

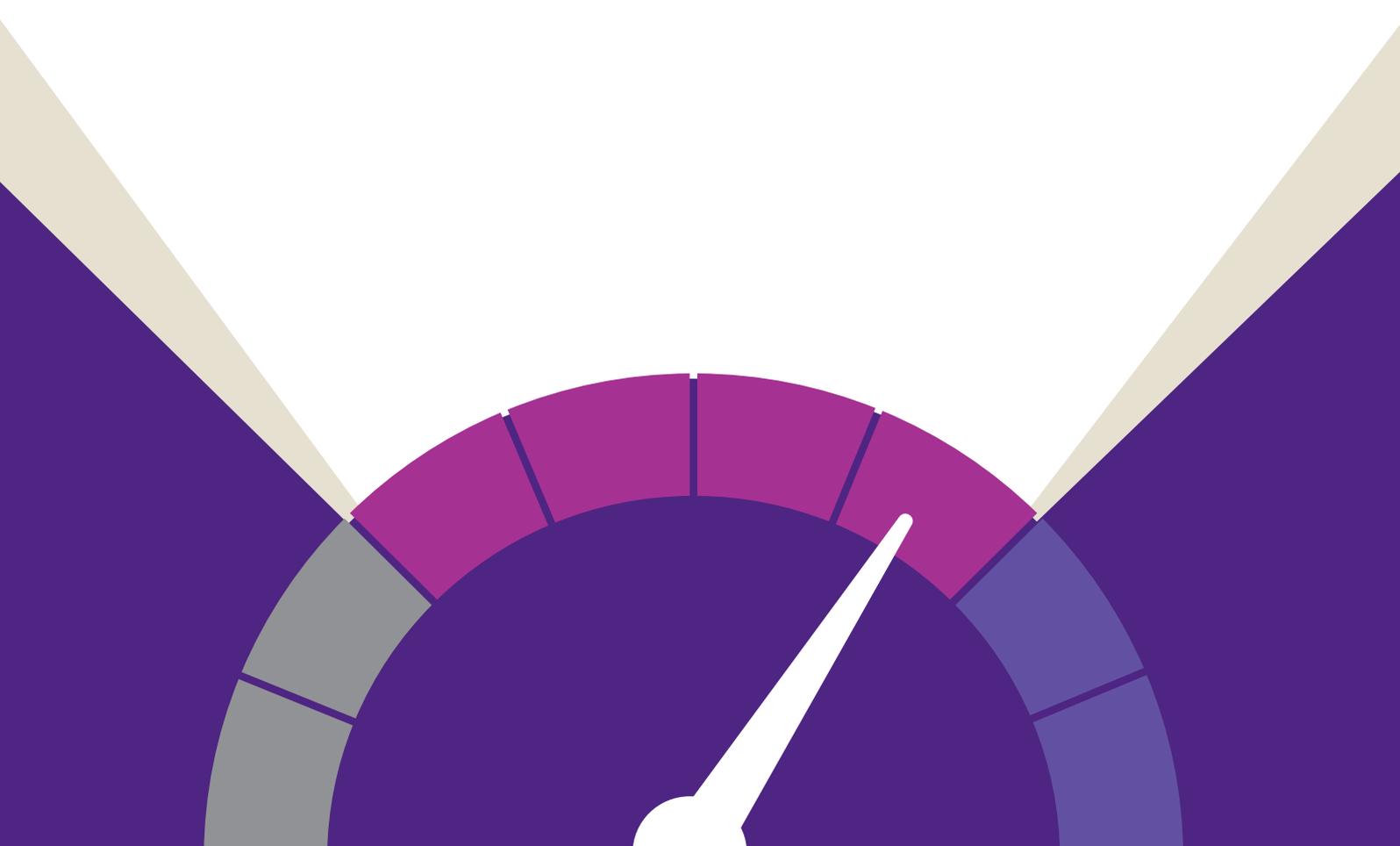


Grant Thornton

An instinct for growth™

The global economy in 2017, looking beyond uncertainty

Grant Thornton International Business Report



Businesses look beyond uncertainty as global optimism rises

Foreword by Ed Nusbaum

If I had to pick one word to describe business sentiment over the past 12 months, it would be uncertainty. During 2016, business leaders around the world awaited Britain's vote on its membership of the European Union and the outcome of the US presidential election.

