



Still On Track, Albeit Slippery Slope

Global economic growth seemed on track to reach 3.9% in 2018 (20basis points higher than 2017), according to the International Monetary Fund, given the rapid expansion in the Euro Area, Japan, China and the United States. Recovery in commodity exporters such as Brazil, Mexico and major SSA countries is also expected to provide some support to global output expansion.

However, escalating trade tensions between the two largest economies, U.S. and China, which threatens to entangle Europe, Mexico and Canada, has since dampened sentiments in recent months. More tariffs could be imposed by the U.S. on China if its fiscal policies drive its trade deficit higher without any action in Europe and Asia to curtail surpluses. In advanced economies, the need for a forward thinking policy perspective is imminent, as aging populations and lower projected advances in total factor productivity also pose as a downside risk to projected growth.

Finally, while global growth seems bent on proliferation, worthy of noting is that favourable environments may not last forever. Attention needs to be placed on vigilant and forward-looking management of monetary and fiscal policies, as well as financial stability in developing countries. Structural and tax policies that raise potential output, investing in people and ensuring that the fruits of growth are widely distributed, are also important.

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Broader and Stronger

The global economic upswing that began in mid-2016 has become broader and stronger. The upswing in global investments and trade has continued to foster growth during the period under review. At 3.8%, global growth in 2017 was the fastest since post-crisis era of 2010 which grew at a range of 3.2% to 3.5%. We have continued to witness an upswing in emerging Europe and even more signs of recovery in several commodity exporters in the Middle East and Sub-Saharan Africa. Nonetheless, economic activities and sentiment in the global space in H1 2018 has been shaped by Tax reforms in the U.S., Geopolitical tensions in the Middle East and escalating trade tensions between China and the U.S., which has threatened to spread to other American and European Economies.

Geo-Political Tensions in the U.S, Middle East and China

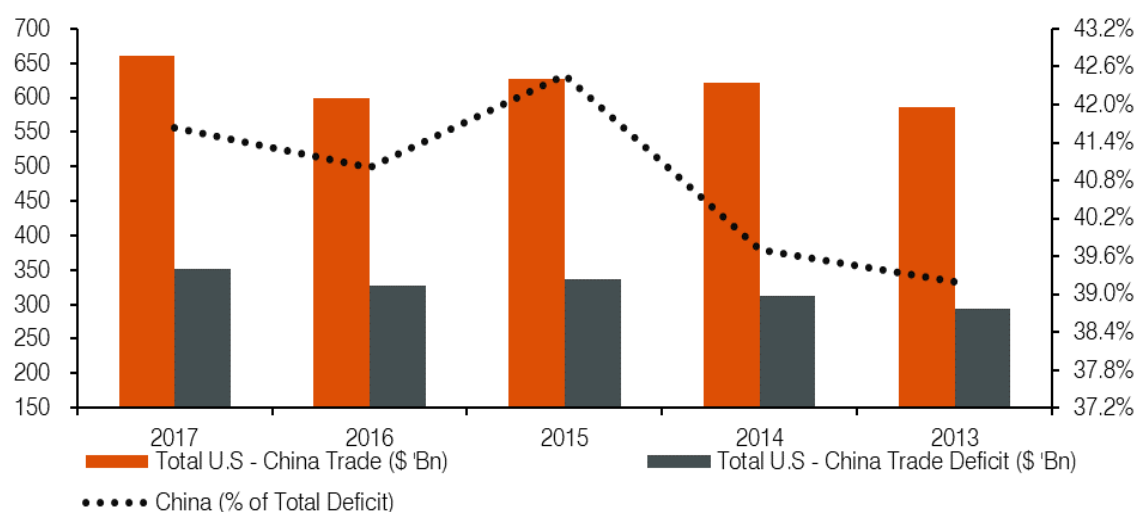
The global scene has been rocked by concerns of an outright trade war between major economic powers as the U.S. intensified its protectionist stance in a bid to improve its economic strength. While the move by the U.S. President was part of campaign promises to reduce the U.S. trade deficit, which stood at US\$568billion in 2017, 66% of which was with China, its implementation caught many off guard given the potential negative impact on the domestic and global growth.

