

EU 2018 – From Risks to Opportunity?

Fujitsu Research Institute

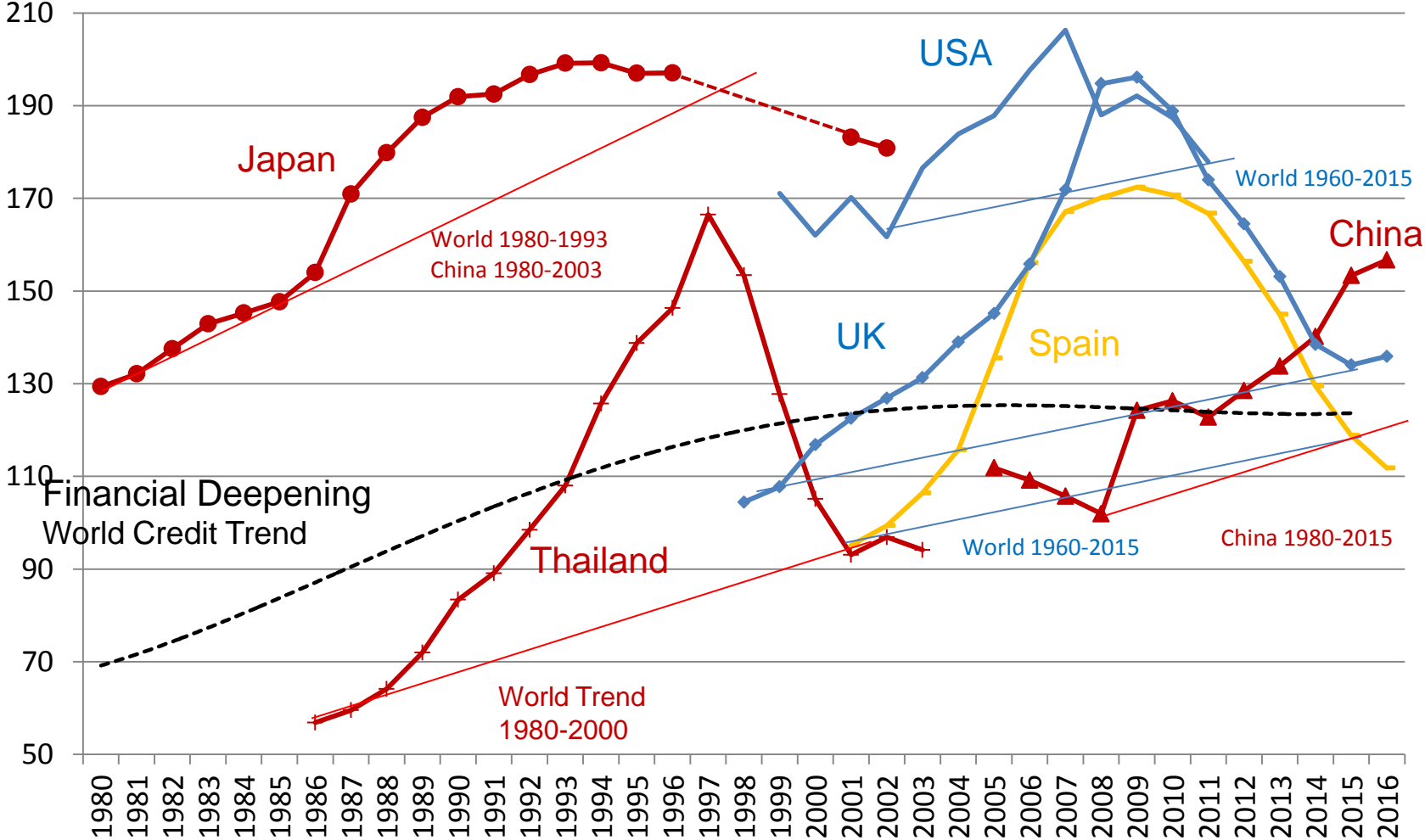
Dr. Martin Schulz

2018.02.07

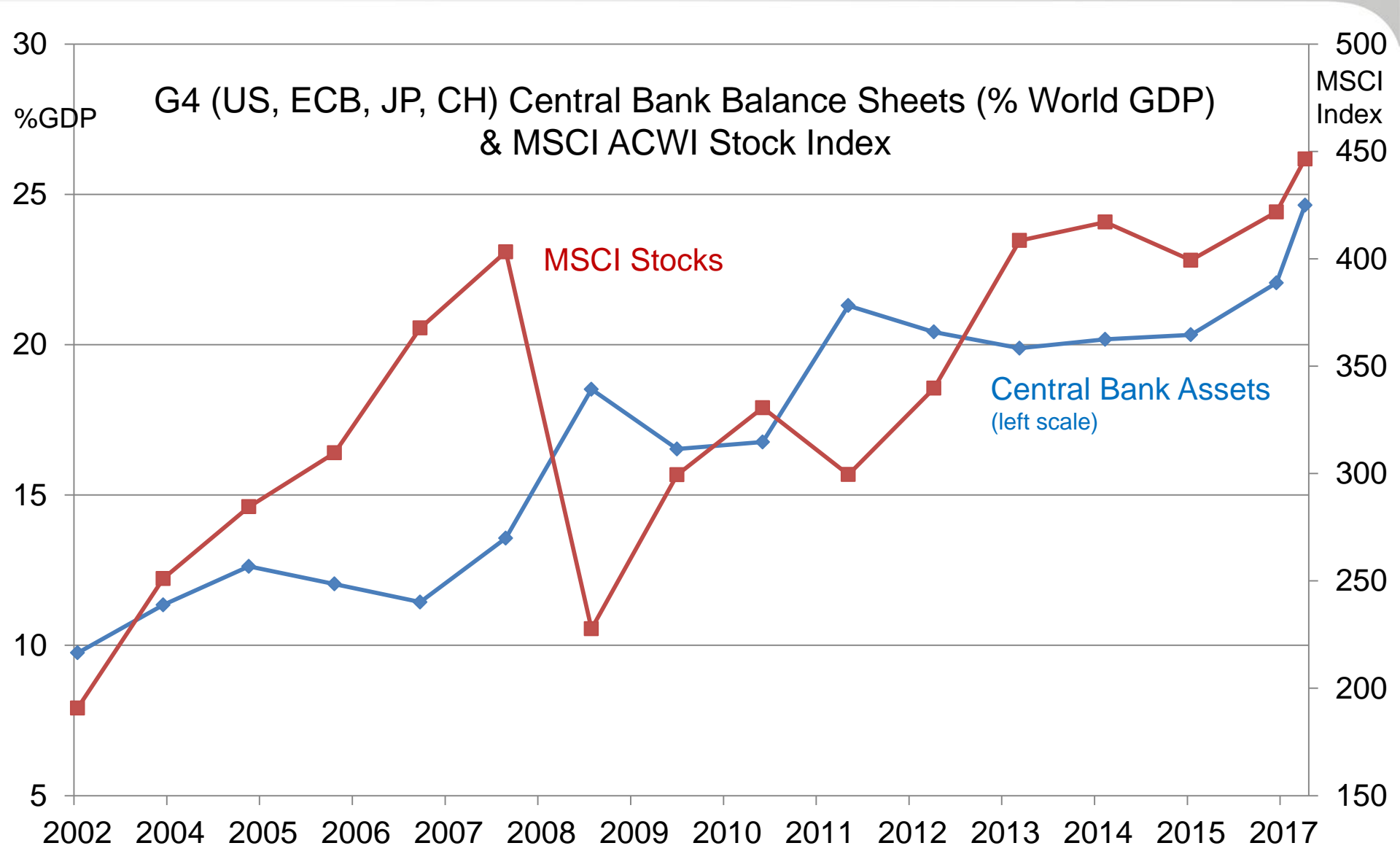
- End of easy money – Europe at risk again?
- EU market recovery – opportunities or more shocks?
- Japan and Europe – trade and investment

Financial Bubbles: Back to Normal?

