

EUROPE AFTER THE BREXIT

OUTLOOK AND OPPORTUNITIES FOR FOREIGN INVESTORS

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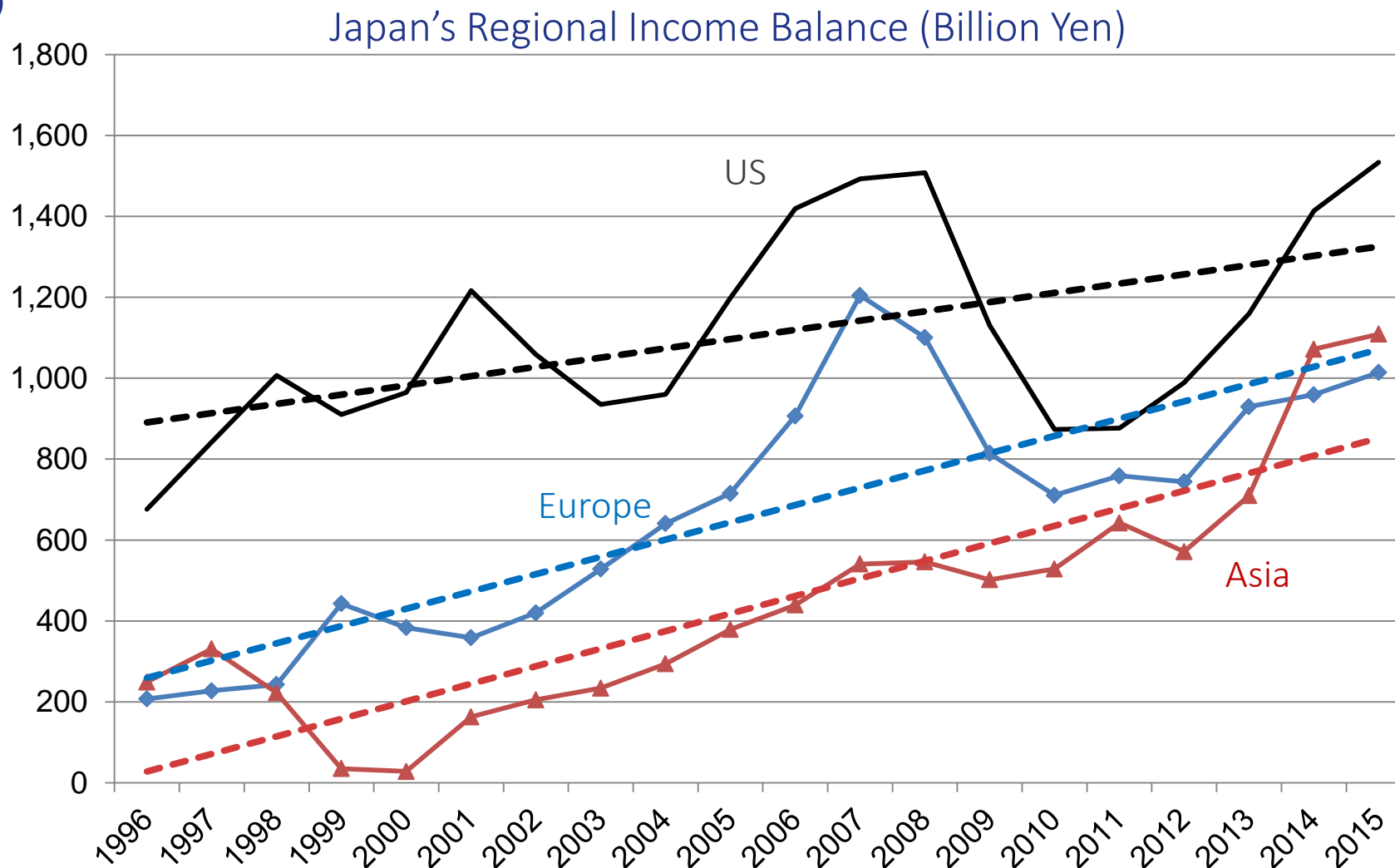
Senior Research Fellow

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- Japanese investment in Europe
 - Strong focus on EU integration
- Europe after Brexit - Four crises and only bad news?
 - Structural reforms and a new policy framework
- Outlook and Opportunities
 - EU Potentials?

- Japanese investment in Europe
 - Strong focus on EU integration

JAPAN'S OVERSEAS INCOMES ON TRACK



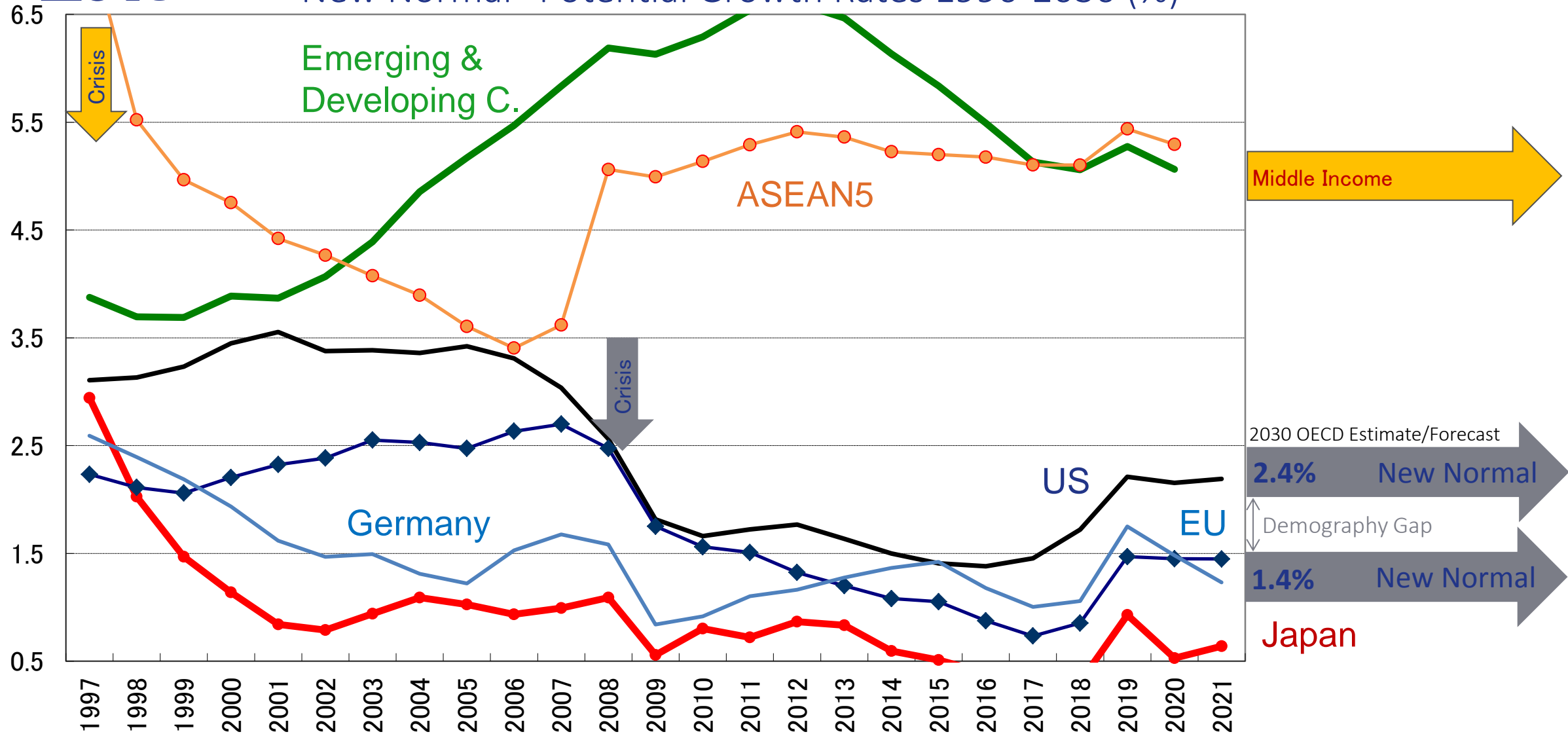
➤ Japan's incomes from Europe and Asia are catching up with US

Note: Current Account, Primary Income, Net Balance.

Source: Data from CEIC (2016).

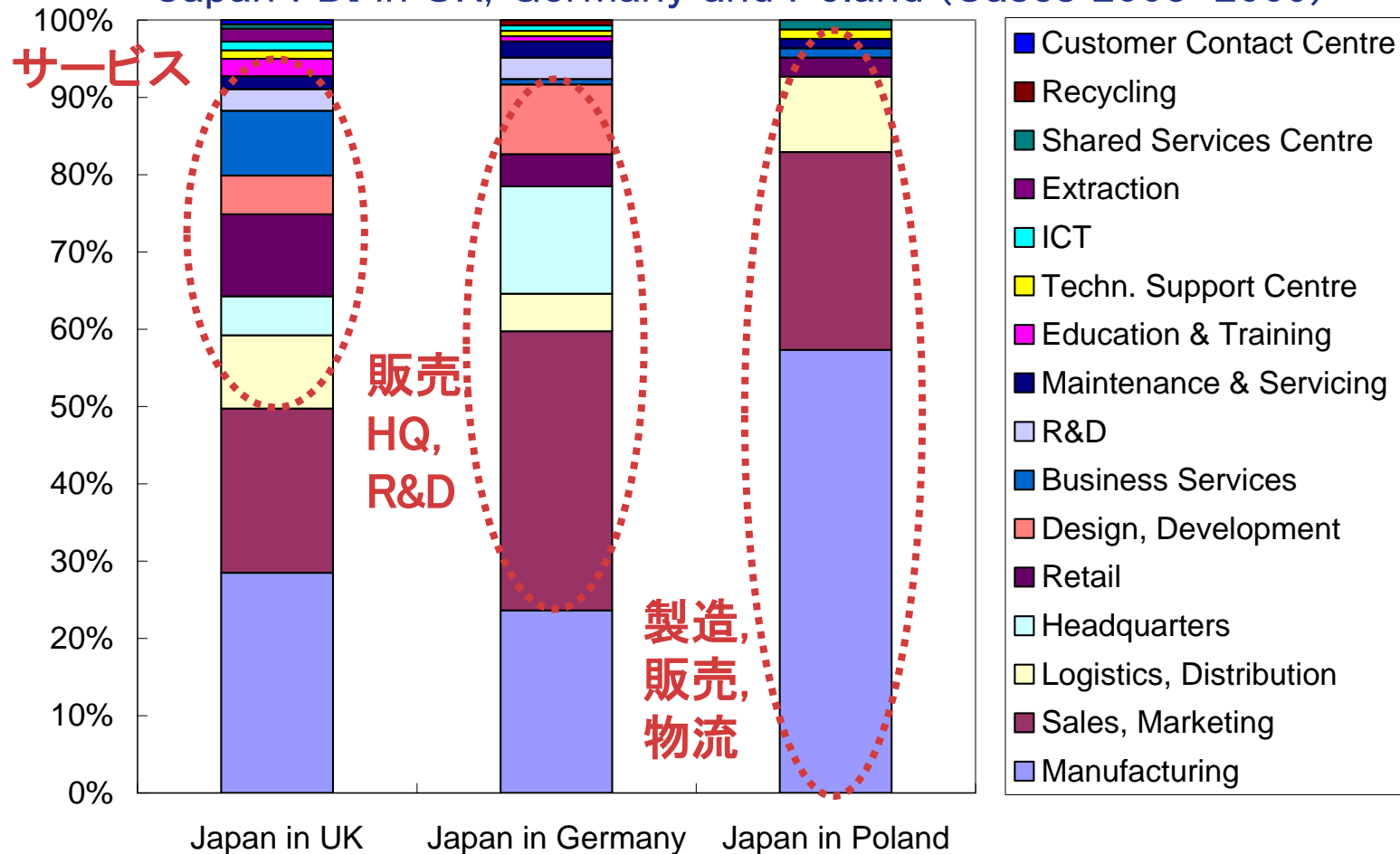
... WHILE POTENTIALS REMAIN LOW?

