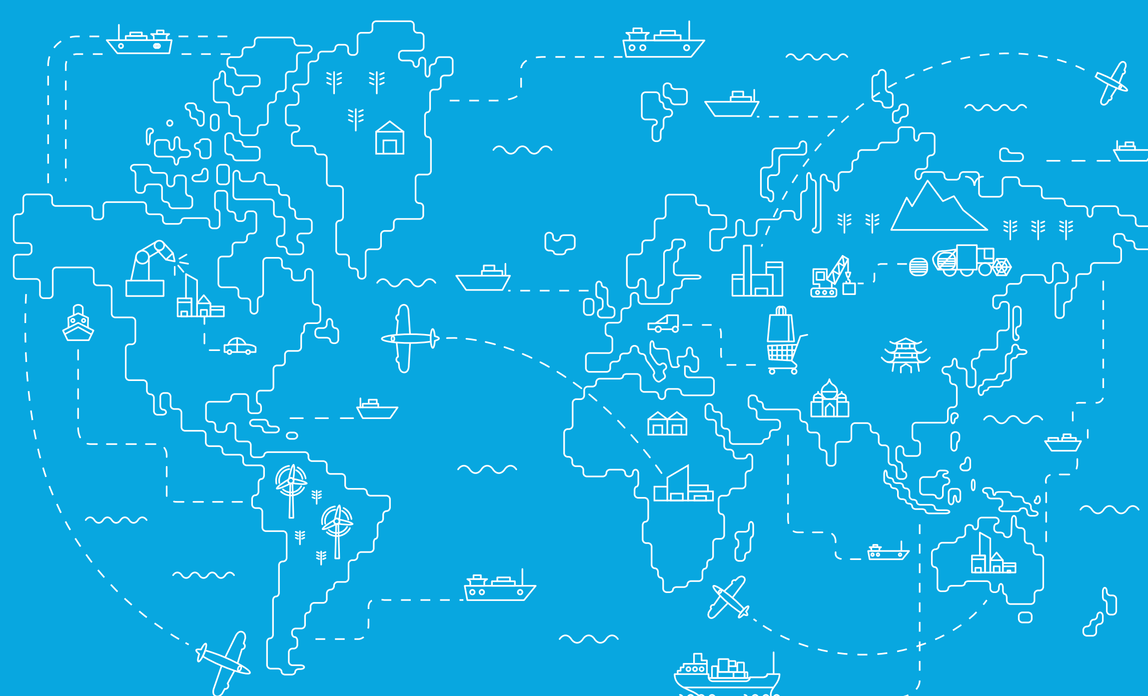
THE REAL ECONOMY

VOLUME 17

GLOBAL EDITION



THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM

THOUGHT **LEADERS**

Our thought leaders are experienced professionals, with years of experience in their fields, and strive to help you and your business succeed. Thought leaders who have contributed content to this issue include:

Joe Brusuelas, Chief Economist, RSM US LLP

Brendan Quirk, RSM Regional Leader, Latin America

Dr. Suresh Surana, Founder, RSM India

TABLE OF **CONTENTS**

FOUR GLOBAL RISKS FACING THE MIDDLE MARKET

by Joe Brusuelas, Chief Economist, RSM US LLP

During the first few months of 2016, risk appetite in global asset markets and international financial conditions turned decisively negative as investors began pricing in much slower global economic growth. Deteriorating fundamental economic data implies a much greater global slowdown may be on the way. Perhaps more unsettling has been the re-emergence of challenges to large globally-active banks and increasing policy risk in the developed world.

MIDDLE MARKET INSIGHT:
The growing segment of middle market firms operating across borders and subject to regional variation in demand should expect reduced pricing power with some risk to both revenue growth and earnings growth.

In the RSM US year-ahead forecast (http://rsmus.com/pdf_download/tre_december_2015.pdf), we outlined how, on a global basis, there was an increasing risk that growth would slow well below 3 percent due to knock-on effects in emerging-market economies and the oil-producing Middle Eastern and North African (MENA) countries. This risk is directly related to the demand deceleration in China and the collapse in global oil and commodity markets. The global economy is now caught in a growth recession and there is an increasing chance of another round of debt, financial and banking crises that could originate in the heart of Europe or China.

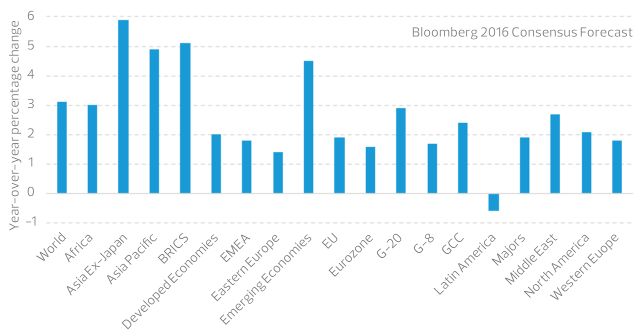
Global growth at the end of 2015 likely decelerated to 2 percent on a year-ago basis, which is consistent with a growth recession. Traditionally, in the developing economies, anything less than 3 percent is a growth recession. Using the 3 percent growth metric, broad swaths of Africa, Latin America, the Middle East and Eastern Europe are caught in a growth recession. Moreover, Asia (excluding Japan) and the entire Asia Pacific only remain out of that category if the direction of growth in China decisively turns for the better.