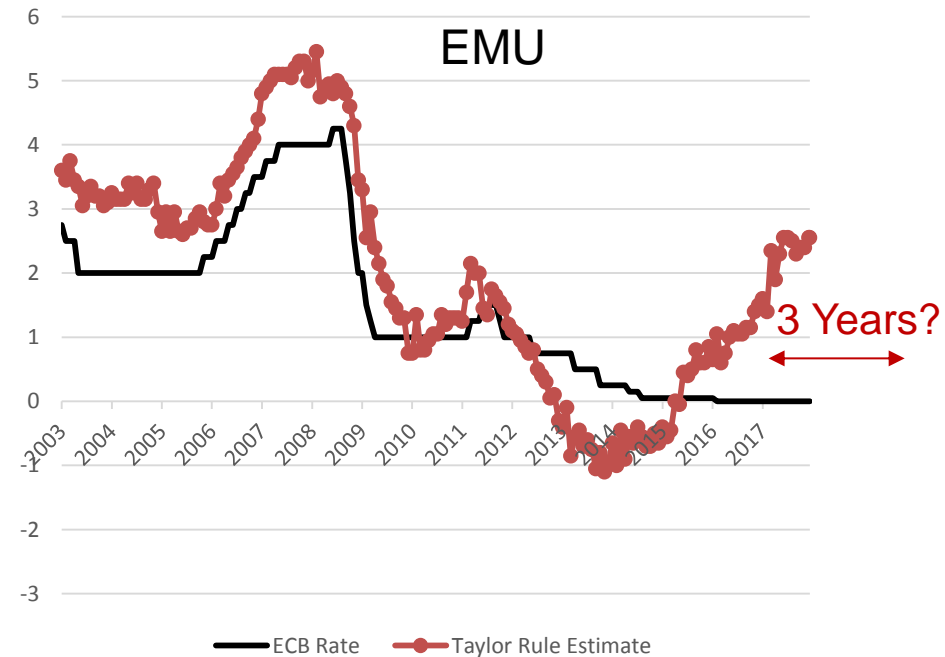
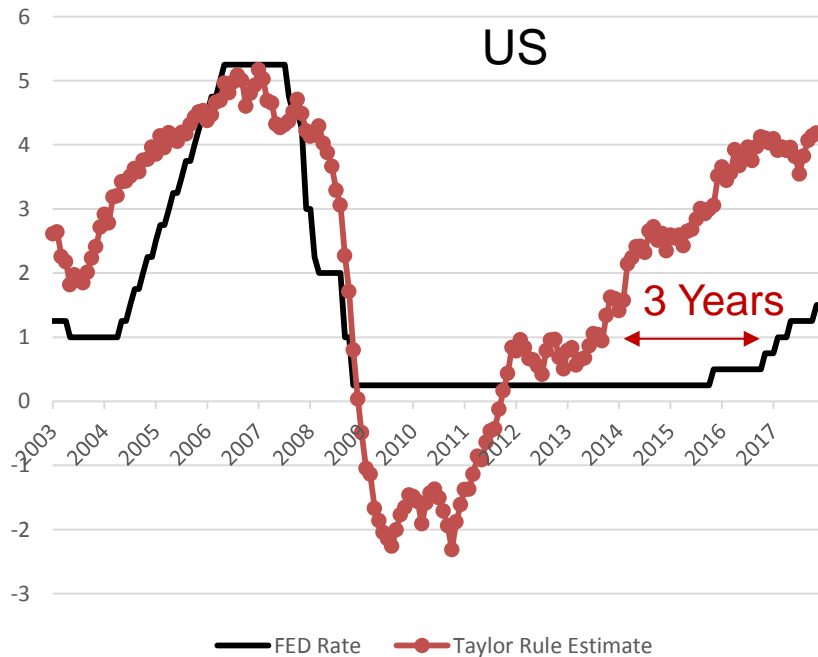
Domestic Credit to the Private Sector (% GDP)



Central Bank Assets Drove Asset Bubbles



ECB Policy Rate vs Taylor Rules for US & EMU



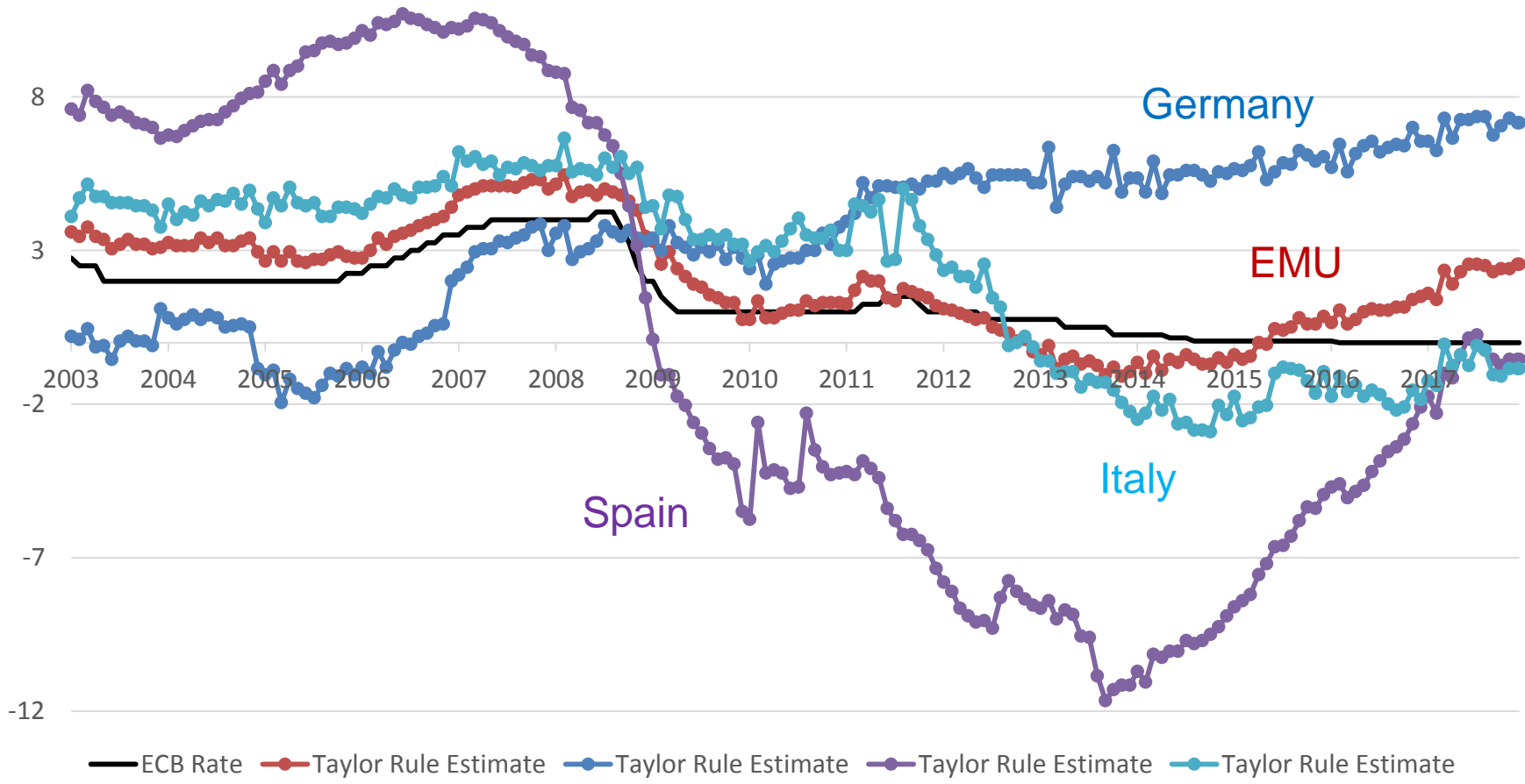
Taylor Rule: Policy Rate = Interest Rate^{long-term} + 0.5 (Inflation Gap) + 0.5 (Employment Gap)

➤ ECB follows FED with a 2-year time lag

Taylor Rule Estimate EU: Policy Rate = Neutral Rate 1.5% + Inflation + α (Inflation – Target 2%) + β (Nairu 8.5% – Unemp)