"New Normal" Potential Growth Rates 1990-2030 (%)



Note: 10-year moving averages of IMF GDP growth rates at constant prices. 2018-30 OECD Forecast.

Japan FDI in UK, Germany and Poland (Cases 2003–2009)



➤ Japanese companies took advantage of regional potentials and market integration

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

UK

- Services
- HQs, R&D

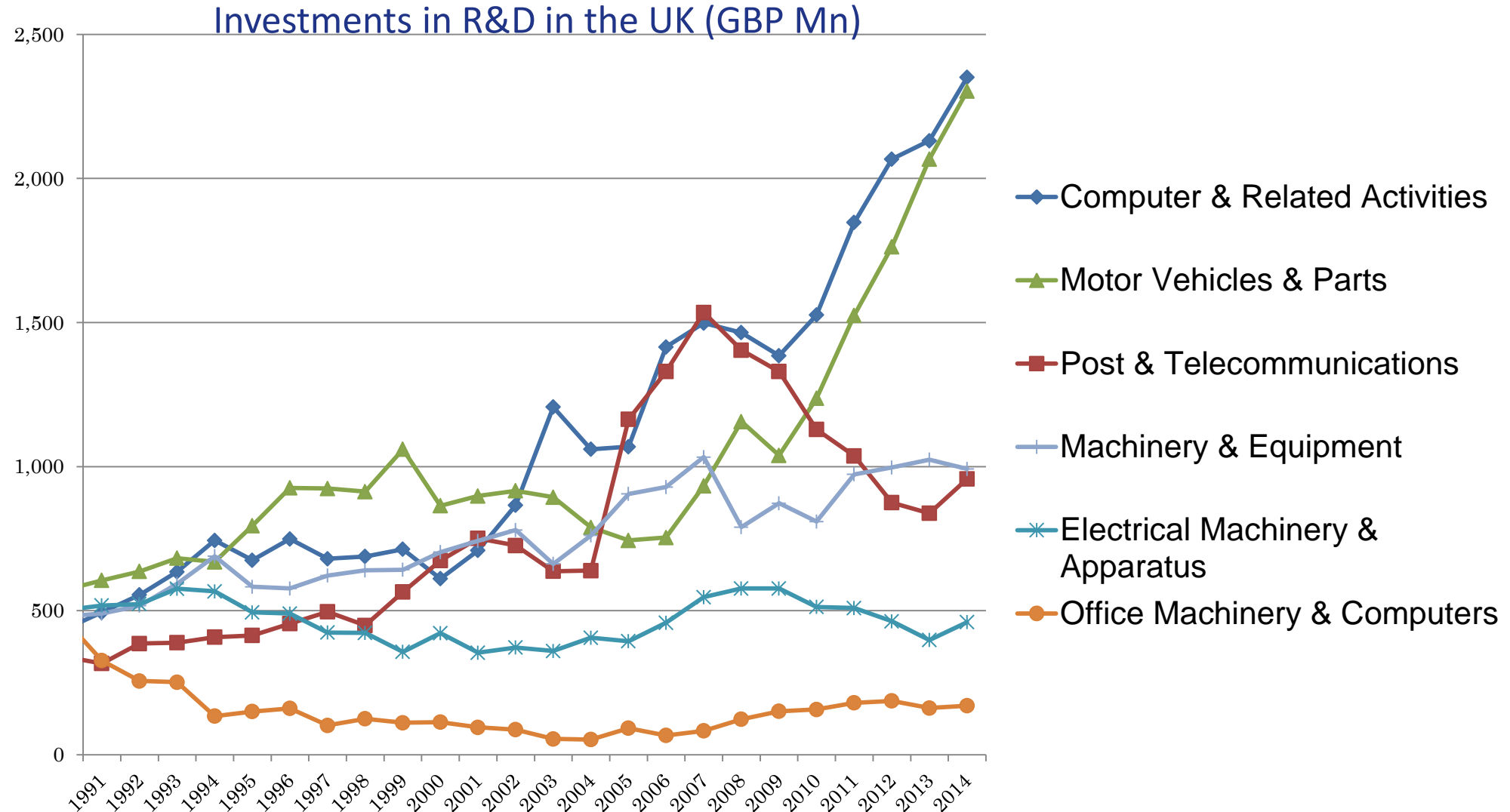
| U.K. | No. | Germany | No. |
|---------------------|------------|-----------------------|------------|
| Commercial Services | 13 | Chemicals | 11 |
| Internet | 10 | Electronics | 11 |
| Food | 9 | Computers | 9 |
| Holding Companies | 9 | Machinery-Diversified | 9 |
| Computers | 7 | Auto Parts & 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 |

Germany

- Mfg, Sales
- R&D

- Japanese companies took advantage of regional potentials and market integration

UK INVESTMENT LEAD TO TECHNOLOGY BOOM



- Europe after Brexit - Four crises and only bad news?
 - Structural reforms and a new policy framework

COUNTRY RISK EUROPE – 4 CRISES

2016

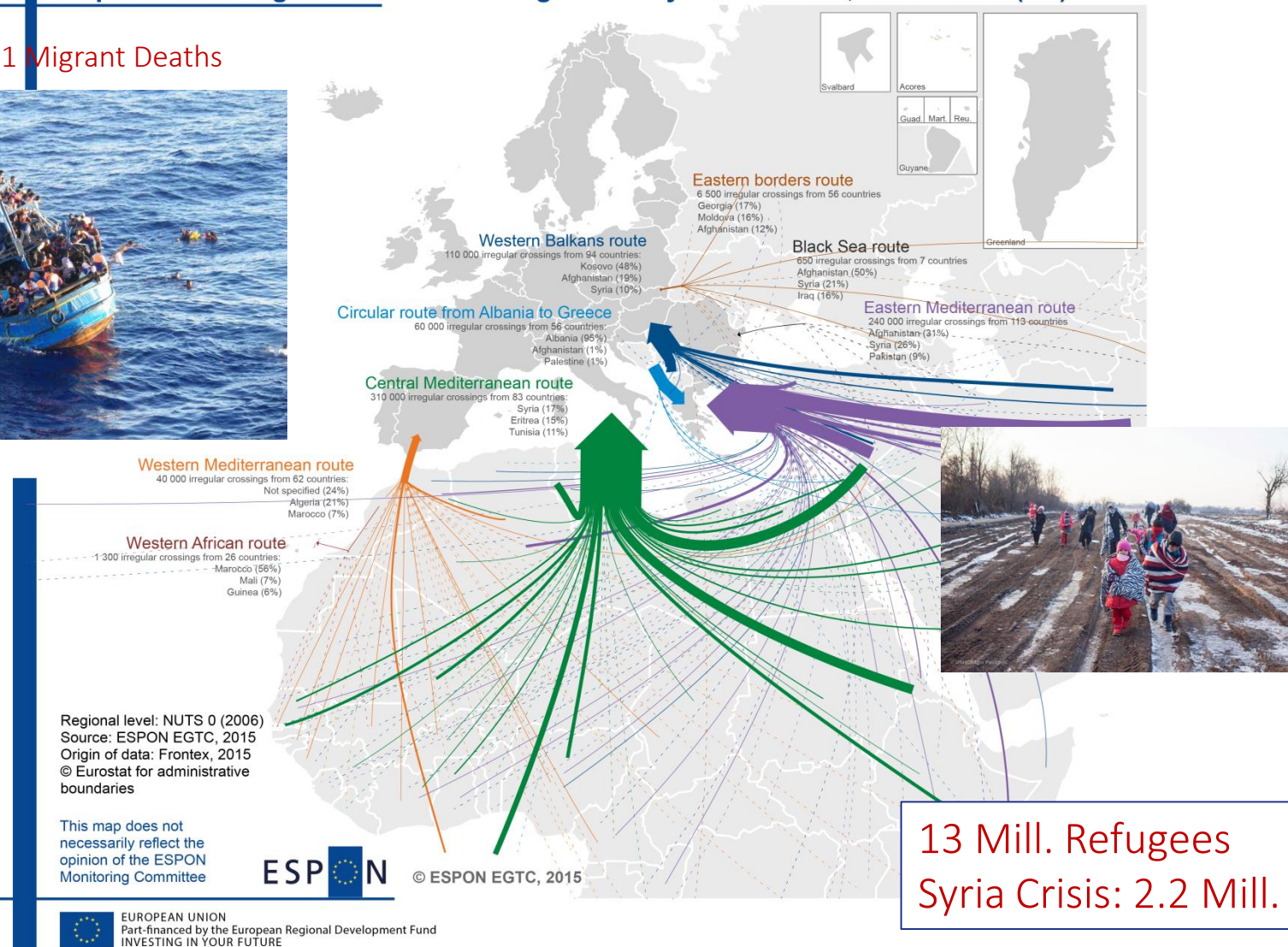


- **Brexit:**
Voters request a more attractive outlook for EU integration
- **Eurozone Reform:**
Difficult push for structural reforms
- **Ukraine Crisis:**
EU cannot intervene or stabilize partner countries
- **Middle East Crisis:**
Instability requires new partnerships with Iran, Arabia, Turkey

IMMIGRANTS TEST GLOBALIZATION

Map 1 - Main irregular border crossing routes by nationalities, 2010 - 2015 (Q1)

2015: 5411 Migrant Deaths



13 Mill. Refugees
Syria Crisis: 2.2 Mill.

Source Map: https://www.espon.eu/main/Menu_Publications/Menu_MapsOfTheMonth/

Source Photos: <http://www.marineinsight.com/wp-content/uploads/2015/04/migrants.jpg>; <http://www.europarl.europa.eu/news/en/top-stories/20150831TST91035/Migration-a-common-challenge>

RESTRUCTURING CREATES LOSERS



Source: www.donaldtrump.com

US - Trump:
"Make America
Great Again!"