Large impact events like these don't just affect businesses in the economies where they are taking place; the ripples are felt worldwide. We all saw confidence freeze as uncertainty took hold.

But with the outcome of both these questions settled, business leaders around the world are telling us, for the most part, that they view 2017 in a much more positive frame of mind. This brighter outlook is particularly visible among businesses in the world's major economic blocs, including the United States and China. Globally, business optimism stood at 38% at the end of 2016, representing a five percentage point jump from the previous quarter, and the highest level in almost two years.

And, despite the Brexit vote and the

subsequent increase in concerns over fluctuations in exchange rates, we have also witnessed a marked rise in business optimism across the European Union, up six percentage points from 28% to 34%.

Of course, many issues are still yet to be resolved, including the shape of the Brexit negotiations and the impact of Donald Trump's presidency on the global economy. It would be wrong to suggest that uncertainty has been replaced with certainty. But at least businesses now know the direction of travel. They know there will be a British departure from the EU and who the next US president is, leaving them with a better sense of the framework they will operate with over the coming twelve months.

Our findings show that the rise in optimism is underpinned by strong fundamentals across a range of key business indicators. Globally, the proportion of firms expecting revenue to increase in 2017 has climbed to its highest figure in nearly two years. China and the US both reported strong leaps in revenue expectations. The global outlook for selling prices and



Global optimism figures

Q3 2016



Global



US



China



EU



Russia

Q4 2016



Global



US



China



EU



Russia

profitability is equally strong, and plans to invest more in plant and machinery are also at a two-year high.

Of course, the picture presented by business leaders across the world is rarely, if ever, favourable in its entirety. Business optimism has dropped by six percentage points in Mexico and by 13 percentage points in Russia. Business leaders in the developed economies of the Asia Pacific, such as Japan and Singapore, similarly report predominantly pessimistic outlooks. Meanwhile, the proportion of EU firms citing exchange rate fluctuations as a constraint of growth has increased significantly, as elections in France and

Germany threaten to inflict new volatility.

The year ahead will not be without its challenges. Debt levels in China are a source of concern, banking worries in Italy are causing murmurs of anxiety across Europe, and anti-corruption measures triggered the withdrawal of large sums of rupees in India. Meanwhile, our research reveals a particular challenge for businesses balancing profit growth with wage growth, which is discussed later in our report.

But, all told, I am greatly encouraged by the knowledge that, for the most part, businesses intend to pursue strategies for further growth. It is vital that these plans are not abandoned, whether they include

investing for greater efficiency, hiring new skilled workers, or researching new markets or services. This year, dynamic firms that look beyond the uncertainty, think long-term and seize on growth opportunities will be best able to navigate the changing global economic landscape and ultimately emerge as winners.



Ed Nusbaum,
Global CEO

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Europe

Businesses show resilience despite Brexit and impending national elections in many countries.

For a region that has faced a particularly turbulent decade, the outlook in Europe for 2017 is looking more favourable as business leaders examine ways to pursue growth strategies.

Business optimism has recovered to 34% in the EU, a 6pp increase from the previous quarter, and has jumped even more significantly in the Eurozone, up 10pp to 37%. This is especially true in Spain, France and the Netherlands, where levels of optimism have been boosted by expectations of improvements in revenue and profitability. In the Eurozone, expectations around selling prices are up by 7pp, profitability by 5pp and exports by 2pp. And despite the country's vote to leave the European Union, business leaders in the UK report a 5pp increase in optimism.

There are encouraging signs that businesses in the region will look to invest more, too – a reassuring indicator of business resilience and strength. These investments are expected to take place

across the board – mainly in plant and machinery, but new buildings, and research and development, are also expecting a dose of capital. The continent has also seen the biggest increase in employment plans anywhere globally, especially in the UK, Italy, the Netherlands and Germany.

While all of this is good news, we cannot ignore the fact that some countries are still suffering from the persistent reverberations of the Eurozone debt crisis in 2009, and continued political instability in some parts has been a source of pessimism. In Italy, for instance, business optimism fell by a considerable margin in Q4, reflecting the uncertain political climate in the lead up to then-Prime Minister Matteo Renzi's referendum on parliamentary reform.