Restructuring: EU Recovering, Germany Booming

ECB Policy Rate vs Taylor Rules for EMU, Italy, Spain

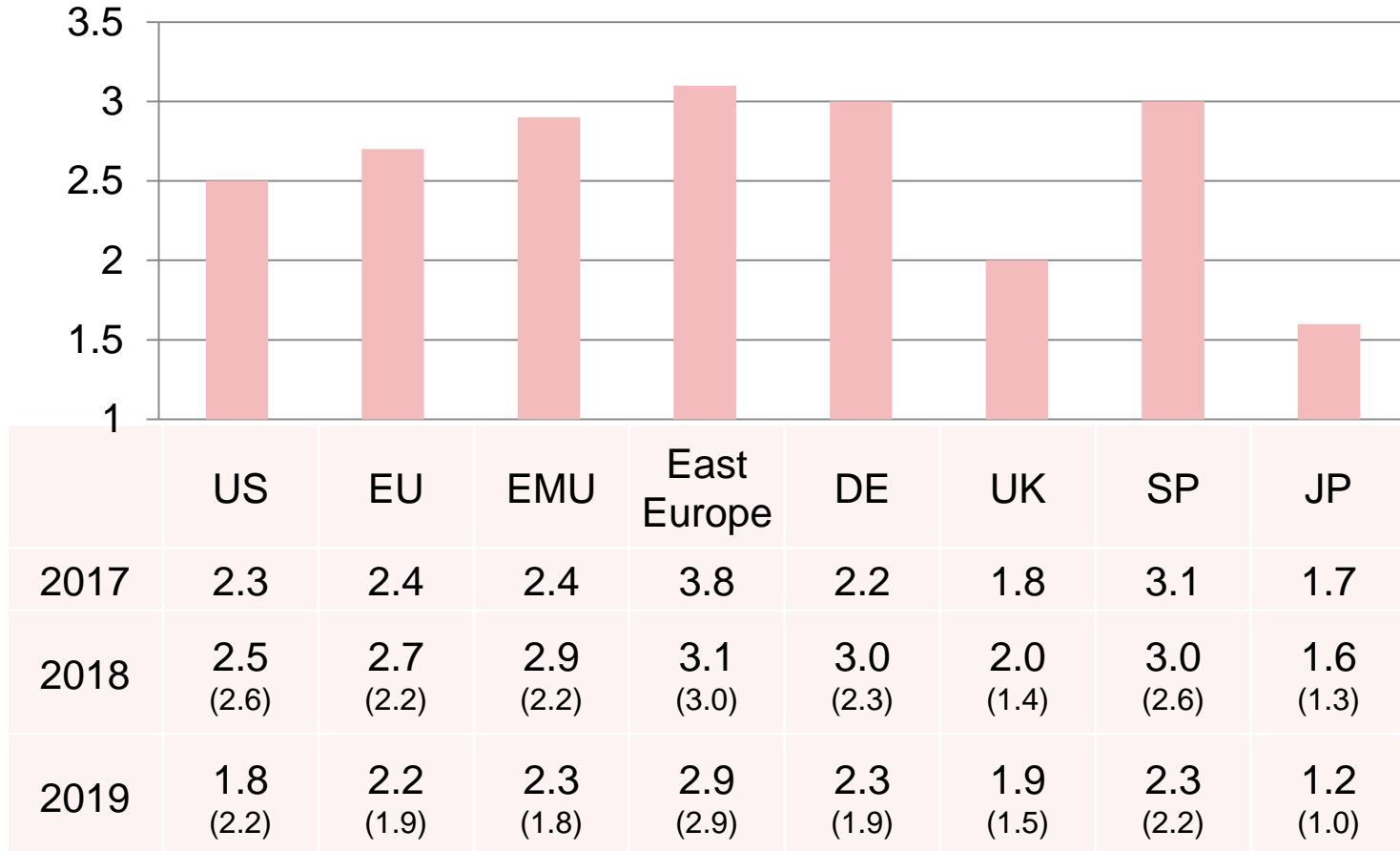


Spain=15%

Taylor Rule Estimate: Policy Rate = Neutral Rate 1.5% + Inflation + α (Inflation - Target 2%) + β (Nairu 8.5% - Unemp)

- EU market recovery – opportunities or more shocks?

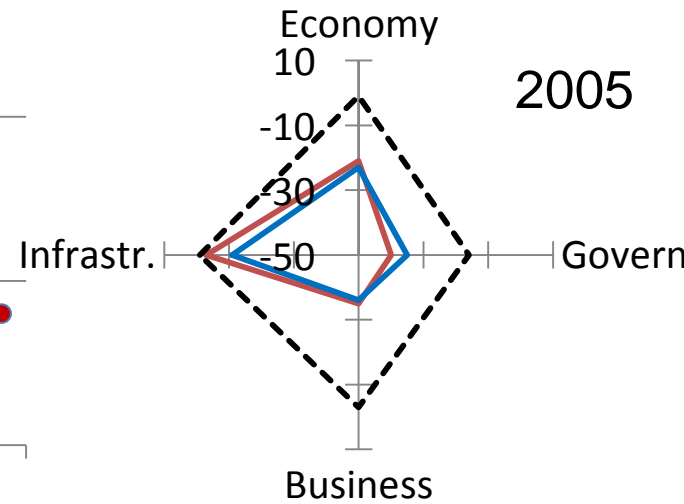
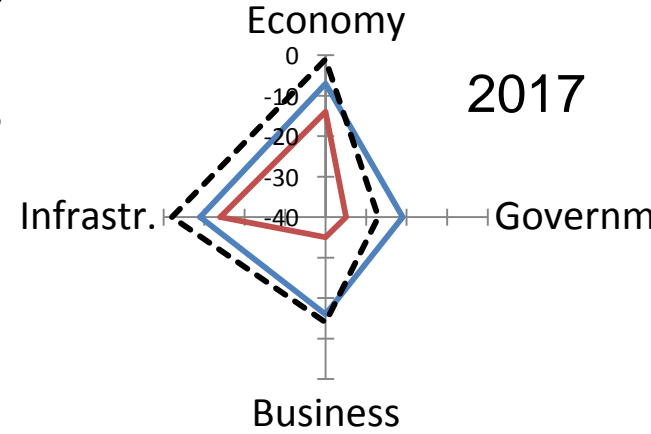
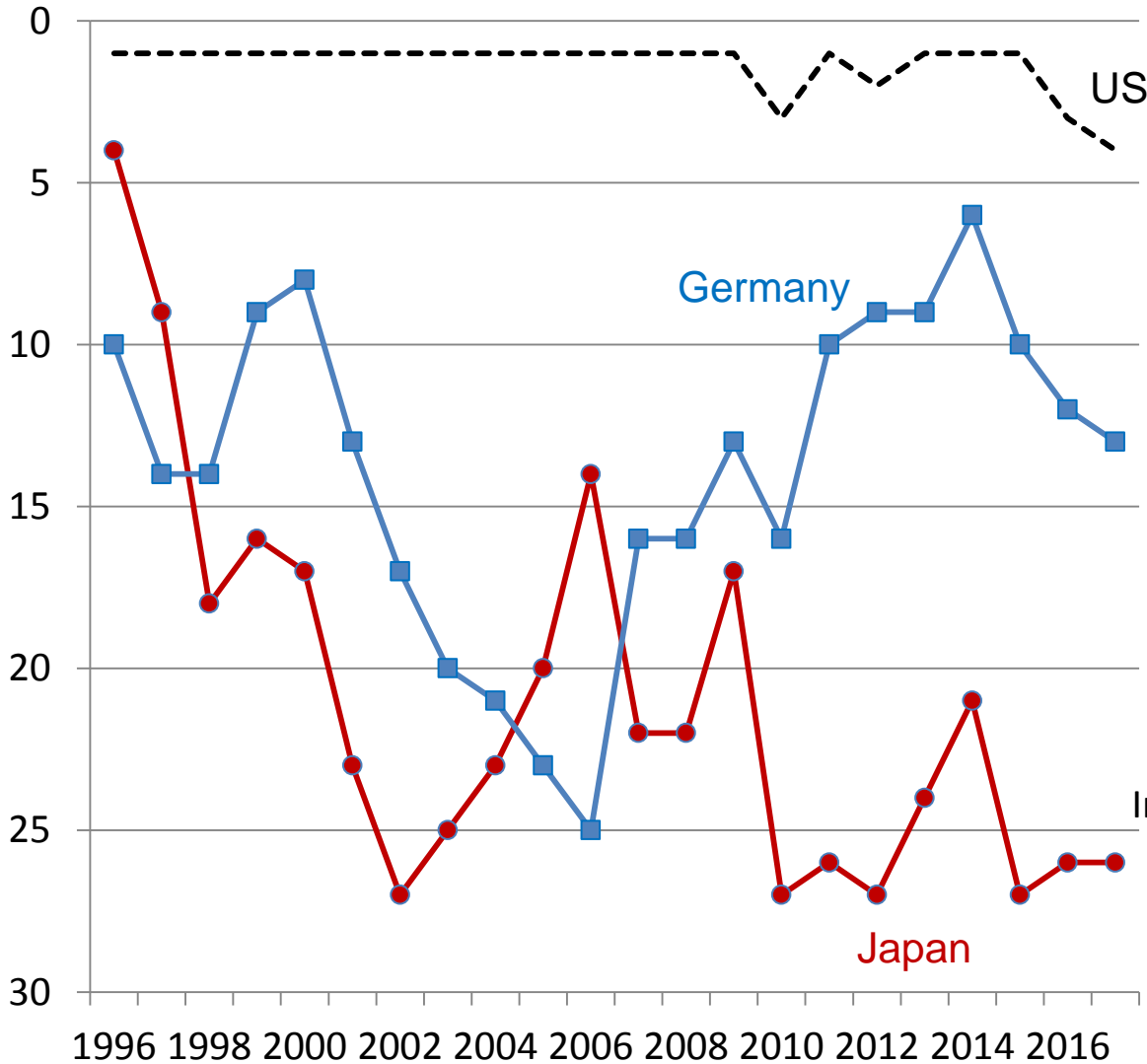
2018 Growth Forecasts



