Industries in 2018

A special report from The Economist Intelligence Unit

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Contents

Overview

Traditional business models will come under strain amid sweeping changes, many driven by technology. Despite the decent economic conditions, political risk will hang heavily over investment decisions.

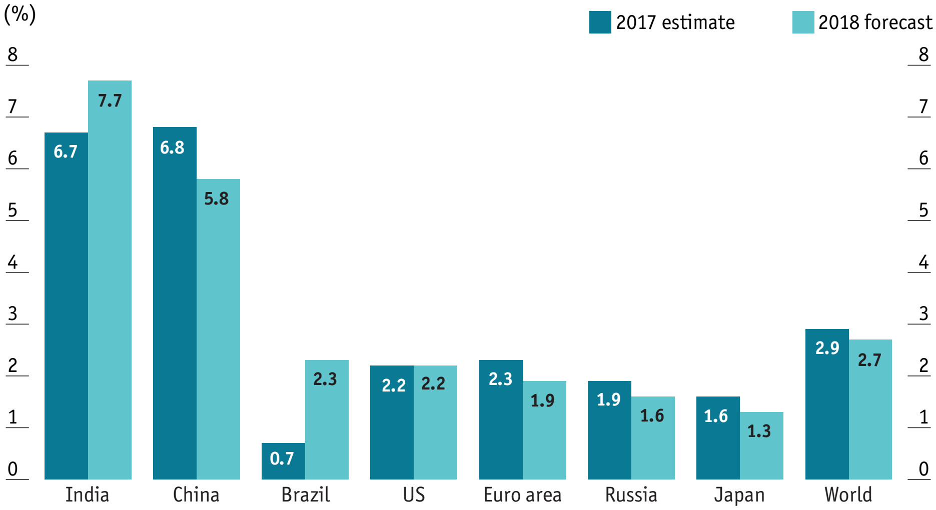
Each year The Economist Intelligence Unit issues a report forecasting how six industry sectors will develop globally over the coming year. This year's report, which gives our forecasts for 2018, highlights how old ways of making money are fast going out of fashion. Perhaps the starkest example of this is in retailing, where online selling is dramatically disrupting the traditional shopping culture. That industry is not alone. Telecoms companies are facing new challenges from technology players, heightening already fierce competition, while established players in carmaking and energy are struggling to adapt to the rise of clean technologies. Pharmaceutical companies face pricing and patenting dilemmas, while regulators are redoubling pressure on financial services companies.

Companies will need to shake up their business models in 2018 to respond to these pressures. However, planning is easier than execution. New regulations, new competitors and new consumer demands will emerge during the year ahead in many markets, while the business environment will develop in ways that may be hard to predict. High levels of political risk will also complicate matters in each of our six industries: automotive; consumer goods and retail; energy; financial services; healthcare; and telecoms. At least global economic conditions will not be bad—although not quite as good as in 2017 (see p8).

This report sets out some of the challenges that lie ahead, but first, here are some noteworthy forecasts from *Industries in 2017*:

- We said that investment in self-driving cars would take on a new impetus. It did: in October 2017 the US government approved a bill that would speed up the development of self-driving cars by exempting them from federal safety standards.

Solid: Real GDP growth at market exchange rates



Source: The Economist Intelligence Unit.

- We predicted that bricks-and-mortar giants would ramp up their online offerings while online shops would make headway in opening physical stores. Walmart has made a series of acquisitions to expand online, and in February Amazon announced the purchase of Whole Foods, marking a push into groceries.

- The election of Donald Trump, we said, would slow the global transition to cleaner energy but not reverse it. So it has proved. Mr Trump has announced the US's withdrawal from the Paris Climate Change Agreement, while China and Europe are steadfastly ploughing on with their decarbonisation efforts.

- Despite fears to the contrary, we predicted that the election of the new US administration would not dramatically roll back financial regulations, nor derail the phasing-in of the Basel III regulations globally. Events to date have proved us right.

- We forecast that India would finally produce a new version of its national health policy. The document came out in March 2017 and aims to more than double public health spending to 2.5% of GDP by 2025.

- We said that Samsung would face a tough battle to overcome the damage done to its reputation by its combustible Galaxy Note 7 phones. In fact, its reputational problems worsened in August 2017 when its chief executive was jailed for bribery. However, the smooth launch of the Galaxy Note 8 still allowed the company to expand its market share.

The year ahead

In 2018 the **automotive** industry will see sales growth in all but eight of the 60 countries we cover, yet the industry will face huge challenges in its biggest markets, the US and China. Aggressive new targets on electric vehicles (EVs) in China will force the pace of their rollout worldwide. Governments will adjust the way in which they deploy incentives to spur take-up of EVs: a mix of congestion charges, parking permits and other measures will start to supplement or even supplant traditional subsidies. This will bring opportunities for carmakers, but also threats. EV development will require heavy investment, and it may not pay off for all carmakers. In China, for instance, local conditions favour domestic players, while elsewhere the plethora of new launches will lead to tough competition.

This will be far from the only big call on automakers' cash in 2018. The development of connected-car technology is gathering pace, as are the regulations to support it. Ride-sharing companies such as Uber have also entered the connected-car arena, but face pushback from regulators who dislike their unconventional business models. For the auto industry as a whole, rising trade barriers will be another dampening factor in 2018. On this front, the US's desire to renegotiate the North Atlantic Free-Trade Agreement (NAFTA) is the greatest risk.

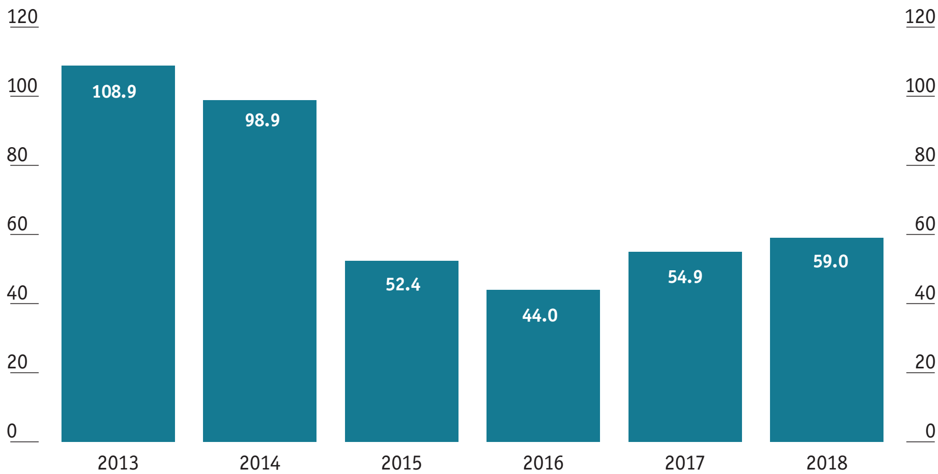
The outlook for **consumer goods and retail** firms looks brighter—but only superficially. Sales volumes will grow by 2.5% in 2018, just slightly slower than in 2017. Bright spots will include the opening-up of markets such as Vietnam and Iran, but not everywhere will benefit. Among the countries facing a sales downturn is the UK, where Brexit will finally bite. E-tailers are also likely to thrive more than bricks-and-mortar stores in both developed and developing markets. Alibaba, China's e-tailing giant, will continue to report strong growth, while Amazon (US) is set for another year of aggressive expansion despite regulatory scrutiny: 2018 may even bring a push into ready-to-eat meals.

Amazon's foray into bricks-and-mortar selling is especially disconcerting for traditional chains. The "retail apocalypse" feared by some will not materialise in 2018, but the rise of e-commerce will shake many old-fashioned shops and bring some crashing down. Big household names in the US will need to close more stores; further hikes in US interest rates will put pressure on those in heavy debt. Old retail's troubles will be especially severe in the US, a US$4trn market, but will extend well beyond it. Consumer-goods makers will not only have to adapt to the changes in distribution but are also being harried by activist investors and upstart boutique brands.

In **energy**, it promises to be another year when US policies will be out of kilter with the rest of the world. Donald Trump's administration will noisily try to dismantle the more climate-friendly policies of his predecessor, Barrack Obama, in a bid to boost the coal and oil industries. Slowly but irreversibly, though, the world is making the shift to cleaner energy. In green-minded Europe, Germany's new coalition government will struggle to hammer out a coherent stance on energy policy, but the UK will take further steps towards decarbonising its economy. Most momentously, China will boost its renewables capacity by roughly 60 gigawatts in 2018—the equivalent of South Africa's entire electricity needs.

Clean technology's rise will come despite barely recovering energy prices. OPEC will continue its herculean efforts to make oil more expensive—partly motivated, in Saudi Arabia, by the upcoming listing of a valuable stake in its national oil company, Saudi Aramco. The grouping will succeed mainly in demonstrating OPEC's diminished sway over oil markets, however, and low prices will hamper oil-producing economies and companies. A barrel of Brent crude will cost an average of just US$59 in 2018, barely up from 2017 and a far cry from recent peaks. Five years ago, prices had soared well above US$100/barrel.

Bottom of the barrel: Brent crude oil prices
(US$/b)



Source: The Economist Intelligence Unit.

The financial crisis left a deep scar on the **financial services** sector, but in 2018 the wound will at last start to feel healed. Steady economic growth, loftier interest rates and a plateau in re-regulation will give financial firms renewed confidence. Banks, especially those headquartered in Asia, will chase after opportunities abroad. As interest rates rise gradually, higher bond yields should burnish the appeal of fixed-income products, taking the shine off equities. Exchange-traded funds will attract investors intent on paying lower fees; fund managers should brace themselves for further consolidation in their industry. Still, most lenders are adapting to stricter standards for capital, liquidity and the like: take Barclays, which will split into two in early 2018 to comply with the UK's ringfencing rules.

There are risks to our optimistic outlook for finance, chief among them China's massive debt pile. But the state—headed by Xi Jinping, his powers newly reinforced by a recent reshuffle at the top—has ample resources to fend off a devastating outcome. Neighbouring India will start to recapitalise its lenders in 2018. Wobbly banks in parts of Europe will keep tumbling, but the threat will not be systemic. Taxpayers, who must mop up the mess, may still fume.

Taxpayers in the US will be reminded in 2018 that their **healthcare** system could do with major surgery. The country's health spending will hit US$3.5trn, over two-fifths of the global total, yet outcomes will remain average for such a wealthy country. The news agenda will be dominated by Republicans' continued efforts to replace Barrack Obama's Affordable Care Act. Whatever its merits, Obamacare will weaken as the pressures mount. With more insurers pulling back from the market, demands from health companies and the public for a viable replacement will grow. Whether the Republicans can supply one will remain unclear, leaving many healthcare and pharmaceutical companies in limbo.

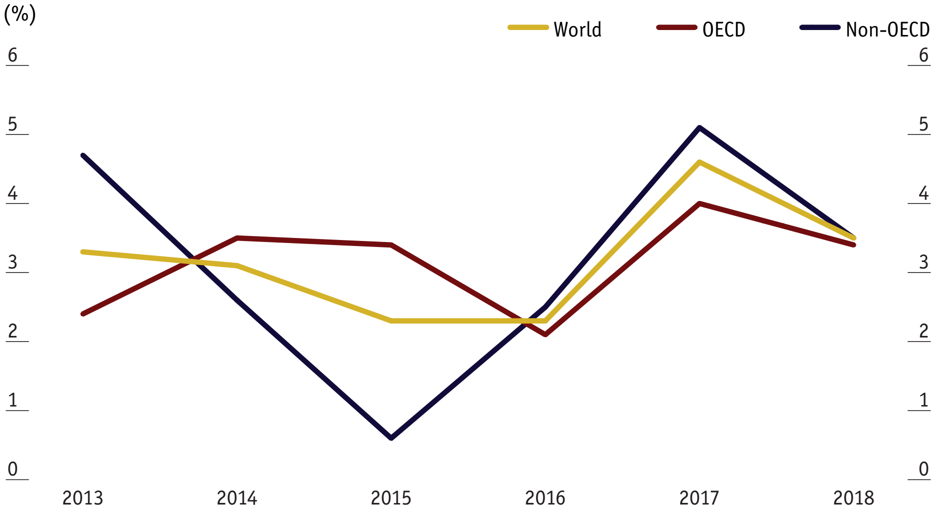
Other countries will make better headway with health reforms, among them developing nations such as India and Pakistan, which are extending care to more of their citizens. China will bolster its national health system, strengthening its family-doctor system and forcing hospitals to reduce their mark-ups on drugs and treatment. Holding down pharmaceutical prices will be a priority not just among Chinese regulators but around the world. Exploiting the potential of biosimilars (generic copies of biotech drugs) will be a priority.

Population ageing will add to the pressures on health systems, particularly in Japan. By 2018, 18m Japanese people will be 75 or older, and their ranks are set to swell fast. So too are the associated long-term care costs, lending urgency to Japan's health reforms in 2018. Ageing figures prominently among Europe's health-related problems, too, but Brexit will loom largest in 2018. Pharma companies will watch nervously as the UK's departure from the EU nears, praying that negotiators can avoid a precipitous rise in non-tariff barriers.

Telecoms companies, meanwhile, will face both opportunities and threats from the global rollout of mobile networks. For every 100 people around the world there will be an average of 113 mobile subscriptions in 2018, with rapid growth in places such as India and Sub-Saharan Africa. In developing countries, the focus will increasingly be on expanding 4G coverage, while in developed ones it will be on testing 5G technologies. Consumers will take advantage of the opportunity to bring yet more of their lives online.

But funding this is placing an intense strain on telecoms companies' balance sheets. Simultaneously, competition is pushing down prices for consumers—who are adding to operators' woes by favouring over-the-top providers of services such as messaging apps, which piggyback on utilities' networks. Another blight will be the close regulatory scrutiny of mergers, particularly in Europe. Still, at least in the US telecoms companies can look forward to the slashing of red tape.

