Global Forecasting Service

Global outlook summary

(Forecast closing date: August 13th 2010)

World economy

The global economic recovery is running out of steam. Policy stimulus is wearing off in many countries, and recent developments in the US and China give special cause for concern. Although the Economist Intelligence Unit forecasts robust world GDP growth of 4.5% (at purchasing power parity) in 2010, growth will drop to 3.6% in 2011 as the effects of the slowdown become more visible. A double-dip recession is unlikely, however.

Ironically, our forecast this month envisages stronger growth in 2010 than before, even though the general outlook has deteriorated. This is because the German economy did spectacularly well—growing at its fastest pace since reunification—in the second quarter of 2010. As a result, growth in the euro zone will end up substantially higher this year. But the momentum won't be sustained. The global recovery since mid-2009 has been the cyclical result of massive stimulus combined with short-term inventory corrections. Once these factors recede, as is already happening in many countries, economic growth will soften.

Job creation in the US has been very weak

The signs are certainly there in the US, where growth has retreated since peaking in the fourth quarter of 2009. Recent jobs data have been dire, and the housing sector has weakened again. The Chinese economy, an ever more important engine of global growth, is also slowing as the government tries to deflate the property bubble that its massive stimulus package helped to create.

These and other factors are leading to increased talk of a global double-dip recession. But we think there is only a 30% chance of this happening. For one thing, businesses are no longer cutting inventories. As destocking was a major factor behind the earlier sharp decline in global GDP, this makes outright recession much less likely than slower growth. For another, companies' financial health has improved as a result of staff and wage cuts made in response to the crisis. Corporate profits, a key driver of economic growth, are now rising. Thirdly, there is the exceptional strength of the recovery still under way in many developing countries. Although emerging markets will slow in 2011 as rich countries buy fewer of their exports, non-OECD growth will remain above 6%.

In this context, we see the recent signs of a slowdown not as an omen of an impending return to recession but as a natural correction after the unsustainable stimulus-induced growth of the past year. This is not to downplay the difficulty of the challenges ahead. The process of adjustment will bring to the fore many structural problems left over from the crisis, including weak banks and the need for fiscal austerity. Households will also continue to have to work off debts incurred during the credit bubble.

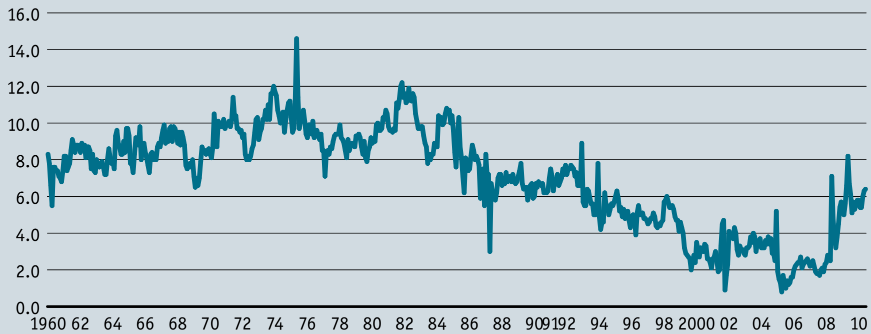
2010: AT A GLANCE

World GDP growth, at PPP	*4.5%*
World inflation (av)	*2.9%*
Oil/barrel (av, Brent)	*US$80*
US$:€ (av)	*1.29*

Developed world

The US recovery is slowing as the temporary forces—stimulus and inventories—that have driven growth in recent quarters weaken. Revised data show that private consumption is much weaker than the government previously thought, and that cautious consumers are saving more of their disposable income. Unemployment remains stubbornly high at 9.5%, and not enough new jobs are being created to replace the 8m or so lost since 2007. In light of recent data, we have lowered our growth forecast for the US to 2.8% in 2010, from 3.3% in last month's forecast. We also now expect growth of 1.5%, instead of 2%, in 2011.

Cautious consumers: US savings rate
(% of personal disposable income)



Source: Bureau of Economic Analysis.

Japan's export-led recovery is unsustainable, meanwhile. China's booming economy has benefited Japanese exporters, as has the US recovery. But both those markets are slowing, and the strong yen is also hurting exporters. This would be less of a problem if the rest of Japan's economy were in rude health, instead of struggling to shake off deflation. Despite these concerns, the strong start to the year should ensure robust GDP growth in 2010 as a whole.

Concerns over euro zone sovereign risk will persist

Things have improved a bit in Europe. Economic growth has picked up, albeit unevenly, in the euro zone. The recent EU bank stress tests—a potential source of stress in themselves—may not have been that credible but largely reassured. Deep problems remain. Fiscal concerns loom large. We think Greece will eventually have to restructure its debt, probably in 2012. Financial markets' confidence in the creditworthiness of euro zone governments, and to some extent in the viability of the euro itself, will remain fragile. Real GDP in the euro zone will grow by 1.3% in 2010, slowing to 0.9% next year.

Emerging markets

With some exceptions, mainly in eastern Europe, emerging markets have been doing extremely well since the end of the recession. Many were less directly affected by the financial crisis, enabling them to grow rapidly once the global recovery got under way. Emerging Asia is spearheading the recovery, owing to a combination of heavyweight fiscal packages, loose monetary policy and recovering trade. Indeed the fear in some cases is that policy has been "too effective" and has inflated asset bubbles. China is a case in point. Given the enormous surge in bank lending, bad loans are likely to rise sharply. The economy should cope, but the challenges it faces are of a different order of magnitude than before. Real GDP will grow by 9.9% in 2010 and 8.3% in 2011.

