Predictions 2017

Seismic Shifts

BREAKINGVIEWS

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Introduction

The world faces 2017 all shook up. After the electoral upsets that kicked off with Britain's vote to leave the European Union and culminated in Donald Trump's victory in the U.S. presidential race, governments, companies and investors are confronted with uncertain and unfamiliar terrain.

The increasingly free flows of trade and capital that stretched across the planet over the past quarter century are in doubt. Two of the world's oldest democracies, the United Kingdom and the United States, have been shocked by insurrections at the ballot box. Faith in established political, corporate and financial leaders is at a nadir. Even the availability of the trustworthy information on which free societies depend can, it seems, no longer be taken for granted.

So it may seem foolhardy to try to predict the coming year. The task is an order of magnitude more difficult than it was twelve months ago. Then the idea of a President Trump seemed improbable – but not unimaginable. Indeed, Breakingviews anticipated that a sluggish economic recovery would damage Hillary Clinton's chances of occupying the Oval Office, though we were less confident about the identity of her opponent.

Similarly, there was a clear possibility that Britain's referendum on membership of the European Union might result in a vote to leave. That is why we included a fictional memo from a bank chief executive preparing to move staff out of the City of London in our 2016 Predictions book.

Other successes included our prognosis that Argentina would reach a settlement with bondholders. We foresaw that Western central banks would be cut down to size after stretching the limits of monetary policy. And though Caterpillar did not attract a public activist investor, it did placate shareholders by parting company with chief executive Doug Oberhelman.

The same crystal ball exercise today, however, involves considering a wide range of once-unthinkable events. What are the chances that Trump stumbles into a military standoff with China? What if the People's Republic responds by aggressively devaluing its currency? How about the possibility that Russian President Vladimir Putin annexes a Baltic state? Or that a new Italian government defaults on the country's debt and crashes out of the euro zone?

To be clear, none of these scenarios seem likely. But they are characterised by what former Bank of England Governor Mervyn King calls "radical uncertainty": they are beyond measurement. These are precisely the types of risks that financial markets struggle to process. When presented with radical uncertainty, hope and fear – or denial – tend to take over.

This is visible in the early response to Trump’s election. Investors have cheered the prospect of large-scale tax cuts and spending on infrastructure, which they hope will boost growth and inflation. But we think that they will eventually have to discount the impact of Trump’s apparent indifference to the Constitution, or his willingness to pursue reckless diplomacy with Taiwan before inauguration.

We expect centrist parties in Europe to reassert themselves in elections in France and elsewhere, but only if they stop trying to appeal to everybody. Angela Merkel will win a fourth term as Germany’s chancellor, but will step down before it ends.

The merger boom will rumble on, if at a reduced pace, partly fuelled with cash repatriated by U.S. corporations. Large deals will increasingly fall foul of trustbusters or uppity shareholders. The Brazilian investors behind Anheuser-Busch InBev and Kraft Heinz, will target Mondelez International. Walt Disney and China’s Tencent are on the prowl.

As we approach the 10th anniversary of the beginning of the financial crisis, the banking sector remains out of kilter. Fragmenting regulations will make it even harder for cross-border lenders to earn adequate returns. Some European investment banks might decide that 2017 is the time to merge their Wall Street subsidiaries. Fund managers, meanwhile, will feel the kind of pay squeeze that bankers have been experiencing for years.

Yet for all the gloom, there are chinks of light. Despite Trump’s scepticism about global warming, market forces will keep renewable energy powered up. New drugs based on magic mushrooms will improve mental health, while the ability to treat genetic diseases by tinkering with DNA will go mainstream. Even Brexit will have a silver lining, prompting investment banks eager to move staff out of London to invest in new international schools.

Some of our predictions may prove wide of the mark, as in years past: Europe did not ditch the Schengen agreement that permits passport-free movement across the continent; Volkswagen’s top brass clung to their jobs; and HSBC decided not to move its head office from London, even though our analysis suggested that Hong Kong or Singapore would be better alternatives.

Despite these caveats, we hope that Predictions 2017 will be thought-provoking and fun to read – and offer some guidance in an increasingly shaken and uncertain world.

Peter Thal Larsen
Global Economics Editor, Reuters Breakingviews
Jan. 3, 2017

Aftershocks

Presidential nominee Donald Trump is introduced at a campaign event in North Carolina, United States, March 7, 2016. REUTERS/Chris Keane

Trump governance carries Chinese characteristics

By Peter Thal Larsen

Donald Trump is bringing Chinese characteristics to American governance. On the face of it, the next U.S. president couldn't be more different from his opposite number in Beijing, President Xi Jinping, who Trump has been trolling on Twitter. Yet the two men – and the cults of personality that have propelled them to power – have a surprising amount in common. Here are some parallels to look for in Trump's first year in office.

Though the reality-TV star has yet to take his oath, he has already displayed several traits that Xi and other Chinese leaders would recognise. He has threatened to purge and even lock up political rivals, displayed an obsession with boosting economic growth and reducing the trade deficit, and shown disdain for free speech and an independent media. Like China's rulers, he appears obsessed with returning his nation to its former greatness – though in the case of the United States this means winding the clock back a few decades rather than several centuries.

Trump continues to rail against China, even after clinching victory. His economic plans, however, suggest a sneaking admiration for the policies pursued by the Communist Party. Apart from cutting taxes, the president-elect has promised to make the country's infrastructure "second to none". That's an objective familiar to Chinese officials, whose fondness for building airports and high-speed train lines helped keep the country humming after the global financial crisis. To finance the splurge, Trump could borrow another Communist Party tactic: entice the country's biggest banks to lend to prestige projects at preferential rates.

In industrial policy, Xi and his cohorts have already shown America the way. Even before taking office Trump displayed a Chinese-style willingness to intervene in private business decisions, bribing and bullying manufacturers like United Technologies and Ford Motor not to move workers overseas. A closer study of Beijing's approach suggests this "America First" policy could go further. For example, Trump could instruct government bodies to only buy from local enterprises, as Beijing is fond of doing. Similarly, he could mimic China's use of vaguely defined cyber security rules to freeze out foreign technology firms.

Like China's rulers, Trump understands the value of family connections. He owes much of his success to his real-estate developer father – a trait he shares with Xi and other "princelings" of the Communist Party. Meanwhile, the presidency is shaping up to be a golden business opportunity for Trump's children, who he says will run his empire while he is in office. China counts many similar "entrepreneurs" who have grown rich as a result of their relatives' political influence. Unlike the ostentatious Trumps, though, the beneficiaries of Chinese nepotism hide their investments in shell companies and tax havens, where they are less likely to be discovered by the media or anti-corruption investigators.

Then there is foreign policy. The People's Republic is notoriously thin-skinned when it comes to international affairs. It is quick to take offence when other countries receive the Dalai Lama, or publish maps which don't conform to China's own view of its borders. Such slights are often described as having "hurt the feelings of the Chinese people".

American diplomacy has historically been less sensitive. Yet Trump is already breaking with that tradition. Electoral success hasn't tamed his habit of lashing out at criticism. His approach to international relations could be similarly touchy. After he accepted a congratulatory telephone call from Taiwan's leader – something no U.S. president has done for decades – Trump responded to the ensuing disapproval by attacking China's currency policy and its expansion in the South China Sea. Such tantrums make Xi look the temperate statesman by comparison.

A fondness for Twitter highlights an important difference with the Chinese leadership. The self-proclaimed billionaire communicates ceaselessly and with little apparent forethought, often contradicting himself within a matter of hours. Xi and other Chinese leaders have a similar scorn for the truth. But on the rare occasions that they speak in public, they favour speeches in which every word has been carefully drafted.

President Trump also faces constraints that his Chinese counterpart does not. The American Constitution limits executive power and defends free speech. The Oval Office is subject to the rule of law: China's Communist Party is literally above it. Xi sits atop an apparatus that controls hundreds of giant state-owned corporations – a power that Trump lacks. And, crucially, the U.S. Commander-in-chief must face the electorate again in four years. By contrast, Xi is as good as guaranteed to be awarded a second five-year term as the party secretary in 2017.

Despite these important differences, China's statist, authoritarian approach may offer the best framework for thinking about the Trump era. In a way, Trump may better resemble the founder of modern China, Mao Zedong, who had a similarly whimsical approach to policy, a fondness for giant earthworks, a hot temper and multiple wives. Expect more similarities to emerge when Trump takes the reins of the American superpower.

Europe's best antidote to populism is unpopularism

By John Foley

Like democracy and the Cold War, European populism after the financial crisis had its origins in Greece. The leftist Syriza party swept to victory in January 2015 promising to dismantle the elite, thumb its nose at European creditors and restore prosperity through radically worker-friendly policies.

Yet less than two years later Syriza has become part of the problem. It has failed to revive employment or growth: half of all young Greeks are still out of work, and GDP is expected to have flatlined in 2016. The centre-right New Democracy party, which Syriza ousted, is more than 15 percentage points ahead in the polls. Once associated with cronyism, it has reinvented itself under leader Kyriakos Mitsotakis as a pro-reform and moderate alternative. If Prime Minister Alexis Tsipras holds an election in 2017, he will probably lose.

For liberal politicians facing radical insurgents elsewhere in Europe, this tale has an encouraging silver lining. It suggests parties that make promises they cannot keep will face consequences.

Populism, which might be defined as a movement that plays on a struggle between corrupt elites and the disadvantaged majority, is well-established but tends to be unstable. In Latin America, countries like Argentina and Brazil that embraced populist leaders are now swinging back to the middle.

Demonstrators take part in a protest aimed at showing London's solidarity with the European Union following the recent EU referendum, in Trafalgar Square, central London, Britain, June 28, 2016. REUTERS/Dylan Martinez

The question is whether this shift will happen in Europe too, and how fast. France, Germany and the Netherlands, where radical anti-establishment parties are in the ascendant, will all hold general elections in 2017. But Austria rejected a far-right candidate as president on Dec. 4, favouring a pro-European member of the Green Party.

Britain will be an important test case. Populists there didn't take power, but they did get what they wanted: a vote to leave the European Union. They campaigned on a series of undeliverable promises of economic prosperity, such as a 350 million pound weekly windfall for the strained National Health Service, and the effortless creation of fast, free and fair trade deals with countries like China and India.

Centrists in Britain are hoping voters might change their minds as economic reality sinks in. Tony Blair, the former UK prime minister, has announced a new movement that would bring together voters and politicians fed up with political polarisation. A liberal pro-EU candidate toppled Brexit-backing parliamentarian Zac Goldsmith in a local election on Dec. 1.

It's not enough for liberals to be the least bad option. If a shift back to the middle is to be sustainable, they need to be strident – and at times unpopular.

Take Angela Merkel. The German chancellor looks set to win a fourth term in the country's federal election, and is one of the few examples of a European leader pursuing a successful centre-ground policy. Her rigid insistence that countries like Greece, Italy, Spain and Portugal stick to EU rules has shored up her support at home but created resentment abroad. By contrast, Merkel's decision to welcome migrants chipped at her domestic ratings, but made her a figurehead for European and humanitarian values.

In France, the unpopularist message is getting through. Centre-right presidential candidate Francois Fillon, the favourite to beat National Front contender Marine Le Pen in the race to replace unpopular President Francois Hollande, is a social conservative who is also an unashamed proponent of liberal markets. On that score, British Prime Minister Theresa May's efforts to create a system that works "for all" look flawed.

Promises to curb the excesses of capitalism have been watered down already, but so have threats to stigmatise hiring foreign workers. Trying to please everyone is a recipe for fuzzy policies that don't work for anyone.

The other challenge is newness. The likes of Merkel, Mitsotakis, Fillon and Blair are known quantities. That suggests a lack of fresh blood. Voters who feel there is nothing over the rainbow but a return to the past will become more disengaged. That's reflected in low turnouts: only 54 percent of the electorate cast ballots in the recent British by-election in Richmond Park. Almost three out of every four voters nationwide took part in the EU referendum.

The moderate centre therefore has its work cut out, and 2017 will be a crunch year. At least over in Greece, there are signs that populism has its limits.

Long-term investors will be tested by Trump

By Tom Buerkle

It will take some resolve for the Trump rally to persist. After a brief plunge in overnight trading after the presidential election victory by the New York real estate mogul, U.S. stocks have been on a tear. Donald Trump, however, keeps chiseling away at bedrocks that underpin capitalism and free markets.

A TV screen showing U.S. President-elect Donald Trump is pictured in front of the German share price index at the stock exchange in Frankfurt, Germany, Nov. 9, 2016. REUTERS/Kai Pfaffenbach

Ahead of the Nov. 8 ballot, there were widespread fears over what the mercurial Trump would mean for equities. Instead, in the dozen trading sessions that followed, through Nov. 25, the Dow Jones Industrial Average was up on 10 of them and gained 4.5 percent. Post-election, the Russell 2000 Index of smaller U.S. stocks extended its run of daily gains to 15, the longest such streak in two decades, which came to an end on Nov. 28.

The surges occurred in anticipation of certain Trump policies. Fund managers have pinned hopes on the prospect of stronger economic growth on the back of tax cuts, infrastructure spending and a business-friendly wave of deregulation.

For investors like $5 trillion BlackRock, which have been urging companies to stop obsessing about quarterly profit and focus on long-term value creation, the reaction can be considered partial vindication. The big picture suggests a fundamental shift is under way from an era of interventionist government to a more laissez-faire one.

Another broader destabilizing Trump message can't be ignored, however. He is now questioning – without any evidence – the popular vote count he lost. Trump also challenged the First Amendment on the morning of Nov. 29, tweeting that flag-burners, who are protected under a Supreme Court ruling, should be jailed.

His unsettling tactics may be a ploy to keep opponents off-balance, a way to divert attention from more controversial subjects, such as his own business conflicts of interest that may violate the U.S. Constitution, or the product of an undisciplined mind. None of those explanations is conducive to the consistency and predictability investors typically crave.

The strength of the American economy and its stocks depends on the rule of law that buttresses it. While it may be easier to stare narrowly at perceived benefits of certain policy initiatives, Trump will test the market's faith.