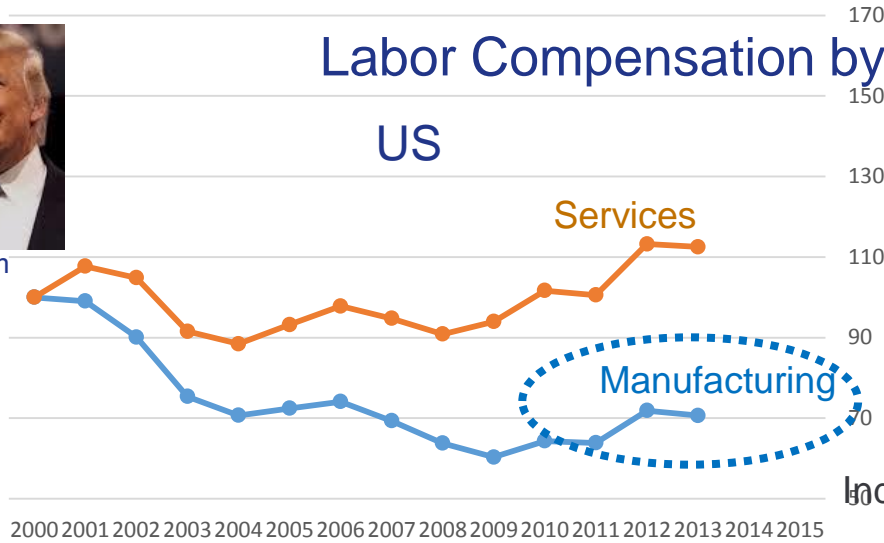


Source: Bloomberg

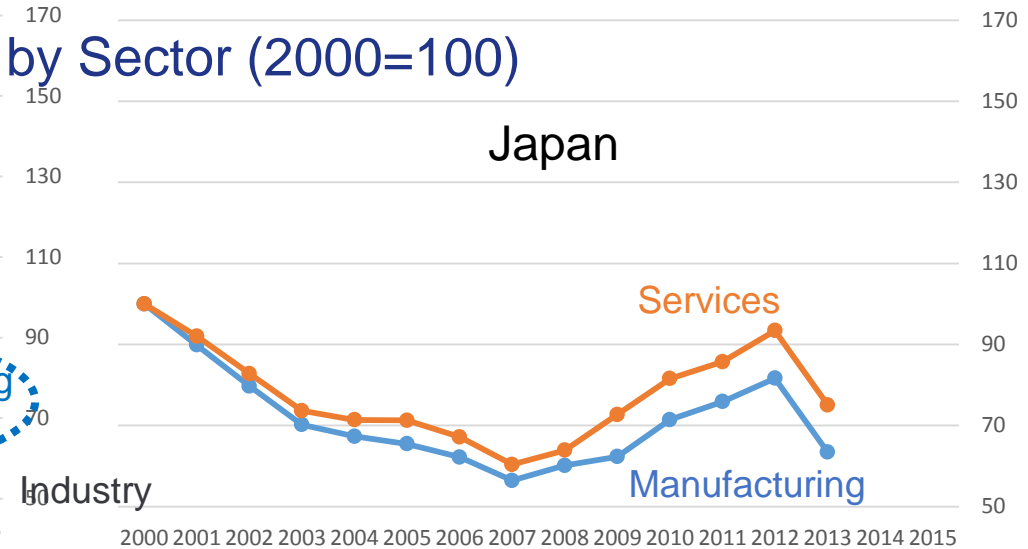
UK - UKIP:
"Controlling our
own borders,
making our own
laws, running our
own country!"

Labor Compensation by Sector (2000=100)

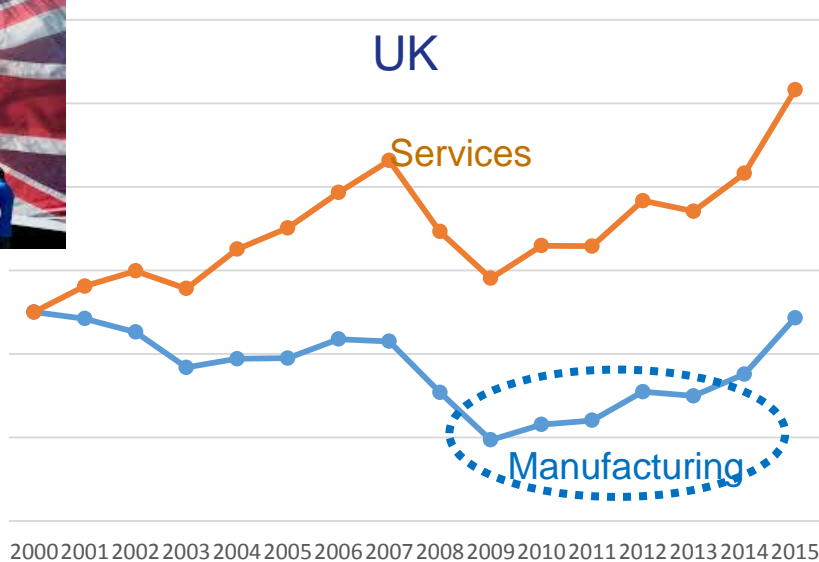
US



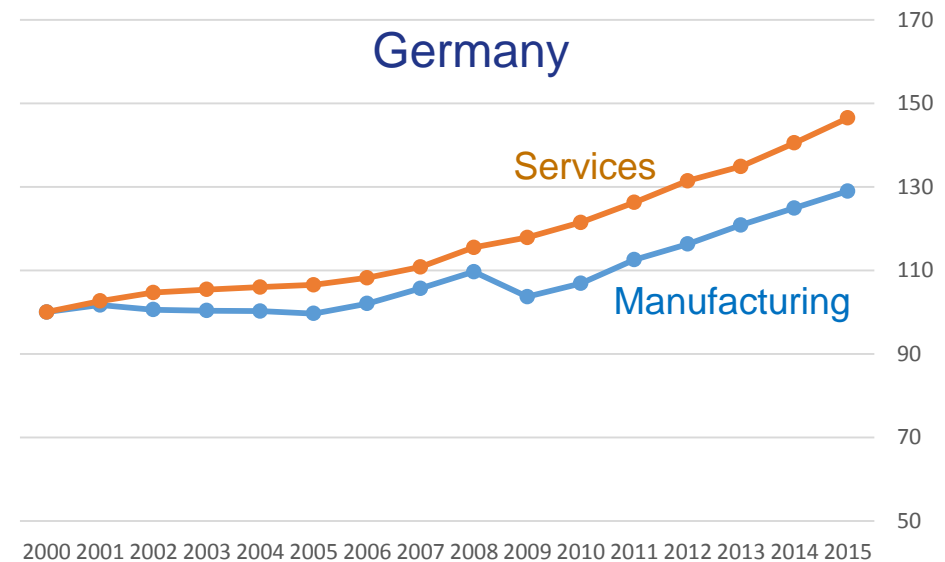
Japan



UK



Germany



Note: 2000 =100, based on compensation in euros.

Source: EU Ameco Database (2016)



