Global Forecasting Service

Global outlook summary

(Forecast closing date: February 11th 2013)

World economy

The outlook for economic growth is gradually improving in many parts of the world. Investors, businesses and consumers are becoming more confident, the Chinese economy is picking up after its downturn in 2012, and—despite a fourth-quarter contraction in GDP—there is evidence of a more sustainable recovery in the US. The Economist Intelligence Unit's forecast for the world economy is largely unchanged this month: we still expect a modest upturn in 2013, leading to stronger growth in 2014. However, we have revised our exchange-rate forecasts, and now expect a weaker yen and a slightly stronger euro.

We forecast that global GDP will expand by 3.4% at purchasing power parity (PPP) exchange rates in 2013. This would mark an improvement on last year, but is still disappointing at this relatively advanced stage of a recovery. The global economy has yet to fully work off the effects of the financial crisis and multi-country housing bust of 2008-09, and the debt crisis in the euro zone—although moving into a less acute phase—remains both a real and present danger to financial stability and a serious drag on economic growth.

Global growth will pick up from mid-2013

Yet, while trading conditions will remain difficult at least through the first quarter of this year, there are already encouraging signs on several fronts: witness the recent strength of US consumer spending and business investment, the pick-up in manufacturing prospects in Germany, Japan's new found political appetite for bolder economic stimulus, and the rise in risk tolerance in financial markets. The easing of financial tensions in the euro zone since mid-2012 is also a hugely important factor. The resulting gains will take some months to materialise fully, but give or take minor differences in timing from one country to another a pick-up in growth is likely from mid-2013. This, in turn, will create the momentum for a more marked global recovery next year, when we forecast world GDP growth of 4% in PPP terms.

Serious risks to this forecast remain. The biggest is the debt crisis in the euro zone. While the actions of the European Central Bank (ECB) since last July—most notably its pledge of unlimited intervention in sovereign bond markets—have reduced market stresses dramatically, the region is still highly vulnerable to political events that could trigger a sudden loss of investor confidence. The general election in Italy on February 24th-25th is just one such source of uncertainty.

2013: AT A GLANCE

World GDP growth, at PPP	*3.4%*
World inflation (av)	*3.4%*
Oil/barrel (av, Brent)	*US$104.5*
US$:€ (av)	*1.33*

In the US, too, bad politics still has the potential to undo the economic recovery. Congress has dodged two bullets by agreeing measures to avert a much-feared "fiscal cliff" at the beginning of 2013, and more recently by delaying a possible showdown over the federal borrowing limit or "debt ceiling". For a few months,

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at least, this puts the remote but potentially catastrophic risk of a technical US sovereign default in the background. But a third and more pressing obstacle awaits on March 1st, when massive government spending cuts could start to take effect unless politicians can agree on alternative measures to address structural fiscal problems. The cuts that would occur if a divided Congress failed to reach a compromise would seriously damage growth prospects, and would force us to lower our US forecast.

Developed world

The underlying US economy is stronger than Q4 data suggested

The US economy continues to expand at a moderate but uneven pace. Preliminary indicators show a loss of momentum at the end of 2012, as real GDP contracted fractionally in the fourth quarter. But one-off factors played a major role in this performance, and the underlying trend is positive. Indeed, recent indicators suggest that the US government will have to revise fourth-quarter GDP upwards. Difficulties remain. A rise in payroll taxes from January 1st will leave consumers with less money to spend, and fiscal negotiations remain a source of uncertainty for businesses. Still, assuming that Congress can agree on a deal to moderate federal spending cuts in the coming months, we forecast a pick-up in the economy in the second half of the year (supported by the Federal Reserve's monetary stimulus). GDP growth will average 2.1% in 2013 and 2.4% next year.