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U.S. company cash deluge will lift only some boats

By Jeffrey Goldfarb

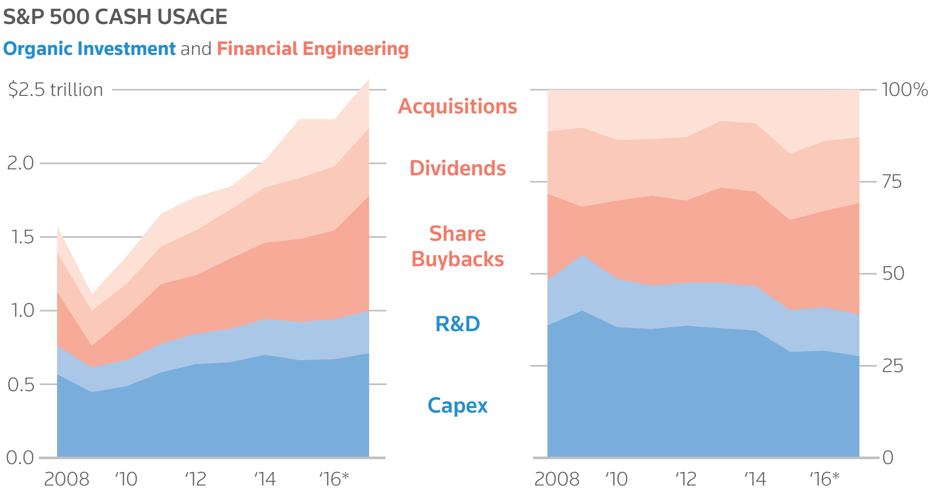
American companies will give new meaning to cash flow in 2017. The chances of sharply lower U.S. corporate tax rates have gone up with Republicans in control of the White House and both chambers of Congress. Such a change would probably lead to a tide of dollars coming home.

Overseas corporate earnings aren't taxed in the United States until they're officially repatriated. That means large sums are considered permanently reinvested in foreign countries. The most commonly cited figure is about $2.5 trillion for companies in the S&P 500 Index. Equipment, inventory and the like account for much of it. Some $1 trillion is in cash and easy-to-sell securities, according to estimates by equity strategists at Morgan Stanley.

During his presidential campaign, Donald Trump suggested a tax holiday enabling cash to be brought back at a 10 percent rate. Such one-off breaks create perverse incentives to move income overseas and wait for another amnesty. Better is something like the plan backed by President Barack Obama and proposed in Congress in 2014 that sought to tax previous foreign earnings at a lower rate while introducing a new territorial system to curb cross-border sleight of hand.

Cash flowing

How companies in the S&P 500 Index will deploy some $2.5 trillion



*Estimates
Source: Compustat, Goldman Sachs Global Investment Research

Politicians and chief executives talk about repatriated cash being deployed to create American jobs and build factories. In reality, shareholders will benefit the most, at least in the short term. Many of the big companies that lobbied for the last tax holiday in 2004 wound up piling the funds into stock buybacks while shrinking their U.S. workforces. Employers invest in factories, research and hiring in response to perceived demand, not because of a government-prescribed windfall.

Of the $2.3 trillion of cash Goldman Sachs analysts expect companies to use this year, about 40 percent will go to capital expenditures and R&D. Assume those two buckets grow roughly in line with GDP, and very little new money that makes its way back to U.S. shores will be dropped into them.

Instead, share repurchases, already at record-high volumes and potentially elevated valuations, will see big increases. Big-eyed CEOs also can be expected to use their tax bonanzas for shopping sprees. According to Thomson Reuters data, cash in mergers and acquisitions by American buyers peaked at 59 percent in 2007, right before the financial crash. The cash flood will lift some boats, but could well sink others.

Merkel can win new term but won’t finish it

By Olaf Storbeck

Angela Merkel has decided to run for a fourth term as Germany’s chancellor, and there is good reason to think she will win. Neither her dented approval ratings nor the rise of the right-wing Alternative for Germany (AfD) protest party look sufficient to lose her the federal election in 2017. After that, Merkel’s best bet is to quit while she is ahead.

Merkel is not without flaws, and voters have noticed. Her resistance to fiscal spending has hampered recovery in the euro zone. Her defining decision in recent years – to open Germany’s borders to Syrian war refugees – has been controversial, and the inflow of a million Muslim migrants has fuelled the rise of the right wing.

Yet in her 11 years in office, Merkel has become a force for calm in Europe. Her cool-headed pragmatism helped keep the euro zone crisis in check. When it comes to Britain’s vote to leave the European Union, Merkel has provided a helpful counterpoint to the hardline views of other European politicians including her finance minister, Wolfgang Schaeuble. Welcoming refugees was a bold humanitarian decision and increased Germany’s international soft power, albeit at a cost to Merkel’s popularity at home.

The AfD is a threat, but a containable one. Even if its roughly 13 percent popularity as measured in recent polls increases to, say, 20 percent, Merkel’s center-left coalition ought to maintain a majority of parliamentary seats. To date, all major parties have shunned the AfD. In 2017 Donald Trump will enter the White House as U.S. president and Brexit negotiations will start in earnest. Merkel can inject stability into a wobbly global system.

Merkel may therefore win another term, but she will not finish it. By 2021, she will have been in office for 16 years. Only Helmut Kohl matched that tenure as chancellor, before losing his fifth election. Merkel is widely understood to have no intention of repeating his mistake.

By stepping down a couple of years after the 2017 poll, Merkel could make way for a successor such as Defence Minister Ursula von der Leyen or Interior Minister Thomas de Maiziere. She would have seen through the crucial part of Brexit negotiations, but would give a successor a couple of years to settle in and campaign in 2021 as an incumbent, which confers a large strategic advantage. The Merkel era isn’t over, but it is entering its final chapter.

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German Chancellor and chairwoman of the Christian Democratic Union Angela Merkel addresses a news conference in Berlin, Germany, Sept. 19, 2016. REUTERS/Fabrizio Bensch

Trump stimulus will only delay next U.S. recession

By Gina Chon

Donald Trump's stimulus will delay but not cancel the next U.S. recession. The president-elect inherits an economy that's in fairly good shape. His planned tax cuts and infrastructure spending should give growth an added short-term boost, which may postpone an overdue downturn.

President Barack Obama bows out with a relatively solid economic record. The unemployment rate hit 4.6 percent in November, a nine-year low. The economy recorded an annualized growth rate of 3.2 percent in the third quarter of 2016, the best performance since 2014.

A supporter of the then U.S. Republican presidential nominee Donald Trump watches election results in New York, United States, Nov. 8, 2016. REUTERS/Carlo Allegri

Trump's plans look set to give growth an extra boost. He wants to cut taxes for all income brackets, and reduce corporate rates from 35 percent to as low as 15 percent. He also wants to spend up to $1 trillion on roads and bridges, which will create jobs.

Yet the United States is already near full employment, which could lessen the impact of Trump's stimulus. The pace of job growth has been slowing as more Americans enter the workforce. The economy added an average 180,000 positions a month in 2016, down from 221,000 a month in the previous year. Unless more long-term unemployed people go back to work – or immigration picks up – the fiscal boost could push up wages, which could lift lagging inflation.

There are no signs that Trump has a solution to improve America's long-term growth potential. Partly because of weak business investment, GDP is expected to grow by a mere 1.5 percent for 2016. The Federal Reserve doesn't believe it will get much better. In September, the central bank lowered its long-run growth projections to 1.8 percent per year, from an earlier 2 percent estimate.

Besides, the history of economic cycles shows the United States is due a recession. The years of unbroken growth since June 2009, which will likely continue into 2017, are set to make up the third-longest period of expansion since 1854, when such data was first recorded.

Since 2015, economists have predicted the extended momentum will soon falter. Trump can delay the downturn, but that increases the risk that the next crunch will come at an inopportune time: just before he faces re-election in 2020.

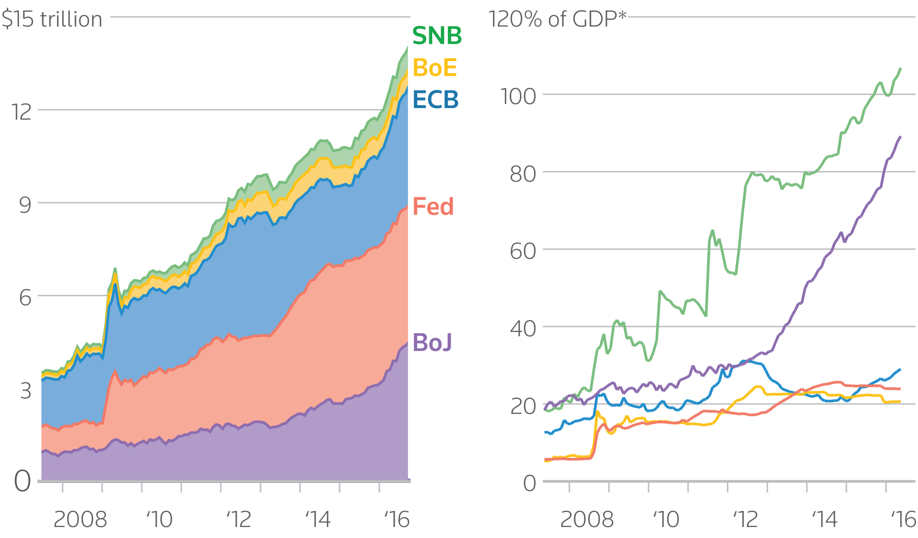
Diverging central banks will power dollar in 2017

By Richard Beales

Donald Trump is promising more U.S. government spending. The coming year will also most likely see tightening Federal Reserve policy, too. That contrasts with continued weak growth and loose monetary conditions in the euro zone and Japan. This divergence between central banks will help the dollar get even stronger against most other currencies.

Overbalancing central banks

Central bank assets



Source: Thomson Reuters Datastream

*IMF nominal GDP (incl 2016 forecast)

The effect has been clear since Trump won the U.S. election on Nov. 8. The Japanese yen, for example, has fallen more than 10 percent against the dollar in just over a month. The Chinese yuan is slightly weaker, as are the euro and the pound.

One factor is that America's economy is expanding faster than the European Union or Japan. But central banks also have a lot to do with it. After years of buying bonds in an effort to ease financial conditions and rekindle inflation, the Bank of Japan's balance sheet has swollen to around 90 percent of the country's annual output.

Though the Fed's stash of over $4 trillion is similar in absolute size, it's closer to a more modest 25 percent of GDP. Moreover, BOJ Governor Haruhiko Kuroda is committed to buying as many bonds as needed to keep Japanese 10-year government bond yields at around zero. By contrast, Fed Chair Janet Yellen and her colleagues are likely to raise rates further in 2017.

Meanwhile the European Central Bank, with another giant balance sheet, has pledged to continue buying tens of billions of euros' worth of bonds until the end of 2017.

A currency offering higher yields should, other things being equal, be a stronger one. The best such correlation currently in evidence is between the yield on 10-year Treasuries and the dollar-yen exchange rate, according to analysts at Brown Brothers Harriman.

Analysts at Deutsche Bank see a "perfect storm" brewing for U.S. dollar strength, with the euro falling below parity by the end of 2017 from about $1.04 in mid-December, and the yen losing further ground.

That scenario may be too extreme. A rising greenback and tighter Fed policy could blow back to squelch U.S. exports and growth, as might any economic trouble abroad. Even so, the pressure to appreciate will persist as long as the U.S. central bank is at odds with global peers.

Russian sanctions will shrivel to soccer boycotts

By Sarah Hurst and George Hay

For Vladimir Putin, Christmas came in November. In quick succession, the Russian president saw the United States and a string of other countries choose leaders that are confirmed or probable Russophiles. The news, on Nov. 30, that the Organization of Petroleum Exporting Countries was to boost oil prices by cutting production was the icing on the cake. These developments will embolden Putin in 2017.

The political turnaround is quite something. The next president of France looks set to

A woman holds a football on stage at the Confederations Cup 2017 official draw in Kazan, Russia, Nov. 26, 2016.
REUTERS/Maxim Shemetov

be either Francois Fillon or Marine Le Pen, who both seem inclined to look positively on Russia. U.S. President-elect Donald Trump was Putin's preferred candidate. Italy, Hungary, the Czech Republic, Bulgaria, Greece, Serbia and Moldova also now have pro-Putin leanings.

This has two geopolitical implications. One is that there will be increasing pressure to lift the economic sanctions imposed on Russia when it occupied Crimea in 2014. The other is that Putin may be encouraged to expand Russian boundaries further.

The usual brake on Russian expansionism has been the domestic economy, which has been wrestling with a budget deficit estimated at 3.7 percent of GDP in 2016. If sanctions are eased and oil prices climb above $50 a barrel, getting the deficit down to the targeted 1.3 percent of GDP in 2019 will get easier. That reduces the pressure to freeze spending in education, health and, crucially, defence.

It will take more than slightly fuller coffers for Putin to risk an armed confrontation with the North American Treaty Organization by marching into Latvia, Lithuania or Estonia.

But the inhabitant of the Kremlin has reason to suspect that aggression might not be met with a strong response – Trump has implied he would not necessarily support NATO in such a scenario. With an election in 2018, Putin could use foreign aggression to help shore up his popular support.

Those Western states that object to Russian expansion – like the United Kingdom and Scandinavian countries – will have fewer ways to respond. They might be reduced to gestures like boycotting the next soccer World Cup, to be held in Russia in 2018. Nothing would better underline how the global order has shifted.

China will show Trump more carrot than stick

By Pete Sweeney

It is traditional for China to test a new American president in their first six months of office. In Donald Trump, however, Chinese diplomats face an unpredictable personality who may react to provocation – or alternatively be seduced by cheap charm. Their response to the U.S. president-elect's initial tantrums suggests China will try a little of both.

Chinese interests clash with those of the United States in five primary areas. The People's Republic wants to reduce the global dominance of the dollar. It wants to weaken the U.S. security-alliance network in Asia. It wants to expand the global influence of Chinese business while restraining the influence of U.S. brands at home. And it wants to preserve the export market that gives China a $300 billion-plus trade surplus with the world's largest economy. Finally, there is the long-term mission to persuade – or force – Taiwan to reunify with the People's Republic.

The Chinese government understands the threat Trump represents. His presidential campaign indulged heavily in China-bashing, so his election demonstrates how weak the pro-China engagement faction has become in American politics.

The former reality-TV star is stocking his new cabinet with hard-liners, none of whom appear inclined to go easy on the People's Republic. He has threatened to label China a currency manipulator, to slap massive tariffs on Chinese imports, and likewise to impose a tax on U.S. firms importing goods made in overseas factories. Most dramatically, Trump upended decades of diplomacy by taking a congratulatory call from Taiwan's president Tsai Ing-wen – believed to be the first such contact since 1979.

China's response so far has been measured. The country's foreign ministry played down the conversation, laying most of the blame on Taiwan. Though it lodged a diplomatic

The People's Republic of China flag and the U.S. Stars and Stripes fly on a lamp post along Pennsylvania Avenue near the U.S. Capitol in Washington D.C. during a state visit, Jan. 18, 2011. REUTERS/Hyungwon Kang

protest, the nationalist mobs have yet to rally. While this may not last if Trump keeps blustering, Beijing has so far confined itself to reaction.

That is because Trump also represents a beguiling opportunity. For all his animosity to China, he has questioned the utility of military alliances with Asian partners, including stalwarts Japan and South Korea. He has also pledged to rip up the Trans-Pacific Partnership which would have tied other Asian countries more closely into America's economic orbit.