➤ Canada-EU FTA (CETA) a litmus test Japan-EU FTA

MIDDLE EAST LONG-TERM STRATEGIES

Turkey
Immigration
Support

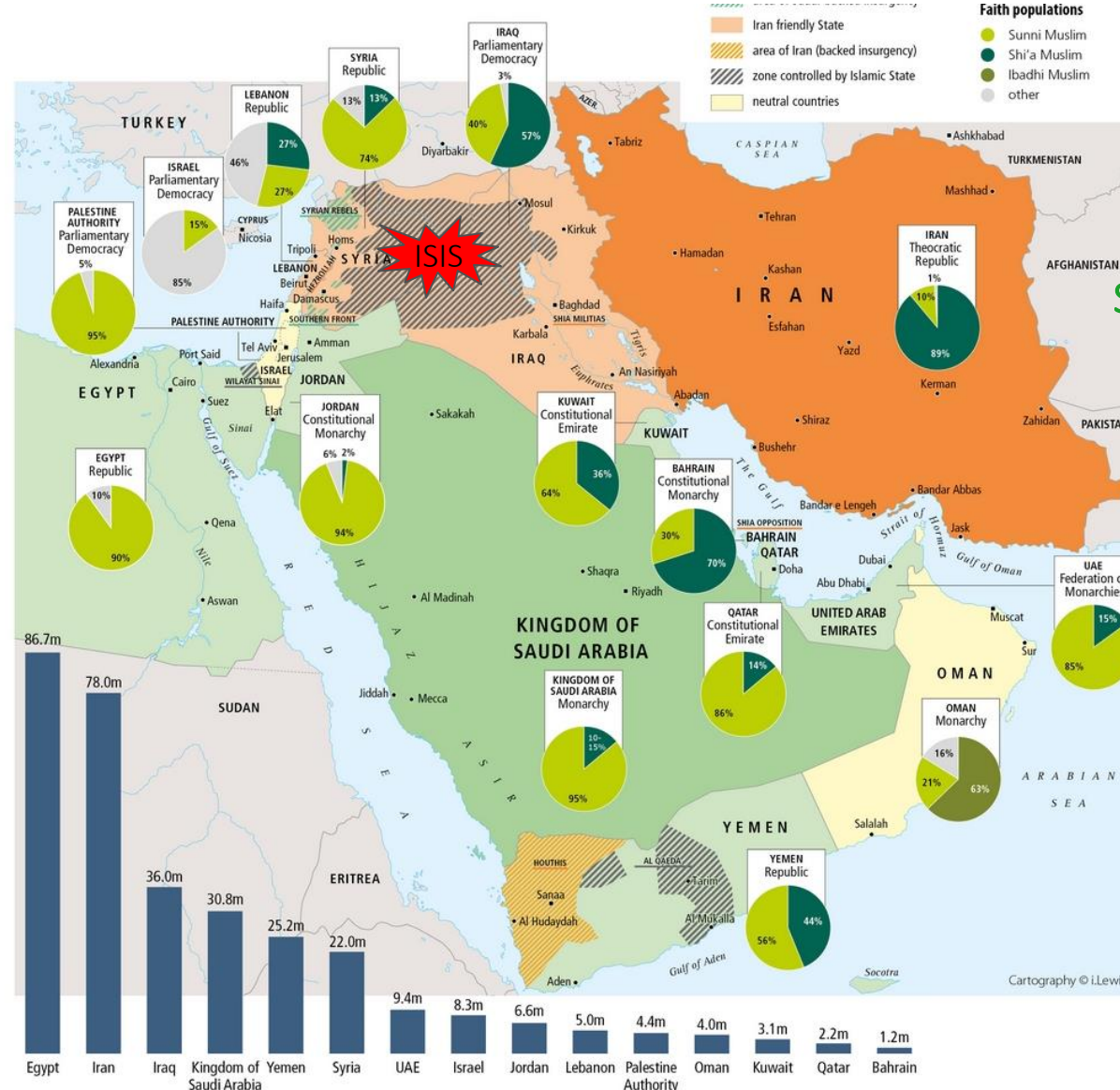
Sunni Muslims

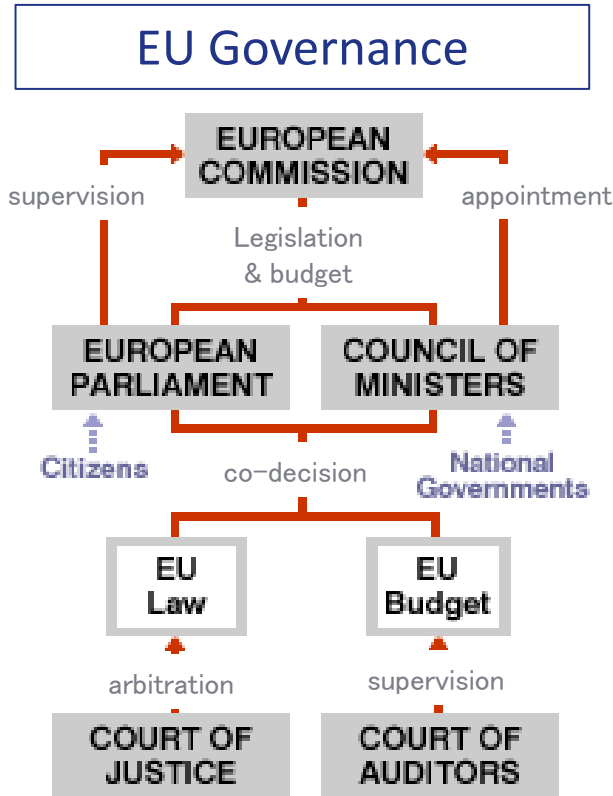
Egypt
Stabilization

Engaging
Iran

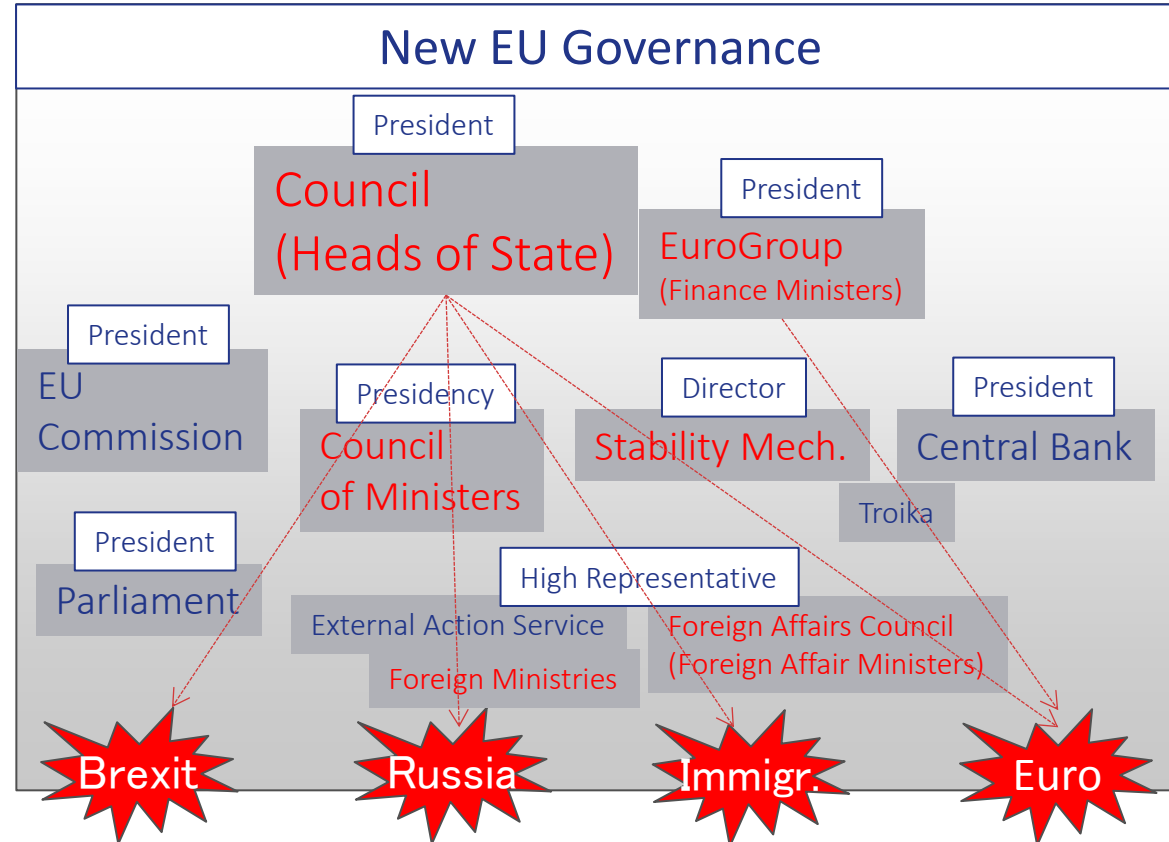
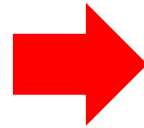
Shi'a Muslims