The current private consensus forecast of 3.1 percent global growth, and the official International Monetary Fund (IMF) estimate of 3.4 percent understates the impact on growth of the downward velocity in asset markets, tighter financial conditions, the build-up of excessive debt in many emerging markets and the significant short-term challenges in China caused by the onset of its deleveraging cycle. If the price of oil continues to float near $30 per barrel, or move down toward $20, there are significant economic and political risks that await the OPEC and MENA states.

The eurozone remains challenged by its lengthy period of deleveraging and the lack of any fiscal support to boost growth. Although the recent depreciation of the euro and massive monetary support out of the European Central Bank has provided economic support, growing concerns about the balance sheets of banks in Germany, Austria and Italy have renewed fears of another financial crisis. With the looming 23 June, 2016, referendum in the United Kingdom on its continued membership in the European Union, financial and policy conditions are coalescing in a way that may prove worse than the risk surrounding the potential Greek exit of the Eurozone in 2010.

While the United States will likely see growth at or above 2.5 percent, demand there isn't strong enough to pull the rest of the global economy out of a growth recession. In addition, given the policy debate in the United States, there is increasing political risk associated with the 2016 elections that could disrupt regional and global trade.

The following four areas represent the greatest risk to global growth during the next 12 to 18 months.



Source: RSM US. Bloomberg

China: The economic slowdown in China has been much sharper than what is indicated by official statistics. Electricity demand on a year-ago basis turned negative in 2015 and implies a growth rate closer to 3 percent, far less than the policymakers' 7 percent target. Capital outflows were close to $1 trillion in 2015, which prompted fiscal and monetary authorities to use $1 trillion in reserves to prop up equity markets and support the currency. Given that total debt in China stood above 260 percent of GDP at the end of 2014, and likely soared above 300 percent last year, there are legitimate questions regarding what steps the fiscal authority could take to support growth without intensifying the current debt and deleveraging cycle. Moreover, with corporate debt standing at 160 percent of GDP, and household debt as a percentage of GDP at 36 percent, there is a legitimate concern about where a rebound in growth will originate.

China faces the "trilemma" that many other maturing emerging market economies have faced. Chinese economic officials can select two of the three following choices: maintain a fixed exchange rate, allow free movement of capital or adopt an independent monetary policy.

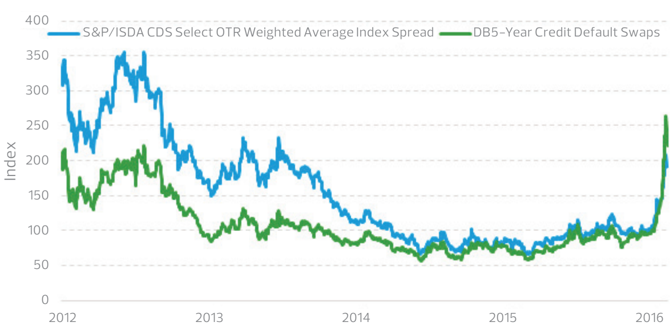
Thus, with the People's Bank of China (PBOC) facing a choice between either stabilising growth or stabilising the value of the yuan, we anticipate that it will choose growth via lower rates and a cheaper currency, which runs the risk of causing an increase in capital outflows and further drain the $3.1 trillion in currency reserves the country says it has.

If the fiscal authority loses control, and the yuan depreciates at a more rapid pace than the 3.8 percent implied by the non-deliverable forward market, this runs the risk of a major disruption in competitiveness and global trade.

Source: RSM US. Bloomberg

European banking and a "Brexit": The setting of a referendum on June 23 on whether the UK should withdraw from the European Union (EU) has profoundly unsettled global investors. There are economic risks relating to a Brexit, and an exit could result in classic tit-for-tat political and economic retaliation from the EU that might result in tariff and non-tariff barriers limiting UK exports to the EU. However, the UK is a net importer with imports from the EU significantly higher than exports. With between 38 percent and 49 percent of U.K exports over the past 18 months absorbed by Europe, the potential risk to the UK and global economy must be considered, although the level of exports to the EU has been steadily in decline over the past 12 months with exports to non-EU countries increasing. (Source: UK Overseas Trade Statistics December 2015, HMRC).

Global oil markets: The inability of oil to find a price floor continues to feed into concerns about a deeper global



Source: RSM US. Bloomberg

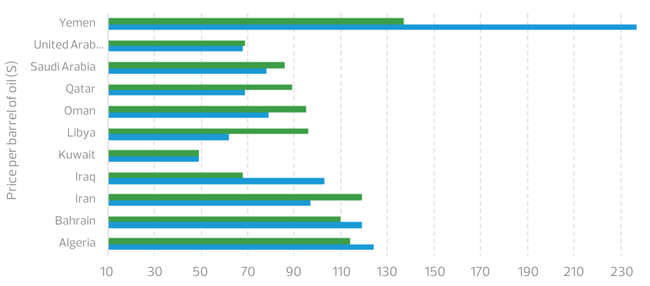
growth recession based on a combination of oversupply and falling demand, especially from China and emerging markets. Currently, the OPEC countries appear incapable of reaching an agreement to curtail or even freeze production. Rather, oil-producing economies continue to increase supply even with cost of the marginal barrel of oil exceeding the price it fetches in the open market simply to retain market share.

In our 2016 year-ahead growth forecast, we indicated there was a risk that the price of oil may fall to about $20 per barrel, just above the inflation-adjusted low of $17.26 reached in 1998 ($11.91 in non-inflation-adjusted terms).