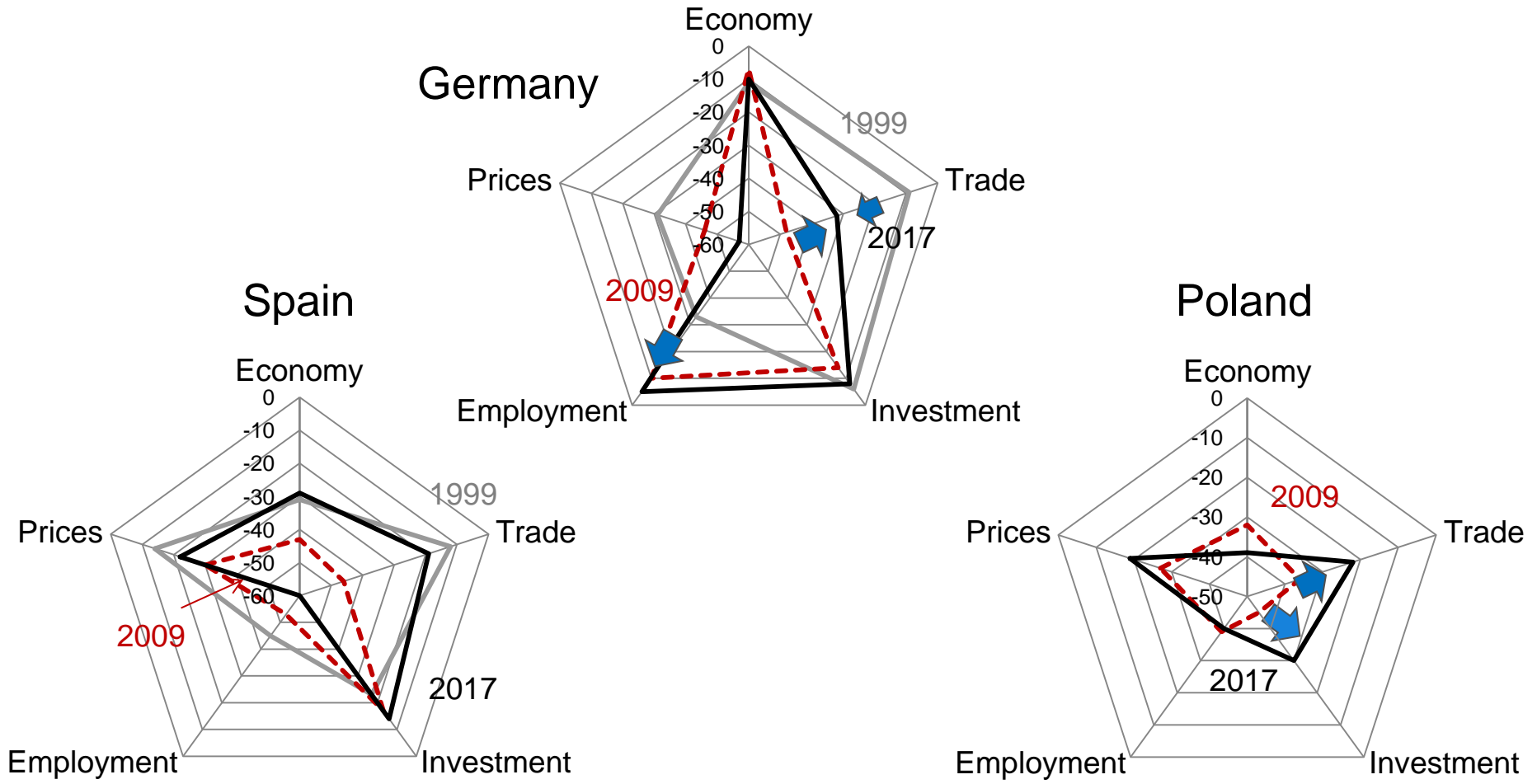
Note: Growth Forecasts by JP Morgan on Feb 2, 2018; (Bloomberg consensus forecasts in brackets)

