World Economic Outlook

The Global Economic Outlook: Best Growth Since 2011, Led by the OECD

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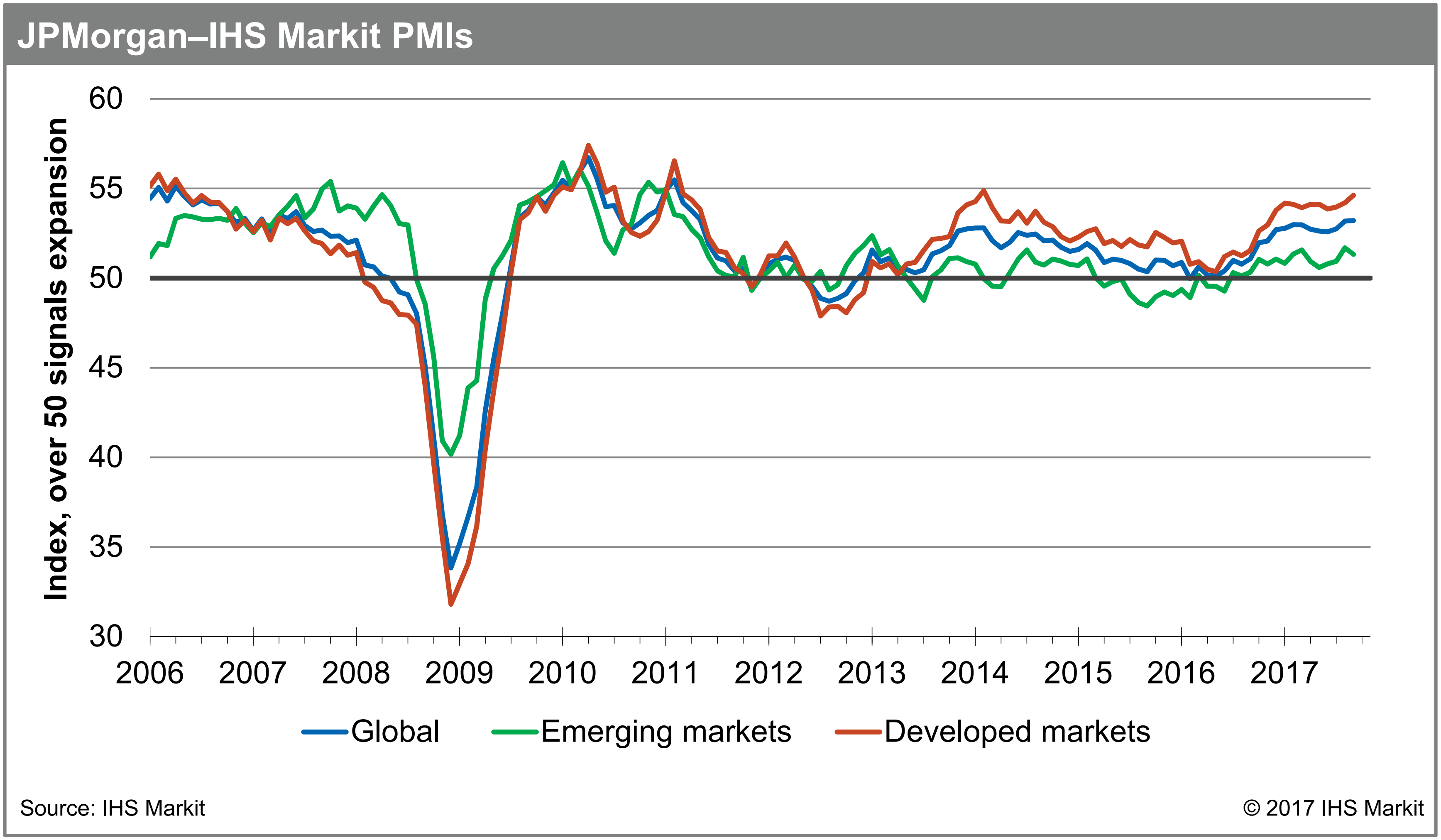
IHS Markit™

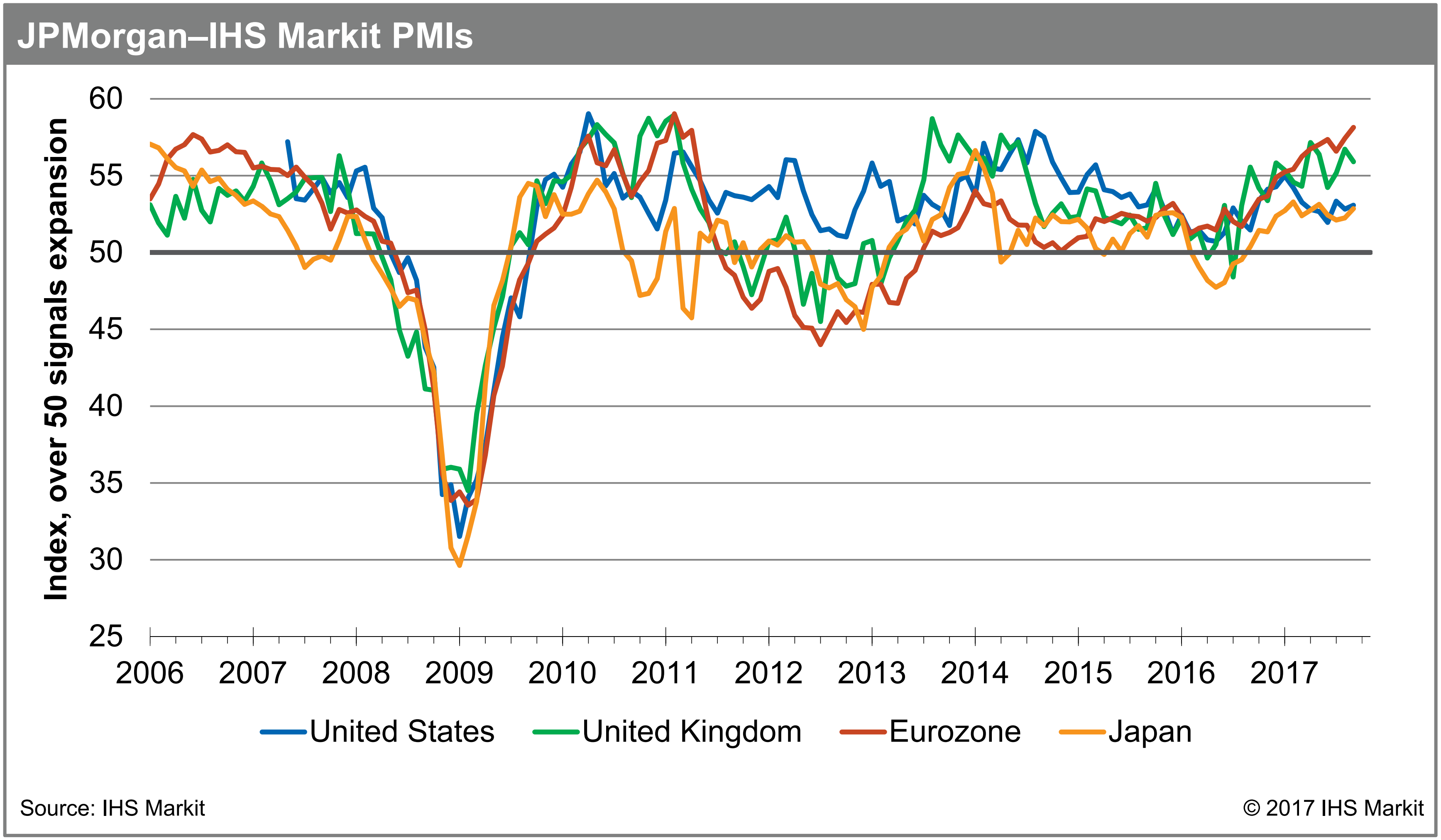
All the signs are pointing to a synchronized global recovery, led by the developed world