With this in mind, China will hold off from doing anything that would force Trump to react and further empower the hawks in his administration. Expect it to abstain from harassing U.S. spy aircraft or building more runways on reefs it claims in the South China Sea. At the same time, however, the Chinese navy could push further into contested areas claimed by Japan and see whether Trump stirs. U.S. deterrence with respect to Taiwan depends on forces based in Japan, so a tepid U.S. reaction could embolden China to take a harder line with Taiwan and South Korea, where it wants the government to ditch plans for a U.S. missile shield.

When it comes to the currency, China will avoid a large-scale devaluation, preferring to keep the exchange rate stable against the resurgent dollar by sealing up key parts of the capital account. That will hobble the yuan's challenge to the dollar, but will warm relations with regional partners, who don't want a currency war.

On investment and trade, though, China will throw harder balls. For all its macroeconomic fragility, the world's second-largest economy remains a singular growth opportunity for some American companies. China has the largest number of potential moviegoers on the planet. It also has the world's biggest population of diabetes sufferers. Trump will receive plenty of visits from American business leaders worried about Chinese retaliation against their mainland investments.

China will also defend cross-border acquisitions. The Committee on Foreign Investment in the United States is showing signs of a more proactive approach to blocking Chinese acquisitions, even when the target is not American. But China's Ministry of Commerce has the power to throw wrenches into big deals involving American companies. It will do so, if only to show that it can.

Chinese leaders see in Trump a personality they recognise: a high-rolling child of wealth, a gaudy real-estate mogul with an autocratic ego; a wheeler and dealer with scant patience for the rules. This personality type is ubiquitous in Chinese boardrooms – and government offices, for that matter. That realisation will allow China to use the carrot as well as the stick – and hopefully reduce, not increase, the risk of miscalculation.

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Russian Revolution won't be the last

By Edward Hadas

The Russian Revolution shook the world, but ultimately did not change it. Contrary to the expectations of both fans and foes of the 1917 uprising, Soviet communism proved a cruel failure, which did not even last a century. Now the political-economic model which defeated communism is under global threat.

In 1919, the journalist Lincoln Steffens said of the nascent Soviet Union: "I have seen the future, and it works." That view was widely shared, in both hope and fear. Enthusiasts believed the Marxists were right: the capitalist system would yield to a classless society led by the strong, efficient and enlightened Communist Party. Communism's opponents were also alarmed by this historical tide. They saw it as a system with an almost irresistible appeal to the world's poor, who were, after all, most of the world's people.

The Ivan the Great Bell-Tower is pictured during sunset in Moscow, Russia, Nov. 21, 2016.
REUTERS/Maxim Shemetov

A century on, it is hard to understand the excitement. Soviet idealism only lasted a few years. The USSR rapidly became a state ruled by terror. After a few decades, it also became a stagnant economy. Meanwhile, the non-communist world developed a far more successful model, a hybrid arrangement which included multi-party democracy, a big competitive private sector, large bureaucratic governments, generous welfare states and liberal social values.

There was no contest. The Soviet bloc collapsed, weighed down by its incompetence. Some of communism's high-minded verbiage and oppressive politics live on in the People's Republic of China, but the ideology is dead.

Still, the failure does not mean history favours the alternative arrangement, even though it has done extremely well by some standards. Material well-being has never been greater in developed economies, and the system improves the standard of living of the poor in developing countries. Democratic capitalism can also make some less economic boasts. When it functions well, as it does in most of western Europe, governments promote justice, guarantee universal services and protect the least fortunate.

For all these successes, something is wrong. The political establishment and the social vision that support the system seem to be under greater threat than when communism was most appealing. History might be about to turn away from the comfortable consensus that has dominated the world for decades.

The discontent is not limited to Trump's America, Brexit Britain and the politically troubled countries in the euro zone. There has been a firm rejection of liberal democracy in China, Russia, Turkey, the Philippines, Egypt and Hungary. Around the world, the appeal of strongman leadership is increasing, along with the appeal of aggressive nationalist and even racial demagoguery.

Today's leaders usually think their model is only suffering from temporary economic problems, but the underlying angst is cultural. Many people are angered and alienated by damaged communities, disjointed societies, corrupt and incompetent governments and business and cultural leaders who are indifferent to their concerns. There are few signs that either establishment politicians or the elite can rise to this historic challenge, and many indications that the people at the top are foundering.

The indications of the end of the liberal, global democratic era are not matched by many hints about the nature of the new order or orders. Russia may once again be in the vanguard of a revolution. The role of Vladimir Lenin, the leader of the Bolshevik uprising of 1917, is being played by another Vladimir, the increasingly dictatorial President Putin. He has many admirers among both the developed world's iconoclasts and the developing world's actual and would-be authoritarian leaders.

However, "Putinism" is likely to work as badly as the first Russian revolutionary model. The Russian president enthuses and controls his people with a mix of economic and political nationalism, tight security, foreign military adventures, Orthodox religion, moral injunctions and a mild personality cult. The hodgepodge of old ideas and techniques has not transformed the country for the better. It has neither brought much prosperity nor inspired many people to give up drinking or have more children.

Russia's model isn't really exportable, but other national movements look even less coherent. The Chinese are stuck with intellectually bankrupt Marxism and Maoism, the British Brexiters have no positive agenda at all, and President-elect Donald Trump has not expressed a coherent ideology. None of the other popular leaders with authoritarian tendencies has a mission which is likely to travel.

Still, the lack of a clear and viable alternative does not guarantee that liberal democracy will survive. The system looks ripe for a revolution, if not in 2017 then sometime this century.

Fault Lines

Globalization backlash misses real danger: Robots

By Gina Chon

The backlash against globalization misses the real danger to jobs in 2017: robots. Voters are rewarding nativist politicians. But campaign promises to bring back manufacturing jobs will soon prove hollow. That's because the bogeyman is automation, not open borders.

Citizens cheered candidates or policies that rejected immigration, outsourcing and trade in 2016. U.S. President-elect Donald Trump drew applause when he vowed to build a wall along the Mexican border while across the Atlantic Ocean, former UK Independence Party leader Nigel Farage played on anti-immigrant sentiment as part of the successful campaign for Britain to leave the European Union. Candidates with similarly skeptical views of immigration and free trade are running in elections in 2017, including in France and Germany.

Trump and his acolytes pitch a vision of a return to a bygone era, when jobs in heavy manufacturing and coal mining will reappear. Reality is different. In the United States, about 5 million manufacturing jobs have been lost since 2000. Yet factories have churned out more, with gross output in that sector increasing to more than $6 trillion from $4.2 trillion over the same period, according to the U.S. Bureau of Economic Analysis.

That's largely the result of increased automation. In 2016 globally, the number of newly installed robots grew by 14 percent, and similar growth is forecast for 2017, according to the International Federation of Robotics. Germany has 301 robots per 10,000 workers, while the United States has 176.

Predictable physical activities are the easiest to automate, which is why factories making automobiles and electronics have seen the biggest increase in robot usage. But sectors like food services, retail and healthcare are also ripe for automation, according to a July 2016 McKinsey report. Momentum Machines is planning to open a restaurant in San Francisco staffed by robots that can make 400 burgers an hour. Amazon is experimenting with grocery stores that dispense with cashiers.

It's easier to campaign against foreign governments or immigrants than automatons. That is why politicians are likely to carry on making promises that they cannot keep. Fighting those past wars will render governments flat-footed in tackling more pressing challenges.

Mega-merger market set for last gasp

By John Foley

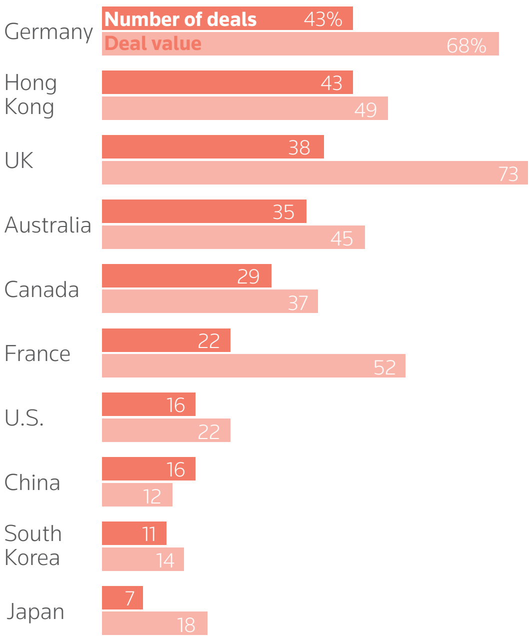
Financial conditions for mega-mergers are excellent. The chances of getting them done are terrible. That's a good thing.

Nearly $850 billion of combinations worth at least $10 billion apiece announced since the beginning of 2015 were waiting to close as of Dec. 1. Among them: Dow Chemical's $130 billion merger with DuPont and AT&T's $85 billion bid for Time Warner.

Some won't get past trustbusters. Efforts to merge four huge U.S. health insurers into two – Aetna with Humana and Anthem with Cigna – have already been challenged. Other overpriced tie-ups deserve to be stopped. Bayer's market value is $12 billion less than it would be had it tracked the MSCI Health Care Index since launching its $64 billion tilt at Monsanto in May.

Buyer's markets

Proportion of acquisitions in major markets undertaken by foreign bidders over the last 5 years.



Source: Thomson Reuters

Where competition authorities don't meddle, politicians might. In Britain, where over one-third of acquisitions since 2010 have been undertaken by foreign companies, officials are now debating new powers to block deals on national-interest grounds. U.S. President-elect Donald Trump's plan to "Make America Great Again" may preclude selling companies to China. That could be fine, since China is imposing new restrictions to prevent capital flight.

As an M&A cycle winds down – global deal volume has fallen 17 percent from a year ago – big targets can be pricier, too. Weaker companies not yet picked off in a shrunken industry may command an unjustifiable scarcity premium. Already, fewer than half of bigger buyers are experiencing a share-price bounce on a deal's announcement, according to Thomson Reuters data. In early 2009, it fell to one in five.

It would be a welcome development if jumbo deals ran out of gas. They've worsened the gradual transfer of value from workers to investors. Anheuser-Busch InBev, which took over rival brewer SABMiller in October for $103 billion, is a master of generating cost savings. That's great for shareholders, but such efficiency may be lost on workers being laid off.

Since debt remains cheap and costs of capital are falling, companies could focus animal spirits on smaller prey. Those generally turn out better for bidders, according to a 2007 Boston Consulting Group study. They also tend to come with less red tape and more genuine innovation. Acquisitions of under $1 billion are just one-third of total deal value, compared with 45 percent in 2013. With any luck, modest mergers will pick up steam.

Rate hikes will help U.S. pensions, but not enough

By Kevin Allison

Interest-rate hikes will help America's underfunded public pensions in 2017. Relief could be fleeting, however, especially if the U.S. economy falters. Illinois and Dallas, in particular, are canaries in a $1 trillion coal mine.

That's roughly the size of the gap between the value of assets owned by U.S. states' pensions and their actuarially calculated obligations to retirees. Looked at another way, their holdings fall about 25 percent short of their $3.7 trillion of total liabilities to former police, teachers and the like. The low interest rates prevailing since 2008 have sapped returns on bonds, making an already tricky funding situation worse.

Higher rates would help get the number down, because government-bond yields are used to discount pension liabilities. It would be a largely symbolic victory, though. The $1 trillion of underfunding is itself an accounting fiction, since it's based on pension systems' own assessments of their likely long-run investment returns.

The average public pension fund made just 1 percent in the fiscal year to June, according to Wilshire Consulting. Consultants at Cliffwater estimate the median U.S. state pension system made a 6.8 percent annual return over the 10 years to June 2015. Yet most still assume that they'll make a 7 percent to 8 percent annual return on their assets indefinitely.

Even if yields perk up further, a 5 percent long-run return assumption may be more realistic. Breakingviews estimates that cutting forecast returns to 5 percent from 7.5 percent would more than double the underfunded amount. To overcome that, rates

An elderly couple looks out at the ocean as they sit on a park bench in La Jolla, California Nov. 13, 2013.
REUTERS/Mike Blake

would either have to rise sharply, which could hurt the broader economy, or pension plans would have to dive into riskier assets, hoping to get lucky. Either scenario makes a bad outcome more likely.

The worst has already happened in Texas, where an ill-fated foray into real estate sparked a bank-like rush to withdraw savings from the $2.7 billion Dallas Police and Fire Pension System. Meanwhile, in Illinois, an official warned in August the state could face “hundreds of millions of dollars in higher taxes or reduced services” from a mere quarter-point reduction in the long-term return assumption at the state’s biggest pension fund.

The bleak conclusion for pension bosses is that even if rates move higher, it’s unlikely to provide much comfort.

Fund manager pay will be next to feel the squeeze

By Neil Unmack

Fund managers will be the next group of finance workers to face bonus pressure. Low returns, lacklustre performance and competition from cheaper passive funds are squeezing fees, revenue and margins. To placate shareholders, asset managers will need to mimic investment banks and take an axe to pay.

The fund-management industry has enjoyed a charmed post-crisis life. Central bank largesse pumped up valuations, boosting assets under management (AUM) while compensation as a share of revenue remained constant. As a result, pay per employee at UK asset management firms rose by 22 percent between 2006 and 2014, according to New Financial. At banks, it fell by a quarter.

The glory years are over, though. Competition is driving down fees: revenue as a proportion of AUM has fallen to around 50 basis points in 2016, from 60 basis points two years earlier, according to Eikon data for a selection of global asset managers.

Investors weary of lacklustre performance are switching to index-tracking funds: these cheaper vehicles now control over 35 percent of the money in global equity funds, up from 25 percent in 2009, according to Bernstein. So-called "smart beta" funds,

St Paul's Cathedral catches the early evening light in London, Britain, Dec. 4, 2016.
REUTERS/Peter Nicholls

which invest according to pre-set factors, are also doing the job for less. Meanwhile, regulators are pushing up compliance costs and – in the United Kingdom – stimulating competition in an attempt to reduce fees.

Faced with this tougher landscape, active asset managers can expand in less transparent markets, like private debt, or in emerging markets, where knowledgeable fund managers are still able to outperform benchmarks.

Even so, growth will not be sufficient to shield pay. Assume a firm expands its assets by 5 percent, but sees its revenue margin fall by 10 basis points from 50 basis points. Even if compensation remains fixed at 36 percent of revenue, overall pay would fall 16 percent, according to Breakingviews calculations.

Shareholders will share some of the pain. But investors in U.S. and European asset managers have already seen returns lag broader indices over the last three years. In 2017, they will demand lower expenses. And, as with investment banks, that means employing fewer people – and paying them less.

Exxon's new boss will confront the end of empire

By Kevin Allison and Fiona Maharg Bravo

Exxon Mobil's next chief executive will confront a weakened empire in 2017. With current boss Rex Tillerson selected as Donald Trump's secretary of state, successor Darren Woods will take charge of the $380 billion oil giant amid still-weak prices and falling reserves.