In Europe, the picture is mixed. The threat of an imminent break-up of the euro zone has mercifully receded—thanks to a yet-to-be-activated ECB bond-buying programme, the mere existence of which has dramatically lowered bond yields for risky peripherals since mid-2012. But the crisis in the real economy grinds on. Unemployment across the euro zone as a whole is at around 12%, and far higher in stressed peripheral countries and among young people. We expect a real GDP contraction of 0.2% in 2013, but improving conditions from the middle of this year will feed through into growth of 1% in 2014.

The new Japanese government is anxious to stimulate growth and generate mild inflation

Japan's economic outlook has brightened since the change of government in December, which heralded a shift to more aggressive monetary and fiscal stimulus. The Bank of Japan (BOJ) has raised its inflation target to 2% and committed to open-ended quantitative easing. The government of Shinzo Abe, the new prime minister, appears determined to press the BOJ to keep up the monetary stimulus, and has also recently unveiled a large supplementary budget. However, we had largely factored these changes in to our forecast last month, so this month our numbers are unchanged. We expect real GDP growth of 0.9% this year and 2% in 2014.

Emerging markets

The industrial cycle is beginning to turn upwards for many bellwether emerging markets, after languishing for much of 2012. Chinese data have been improving—albeit patchily—since the fourth quarter of 2012. The effects of recent stimulus will flow through into a more visible recovery this year, when we expect aver-

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age GDP growth of 8.5%. But the boost from stimulus will prove temporary, and Chinese growth will drop below 8% again in 2014. In India, growth in the year to March 2013 will be a disappointing 5.4%. However, we expect monetary easing to lift growth to well over 6% in the following (2013/14) fiscal year.

The troubles in the euro zone continue to overshadow growth prospects in the transition economies of eastern Europe. Several countries—including the Czech Republic, Hungary, Slovenia and Croatia—contracted in 2012. Although 2013 is set to be another difficult year, we expect conditions to improve as the year progresses. A marked easing of conditions in euro zone funding markets should translate into more readily available bank financing in eastern Europe, helping growth prospects. While the balance of risks for the transition economies has improved, we are keeping our forecasts broadly unchanged this month. Regional GDP will grow by 2.6% this year, the same rate as in 2012, and by 3.3% in 2014.

Latin American growth will bounce back in 2013 and 2014

Latin American growth slowed last year as the region struggled under the effects of recession in the euro zone, a slowdown in China and the sluggish performance of the US economy. One striking development in the past two years has been the reversal of fortunes in the region's two largest economies, Brazil and Mexico. Brazil, the poster child of the boom period, has faltered as it has run into capacity constraints stemming from policy deficiencies. Mexico, which fared poorly for much of the past decade, is benefiting from having regained a larger share of the US market. We maintain the view that the recent downturn in Latin America has been cyclical rather than structural. Brazil should see a modest rebound in GDP growth to 3.5% in 2013, although the risks remain on the downside. For the region as a whole, we forecast that economic growth will accelerate to 3.6% this year and to 4% in 2014.

Iran continues to feel the effect of economic sanctions

Growth in the Middle East and North Africa (MENA) will be constrained in 2013 by a further contraction in Iran's economy as oil production declines and international sanctions hamper non-oil economic activity. Political turbulence will also continue to take a toll on a number of economies in the region. But high oil prices and expansionary fiscal policies will sustain strong rates of growth in Saudi Arabia and the Gulf States. Average GDP growth in MENA as a whole will slow slightly to 3.3% this year, before accelerating to 4.4% in 2014.

Despite the relatively gloomy external backdrop, we expect Sub-Saharan Africa to grow by 4.5% in 2013 and by 5% in 2014. Oil exporters such as Angola, Cameroon, Chad, Equatorial Guinea and Ghana will benefit from rising hydrocarbons output. New mining production in several countries (for example, Niger and Sierra Leone) will be positive for growth. Africa will also benefit from continuing strong Chinese investment inflows. However, South Africa, the region's largest economy, will remain weak.