➤ Recovery in the EU pushes growth beyond the US

IMD Competitiveness: Macro Economy

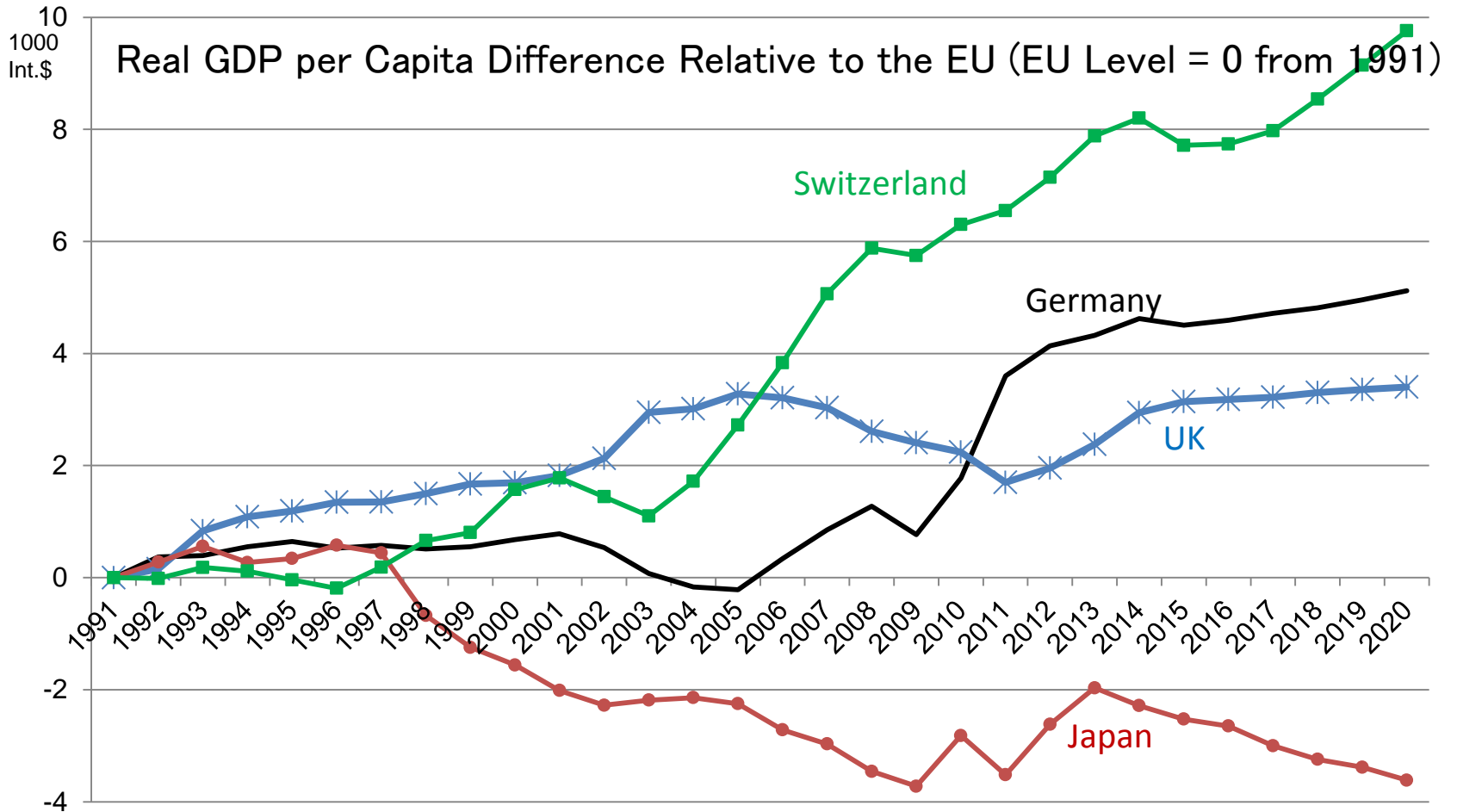


IMD Competitiveness: Economic Performance



➤ Competitiveness has recovered in most regions

Big Restructuring Impact on Real Incomes

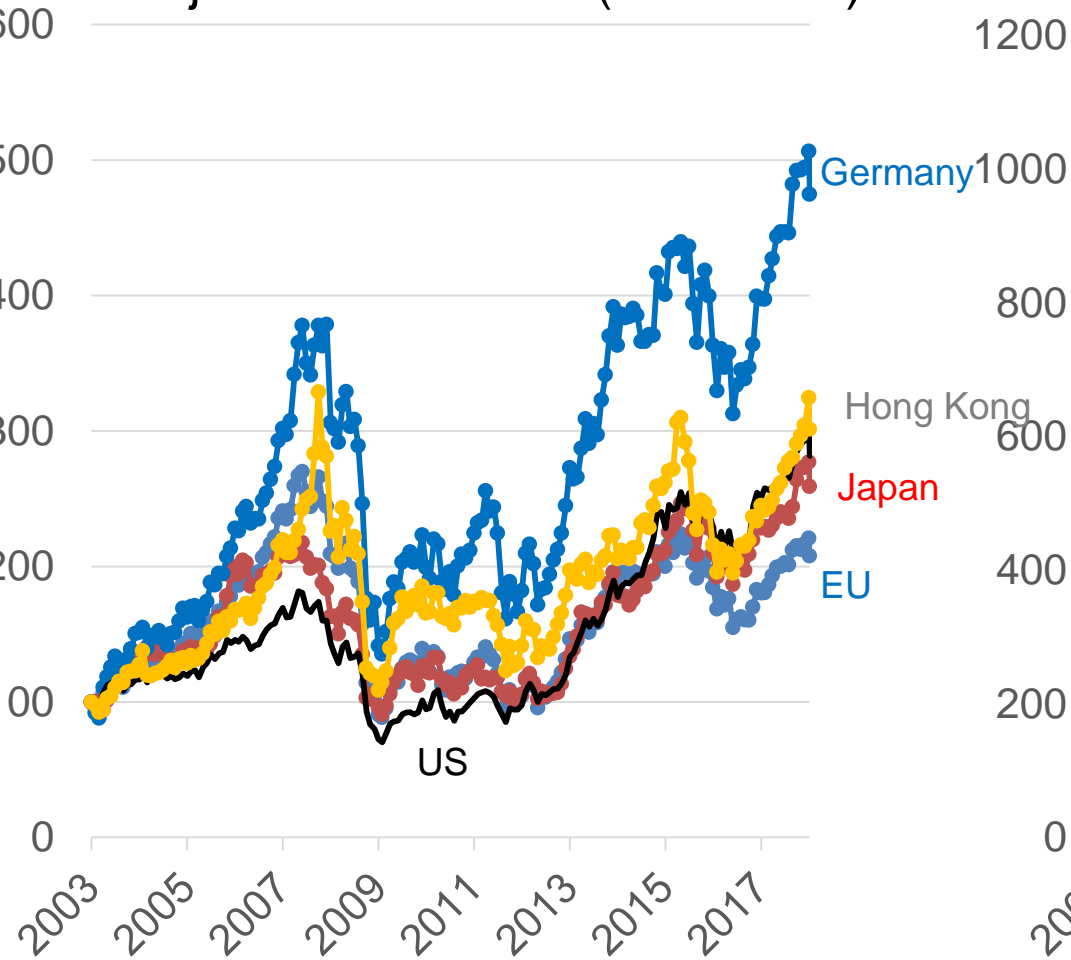


Note: Based on purchasing power parities (PPP) calculated as IMF "international" dollars.

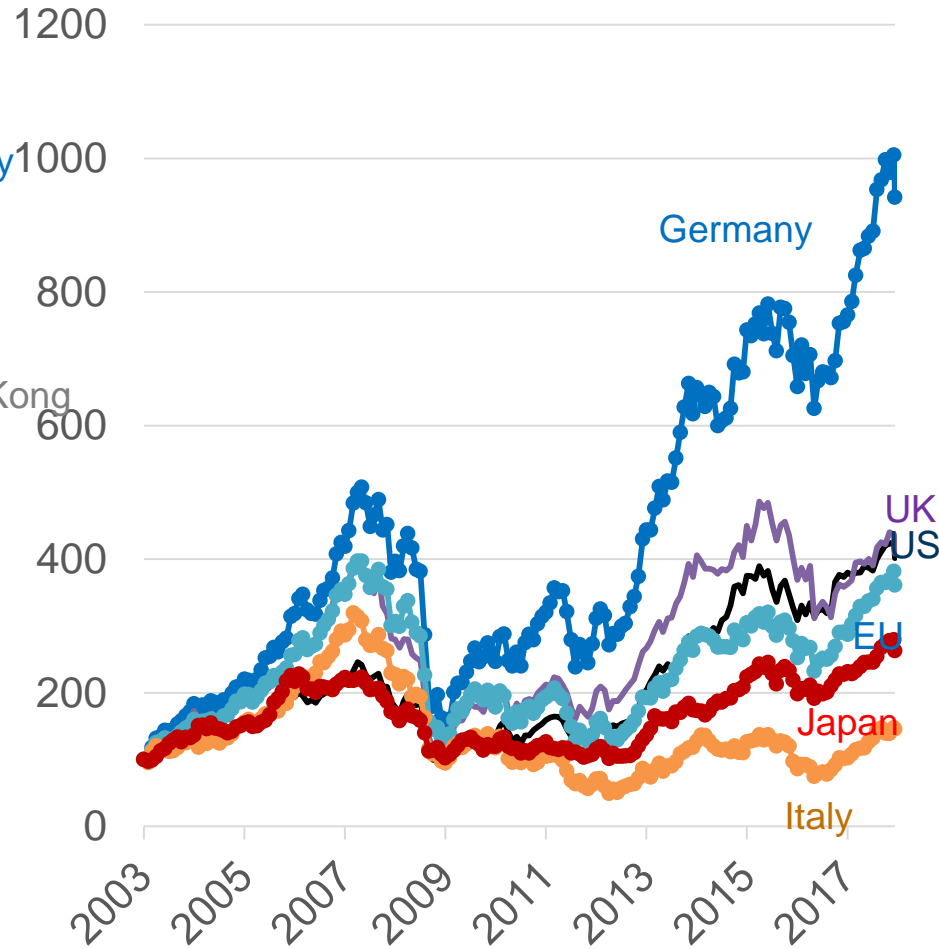
■ Restructuring resulted in growth and imbalances

EU Mid-Size Companies Gained from EU Integration

Major Stock Indices (JPY Base)



Mid-Caps (JPY Base)

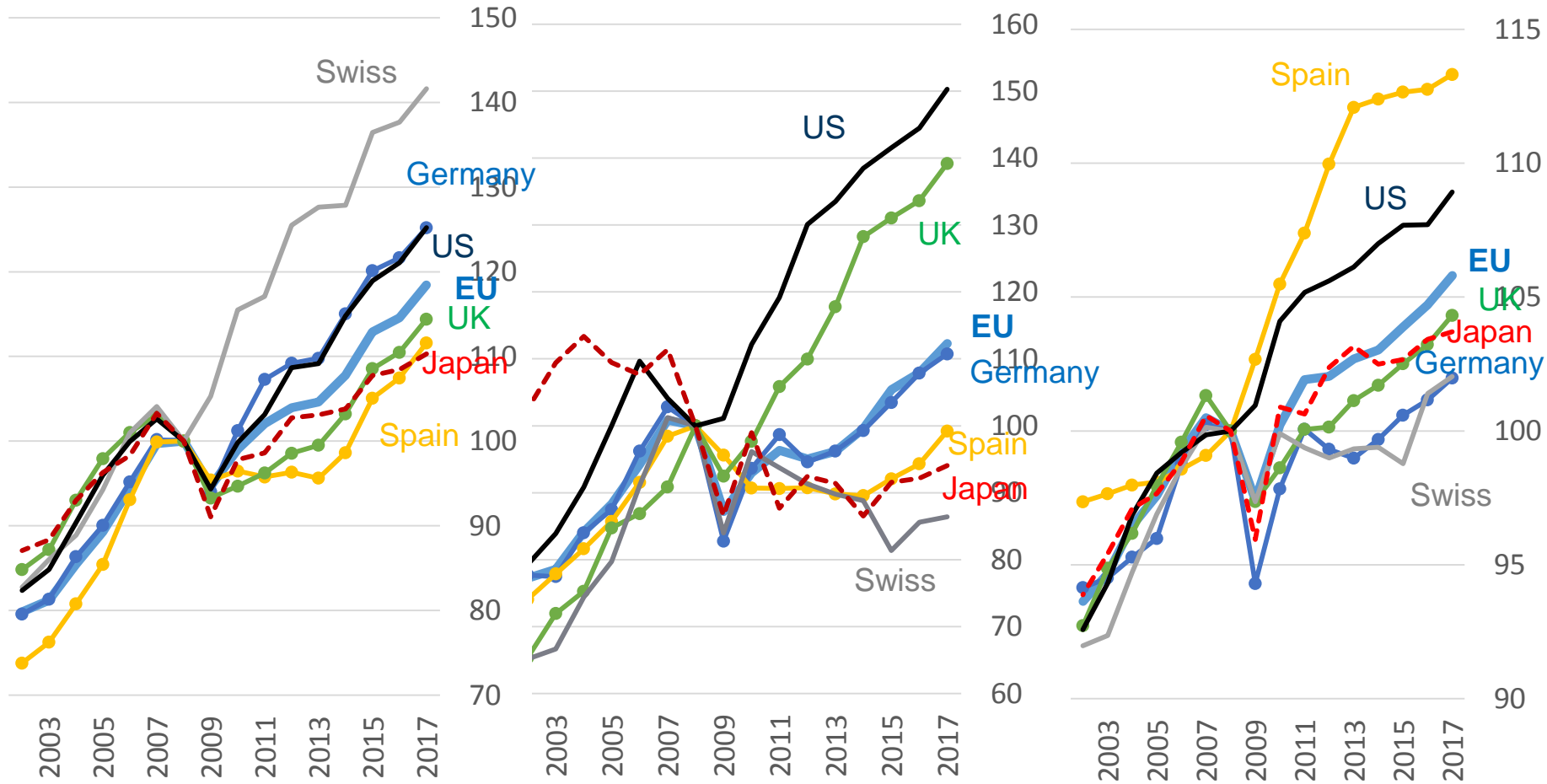


Note: SP500, Dax, Hang Seng, Stoxx, Nikkei country indices.

Real Disposable Income

Net Operating Surplus

Labor Productivity



Note: 2008=100. 2010 prices. Based on local currencies.