With Saudi Aramco hoping to take over as the world's biggest listed oil group and rival Shell coming up fast, Exxon's days as Big Oil's unparalleled heavyweight are numbered.

Known for its high-quality assets and investment discipline, Exxon was worth $350 billion when Tillerson became CEO in 2006, more than double its next-closest listed competitor, the $150 billion Royal Dutch Shell.

That was before the shale-oil boom redrew the global petroleum map. Exxon was late to the party, then overpaid when it finally jumped in with a $39 billion deal for XTO Energy in 2009. Two years of low prices and natural declines in production from Exxon's more conventional fields have also taken a toll.

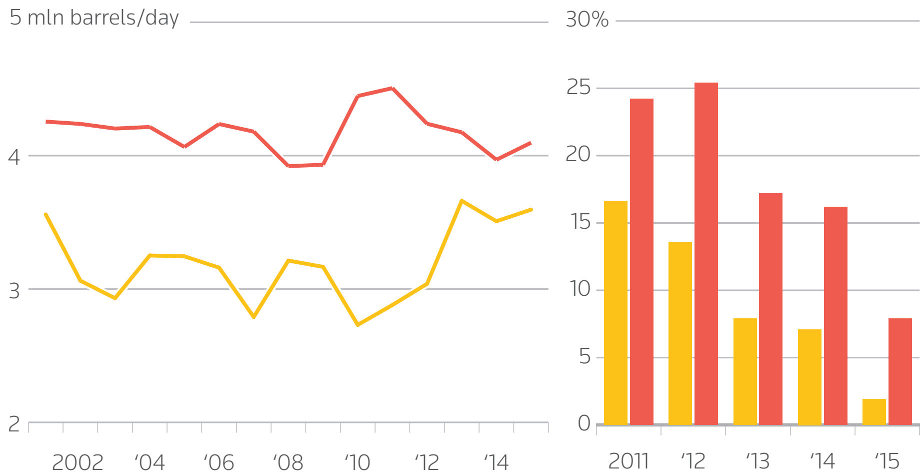
The Texas giant's oil output was flat at 3.9 million barrels per day in the third quarter as crude held below $50 a barrel. It has warned it might cut the crude reserves reported in its books by nearly 20 percent if the recent OPEC-inspired price rebound fizzles out.

Imperial advantage

Oil Production

Return On Average Capital Employed

Exxon Mobil vs. Royal Dutch Shell



Source: Thomson Reuters, company filings

The company's market cap of around $380 billion is not much changed from a decade ago, and could soon be dwarfed by state-owned Aramco, which analysts estimate could be worth up to $1 trillion if it goes ahead with an expected 2018 IPO.

Meanwhile, Shell – now valued at more than $200 billion thanks to its 2015 acquisition of BG Group – may produce more barrels than Exxon by 2019. Shell boss Ben van Beurden also wants to beat his larger rival in terms of total shareholder return.

The good news for Woods is that Exxon still dominates in one key respect: return on average capital employed. Its low-cost assets and famed efficiency allowed Exxon to generate a return of about 8 percent on the share capital and debt provided by its investors as prices slumped in 2015, well ahead of Shell's 2 percent. Over the past five years, Exxon's ROACE has bested Shell's by nearly 7 percentage points on average. That's one imperial feature that will take time to erode.

First published on Dec. 13, 2016.

Banking whales have had their day

By George Hay

In November 2015, Mark Carney signalled the end of "too big to fail". Globally harmonised regulation centred on new-fangled "bail-in" innovations would allow mega-banks to collapse without ruining their host countries, the Bank of England boss said proudly. Yet the rules keep coming, and cross-border cohesion is splintering. In 2017, the twin imperatives of being safe and efficient will get even further apart.

Following the 2008 financial crisis, a legitimate response to the billions of dollars spent on emergency bank recapitalisations would have been to break banks with trillion-dollar balance sheets up into smaller chunks.

Instead, figures like Carney and his global regulatory colleagues on the Financial Stability Board – some of whom had worked for the biggest banks – opted for something different. As long as banks were much better capitalised and could fail without impoverishing their host nations, it didn't matter how big they were. The Bank of England governor made this explicit in a speech back in October 2013: he envisaged the UK financial sector reaching nine times GDP, helped by the ability of banks to receive ready liquidity and fail safely.

The first bit, making sure banks had more padding, went well at first. Between 2011 and end-2015, the major banks grew their capital compared to their risk-adjusted assets to almost 12 percent from 7 percent, according to the Basel Committee on Banking Supervision. Meanwhile, regulators made progress in ensuring the quality of this so-called core Tier 1 capital was harmonised and cleansed of bogus, non-loss-absorbing fare to ensure what's left would actually be able to offset shocks.

Unfortunately, a high-water mark has been reached. Attempts to create a transatlantic consensus on the denominator of the capital ratio – by standardising risk-weighted assets – are dragging on. European politicians in particular are worried about the effect that a big jump in capital requirements will have on banks who are already failing to generate the minimum returns shareholders should expect.

Bank resolution – the process of winding up a bank without scorching the earth around it – also faces challenges. The idealised view of resolution, set out in a joint paper by the Bank of England and U.S. Federal Deposit Insurance Corporation in December 2012, had big banks holding stocks of loss-absorbent debt at the level of their holding companies. If they got into trouble, the home regulator would turn some of the debt into equity, and see the affected country was supported. Global banks could be efficient, massive and safe all at once.

Bank of England Governor Mark Carney leaves 10 Downing Street in central London, Britain, Oct. 31, 2016.
REUTERS/Stefan Wermuth

The trust between regulators that this vision requires just hasn't materialised. Scarred by Lehman Brothers' demise, many bank overseers have demanded that between 75 percent and 90 percent of the debt that they might one day demand be "bailed in" is kept within their own borders. For regulators, that might seem rational – they wouldn't have to worry about their peers reneging on the deal in a crisis. For banks it traps capital in each jurisdiction, making it less efficient to be global.

In 2017 this will add to new strains, such as Britain's exit from the European Union and the anti-free trade rhetoric of U.S. President-elect Donald Trump – especially for banks that are already struggling to make an economic profit. HSBC, the archetypal global trade financier, still makes a return on equity of less than 2 percent on half its $171 billion of capital, Deutsche Bank analysts reckon. A more balkanised regulatory world with smaller trade flows will increase the pressure to downsize further, especially in the United States.

American rules requiring large foreign banks to set up intermediate holding companies with their own boards and stress-test requirements are one reason why HSBC looks relatively overcapitalised there. In November, the European Commission laid out regulations that will in turn reduce the capital flexibility of U.S. banks in Europe.

The new rules could even hit big cross-border European lenders like Credit Agricole and UniCredit. Despite the fact they are supervised by a single, Frankfurt-based regulator, they could still have to trap capital in separate pockets around the 19 states of the euro zone. Worse, wary regulators might in future insist on ever-higher levels of trapped capital in their jurisdictions to protect their own markets, making it even harder to compete effectively against local competitors.

The less trust in a global system, the harder it will be for global banks to satisfy their investors. Compared to pre-2008, the biggest banks now face not only capital balkanisation, but tougher penalties for misbehaviour too. Trump may signal less collegial international cooperation, but he probably won't do much to change extraterritorial American laws holding banks criminally liable for wrongdoing in far-off lands – as happened to HSBC in Mexico. The rosy vision of a global harmony that benefits banks, regulators and shareholders belongs to another era.

Protectionism is key threat to China's M&A boom

By Rachel Morarjee

Protectionism is the top threat facing Chinese dealmakers. Beijing may clamp down on overseas acquisitions and stop companies splurging billions on non-core businesses. But mooted restrictions would not have halted most recent big deals. A larger headache could be Western countries raising the drawbridge.

Chinese companies went on a record buying spree in 2016, amassing more than $200 billion of deals by late November. That seems to have led to official indigestion. Media reports suggest regulators are preparing to restrict or bar outbound deals above $10 billion, and to take a tough stance on $1 billion-plus deals outside a buyer's core business. Currency controls are also tightening.

The curbs, however, are less draconian than first appearances suggest. Only a few deals, like HNA Group's bid for U.S. electronics distributor Ingram Micro, are both big enough and left-field enough to obviously fall foul of the mooted rules.

The largest deal of the year, ChemChina's $43 billion acquisition of Syngenta, would probably still get a green light from Beijing. It fits the buyer's core business and helps secure China's food supply. Other big-ticket acquisitions that bring in vital technology, like white-goods firm Midea's purchase of German robot maker Kuka, are also still likely to win approval.

A more important problem will be the Western backlash against globalisation. That could see various countries erecting barriers to Chinese investment. Deals that make strategic sense to bureaucrats in the People's Republic could become political footballs in foreign markets.

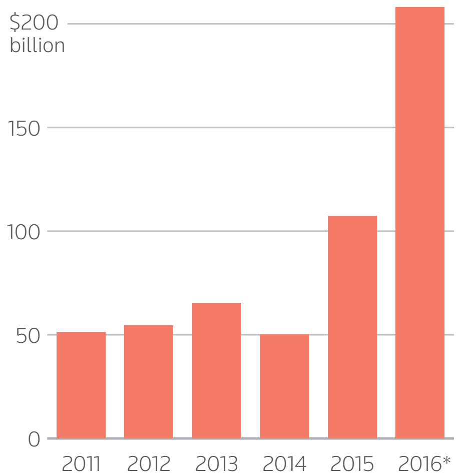
The PRC seems certain to get a rougher ride in President-elect Donald Trump's America. There are already rumblings in Congress about barring all U.S. acquisitions by state-owned companies from the mainland, and subjecting private firms to more scrutiny. Elsewhere, Germany is looking at mechanisms to bar some future Chinese deals. And Australia may move closer to the Canadian approach, which allows the government to block any deal not of "net benefit" to the nation.

The appetite for overseas deals will remain keen – but companies will face more barriers before they can get at the buffet.

First published Nov. 29, 2016.

Too much, too fast

China has been on an outbound M&A binge in 2016



Source: Thomson Reuters *to end-November

China's central bank will lose its longtime leader

By Pete Sweeney

China's leading financial reformer will step down in 2017 after nearly 15 years at the helm. As part of the "Shanghai clique" led by Jiang Zemin, People's Bank of China Governor Zhou Xiaochuan belongs to a faction President Xi Jinping has been trying to pry out of government. The country's longest-serving central bank chief will prefer stepping aside to watching his legacy dismantled, but investor unease will increase.

Official heads are expected to roll during the upcoming party congress, a scheduled leadership transition event in late 2017, as Xi puts loyalists into key positions. But Zhou will be missed. The affable technocrat has run the PBOC since 2002 for good reason.

His competence, straight talk and good English inspired confidence at home and abroad that the currency and money markets of the world's second-largest economy

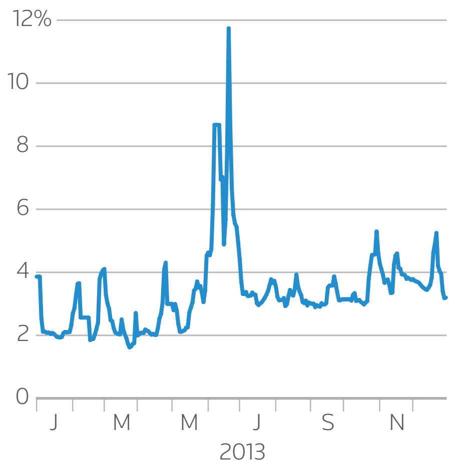
Zhou's accidents

The yuan shock depreciation in August 2015

Offshore yuan (CNH) to dollar (inverted scale)

The money market crunch of 2013

Overnight repo rate



Source: Thomson Reuters Datastream

were in reliable hands. Apart from a few dramatic wobbles, Zhou kept monetary policy and currency predictable. He navigated the global financial crisis with aplomb and secured the yuan's inclusion in the International Monetary Fund's reserve-currency basket.

Reform will decelerate after Zhou, and the timing could not be worse. Progress towards fixing immature financial markets stalled during the 2015 stock-market crash, and officials are again reaching for debt-to-equity swaps to bail out banks and rickety state firms. In the last two years swelling liquidity and politicised lending have misdirected capital back into asset bubbles and old-economy infrastructure spending, instead of the productive investment and efficiency upgrades China needs. All of this makes it harder for China to escape the dreaded middle-income trap.

The banking system Zhou tried to patch still leaks. Standard & Poor's estimates banks will need $1.7 trillion in fresh capital by 2020. And capital outflows have intensified so much that China is closing the capital account back up, hobbling the internationalisation of the yuan – Zhou's signature policy accomplishment.

His likely replacement, Shandong Governor Guo Shuqing, boasts a similar CV to Zhou, with stints at state-owned banks and at the PBOC. But unlike Zhou, Guo has a reputation for loose talk that strays off brief. Gaffes won't play well in the current climate. Guo might come to regret this promotion.

Maduro will survive, just, on Venezuelan tightrope

By Martin Langfield

Venezuela's economy is a wreck, but the Bolivarian revolution's inept leader, President Nicolas Maduro, has probably done just enough to avoid being forced from office in 2017, unless by Chavista colleagues. A bond swap and army-led food distribution helped. But his gutting of institutions risks violence that may yet be his undoing.

The International Monetary Fund reckons the Andean nation's output shrank 8 percent in 2016 and inflation was almost 500 percent. Toward the end of the year the bolivar weakened some 60 percent to more than 4,000 to the dollar on the black market. The government maintains a fixed rate of 10 to the dollar mainly for imports of food and medicine, a wildly unrealistic level that stymies essential imports and fosters corruption. The poor suffer most from such mismanagement.

Hit by lower oil prices in recent years, Venezuela has been teetering on the edge of default. A bond swap in October involving debt of state oil company PDVSA helped Maduro in the short term by lowering payments in 2017 and 2018 while raising them down the road. Reserves have dropped to around $11 billion, barely enough to cover $9 billion of debt payments due in 2017. The Organization of Petroleum Exporting Countries' November deal to cut production, aimed at forcing crude prices higher, could hardly have come at a better time for the government. Oil exports are its lifeline.

Maduro, a former bus driver and union leader, has co-opted the army, putting Defense Minister Vladimir Padrino in charge of CLAP, a program distributing food and basic goods to the poor that critics say rewards loyalty to the government. Opposition and rights groups say more than 100 people are in prison for political reasons, 10 times as many as when the revolution's founder, Hugo Chavez, died in 2013. Authorities halted a recall referendum drive against Maduro, citing alleged fraud.

With the Vatican trying to mediate between government and opposition, Maduro is on a tightrope. His gutting of institutions such as courts, electoral bodies and the legislature increases the risk of street violence. Some elements of the military and his fellow Chavistas might prefer to sacrifice Maduro and negotiate a transition to a more conciliatory government if bloodshed gets out of hand. Yet barring sustained protests or a new oil-price collapse, it looks like Maduro will make it, just, to 2018.