With this said, the U.S. is widely credited with igniting trade tensions in January 2018 following the announcement of 30% tariff on imported solar panels, most of which come from China and taxes on large residential washing machines starting at 20%. With the Trump administration further imposing tariffs on steel and aluminium imports as well as tariffs on US\$34billion worth of imports from China, the much discussed trade war appears closer than ever. This is even more so given the retaliation by China to impose tariffs on US imports worth around US\$3billion. While China's response may appear insignificant, there have been reports of Chinese authorities restricting the ease of doing business for U.S. companies. In the extreme, China which holds roughly 20% of U.S. treasuries held by foreign countries, could retaliate by slowing purchasing of U.S. securities or sell existing holdings. This could lead to decline in bond prices, pushing yields north, pressuring the cost of borrowing for U.S. companies as well as Emerging Market economies which could have a catastrophic impact of global growth.



Nonetheless, we opine that the ongoing tensions between the two economies that account for about 40% of global Gross Domestic Product (GDP) could be a negative for the cost of production in the respective economy's aggregate output and consequently the IMF's global growth projection.

Figure I: U.S—China Trade Deficit



Source: Bloomberg, Investment One Financial Services Research.

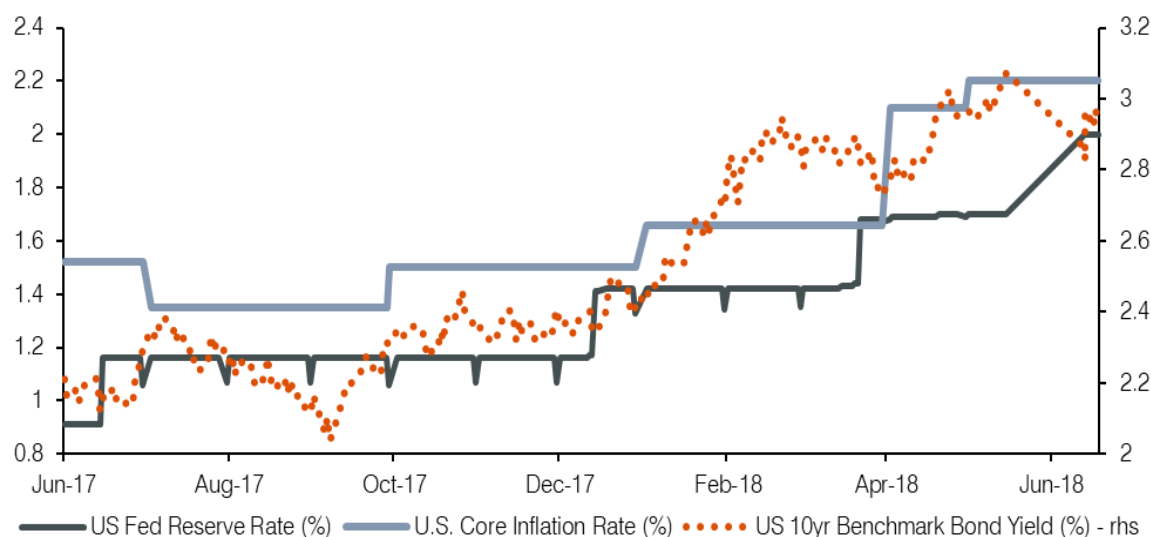
U.S Tax Reforms and Rate Hikes

In December 2017, the Republican tax overhaul in the U.S. was announced, focusing mainly on corporations and households with the aim of increasing the corporate and consumer spending. The legislation, which reduced corporate tax from a maximum of 35% to 21% and marginal tax rate on income by 2.75%, could also incentivize corporate giants to repatriate cash stored in more tax-friendly jurisdictions overseas. Consequently, it has been widely viewed as a positive catalyst for the U.S. economy. According to a leading American investment bank, U.S. households could take home an additional US\$128 billion in 2018 while the corporate tax cuts boosted business sentiment in Q1 2018, as unemployment rate dropped to an 18-year low of 3.9%. Also, economic growth printed at 2.3% in Q1 2018, beating market expectations of 2.0%.