- EU of “many speeds” emerging
 - EU Council has become the de-facto executive institution, enforcing national reforms from banking to security
 - National (reform) policies lead to different national levels of integration with a stronger focus on trade, industrial policy, competition
 - EU integration policies are challenged by national agendas

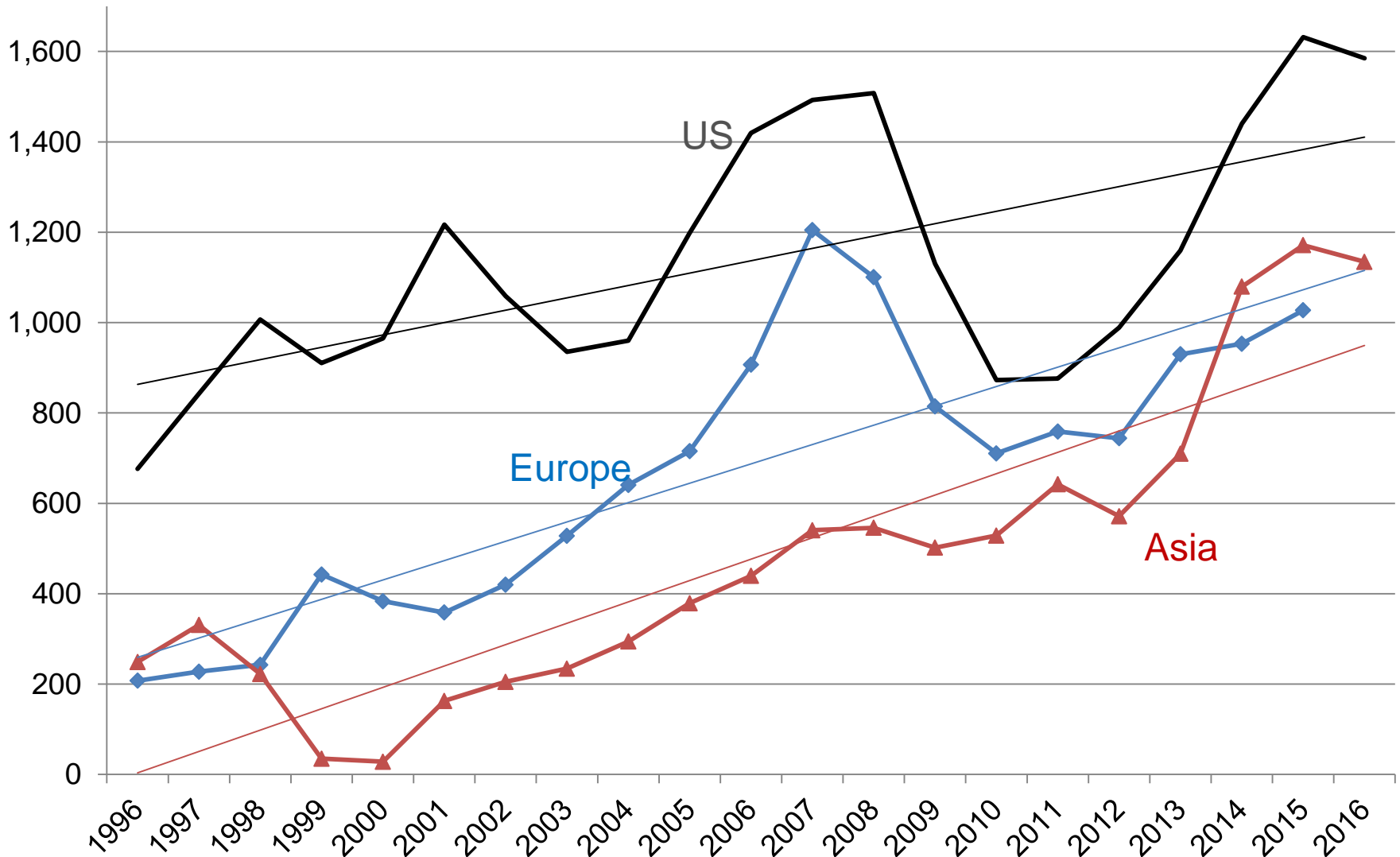
- Macron plan
 - EU Finance Minister & Budget for integration policies
 - EU Investment Initiatives (Fonds) for regional growth
 - Protecting the “core” EU with stronger institutions & representation

- Macron/Merkel/Schulz (France-Germany) negotiations
 - European Monetary Fund (EMF) with EU finance minister
 - Finalizing banking union, stabilizing fiscal policies
 - Support investment at the national level, financing EU investment funds

- Japan and Europe – trade and investment

Japan's Foreign Income: Europe remains Attractive

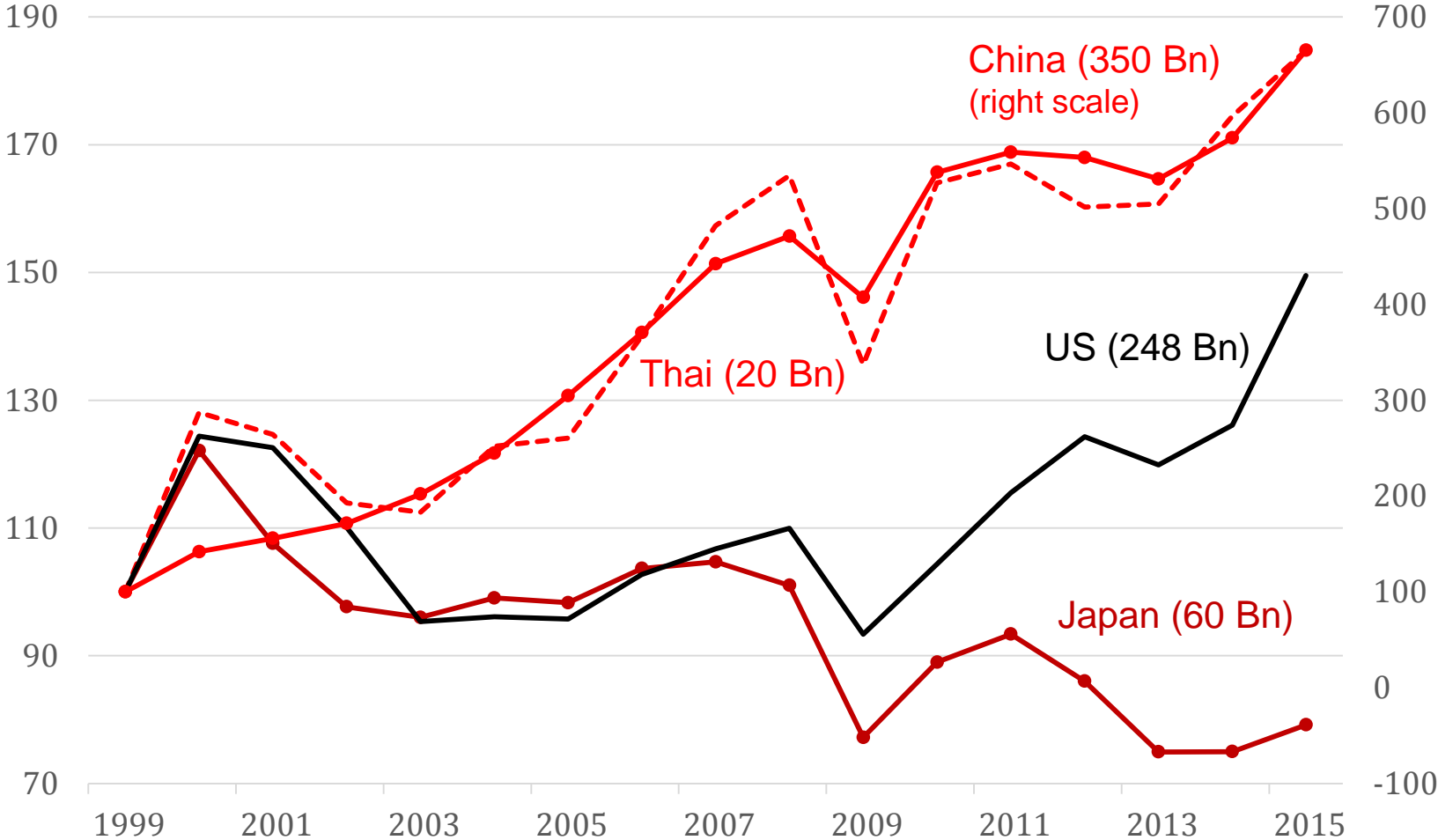
Japan's Regional Income Balance (Billion Yen)



Note: Current Account, Primary Income, Net Balance.

EU Trade – Japan Remains Below Potential

EU Import (1999=100; (Euro Bn))



Note: Korea, Thai imports as 6-month averages

Source: Data from CEIC (2017).