Given the nearly 70 percent decline in oil prices since June 2014, countries such as Venezuela, Nigeria and Russia have fallen into economic depression and may choose to default on global debt obligations in the near to medium term. Nigeria, along with Angola and Iraq, is in talks with the IMF to seek financial restructuring, Venezuela (10 percent contraction in growth and 720 percent increase in inflation) is experiencing the worst bout of hyperinflation since that seen in Zimbabwe in the 1990s, and Russia (fiscal breakeven of $105 per barrel) clearly cannot meet its basic social commitments with the price per barrel at recent levels.

Moreover, with the MENA and oil-producing countries experiencing significant fiscal adjustments during a time of regional geopolitical tensions, global investors and firm managers with exposure to the region are rightfully concerned that conditions could deteriorate and spillover into international financial markets and the global real economy.

Central banking and fiscal policy: Five of the major central banks among the developed economies have adopted



Source: RSM US. IMF

negative interest rate policies during the past few years. This unorthodox policy shift is fraught with risks and carries with it the seeds of a return to the *beggar-thy-neighbour* policies that were characteristic of the worst portion of the global Great Depression during the 1930s. Given the slowdown in overall economic activity in the global economy, the policy-sensitive financial sector will likely bear the brunt of the latest experiment in central banking.

Meanwhile, the scope of central bank asset purchases could include a much broader range of assets along the lines of what the US Federal Reserve did in 2008. Asset purchases could include property, high-yielding assets or even equities under certain circumstances.

With interest rates near zero and real interest rates in negative terrain in the developed economies, a rational economic choice would be to turn to fiscal policy to support growth in times of an economic slowdown. With monetary policy constrained by the zero bound, policymakers would see a greater bang for their buck from fiscal policy.

In Europe, the choice has been austerity based largely around German policy preferences, which triggered a bout of deflation that the continental economy has yet to recover from. In the United States, political polarisation and stark ideological differences have, until very recently, resulted in limited fiscal support for the economy. In China and many emerging markets, elevated debt levels have made a turn to more robust fiscal operations a second-order choice for fiscal authorities.

CHANGES TO **INDIA'S FOREIGN DIRECT INVESTMENT RULES** CREATE MAJOR OPPORTUNITY FOR MIDDLE MARKET

by Dr. Suresh Surana, Founder, RSM India

In the midst of an uncertain global economic outlook, India is emerging as the new global economic hotspot. The Indian economy is estimated to grow at 7.6 percent in financial year 2015-16 with a gross domestic product of 8 trillion (PPP basis) and is expected to grow at 7 percent to 7.75 percent in financial year 2016-17, making it the fastest-growing major economy in the world. Further, India's other macroeconomic parameters, such as inflation, the fiscal deficit and current account balance, have exhibited distinct signs of improvement.

As businesses confront a flat top line and falling bottom-line thanks to a sluggish global economy, there is a greater need for internationally-active businesses to seek newer pastures. India represents a significant opportunity for US and global businesses. There were major relaxations in India's foreign direct investment (FDI) regime in November 2015, and likely to be further changes this year.

Foreign direct investment limits by sector

Sector No.	Sector	Current market size	FDI limit and entry route
1	Textiles	US$108 billion	100% under automatic route
2	IT and ITES	US$146 billion	100% under automatic route
3	Infrastructure		
	Industrial parks (new and existing)		100% under automatic route
	Construction development and infrastructure	US$465 billion	
	Railway infrastructure		
4	Property	US$94 billion	FDI permitted only in construction and development (not trading)
5	Telecom services(including telecom infrastructure providers category-I)	Number of subscribers 1.022 billion	100% (automatic up to 49% government route beyond 49%)
6	BFSI		
	Banking (private sector)	US$2.68 trillion	74% (automatic up to 49% government route beyond 49% and up to 74%)
	Banking (public sector)		20% under government route
	Insurance		49% (automatic up to 26% government route beyond 26% and up to 49%)** **As per Union Budget announced on Feb. 29, 2016, the limit under automatic route for insurance sector shall be raised to 49%
7	Automotive and auto ancillary industry	US$112 billion	100% under automatic route
8	Defence	US$37 billion	49% (automatic route up to 49% and above 49% under government route on case to case basis, wherever it is likely to result in access to modern and 'state-of-art' technology in the country)
9	Retail		
	Single brand product retail trading	US$600 billion	100% (automatic up to 49%, government route beyond 49%)
	Multibrand retail trading		51% (51% under government route)
10	Online and e-commerce	US$38 billion	100% under automatic route (B2B)
11	Pharmaceuticals and life science	US$30 billion	Greenfield-100% under automatic route Brownfield-100% under government route

INDIA (cont.)

Recent significant changes to India's FDI policy include:

1. One hundred percent FDI in LLPs is now permitted under automatic route.

FDI policy on limited liability partnerships (LLP) has been amended to provide that investments in LLPs will not require government approval. One hundred percent FDI is now permitted under the automatic route in LLPs operating in sectors and activities where 100 percent FDI is allowed and if there are no FDI-linked performance conditions. An LLP model is an alternative structure in the company model and is more attractive due to the fact that currently there is no dividend distribution tax (DDT) imposed dividend distributions by the LLP. The effective DDT rate is 20.35 percent on distribution of dividend by a company.

2. Downstream investment is permissible for an LLP.

An LLP having foreign investments will be permitted to make downstream investments in another company or LLP in sectors in which 100 percent FDI is allowed under the automatic route and there are no FDI-linked performance conditions.