On the back of an improving economic outlook for 2018, the U.S. Fed reserve signal scope for another two rate hikes in H2 2018, following increases effected in March 2018 and June 2018, which took the U.S. Fed rate to a range of 1.75% - 2.00%.

Figure II: Movement in the U.S. Fed Reserve Rate, Treasury Yields and Inflation



Sources: Bloomberg, Investment One Financial Services Re-

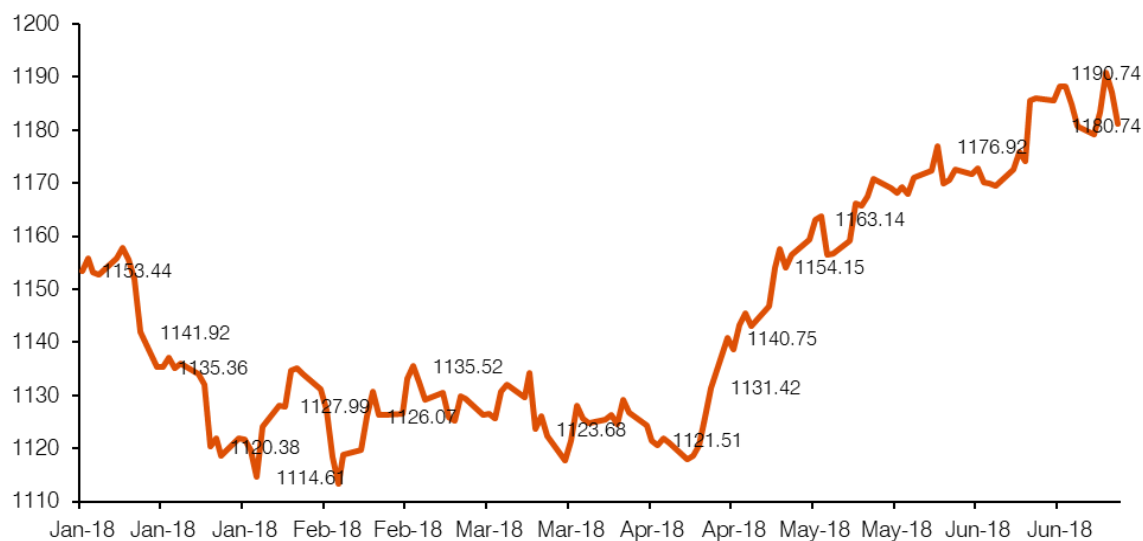
With increasing U.S Treasury yields and a strengthening U.S. Dollar, about 24 key Emerging Market economies risk being thrown into a recurrent cycle of dwindling currencies and mounting pressure on their foreign currency reserves.

Worthy of note is the 'risk off' sentiment witnessed in Argentina and Turkey. During H1 2018, Argentina called on the IMF to seek a financial deal after selling nearly 15% of its foreign currency reserves to support its local currency (Argentine Peso) and raising its benchmark interest rate three times in the space of a week to 40%. Turkey on the other hand has seen its foreign currency reserves fall by nearly US\$3bn since February 2018, which led the Turkish President, Recep Tayyip Erdogan to gather his top economic officials to discuss the falling Lira as well as necessary measures to be taken to tackle rising inflation and interest rates.



With U.S. interest rate set to rise further and the geopolitical and trade tensions showing no signs of slowing, we could see the sell-off in emerging and frontier markets continue in the near term.