Arabia
Stability





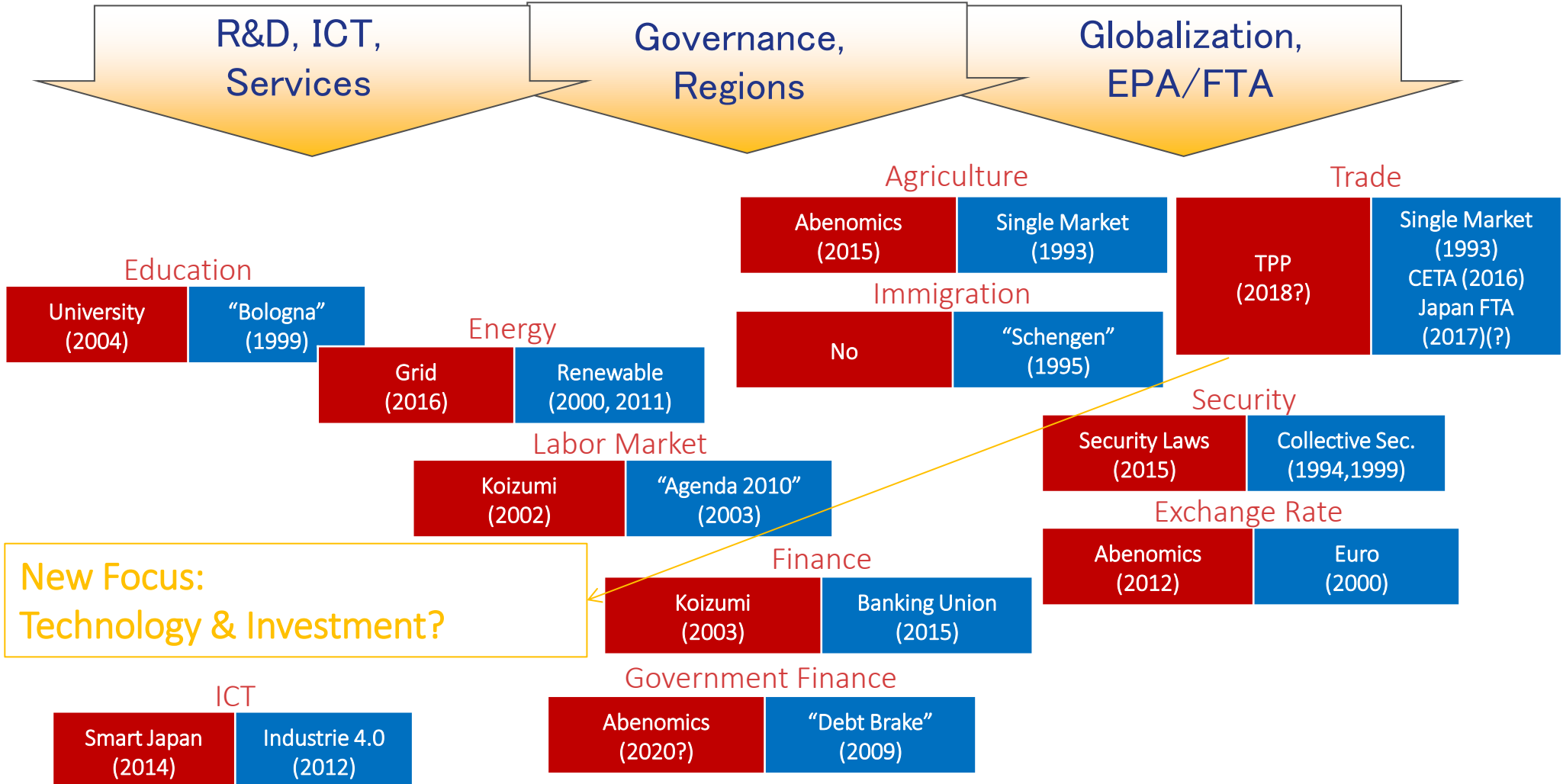
Supra-National
Integration



Inter-Governmental
Reform

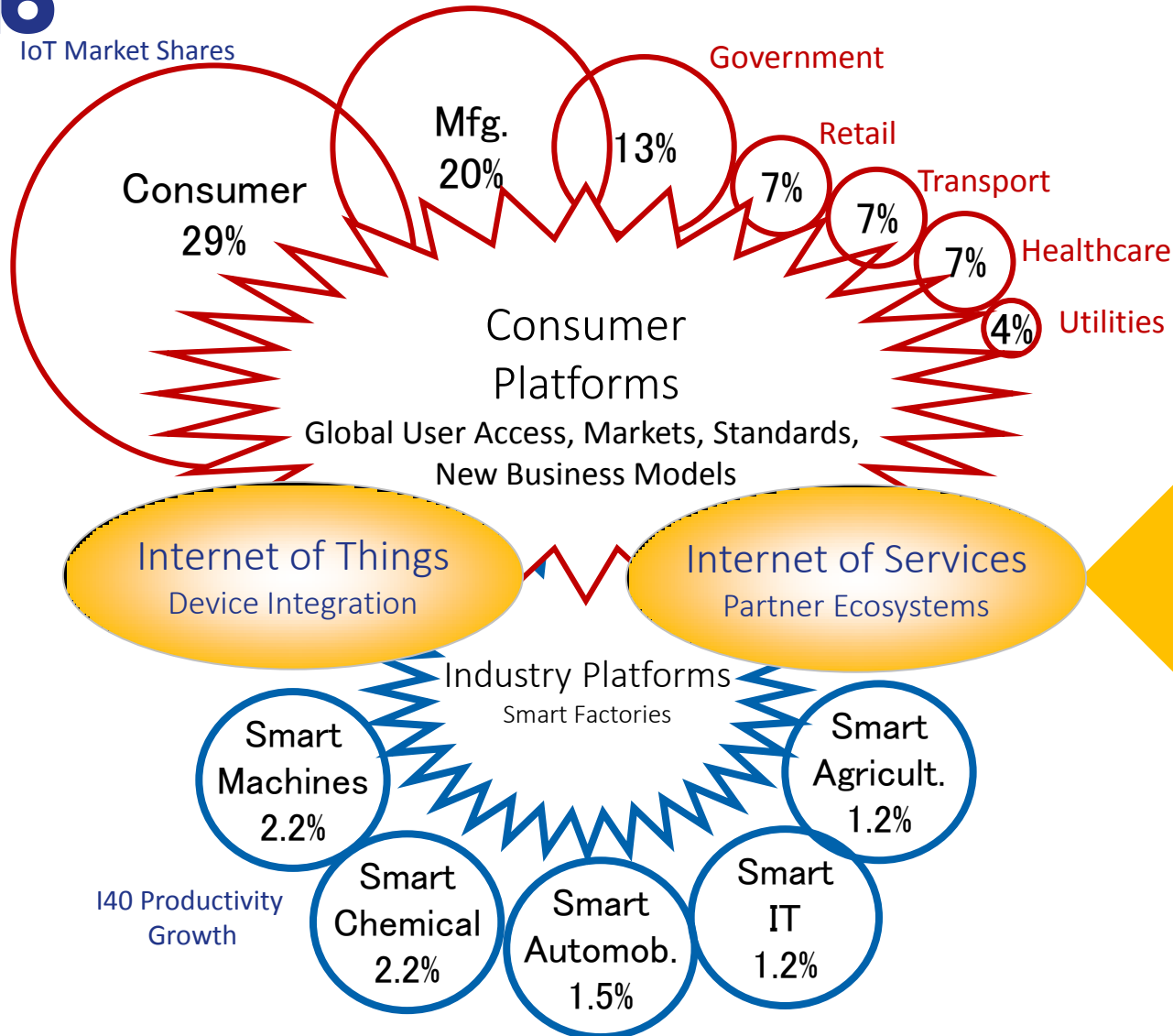
- Strong inter-government EU Council enforces more executive powers

Reform Policy Comparison: Japan – Germany



INDUSTRIAL POLICY: INDUSTRY 4.0

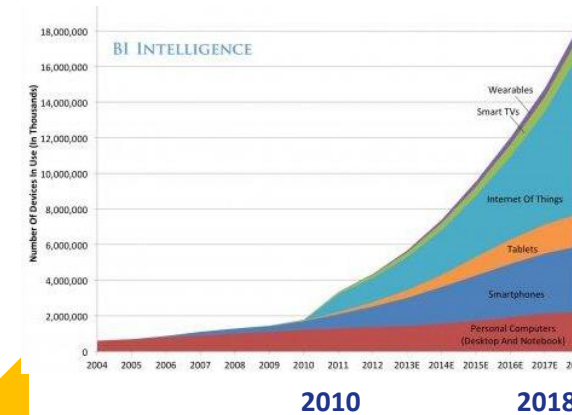
IoT Market Shares



Source: Graphs: Acatech, Siemens.

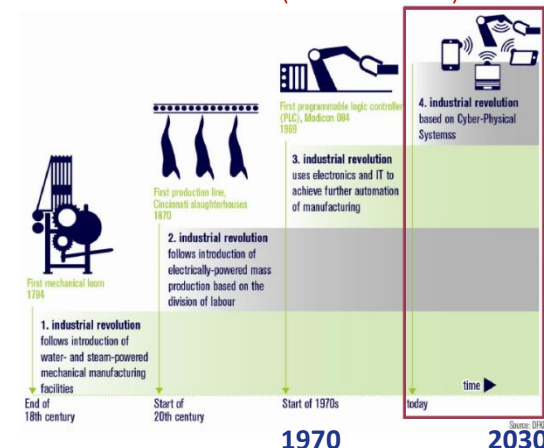
Source: Data from IDC, Fraunhofer (2014)

IoT Market "Revolution"
+20% YoY (Market Size)



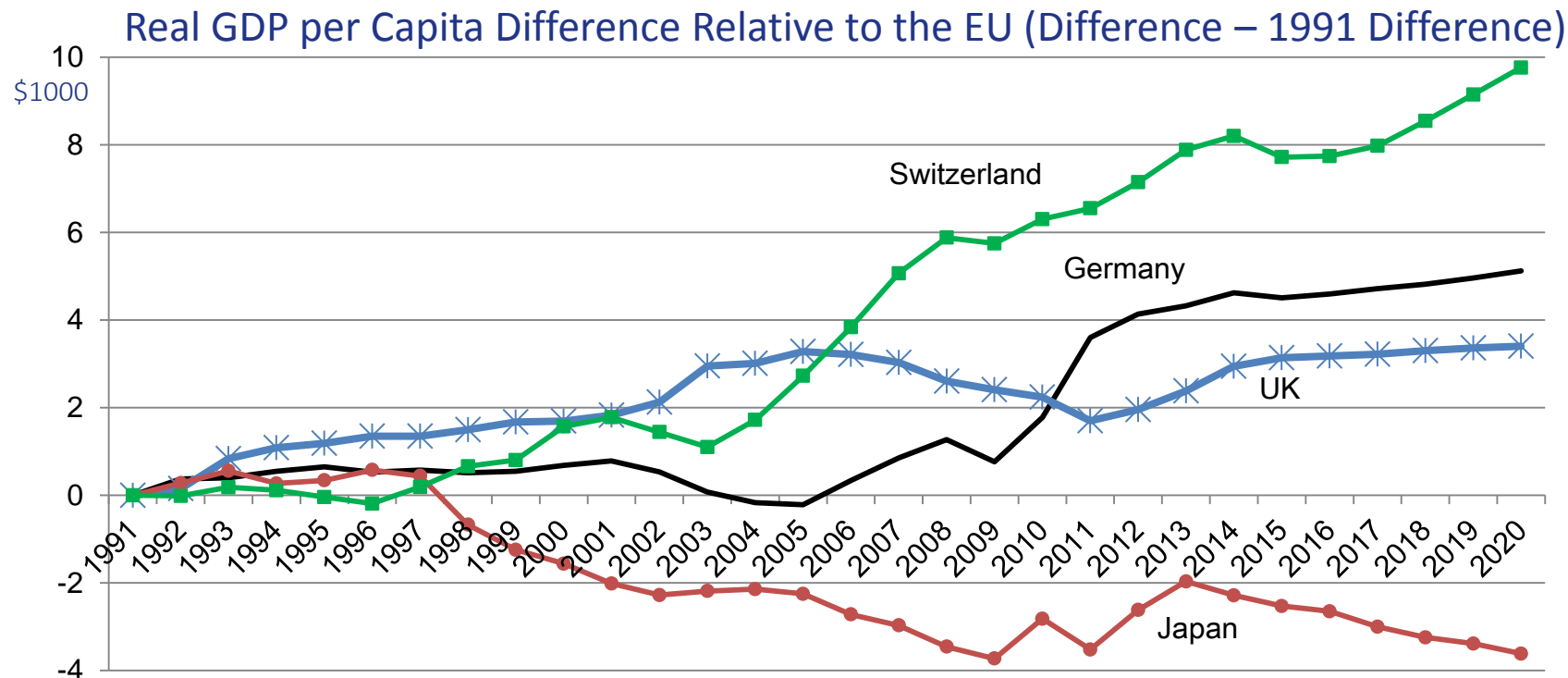
Reform Opportunities

I40 Market "Evolution"
+1.5% YoY (Value Added)



- Outlook and Opportunities
 - EU Potentials?

UK BREXIT POTENTIAL?



Note: Based on purchasing power parities (PPP) calculated as “international” dollars.

Source: IMF-WEO Database (2015).