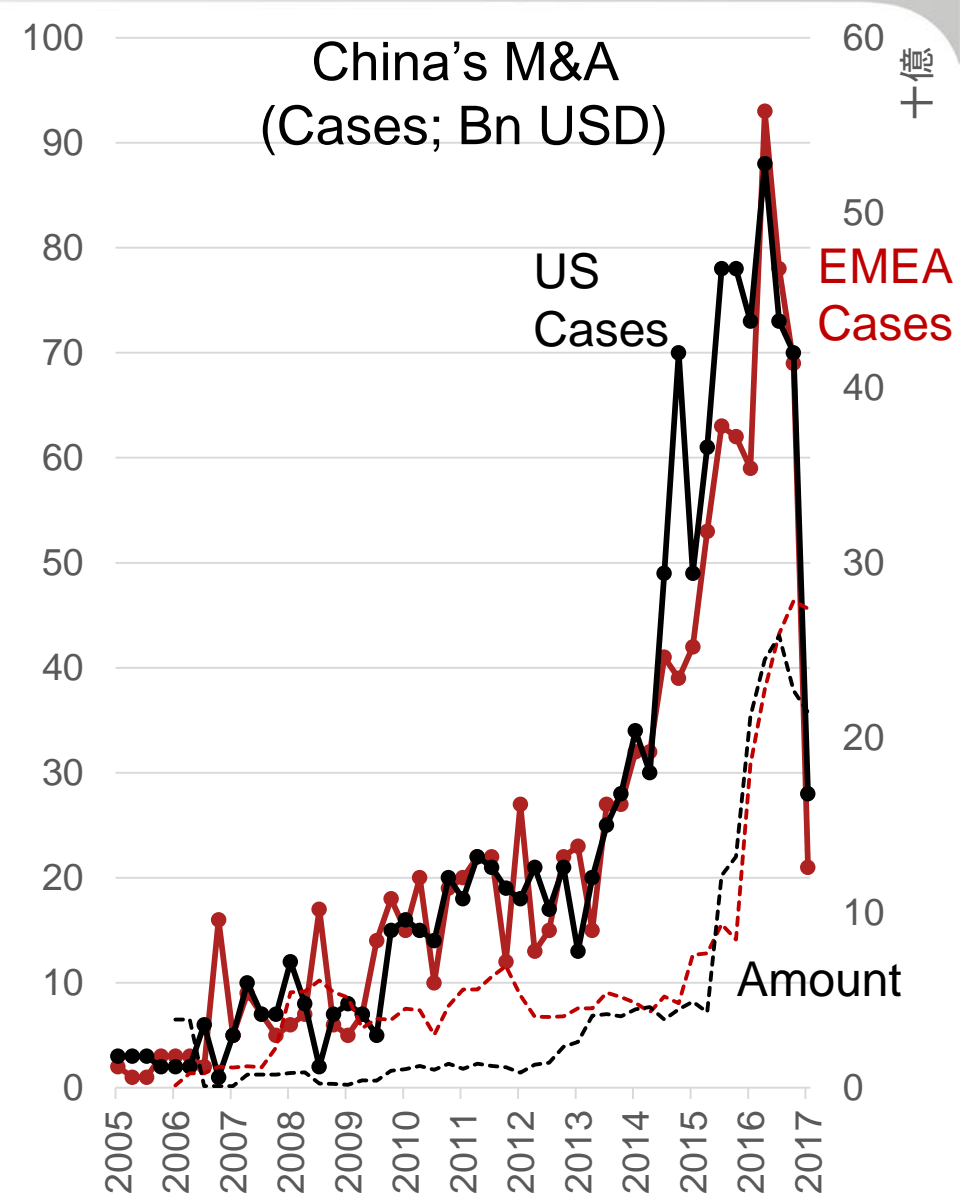
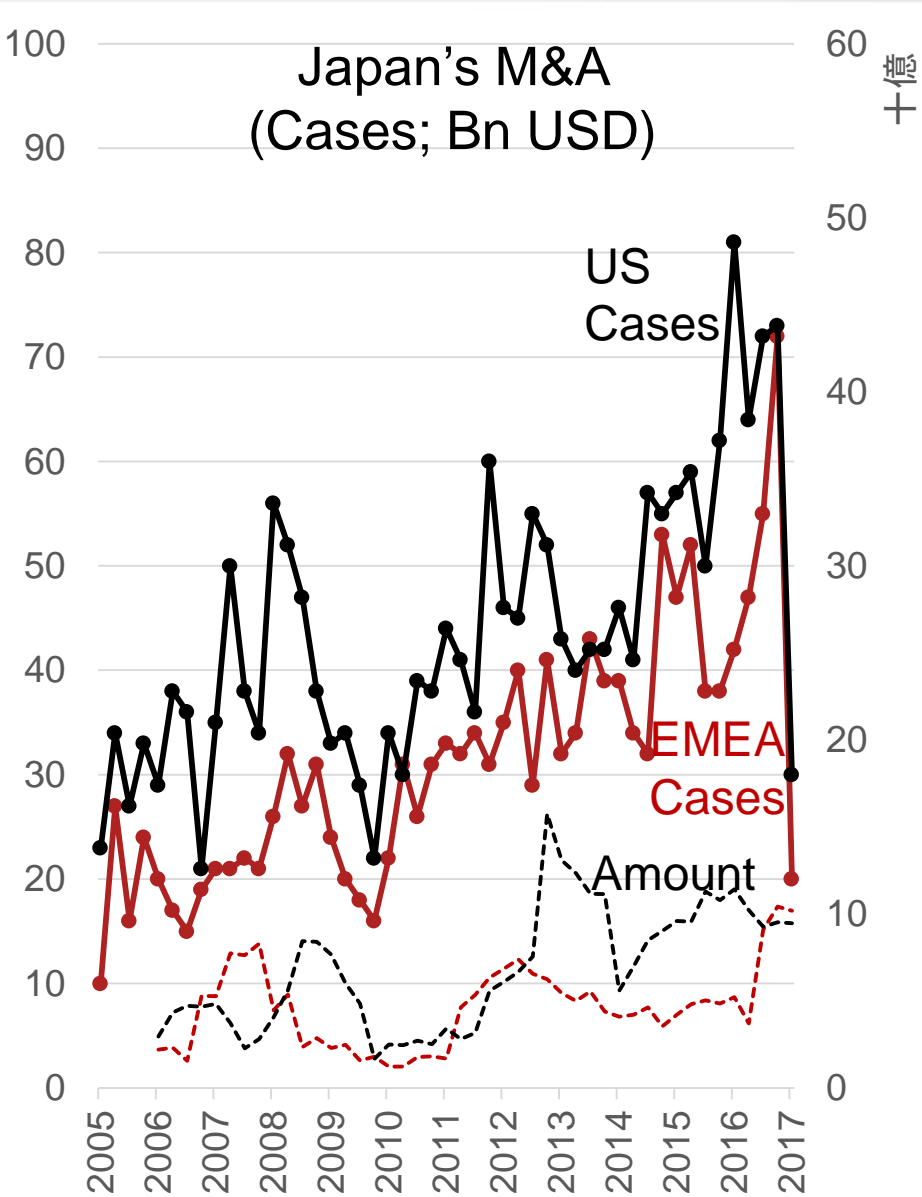
Top 5 Bilateral Export Gains by Industry (% share of total increase)

EU 28 Winning Sectors	Japan Winning Sectors
Food, feed, processed foods (55%)	Motor vehicles (47%)
Other manufacturing (14%)	Other machineries (21%)
Chemicals (incl. pharmaceuticals) (12%)	Electrical machinery (10%)
Business services (4%)	Chemicals (incl. pharmaceuticals) (8%)
Motor vehicles (3%)	Other transport equipment (7%)

■ GDP impact +0.2% for Japan and +0.1% for EU

➤ Only +5% EU and +1% Japan service export gains!

Investment has become the Most Important Driver



Note: All initiated crossborder cases, including canceled deals. Amounts as 5-quarter averages

Japanese & German M&A Cases in EMEA (2013-2018)

Top Sectors	Japan %	Germany %
Communications (Media, Advertisement, Internet)	11	10
Consumer, Cyclical (Auto Parts, Retail)	11	11
Consumer, Non-cyclical (Biotechnology, Commercial Services, Pharmaceuticals)	19	17
Energy (Alternative Sources)	6	5
Industrial (Electrical Comp., Electronics, Transportation)	20	17
Technology (Software)	15	12

➤ Almost identical investment preferences in JP & DE

China's EMEA and US M&A by Sector (Cases; EMEA %)

	US	EMEA	UK	Germany	Holland
Total Cases	1000	905	16.13%	17.20%	7.18%
Industrial	10.60%	21.44%	8.25%	27.84%	6.19%
Consumer, Cyclical	11.40%	17.35%	19.11%	21.66%	7.64%
Consumer, Non-cyclical	23.50%	15.14%	16.79%	10.95%	10.22%
Financial	7.80%	10.39%	28.72%	11.70%	7.45%
Energy	4.30%	9.17%	15.66%	12.05%	6.02%
Technology	20.40%	8.29%	14.67%	6.67%	12.00%
Basic Materials	2.30%	7.18%	12.31%	12.31%	4.62%
Communications	14.30%	5.08%	30.43%	15.22%	2.17%
Utilities	0.60%	1.99%	16.67%	5.56%	0.00%
Diversified	0.70%	1.66%	6.67%	53.33%	13.33%

Trade Barriers?