Stop-start: Trade in goods



Source: The Economist Intelligence Unit.

Although White House policies continue to concern many companies in our six industries, the threat of a damaging trade war has receded since our 2017 report as geopolitical and business realities win out. Even so, global trade growth will decline from 4.6% in 2017 to 3.5% in 2018, mainly owing to a slowdown in China's economy. Political risks will remain strong, particularly in the EU: as Brexit edges nearer, the risk that the negotiations will break down remains high. In 2018 companies will need to remain flexible enough to deal with such risks, while also seizing the opportunities presented by continued global growth.

The global economy in 2018

The global economy has been at its healthiest for some time in 2017, but this will prove a fleeting state. Inflation will pick up and central banks will begin to tighten somewhat more aggressively. The European Central Bank (ECB) will start to taper its quantitative easing in 2018. Moreover, political risk is at its highest level for years: there is long-term policy uncertainty in the US, little clarity on Brexit negotiations in the EU, and North Korea is flexing its muscles. Global GDP growth will thus tail off slightly in 2018, to 2.7% at market exchange rates.

The non-OECD world will manage to grow by 4.4%, while the expansion among OECD countries will slow gently to 2%. The US economy will grow by 2.2%, a level that is fast becoming the new normal. The greatest shadow of unpredictability hangs over the world's largest economy. Donald Trump is an erratic leader, making him a difficult ally at home (for his fellow Republicans) and abroad. This will give the US's rivals, including Russia and China, the chance to extend their influence.

Still, the debt-laden Chinese economy will slow to 5.8% in 2018, marking a steeper decline compared with recent years. The slowdown will be policy-induced, however, so the credit bubble will deflate rather than burst. Countries such as Australia, Chile and Mongolia, which export non-oil commodities to China, will also feel the chill.

Higher oil demand in Asia and OPEC members' willingness to extend a supply agreement into 2018 will at least offer some support to oil prices, which will rise to US$59/barrel, from an estimated US$55/barrel in 2017. In oil-dependent Russia, structural weaknesses will dampen economic growth, and The Economist Intelligence Unit does not expect significant reforms before the presidential election in March 2018.

In Europe, political risks will again be in evidence, but the biggest challenge for the euro zone will come from the economy, given the underperformance of markets in southern Europe, such as Italy and Greece. Higher borrowing costs in the US, China and Europe will also temper global growth—another reason why it will fall a touch in 2018.

Automotive: Double challenge

In 2018 the global automotive industry will have to face up to major changes in its two biggest markets, the US and China.

Despite the impact of low commodity prices in regions such as Latin America, the past few years have been fairly calm for the global automotive industry. In 2017 only nine of the 60 countries covered by The Economist Intelligence Unit's automotive service saw vehicle sales fall. In 2018 we expect only eight to do so, as markets such as Brazil and Russia recover. Even so, carmakers will meet major challenges in the world's two biggest markets—China and the US—and the resulting pressures may reshape their business strategies for years to come.

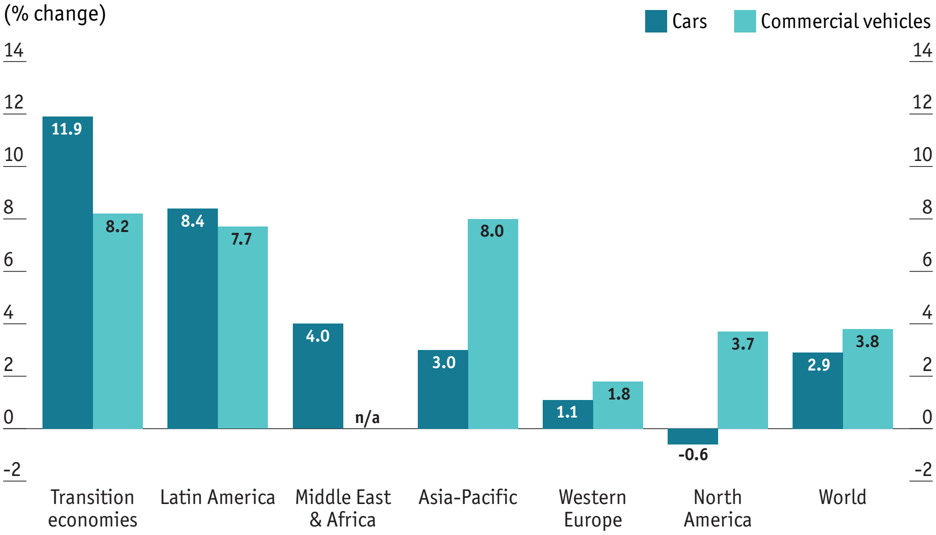
In China, the challenge was set out in September 2017, when the Ministry of Industry and Information Technology announced draconian new rules to drive up production of new-energy vehicles (NEVs), a category that covers both battery and plug-in electric vehicles (EVs). The new regulations require all carmakers selling over 30,000 vehicles a year in China to gather NEV credits that are equivalent to 10% of their sales volumes by 2019 and 12% by 2020. Meeting these targets will lead to a step-change in the way that carmakers invest in EVs worldwide.

The challenge in the US came around one month earlier, when the government started renegotiating the North Atlantic Free-Trade Agreement (NAFTA), which has underpinned trade between the US, Canada and Mexico since 1994. If NAFTA is revised, or maybe even disbanded, the auto industry will need to rethink its entire production strategy in the region, and perhaps beyond.

Charging ahead

The full implications of these twin challenges will begin to become apparent in 2018. In China, carmakers have successfully lobbied against the NEV targets that had originally been proposed for 2018, arguing that they needed time to adjust.

The rebound: Vehicle registrations in 2018
(% change)



World=60 biggest economies only.
Source: The Economist Intelligence Unit; local sources.

Nevertheless, the looming 2019 deadline means that they will not have long, forcing the pace on NEV investment, launches and sales in 2018.

On the face of it, the 10% target appears unattainable. Of the 26m cars we expect to be sold in China in 2018, only 3% are likely to be NEVs. However, the guidelines suggest that carmakers will get more than one credit for some types of NEVs, such as long-range, pure-battery EVs. Carmakers may also, if necessary, buy credits to make up any deficit. Even so, they will need to move quickly in 2018 to ensure they have sufficient NEVs on the market.

Foreign carmakers will face a particular challenge. At present the NEV segment is dominated by local manufacturers, led by BYD Auto, which together account for over 95% of the market. US-based Tesla is the only foreign EV-maker to figure

Electric avenue: Electric car sales, 2016
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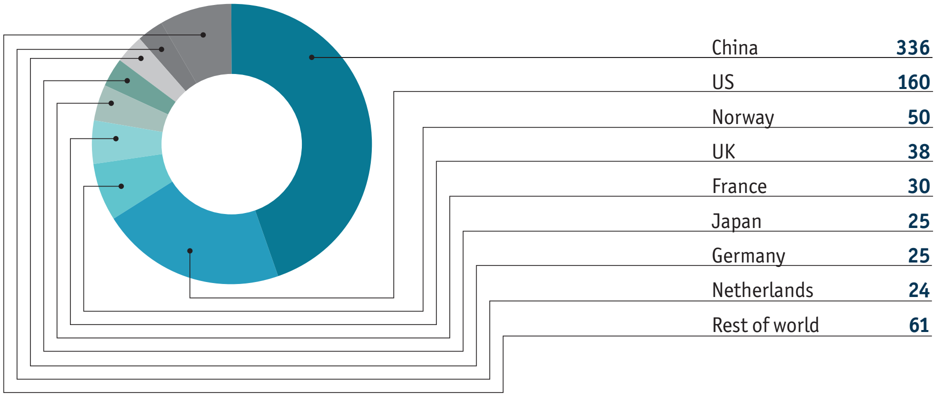


Source: International Energy Agency.

among the top 20 models. By contrast, the overall car market leaders Volkswagen (Germany) and General Motors (GM; US) sell around 4m cars a year in China, and practically no NEVs. Moreover, the Chinese government may be keen to keep it that way—its NEV programme is intended to build up China's global dominance in EV technologies. It is a strategy that may succeed: BYD is already the world's biggest seller of EVs, ahead of Renault-Nissan (France-Japan) and Tesla.

Following the giant

With the world's biggest market demanding more EVs, producing such cars will become more cost-effective, encouraging investment and launches worldwide. Globally, Volkswagen has earmarked US$24bn to develop EVs across all its car brands by 2030. It is not alone. Ford has set aside US$4.5bn and has plans for 13 new global EVs by 2022. GM will launch at least 20 EVs by 2023, while BMW has plans for 15. As for Volvo Cars, owned by China's Geely, all its models will have electric or hybrid options from 2019 onwards.

With all these new models appearing, EV prices will fall and investment in supporting infrastructure will rise, encouraging yet more sales. Indeed, according to the International Energy Agency (IEA), carmakers' current launch plans suggest that the global EV stock could reach anywhere between 9m and 20m by 2020, and 40m-70m by 2025.

All this will force governments to alter the way they support the EV revolution. In Norway, the world's most advanced market for EVs, they already account for around 35% of new car sales, but that is mainly attributable to heavy subsidies. These will still be necessary, but in 2018 they will only be part of the armoury used to persuade drivers to switch to EVs. More and more countries and cities will introduce tools such as duties, taxes, parking permits and congestion charges to encourage the purchase of low-emission vehicles. As a result, global sales of full EVs could top 1.3m in 2018, up from 774,000 in 2016 and an estimated 1m in 2017.

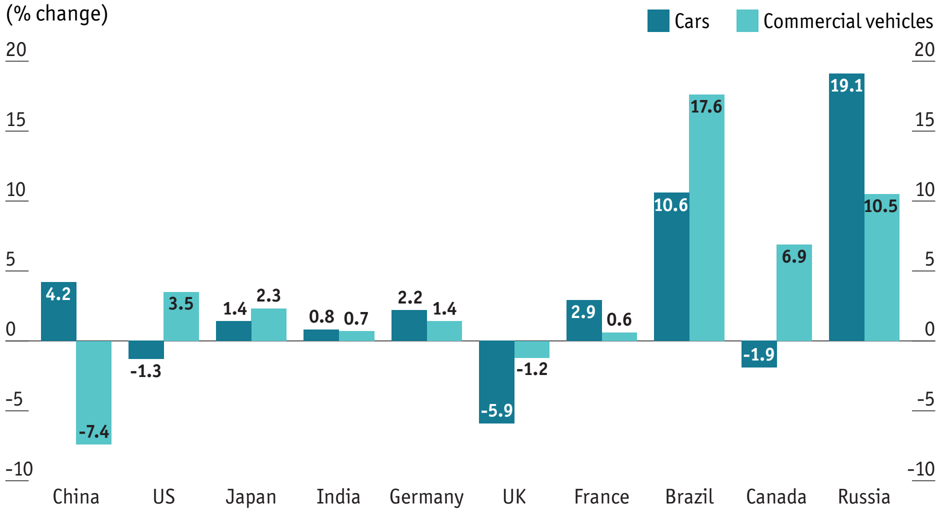
Public vehicles will be a prime target. Thailand, for example, wants to electrify the country's tuk-tuk fleet, while India is aiming to electrify public transport in several of its major cities. Buses are going electric in many major cities throughout the world. All this will help towards the long-term goal of banning the sale of new fossil-fuel vehicles entirely. France and the UK are just two of the countries that have set a goal to do just that by 2040, while India and Slovenia are aiming for 2030, in line with the Paris Climate Change Agreement. Norway has an even more ambitious target date of 2025.

Only connect

At the same time, the effort to clean up vehicles that run on conventional fuels will continue in 2018. The EU, which introduced real-world emissions testing in September 2017, will spend part of the year debating its proposed vehicle emissions targets for 2025 and 2030. The US administration, which is more sceptical about climate change, may step back from tighter emissions rules but will continue to regulate pollutants closely for public health reasons. Developing markets, which face far more urgent pollution problems, will step up action too.

Coping with all this will require massive investments from carmakers, which will face other pressing calls on their cash in 2018. Prime among these will be the development of connected car technology, which is gathering pace. GM, which has set up a large team in Canada to focus on self-driving cars, says it is well on the way to launching its first models, while Renault-Nissan plans to launch more than ten autonomous models by 2020. Regulations for self-driving vehicles are also in the works, with the US deciding in October 2017 to exempt them from some federal standards (such as the need for steering wheels) to encourage their development.

Ups and downs: Vehicle registrations in 2018
(% change)



Top ten markets by 2018 sale volumes.
Source: The Economist Intelligence Unit.

Production pressures

At the same time, carmakers will face more fundamental strategic pressures as trade barriers rise and fall. For the most part, the trend is still towards trade liberalisation. Vietnam is due to sign a free-trade agreement with the EU in 2018, for example, while Chile has just started negotiating one of its own. Progress towards a Trans-Pacific Partnership (TPP) agreement continues, despite the US's decision to pull out. Meanwhile, the member states of the Association of South-East Asian Nations (ASEAN) are planning to finalise talks on their Regional Comprehensive Economic Partnership in 2018, integrating their economies more closely than ever.

The exception, however, is in North America. So far the negotiations over NAFTA have been tough, with the US proposing new rules of origin for the auto sector against staunch opposition from Mexico and Canada. Currently, carmakers wishing to sell within NAFTA must source 62.5% of their components in North America. The US wants to raise this to 80%, of which 50% would come from the US. If Canada and Mexico agree, then carmakers will have to restructure their supply chains, pushing up costs and eating into profits. Suppliers in non-NAFTA countries such as China would also suffer.

Even worse for the auto industry, however, would be a complete collapse of the talks. After all, carmaking is a low-margin business that sometimes tips into unprofitability. The introduction of trade tariffs within the NAFTA region—particularly at a time when US car sales are falling—could upend carmakers' financial calculations.