Figure III: Bloomberg Dollar Index - USD Against Major Currencies



Sources: Bloomberg, Investment One Financial Services Re-

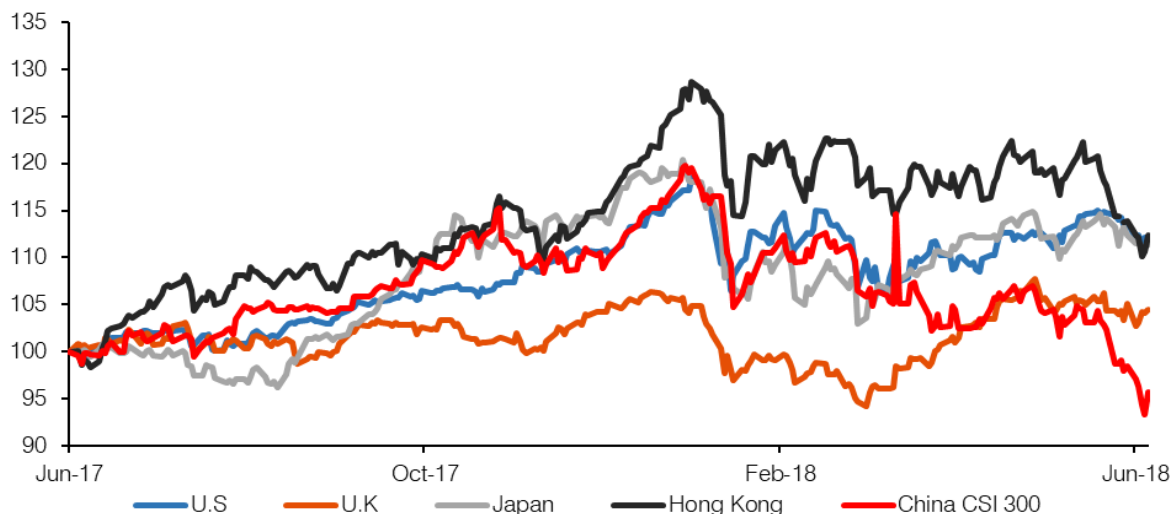
Return of Uncertainty

Financial conditions remain supportive of growth in the global market. Albeit recent geo-political tensions, fears of worsening trade wars and increases in bond yields in the U.S have sent ripples into the equity markets of advanced economies.

Growth in the Eurozone and Japan are no longer above trend as they were towards the end of 2017. Improved household consumption, investment and exports are the major factors that continue to support growth in the above regions. In Europe, improved domestic demand alongside a rebound in energy prices since 2016 have helped boost inflation above 1%; nonetheless, core inflation, which the ECB assesses to make policy decisions, remains passive justifying continuation of the ECB's QE/asset buying program, until September 2018. This will act as a support system to inflation, but ongoing slack in the Eurozone could limit growth in wages and hence inflation.



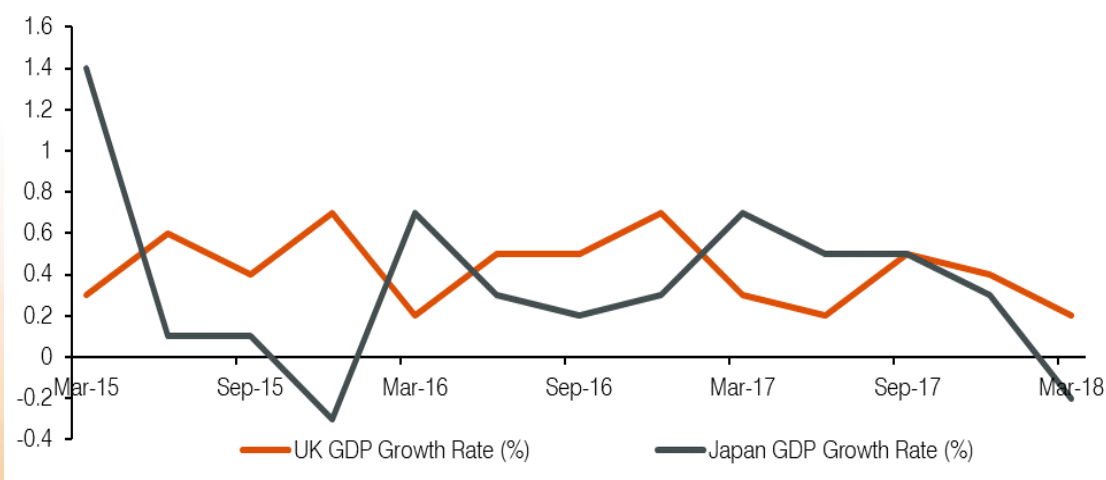
Figure IV: Equity Markets Performances in Major Economies



Sources: Bloomberg, Investment One Financial Services Research.