Technology

Technology

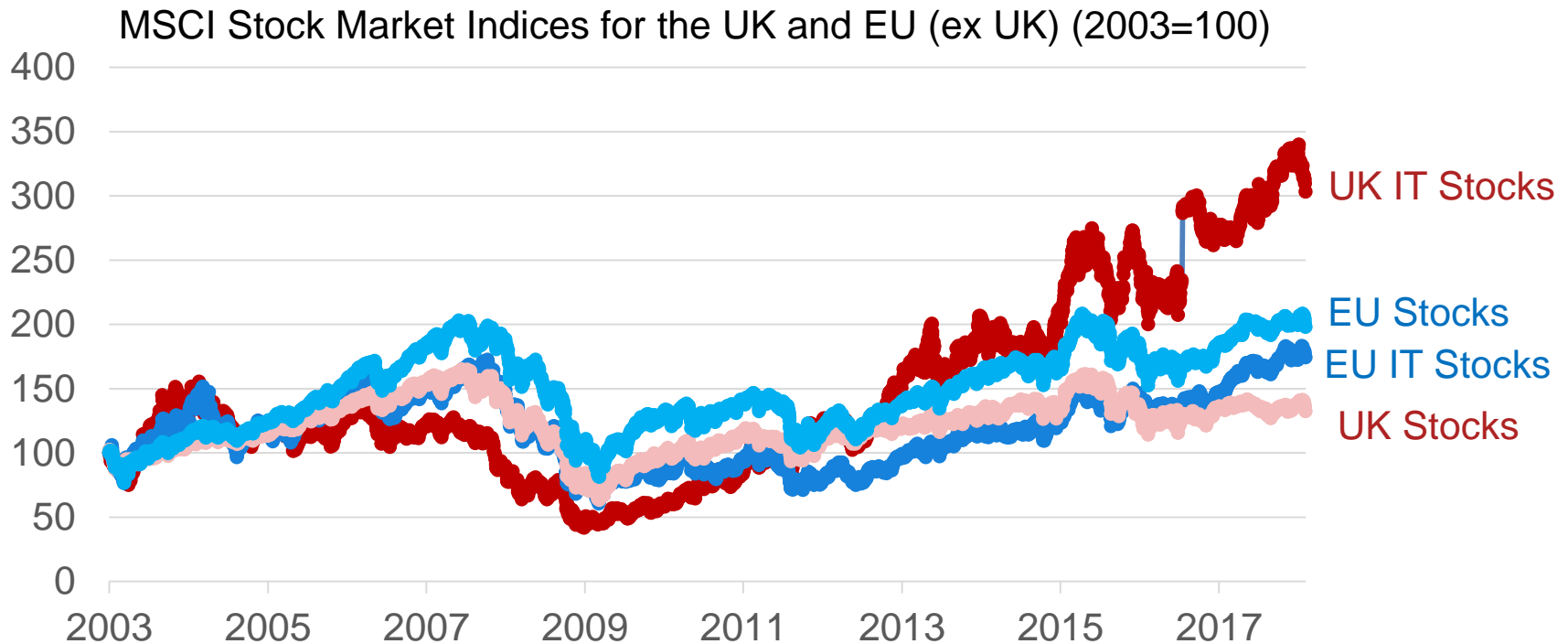
Note: All initiated crossborder cases, including canceled deals.

- Strong potential for EU Standards and regulations
 - if aligned with Japan's Asian investment

- Investor State Dispute Settlement (ISDS) Agreements
 - could not be advanced in Asia
 - new mechanisms necessary, EU Multilateral Court unlikely

- E-Commerce has become the most important economic issue
 - more than standards, governance will be key

Brexit Challenges: UK Innovation Center at Risk?



Note: EU indices exclude UK stocks.

- UK government estimates of Brexit costs:
 - “Hard Brexit”: -8% lower GDP in 2030 (WTO Tariffs)
 - “EU FTA”: -5% lower GDP
 - “Soft Brexit”: -2% when joining the general European Economic Area (EEA)
- UK’s dynamic service, R&D and universities profited from EU
- Finance, mobility and machinery technology might be at risk

Japanese M&A Cases in the UK and Germany (2011-2016)

U.K.	No.	Germany	No.
Commercial Services	13	Chemicals	11
Internet	10	Electronics	11
Food	9	Computers	9
Holding Companies	9	Machinery-Diversified	9
Computers	7	Auto Parts & Equip.	8
Alt. Energy	7	Commercial Services	5
Advertising	6	Misc. Mfg	4
Software	6	Pharmaceuticals	4
Entertainment	4	Biotechnology	3
Misc. Mfg	4	Hand/Machine Tools	3
Total	139	Total	109

UK Investment

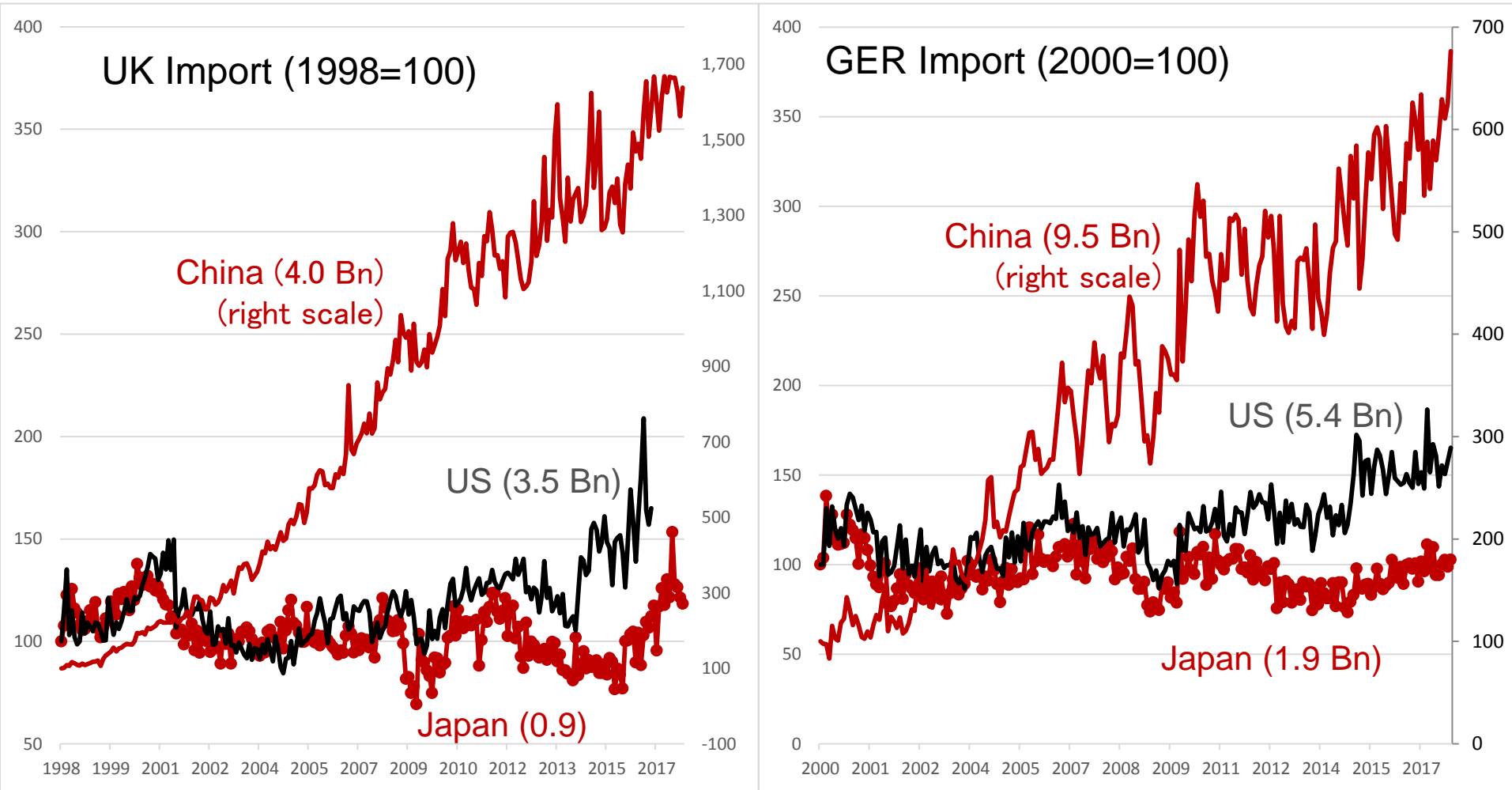
- Services
- HQs, R&D

German Investment


- Mfg, Sales
- R&D

Brexit Challenges: China's Supply Chain Focus on UK

EU Import (1999=100; (Euro Bn))



- “Real” growth remains strong well into 2019
- Reform plans are “uninspiring” but “doable,” Brexit impact is limited, policy challenges remain at the regional level
- EU competitiveness has improved, investment opportunities seem stronger than trade opportunities



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