- For the first time since 2007, all the Organisation for Economic Co-operation and Development (OECD) countries are growing—nearly three-quarters are seeing a pickup in growth in 2017.
- Good news: In many of these economies, domestic demand growth is stronger than GDP growth.
- The IHS Markit Purchasing Managers' Indexes (PMIs) point to a sustained expansion in the developed world but continued fragility in the emerging world.
- Data "surprises" in the past year have been predominantly on the upside.
- Moreover, recently almost all the forecast revisions have been upward—a pleasant change from the past few years.
- Despite continued high levels of political uncertainty, indexes of policy uncertainty have fallen in recent months (even in the United States!).
- World trade is in the midst of a cyclical rebound, and exports from the United States, Europe, and Asia are growing strongly—but because of long-term structural shifts, a return to the "hyperglobalization" of the 1990s and 2000s is unlikely.

Manufacturing PMI

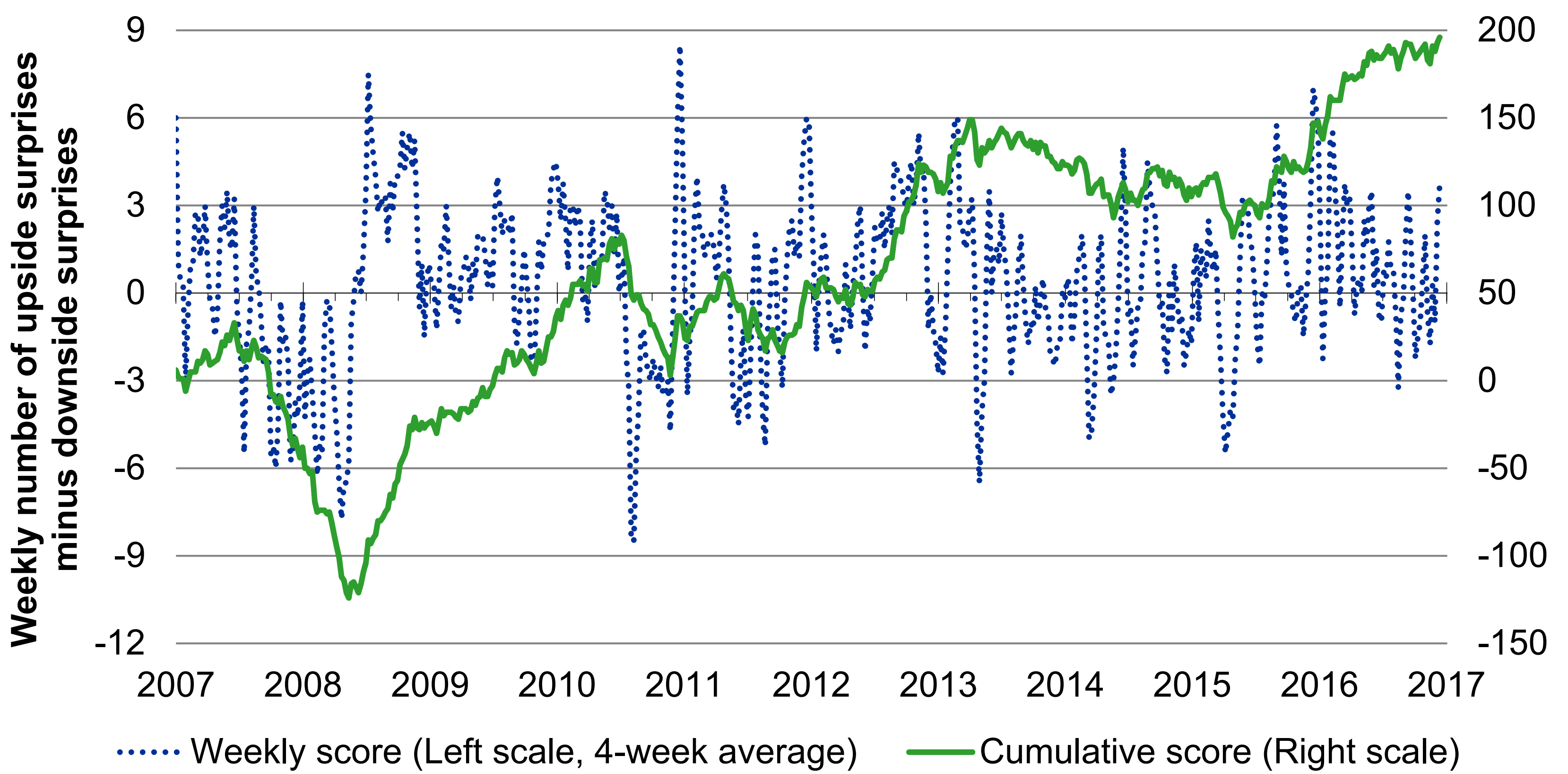


Manufacturing PMI



Net output surprises

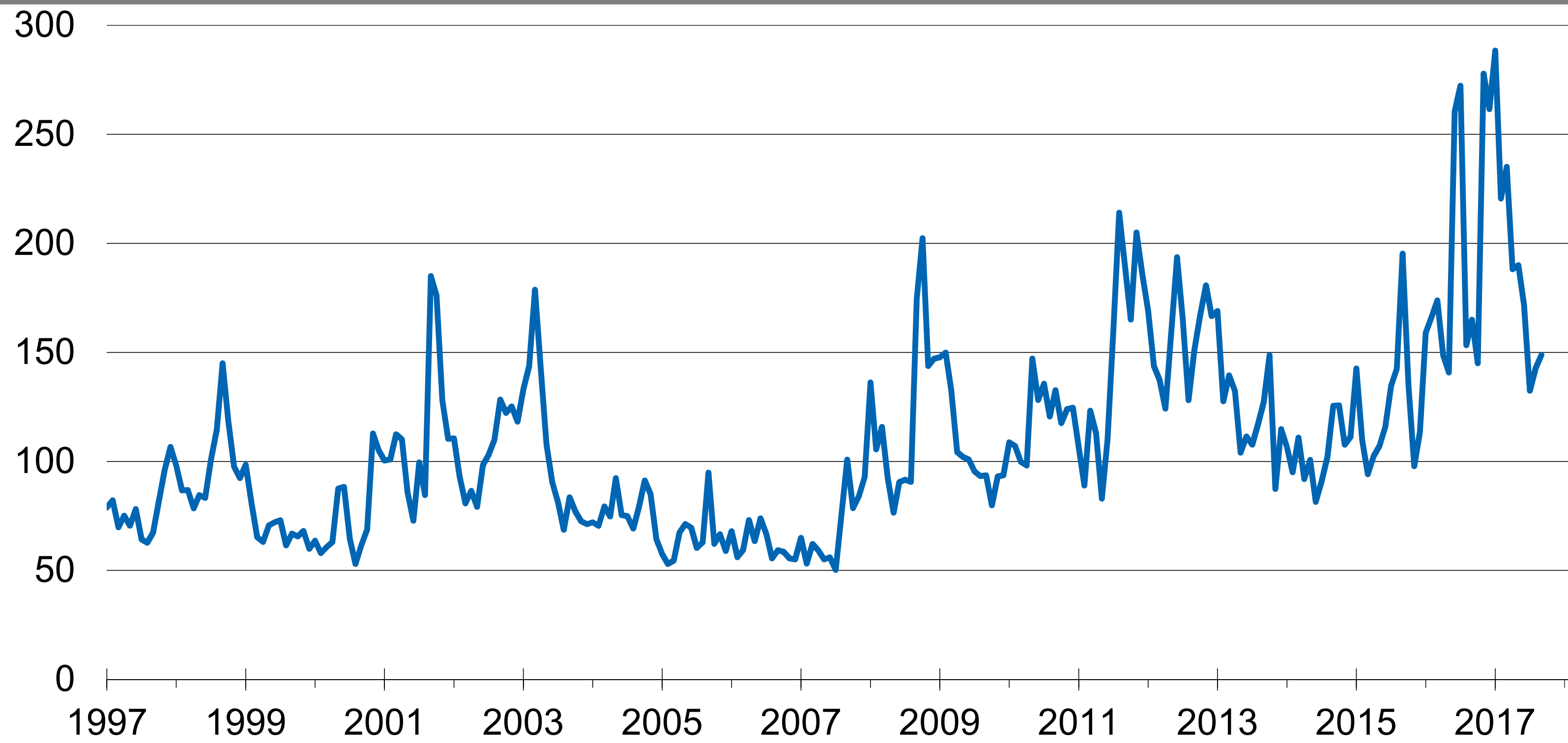
Net output surprises for eight* major advanced economies



Note: Eight countries are the G7 plus Australia.
Source: IHS Markit

Policy uncertainty—Global

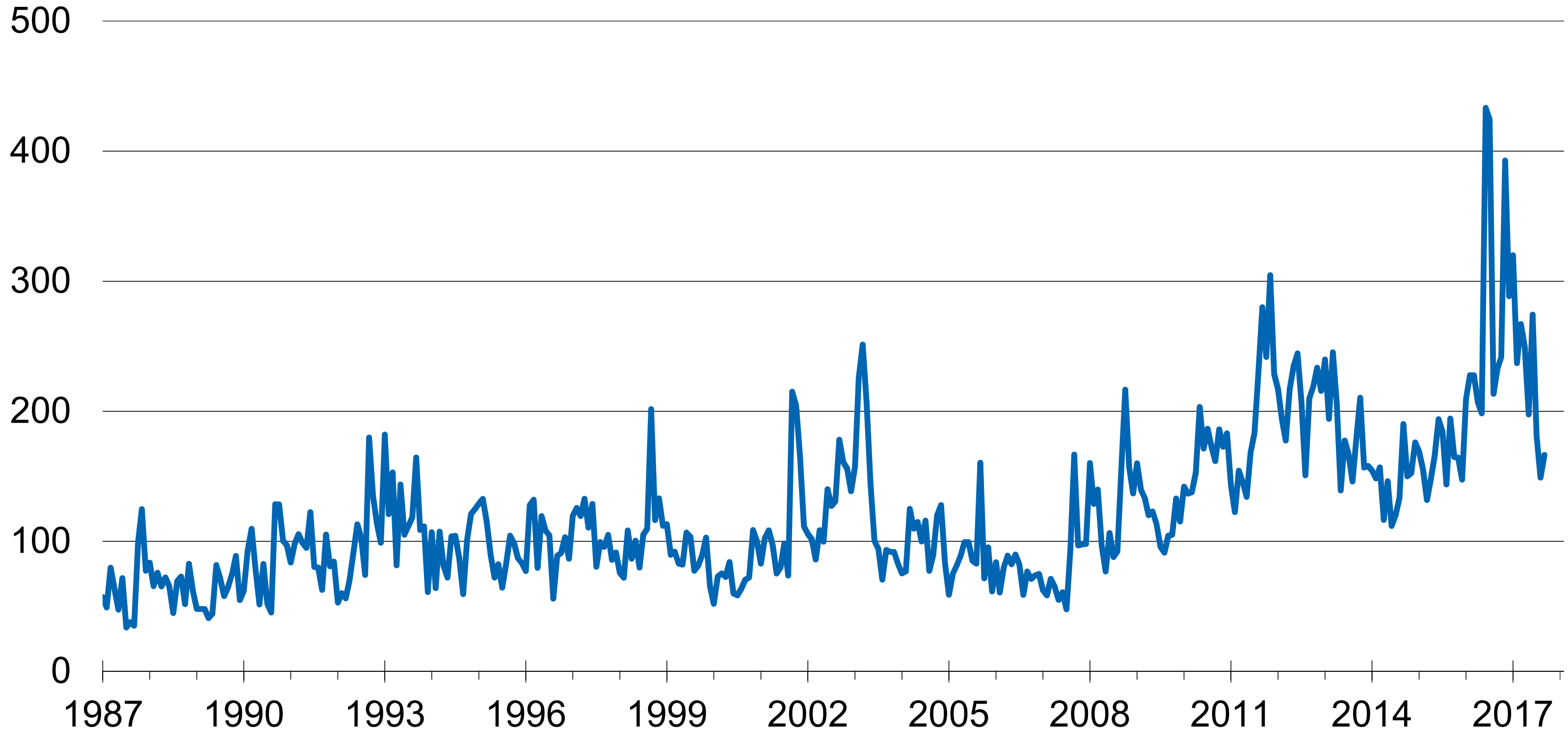
Economic Policy Uncertainty Index



Source: “Measuring Economic Policy Uncertainty” by Scott Baker, Nicholas Bloom, and Steven J. Davis at www.PolicyUncertainty.com.

