agriculture in 2017. Of these, labour reform is the area in which many global investors are hoping Abe will make the most concerted effort to boost the economy by shifting employment practice away from the inflexible and costly protections currently enjoyed by many full-time workers in Japanese companies. Such an achievement can be expected to generate a surge in corporate restructuring, and offer opportunities for foreign acquirers. Hon Hai's acquisition of Sharp signals an opening of the floodgates.

But hand-in-hand with this, Abe is also aiming to boost popular sentiment and confidence that economic recovery is here to stay. His administration is pushing companies to share a greater proportion of their increased profits with their workforces in the form of higher salaries, and to ensure that labour reforms are household-friendly. Thus far, higher incomes for workers have chiefly been paid as higher bonuses rather than through pay raises and, although this has helped spur an increase in consumption, it has not achieved the degree of growth which Abe had hoped for. The administration will be particularly keen to promote wider participation in the labour market, thus underpinning a sense of optimism around rising household incomes, and erasing Japan's deflationary mindset.

Sacrificing old allies for new growth

No aspect of Japan's economy is more vulnerable to its changing demographics than its agricultural sector. Traditionally a bastion of support for the conservative LDP, it is now at the centre of proposals for fundamental reforms to boost competitiveness and incomes. At the heart of the proposed reforms is a shake-up of the monopoly over procurement of farm supplies and output hitherto enjoyed by Japan's National Federation of Agricultural Cooperative Associations. Success here will not only prompt much needed consolidation and efficiencies, but will be another key factor in Abe's chances of re-election as LDP president in September 2018.

None of these domestic reforms, however, will remain immune to events outside Japan. Much to his credit, Abe has not been slow or shy in addressing this fact and he can be expected to work quickly on alternatives with both the US and with other partners on a successor to the abortive Trans-Pacific Partnership (TPP). Abe fully realises that Japan's access to foreign markets and assets are tied to the openness of global trade; the success of his meeting with President Trump has sparked hope that Japan will be able to keep these routes open.

Impact for businesses

This active championing of open international trade and resistance to protectionist sentiment tallies with Japan's strong reliance on exports and open markets. This is sustained by Japanese companies' expertise in the field of industrial digitisation and machine-to-machine communications, considered a key market during the next few years. There is every reason, therefore, to expect the momentum for mergers and acquisitions involving Japan to continue apace in 2017. While outbound mega-deals such as Softbank's acquisition of ARM Holdings are testament to Japanese firms' continued interest in establishing themselves outside their home market, Hon Hai's acquisition of Sharp also demonstrates the degree to which Japan itself is opening to restructuring of less competitive industries.

With the Abe administration committed to a stewardship code for institutional investors to play their part in corporate reform, there should also be greater confidence among foreign investors in the shift of corporate governance standards in Japan towards global norms.

Although the pressure of Japan's demographics and the uncertainties of the international environment are increasing the pressure on the Abe administration to deal with the tangle of policy issues it currently faces, 2017 should provide a predictable and politically stable outlook for the country. Outside any 'unknown unknowns', Japan should be set for a year in which its leader continues to grow in international stature and its companies seek strategic assets, giving it both a voice on the world stage and a growing presence in key markets. Likewise, its continuing reforms lay out a welcome mat for those seeking to make Japan their next market or strategic growth story.

Aston Bridgman – Principal and Co-President of Finsbury Japan, Tokyo.



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