Meanwhile, the EU is also facing rising barriers as the UK prepares for its exit in 2019. UK carmakers will spend 2018 reviewing their EU supply chains and preparing contingency plans in case 10% tariffs are imposed after Brexit. German automotive manufacturers will be contemplating the potential loss of a market that accounted for 18% of its car exports in 2016. Add this to the NEV challenge in China, and 2018 could be a fraught year despite the continued growth in demand.

What to watch for

- **Electrified:** India is trying to phase out sales of new fossil-fuel vehicles by 2030 in favour of EVs. A full-scale policy is due to be released by December 2017, but the government will also be offering grants to all cities with over 1m inhabitants that want to electrify their public transport system. However, there are fears that the plans will be held back by India's inadequate charging network and by parts shortages.

- **Football fever:** Russia's vehicle market is finally in recovery, spurred by government subsidies and an economic upturn. The government has allocated Rb30bn (US$490m) to help companies renew their car fleets, plus another Rb60bn in subsidies to enable domestic producers to source more content locally. The truck market should also benefit from government-funded infrastructure projects ahead of the 2018 FIFA World Cup.

- **Over Uber:** Brazil's Senate has approved new regulations for ride-sharing apps such as Cabify and Uber that will make them subject to local city authorities for licensing, taxes and other rules. It has stepped back from proposals that would have required app cars to have red licence plates like other forms of public transport, and for their drivers to own the vehicles they drive. The new regulations will nonetheless cause ructions in the taxi market in 2018.

Company plans for 2018

- **BYD/Great Wall:** BYD, the leader in the electric vehicle (EV) market in China, plans to launch up to five new vehicle models next year. The company is also investing US$22.5m at its plant in Hungary until end-2018. Meanwhile, another Chinese automaker, Great Wall, will open an assembly plant in Russia in 2018. The maker of sports utility vehicles (SUVs), which has entered the premium vehicles segment with its Wey brand, plans to launch three crossover SUVs under the brand next year.

- **Daimler/BMW:** Daimler's Mercedes-Benz brand, which is the leader in the premium vehicles segment this year, will continue to maintain its lead in 2018. The company will focus on emerging markets, launching plug-in hybrids and EVs in India next year and starting construction of a passenger-car plant in Russia. Its competitor, BMW AG, is currently strengthening its German facilities to produce EVs.

- **Delphi:** In September 2017 the auto parts maker announced that it will rename itself Aptiv and spin off its powertrain division. The latter will trade under the name Delphi Technologies, while Aptiv will concentrate on technology related to self-driving vehicles. Both companies will unveil their new branding in January 2018 as they begin trading separately.

- **Fiat Chrysler:** In 2018 the US-Italian automaker plans to divest its non-core assets, such as its components business, to lower its US$5bn debt. The company may also announce plans to divest or spin off its Maserati, Jeep and Alfa Romeo brands next year. Automakers such as Jaguar Land Rover and Great Wall have already shown interest in buying these units. The latter has also expressed its interest in buying the whole company.

- **General Motors:** The US car giant will launch two new EV models next year as part of a plan to launch 20 EVs by 2023. The company also plans to test self-driving Chevrolet EVs in the fleet of Lyft, a US ride-hailing company, in 2018.

- **PSA:** The French automaker plans to expand into emerging markets and cut costs under its new "Push to Pass" strategy. It will enter India next year. It also plans to market vehicles equipped with "driver-supervised" automated driving functions, such as navigation through traffic jams and parking, in 2018.

- **Renault-Nissan:** The Franco-Japanese auto alliance will launch the new model of the Nissan Leaf EV in 2018, starting with Europe. With a longer range, the new model of the EV will be expected to shake up the traditional EV market. The alliance also toppled Volkswagen as the largest automaker in terms of sales in the first half of 2017. It will be expected to maintain this lead into 2018 with its strong line-up and push into online sales.

- **Tesla:** The US carmaker expects to deliver new orders for its Model 3 sedan by the end of next year. The Model 3 sedan is Tesla's first mass-market electric vehicle and is central to its plan to raise annual sales to about 500,000 vehicles over the next few years. However, the automaker has said that it does not expect to meet its target of producing 500,000 EVs next year.

- **Volkswagen:** The German automaker plans to sell over 1m vehicles of its namesake and Audi brand in the US next year. The company has also announced plans to invest US$20bn in new vehicles such as clean energy cars, technologies and manufacturing capacity in China (its largest single market) by 2018.

- **Volvo Cars:** The Swedish carmaker, owned by China's Geely, will start manufacturing the new model of its S60 sedan at its plant in Charleston in the US from 2018, as part of a US$1.1bn investment under its "build where you sell" strategy. Geely, meanwhile, plans to begin sales of its first vehicle developed under its premium Lynk brand in Europe next year.

2018 calendar: Automotive

January

12-21: European Motor Show, Brussels, Belgium
13-28: North American International Auto Show, Detroit, US
25: Ford reports 2017 results
25: Fiat-Chrysler reports 2017 results
January 26-February 4: The Washington Auto Show, Washington DC, US

February

2: Daimler reports 2017 results
8: General Motors reports 2017 results
8: Volvo Car Corp reports 2017 results
9-14: New Delhi Auto Expo, India
10-19: Chicago Auto Show, US
16: Groupe Renault reports 2017 results
16-25: Canadian International Auto Show, Toronto, Canada
22: Tesla annual report 2017

March

8-18: Geneva International Motor Show, Switzerland
13: Volkswagen reports 2017 results
14-19: Cairo Automech Formula, Egypt
28-31: The 37th Bangkok International Motor Show, Thailand
March 30-April 8: New York International Auto Show, US

April

1-9: Seoul Motor show 2018, South Korea
1-8: The 37th Bangkok International Motor Show, Thailand
6-15: Zagreb Auto Show, Croatia
April 25-May 4: Beijing Motor Show, China
26-28: International Vienna Motor Symposium, Austria

May

10-11: Toyota reports 2017-18 results
17-20: The London Motor Show, UK

June

6-7: TU Automotive '18, Detroit, US

July

19-22: Seoul Auto Salon, South Korea

August

2-12: Indonesia International Motor Show, Jakarta, Indonesia
August 29-September 9: Moscow International Auto Show, Russia

September

11-13: Electric and Hybrid Vehicle Technology Expo, Michigan, US

19-27: 67th IAA Commercial Vehicles 2018, Hanover, Germany

20-27: 68th International Motor Show, IAA, Frankfurt am Main, Germany

October

2-5: FISITA 2016 World Automotive Congress, Busan, South Korea

2-14: Mondial de l'Automobile, Paris, France

25-Nov 4: Tokyo Motor Show, Japan

November

6-18: São Paulo International Motor Show, Brazil

7-18: Salon Internacional Automovil, Barcelona, Spain

23-26: Istanbul Comvex, Turkey

November 26-December 9: Los Angeles Auto Show, US

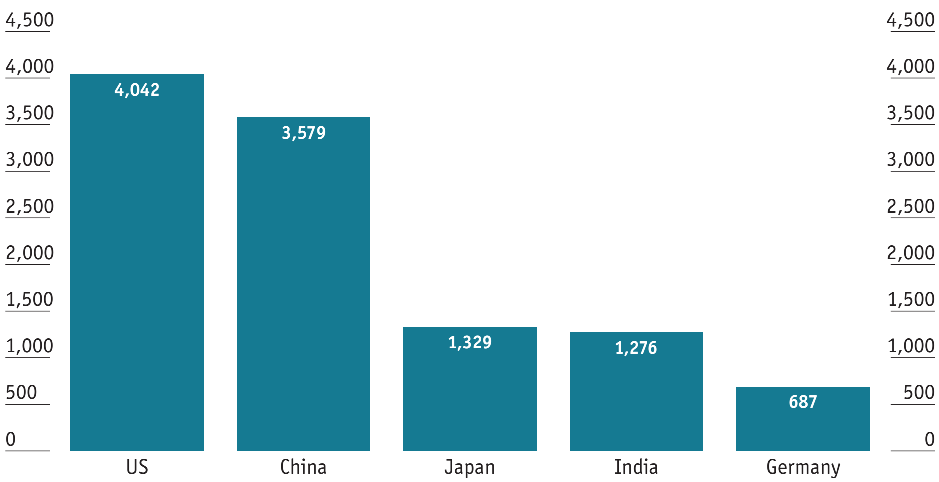
November 30-December 9: Bologna Motor Show, Italy

Consumer goods/retail: Apocalypse? No

Retailers will be harried by the rise of e-commerce, while consumer-goods firms will face an onslaught from activist investors and increased competition from craft products.

On the surface, the global retail and consumer-goods sector is enjoying a period of stability. Retail volumes are estimated to have risen by a steady 2.8% in 2017, with 2018 expected to see only a slight slowdown to 2.5% growth. The US, the world's largest retail market in nominal US dollar terms, will manage growth of 2.4% in 2018, on a par with 2017. Retail sales there will pass the US$4trn-mark as sales per capita exceed US$12,000. Beneath the surface, however, things are less serene.

Top five: Retail sales in 2018
(US$ bn)



Sources: The Economist Intelligence Unit; Planet Retail.

The steady global expansion masks sharp regional disparities. All regions are expected to return to growth in 2018, following declines in Latin America, the Middle East and Africa in 2017. Yet volume growth in other regions is decelerating. Asia will see its slowest growth in five years, while western Europe will experience relative stagnation, with growth of just 0.9% undermining the improvements of recent years. Growth in the transition economies of Central and Eastern Europe, while a positive sign, is deceptive: the region is still recovering ground following the economic turmoil and currency weakness that stemmed from the collapse in oil prices in 2014-15 and the conflict in Ukraine.

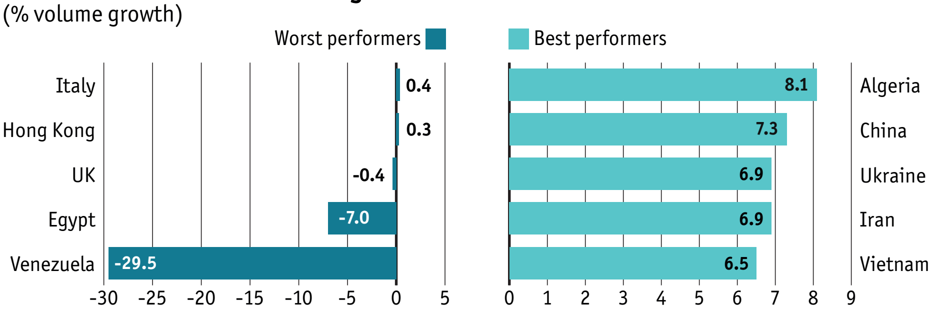
While global retail sales are expected to expand solidly in 2018, regional growth will range from 0.8% in the Middle East and Africa to 3.7% in Asia and Australasia.

Winners and losers

The variation in sales growth is even more pronounced at the country level, ranging from over 8% for Algeria to a decline of almost 30% in Venezuela. The challenges facing the Venezuelan retail and consumer-goods market are well known, and recent economic volatility in Egypt has undermined sales there too. Also threatening to bring problems for retailers in 2018 are Hong Kong, Italy and the UK.

The UK's decision to leave the EU had been expected to lead to a sharp but relatively short decline in consumer sentiment. Instead, the impact is likely to be less pronounced but longer-lasting as negotiations drag on and the weakness of the ruling Conservative-led coalition undermines progress. Although UK sales outperformed expectations in 2016-17, shoppers are expected to tighten their belts in the face of inflation, rising interest rates and stagnating wages. Sales will decline in 2018.

From worst to best: Retail sales growth in 2018
(% volume growth)



Sources: The Economist Intelligence Unit; Planet Retail.

Even some fast-growing markets are giving retail and consumer firms cause for concern. Chinese retail growth will be among the world's strongest in 2018 but is nonetheless diminishing quickly. Rewind to 2011, and China was driving international retail growth in the wake of the global economic crisis, with sales volumes rising by over 13%. Contrast that with forecast growth of 7.3% in 2018, to be followed by further declines. China is also proving a difficult market to crack for foreign players. Strong state support for domestic firms and Alibaba's dominance in e-commerce are crowding out potential market entrants from abroad.

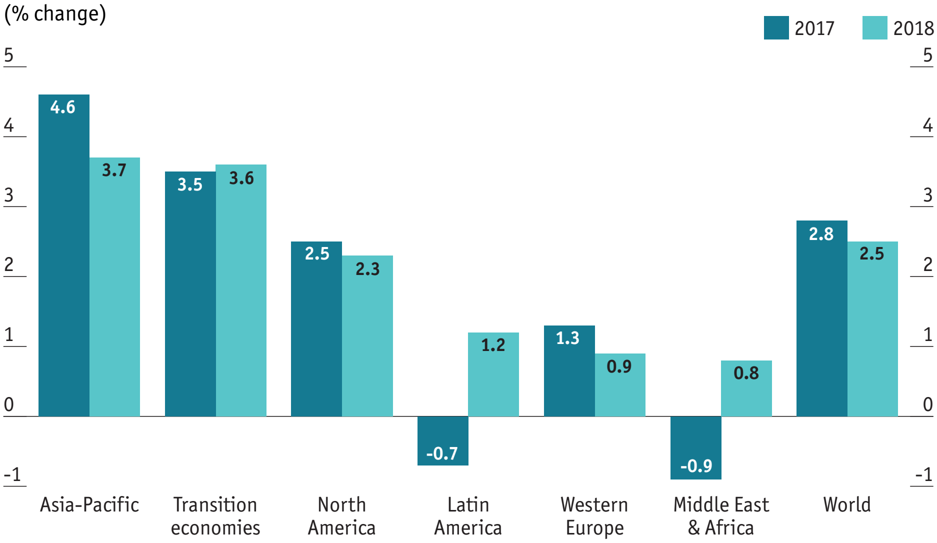
On a brighter note, other markets are gaining momentum. Vietnam is generating strong interest among retail and consumer-goods firms thanks to the rising wealth of its citizens and a period of relative political stability. Iran, too, is becoming a focus of intense interest from investors as they are granted access to its vast and largely untapped consumer base.