Elsewhere, eastern Europe has put the worst of the crisis behind it. Having contracted sharply in 2009, the regional economy will grow by 3.1% this year and 3.6% in 2011. Exports and industrial production are recovering. However, the Balkan and Baltic economies are lagging behind the rest of the region, and financial markets in general remain vulnerable to contagion from the euro zone.

Growth in Brazil this year will be the fastest in decades

Latin America is on course for robust growth of 5.2% in 2010. Leading the way is Brazil, which we forecast will grow by 7.8%, its fastest rate in decades. Chinese demand for commodities initially helped Latin America to emerge from recession, and in the past six months the recovery in the US has also fed through into the region. Unfortunately, this means that Latin America will feel the effects of the US slowdown in 2011, and growth will ease to 3.7%.

In the Middle East and Africa, higher oil prices, loose policy, Chinese demand for raw materials, and the pick-up in global growth have been driving the region's economies. These factors will result in GDP growth of roughly 4.5% in 2010. Unlike in other regions, growth will continue at the same pace next year, thanks in part to rising oil production and heavy government spending.

Exchange rates

The euro will remain under pressure, despite its recent rally

The euro has come under intense pressure in 2010. It has fallen sharply against major currencies since the start of the year, and even the announcement in May of a massive EU-IMF financial package did little to halt its slide. Although the euro has rallied quite a bit since hitting a low of US$1.19:€1 in June, this largely reflects technical factors and won't last. The currency is already weakening again, as fears of a double-dip recession have encouraged investors to seek the safety of the dollar. We expect an average exchange rate of US$1.29:€1 in 2010 and US$1.24:€1 in 2011.

In emerging markets, the main news in recent months has been China's loosening of its currency peg to the US dollar in June. The move aims to deflect for-

Euro wobbles
(daily US$:€ exchange rate)

Sources: Federal Reserve Bank of New York; Haver Analytics.

eign criticism of Beijing's exchange-rate policy. But it may not succeed unless the renminbi appreciates much more than it has done so far. Our forecast is that the ever-cautious Chinese authorities will let the renminbi rise only gradually.

Commodities

Commodity prices have been volatile, dropping sharply in the second quarter only to rally in July and early August. Surging wheat prices have added to fears of a commodity bubble, but these concerns look misplaced given ample stocks of most commodities and the prospect of slowing economic growth. Also, a recent slide in the US dollar, which amplified price rises as most commodity trade is conducted in dollars, looks to have been temporary.

Since hitting US$85 a barrel in early August, oil prices have slipped back to about US$77 a barrel. We still think oil will average nearly US$82 a barrel in the second half of this year, as the recovery in global oil consumption, coupled with limited OPEC supply, will support prices. However, a stronger US dollar, relatively high global oil stocks and economic uncertainty will prevent big price rises. Oil prices will ease to US$78.5 a barrel in 2011 as economic growth slows.

The rise in wheat prices is less alarming than it looks

The recent spike in wheat prices after reports of poor harvests in Russia, Ukraine and Kazakhstan has grabbed headlines. However, record global crops in the past two years have created a supply buffer, and we do not expect the current high prices to be sustained.

World economy: Forecast summary

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth (%)										
World (PPP* exchange rates)	4.5	5.1	5.2	2.7	-0.8	4.5	3.6	3.9	4.1	4.2
World (market exchange rates)	3.6	4.0	3.9	1.5	-2.2	3.2	2.4	2.9	3.0	3.1
US	3.1	2.7	1.9	0.0	-2.6	2.8	1.5	2.0	2.4	2.4
Japan	1.9	2.0	2.3	-1.2	-5.3	3.0	1.3	1.3	1.1	1.2
Euro area	3.6	3.0	2.7	0.5	-4.1	1.3	0.9	1.3	1.6	1.7
China	11.3	12.7	14.2	9.6	9.1	9.9	8.3	8.4	8.2	8.0
Central and eastern Europe	5.7	7.3	7.3	4.7	-5.6	3.1	3.6	4.1	4.2	4.1
Asia & Australasia (excl Japan)	7.5	8.3	9.3	5.7	4.9	7.7	6.4	6.6	6.6	6.5
Latin America	4.9	5.6	5.6	4.0	-2.1	5.2	3.7	4.1	4.1	4.3
Middle East & North Africa	6.1	5.9	5.3	5.9	1.4	4.4	4.4	4.6	4.6	4.8
Sub-Saharan Africa	6.8	6.7	7.0	4.9	0.9	4.5	4.5	5.6	5.0	5.0
World inflation (%; av)	3.0	3.3	3.4	4.9	1.6	2.9	2.7	3.0	3.2	3.3
World trade growth (%v)	7.5	9.1	7.6	3.8	-11.1	9.6	5.5	6.2	6.4	6.6
Commodities										
Oil (US$/barrel; Brent)	54.4	65.4	72.7	97.7	61.9	80.0	78.5	82.3	78.3	75.5
Industrial raw materials (US$; % change)	10.2	49.6	11.2	-5.1	-25.6	32.9	3.4	3.8	0.8	0.8
Wheat (US$/tonne)	158.5	200.3	268.7	340.9	234.8	213.3	213.8	215.0	230.0	250.0
Exchange rates (av)										
¥:US$	110	116	118	103	94	89	90	90	89	88
US$:€	1.25	1.26	1.37	1.47	1.39	1.29	1.24	1.20	1.18	1.18

* PPP = Purchasing power parity.
Source: Economist Intelligence Unit.