Policy uncertainty—Europe

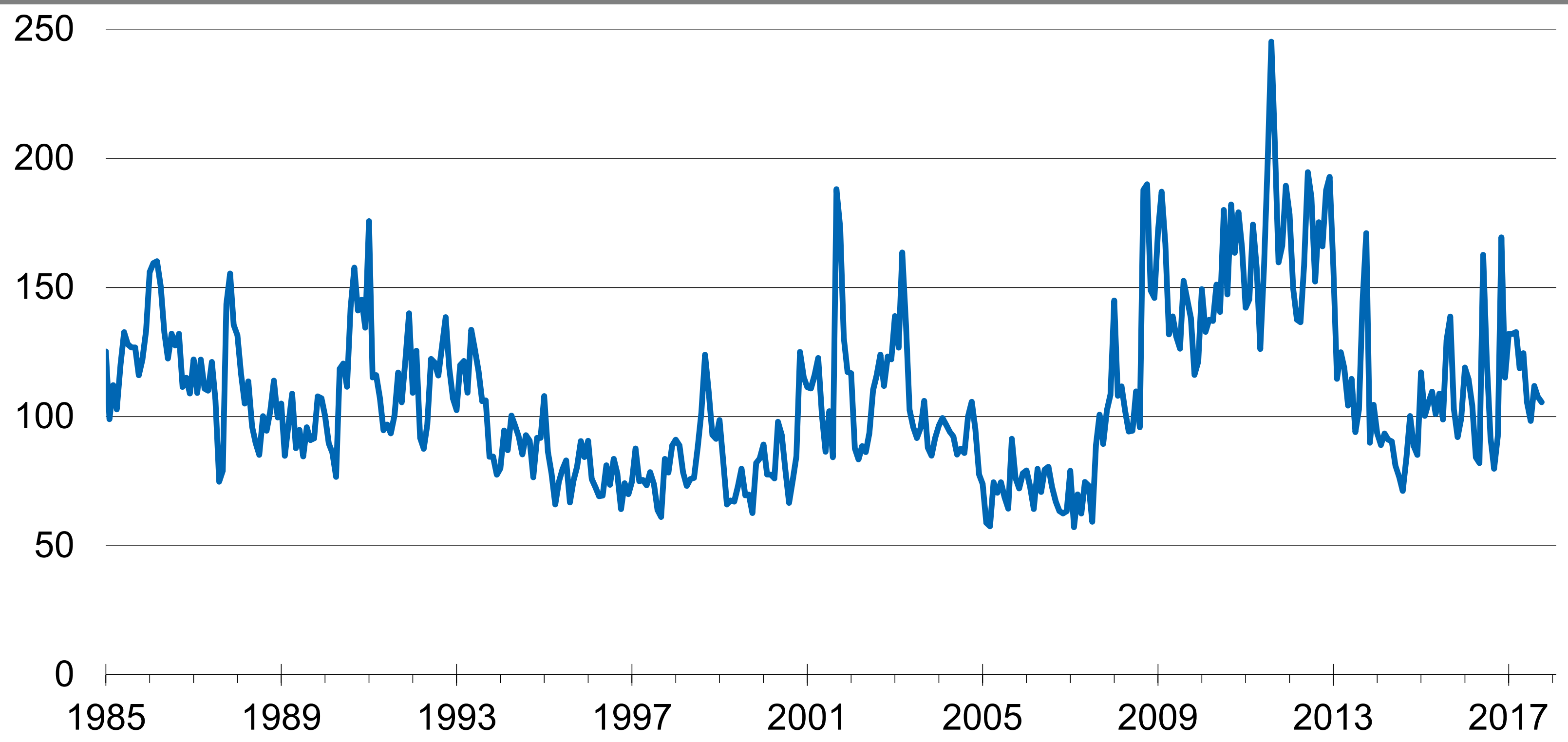
Economic Policy Uncertainty Index



Source: "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom, and Steven J. Davis at www.PolicyUncertainty.com.

Policy uncertainty—United States

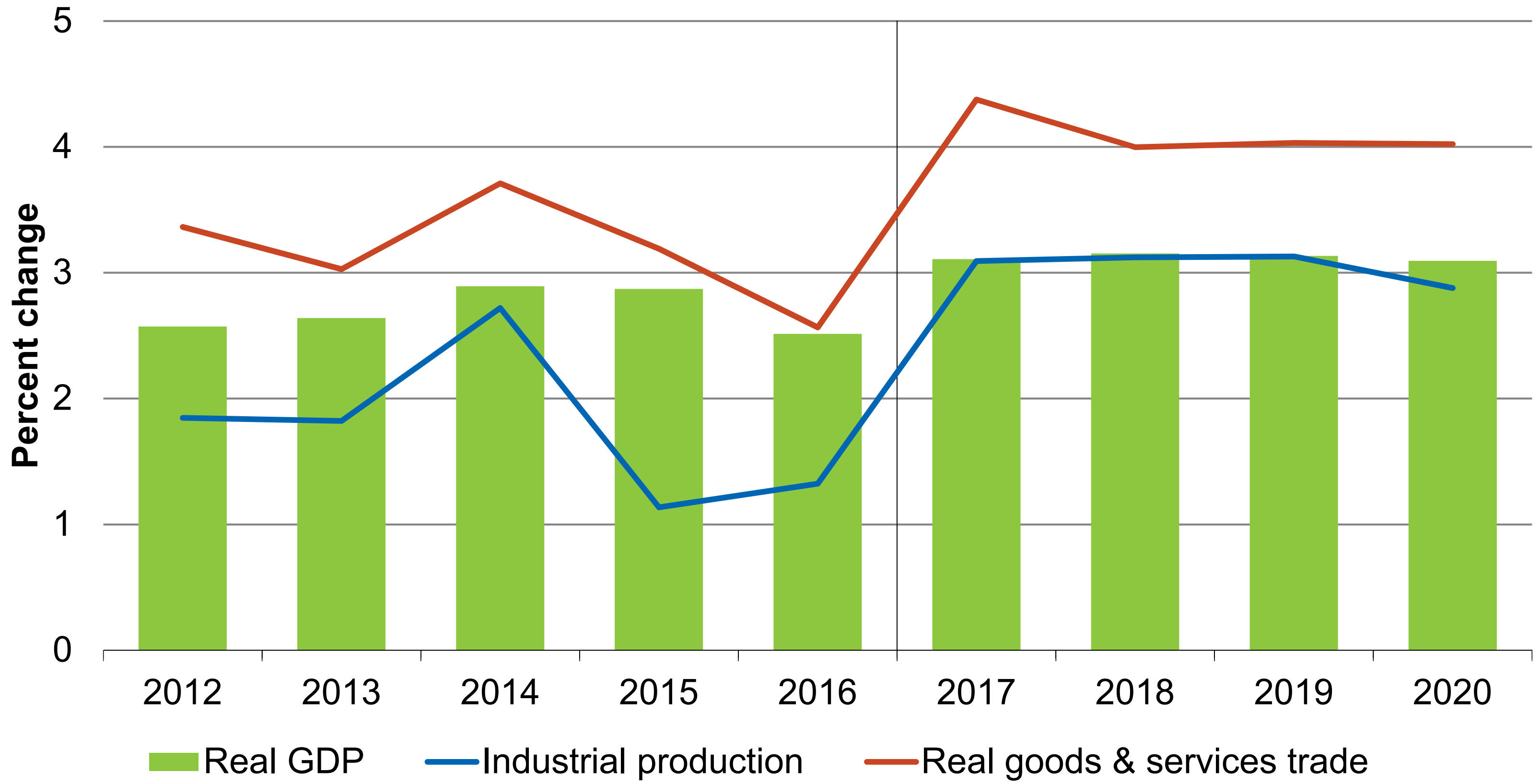
Economic Policy Uncertainty Index



Source: “Measuring Economic Policy Uncertainty” by Scott Baker, Nicholas Bloom, and Steven J. Davis at www.PolicyUncertainty.com.