Retail apocalypse

The US will be the world's largest retail market in 2018—China's slowing sales are unlikely to overtake the US's for at least half a decade—but it could also be one of the most problematic. Real wage growth, falling unemployment and access to cheap credit will sustain solid spending. However, the structural switch towards e-commerce is weighing on the finances of indebted bricks-and-mortar retailers. The "retail apocalypse" predicted by some doom-mongers has failed to materialise, but some 5,300 store stores will close in the US in 2017, over half of them owing to bankruptcies, according to JLL, a real-estate firm. Household names such as Kmart, Sears, Macy's and JC Penney all have significant closure plans.

Given the pace at which shopping is moving online, this may be a necessary

Unequal growth: Retail sales volumes by region
(% change)



Sources: The Economist Intelligence Unit; Planet Retail.

correction. It is no less disruptive for that. In 2018 The Economist Intelligence Unit expects the US Federal Reserve, the central bank, to raise rates three times, leaving little wiggle room for retail and consumer firms already struggling with heavy debts. This comes as consumer sentiment in markets around the world is being hurt by political uncertainty—witness Brexit, Donald Trump's presidency in the US, Catalonia's unofficial vote to secede in Spain and Saudi Arabia's anti-corruption campaign.

Amazon's disruption of the retail and consumer-goods industry is also reaching new subsectors and geographies. Most notable among a number of recent strategic moves is its push into bricks and mortar through its acquisition of Whole Foods for US$13.7bn and its rollout of bookshops and checkout-less stores. Amazon is also reportedly mulling the launch of a service delivering ready-to-eat meals in 2018. Beyond the US, the company will aim to make inroads in Australia, where it will soon be fully launched, and ramp up its presence in India.

While there will be no retail apocalypse in 2018, there will be casualties.

What to watch for

- **Activist investors:** The food and beverage sector is a prime target for the cost-cutting and margin improvement pushed by activist investors. Their targets include some of the biggest names in consumer goods, such as Nestlé and Procter & Gamble (see below). The predators look increasingly hungry and will strive to take further bites out of the industry in 2018.

- **Craftification:** Better-off consumers, eager to set themselves apart from their peers, are favouring small, tailored brands. A growing range of "craft" or boutique products is reaching ever more consumers. The global craft-beer movement has spread from the US as far as China; craft spirits, especially gin, are now seeing a similar explosion. The upstarts rely on agile distribution strategies to harry established players. But the latter are fighting back by buying craft competitors: Unilever, notably, has led the charge. We expect more such moves in 2018.

- **Virtual assistants:** As artificial intelligence (AI) meets the Internet of Things (IoT), personal digital assistants and the devices that host them are becoming increasingly embedded in the home. They are even starting to integrate with one another. In 2018 Sonos, a US company, plans to market a speaker system that works with Apple's Siri, Google Assistant and Amazon's Alexa.

Company plans for 2018

- **Amazon:** The ascendant online retailer is reportedly looking to launch a shipping service for third-party sellers in the US in 2018. Sellers listed on Amazon's marketplace currently use FedEx or UPS to deliver orders. The service is reportedly already being tested in some West Coast states, under the name Seller Flex.

- **Cencosud:** The Chilean retailer will divest non-core assets worth US$1bn by 2018 as it focuses on its core retailing operations. The move will help one of Latin America's largest shopping chains to reduce debt and spur growth. Which assets will be up for sale, however, remains a mystery.

- **Coach:** The luxury-goods maker's holding company, formerly Coach Inc, will enter 2018 with a new name: Tapestry. The US company is refashioning itself as a multi-brand retailer, following acquisitions of Stuart Weitzman in 2015 and Kate Spade in 2016. It would be no surprise if the firm went shopping again in 2018 as it seeks to appeal to younger customers.

- **Essilor:** The European Commission is expected to give its final decision on whether the proposed merger of Essilor and Luxxottica is anti-competitive. The deal between the world's largest ophthalmic lens company and its biggest eyewear maker would bring together brands such as Ray-Ban, Vogue Eyewear, Oakley, Varilux, Crizal and Transitions.

- **Kroger:** The US retailer plans to sell its convenience store business amid mounting pressure from online retailers such as Amazon. It will also launch a new apparel brand in its home market in 2018. As part of its "Restock Kroger" plan, the company will concentrate on revamping stores, use data and machine-learning technologies to improve the customer experience and expand its "Scan, Bag, Go" service to 400 stores.

- **Procter & Gamble:** The maker of Tide detergent and Gillette razors is likely to come under increased pressure from activist investors in 2018. An attempt by Nelson Peltz, a founder of Trian Fund Management, to gain a seat on P&G's board hung in the balance at time of publication. He remains popular with other shareholders. Boosting merger and acquisition (M&A) activity could be a way for the company to pacify shareholders in 2018.

- **Souq.com:** Amazon's subsidiary in the Middle East will face increased competition in Saudi Arabia from the UAE's Noon.com. Noon, which is expected to launch in the Kingdom in late 2017, is backed by prominent Middle Eastern investors and the Saudi Public Investment Fund. The battle over Saudi Arabia's underdeveloped e-commerce market is set to heat up further as China's JD.com mulls entering the fray.

- **Tesco:** The UK's largest grocery retailer is buying Booker, a food wholesaler, in a deal that is expected to close in 2018. It would create the country's largest food group, but hurdles remain. It faces scrutiny from the country's competition authority and the opposition of at least two of Tesco's shareholders, who argue that Tesco ought to be focused on restructuring and cutting costs.

- **Yum:** The fast-food operator is on track to operate 98% of its stores as franchises by end-2018. The parent of Burger King and Pizza Hut has signed re-franchisement deals in Australia, Thailand and Turkey and has similar plans for its Chinese subsidiary, Yum China, which was spun off from Yum in October 2017. Yum China will get a new boss in March with the promotion of its head of operations, Joey Wat, to chief executive.

- **Unilever:** The consumer goods giant will start 2018 with a wider rollout of its new brand, ApotheCARE Essentials, which aims to capitalise on demand for natural products. This is part of a strategic shift since it rebuffed a takeover attempt by its rival, Kraft, in early 2017. The company is also revamping its product line-up and restructuring business units. Still, a fresh bid by Kraft in 2018 would come as no surprise.

2018 calendar: Consumer goods

January

December 26, 2017-January 28: Dubai Shopping Festival, UAE
5-7: London Fashion Week Men's, UK
9-12: International Consumer Electronics Show, Las Vegas, US
10: Metro Group trading statement for Christmas quarter
14-16: Retail's BIG Show, New York, US
16: Carrefour reports Q4 2017 results
17-21: Paris Men's Fashion Week, France
21-25: Paris Haute Couture, France
26: Unilever reports 2017 results
30: McDonald's reports 2017 results

February

3: Yum! Brands reports 2017 results
8: IGD Asda Trade Briefing, Harrogate, UK
8-16: New York Fashion Week, Autumn/Winter
13: Reckitt Benckiser reports 2017 results
16-20: London Fashion Week, Autumn/Winter, UK
20: Walmart reports fiscal 2018 results
21-27: Milan Fashion Week, Autumn/Winter, Italy
27 February-March 6: Paris Fashion Week, Autumn/ Winter, France

March

1: Carrefour reports 2017 results
5-8: Global Food Safety Conference, Tokyo, Japan

April

4-6: Next Generation Retail Summit US, Florida, US
17-19: The World Retail Congress, Madrid, Spain
19-20: Global Retailing Conference, Arizona, US
22: Tesco reports 2017 results

May

2-3: Retail Business Technology Expo, London, UK
14-16: Next Generation Retail Summit Europe, Ayrshire, Scotland
17: The Retail Conference, Nottingham, UK

June

13-15: The Global Consumer Goods Forum, Singapore
20-24: Paris Men's Fashion Week, France

July

1-5: Paris Haute Couture, France

September

6-14: New York Fashion Week, Spring/Summer, US

14-18: London Fashion Week Spring/Summer, UK
19-25: Milan Fashion Week, Spring/Summer, Italy
September 25-October 3: Paris Fashion Week Spring/Summer, France

November

11: Singles Day, China
23: Black Friday
26: Cyber Monday

December

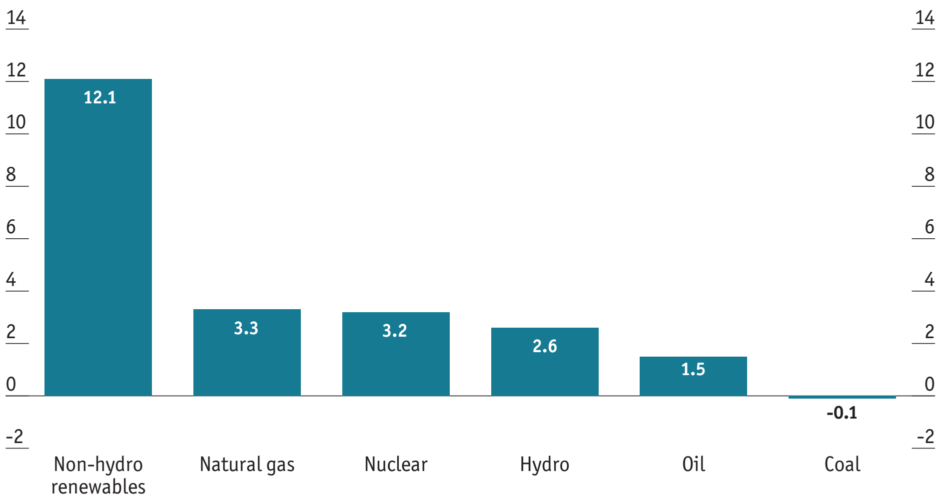
22: Super Saturday

Energy: Sustainable momentum

The global transition towards clean energy will make further progress, notwithstanding Donald Trump's policies. Prices of fossil fuels will languish.

The biggest call in last year's Industries report was that the election of Donald Trump as US president would not halt the transition towards cleaner energy around the world, although it might slow it. In June 2017 Mr Trump duly announced that the US would withdraw from the Paris Agreement on climate change, a decision that sent shockwaves around the world. The Economist Intelligence Unit continues to believe, however, that while the US's abandonment of the pact is a setback for the global shift towards clean energy, it will not throw it into reverse. In the US, certainly, the move to scuttle Barrack Obama's Clean Power Plan (CPP) will have a noticeable impact. Yet nothing suggests that other major economies will follow suit. We expect investment in renewables capacity to drive power investments globally in 2018 and beyond.

Shift to renewables: Energy consumption in 2018
(% change)



Source: The Economist Intelligence Unit.

In this article, we assess the outlook for the major energy economies of the US, Europe and China, and what it means for prices.

The world of energy

Energy policy in the US will continue to be contentious in 2018. The Trump administration will seek to wind back regulations and policies that it believes place an unnecessary burden on fossil fuel production. In early October 2017 the head of the Environmental Protection Agency (EPA), Scott Pruitt, announced that he intended to repeal the CPP, Mr Obama's signature climate policy. We expect this move to be fought in the courts in 2018.

Where the administration sees fit, it will also intervene in the energy market to protect fossil fuels. Rick Perry, the energy secretary, wants coal (and nuclear) plants that keep at least 90 days' worth of fuel on site to be better compensated for contributing to the stability of the electricity grid. Mr Trump may also raise tariffs on imported solar panels, which might help some domestic producers but will raise the cost of deploying solar equipment.

Nevertheless, solar and wind power, with natural gas, will continue to spur capacity additions in the US power sector in 2018. Coal plants will be shuttered in gathering numbers. The policies of the current administration may shore up coal-fired power in the short term, but this will not last.

In Europe, much attention will focus on Germany and its climate policies. Germany's "energy transition" (Energiewende) policy has led to a big boost in renewables generation. But Germany is set to miss its target to cut emissions by 40% from 1990 levels by 2020. Dependence on coal has remained stable, with renewables displacing nuclear. Emissions have not fallen meaningfully in the past three years. Germany's chancellor, Angela Merkel of the Christian Democratic Union (CDU), faces a delicate balancing act on climate. Even if she succeeds in forming a new government following the collapse of coalition talks, the country's political parties are likely to remain at odds over the policy. Reducing emissions is not the only priority of the Energiewende, but Germany's claim to leadership in climate policy will be questioned as long as coal remains its largest source of electricity.

More quietly, the UK is making a clean-energy transition of its own. It has made the most dramatic cuts to carbon dioxide (CO2) emissions of any major European economy in recent years and is stepping up its actions. A Clean Growth Strategy was released in October, part of a commitment to cutting emissions made under the Climate Change Act. Awarding lower-cost offshore wind contracts will further decarbonise the UK's electricity supply. The UK may yet emerge as the most successful European country on this measure, with coal scheduled to be phased out by 2025.