3. Minimum floor area and capitalisation requirements for the construction and development sector have been removed.

Some of the stringent conditions pertaining to investment in the construction and development sector in India revolved around the adherence to the minimum floor area requirement and the minimum capitalisation requirement. Recently, the minimum floor area of 20,000 square metres in construction and development projects, and the minimum capitalisation of US$5 million to be brought in within a six-month period of the commencement of business operations, have been removed. It was also clarified that leasing of immovable property shall be permissible. However, FDI is not permitted in property trading and construction of farmhouses.

4. Defence sector allows up to 49 percent FDI under automatic route.

As a move to support the 'make-in-India' drive, the government has liberalised FDI in the defence sector and has permitted 49 percent FDI under the automatic route. Considering the fact that about 60 percent of defence requirements are met through imports, and the allocation for defence in the 2016 budget was approximately US$37 billion, this is a very lucrative sector for attracting FDI, particularly for US defence-related companies.

5. Investment by companies, trusts or partnerships owned and controlled by Non-Resident Indians (NRIs) on a non-repatriation basis is to be treated as domestic investment.

Investment made by NRIs on non-repatriation is deemed to be domestic investment at par with the investment made by residents. In order to attract larger investments by the NRI community (more than two million reside in the United States), the special dispensation of NRIs has now been extended to companies, trusts and partnership firms, which are incorporated outside India and are owned and controlled by NRIs. Henceforth, such entities owned and controlled by NRIs will be treated at par with NRIs for investment in India.

6. Manufacturers are permitted to undertake wholesale and retail sales, including through e-commerce without government approval.

A manufacturer will now be permitted to sell its product through wholesale and retail routes, including through e-commerce without government approval.

7. Single-brand retail trading liberalisation for (SBRT) and the retail sector.

Entities which have been granted permission to undertake SBRT will be permitted to undertake e-commerce activities. The mandatory sourcing requirement of 30 percent of the value of goods purchased has been relaxed subject to government approval.

These amendments to India's FDI policy are meant to liberalise and simplify the process in order to make it easier to do business in the country and to attract larger FDI inflows. Both would contribute towards the growth of investments, incomes and employment.

Many foreign investors have found that doing business in India is not easy. Moreover, there is a great deal of uncertainty in the administration of tax laws. The Vodafone retroactive amendment of tax laws about four years ago, after Vodafone won the verdict in India's apex court against a US$2 billion tax demand, has been criticised globally and has tarnished India's reputation.

The government of India has implemented a series of measures to improve the ease of doing business. The emphasis has been on simplification and rationalisation of the existing rules and introduction of information technology to make governance more efficient and effective.

Some of the significant measures taken include:

1. A scheme for reducing litigation and burying the Vodafone ghost

The Direct Tax Dispute Resolution Scheme 2016 has been proposed, which would permit the taxpayers whose appeals are pending before the first appellate authority to pay the tax and interest up to the date of assessment and 25 percent of the minimum imposable penalty. There will be no further penalty or prosecution or interest for the period after assessment. The total disputed amount in litigation is estimated at US$90 billion with 300,000 cases. In the case of tax disputes, due to retroactive changes of law (such as Vodafone for indirect transfer of shares), it is proposed to permit the settlement of dispute subject to the payment of tax, which will ensure complete immunity from interest, penalty and prosecution. This can help restore the confidence of international investors.

2. An online process of applying for an industrial licence (IL) and an industrial entrepreneur memorandum (IEM)

The process of applying for an IL and an IEM has moved online, and this service is now available to entrepreneurs on 24/7 basis at the eBiz website. This eased filing applications and online payment of service charges. Twenty services are integrated with the eBiz portal, which will function as a single-window portal for obtaining clearances from various governments and government agencies.

3. A proposed single-day company registration process

A proposed amendment in the Companies Act, 2013 is to improve the environment for start-ups. The objective is to ensure that the registration of companies can be done in a single day.

4. A new, lower (25 percent) corporate tax rate (plus applicable surcharge and tax) for new domestic manufacturing companies incorporated on or after 1 March, 2016

The normal maximum marginal corporate tax rate in India is 34.608 percent. The proposed reduced rate for corporates is a welcome measure for investment into the manufacturing sector.

5. A proposed deferral of the Place of Effective Management (POEM) provision

It is proposed that the determination of residency of a foreign company on the basis of POEM be deferred by one year. This is a welcome move considering more clarity and transition provisions are also expected.

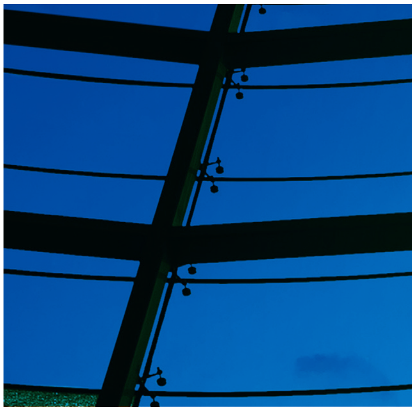
6. Deduction under section 80JJAA extended to service sector

The Union Budget 2016 proposes to broaden and liberalise the scope of the employment generation incentive (30 percent additional deduction available on emoluments paid to new employees) available under section 80JJAA of the Income Tax Act. The deduction will be available not only to taxpayers deriving income from the manufacture of goods but also those rendering services.