■ UK government estimates of Brexit costs:

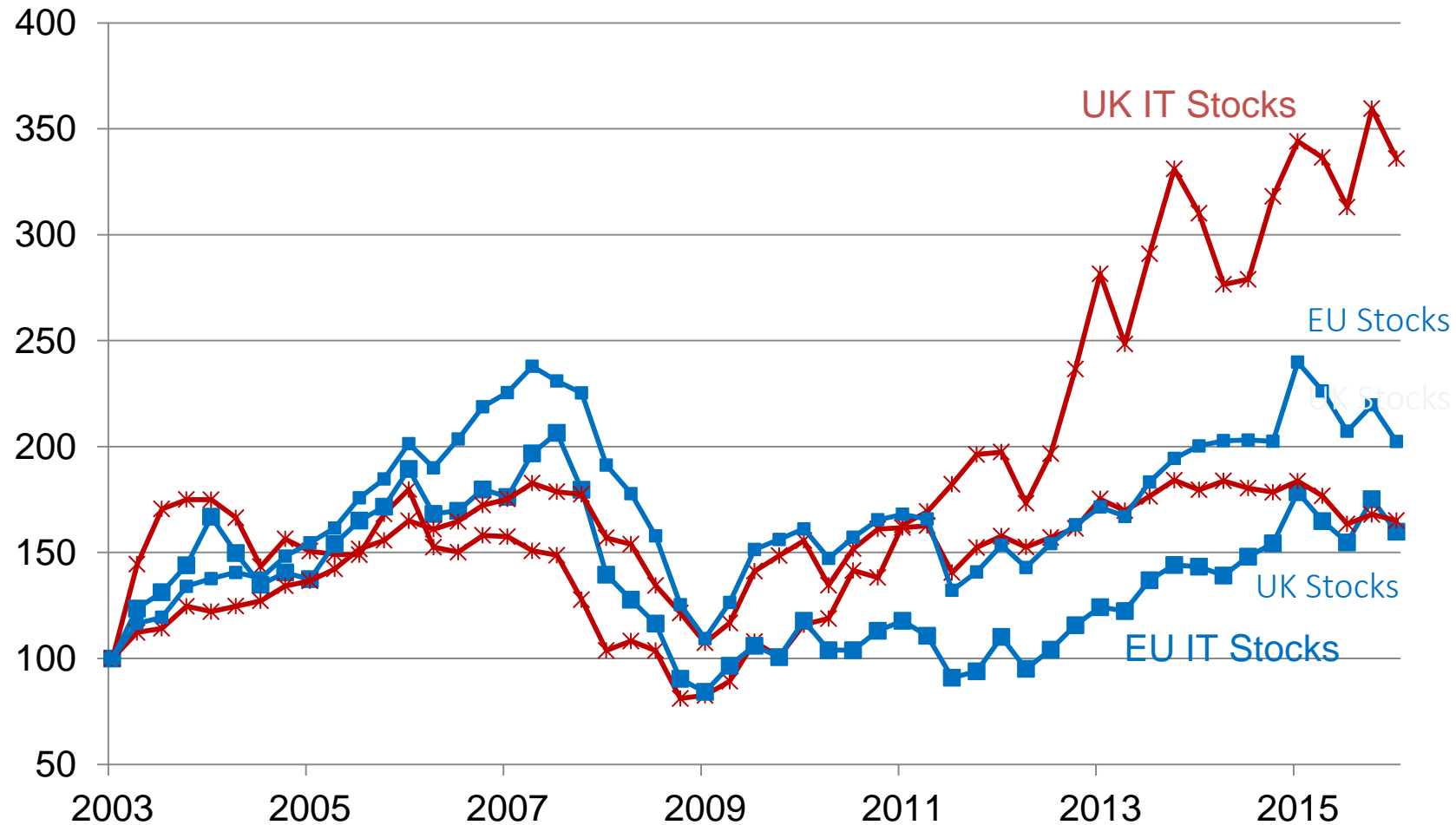
- -6.2% lower GDP in 2030 with non-favorable EU trade terms
- -3.8% lower GDP when joining the general European Economic Area (EEA) FTA

■ Swiss case depends on extreme globalization and swift reforms

- High immigration, currency peg to euro, industry restructuring, deflation

UK CHALLENGE: SERVICE CENTER AT RISK?

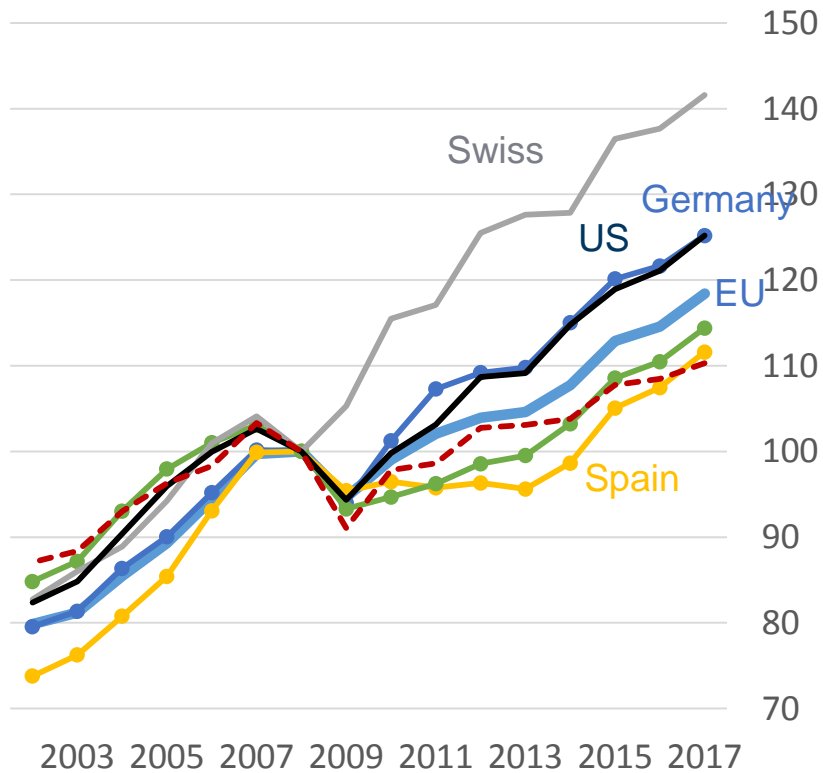
MSCI Stock Market Indices for the UK and EU (ex UK) (2003=100)



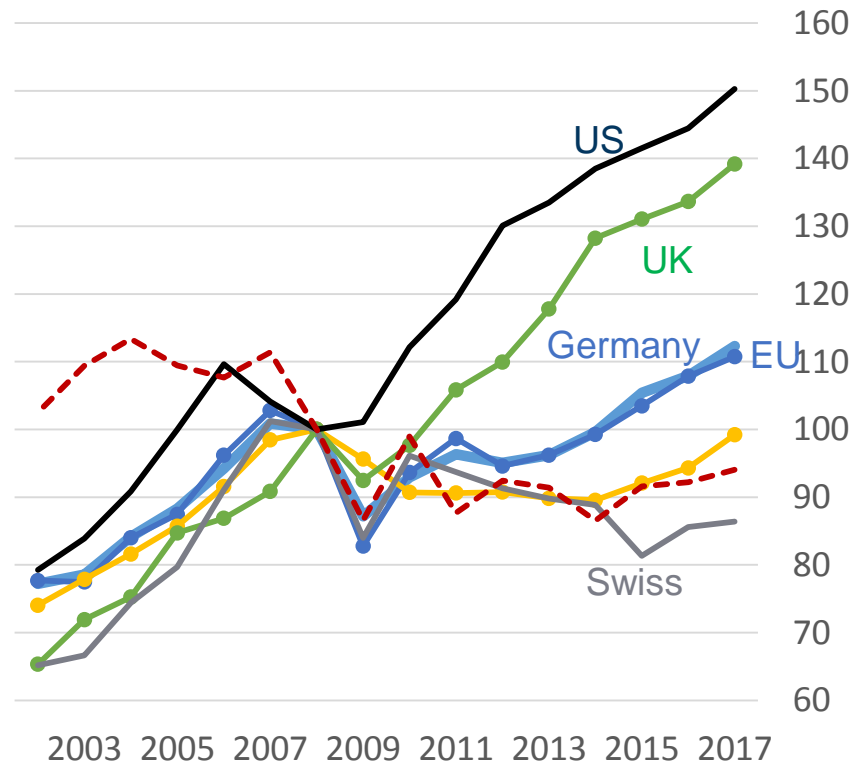
Note: EU indices exclude UK stocks.

Source: Data from Bloomberg.

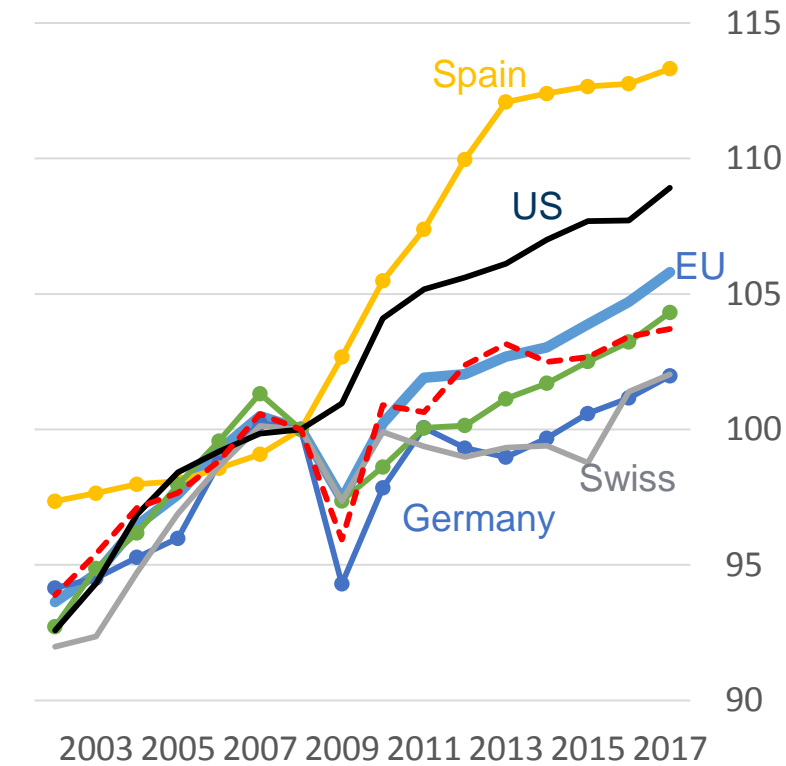
Real Disposable Income (PPP)