Under Construction

SEC Chairwoman Mary Jo White testifies before a House Financial Services Committee hearing in Washington D.C., United States, Nov. 15, 2016. REUTERS/Joshua Roberts

Biggest financial merger of 2017: SEC and CFTC

By Gina Chon

What will be the top financial merger of 2017? Will it be UniCredit buying Deutsche Bank, or Bank of China swooping on JPMorgan? Think again. It will be America's two markets watchdogs – the Securities and Exchange Commission and the Commodity Futures Trading Commission – crunching into one über-regulator.

President-elect Donald Trump has vowed to cut regulation. The country's labyrinth of finance overseers offers a rich target, starting with the SEC-CFTC. But thanks to their heavy entrenchment in Congress, Trump and his Treasury secretary-nominee, Steven Mnuchin, will need to marshal all their negotiating skills to hammer out a deal.

The existence of two market watchdogs is the most glaring example of America's patchwork of financial regulation. The SEC was created in 1934, after the stock market crash, to bring securities oversight to the federal level. The CFTC wasn't established until 1974 and took on regulating futures trading from the Agriculture Department.

Both missed warning signs of the financial crisis, partly because there was no legal authority to oversee the opaque over-the-counter derivatives market. Yet both saw their powers expanded under the Dodd-Frank Act of 2010, which Trump has pledged to roll back.

Competing jurisdictions in Congress over the SEC and CFTC, and the donor money that comes with them, have prevented a merger. The SEC reports to House and Senate banking committees. The CFTC is under the agriculture committees. Lawmakers raise campaign donations based on this power. That's why the agencies survived the Dodd-Frank reforms.

Under Trump, several regulators could be gutted or folded into other agencies. The Financial Stability Oversight Council, which designates non-banks that pose systemic risks, is a target. So is the Consumer Financial Protection Bureau. Overhauling these smaller bureaus would provide an excuse to combine the SEC and CFTC.

Many firms are regulated by both agencies, which conduct regulatory exams and bring enforcement actions. That offers opportunities for reducing costs. One area is rent and utilities, where the CFTC proposes spending $28 million in 2017. The SEC estimates a $33 million bill. They could also cut redundant offices like the inspector general, which would reduce their $20 million total budget, or the general-counsel operations, costing $67 million.

The overarching goal should be to create a single agency less susceptible to arbitrage by market participants and less likely to get caught flat-footed in a crisis. If a tie-up between the SEC and the CFTC can accomplish this, it would be a good use of Trump's dealmaking skills.

Race to build will add impetus to old-world stocks

By Andy Critchlow

The infrastructure sector is about to get a bit more exciting. In 2017, the need to spend billions of dollars improving tired infrastructure to boost productivity and economic growth could be one of the few areas where Donald Trump, Angela Merkel and Theresa May will agree. A long-overdue building boom among some of the world's largest developed economies will give underperforming old-world stocks fresh impetus.

Build it and they will come

Total investment as a percentage of GDP

Source: IMF

The S&P Global Infrastructure Index – which comprises 75 global companies – has remained flat over the last decade, performing badly against both the Nasdaq and the S&P 500. The underperformance is partly because developed-market firms have been too dependent on construction activity coming from unpredictable developing markets such as Asia and the Middle East. That in itself reflects a historical lack of investment.

Back in 1980, gross fixed capital formation in the Group of Seven nations was more than 25 percent of GDP, according to the International Monetary Fund. By 2014 this measure, which includes public and private investment in infrastructure but also other assets like buildings and land, had fallen to 20 percent. Britain, Germany and the United States all spent less than that. In the UK, public sector net investment – a closer proxy of state infrastructure spending – hovers around 2 percent of GDP, well below the 6 percent regularly recorded annually in the 1960s. Britain, Germany and the United States all spend less than 3 percent, less than big peers in the Organisation for Economic Co-operation and Development.

That could be about to change. As part of his campaign, President-elect Donald Trump signalled that between $500 billion and $1 trillion could be used to fund public works in the world's largest economy. Germany could also see more spending on projects if Chancellor Angela Merkel is re-elected for a fourth term in office in 2017. On Nov. 23 the UK committed to spending 23 billion pounds extra on new infrastructure over the next five years.

Infrastructure providers shouldn't start hiring indiscriminately. Take the UK's earmarked 240 billion pound spend on economic infrastructure by 2020/21. Only around a third will come from public funding – the rest requires private-sector involvement, and a UK government scheme to encourage this type of funding attracted only 1.7 billion pounds of guarantees in its first two years, out of a possible 40 billion pounds. The latest injection of public money will only take UK public-sector net investment back to 2.3 percent of GDP.

Still, that's higher than where it's been for most of the last 30 years, and other countries' plans have yet to be fleshed out. It should at least allow infrastructure companies to make up some of the gap.

3G will take another bite of corporate America

By Kevin Allison

The Brazilian billionaires at 3G Capital that turned Kraft Heinz and Anheuser-Busch InBev into mega-acquisition machines will dive back into the buying business in the coming year. Their next target should be Mondelez International, the $66 billion food conglomerate that failed to coax chocolatemaker Hershey into a sale in 2016. A deal will require some unusual ingredients.

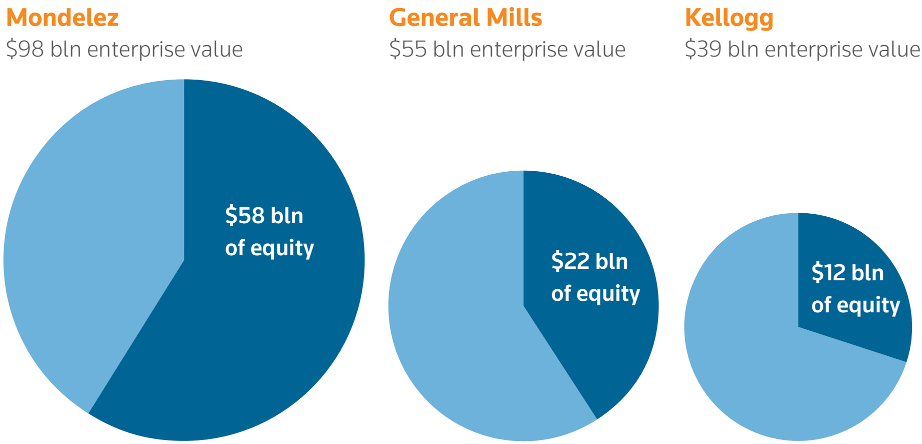
3G – co-founded by banker-turned-beer-magnate Jorge Paulo Lemann – gobbled up Heinz for $28 billion in 2013 with the help of Warren Buffett. Two years later, Lemann and his partners combined Heinz ketchup with Cheez Whiz with a $36 billion swoop on Kraft. Speculation about 3G's next target heated up in early November after a Brazilian blog said it was raising up to $10 billion of fresh funds. Using the combined Kraft Heinz to swallow Mondelez, whose shares gained as much as 12 percent on Wednesday after a Swiss news report said a bid was in the works, would be a natural next step.

While the maker of Cadbury chocolates run by Irene Rosenfeld has been cutting costs since it was spun out of Kraft four years ago, it's still not as profitable as its former parent. That would give 3G new fat to cut after it finishes stripping out $1.5 billion of merger-related savings at Kraft Heinz by the end of 2017.

It would be about a $100 billion mouthful, including assumed debt, supposing 3G paid

Cookie monster

How much equity would 3G/Kraft Heinz need to fork over for the next deal? Assumptions: a 30% takeover premium and leverage limited to combined net debt below 5 times EBITDA.



Source: Breakingviews calculations

a 30 percent premium. The equity required would be daunting: Kraft Heinz owners would have to fork over nearly $60 billion of it to keep combined net debt below five times EBITDA. If they use Kraft shares, 3G and Buffett – who today own just over half the firm – would end up with less than a third of the enlarged entity.

But they'd still be the biggest shareholders by a mile. And the financial rewards could be mouth-watering. 3G sought savings worth 6 percent of combined sales in the Kraft Heinz merger. Apply that to the 2017 revenue analysts are penciling in for Kraft Heinz and Mondelez, and the buyers could squeeze out over $3 billion more pre-tax income a year, worth more than $20 billion taxed and capitalized.

If Mondelez proves too rich, Kraft could seek out a smaller target. Buying cereal makers Kellogg or General Mills without racking up excessive debt would require a more manageable $12 billion and $22 billion of equity, respectively. But neither offers the scale of a Mondelez deal. Whichever way the cookie crumbles, 3G is poised to take another bite out of Corporate America.

First published Dec. 15, 2016.

Disney buying Netflix could be practical magic

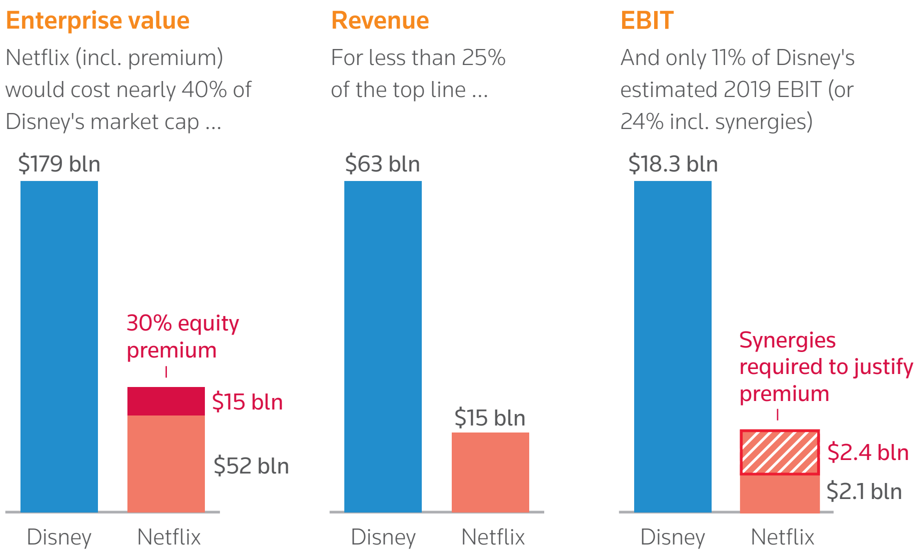
By Jennifer Saba

Walt Disney may be looking for a bit of two-for-one magic. The $160 billion entertainment conglomerate is on the hunt for technology to connect consumers directly with its movies and TV shows. It's also in need of a successor to Chief Executive Bob Iger. A Netflix acquisition including founder Reed Hastings might just answer both dreams – though it would be pricey.

The Magic Kingdom lost some of its zip in 2015, when Iger indicated that fewer people were paying for its cable sports network and profit engine ESPN. Shares of Disney are off about 20 percent since then.

All the same, the company has been one of the forward thinkers in its business when it comes to bypassing traditional cable boxes. ESPN is part of new packages like Dish Network's Sling TV. Iger splashed out $1 billion for a one-third stake in Major League Baseball's streaming technology, with the option to buy it out.

A bigger Magic Kingdom?



Source: Thomson Reuters Eikon, Breakingviews calculations

Disney could, however, think much bigger. Netflix could provide more streaming know-how and 87 million subscribers worldwide. Hastings, meanwhile, has defied the odds in developing his 20-year-old creation from mail-in DVDs to an online leader and content producer. He could be a candidate to replace Iger, who is slated to step down in 2018.

Netflix would be expensive, though. It trades at well over 100 times next year's estimated earnings, compared with Disney's 16 times multiple. Assuming a standard 30 percent premium, the purchase would cost $65 billion. To match the $15 billion uplift from the market price in present-value terms, Iger would need to find over $2 billion in annual cost savings. That's a big chunk, but Disney could plausibly substitute a third of the content Hastings plans to spend more than $6 billion a year to make and buy.

Netflix would still offer Disney an inadequate financial return. Sometimes, though, there's more at stake, like leap-frogging into the latest technology and securing the right leader. The House of Mouse paid nearly 50 times earnings for Pixar in 2006, but the purchase solved strategic problems and reinvigorated its animation studio.

Asked recently about acquisitions including Netflix, Iger didn't get specific but didn't rule anything out either. Lots could go awry with a big, bold purchase, from a shareholder backlash to culture battles. Still, the storyboard is something Disney might want to sketch out.

GE's succession path lit by dueling deals

By Rob Cox

Succession planning is a big deal at most public companies. For the first time in 124 years, General Electric's may be determined by dealmaking. As Jeff Immelt nears retirement, the progress of two large acquisitions in the coming year will help guide GE's board on who should get the top job.

The chairman and chief executive took over from Jack Welch in 2001, but most of his legacy has been imprinted since the financial crisis nearly toppled the maker of jet engines, wind turbines and locomotives. Immelt hacked back GE Capital, which imperiled the parent, and jettisoned assets in media, plastics and even its famed appliances division.

That enabled the $275 billion company, now based in Boston after Immelt uprooted it from Fairfield, Connecticut, to go on the offensive with moves that promise to significantly expand two important divisions. First was the $13.5 billion acquisition of Alstom's power businesses in 2015. Now, GE is planning to merge its energy business

General Electric Chief Executive Jeff Immelt speaks at a news conference in Massachusetts, United States, April 4, 2016.
REUTERS/Brian Snyder

with $29 billion Baker Hughes. Immelt signed the deals, but making them pay off is a job for his lieutenants.

In the case of Alstom, that's Steve Bolze. The 23-year GE veteran, who leads the power division, is off to a good start. Shortly after absorbing Alstom, GE more than doubled its targeted cost savings from the French company to $3 billion. If these pan out over the next year or two, Bolze will be hard to beat for Immelt's seat.

Close on his trail is Lorenzo Simonelli, who joined a year after Bolze and leads the oil and gas division that is in the process of integrating with Baker Hughes as a public company of its own. It's a complicated arrangement that presents a dramatic new blueprint should GE one day abandon its conglomerate structure.

There are other contenders inside GE. Vice Chair Beth Comstock, who runs marketing and the lighting operation, would be the first woman to lead the enterprise founded by Thomas Edison. Chief Financial Officer Jeff Bornstein has an unrivaled purview across GE's businesses.

With pushy investors like Nelson Peltz burrowed into GE, however, the contest may come down to a simpler equation of who delivers the biggest numbers. At the moment, Bolze and Simonelli are best positioned to squeeze new profit out of deals large enough to be noticed even at a giant like GE. The year ahead may be the most important of their careers.

Lenovo could follow Dell's buyout blueprint

By Robyn Mak

Lenovo could follow Dell's buyout blueprint. Sales keep falling at the Chinese tech giant, and its stock has shed nearly 40 percent in 2016. If Lenovo's bosses and main shareholder think the market is too pessimistic about its turnaround, there is a ready-made solution: mimic its U.S. rival and take the company private.