7. Tax incentives to qualifying entities in the Start-up India scheme

India, the fourth largest base for new businesses in the world and home to more than 3,100 tech start-ups, is set to increase its base to 11,500 tech start-ups by 2020. The budget proposed to provide a 100 percent deduction for a period of three consecutive years out of the initial five years for eligible start-ups.

With the overall focus on improving business sentiments combined with consistent economic growth, controlled inflation rate, low fiscal deficit, strong foreign exchange reserve, ease of doing business measures, clarity in tax laws as well as the other macroeconomic indicators, India presents a compelling proposition for long-term investment for global value investors.



LESS THAN ZERO: THE RISKS AROUND NEGATIVE INTEREST RATE POLICY

Five of the major central banks among the developed economies have adopted negative interest rate policies over the past few years that carry unforeseen risks to the global financial system. Negative interest rate policy is best understood as tax on excess reserves held by large financial institutions at the central bank. The policy goals are quite straightforward and typically involve directly limiting capital inflows through a reduction of the interest paid on holding government and privately issued securities resulting in an indirect depreciation of the domestic currency. Second, it is an attempt to spur a general increase in the level of overall prices under conditions that approximate disinflation or deflation. The latter involves inducing an incentive for banks to increase lending to derive a higher rate of return in contrast with the tax paid on holding excess reserves.

The logics of driving rates into negative terrain are quite similar to reducing interest rates when the economy slows, contracts or unemployment rises: reduce borrowing costs for households and firms, influence inflation expectations, and reduce both the nominal interest rate and the real interest rate or the rate adjusted for inflation. Lower real rates then stimulate overall economic activity through the credit channel and trade channel via devaluation of the domestic currency and an improvement in competitiveness for domestic exporters.

This unorthodox policy shift is fraught with risks and carries with it the seeds of a return to the *beggar-thy-neighbour* policies that were characteristic of the worst portion of the global Great Depression during the 1930s. Given the slowdown in overall economic activity in the global economy the policy sensitive financial sector will likely bear the brunt of the latest experiment in central banking.

Paradoxically, the easy breaching of the theoretical zero boundary on interest rates makes it possible that other central banks, including the US Federal Reserve and Bank of England, will actively consider adopting such a policy when their respective current business cycles end.

Risks to the financial sector and the middle market via such policies cannot be overstated. A negative interest rate policy would wreak havoc with tax planning for middle market firms altering incentives. Under such conditions, middle market firms would likely turn to making prepayments on taxes and utilities to avoid the costs of holding cash.

Under a framework of negative interest rate policy, the benefits are limited but clear. The risks around the policy, however, are asymmetric and fall under four general categories.

Avoidance and hoarding: The imposition of a tax on holdings of excess cash would likely result in large banks, financial institutions, pension funds or insurance companies moving to store cash despite the cost of insurance, transportation and storage. Munich Re, the large German insurance group that is the second largest reinsurer in the global economy and has €231 billion of assets under management, has already moved to store €10 million in euros to avoid paying negative interest rates. Moreover, should firms be allowed to pass the cost of taxation along to consumers, then households would likely move to holding cash in safety deposit boxes or personnel safes. All the above will distort financial conditions and household spending.

Financial system: Distortions to financial markets, especially fixed-income securities markets, is guaranteed. Until February 2016, roughly $7 trillion in government

securities had yields of less than zero. Investors that hold those bonds to maturity will take losses. Should the policy be sustained, a parallel financial system would almost certainly evolve quickly as an option for households and firms seeking to avoid the cost of taxation causing a general deleveraging of the banking system itself. Even if laws are passed to prevent banks from passing the costs on to depositors, the deadweight caused by the tax would generally result in losses via declines in profit margins, in the share price of the banks resulting in a general decline in overall financial stability. Moreover, should banks be allowed to pass on costs to customers, the resulting hoarding of cash would deprive banks of loanable funds to make loans to creditworthy customers.

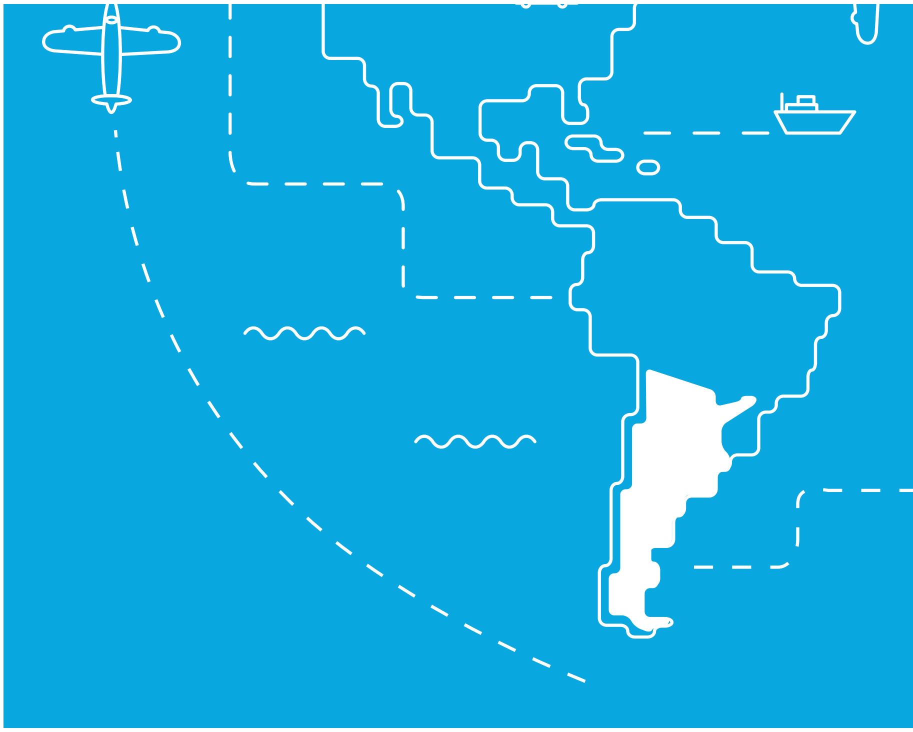
Policy alignment: One of the indirect policy goals of negative interest rates is an improvement in the competitiveness of domestic exporters. While, the notion of currency wars is a popular talking point in the financial press, policy coordination and the development of currency swap agreements to prevent funding problems have ensured that this is not the case. One problem with the advent of negative interest rate policy is that it opens the door for a return to the *beggar-thy-neighbour* competitive currency depreciations during the 1930s. The NIRP policies of Denmark and Switzerland were directly put in place to achieve currency depreciations. Adoption of NIRP policies by the United States or UK implies the risk of a much greater disruption of the global financial and trade system.