However, business performance indicators

in Italy are still looking strong, with increased expectations for revenue (up 4pp to 52%), profitability (up 16pp to 48%) and exports (up 16pp to 28%).

The impact of the British vote to leave the European Union continues to be seen among countries with close links to the UK – namely Ireland and Poland – which are feeling less optimistic, with the timing and content of Brexit negotiations still uncomfortably unclear. In these countries, nearly all business indicators have taken a turn for the worse.



“Uncertainty has been the word of the year for both the global and the Spanish business environments in 2016. Now, we already know the outcome of some of the most important concerns and that opens up a certain rest period that benefits business optimism.”

Alejandro Martínez Borrell
President, Grant Thornton Spain

Employment figures



The Brexit bounce-back

In 2016, the UK voted to leave the European Union. The momentous decision saw business optimism fall in the UK in the immediate aftermath. However, since then, and despite uncertainty over the government's negotiating position on Brexit, optimism has actually bounced back by 5pp to 26% at the start of 2017. It's not just optimism which has improved in the UK, either. Businesses are expecting

increased employment (+18pp), revenue (+1pp) and profitability (+4pp) for the next 12 months. Strikingly, there is also a big upturn in expectations for investment in R&D (+14pp) – perhaps as firms look to the future of a life outside the EU with new products or markets in mind.

Of course, the Brexit process will be bumpy and UK firms remain concerned about exchange rate fluctuations (+12pp) –

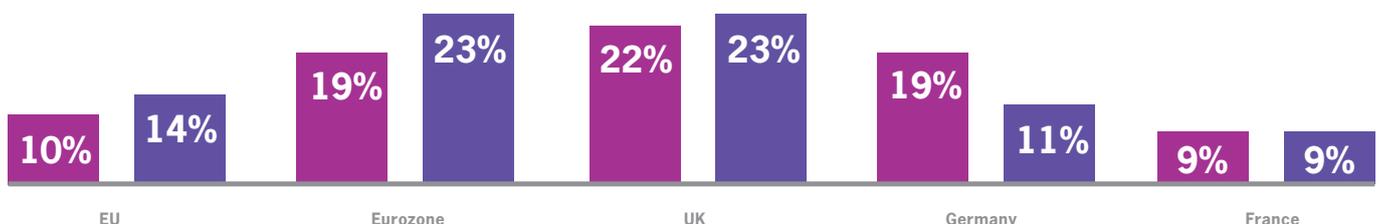
evidence that they see the weaker pound as a challenge rather than an opportunity. But, on the whole, the British business community is breathing more normally now after a jolt following the result.

“Whilst leaving the Single Market provides significant challenges to UK exporters, they should take some encouragement in the PM's vision for a global Britain and acknowledgement that Britain wants to remain a ‘best friend and neighbour to our European partners’. Government efforts to ‘build a truly global Britain’ will be welcomed by the business community, who will now be looking for practical support and incentives from the Government (e.g. tax credits). The next few years will require new ways of thinking and working – both within Government and in the business community.”



Robert Hannah
COO, Grant Thornton UK

Investment in research and development ■ Q3 2016 ■ Q4 2016



North America

Optimism across the region is on the rise, led by US post-election.

Business optimism in North America has rebounded strongly, climbing to 51% in the fourth quarter of 2016 - its highest level since Q3 2015.

This has largely been driven by the US, where uncertainty surrounding the outcome of the presidential election has now been resolved.

Optimism in the US has leaped by 10pp to 54%, a positive outlook that is also reflected in improvements across a number of key business indicators, including an 11pp and a 7pp increase in revenue and profitability expectations, respectively.

By contrast, optimism in Canada has dropped by 17pp from 50% to 33%. However, it remains higher than it did a

year ago, and there are other encouraging signs for the country, as expectations for revenue and exports improve.