However, as inflation inches further, we expect the ECB to come under increasing pressure to raise interest rates in an effort also to limit the growing variance between its main financing rate and the U.S Federal Funds rate. On the other hand, as England still stalls on a fixed Brexit date, the Bank of England met in May 2018 and decided to leave interest rates unchanged at 0.5% after a Q1 2018 economic slump and slower than expected inflation figures. In updated forecasts, the UK central bank reduced its growth rate by 0.4% to 1.4% in 2018.

Figure V: Growth in the U.K and Japan



Sources: Bloomberg, Investment One Financial Services Research.

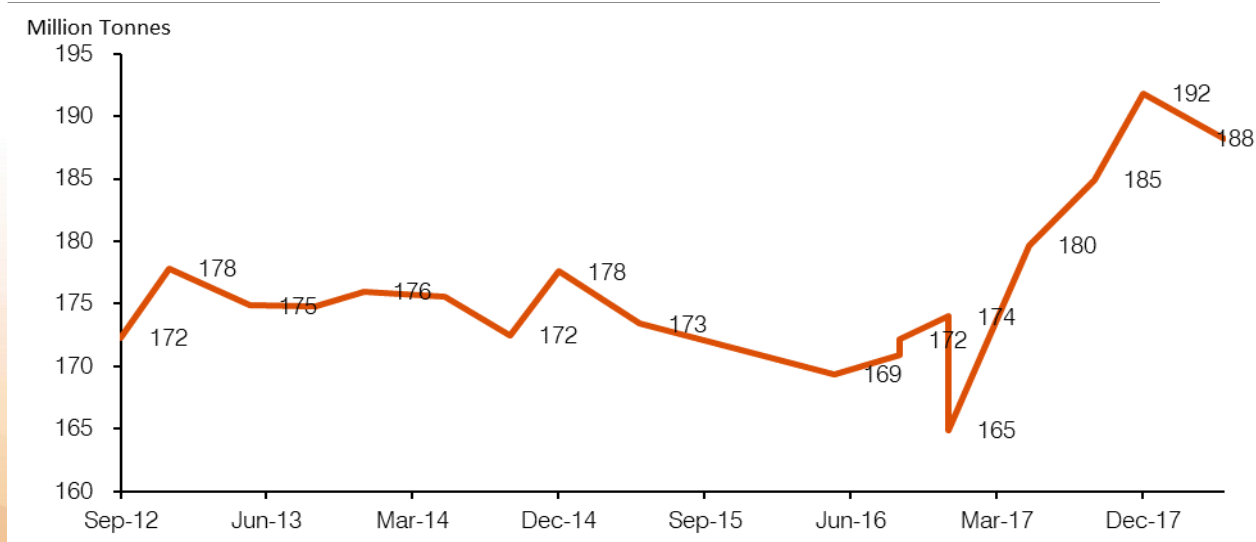


Commodities

Commodity prices strengthened in the first half of 2018. Broad based price increases were supported by both demand and supply factors with GDP growth increasing to 3.8% in 2017, from 3.2% in 2016. On the supply side, production has been held back for several commodity-specific reasons, including the continued OPEC and non-OPEC oil production cap at 32.5mbpd, measures by China to reduce polluting metals and energy production and lower grain planting intentions in the United States.