World trade volume and industrial production are accelerating markedly in 2017

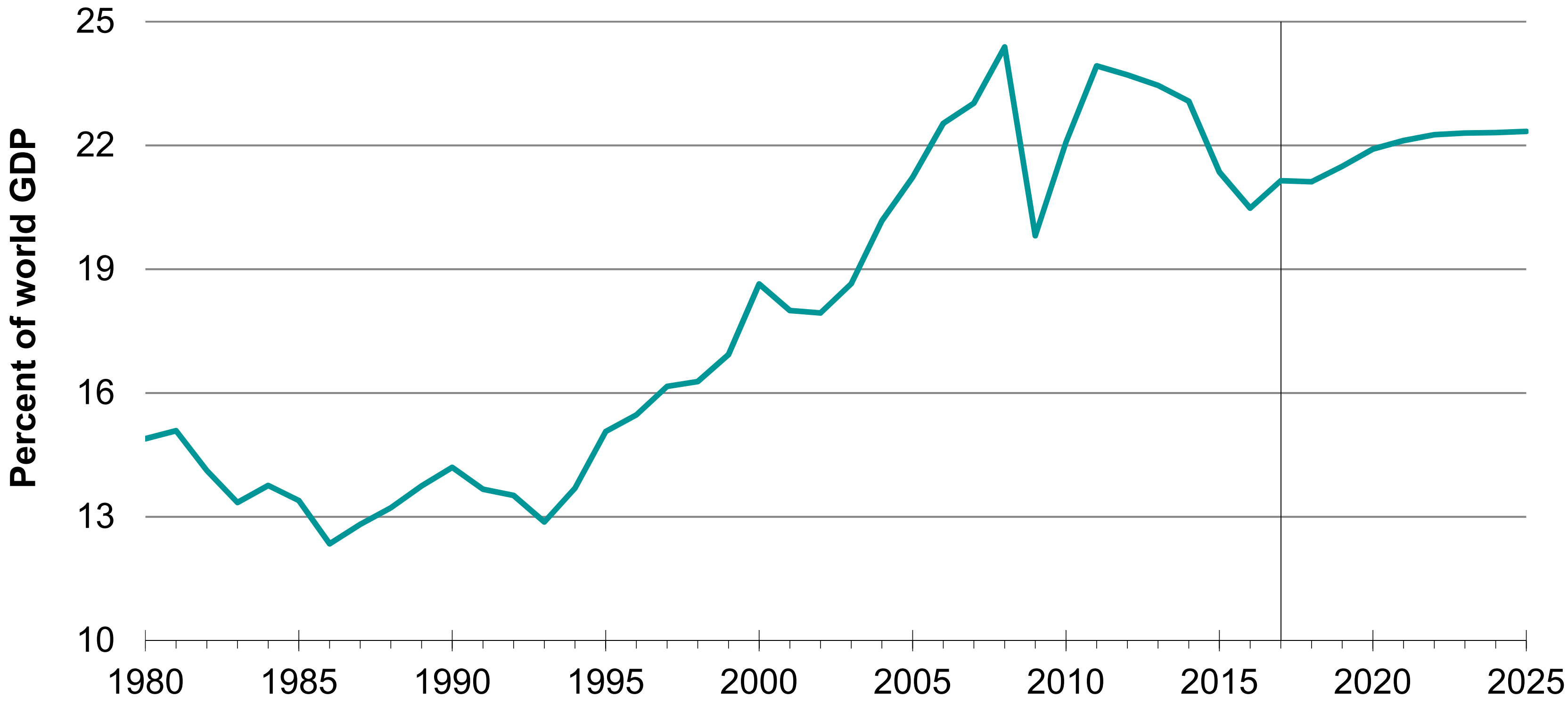
Global real GDP, industrial production, and real exports



Source: IHS Markit

A cyclical rebound in world trade—What about the longer term?

World imports



Source: IHS Markit

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Why did growth in world trade slow?

Cyclical forces

- Slow growth in aggregate world demand
- Weak capital spending
- Collapse in commodity prices

Structural forces

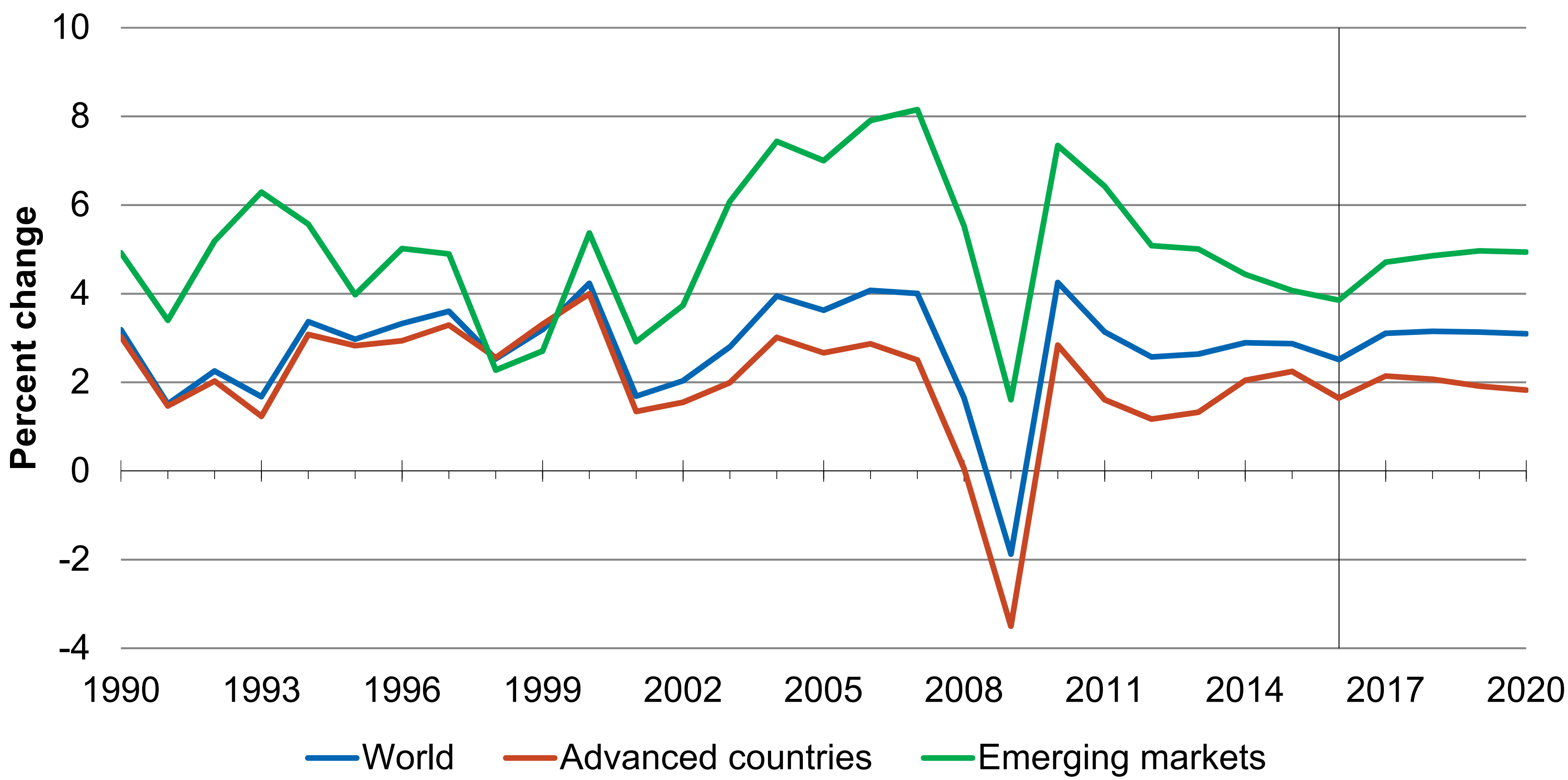
- Shift from manufacturing to services
- Shortening of global supply chains
- Lack of trade liberalization
- Technological advances