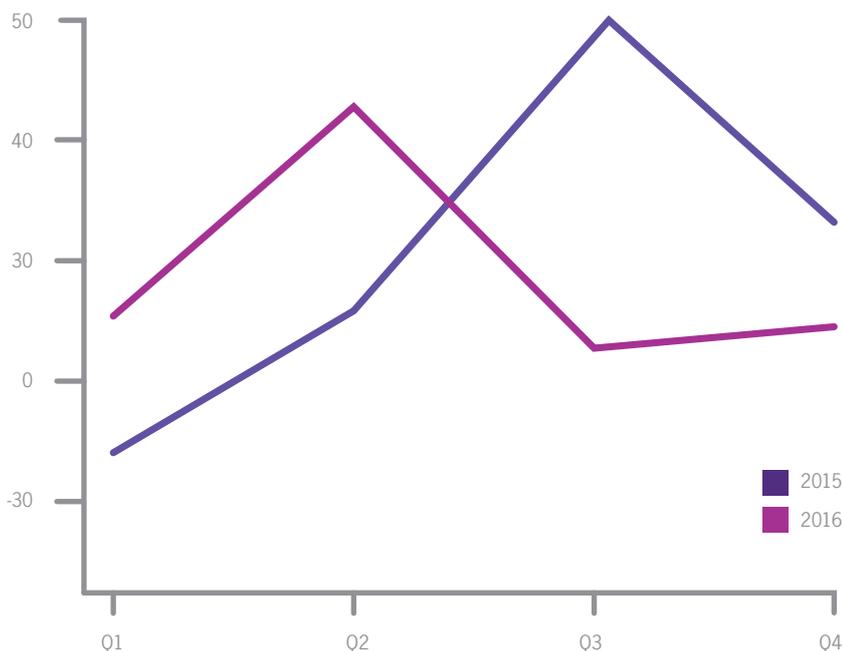
These indicators of business confidence are likely to have been boosted by the EU-Canada Comprehensive Economic and Trade Agreement, reached towards the end of 2016 after negotiations lasting a decade. For Canada, the trade deal offers renewed hope for a boost in trade with the EU, the world's largest economic bloc. This may explain why export expectations in the country are at their highest point in a year,

increasing 4pp since the end of 2015.

Businesses in North America may be experiencing some respite from the uncertainty of the last year, with confirmation of the next president to occupy the White House. However, the possibility of changes to the North American Free Trade Agreement has stirred fears that the Canadian dollar will weaken, which could impact confidence among business leaders in Canada.

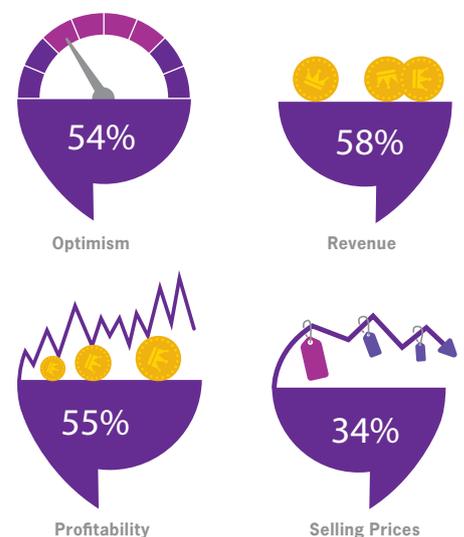
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Chart representing optimism in Canada over the last two years



United States optimism and business confidence

Q4 2016



Asia Pacific

Asia Pacific is at a fork in the road when it comes to optimism, with the region's developed and emerging economies on different paths.

Looking to the next 12 months, business leaders across Asia Pacific report a split in levels of optimism, suggesting that emerging and developed Asia Pacific economies are travelling in different directions when it comes to their outlook for the months ahead.

In the developed Asia Pacific economies collectively, business optimism fell 8pp in the final quarter of 2016, with businesses in countries like Japan continuing to report notably gloomy outlooks. The dip across these developed economies is due in part to the prospect of the Trans-Pacific Partnership (TPP) being scrapped – a trade agreement out of which countries in the developed economies of the region, such as Australia and New Zealand, stood to benefit most. The surge in optimism seen in China could be a by-product of this, as it looks to implement its own regional economic partnership, which could fill some of the gap left by the TPP.

In sharp contrast, business leaders in the emerging economies of Asia Pacific are expecting brighter times ahead, with collective optimism jumping by 11pp in the final quarter of 2016. Such high levels reflect what can happen when closer economic ties are established, following the formation of the ASEAN Economic Community in 2015.