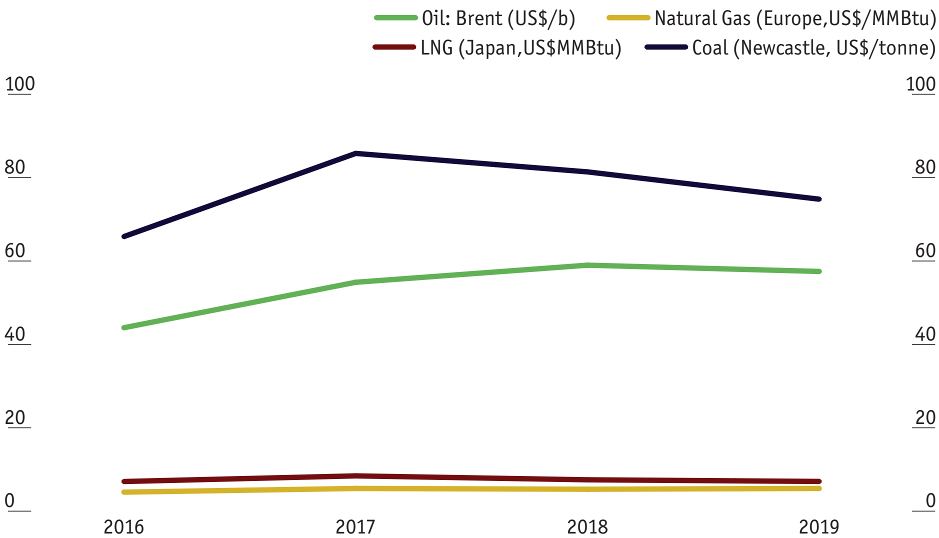
The comparable transition in China, the world's largest energy consumer, continues apace, with significant increases in renewables capacity projected in 2018. It is chasing ambitious targets for renewables under its 13th five-year plan to 2020. The International Energy Agency (IEA) expects China's electricity capacity from renewables to grow by two-thirds over 2017-22, reflecting significant additions of both solar and wind power. In 2018 alone China is expected to add 60 GW of renewables capacity, of which two-thirds will be solar and wind. A long-awaited emissions-trading scheme should also be under way by 2018, another part of China's campaign to wean itself off dependence on fossil fuels. But China will need to put the brakes on its construction of coal plants, which still provide most of the country's power. Impressive as China's clean-energy capacity additions are in absolute terms, its chief source of renewable electricity will remain hydropower, which can harm the environment.

Turning the corner

The energy transition will dominate the energy headlines, but an overwhelming share of consumption is still sourced from fossil fuels. Prices for oil, gas and coal bottomed out a few years ago, but despite rises in 2018 they will continue to lag well below their recent highs. In the longer term the oil market will face a challenge from the rise of electrical vehicles, but we do not expect this to affect prices just yet. Meanwhile coal and gas will fight it out for market share in the power sector—as has already been seen in the US and, to some extent, in Europe.

In the case of oil and gas, ample supplies are to blame for low prices, despite OPEC's efforts to hold down production with a quota. In May 2017 the cartel

Gradual gains: Commodity price forecasts



Source: The Economist Intelligence Unit.

decided to extend its output cut of 1.2m barrels/day (b/d) until March 2018, with the help of a further cut of 600,000 b/d from other producers such as Russia. This has helped to keep prices above US$50/b. We believe OPEC will extend the cuts beyond March, but compliance—which has so far been impressive—could unravel towards the end of 2018. Also weighing on prices will be slowing growth in China's oil demand and a rebound in the output of shale oil in the US. Overall, we forecast an annual average price of US$59/b for Brent in 2018, up by just US$4 from an estimated US$55/b in 2017.

We are somewhat more bullish on natural gas, forecasting an increase in Henry Hub prices to US$3.43/MMbtu in 2018, from US$3/MMbtu in 2017. Prices in the US will be underpinned by growing demand for exports, both by pipeline (mainly to Mexico) and as shipments of liquefied natural gas (LNG). In Europe we expect a slight fall in natural-gas prices to US$5.26/MMbtu, from US$5.44/ MMbtu in 2017.

Coal markets, meanwhile, are in the grip of stagnating demand. Newcastle thermal coal prices have had a good year in 2017, after a boost from strategic output cuts in China. We expect a slight fall in 2018, with an annual average price of US$84.78/tonne. Although China will continue to restrain output, lacklustre demand globally will hold down prices.

What to watch for

- **OPEC: still cutting it?** We expect OPEC to extend output cuts until at least the third quarter of 2018, but the grouping is prone to fractiousness. If the pact ends before market conditions have tightened enough, oil prices will plummet. OPEC wants to prop up prices without helping US shale producers too much. Despite this, US output will increase in 2017-18—not at the same rate as in 2012-14, when prices were much higher, but enough to stop the cartel from controlling prices as much as it would like.
- **US LNG trains leave the station:** In the second half of 2017 natural gas exports from the US will exceed imports, and in 2018 this will be true over the full year. New LNG terminals are partly to thank. Five projects—Cove Point, Cameron, Elba Island, Freeport and Corpus Christi—should come online by 2019, joining Sabine Pass, currently the sole operating plant. Liquefaction capacity will increase from 1.4bn cu ft/day in 2017 to 9.5bn cu ft/d by 2019 as the US chases Qatar and Australia, the world's biggest LNG powers.

- **Australia: energy battleground:** Energy policy in the "lucky country" is increasingly contested. Electricity and natural-gas prices in the resource-rich country have spiralled. Extreme weather causes blackouts; debate over decarbonising electricity supplies rages on. The centre-right government is eschewing calls for a clean energy target to replace the Renewable Energy Target (RET) when it expires in 2020. It wants a national energy guarantee, requiring utilities to provide a share of electricity from reliable and readily available "dispatchable" sources, such as coal and gas, and limiting the emissions-intensity of generating stock. Details will become clearer in 2018.

Company plans for 2018

- **BHP:** The Anglo-Australian diversified miner has restructured its management and operations to ease concerns raised by investors led by a US-based hedge fund, Elliott Management. BHP has decided to exit shale oil and gas exploration in the US and restructure its mining operations; it has also rebranded itself as part of its efforts to ride out the weaknesses in the minerals market. The coming year will test the success of BHP's strategies in improving its income.
- **China Shenhua Energy:** China's largest coal producer is setting up the world's largest power utility following its takeover of China Guodian, one of China's top-five power utilities. With the deal expected to be completed in 2018, Shenhua will change its name to China Energy Investment. It will have assets worth over US$272bn and power-generation capacity of more than 225 GW.
- **Dong Energy:** The Danish company recently changed its name to Orsted to mark its shift from fossil fuel to clean energy. In giving up oil exploration and coal usage in power generation, the world's largest offshore wind installer says it is preparing for "a world that runs entirely on green energy". Dong recently bagged a contract to build the world's biggest offshore wind farm in the UK, among other projects, and is expected to pick up new offshore wind assets from auctions in 2018.
- **Eletrobras:** Brazil's national power utility, the largest in Latin America, wants to complete offloading a number of assets by next year to reduce its debt burden and streamline operations. It started at end-October 2017 by selling certain power generation and transmission assets and has attracted interest from foreign players such as France's ENGIE.

- **Gazprom:** The world's largest natural-gas producer is seeking to construct a number of pipelines to Europe, including TurkStream and Nord Stream, as well as stepping up exploration in Russia and beyond. Gazprom is hoping to reboot its export revenue, which has come under pressure from lower global commodity prices and from the impact of US and EU sanctions on Russia. It has also encountered increasing competition from compatriot Rosneft, which is eyeing gas exports to Europe and Asia.

- **Kuwait Foreign Petroleum Exploration Co (KUFPEC):** The upstream unit of Kuwait Petroleum has shown a strong appetite for foreign assets. In September 2017 it agreed to acquire an additional stake in a North Sea oilfield from Total. This will add about 34m barrels of oil equivalent (boe) to KUFPEC's reserves. It operates 54 assets in 14 countries. In October a deal to acquire Royal Dutch Shell's two Thailand units was cancelled owing to delays. In 2018 KUFPEC is expected to strike more deals to expand its reserves.

- **Oil and Natural Gas Corp (ONGC):** India's largest oil producer is acquiring control of Hindustan Petroleum (HPCL), India's second-biggest fuel retailer, in a deal that is expected to close in 2018. Together, the two will create India's first state-run integrated energy company, and their merger is likely to be the first of several in India's fuels market. Separately, ONGC and HPCL have announced plans to increase their respective production and refining capabilities.

- **Saudi Aramco:** In 2018 the world's largest oil producer is looking to list a 5% stake in the company for up to US$100bn—a sale that would value the whole company at around US$2trn. The move has created strong interest worldwide, including from an unnamed Chinese state-backed group. However, it has also encountered some internal resistance as it may open the company to external scrutiny. Saudi Arabia wants to use the funds from the listing to reduce its reliance on oil export revenue.

- **Total:** In 2018 the French oil giant will continue to diversify its business into electricity and clean energy—a strategy that has cushioned it from the impact of weak oil prices. It has recently made a foray into France's retail power industry and acquired stakes in a renewable energy producer and an energy services company. Total has also been acquiring high-margin oil and gas assets worldwide to drive production growth, while offloading non-core acreages.

- **YPF:** Argentina's national oil producer has entered into several partnerships with foreign oil and gas producers such as Total, BP, Exxon Mobil, Royal Dutch Shell and Statoil to drill in the country's giant Vaca Muerta shale formation. Argentina's oil and gas industry has long suffered from poor investment, but the fall in global oil prices has made the region crucial for high-margin exploration. 2018 will see more partnerships and a rise in output from Vaca Muerta.

2018 calendar: Energy

January

15-18: World Future Energy Summit, Abu Dhabi, UAE

21-26: Arctic Frontiers, Tromso, Norway

28-29: ExxonMobil reports 2017 results

28-29: Chevron reports 2017 results

February

2: Royal Dutch Shell reports 2017 results

7-9: International Conference on Clean and Green Energy, Paris, France

8: BP reports 2017 results

9: Total reports 2017 results

March

2-3: 2018 MIT Energy Conference, Boston, US

13-15: Oil and Gas Asia 2018, Karachi, Pakistan

19-21: Doha International Sustainable Energy Conference, Qatar

20-23: Offshore Technology Conference Asia, Kuala Lumpur, Malaysia

April

April 30-May 3: Offshore Technology Conference, Houston, US

June

12-14: Global Petroleum Show, Calgary, Canada

August

21-23: World Renewable Energy Technology Congress, New Delhi, India

September

10-12: Third International Conference on Energy Production and Management, New Forest, UK

October

17-19: World Energy Engineering Congress, Charlotte, US

November

5-16: UN Climate Change Conference (COP 24), Katowice, Poland

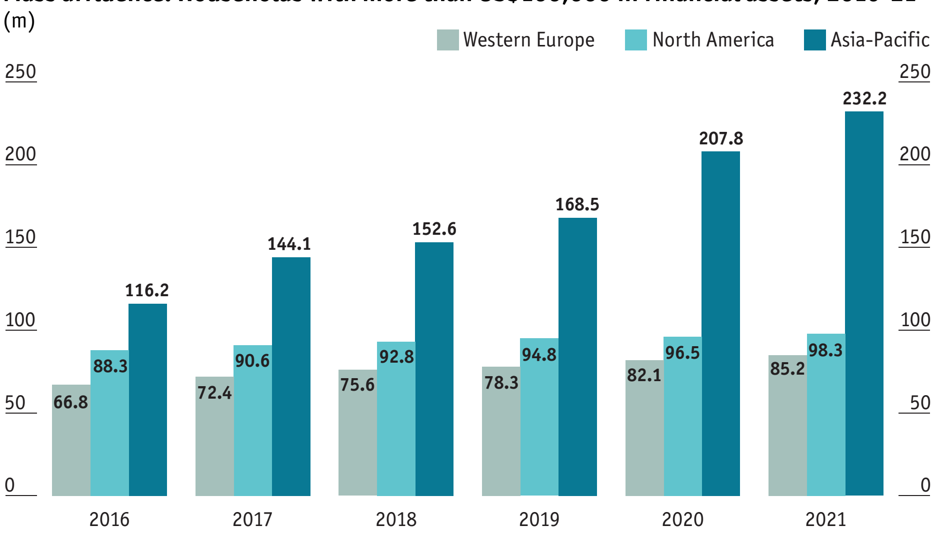
Financial services: The future arrives

The outlook for finance is the most upbeat for a decade, despite the risks lurking in China and other markets.

A decade after the financial crisis, in 2018 conditions for financial firms will begin to settle into a steady state. Global economic growth will strengthen, interest rates will return to normal, financial firms will again pursue international opportunities, and regulators will take a break from applying ever stricter standards.

Firms in the sector that prosper in this environment should be in a good position to face the future. However, those that falter will need to stop waiting for a further improvement in economic and operating conditions and rethink their business models.

Mass affluence: Households with more than US$100,000 in financial assets, 2016-21



Source: The Economist Intelligence Unit.

Fixed income

Moderate hikes in base interest rates in North America and the tapering of asset purchases in the euro zone should lead to somewhat higher bond yields, attracting investors back into fixed-income instruments. This should take some of the shine off stocks that are currently enjoying rich valuations, but the effects will be limited as central banks are likely to move gradually. Their cautious approach will also keep volatility low, leading to continued weak demand for hedging instruments at investment banks' trading desks.

So long as rates remain low on investment-grade government and corporate bills, investors will flock to the high yields available on risky bonds such as those recently issued by Argentina, Ukraine and Greece. The slow ramp-up in rates in 2018 will mean that the window remains open for such issuers.

Whatever happens in the push and pull between stocks and bonds, investors will continue to seek out low-cost investment vehicles such as exchange-traded funds. The Economist Intelligence Unit expects that the shift to such funds will run strong in 2018 as investors focus on reducing the fees they pay. We also anticipate a further consolidation among the providers of these funds. Since revenue margins are slim, a fund manager needs good economies of scale to turn a decent profit.

Remaking financial firms

After many years of sub-par performance, in 2018 an increasing number of financial firms will return to levels of profitability that beat their cost of capital. They will be boosted by stronger business volumes, improved operating margins, better returns on investments and the fruits of a long period of cost-cutting.

However, many financial firms are ill-situated geographically to take advantage of the strongest pockets of growth. In short, they are heavily overweight in mature and developed markets and underweight in more rapidly growing emerging markets. Some have recently moved to fortify the positions they maintained in developing countries in the lean years. Unfortunately, not all high-growth markets are open to them; China's insurance volumes are booming but few foreign companies are in a position to benefit.