Exchange rates

Major currencies have been exceptionally volatile in recent months, leading to calls for official intervention by some policymakers and to charges of currency manipulation by others. The yen and the euro have been at the centre of the

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action. The yen has weakened as the new Japanese government has pursued a more aggressive anti-deflationary stance. The euro has been rising in fits and starts against the US dollar, buoyed by returning risk appetite, quantitative easing in the US and European financial institutions' repayment of ECB loans. Against this backdrop, we are lowering our yen:dollar forecast: we now expect an average exchange rate of ¥92.8:US$1 in 2013, compared with ¥88 previously. We have also adjusted our forecast for the dollar:euro rate, and now expect the US dollar to be weaker than previously envisaged, at US$1.33:€1 in 2013 and US$1.31:€1 in 2014.

Commodities

The oil market will be pulled in different directions in 2013

Commodity prices started the year on a relatively strong note, although as an asset class they have underperformed equities. Several general factors have supported commodity valuations, including the relative weakness of the US dollar, signs of stronger economic momentum in China and investors' heightened risk appetite. More specifically, oil prices have risen in the wake of the "mini-deal" that averted the US fiscal cliff. However, we continue to believe that the oil market will be pulled in different directions. Weak European demand and the threat of another stand-off over US fiscal policy, combined with a fundamentally oversupplied market, will exert downward pressure on prices. At the same time, political risk premiums will add upside volatility at times throughout the year. We expect a barrel of oil (dated Brent crude) to cost an average of US$104.5 in 2013 and about the same in 2014.

World economy: Forecast summary

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP growth (%)										
World (PPP* exchange rates)	2.4	-0.8	5.0	3.8	3.0	3.4	4.0	4.1	4.0	4.1
World (market exchange rates)	1.3	-2.3	3.9	2.6	2.1	2.3	2.9	2.9	2.9	3.0
US	-0.3	-3.1	2.4	1.8	2.2	2.1	2.4	2.3	2.3	2.4
Japan	-1.1	-5.5	4.7	-0.5	1.8	0.9	2.0	1.5	1.1	1.1
Euro area	0.2	-4.3	2.0	1.5	-0.5	-0.2	1.0	1.3	1.5	1.4
China	9.6	9.2	10.4	9.3	7.8	8.5	7.8	7.7	7.3	6.4
Eastern Europe	4.5	-5.6	3.4	3.9	2.6	2.6	3.3	3.7	3.8	4.1
Asia & Australasia (excl Japan)	5.6	5.0	8.4	6.5	5.6	6.3	6.4	6.3	6.2	6.2
Latin America	3.9	-1.9	5.9	4.3	3.0	3.6	4.0	3.8	3.9	3.9
Middle East & North Africa	4.4	1.3	5.2	2.5	3.6	3.3	4.4	4.7	5.0	5.1
Sub-Saharan Africa**	4.8	1.2	4.5	4.6	4.0	4.5	5.0	5.0	5.4	5.7
World inflation (%; av)	4.5	1.5	3.0	4.1	3.4	3.4	3.5	3.4	3.3	3.3
World trade growth (%)	2.5	-11.5	14.1	6.3	2.9	4.2	5.2	5.4	5.5	5.6
Commodities										
Oil (US$/barrel; Brent)	97.7	61.9	79.6	110.9	112.0	104.5	104.8	107.3	110.0	115.0
Industrial raw materials (US$; % change)	-5.3	-25.7	45.4	21.1	-20.0	5.5	4.0	2.7	1.9	2.3
Food, feedstuffs & beverages (US$; % change)	28.0	-20.3	10.7	30.1	-3.7	-4.2	-5.4	0.4	1.9	1.7
Exchange rates (av)										
¥:US$	103.4	93.6	87.8	79.8	80.0	92.8	94.5	96.3	98.0	97.0
US$:€	1.47	1.39	1.33	1.39	1.29	1.33	1.31	1.27	1.26	1.26

* PPP = Purchasing-power parity. ** Refers to Angola, Kenya, Nigeria and South Africa only.
Source: Economist Intelligence Unit.

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