Despite the split when it comes to optimism, the outlook on a number of key indicators is reassuringly strong across the Asia Pacific region as a whole. The proportion of firms expecting profitability to increase over the next 12 months has increased by 5pp to the highest levels in

almost two years. Employment expectations remain healthy at 29%, and research and development plans for 2017 are higher than this time last year – up 8pp from 23% to 31% – albeit slightly down from the 32% recorded in Q3.

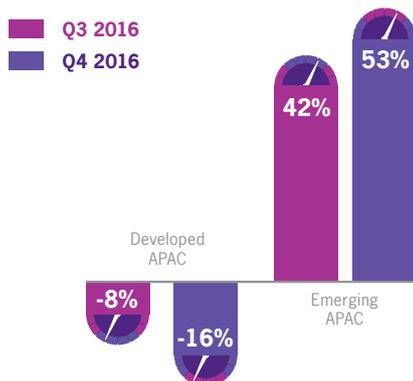
Research and development in parts of Asia Pacific is sparking new ways of thinking in a variety of industries. However, the rise of automation will throw up new challenges for businesses and employees. Only recently, one major Japanese firm announced it will lay off workers and replace them with artificial intelligence (AI) systems that calculate insurance pay-outs.



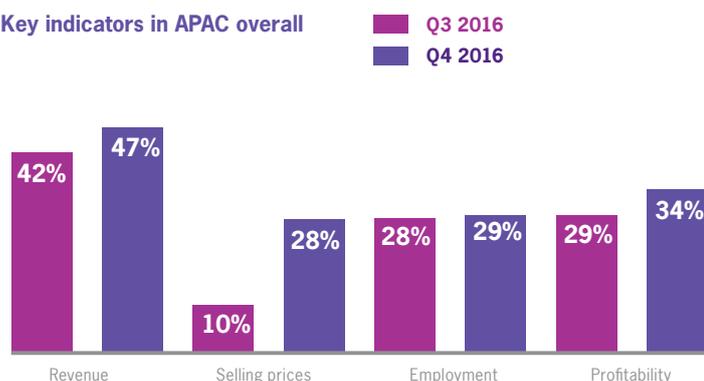
“China’s strategic push on the regional economic collaboration within APAC will serve as a strong driving force for sustainable economic development.”

Liu Dongdong
National Head of Advisory Services Grant Thornton China

Optimism in developed and emerging APACs



Key indicators in APAC overall



Latin America

The region's biggest players experience a reversal in fortunes.

The outlook looks particularly favourable for Brazil. The largest economy in Latin America has come out of a torrid year and a half of political and economic disasters, during which the country endured a recession and corruption scandals at the very highest level of Governmental office.

With the impeachment and removal of former President Dilma Rousseff, and the halo effect created by the Rio Olympics, business leaders anticipate a positive change in their fortunes. Optimism in Brazil has lifted 14pp to 59%, a spectacular 71pp improvement over the year. The return of confidence is also reflected in key areas of business performance: revenue forecast is up by 5pp, and both selling prices and investment in research and development forecasts have risen by 10pp.

This marks a turning point in the country's economic recovery, which is now being driven by solid economic policy. The new government has committed to balancing its books by tightening spending

and cutting interest rates for the first time in four years.

Meanwhile, Mexico, the second largest economy on the continent, tells a dramatically different story. Business optimism has plunged to an all-time low of just 8%. The peso has dropped steadily over recent months, reaching its lowest ever ebb against the dollar in the final quarter of 2016.

Mexico is on the frontline of the incoming US administration's plans to bring companies 'home', possibly renegotiating or even scrapping the North American Free Trade Agreement and possibly imposing higher tariffs on exports.

The divergence between Latin America's

two top players, Brazil and Mexico, is a complete reversal in fortunes from a year ago, when business optimism in Brazil fell to -12% and rose in Mexico to 54%.