Asset bubbles: In an economic environment best described as secular stagnation, slow growth, low interest rates and low inflation–policy options available to central banks to reach full employment are limited. Thus, under conditions where central banks have to risk stoking bubbles to reach full employment the adoption of negative interest rates is a rational and reasonable response from the point of view of policymakers. In Sweden where negative interest rates were adopted in 2014, home prices have increased and roughly half of all mortgages are of the variable rate variety, and over 90 percent of those loans will reset within five years risk of a bubble is rising. Should the Swedish central bank hike rates during that time, it would carry with it the risk of piercing the bubbles that are building in the housing and financial system.

The early evidence, with respect to charging banks for holding excess reserves, has been less than impressive. Limiting capital inflows via NIRP to improve competitiveness for domestic exporters in Denmark and Switzerland have not resulted in noticeable depreciations in either economy and there is evidence of a growing bubble in the Swedish housing market. While there has not been a disruption in financial markets following the announcements in Europe and Japan, it is still too early to estimate the efficacy of the policy shift.

That being said, there are some very noticeable differences in the construction, depth and breadth of US and UK capital markets compared to those in Europe and Japan that make it difficult to implement NIRP. For example, in the United States, given the size of the Fed's balance sheet and the roughly $2.5 trillion on reserve, to make the policy work a large quantity of reserves would have to be made exempt. Assuming that the Fed imposed a tax on 2.6 percent of excess reserves, which is the same as the European Central Bank that would only hit $625 billion reserves leaving $1.87 trillion or roughly 75 percent reserves untouched. Given that only a fraction of the reserves subject to taxation would actually be lent to creditworthy customers, the risks around the policy in the United States strongly imply that such a policy could result in monumental distortions to both the economy and financial system.

There is some concern that as the business cycle comes to an end in several of the large economies central banks will not possess the policy tools to respond. That is not the case, however. The effectiveness of those policies are reaching their limits. With rates remaining at or below zero, the case for a much more robust fiscal response grows despite misgivings of many domestic economic, financial and political actors. A greater balance between fiscal and monetary policy would reduce the need to resort to such an unorthodox policy as negative interest rate policy and the risks they entail.



ARGENTINA: CRUCIAL REFORMS PUT COUNTRY ON PATH TO MORE STABLE ECONOMY

by Joe Brusuelas, Chief Economist, RSM US LLP

An initial series of crucial reforms has put Argentina on the path toward obtaining easier access to global credit, a significant benefit to that country's middle market business community. President Mauricio Macri's decisions to adopt a free-floating currency regime, which has resulted in a de-facto 35 percent devaluation of the peso, and to reach a $4.65 billion agreement with foreign creditors, represent a significant pivot in Argentina's domestic policy. These decisions bring to an end a nearly 15-year period of economic havoc within the economy.