Net Operating Surplus



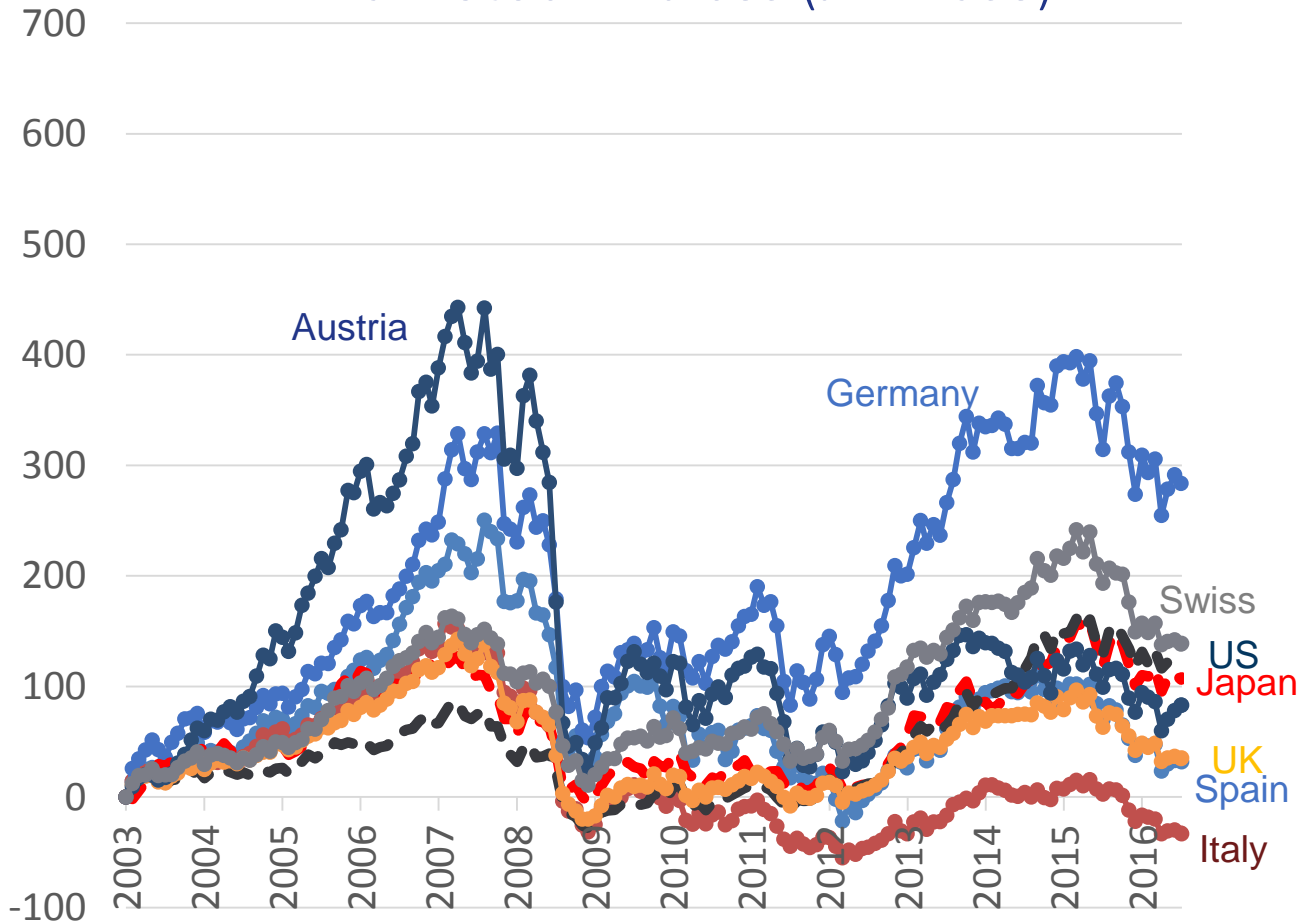
Labor Productivity



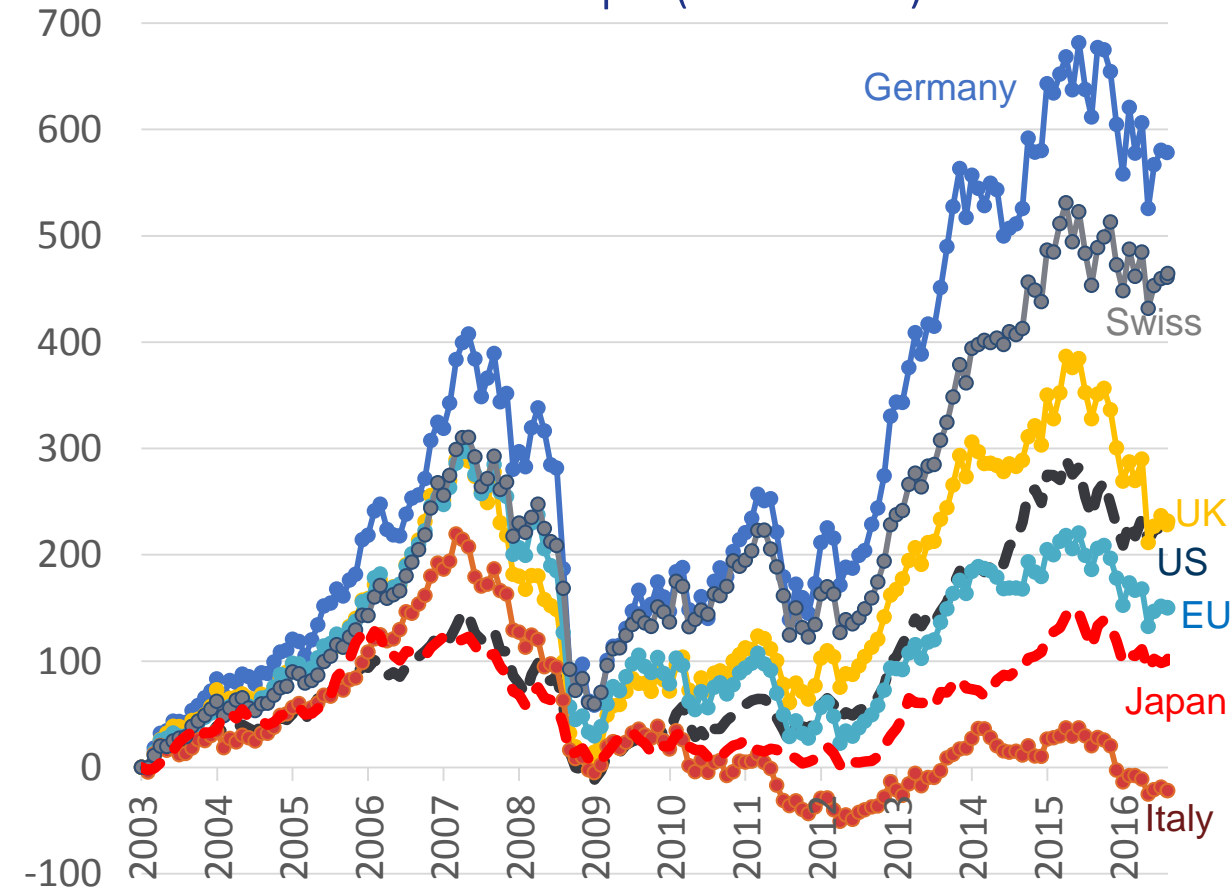
— European Union — Germany — Spain — United Kingdom — Switzerland — United States - - - Japan

➤ Disperse opportunities: Wide variety of real income, profit and productivity growth

Main Stock Indices (JPY Base)

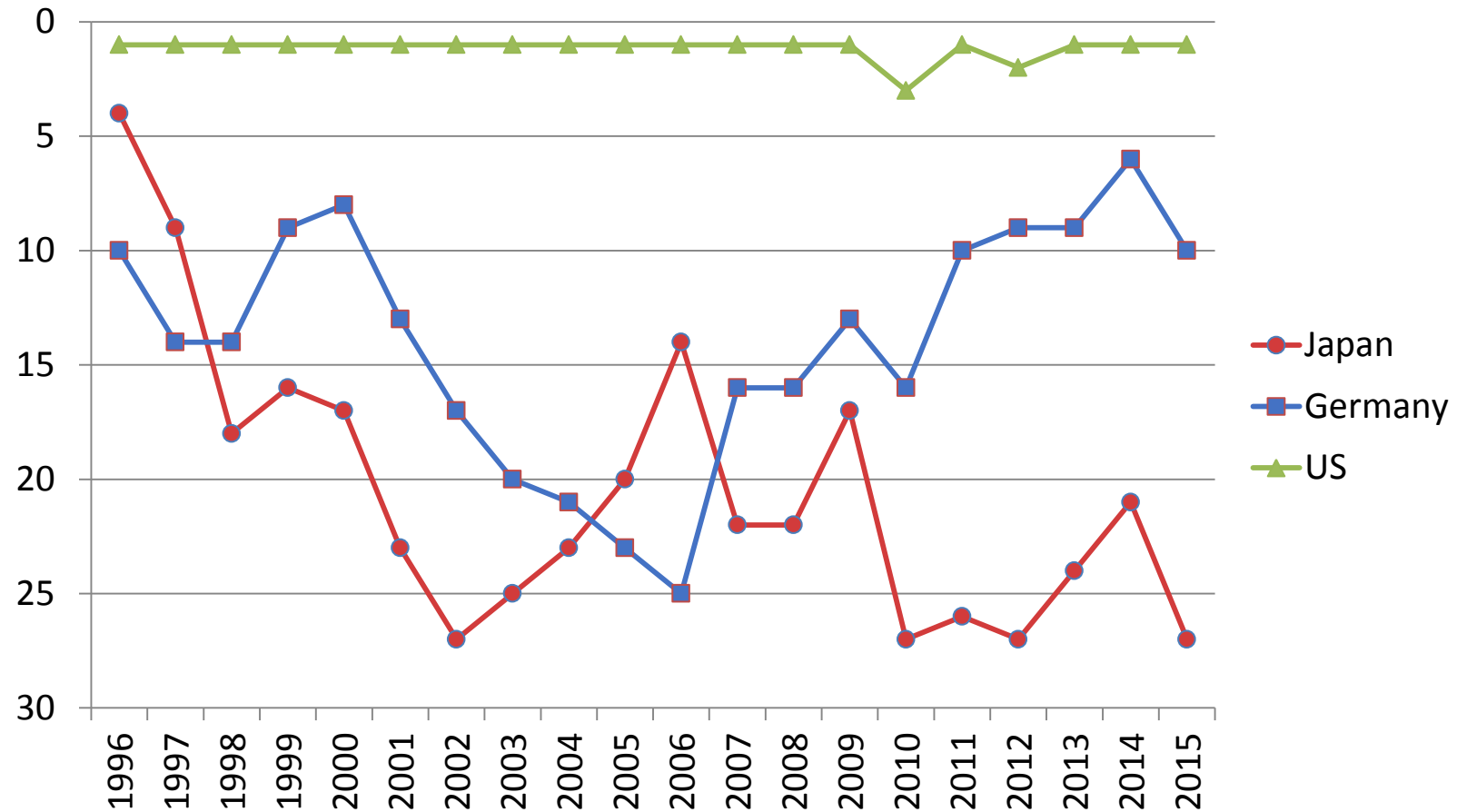


Mid-Caps (JPY Base)