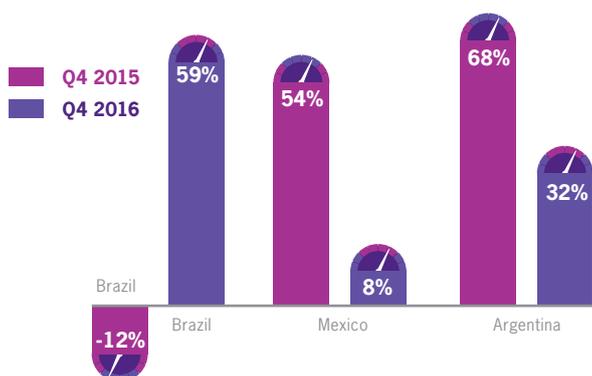
In Argentina, optimism improved from the previous quarter by 6pp to 32%, but the region's third largest economy still hasn't recovered to the high levels recorded a year ago. However, expectations for revenue have crept up during the second half of 2016, and a steady increase in employment expectations is good news for a country where unemployment currently sits at 9.3%.



"Mexican business people are concerned about the country's economy in 2017. The new US president presents various challenges in business and politics if campaign promises are to be kept. The Mexican Peso has lost a lot of ground against the US Dollar and inflation is forecasted high for this year with the terrible combination of lower GDP growth."

Mauricio Brizuela
Managing Partner, Grant Thornton Mexico

Graphic representation of optimism figures



Economic indicators for Brazil



Africa

A generally stable outlook for some of Africa's biggest economies, but concerns over shortage of finance loom large.

Business leaders in some of Africa's biggest economies report a mixed picture.

In Nigeria, levels of optimism took a positive swing in the final quarter of 2016, after a recession in August 2016 saw business leaders expressing an altogether more downbeat tone in Q3. However, the country's economic downturn has not been shaken off just yet, with expectations for revenue, selling prices and exports dropping over the last three months.

In South Africa, business optimism has slipped 4pp from the last quarter to just 6%. However, this is still an improvement on business confidence for the country for the better part of the last two years. And there has also been a mild improvement across a number of key indicators, with expectations for profitability rising by 5pp to 49%.

Expectations for revenue, selling prices, and employment have also improved from the previous quarter.

Botswana, on the other hand, has seen a far more dramatic descent into overall pessimistic territory, with businesses reporting a 30pp fall in optimism over the quarter – from 24% to -6% – following a steady decline throughout 2016. However, this sentiment is not reflected by business leaders when it comes to specific indicators, with profitability expected to increase by 6pp to 58%. Similar expectations are held for revenue, exports and profitability, which have all seen minor upticks over the quarter.

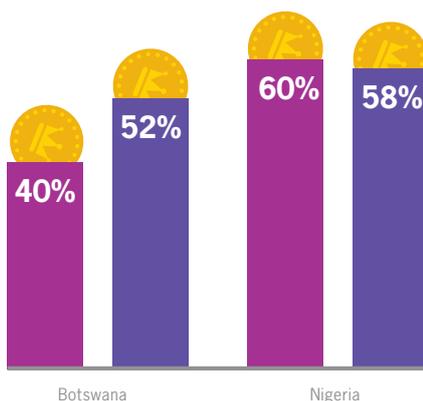
Access to finance appears to be a growing concern for business leaders in Africa. Two

of the continent's more significant economic players, Botswana and Nigeria, are reporting a sharp increase in problems relating to accessing finance. South African firms do not seem as credit constrained, but this might reflect less demand for finance given that their revenue expectations have weakened, leading to a reduced demand of working capital. This could weigh on investment plans, and act as a drag on growth prospects in the region.

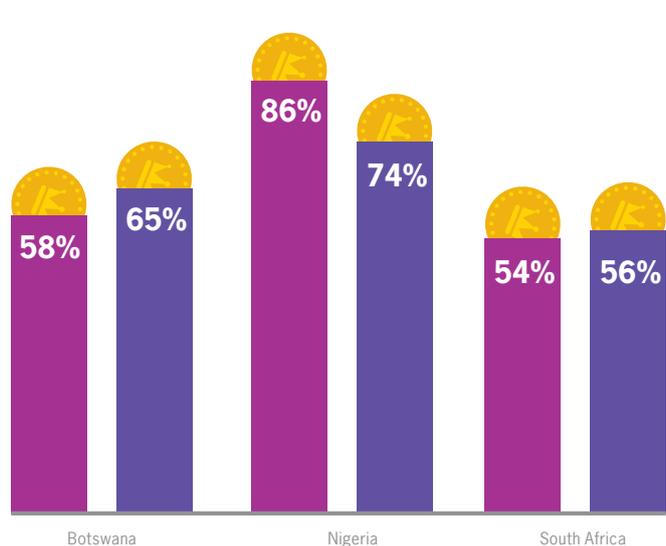
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Shortage of finance statistics

■ Q3 2016
■ Q4 2016



Revenue expectations



Global insight – wages and workers

Businesses foresee greater profitability but the disparity between profits and wages continues.