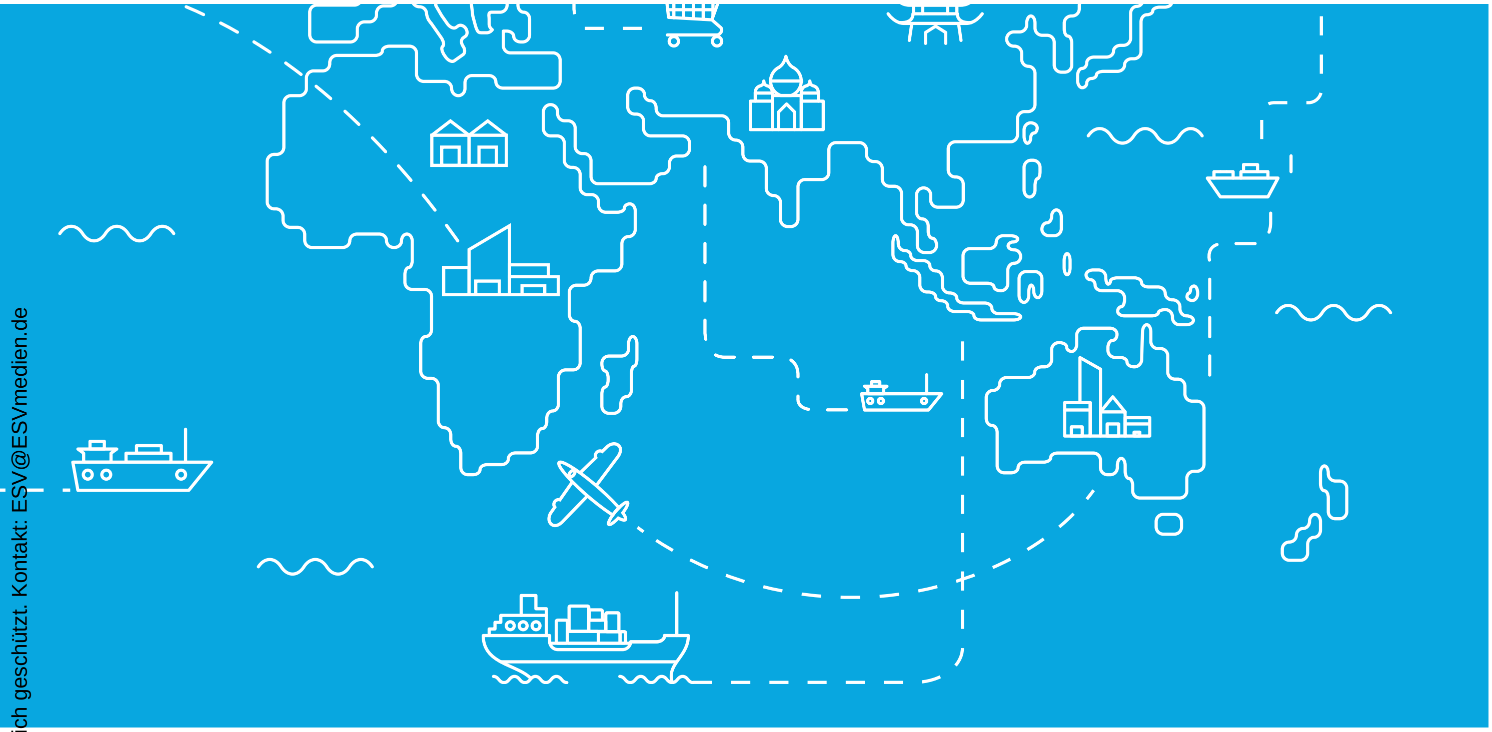
While the success of the reforms isn't guaranteed, and further difficult steps need to be taken to put the budget on a more sustainable path, one that may temporarily increase economic inequality, they represent the best chance to reverse the damage done since the 2001 debt default. The reforms will also increase trade competitiveness and set the stage for the re-entry of Argentina back into the global commercial community.

According to Brendan Quirk, RSM Regional Leader, Latin America: "With the March visit of President Obama, and other international visits from France's Francois Hollande and Italy's Matteo Renzi, it is clear that the international community is supportive of this new administration. RSM also hears from the business community that many companies are excited by the impending growth that this change means for Argentina's economy."

Ending the "cepo" devalued the peso to 15 to the US dollar from 9.7 and, in conjunction with lifting export taxes, was cleverly structured so that only those with immediate need for foreign currency, such as investors or those in the tradeable sector, were allowed access to foreign exchange. The result was a relatively frictionless transition to a free-floating rate.

From an economics standpoint, the policy was well-designed and implemented, and pulled demand forward in a way that favoured agricultural and commodity exporters while jump-starting commercial activity. For many in the global investment community and in the major capitals of finance, this initial step by the Macri administration was well received and impressive. It represents a major step forward in rebuilding global investor confidence in the direction of Argentina's economy.

Given that the government may need to raise upward of $15 billion US dollars in foreign investment to smooth the transition back toward a market-oriented economy,



the competence in which the initial float took place, and the speed in which it reached an agreement with foreign creditors, cannot be underestimated.

That initial policy decision signals that the Macri administration intends to target growth while taking a more balanced approach toward inflation which, if left unattended, would result in a decline in real wages that could derail this series of reforms. As expected, the change in the exchange rate regime was followed by an increase in inflation to about 4 percent on a monthly basis (32.9 percent year over year) in February. Meanwhile, the central bank lifted the policy rate to 37.5 percent from 29 percent.

Even so, the economic challenges for Argentina remain. The global slowdown, collapse in commodity prices and the deteriorating economy in Brazil, Argentina's most important trading partner, all make the timing of the reforms and those to follow more difficult than would otherwise be the case.

The Macri administration has adopted what might be termed an incrementalist approach that attempts to balance domestic political constraint with economic necessities. While eschewing the economic reform shock therapy that has been in vogue in many emerging markets during the past two decades, the Macri administration's sequencing of policy reforms is probably the best that could be accomplished given the wake of the debt default and the policies over the Kirchner–Fernandez years.

The policy challenge going forward is twofold: the administration must avoid a rapid pass-through of inflation to the household sector, which would result in real wage declines, while implementing a long-term framework credible to the central bank and foreign investors that reduce the pace of growth in government spending. Not only would a credible budgetary path and moves to curb inflation, keep a lid on interest rates, it would impress foreign investors whom the administration is counting on to provide foreign direct investment and to bridge financing to cover gaps in financing while the reforms take time to work.

The primary fiscal targets put in place seek to obtain a mix of subsidy cuts and efficiency gains while boosting spending this year. This would put the primary fiscal deficit, as a percentage of gross domestic product, on a glide path to 0.3 percent by 2019 from its current 4.8 percent. The government is also targeting a reduction in inflation to between 3.5 and 6.5 percent in 2019 from the current level of 32.9 percent this year.