Global outlook summary

- Global growth will pick up from 2.5% in 2016 to 3.1% in 2017 (the strongest since 2011) and 3.2% in 2018, led by the United States, Europe, and Japan.
- The US economy will see decent growth (2.0–2.5%) even without stimulus—but the near-term impact of the hurricanes will increase the volatility of the data.
- Expansions in the Eurozone and Japan are gaining momentum (especially domestic demand), thanks to growth-supportive policies—but stronger currencies and ongoing structural problems will limit the upside.
- China's near-term strength masks longer-term fragilities.
- Emerging markets will benefit from stronger global growth, rising commodity prices, and a weaker dollar.
- In this environment, inflation rates and interest rates will rise gradually—and the dollar will keep sliding as investors become more optimistic about the rest of the world (and if US political uncertainty remains high).

World GDP growth

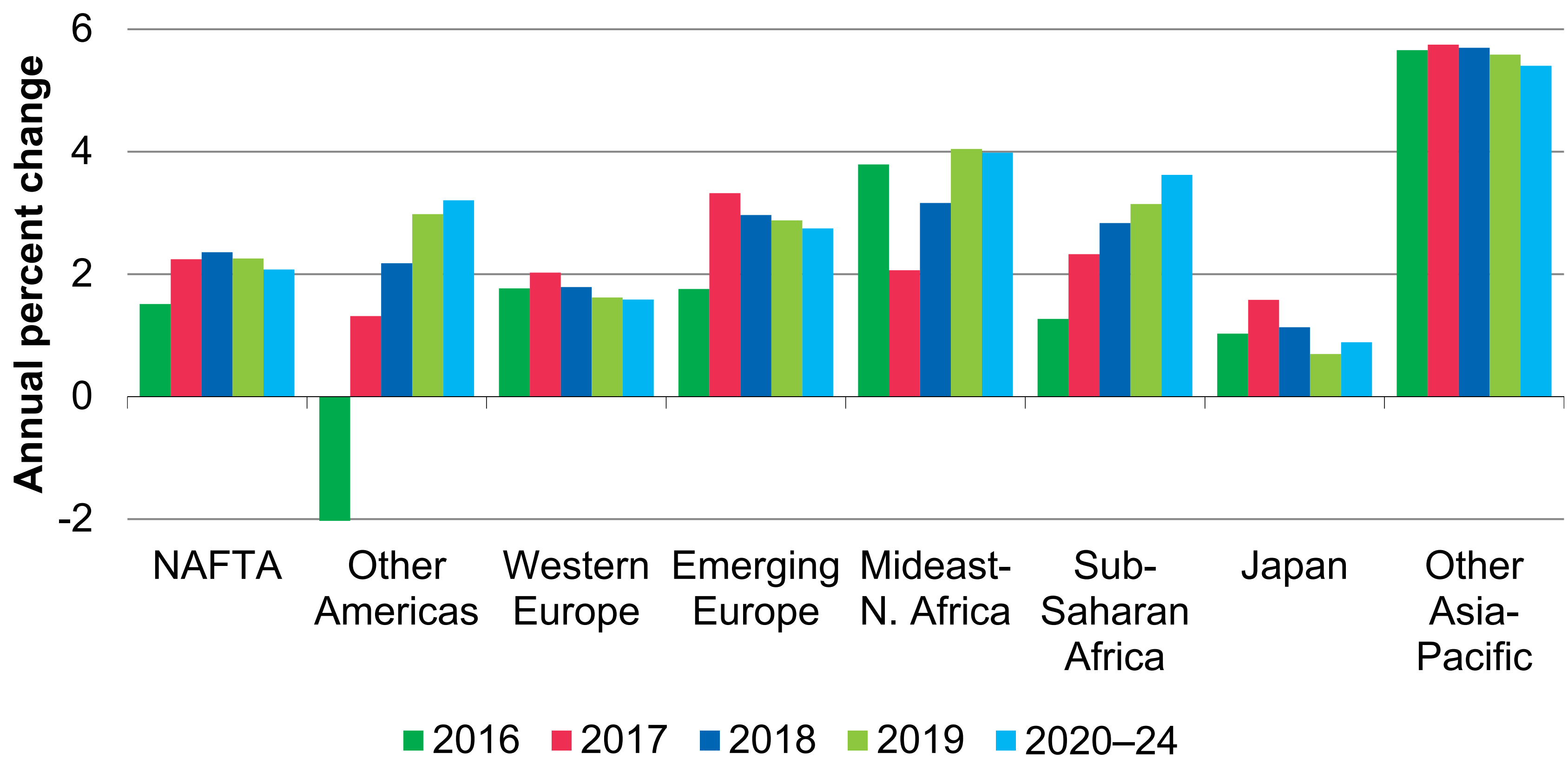
Real GDP



Source: IHS Markit

Asia-Pacific (excluding Japan) will continue to achieve the fastest growth in real GDP

Real GDP



Source: IHS Markit

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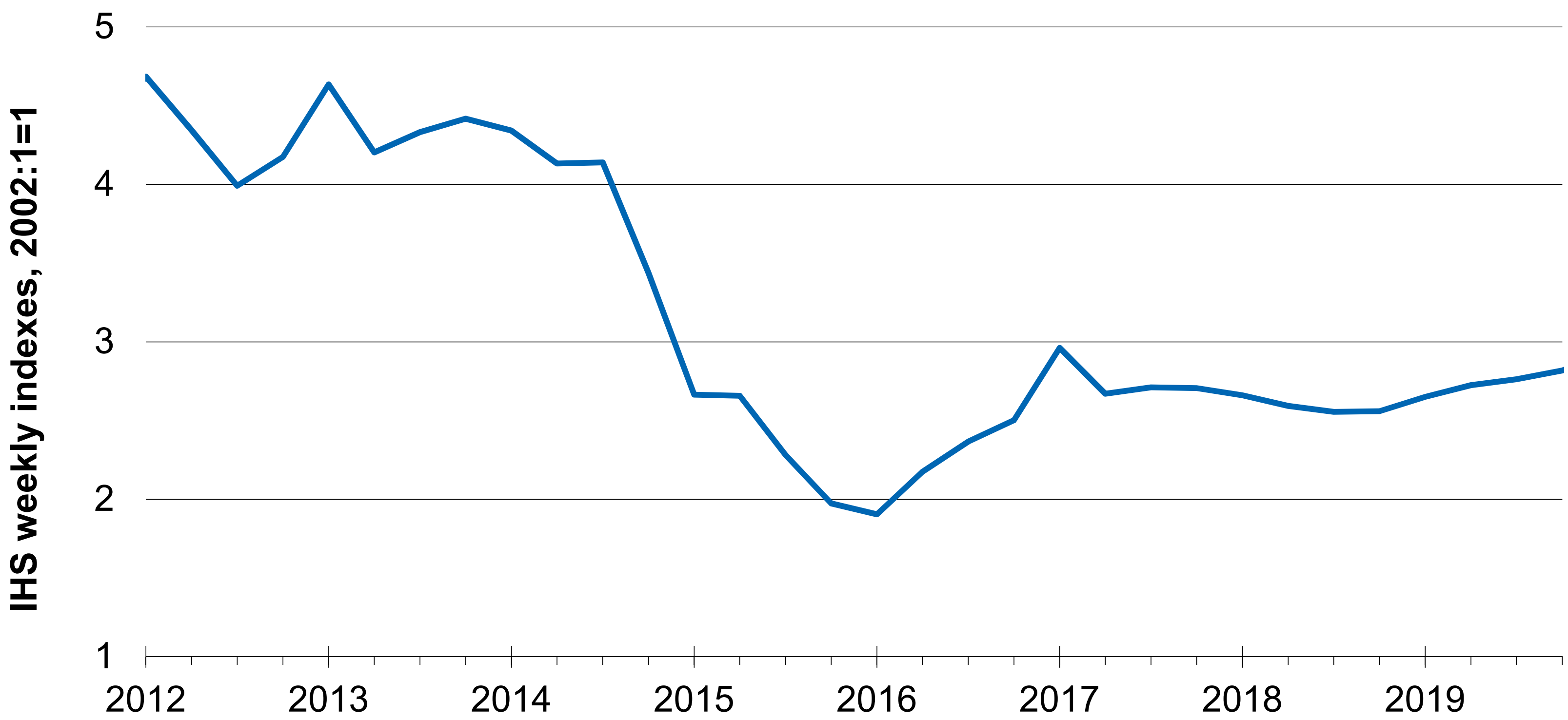
Why is inflation so low?