Lenovo reported another disappointing quarter for the three months to September. Revenue from personal computers and tablets, which make up 70 percent of the total, fell 8 percent year on year to $7.8 billion. Lenovo's smartphones and data-centre businesses, once seen as new drivers of growth, reported similar declines. As in the previous quarter, the company returned to profit on the back of a one-time property sale.

The case for boss Yang Yuanqing to lead a Dell-style buyout is growing. PCs are in decline, and smartphone growth has peaked. Since Lenovo's $2.9 billion purchase of Motorola's old handset business in 2014, public investors have wiped out half of the company's market value. Yang has already been slashing costs and restructuring, but going private could make it easier to make even more painful adjustments. Lenovo shares trade at less than nine times forward earnings – below listed rivals HP and Asustek, despite its No. 1 market share in PCs. If public markets are undervaluing the company, a leveraged buyout could generate big returns.

Lenovo Chairman and Chief Executive Yang Yuanqing speaks during a news conference in Hong Kong, China, May 21, 2015. REUTERS/Bobby Yip

Lenovo's market capitalisation is $7 billion. With a 35 percent premium, and net debt of about $100 million, a management-led buyout could be worth $9.6 billion on an enterprise-value basis, Breakingviews calculations suggest. That's roughly the same size as internet firm Qihoo 360's take-private last year.

Lenovo's largest shareholder, the state-backed Legend Holdings, already owns 31.5 percent. Borrowings could fund the $6.6 billion needed to buy the rest of the equity and assume the existing debt. Analysts at Bernstein reckon it will make $1.6 billion in EBITDA next year, meaning leverage would be a shade over four times that amount. That is not too bold for a buyout.

Yang is already dabbling in financial engineering by selling and leasing back buildings. An LBO would super-size that strategy.

First published Nov. 4, 2016.

Tencent heads for a high score in gaming M&A

By Robyn Mak

Tencent's M&A could hit new levels in 2017. The $233 billion Chinese tech giant will probably follow its purchase of mobile-games maker Supercell with similar-sized deals abroad. A bolder move would be buying U.S. heavyweight Activision Blizzard.

A performer plays a game on an iPad before an opera in Beijing, China, Sept. 16, 2011. REUTERS/Jason Lee

As well as operating WeChat, the ubiquitous chat app, Tencent is dominant in gaming at home, accounting for half of industry revenue. But it is a weakling overseas, with many games lacking global appeal: data tracker Newzoo estimates just 15 percent of gaming revenue came from outside of Asia in 2015. If Tencent is truly ambitious about long-term growth, it will need to tap gamers abroad.

So far, Tencent has taken stakes in small outfits from South Korea's CJ Games to Glu Mobile in San Francisco. In June it stepped things up by agreeing to buy Supercell, the Finnish group behind "Clash of Clans", in an $8.6 billion deal.

Similar buys will surely follow. Japanese-listed Nexon, with a $6 billion market value, smaller counterpart GungHo, or South Korea's NC Soft could be prime targets: all three have games that are already popular in the region, and publish these in China through Tencent.

The real prize would be the $27 billion Activision Blizzard. The U.S. gaming group's stable runs from "Call of Duty", the best-selling military videogame, to mobile hit "Candy Crush". Its newest release, "Overwatch", is quickly becoming a serious contender to Tencent's "League of Legends".

Tencent already owns 5 percent of Activision. The remainder, with a 30 percent takeover premium to November's volume-weighted average stock price, would cost just under $39 billion, including assumed debt. If Tencent borrowed the whole amount that would require debt of about 2.7 times combined EBITDA, which should hit $14.4 billion in 2017, according to analyst forecasts compiled by Thomson Reuters.

Taking on that much debt would be a gutsy move. Alternatively, Tencent could sell fresh equity in Hong Kong to raise funds. Or Tencent could take a more cautious approach, as it did for Supercell: putting together a consortium of buyers and keeping the deal off its own balance sheet. Pulling this off would not be easy. But it would take Tencent's global reach up a level.

India is gearing up to recapitalise its big banks

By Una Galani

India's banks need a cash injection, and 2017 looks like the year that they will get it. The country reckons ailing state lenders need at least 1.8 trillion rupees ($27 billion) or more to shore up their balance sheets and meet global capital requirements. Now Prime Minister Narendra Modi may have a way to rally political support for such a move.

A notice is displayed outside an ATM in Kolkata, India, Nov. 29, 2016.
REUTERS/Rupak De Chowdhuri

Bad loans are a real problem. Non-performing and stressed assets at state lenders already stood at almost 15 percent of total loans at the end of March, according to the Reserve Bank of India. But sceptics argue that providing banks a lifeline is a low priority for New Delhi. Any spare cash the government can find, they insist, is more likely to go to vote-winning issues in a country made up of 29 states and thus perpetually stuck in an election cycle.

Yet the shock decision in November to scrap almost $250 billion of high-value banknotes will help rally public support for a recapitalisation, if the resulting cash crunch hurts micro, small and medium enterprises. These businesses account for around 7.5 percent of all bank credit, excluding food-related loans, RBI data shows.

Small businesses will need easier access to credit, and in some cases, debt writeoffs. But banks are currently too feeble to be much help. Fixing that problem would fit the prime minister's effort to reposition himself as a champion of the poor who is willing to tackle elite corruption at almost any cost. Until now, discussion of bad loans has centred on big business and crony capitalism.

Modi could fund a recap by tolerating a one-off increase to the fiscal deficit, which is targeted at 3.5 percent for the current year; top economists have expressed support for such a move. That would also build on recent efforts to force banks to acknowledge that they have a problem in the first place.

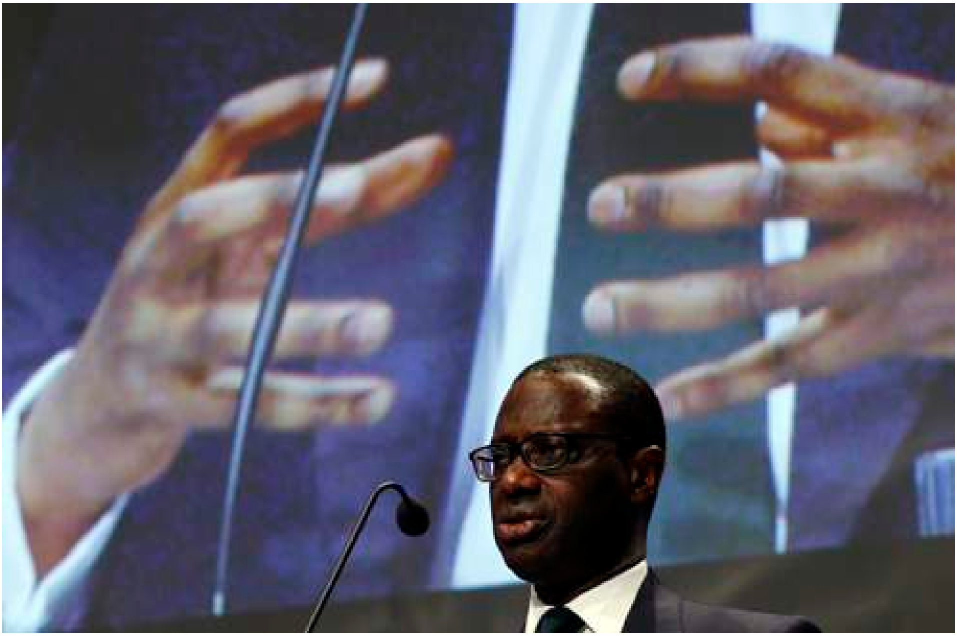
New Delhi will probably prioritise any funds it can muster for the healthiest government-controlled banks like State Bank of India, the country's largest lender, and Bank of Baroda, and force them to consolidate weaker ones. India's banks need the money and Modi might now have a favourable way to spin it.

First Boston-Bankers Trust may unite in 2017

By Rob Cox

Credit Suisse Chief Executive Tidjane Thiam is clearly frustrated with the investment banking operations of the institution he oversees. And with good reason: Wall Street banks seem to have mostly won the battle for supremacy over who gets the lion's share of the fees the world's biggest corporations and investment managers pay to bankers and traders.

Yet at the same time the cost of maintaining the $29 billion Swiss bank's business of financing companies, advising them on mergers, and making markets in a bewildering array of stocks, bonds and other instruments remains high. Meanwhile regulators keep demanding that banks put up more expensive capital against these activities.



Chief Executive Tidjane Thiam of Swiss bank Credit Suisse speaks during the Forum 100 conference in Lausanne, Switzerland, May 19, 2016. REUTERS/Denis Balibouse

So it is logical that Thiam, and perhaps other European bank executives like John Cryan at Deutsche Bank, Jes Staley at Barclays, Stuart Gulliver at HSBC and Sergio Ermotti of UBS, might consider more radical ways to reduce their financial commitments to some of these operations. The Zurich-based bank is talking to a rival about pooling costs, Thiam told the Financial Times, suggesting "this is just the beginning."

It's easy to see where this deliberation might lead. If they can't make it on their own, Thiam and others may conclude they should join forces to take on their U.S. competitors. The idea of merging investment banks may sound very fin de siècle, and not a little stupid. After all, Credit Suisse paid $11.5 billion for Donaldson, Lufkin & Jenrette back in 2000, only to see the New York firm's rainmakers depart and their combined market share fail to materialise. It later wrote off the value of the acquisition.

However, many of the European banks that bulked up over the past few decades on Wall Street now stand at an existential crossroads. They're gazing at a future in which these businesses, even if they are able to make a profit, will probably struggle to cover their costs of capital in the foreseeable future. This puts them at a competitive disadvantage in wooing clients and retaining talent relative to the American firms. It's an ugly cycle.

Look at where the non-U.S. banks stand in the industry league tables compiled by Thomson Reuters. While not necessarily a reflection of profitability, it's generally accepted that the industry's high fixed costs mean scale allows a greater proportion of the fees to drop to the bottom line. Not one firm headquartered outside of Manhattan ranks in the top three advising globally on mergers and acquisitions, underwriting debt and equity or arranging big syndicated loans so far this year.

Credit Suisse's best showing is as the sixth-ranked M&A adviser, just ahead of Barclays. Deutsche came in tenth in mergers, and seventh on debt, equity and loans. Barclays managed fourth spot in debt, just ahead of HSBC. All of this despite the fact that Credit Suisse bought DLJ and First Boston before that; Deutsche Bank spent $9 billion on Bankers Trust back in 1999; and Barclays picked up the American carcass of Lehman Brothers after the financial crisis for a bargain $1.8 billion.

As the head of one U.S. bank told me: "It's over – the Americans won." The top slots in the rankings for core investment banking products are now all held by some combination of Goldman Sachs, Morgan Stanley, JPMorgan, Citigroup and Bank of America Merrill Lynch. The picture is broadly similar in the arenas of stock and bond-market trading.

Maintaining these subscale franchises is expensive. Credit Suisse squeezed out a profit before tax of 73 million Swiss francs in its investment banking and capital markets arm in the first half 2016, on 931 million Swiss francs of net revenue. Its global markets division lost 44 million Swiss francs on pre-tax income of 2.9 billion Swiss francs. These two divisions accounted for about 40 percent of the bank's core risk-weighted assets. By comparison, Credit Suisse's international wealth-management, Asia Pacific and Swiss banking arms made a combined 1.9 billion francs on 6.8 billion of net revenue.

Things aren't much better over at Deutsche Bank, whose massive global markets division eked out a 3.7 percent return on tangible equity in the third quarter. To cover its cost of capital, my colleague Dominic Elliott reckons the bank would need to slash costs by a fifth.

One way to be more efficient would be for Deutsche and Credit Suisse to crunch their U.S. businesses together. They would also enjoy bigger scale. If the banks were able to maintain their respective market-share positions under one roof, they would vault up the rankings. A Credit Suisse-Deutsche Bank duo, for instance, would have challenged JPMorgan as the leading underwriter of global equity and equity-linked securities, raising some $47 billion for clients, year to date. And it might figure as a top five M&A adviser.

Merging would undoubtedly be messy. Conflicts of interest would make it hard for the combined group to keep all its clients. The best employees might leave. Regulators, too, might balk at the idea of big balance sheets getting bigger. A merger of Credit Suisse and Deutsche's U.S. holding companies would potentially create a $700 billion institution.

Winning approval for such a deal would take finesse from the banks concerned. The Federal Reserve would need to be persuaded that one better managed, more profitable and less risky institution was preferable to two weak subsidiaries. Analysts at Macquarie Research pointed out last week that "Deutsche Bank has the largest U.S. balance sheet of European peers and is also the most weakly capitalised of peers. This must be an uncomfortable position for U.S. regulators."

Over time, their parents in Switzerland and Germany could eventually spin off all or part of the combined enterprise to investors, reducing their exposure. But a successful combination – call it First Boston Bankers Trust – might even attract other banks facing a similar future of death by a thousand cuts. Who knows, one day maybe Lehman Brothers and Dillon, Read could join the reunion, too.

First published Nov. 1, 2016.

Gulf bank mergers will solve an oily problem

By Andy Critchlow

Oil prices have become a curse both for banks in the Gulf and the countries that hold stakes in them. Well-capitalised by international standards, bank balance sheets still look too exposed to the unpredictable swings in the value of crude, which directly affect the demand for credit. More consolidation of the sector in 2017 will help local lenders to attract international capital and give cash-strapped governments an excuse to exit.

The slow recovery in prices since crude fell below $30 per barrel in January has been painful but not terminal for banks in Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – the countries which form the Gulf Cooperation Council (GCC). Although deposits have been under pressure and non-performing loan ratios are on the rise in some markets, no lenders have failed or required pre-emptive bailouts. Most of the pain of a near 25 percent slide in oil over the last two years has been felt by governments forced to make deep and politically sensitive spending cuts to cover budget shortfalls.

Raising cash from the sale of bank stakes would be a simpler option. At current prices Saudi Arabia could generate over $14 billion through the sale of its overall 64 percent stake in National Commercial Bank, the kingdom's biggest lender by market value. Exiting its banking investments would also allow Riyadh to avoid taking riskier

The shadows of investors are seen cast on a screen as they monitor stock prices at the Falcom investment bank in Riyadh, Saudi Arabia, Aug. 5, 2014. REUTERS/Faisal Al Nasser

measures that are intended to reduce its exposure to oil, like selling a stake in wholly owned state producer Saudi Aramco.

Some consolidation among the region’s 42 lenders has already occurred. National Bank of Abu Dhabi and First Gulf Bank won board approval in July for a $29 billion merger that will create a domestic banking champion in the United Arab Emirates, the second-largest economy in the GCC. Yet Abu Dhabi – which depends on oil exports for the majority of its export income – will retain control of the combined giant.

The problems caused by a one-dimensional economy are evident across the entire GCC, where even sectors such as real estate and retail are sensitive to the risks of falling crude prices and pose a risk to banks. Consolidation of the sector in 2017 should allow governments to exit their charges – and plug some budgetary holes.