If that doesn't happen, and inflation expectations form around a rapid expansion in government spending, then the central bank would have little choice but to raise interest rates even higher, thus throwing the economy into recession. With markets pricing in a further 18.1 percent devaluation of the peso to 18.9 to the US dollar, the potential for rising inflation and falling real wages remains the greatest risk for the new administration.

BEPS A SIGNIFICANT CHALLENGE FOR MIDDLE MARKET FIRMS

Far-reaching impacts on multinationals

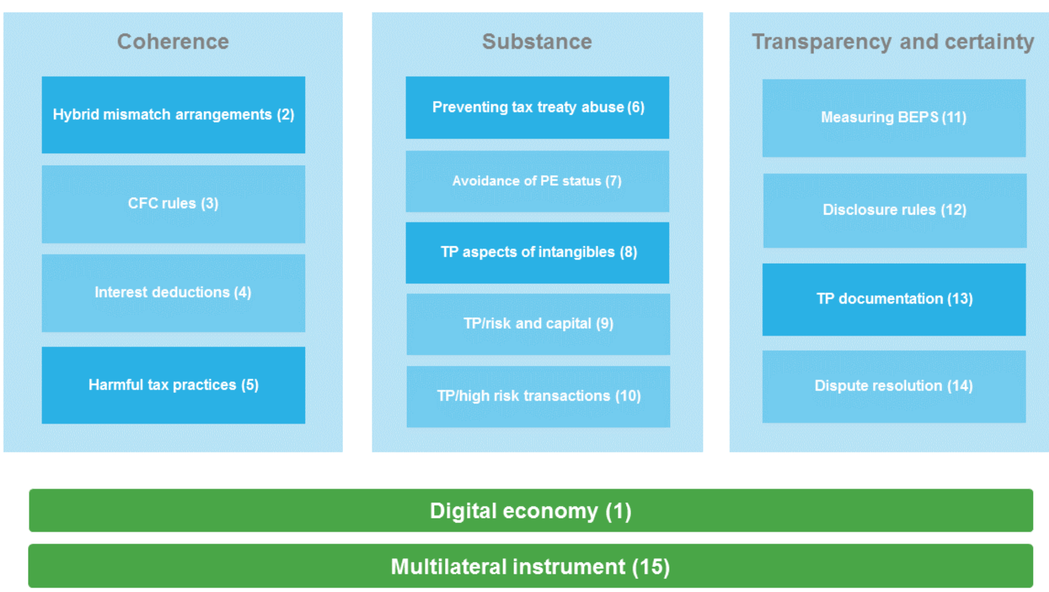
Changes in international taxation resulting from the Base Erosion and Profit Shifting (BEPS) initiative undertaken by the Organization for Economic Cooperation and Development (OECD) and the G20 countries present some of the biggest business challenges in recent history, with far-reaching impact on international operations. Businesses should consider potential changes now, even in advance of specific implementation of national tax legislation.

What is BEPS?

BEPS refers to the tax base erosion and profit shifting resulting from unintended gaps and mismatches between different countries' tax systems. These gaps can be used by multinational enterprises (MNEs) to make profits disappear for tax purposes, or to shift profits to locations where there is no or very low real activity, but where taxes are low, resulting in little or no overall corporate tax being paid.

In 2013, the OECD and the G20 countries (key industrialised and developing countries) developed the (BEPS) Project. The BEPS Project aimed to provide governments with ways to close perceived gaps in existing international tax rules that might allow MNEs to reduce profits or shift them artificially to low- or no-tax jurisdictions in which the MNEs have little or no economic activity. The project action plan identified 15 action items aligned along three fundamental pillars:

- Establishing **coherence** in the domestic rules that affect cross-border activities
- Reinforcing **substance** requirements in the existing international standard
- Improving **transparency**



Delivery of the BEPS package

In October 2015, the OECD presented the final package of measures on the 15 action items intending to initiate a comprehensive and coordinated reform of international tax rules. These measures include:

- Changes relating to bilateral tax treaties, including a minimum standard to prevent treaty shopping
- Revisions to the transfer pricing rules, which determine the tax treatment of intragroup transactions to focus on the substance of the transactions rather than their legal form
- An update of the framework for evaluating the potential harmful effects of preferential regimes introduced by governments, with a specific focus on patent boxes and tax rulings
- Model domestic law measures to counter BEPS

Impact on the middle market

Countries have begun implementing BEPS proposals, with some moving quickly. Pulling from data compiled from more than 500 global businesses, RSM will be issuing a major report on the impact of BEPS on the middle market. That report will be available on 6 June at http://www.RSMUS.com. Businesses doing business in foreign countries need to track what is happening in each jurisdiction in which they operate. Companies should take a look at their global operational and tax footprints, engage in strategic planning in order to be flexible enough to adapt to specific BEPS driven changes and evaluate current systems in light of preparedness for compliance obligation changes.

While smaller MNEs will not need to comply with all of the disclosure requirements resulting from the BEPS Project, they will still have to deal with the same substance and international tax changes that affect other companies. They may even need to restructure operations. Furthermore, the impact of BEPS is broader than just tax. Its impact can be felt across finance, treasury and geographies, and implicates compliance, controversy and M&A deals.

For more information on RSM, please visit **www.rsm.global**.

For media enquiries, please contact Gillian Hawkes, RSM PR & Communications Manager at +44 (0) 20 7601 1080 or gillian.hawkes@rsm.global.

www.rsm.global

TRE-NT-ALL-ALL-0516-Global Edition