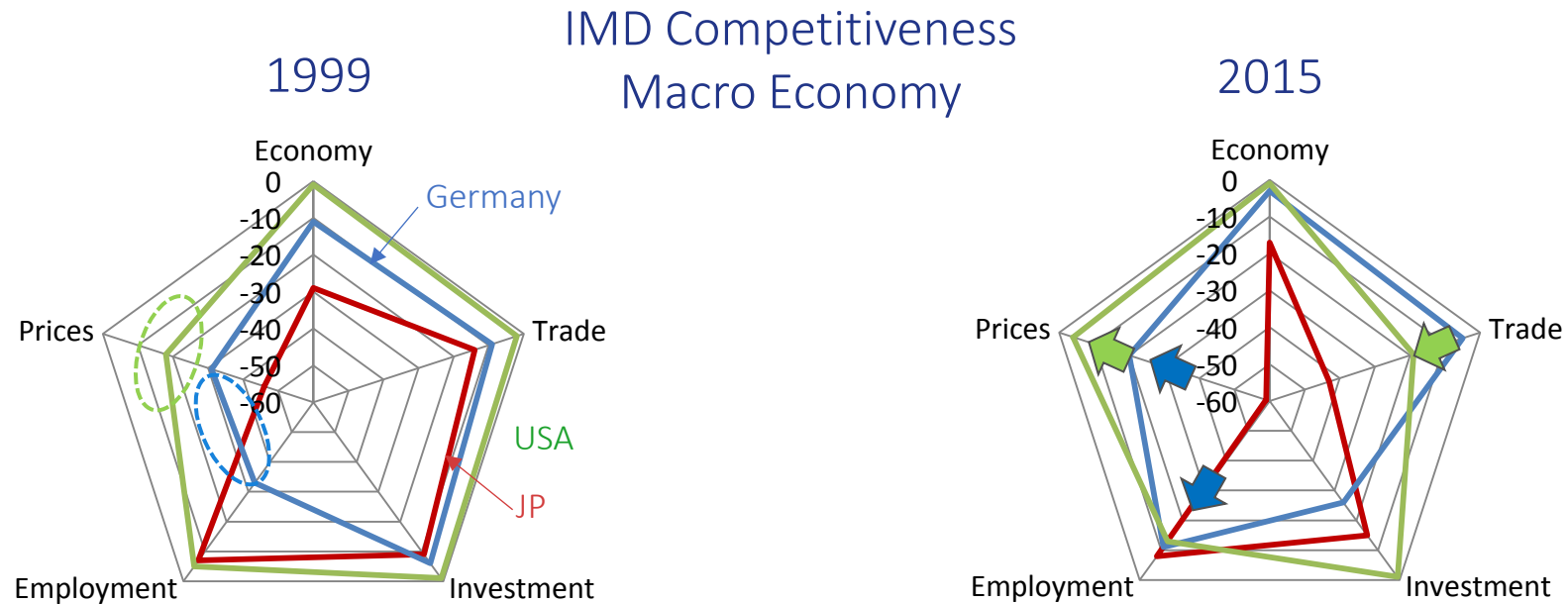


➤ Significant opportunities: EU mid-size companies gain from market integration

IMD Competitiveness: Macro Economy



➤ EU integration pays off for Germany



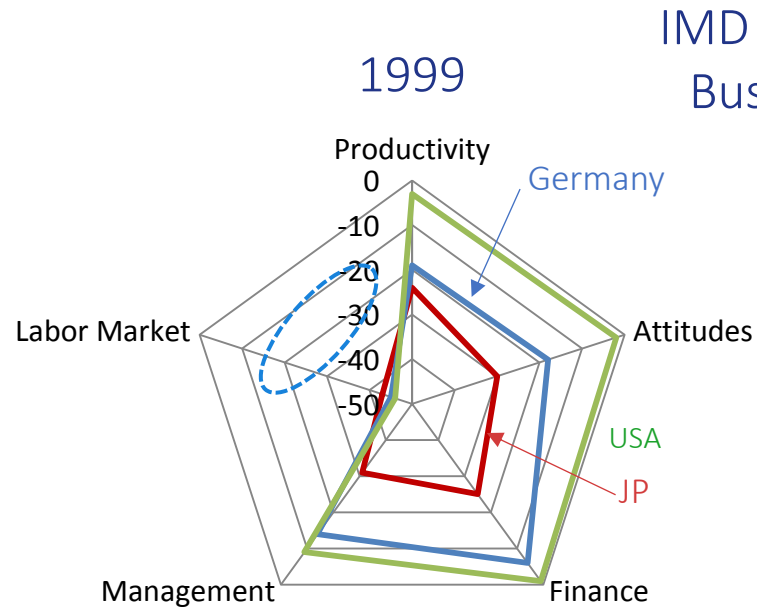
Challenge: Price Competitiveness

- US strong overall economy
- Germany high prices, low employment

Change: Market Reform

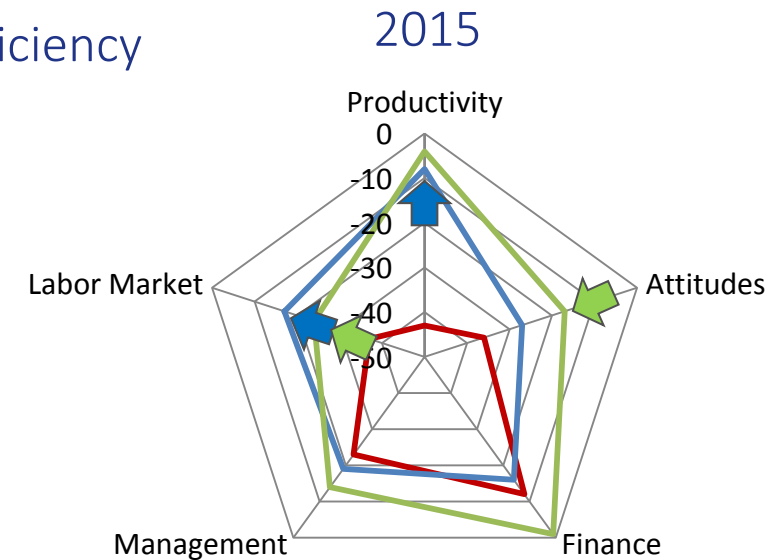
- Prices down, but USD challenges trade
- Price competitiveness boosts employment

- Significant macro framework improvements through EU integration



Challenge: Labor Market

- US strong efficiency except labor
- Germany stagnant labor market, low productivity

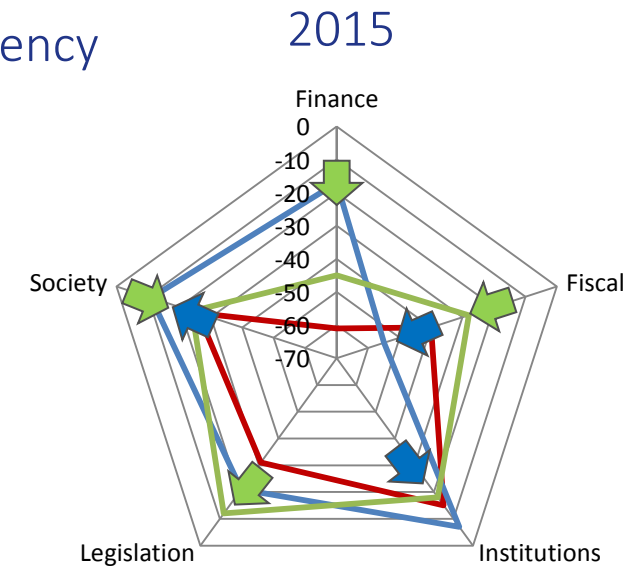
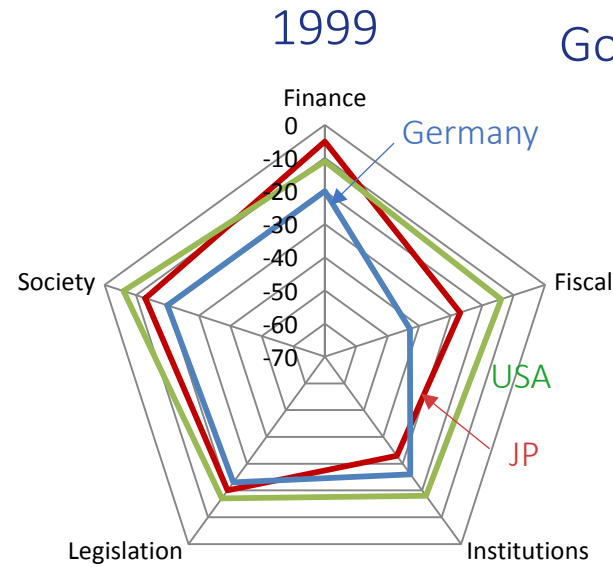


Change: Governance Reform

- Cost cutting depresses sentiment
- Labor reform boosts productivity

- Business efficiency boost during EU integration in Germany

IMD Competitiveness Government Efficiency



Challenge: “Competition with Asia”

- US strong framework
- German underperformance

Change: Institutions & Finance

- Financial crisis hits social framework
- Institutional efficiency, social flexibility

➤ Financial crisis and governance reforms created instability

Charles IV established flexible
European inter-government policies



Europe's first "constitution" of 1356
(Golden Bull) regulated inter-
government elections of the Holy
Roman Emperor for almost 500 years.

Charles IV: Heir of Luxemburg, raised in Paris, ruling from Bohemia,
prepared Europe for the modern age



- Brexit: Negotiation “noise” and uncertainty
 - “Hard Brexit” options and strong trade integration lead to a new “special relationship” with full market access but limits for social security etc.
 - UK policy initially expansionary, but needs to turn restrictive from 2018 to stabilize currency and increase competitiveness
- EU Reform: 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
- Foreign Investors: Focus on integration opportunities
 - EU integration continues with more competitive diversity and restructuring opportunities
 - Manufacturing opportunities in the UK, service improvement in Germany, restructuring potentials in Spain, ...