Good Vibrations

Post-It notes are displayed in the UBS "fintech lab" at Canary Wharf in London, Britain, Oct. 19, 2016.
REUTERS/Hannah McKay

Thruppence: Ten buzzwords to expect in 2017

By Breakingviews columnists

Every year brings a passel of new corporate jargon and political doublespeak to the global lexicon. Some of these words and phrases come and go while others stick around for generations and take on entirely new meanings. In that spirit, we asked Breakingviews columnists to weigh in on euphemisms they expect to hear – or disappear – in the year to come.

Import Substitution

When U.S. President Donald Trump slaps tariffs on imports from Mexico and China in an effort to revitalize America's manufacturing base, U.S. enterprises will be called upon to produce their own versions of popular items, including pretty much everything sold on Wal-Mart's shelves, plus cars and iPhones. For further insight, see Belarusian Parmesan. – Rob Cox

Fiscal Space

This largely meaningless phrase will be on every finance minister's lips in 2017. It's shorthand for the amount of extra debt a government can take on to fund tax cuts or investment. The problem is that it is almost impossible to measure. A country's capacity for borrowing depends not just on its current deficit and debt, but also on assumptions about future growth and interest rates, and whether the extra spending will boost potential output. So free-spending ministers will say they are taking advantage of fiscal space, while champions of austerity will insist no such space exists. In the end, governments will do what they wanted to do anyway. – Peter Thal Larsen

Bond Proxies

Expect to see less of this 2016 buzzword, which was shorthand for reliable stocks with high dividends that could substitute for real fixed-income securities in a world of super-low yields. With bond yields rising sharply since Trump's election, the need to scout around for proxies should fall away. – Quentin Webb

Normalization (1)

HBO show host John Oliver implored his viewers not to get complacent about Donald Trump's dangerous policies, like his promise to ban Muslims from coming to America. It's the new rallying cry to prevent the banality of the absurd. – Jennifer Saba

Normalization (2)

Progressives and the media have been talking about this since U.S. election day, arguing it's important to speak out loudly against hate speech, white nationalists in the cabinet, and other norm-busting behavior by the incoming president and his fans/cronies, lest it come to be seen as normal. But after years of low rates and record corporate profits, investors may be more worried about normalization of a different sort. – Kevin Allison

Red Tape

In an era of promised deregulation, bureaucracy has virtually no support anywhere. Though Donald Trump has perhaps been the most vocal political leader in promising to roll back environmental rules and regulations on the financial-services industry, he will not be the last. Watch for candidates in the Dutch, French, German – and possibly Italian – elections of 2017 to go after this rouge enemy with no vocal defenders. – Rob Cox

Emergency Rule

Can be invoked as in France and Turkey after an attack, coup attempt or financial crisis. It's a way to justify massively increased state powers. In the wrong hands, it allows despots to extend their maximum terms in office. As citizens show a preference for authoritarianism over chaos, states of emergency will become more common. – Sarah Hurst

Contextual Commerce

The fintech crowd will outdo itself in 2017 with this near-meaningless phrase. It simply refers to the ability for an app to offer extra services. It's like Uber letting you order food or check into a hotel. Really it's a euphemism for making rampant consumerism exceptionally easy. – Antony Currie

Pivot To China

This term will be trotted out to explain any action by Asian governments that the United States doesn't like. It entered service in Washington D.C. to describe Philippine President Rodrigo Duterte's reconciliation with Beijing despite territorial disputes, and proved handy for similarly warm language from Malaysia's Prime Minister Najib Razak. Expect lots of pivots. – Pete Sweeney

Compliance

The financial services industry has long used this term to denote acquiescence to restrictions on their trading operations and higher capital standards. Now that OPEC is back in the game of setting energy quotas and cutting production, it will take on a new connotation as member states inevitably fail to comply with the cartel's wishes. – Andy Critchlow

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Markets keep climate-change fight alive

By Antony Currie

Markets will help keep the world's climate hopes alive in 2017 and beyond. Donald Trump's victory in the U.S. presidential election will make him global warming's denier-in-chief. He has dismissed the scientifically proven phenomenon as a "hoax" and "created by and for the Chinese in order to make U.S. manufacturing non-competitive." It's a huge blow for reducing emissions – the United States is the world's second-largest polluter. There are, though, reasons to be hopeful.

It might not seem that way. Trump is already looking for a way to speed up the four-year process of taking the United States out of the 2015 U.N. Paris accord, according to Reuters. His scramble to back out of the pact comes as the 200 countries that signed it meet in Marrakesh, Morocco, to discuss next steps.

Trump also wants to overturn a series of executive orders issued by President Barack Obama that sought to curb greenhouse-gas emissions. And the Alliance of Automobile Manufacturers is already lobbying for Trump's administration to give the industry some relief on emissions rules.

Moroccan Foreign Minister and COP22 President Salaheddine Mezouar and French Minister for Environment Segolene Royal open the UN Climate Change Conference 2016 in Marrakech, Morocco, Nov. 7, 2016. REUTERS/Youssef Boudlal

These actions would be a huge setback for the environment. But the Trump-led federal government is not the only force that matters in the fight to prevent dangerous global warming. For starters, unlike with trade deals, pulling out of the Paris accord will not kill it. Plenty of other countries, including China – the biggest polluter – intend to stick with the plan. That should reassure companies investing to bring new green products to market.

Many U.S. states and cities have also committed to reducing greenhouse gases; New York City, for example, pledged an 80 percent cut by 2050. Such goals help attract innovative people and firms working on the technologies needed to help avert climate disaster – from smart use of tech and big data to far larger projects such as building autonomous and electric vehicles. Some 75 percent of all greenhouse-gas emissions either emanate from or are supplied for urban areas, making cities' action crucial.

Trump can't stop renewable energy from going mainstream, either: wind, solar and hydroelectric power have accounted for more than half of new capacity added each year since 2013 and should outpace fossil fuel by four-to-one by 2030. Merely cutting excessive use can reap benefits quickly. The American Council for an Energy-Efficient

Economy, a clean-energy think tank, has calculated that U.S. utilities' investments in energy efficiency created over $2 in consumer benefits for every dollar spent.

Meanwhile, a small but growing number of companies are proving there's a financial benefit to going greener. Over a five-year period, 62 companies between them cut their emissions 29 percent and grew their businesses 26 percent, according to financial not-for-profit research group CDP. Electronics firm Philips already sources all its U.S. power needs from renewable energy. And powerhouses like General Electric are growing such businesses at a fast clip.

On top of that, more than 1,200 of the world's largest companies now use their own carbon prices to guide investment decisions. That's up from just 35 companies four years ago, according to CDP, which represents 827 investors with over $100 trillion in assets who want greater transparency on climate risks. None of that will disappear when Trump moves into the White House.

Some of the new president's policies will even inadvertently help the cause: Trump's $1 trillion-plus infrastructure program should spur environmentally friendly upgrades to the nation's water works and highways. Green investment should also benefit as U.S. companies get amnesty on $2 trillion or more in profit they keep overseas to avoid double taxation.

Throwing President Obama's climate legacy on the coal fire is a bad move both from both an ecological and economic perspective. But the fight against climate change is far from dead. A new, retrograde U.S. climate policy may just turn up the heat on other players to up their game.

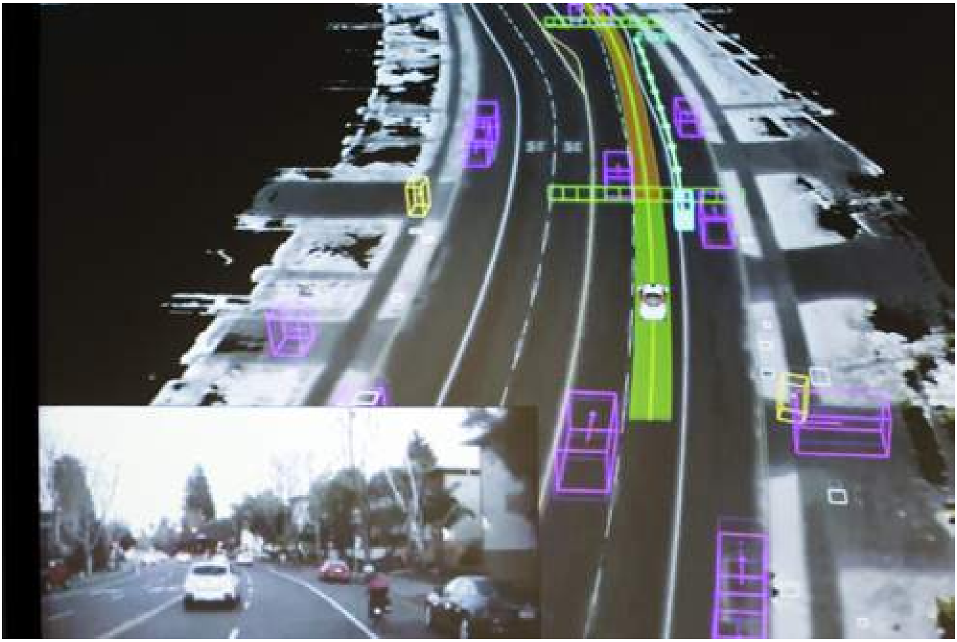
First published Nov. 15, 2016.

Driverless cars will be steered by insurers

By Richard Beales

Who's to blame in an autonomous-vehicle crash? With no driver to cover based on age or accident record, it's a big question. Safety improvements also should reduce losses, threatening to erode nearly $200 billion a year in U.S. private-car insurance premiums alone.

Warren Buffett, chairman of Geico owner Berkshire Hathaway, has said driverless cars will be bad for business. Allstate has echoed the sentiment, and is spending money on data scientists and other ways to develop new products and services.



Data is visualized by a Google self-driving car during a presentation at a media preview in California, Sept. 29, 2015.
REUTERS/Elijah Nouvelage

What's bad for insurers can be good for society, but only if existing structures evolve to encourage computerized drivers once they're safer than humans. Regulations matter, as does the allocation of blame for accidents. Liability premiums totaled $116 billion in 2015, according to the Insurance Information Institute, a business that could both shrink and change drastically.

Existing technology requires drivers to stay alert. Tesla Motors, for example, has made clear that its Autopilot system is not fully autonomous. Driverless vehicles undergoing testing also have people on hand. With full autonomy probably just years away, however, insurers need to know whether liability will fall to the owner, carmaker, software developer or elsewhere. The early money is on a shift to manufacturers like General Motors or potentially Alphabet unit Google, perhaps with insurance essentially covered in the sale price. That would be a radically different model than exists today.

Most accidents are caused by human error, so autonomous vehicles should cost less to insure. Despite driver-assistance systems, however, insurance losses are still rising in the United States. It's not clear what technology, or time lag, will turn this around. A new risk is that cars will need software updates and, most likely, real-time connectivity. The potential cost of cyber security flaws that allow viruses or deliberate hacking is huge.

The U.S. government in September unveiled an autonomous-vehicle policy, which will help guide discussion. In November, Michigan passed the first state legislation that envisages fully driverless vehicles, as opposed to just the testing that is already allowed by a half-dozen or so other states.

If a highly publicized May 2016 crash involving Tesla's Autopilot system ends up in court – or any similar case emerges – that could shed further legal light, too. All told, 2017 should help give insurers more of the information they need to take greater control of driverless cars.

Tesla teaches car rivals to love each other

By Olaf Storbeck

Tesla and Google are forcing established carmakers to shift into a more cooperative gear. Spurred on by Elon Musk's upstart, four of the industry's biggest rivals are teaming up to build charging infrastructure for electric cars in Europe. More collaborative deals are bound to follow.

The move, announced on Nov. 29, is the second major example of cross-company partnership after BMW, Daimler and Volkswagen's Audi brand teamed up in 2015 to buy Nokia's digital-maps division for 2.8 billion euros, including debt. That deal was a response to Google, which owns digital maps and is investing in driverless cars.

As conventional engines struggle to meet ever-tighter emission rules and battery prices fall, established carmakers are gradually turning away from the internal combustion engine. BMW, Daimler and Volkswagen all put electric cars at the centre of their new mid-term strategies in 2016. Daimler plans to spend 10 billion euros – 15 percent of its market value – in the field by 2025. Volkswagen reckons that, in 10 years' time, one in four of the vehicles it sells will be electric.

But drivers will only buy battery-powered cars if they can easily recharge them en route. The associated infrastructure does not come cheap. A high-speed charging station currently costs up to 25,000 euros and loses money on an operational basis. If the market share of battery cars rises to 20 percent of new sales within a decade, building the necessary charging infrastructure in Europe would add up to an investment of more than 2 billion euros, a Breakingviews calculation suggests.

Counting on stretched governments or outside investors to build this crucial infrastructure would be a gamble for carmakers – particularly as Tesla already operates its own

An attendee holds a license plate as Chief Executive Elon Musk presents him with the first Tesla Motors Model X electric sports-utility vehicle during a presentation in California, United States, Sept. 29, 2015. REUTERS/Stephen Lam

proprietary charging network. Sharing the bill eases some of the pressure on already-bloated research and development budgets.

Carmakers are likely to team up in other areas as well. Joint production of battery cells is one obvious candidate for partnership. Shareholders will welcome collaboration that helps lower costs. But consumers may see a dark side. The risk is that old rivals form a cozy cartel, or use the new alliances to freeze out competitors. Trustbusters will need to keep their eyes on the road.

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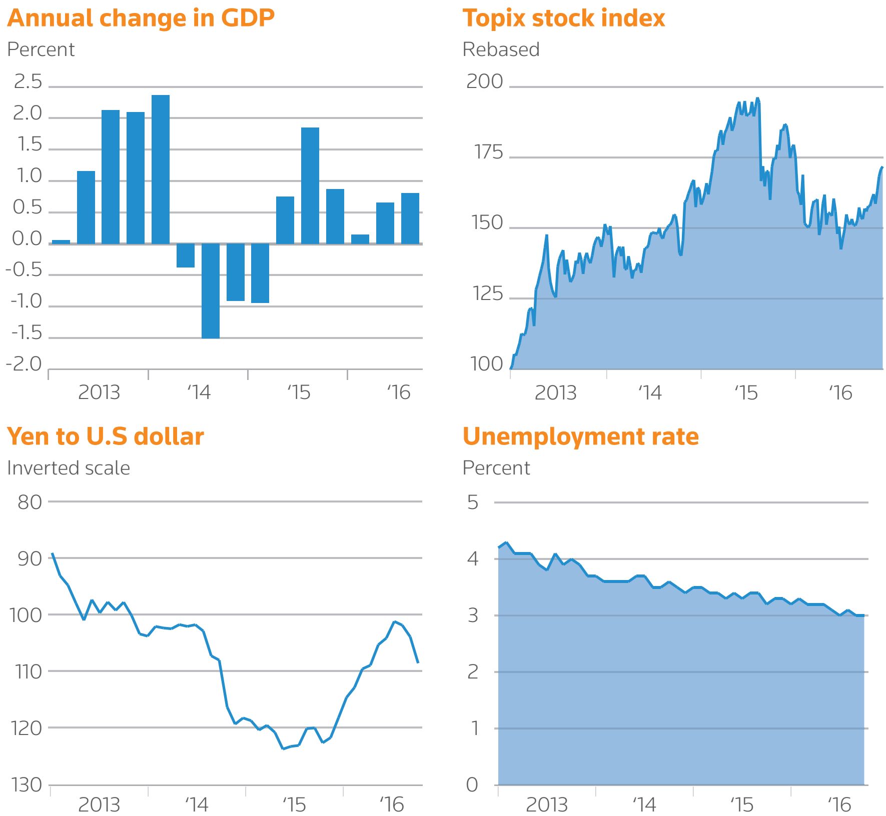
Japan and Abe can profit from the Donald Trump era

By Quentin Webb

Shinzo Abe can turn the Donald Trump era to his advantage. At first blush, the quixotic behavior of the U.S. president-elect presents risks for Japan, which relies on globalisation and America's role as regional policeman. Hence the Japanese prime

The Abe dashboard

Japanese growth, stocks, the yen and unemployment under Prime Minister Shinzo Abe



Source: Thomson Reuters Datastream

minister got in to see the real-estate developer before any other world leader. But for all that, Abe could reap political and economic dividends.