Many financial firms are still carrying out basic restructuring to wring out costs, reshape their geographical profiles or escape the most onerous regulations that apply to the largest firms. In other cases, firms that had to be rescued in the 2008-09 crisis are just getting back on their feet as governments sell off stakes and refloat them on stockmarkets.

Banks from Asia's principal economies are taking the lead in exploring new territories. They have gained licences, usually for simple branch operations, in many markets around the world. Eschewing complicated acquisitions and entanglements with retail operations, they are seeking corporate and investment business as companies from their home markets expand around the globe.

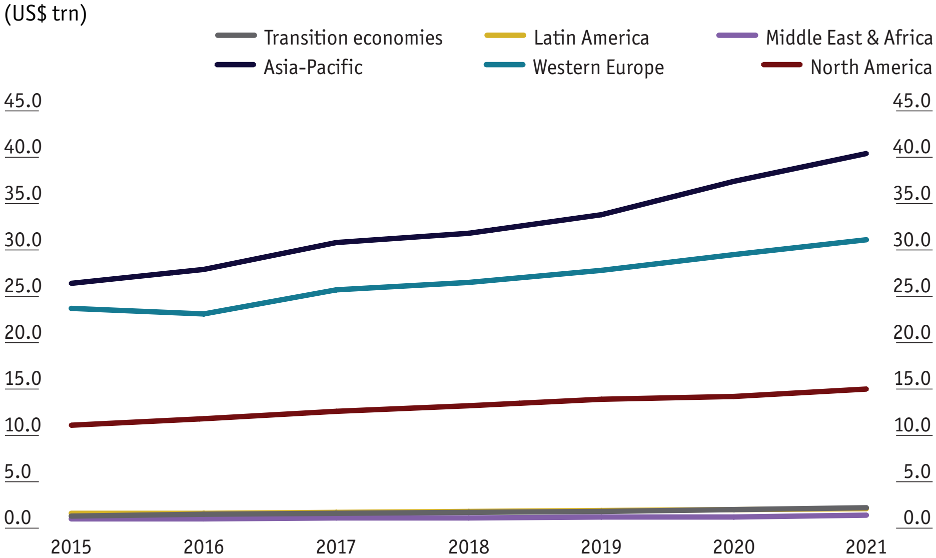
A plateau for re-regulation

2018 will mark the start of a plateau in financial regulation. Firms will get a respite after nearly a decade of the tightening process that began shortly after the collapse of major companies at the end of the last decade. This is the final year to comply with the core Basel III rules, which enter into full force in January 2019. Most lenders now appear to meet the strict new standards on capital and liquidity, and in the case of the biggest banks also supplementary capital buffers.

In 2018 we should also begin to see the consequences of the new automatic sharing of tax information between countries. This ought to lead authorities to crack down on individuals and companies that have tucked away undeclared, untaxed assets in foreign markets. Although these efforts could erode the advantages of jurisdictions such as Switzerland and Singapore that have kept their customers' secrets, we expect these financial hubs to retain their overall appeal.

The pause in regulatory tightening is unlikely to lead to the full-scale rollback that appeared possible after the Brexit vote and the election of Donald Trump in the US in 2016. Any shift in the UK will have to wait until after the country leaves the European economic bloc in 2019, while in the US the new administration has proved unable to assemble a legislative majority around its key proposals. Nevertheless, a consensus has emerged globally that smaller financial firms should not be held to the same strict standards as their larger rivals; regulators

Loan boom: Customer loans by banking sector
(US$ trn)



Source: The Economist Intelligence Unit.

will use their authority to ease the burdens on such firms.

Regulators will also move to step up the supervision—but also the facilitation—of innovations in finance, including mobile banking, peer-to-peer lending and payments, on-demand insurance, investment robo-advisers and crowd-funded ventures. China's recent crackdown on cryptocurrencies shows that some of this intervention will be heavy-handed.

Scary risks in murky places

Despite the brighter outlook, global finance continues to harbour big risks in hard-to-measure places. The main example is the huge run-up in Chinese debt in recent years. Following the 19th Communist Party Congress in late 2017, we believe that China's newly strengthened leader, Xi Jinping, will move to tackle this peril in 2018. Fortunately the country has sufficient reserves to sort out the mess.

India's state banks, like those in China, are heavily burdened with bad loans, although better reporting means that the problem is more clearly understood. A plan by India's government to recapitalise its lenders will take flight next year, an important first step in tackling the problem.

Troubled banks in Russia and southern Europe will continue to fail, but fortunately our analysts anticipate that these collapses will not pose risks for entire national financial systems. In most cases, local taxpayers will bear the costs.

Stronger economies and higher interest rates will help most financial firms in 2018. They will also get boosts from their own recent efforts at reinvention and lighter treatment from their supervisors. It won't be paradise, but will probably be as good as it gets.

What to watch for

- **Research constraint:** Europe's giant capital-market reform, known as MiFID2, comes in with the new year. Although it contains many measures, the prohibition on brokers bundling trade execution charges with research services has attracted the greatest attention. Many big fund managers will not pass on the cost of research to investors, so will be stingier about buying it.
- **Lively insurance:** Indian insurers will keep turning themselves into publicly traded companies. HDFC Standard Life, a private joint venture, plans a listing in 2018 following some successful recent initial public offerings (IPOs) by insurers. The newly bolstered underwriters should begin to erode the dominance of India's state-owned insurers.
- **Lost passports:** UK-based financial firms will continue to announce shifts of business units and workforces to other EU locations ahead of Brexit, which we expect to deprive them of their passports allowing services for clients across the EU. Frankfurt appears the main winner so far, although some firms are taking the opportunity to move staff to lower-cost locations such as Poland.

Company plans for 2018

- **Barclays:** To comply with the UK's ringfencing requirements, Barclays will split into two units in early 2018. One will house its core retail-banking operations in the UK, while the other will comprise the corporate and investment bank. Each business will have its own board of directors and a separate funding structure.

- **Citigroup:** Anticipating a "hard" Brexit, Citi will move its private banking headquarters in Europe from London to Luxembourg. It will also base its trading and capital-markets operations in Frankfurt. After details of the Brexit negotiations become clearer next year, a lot more banks will scale back operations in London.

- **Goldman Sachs:** After a few miserable quarters, Goldman's fixed-income desk (specifically its commodities unit) is in need of a revamp. Goldman is going to restructure the unit, much as Morgan Stanley, a smaller rival, did in 2016. This will probably involve job cuts, less focus on hedge funds and the automation of some trading operations.

- **Japan Post:** The Japanese government will reduce its stake in Japan Post through several share sales over the next few years and use the proceeds on earthquake reconstruction efforts. Japan Post Holding, the parent company, has a less public-spirited reason to sell down its stake in the banking and insurance units, namely the funding of acquisitions in non-bank financial firms such as asset managers and leasing companies.

- **National Stock Exchange (NSE, India):** India's largest bourse aims to launch its US$1.5bn initial public offering (IPO) in the second half 2018. It will refile its application once a probe by the Securities and Exchange Board of India (SEBI) is concluded satisfactorily. The capital-markets regulator wants to know whether the NSE provided preferential access to certain brokers to its co-location servers, which speed up algorithmic trading.

- **Old Mutual:** The Anglo-South African lender aims to complete the break-up of all four of its business units—Old Mutual Emerging Markets, Old Mutual Wealth, Nedbank and OM Asset Management—by end-2018. It will also list its UK wealth management unit and a holding company for its emerging-markets business in London and Johannesburg next year.

- **OTP Bank:** The Hungary-based lender's chief executive, Sandor Csanyi, plans to buy at least five regional banks in 2018 and 2019 to expand in Central and Eastern Europe. OTP Bank has around US$1bn of cash at its disposal to fund the purchases.

- **Tencent:** The Chinese internet giant, which owns 12% of ZhongAn, a publicly listed online insurer, is expanding its own insurance operations. Tencent's subsidiary, Weimin Insurance Agency, recently received the green light from the China Insurance Regulatory Commission to commence operations. Tencent will sell insurance policies through its social media and messaging apps, WeChat and QQ, which boast a combined total of 900m users.

- **Ualá:** This newly launched mobile banking app, backed by billionaire investors such as George Soros and Steve Cohen, will speed up Argentina's transition to a cashless economy and increase financial inclusion. The low-cost service expects to hit 10,000 users within 2017 and to accrue more the following year. Its appeal will be burnished by its lack of transaction or maintenance fees. New users receive a prepaid Mastercard.

- **Wells Fargo:** More issues relating to the bank's fake-accounts scandal could come to light. Its chief executive, Tim Sloan, says that the bank has hired external consultants to dig into and assess its practices and that this could lead to "additional headlines" in the near term. Meanwhile, Wells Fargo's cost-cutting programme will continue unabated: it aims to have closed 400 branches by end-2018.

2018 calendar: Financial services

January

12**:** JPMorgan, Wells Fargo and BlackRock report 2017 results
16**:** Citigroup reports 2017 results
17**:** Bank of America reports 2017 results
23**:** UBS reports 2017 results
25**:** Nordea reports 2017 results
30-31: First US Federal Reserve meeting of the year (Federal Open Market Committee)
31**:** Santander reports 2017 results

February

2: Deutsche Bank reports 2017 results
14: Credit Suisse reports 2017 results
15: Investing for Impact, Economist Events, New York, US
16: Allianz reports 2017 results
20: HSBC reports 2017 results
21: Lloyds reports 2017 results
22: Finance Disrupted, Economist Events, London, UK
22: Barclays reports 2017 results

March

7: Standard Chartered reports 2017 results
14: Raiffeisen reports 2017 results
20-21: US Federal Reserve Meeting (Summary of Economic Projections)
26-27: Future Digital Finance Conference, New York, US

April

10-11: Africa Banking and Finance Conference, Lagos, Nigeria

May

1-2: US Federal Reserve meeting
3: National Australia Bank announces half-year 2018 results
7-9: The Financial Brand Forum, Las Vegas, US
21-23: FINRA Annual Conference, Washington DC, US

June

12-13: US Federal Reserve meeting

July:

31 July-1 September: US Federal Reserve meeting

September

25-26: US Federal Reserve meeting

November

7-8: US Federal Reserve meeting

December

18-19: US Federal Reserve meeting

Healthcare: Delicate operations

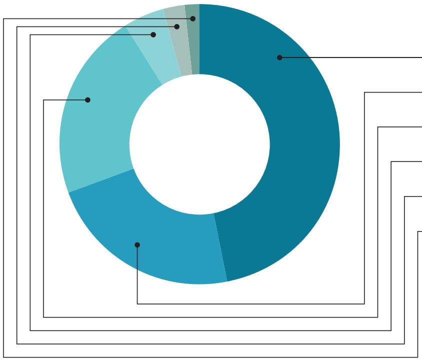
US attempts to overturn Obamacare will still head the agenda in 2018, but other countries may have more success with their reform plans.

Efforts to overturn the 2010 Affordable Care Act (ACA, commonly known as Obamacare) have loomed over the US healthcare sector in 2017 and are likely to do so again in 2018. Whereas the Republicans spent much of their first year in office trying to draft and pass reforms to "repeal and replace" Obamacare at the national level, over 2018 they will focus on dismantling the current system from the inside. But as the system crumbles, there will be increased pressure from the public and from industry to come up with viable alternatives. Individual states are already stepping into the breach.

The process started in earnest in October 2017 when the US president, Donald Trump, used an executive order to rein back subsidies for Obamacare insurance policies. Although regulators and insurers are now trying to sort out the resulting chaos, the decision will probably push up premiums further. During 2018 more insurers are likely to scale back coverage or get out of the market entirely, while more young and healthy people are likely to choose to pay the fine rather than get cover. If this continues, eventually Obamacare will become in effect a system for the old and the sick, and its unsustainable finances will strengthen calls for a rethink.

That, at any rate, appears to be what Mr Trump and his colleagues are banking on, but it will be a delicate process. With his popularity already shaky, Mr Trump will need to move adroitly during the coming year to avoid blame for Obamacare's downfall. The efforts of individual states to set up their own systems, though vital, may not be enough. The ACA, flawed as it was, has strengthened many Americans' appetites for broader coverage and highlighted what poor value for money the US gets from its outsize spending on healthcare. At some point all sides

US and them: Health spending by region in 2018
(US$ bn)



North America	**3,671.2**
Asia-Pacific	**1,746.6**
Western Europe	**1,688.6**
Latin America	**359.3**
Transition economies	**199.9**
Middle East & Africa	**124.2**
World	**7,920.5**

World=60 biggest countries only.
Source: The Economist Intelligence Unit; World Health Organisation.

will need to reach a more sustainable compromise. Unfortunately, that is unlikely to materialise in 2018.

What happens in the US will be vital to the global healthcare and pharmaceuticals sector over the coming year. The Economist Intelligence Unit expects US healthcare spending to reach US$3.5trn, which is around 44% of the global total (based on the 60 biggest economies). Pharmaceutical spending will reach around US$444bn, or around 36% of the global total, despite efforts to rein back prices. No other market will come close: health spending in China and Japan, the nearest contenders, is less than one-sixth as high.