Sugar is on track to becoming the worst performing commodity in 2018, with sugar futures down 25% so far in 2018 as demand growth slows and production surges. Consumers are increasingly becoming aware of the negative health impact posed by continued consumption. Although global demand is still on the rise, the pace has slowed from 1.7% over the past decade to 1.4% in recent times according to Green Pool Commodity Specialists. In addition to creeping demand hurting sugar prices, booming sugar production especially in India, the world's second largest producer exacerbates the commodity's outlook. However, world's largest producer of sugar, Brazil, is set to lose a significant portion of its market share to its competitors, as commodity experts forecast a c.7.8 million tonnes drop in the nation's exportable surplus, from its current levels of 30million tonnes. This is largely the result of current sugar prices disincentivizing an increase in production levels.

Figure VI: Global Sugar Production

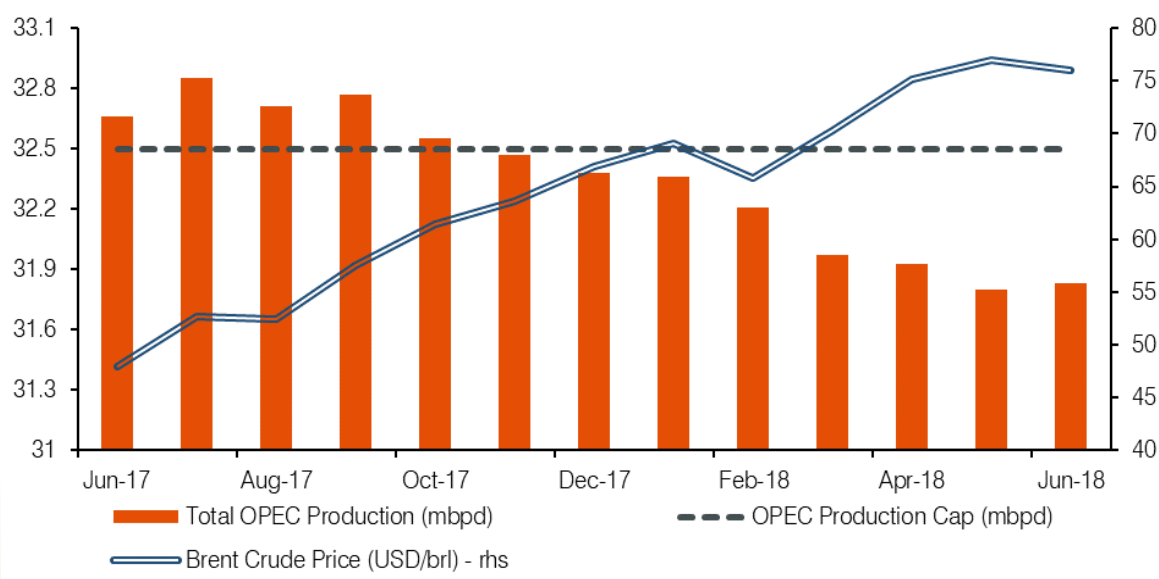


Sources: NBS, Investment One Financial Services Research.



Increased geopolitical concerns in the Middle East as the U.S pulled out of the Iran nuclear deal and re-imposed sanctions on the OPEC nation, increased tensions between Iran and Saudi Arabia in Yemen and about 174% compliance rate by OPEC nations, saw the supply glut that eroded oil prices in 2014 disappear withstanding increases in U.S. shale oil production. Oil prices have since risen 19% this year to a 3 ½ year high of \$79.44 per barrel. Higher oil prices could feed into higher natural gas prices and potentially lead to a decline in coal prices as energy demand shifts towards less polluting sources. However, members of the OPEC cartel and its non-OPEC allies met in June in a final attempt to conclude on the lingering discussion surrounding the need to loosen supply caps in line with the vox populi. The decision was made to boost supply by 1 million barrels per day in H2 2018. This was done on the premise of bridging the supply deficit caused by Venezuela which is down 19% YtD.

Figure VII: OPEC Production versus Brent Crude Prices



Sources: Bloomberg, Investment One Financial Services Research.



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