Unusually for Japan, Abe is now one of the longest-standing leaders of a major democracy. That gives him more global clout, and greater domestic appeal, as a fixture in a world upended by populism. In Washington, too, Tokyo will have an ally in Japanophile Commerce Secretary Wilbur Ross. And for all of Trump's potshots at Japan during the campaign, Abe's right-wing Liberal Democratic Party has always been closer to Republicans than Democrats.

All of this will help if Abe wants to call a snap election to nab a stronger mandate and, with a tweak to party rules, stick around for the 2020 Tokyo Olympics triumph. Nor is Trump's casual disregard for Asia's balance of power all bad news for Abe. American wavering bolsters the case for reforming Japan's pacifist constitution – a long-held, politically fraught goal for Abe.

Economically, the likely death of the Trans-Pacific Partnership is indisputably a blow. Some in Asia-Pacific, including Abe's colleague Taro Kono, hope the trade pact could be reborn as a "Trump Pacific Partnership", as Kono dubbed it in a December Breakingviews predictions panel. That looks optimistic.

Nonetheless, the wider backdrop is copacetic. If the U.S. economy picks up, as now seems likely, Japan's usually follows. As of early December, the yen had sunk to a very comfortable 113 to the dollar – enough to juice exporters' profits without hitting consumers too hard. Many firms have bought sizeable businesses abroad, such as drinks giant Suntory, insurer Sompo, or construction equipment-maker Komatsu. They will get a boost as foreign profits are repatriated in yen.

Abe also has extra cover to step up fiscal stimulus. After all, increasing government handouts is always easier than pushing painful structural reforms to job security or immigration. The irony is that a year ago the Group of Seven could hardly bear to endorse Abe's call for fiscal policy to take over from overworked central banks. Now America is bracing for an infrastructure splurge, the Bank of Japan is underwriting interest-free 10-year money, and Abe stands tall.

Psychedelic drugs enlighten $2.5 trln problem

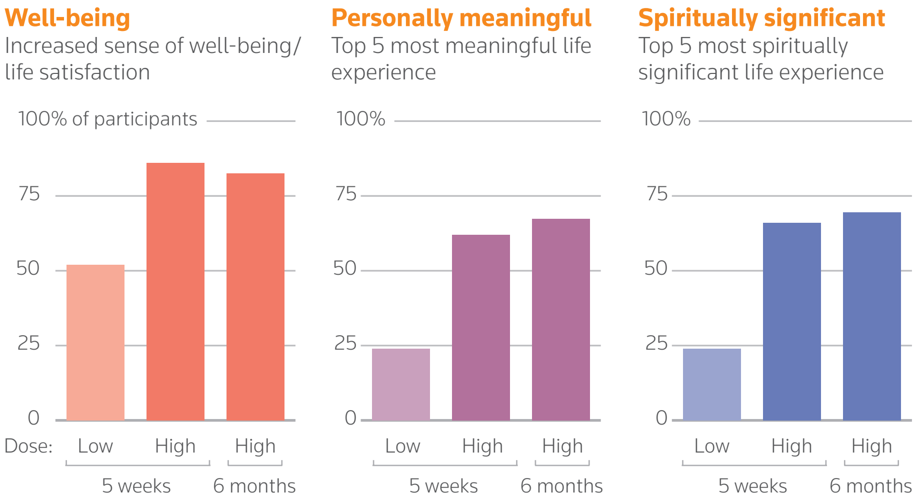
By Dominic Elliott

Tune in, turn on, cash out: magic mushrooms could boost economic productivity and offer decent investment returns simultaneously. Recent clinical trials of psilocybin, the active ingredient of the illegal psychedelic fungi, show it has alleviated some select forms of mental health suffering without causing significant side effects. A single administration in a supportive clinical environment can provide immediate and lasting results for six months and beyond – a substantial improvement on current therapies.

As well as huge gains for individuals, there could be enormous benefits for society. The cost of mental illness globally was as much as $2.5 trillion in 2010 and could more than double by 2030, reckons the World Economic Forum. Using those numbers, medical journal The Lancet has argued that investments in mental-health treatment have high

'Shrooms for improvement

Magic mushrooms' active ingredient benefited the majority of 51 cancer patients with depression and anxiety in a trial conducted by Johns Hopkins University scientists.



Source: Journal of Psychopharmacology, Johns Hopkins University

returns. If $10 billion were invested every year from now until 2030, the net present value of enhanced economic productivity might be $400 billion.

Investing in psychedelic medicine thus seems a no-brainer. Two separate clinical studies of cancer patients with depression or anxiety, the findings of which were published on Dec. 1, found meaningful improvements in mood without serious adverse reactions. Laboratory work on the use of trippy pharmacology to treat disease had been similarly problem-free in the 1960s. But funding for research dried up abruptly when the politically provocative escapades of enthusiasts like psychologist Timothy Leary caused the United States and other countries to outlaw hallucinogenic drugs at the start of the 1970s.

Despite its status as a controlled substance, psilocybin has started going into traditional late-stage pharmaceutical development. International trials are slated for the Netherlands, Norway and the United Kingdom over the next two years – and could be extended to other countries.

Commercialising psilocybin could be knotty. Innovative financial solutions will probably be required to fund the costs of specialist training for supervisors and the production of pharmaceutical-grade quality. It may be too much to expect 'shroom bonds to catch on in the next 12 months. But after psychedelic medicine's fraught trip to scientific rehabilitation, an alternative reality is now here.

Gene therapy is ready to become hereditary

By Robert Cyran

Gene therapy is about ready to be the next big thing. The prospect of treating diseases by tinkering with DNA has a long history of both promise and frustration. Steady progress means 2017 should be the year the technology finally hits the U.S. market. The problem may be figuring out how to pay for cures.

A person holds pharmaceutical tablets in this picture illustration taken in Ljubljana, Slovenia, Sept. 18, 2013. REUTERS/Srdjan Zivulovic

In the 1990s, researchers used viruses to replace defective genetic code, essentially healing an immune-system disease. The resulting boom was short-lived, however. A death and several cases of cancer in subsequent trials ended most of the related research.

Scientists who stuck around in the field have made advances. Infective agents used today are less likely to insert their payload into a location that causes cancer, and are more likely to successfully modify targeted cells.

Two or more gene therapies soon could be approved in the United States. GlaxoSmithKline's treatment for a rare and deadly immune disease probably will get the green light from regulators on the strength of the data. Smaller biotech Spark Therapeutics also will seek signoff for a therapy to restore vision in an inherited form of progressive blindness.

Neither may generate bountiful cash. GSK estimates there are perhaps 12 new American patients for its drug each year. It charges about 600,000 euros per person in Europe, where it already has been approved. The $90 billion pharmaceutical company hopes, however, to use its viruses, factories and know-how to roll out a different new treatment annually.

Spark's bigger promise is in hemophilia. Subsequent potential cures could be blockbusters. Sickle-cell disease, for example, can cut decades off a patient's life, but may be amenable to a cure. It afflicts 100,000 Americans.

These genetic developments are also having an effect in bigger diseases. One of the hottest areas in oncology is modifying immune cells to recognize cancerous ones. Regenerating damaged tissue offers even bigger, more distant prizes.

They won't come cheaply. The industry initially thought most one-shot cures would be priced at $1 million apiece. Given that hundreds could be developed, the resulting sums would be prohibitive for many societies. Payment for therapies based on efficacy and evidence of savings elsewhere, such as reduced hospitalization, may offer a way to solve the conundrum. These genetic problems could be passed down starting next year.

Investment banks' next trade will be EU education

By Dominic Elliott

Education could be the big trade of 2017 for investment banks. No European city has as many international school places as London. That's a problem for firms thinking of shifting staff out of the UK capital following the referendum to quit the European Union. The solution is for banks to get into the education business themselves.

Westminster School students gather for a group photograph outside Westminster Abbey in London, Britain, April 29, 2016. REUTERS/Stefan Wermuth

In London, bankers can choose from a wide range of state-funded, private and international schools when deciding where to send their offspring. In other European countries, however, English-language education is more limited. Madrid has 20 schools that meet the U.S. government's approval. But Paris has just 11, while no other European financial centre makes double figures. French government-approved schools are even less prevalent.

Investment banks have long been aware of the problem. Years before the Brexit vote, JPMorgan wanted to work out how hard it would be to move its London-based currency trading desk to Paris. The U.S. bank concluded it would take 30 years to find school places for the children of the department's 800 employees, says a person who worked on the project.

Banks also have a knack of coming up with financial solutions. In Asian cities like Singapore and Hong Kong, financial institutions buy corporate debentures – effectively interest-free loans – that guarantee them a certain number of places at local international schools. In London, French banks BNP Paribas, Calyon and Société Générale extended a long-term loan to fund the creation of a French school in Kentish Town in 2011. BNP also financed the foundation of a lycée in Wembley in 2014.

According to corporate relocation executives, new schools often spring up in short order when workers move to a city. But housing shortages make it harder for finance workers to move. Only Madrid appears to have any great additional housing capacity, though even then only enough to absorb a smattering of refugees from the City of London.

So banks will need to work hard to persuade staff of the merits of relocating. Funding new schools – and using the promise of guaranteed places for their children to lure workers – could be the year's hot investment-banking trade.

Drones will take off for big business

By Robyn Mak

Commercial drones are getting ready for take-off. Today's niche market mainly targets hobbyists. But that will change as countries clear up legal uncertainty and big corporations turn to commercial drones for everything from crop-dusting to parcel delivery.

Drones, or unmanned aerial vehicles, have long been used by the military. In the past few years, consumer demand has steadily risen as costs have come down and the technology has improved rapidly. Tech enthusiasts and photography aficionados have been particularly keen. Shenzhen-based DJI's remote-controlled, foldable Mavic Pro is one of the holiday season's most anticipated gadgets. Data tracker IHS Markit reckons consumer drone sales will hit $1.6 billion globally in 2016.

Businesses are also looking to the sky. Amazon boss Jeff Bezos first unveiled his vision of using drones to deliver packages back in 2013. And Chinese peers Alibaba and JD.com have recently trialled drone deliveries across the People's Republic. Traditional industries like farming, energy and building are testing ways to use unmanned aircraft for everything from oil and gas exploration to repairing wind turbines.

Despite the huge promise, the commercial market is still tiny, and less than half the size of the consumer market. Most countries have yet to establish clear guidelines for commercial drone usage. And as businesses start using drones to collect data and information, privacy will become a big concern.

But change is afoot. In early 2016, before the Chinese aviation watchdog issued the country's first set of interim rules specifically on unmanned aircraft. And in July, the United States introduced new licensing and safety requirements for businesses to operate small drones. Other countries are likely to follow suit.

Photographers take pictures of a drone flying at DJI's flagship store in Hong Kong, China, Sept. 22, 2016, two days before its opening. REUTERS/Bobby Yip

The financial windfall for drone makers, like the $10 billion DJI, will be small at first but could in time be huge. In China, the commercial drone market will be almost as big as the consumer one by 2020, reckons Jean Xiao, research manager at IDC. The country's overall drone sales will expand roughly ninefold. Tech groups from chipmaker Qualcomm to venture-backed upstarts like 3D Robotics are racing to develop hardware and software. For the drone industry, the sky's the limit.

Harry Potter can add magic to predictive power

By Jeffrey Goldfarb

Harry Potter's upcoming 20th birthday is a good occasion to add some magic to predictive power. It's a well-worn tale that, before the boy wizard first hit British bookshelves on June 26, 1997, author J.K. Rowling was turned away by dozens of agents and publishers who couldn't see the value of investing in such a fantastical yarn. Similarly closed minds help explain why recent political upheavals have surprised many and economic outlooks are so often wrong. A little imagination could help.

Guests take a ride on a rollercoaster outside the Hogwarts School during a soft opening and media tour of "The Wizarding World of Harry Potter" theme park at the Universal Studios Hollywood in California, United States, March 22, 2016. REUTERS/Kevork Djansezian

The two-decade mark is a good time to take stock of the success spawned by occurrences at Hogwarts School of Witchcraft and Wizardry. More than 450 million copies of the seven books have been sold around the world. The global box office for the related movies is over $8 billion and rising.

NBCUniversal's theme park revenue has grown strongly since it opened its Harry Potter attraction in Florida in 2010. A new TV deal with the Comcast-owned company will generate still more galleons. There are countless T-shirts and toy wands, as well as a West End play inspired by Rowling's characters.

Not even Albus Dumbledore could have seen it all coming, but just a bit of vision might have prophesied at least a modest-selling children's series. The same can be said for economists who failed to anticipate the dozens of downturns around the world in 2008 and 2009.

Even when Hollywood does the advance work by dreaming up disaster scenarios, risk assessors fail to pay attention. Low-probability tragedies such as the Deepwater Horizon debacle and the Fukushima earthquake and tsunami were widely underestimated by companies, politicians and investors. In Silicon Valley, where venture capitalists are generally open to some of the wildest ideas, many have rejected and missed out on big successes including Airbnb.

Bad data, modeling errors and general randomness all can easily be blamed. Just as often, however, confirmation biases and tendencies to fall back on conventional analysis or wisdom create blind spots. That is how world leaders and investors ended up so thoroughly bewildered by Donald Trump's election victory and Britons voting to withdraw from the European Union.

There are no spells to help Muggle forecasters get it 100 percent accurate. To encourage creative thinking, however, perhaps they should add a column to every spreadsheet labeled "Patronus," the positive force that acts as protection in the wizarding world. And when building a library of inspirational business books for 2017, be sure to add "Harry Potter and the Philosopher's Stone."

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