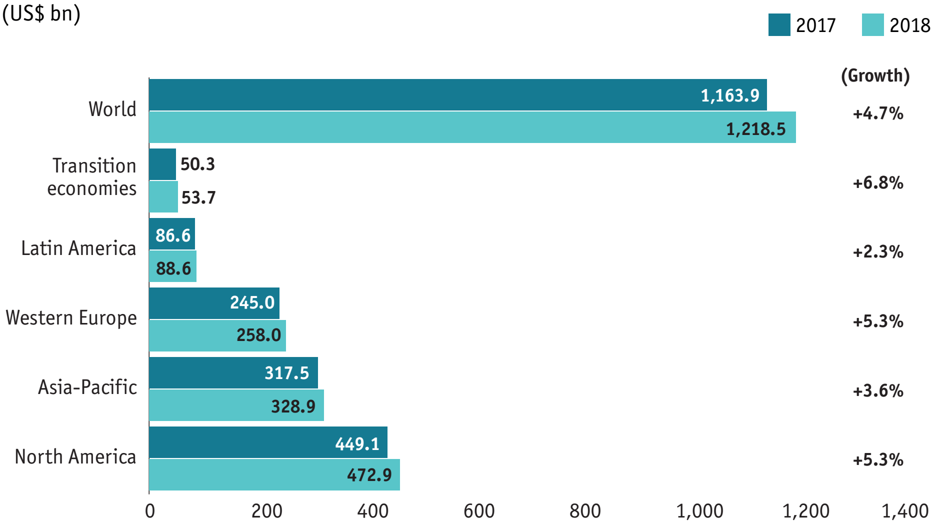
Asian duo

These two markets will, however, see important changes in 2018. In China, where total healthcare spending will be around US$740bn, the government will continue with its efforts to broaden and deepen the national healthcare system. This will involve implementing the numerous reforms begun in 2017 or earlier. Two of the three public health insurance schemes, the New Rural Co-operative Medical Scheme and Urban Resident Basic Medical Insurance, are gradually being merged. Tax breaks introduced in mid-2017 will encourage more people to take out top-up private insurance.

In the meantime, China's family-doctor system will expand, and hospitals will start to adopt new management procedures. These will include new payment schemes and a double-invoice system intended to reduce hospitals' reliance on mark-ups from selling pharmaceuticals. Pressure on pharmaceutical prices will increase still further. However, other measures will be aimed at improving drug quality and speeding up the approval of innovative medicines. This follows a ruling in October 2017 allowing companies to use foreign trial data to support their applications.

It is a packed agenda, and not all of it will work. As is usual in China, many of the reforms will be done on a pilot basis in particular regions and cities, and even when the policies are supposed to be national, implementation will vary across the country. Pharmaceutical companies will have to adapt quickly to cope with the changes and to benefit from market growth, which we expect to be around 8% in local-currency terms but just 3% in US dollar terms.

Pill poppers: Pharmaceutical spending by region in 2018
(US$ bn)



World=60 biggest countries only.
Source: The Economist Intelligence Unit.

Japan, where healthcare spending will near US$510bn, is struggling to cope with its biggest challenge: population ageing. By next year nearly 18m Japanese people will be aged 75 or older and numbers will rise steeply. The government's 2017/18 budget set out the costs of what is dubbed the "2025 problem", the year in which the country's post-war baby boomers will all be at least 75 years old. It calculated that social security spending on medical care will rise by over 50% between 2012 and 2025, while long-term care costs will rise by over 130%.

The government's efforts to make the health system more efficient will lead to several changes in 2018. Management of the National Health Insurance will pass from municipalities to prefectures, and patients will be given greater rights to use private providers when needed. The government also intends to push ahead with plans to roll out health technology assessments for pharmaceuticals, in a bid to increase cost-efficiency. It will also start reviewing all drug prices annually, with the newest and most expensive reassessed on a quarterly basis.

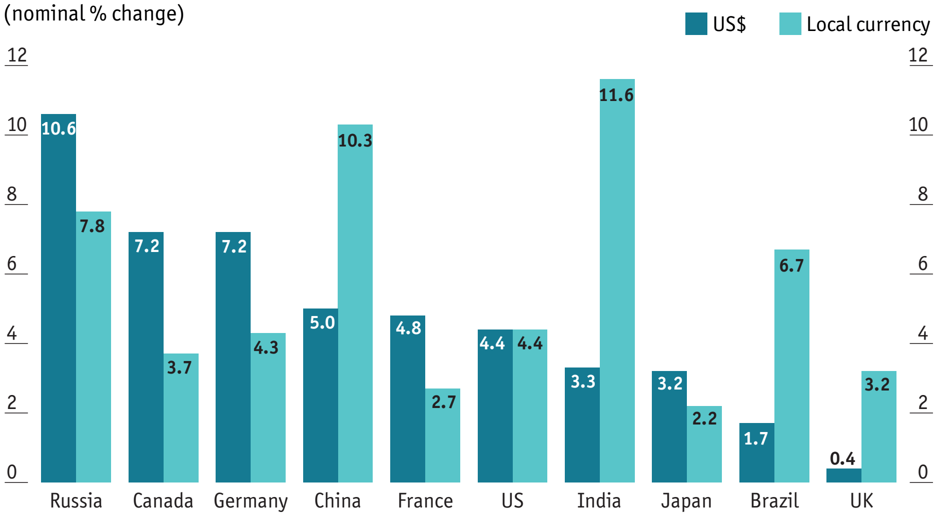
The road to Brexit

Europe will be fighting its own battles over population ageing and rising patient demand in 2018. Germany, having re-elected Angela Merkel as chancellor, will work to improve its long-term care systems as it, too, copes with population ageing. The government also aims to have a fully functioning e-health system by mid-2018. France, under its new president, Emmanuel Macron, will raise healthcare spending but move to improve efficiency. That will mean rejigging payment systems for general practitioners and increasing training in preventative care.

Throughout Europe, the effort to hold down drug prices will continue, with the focus on ensuring competition in the generics market. In western Europe, where pharmaceuticals now account for less than 10% of healthcare spending, the room for manoeuvre is getting smaller. In Central and Eastern Europe they account for over 20%, and the effort to bring that down is becoming more urgent. Pharmaceutical companies in Russia, meanwhile, will be struggling to implement expensive new labelling requirements intended to improve drug safety and crack down on fraud.

The continent's biggest challenge, however, is likely to be the Brexit talks ahead of the UK's exit from the EU in 2019. For the pharmaceutical industry the trade talks will be crucial: although tariff barriers should not rise for most drugs even without an EU deal, a steep rise in non-tariff barriers would disrupt trade badly. Rules on everything from drug safety to clinical trials need to be aligned, and British influence over the process will diminish when the European Medicines Agency leaves London for Amsterdam in 2019. Given the importance of the UK's life sciences industry, the stakes are high. Managers in England's National Health Service (NHS), meanwhile, will be eyeing negotiations over the rights and free movement of existing EU workers in the UK as staffing pressures continue to rise.

Russian recovery: Health spending growth
(nominal % change)



Source: The Economist Intelligence Unit.

Universal trends

While Brexit is a watershed moment for the UK's healthcare sector, smaller countries also face some far-reaching changes. India will be starting to implement the National Health Policy it unveiled in March 2017, which aims to provide free drugs, diagnostics and emergency services to all Indians through public hospitals. Indonesia will be scurrying to meet its goal of universal coverage by 2019, while the Philippines has a similar goal for 2022. Pakistan will continue to pilot the prime minister's National Health Insurance Programme for low-income households.

Many countries in Latin America and the Middle East, as well as Russia, will be reassessing funding for healthcare as their economies recover from the effects of low global commodity prices. In Mexico, for example, the government has promised to unify public healthcare services into a universal social service, while Brazil's government is considering introducing a compulsory health insurance system. South Africa is due to release its long-awaited plans for health insurance in late 2017, although they may be delayed again.

In all of these countries public expectations are high, and governments and payers will no doubt fail to meet them. Yet the steady improvement in population health will continue in 2018. Despite the myriad risks of war, pollution, climate change, antimicrobial resistance, pandemics, obesity, population ageing and drug prices, we still expect that global life expectancy will hit a new high of 73.4 years next year. Every single one of the 60 countries we cover will benefit. Amid all the wrangling over reform and rising healthcare costs, that is worth celebrating.

What to watch for

- **EU regulations:** Data protection rules will come into effect in May 2018, followed by rules on e-procurement in October 2018. However, the implementation of new clinical trials regulations, initially scheduled for 2018, has been delayed until 2019. The EU will also be working towards the full implementation of its 2017 Medical Devices Directive by 2020, and for in vitro diagnostics medical devices in 2022.
- **Patent expiry:** Generic competition looms in the US for two erectile dysfunction drugs: Pfizer's Viagra (sildenafil) has protection until 2020 but will face competition from Teva's copy from the end of 2017, while Eli Lilly's Cialis (tadalafil) will lose patent protection in September 2018.
- **Polio eradication:** The Global Polio Eradication Initiative is likely to narrowly miss its 2018 deadline for wiping out the disease worldwide. At the end of October 2017 the only countries where the disease is still endemic—Afghanistan, Pakistan and Nigeria—reported a combined total of 12 wild polio cases this year, along with 61 vaccine-derived cases.

Company plans for 2018

- **Aspen Pharmacare:** The South African drugmaker announced in July that it was looking to make several acquisitions over the next 12 months in emerging markets. These acquisitions will be made in Aspen's existing business areas, with a particular focus on expanding its women's health division to generate higher revenue or lower costs. Aspen began its international expansion a decade ago and is now present in 150 markets.
- **GlaxoSmithKline:** The UK drugmaker plans to achieve £1bn (US$1.3bn) in annual cost savings by 2020, partly by divesting 130 non-core brands with annual sales of £500m. More than 20 pre-clinical and 13 clinical programmes will be either be divested, terminated or franchised with other companies to allow GSK to focus on its core therapeutic areas.
- **Ipsen:** The French drugmaker is looking to spend at least US$1.2bn in the next three years to acquire experimental drugs. Ipsen has set up teams in the UK, the US and China to hunt for acquisitions. The move is reportedly in line with the company's broader strategy, revealed in May, to acquire cancer, neurological and rare-diseases drugs.

- **Johnson & Johnson:** The healthcare firm is reviewing options for its blood-glucose monitoring business, LifeScan, on the back of changing customer needs, rapidly evolving market dynamics and increased competition. One of its diabetes care companies, Animas, has already announced that it will cease operations in the US and Canada.

- **Krka:** The Slovenian drugmaker revealed in September that it would set up a joint venture in China and take up a majority stake in the newly formed company in the coming months. The joint venture will expand Krka's presence in China, where it has already bought a 51% stake in a small unnamed private company. Krka, which is Slovenia's largest listed company, wants to increase its sales volumes by at least 5% a year on average in 2018-20.

- **Merck KGaA**: The German drugmaker is exploring options for its consumer health business, including full or partial sales, citing increasing financial constraints within the company. The divestment will also enable the company to focus on its core business of developing prescription drugs for cancer and multiple sclerosis.

- **Ontex Group:** The Belgium company expects to open a new plant in Poland to expand its global personal hygiene business further. The plant, expected to be operational by the end of 2018, will support the central European business of its retail division for mature markets. Ontex plans to invest €40m (US$47m) in the facility and employ 170 people by 2020.

- **Pfizer:** The US drugmaker will decide by 2018 whether to spin off or sell its consumer healthcare business, which it considers has the potential to be "more fully realised" outside the company. A successful divestment of the business, which recorded sales of US$3.4bn in 2016, will help Pfizer streamline operations and cut costs.

- **Shire:** The UK-Irish drugmaker will complete assessing options for its neuroscience unit by the end of 2017. The unit has benefited from strong demand for its existing treatment for attention deficit hyperactivity disorder (ADHD) and from the approval of a new one. This means the unit could now operate as a standalone company, allowing Shire to focus on its core business of developing rare-diseases drugs.

- **Valeant:** The embattled Canadian drugmaker faces a 2018 deadline to repay US$5bn in debt as its 18-month repayment period finishes at the end of March. In June 2017 Valeant said that it had already reduced its debt by nearly US$3.6bn since the end of the first quarter of 2016, suggesting it will be ahead of schedule.

2018 calendar: Healthcare and pharmaceuticals

January

25: Novartis reports 2017 results

26: Bristol-Myers Squibb reports 2017 results

27: AbbVie reports 2017 results

31: Eli Lilly and Pfizer report 2017 results

February

1: Roche reports 2017 results

2: Merck & Co and AstraZeneca report 2017 results

7: Gilead reports 2017 results

8: GlaxoSmithKline and Sanofi report 2017 results

12-13: 20th International Conference on Medical, Biological and Pharmaceutical Sciences, Kuala Lumpur, Malaysia

22: Bayer reports 2017 results

22: The Economist Mental Health Summit, London, UK

27-28: European Pharma CI Conference, Lisbon, Portugal

March

14-16: 10th Asia Pacific Global Summit on Healthcare, Singapore

April

19-22: HIV and Hepatitis in the Americas, Mexico City, Mexico

May

28-29: 14th International Conference on Health and Primary Care, London, UK

19-23: ISPOR 23rd Annual International Meeting, Baltimore, US

21-26: World Health Assembly, Geneva, Switzerland

June

14-16: 11th International Conference on Clinical Paediatrics, Rome, Italy

18-21: World Preclinical Congress, Boston, UK

August

28-Sept 1: WHO Regional Committee for Africa

September

5-9: WHO Regional Committee for South-East Asia, Maldives

8-11: ISPOR 7th Asia-Pacific Conference, Tokyo, Japan

12-15: WHO Regional Committee for Europe, Copenhagen, Denmark

26-30: WHO Regional Committee for the Americas, Washington DC, US

October

3-6: WHO Regional Committee for the Eastern Mediterranean, Cairo, Egypt

10-14: WHO Regional Committee for the Western Pacific, Manila, Philippines

18-19: 13th World Pharma Congress, Warsaw, Poland

December

1: WHO World AIDS Day

Telecoms: Throttled?

Mobile subscriptions continue to rise steadily, but the telecoms sector's finances will come under increasing strain in 2018.

According to the GSMA, the number of mobile subscribers reached 5bn in June 2017. As a result, around two-thirds of the world's population now has access to a mobile service. For the global telecommunications industry, this will represent a huge opportunity in 2018. However, the resulting financial strains may also prompt a rethink of strategy and investment priorities.