As overall levels of business optimism around the globe have risen, so too have expectations for profitability and revenue, climbing by 5pp to 41% and 50%, respectively, to their highest points since Q2 2015.

And yet, while half of businesses tell us they expect to generate greater levels of revenue and four in ten expect to become more profitable in 2017, only 20% plan to offer wage increases to their employees above inflation rates. And although this figure has been climbing slowly since the middle of 2015, it is not doing so at the pace at which firms envisage growth in profits.

As a result, we can expect the conflict between labour and capital to intensify throughout 2017. Indeed, we have already begun to witness this, with many attributing a growing resentment among workers over the disparity between corporate profits and wages as a factor in the outcomes of the British vote on the EU referendum.

With further elections scheduled to take

place this year in the likes of France, Germany and the Netherlands, discontent over income inequality could set in motion a new set of political upsets - particularly in countries where unemployment levels are already high.

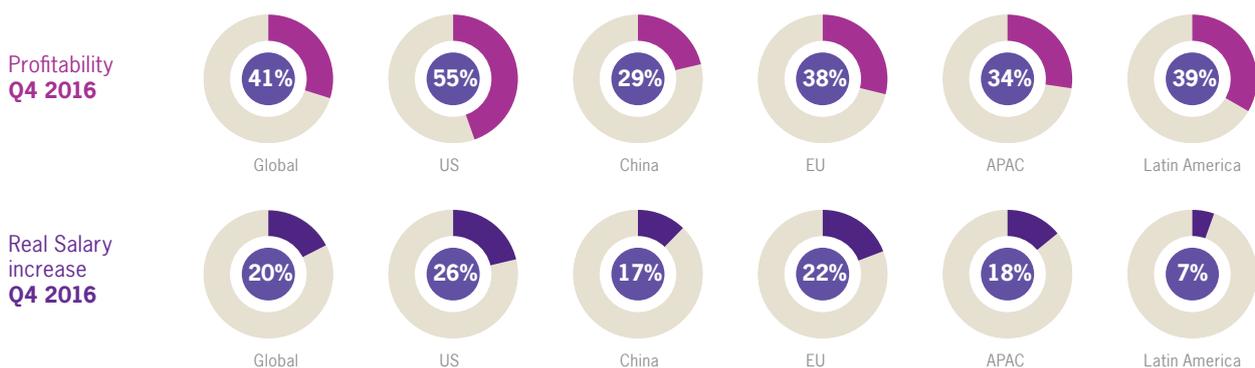
Businesses must be wary of the perception that the wages they pay their staff are not increasing in line with profits. Aside from the political unrest such sentiment can cause, businesses must come to terms with the potential damage to their reputation if staff feel unrewarded. In many of the world's major economies, issues related to corporate governance are becoming increasingly prominent, with political leaders intervening to emphasise that good governance must come from the

upper echelons of business. The British Prime Minister, Theresa May, has spoken in recent months about the need to ensure that in business “everybody plays by the same rules” to create an economy that benefits everyone.

Offering fair and adequate levels of pay is one example of how firms can go about improving their stature in this regard. From a commercial standpoint, businesses could also face the prospect of a talent drain if competitors lure skilled staff with the promise of greater salary or profit share.

As optimism, revenue and profitability expectations increase globally, so too will workers expectations of above inflation rate wage increases.

Profitability and wages expectations for Q4 2016



About Grant Thornton IBR methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,600 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in over 36 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from interviews with more than 2,600 chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 36 economies conducted between October and December 2016. The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1000 employees; in the United States, those with US\$20m to US\$2bn in annual revenues; in Europe, those with 50-499 employees.

More information: www.grantthornton.global

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