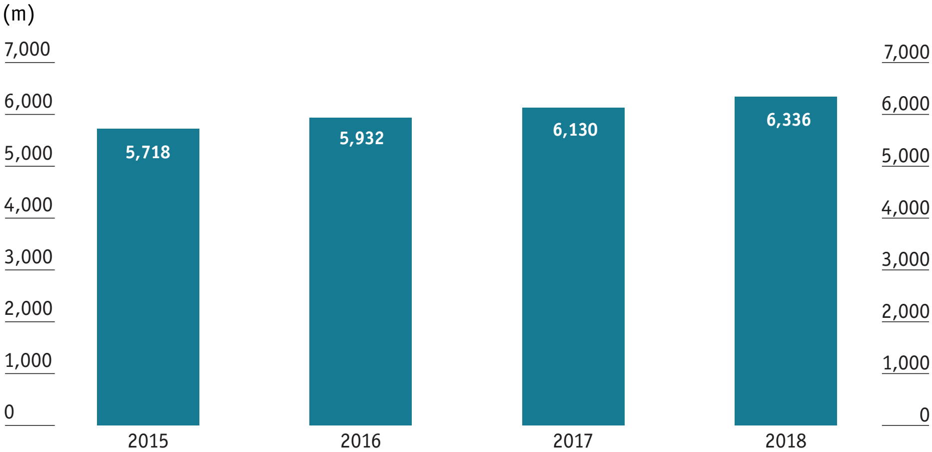
First, the opportunities. The Economist Intelligence Unit forecasts that in 2018 there will be an average of 113 mobile subscriptions per 100 people in the world's 60 biggest markets. Much of this growth will be driven by the increasing uptake of mobile phones and smartphones in Asia, particularly India, and in the emerging markets of Sub-Saharan Africa, the fastest-growing region worldwide.

Operators will focus on expanding their footprint in 2018, amplifying mobile coverage and introducing 4G in as many developing countries as possible. In more developed markets, improvements to 4G reliability will be followed by more extensive testing of 5G as the industry works towards full deployment by 2020. The rollout will allow smartphone users to access all manner of online content that can increasingly be used to organise or enhance their lives.

Not everywhere will benefit. In Latin America, for example, exchange-rate fluctuations and low economic growth will continue to force consumers to pare back spending in 2018, pushing down total revenue in US dollar terms for both fixed and mobile telecoms. Data demand remains high, however, and mobile subscription and penetration rates will rise at a steady rate, with the number of mobile subscribers reaching 566m in 2018.

The picture in Asia and Africa will be much brighter as rural populations join urban dwellers in making use of mobile connectivity. Across the Middle East and Africa, the mobile penetration rate will increase from 111 per 100 in 2017 to 115 in 2018, while in Asia it will rise from 101 to 104. Asia, in particular, will move towards more bundled offerings in 2018 as a way of managing large voice and data volumes. Both regions should see mobile revenue rise, even as fixed-line revenue remains in decline.

Phone numbers: Global mobile subscriptions



Source: The Economist Intelligence Unit.

Margin squeeze

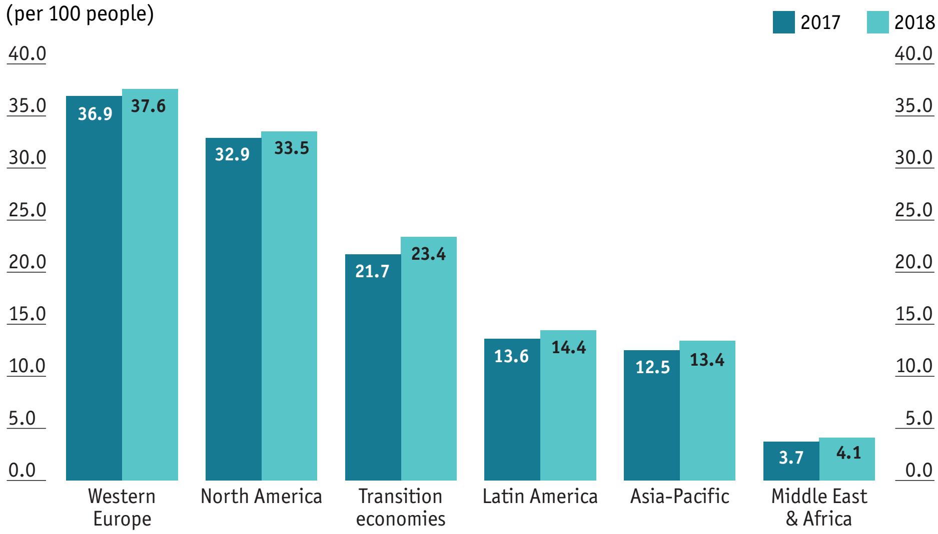
The seemingly insatiable appetite for mobile connectivity has a downside for telecoms companies, however, in that it demands massive capital expenditure. At the same time, increased competition is forcing down prices. This is great news for consumers, who can choose from a range of cheap data-rich packages, but less so for operators, which have to offer more and more discounts or bundled services. As prices fall, average revenue per user (ARPU) suffers. In 2018 we expect ARPU across our 60 markets to fall by 2.3% for mobile operators, and by 11.5% for fixed line.

ARPU can recover in time, at least in the mobile sector, but part of the problem for operators is the blurring of the boundaries between telecoms companies and IT. The days when operators could rely on revenue from a reliable voice and SMS service are long gone. Competition from over-the-top (OTT) providers such as WhatsApp, Skype and Netflix has backed the telecoms sector into a corner. Now it faces a new challenge from app developers, whose business interests are expanding rapidly.

In 2018 operators will have to adapt to this new ecosystem. They will need to develop more partnerships with OTT players, offer new differentiated OTT services and enable a wider range of mobile applications. They will also need to build greater flexibility in backhaul infrastructure by maximising the potential of software-defined networking (SDN) and network functions virtualisation (NFV). Even so, they will remain vulnerable to takeovers from internet players such as Facebook and Google, in a trend that will challenge net neutrality rules.

More positively, 2018 will see the continued growth of Internet of Things (IoT) technologies, with the launch of new devices that rely on continuous connectivity. For some companies, this will open up new revenue streams. Increased use of big data analytics and cloud computing will drive the development of smart homes, autonomous vehicles and improvements to commercial operations. There will be disagreements over technology standards, particularly for connected vehicles, as telecoms operators and carmakers jostle for market space. All this, however, will underscore the need to invest heavily in fast and reliable connectivity.

On line: Broadband penetration
(per 100 people)



* Fixed broadband only
Source: The Economist Intelligence Unit.

EU rules OK

As always, regulation will affect how quickly operators can roll out infrastructure and restrict their room for manoeuvre as they compete and consolidate. In Europe, for example, the elimination of EU roaming charges will bite further into the margins of telecoms companies in 2018. Beyond 2018, however, roaming revenue could recover as consumers become used to using mobile services abroad, boosting demand.

Meanwhile, the EU's competition commissioner, Margrethe Vestager, will continue to scrutinise merger and acquisition (M&A) proposals closely in order to protect consumer choice and ensure a competitive environment. Indeed, in early October 2017 the European Parliament dashed operators' hopes that it was shifting towards "light-touch" regulation when it backtracked from earlier deregulation proposals. Although the parliament acknowledged the need to encourage investment in 5G, it limited the regulatory benefits enjoyed by operators that team up to deliver next-generation connectivity. It also voted to ensure that regulators are given greater powers to tackle "joint dominance" and oligopolistic behaviour.

In the US, however, deregulation is gathering pace. In October the head of the Federal Communications Commission, Ajit Pai, explicitly stated that the commission's aim is to "eliminate, as much as we can, government regulation of the telecommunications marketplace". The process of dismantling Obama-era net neutrality regulations, for example, has already begun, and a repeal of the rules could come as early as December 2017. Were net neutrality to be overturned, it could allow companies such as Verizon and AT&T to reassert their dominance in a market that is already narrowing.

In developing markets, meanwhile, rapid market growth will not prevent competition from becoming intense, sometimes forcing regulators to intervene. In Mexico, regulators will continue to try to rein back America Movil, whose takeover of Telmex has given it around two-thirds of the mobile market. In India, Reliance Jio will continue to unsettle the sector by forcing its competitors to match its slew of free and low-cost packages. Regulators will monitor the situation closely, in a bid to ensure that there is no predatory pricing. However, in 2018 Jio's growth is more likely to be stopped by a long-rumoured merger between Vodafone and Idea Cellular, which may even stop Jio in its tracks.

As a result of these pressures, telecoms companies will struggle to benefit from the growth in connectivity in 2018. While subscriber numbers will continue to rise, we expect total telecoms revenue in the 60 biggest markets to fall by 2% in US dollar terms, to US$1.2trn. This will largely reflect a 3% rise in telecoms investment as operators spend money on connectivity, which they hope will pay off in the longer term.

What to watch for

- **AI future:** In October Google's artificial intelligence (AI) unit, Deep-Mind, unveiled a program called AlphaGo, which can master the complex Chinese game of Go in just three days. Hailed as a breakthrough in AI engineering, AlphaGo's advanced neural network forms part of Google's plan to put itself on an "AI first" footing. In 2018 DeepMind will take a lead in embedding AI capability in all Google products and services, but others will not be far behind. Indeed, every new upmarket smartphone may well have an AI chip before the year is out.

- **Cyber-security:** In October Yahoo revealed that a customer data breach had affected all of its accounts. In 2018 cyber-security will be among the top concerns for companies and regulators, particularly when it comes to IoT-related deployment. With cybercrime increasingly about financial gain, banks will become more directly involved in identity verification, while the use of blockchain technologies will spread. Businesses are also at risk from governments, such as that in China, whose cyber-security and censorship laws could hinder trade and foreign direct investment.

- **Stressed debt:** In April 2017 the Reserve Bank of India (the country's central bank) cautioned against commercial banks providing loans to the Indian telecoms sector, where tough competition has strained company finances badly. Banks such as the State Bank of India have already had to introduce additional provisioning measures to guard against bad debts. Unless market competition eases quickly in 2018, telecoms companies warn that debt levels may rise by another 15%, taking them to three times their 2015 level and leading to as many as 150,000 job cuts.

Company plans for 2018

- **9mobile:** Nigeria's troubled mobile operator, 9mobile, previously known as Etisalat Nigeria, will strive for a new beginning in 2018. A consortium of banks is looking for a buyer for the company, which has failed to repay debt worth about US$1.2bn. Vodacom, Virgin Mobile and Bua Group are reportedly interested in a deal.

- **Apple:** Apple will move to set up retail outlets in India in 2018 to cement its position in the second-largest smartphone market in the world. The country in which the iPhone-maker started assembling some of its products is in the process of reviewing Apple's application for tax breaks. Apple products are currently sold in India by authorised resellers.

- **Bharti Airtel:** After going on an acquisition spree this year, India's Bharti Airtel will have its work cut out in 2018. The company will focus on clearing regulatory hurdles and completing its planned takeover of the mobile phone business of Tata Teleservices, as well as that of the Indian unit of Norway's Telenor.

- **Google:** In 2018 Google will increase its focus on its hardware business, positioning itself as a strong contender against smartphone-makers such as Apple and Samsung. The company took a step in that direction this year by taking over the Pixel smartphone division from HTC Corp, its manufacturing partner.
- **Huawei:** China's Huawei seems poised to offer a fair bit of competition to smartphone giants Apple and Samsung in 2018. It accounted for 11.3% of the global market in the second quarter of 2017, with Apple at 12%. Huawei expects the Mate 10 series of smartphones, launched in October, to offer strong competition to Apple's iPhone 8.
- **Telekom Austria.** Telekom Austria plans to unite its businesses across eight :markets under its A1 brand. The company will finish launching the A1 brand in all its markets in 2018 in order to complete the rebranding initiative. This move is likely to affect the operator's finances in the first quarter of the next fiscal year.
- **TPG Telecom Ltd:** TPG Telecom, an Australian internet provider, plans to roll out a mobile network in Singapore by December 2018. The operator, which bid successfully for 4G spectrum in Singapore in 2016, plans to invest US$150m-200m in the Asian country over the next two years.
- **Verizon:** Verizon will embark on a cost-cutting spree in 2018 to meet its target of saving US$10bn by 2021. The US mobile operator will also reduce its operational and capital expenditure to fund dividend payments in 2022.
- **Vivendi:** In the midst of a lot of controversy surrounding its investments in Italy, Vivendi will see increased intervention from a concerned government. Soon after the French company had appointed a former executive as the CEO of Telecom Italia, the Italian government ordered it to appoint Italian citizens to oversee all strategic decisions.
- **Vodacom:** Vodacom, the largest mobile operator in South Africa, has set its sights on launching a 5G network by 2020. In 2018 it will increase investments in infrastructure to expand its 4G coverage across the entire country. It has invested more than US$2.4bn in the country over the past four years.

2018 calendar: Telecoms

January

26: Nokia reports 2017 results

28: International Exhibition of Internet of Things, Riyadh, Saudi Arabia

29: Samsung reports 2017 results

31: Elisa reports 2017 results

February

6: Millicom reports 2017 results

14: America Movil reports 2017 results

February 26-March 1: Mobile World Congress, Barcelona, Spain

March

19-20: Telecoms World Asia, Bangkok, Thailand

21-22: IoT Asia 2018, Singapore

April

10-11: Gigabit Access, Brussels, Belgium

20: Verizon reports Q1 2018 results

20: Nokia reports Q1 2018 results

25: Ericsson reports Q1 2018 results

25: Etisalat reports Q1 2018 results

28: IoT Expo, London, UK

May

11: Deutsche Telekom reports Q1 2018 results

23: Vodafone reports Q4 2018 results

July

18: Ericsson reports Q2 2018 results

27: Verizon reports Q2 2018 results

August

6: Saudi Telecom reports half-year 2018 results

September

18-20: 2018 NORDUnet Conference, Elsinore, Denmark

October

30: Ericsson reports Q3 2018 results

October 31-November 1: Total Telecom Congress, London, UK

December

9: Deutsche Telekom reports Q3 2018 results

14: Vodafone reports half-year 2018 results