- No sustained inflationary liftoff—yet—anywhere
- Flashbacks to the 1960s and 1990s
- Many explanations, but little consensus—Price inflation
  - Lackluster growth and, for some countries, still-large output gaps
  - Excess industrial capacity
  - Technology
  - Rolling positive supply shocks (e.g., commodity markets)
- Many explanations, but little consensus—Wage inflation
  - Labor market slack
  - Time lags
  - Demographics
  - Poor productivity growth
  - Technology and globalization
  - Earnings pressure and the shift in market power
- Bottom line: Inflation will rise in the next couple of years—but slowly

Industrial materials prices are recovering but remain well below their previous peaks

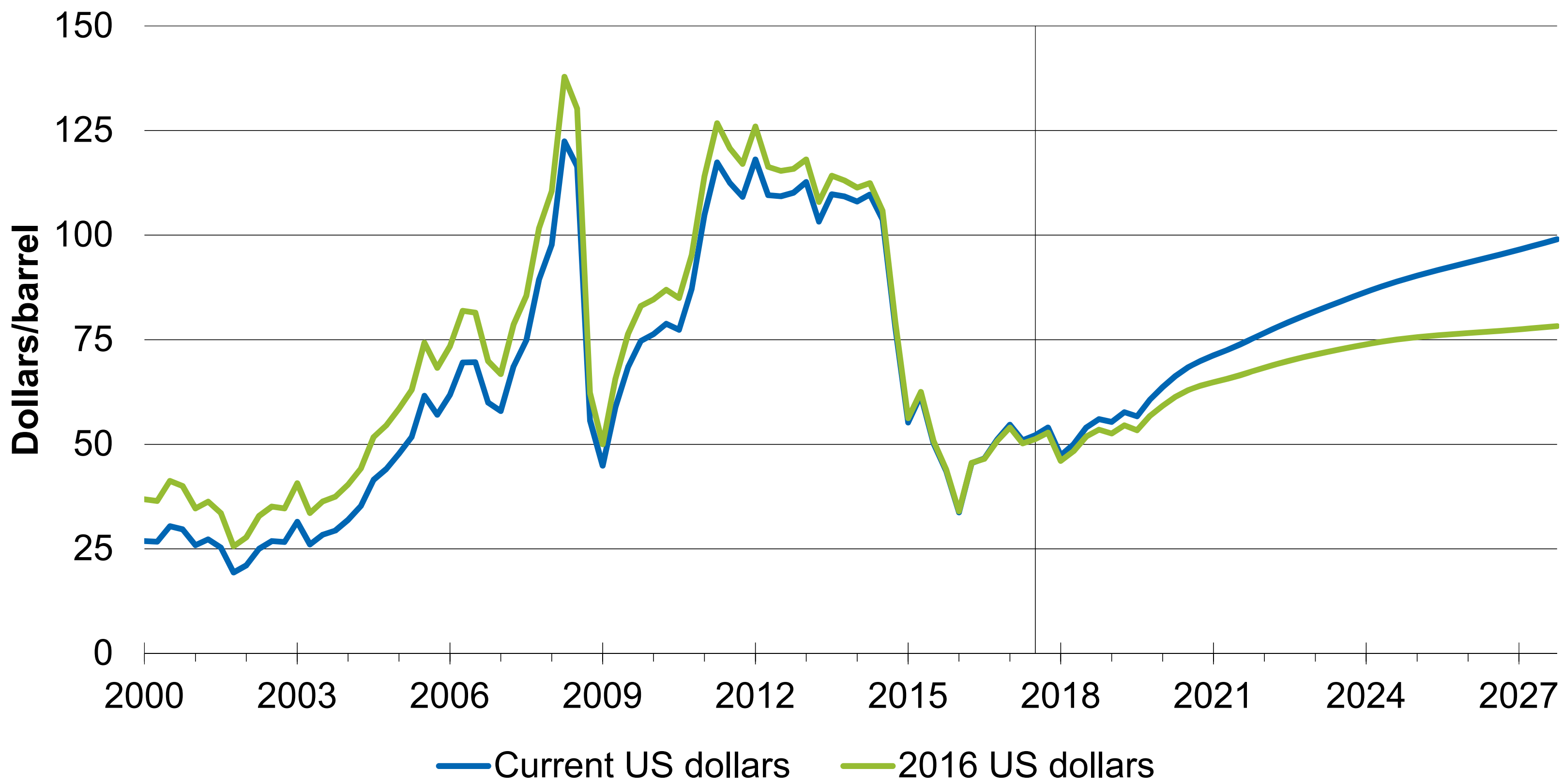
IHS Markit Materials Price Index



Source: IHS Markit

Crude oil prices will gradually recover after 2018

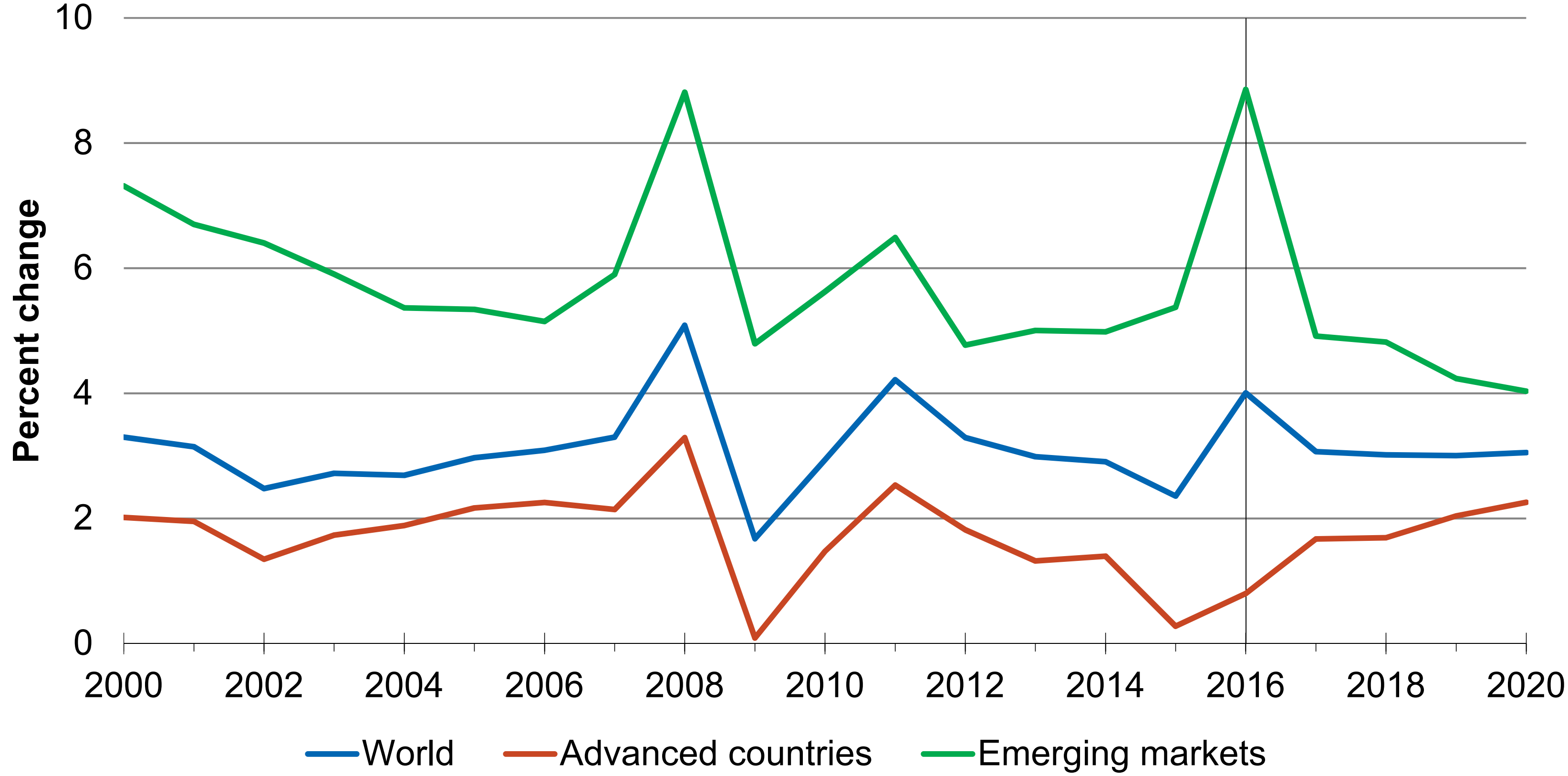
Price of Dated Brent crude oil



Source: IHS Markit

Inflation is trending upward slowly in developed markets

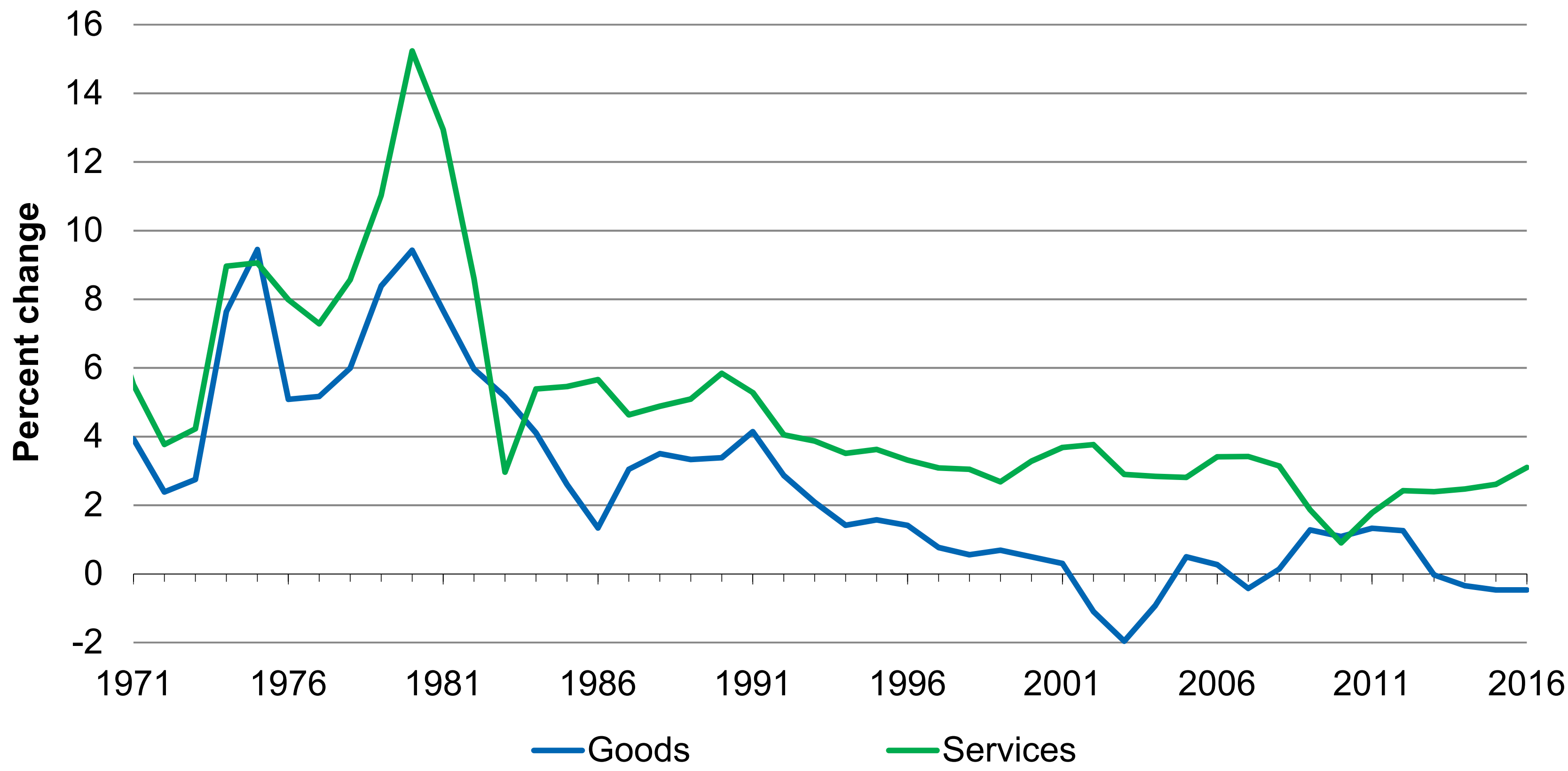
Consumer price inflation



Source: IHS Markit

Weak core goods inflation—United States

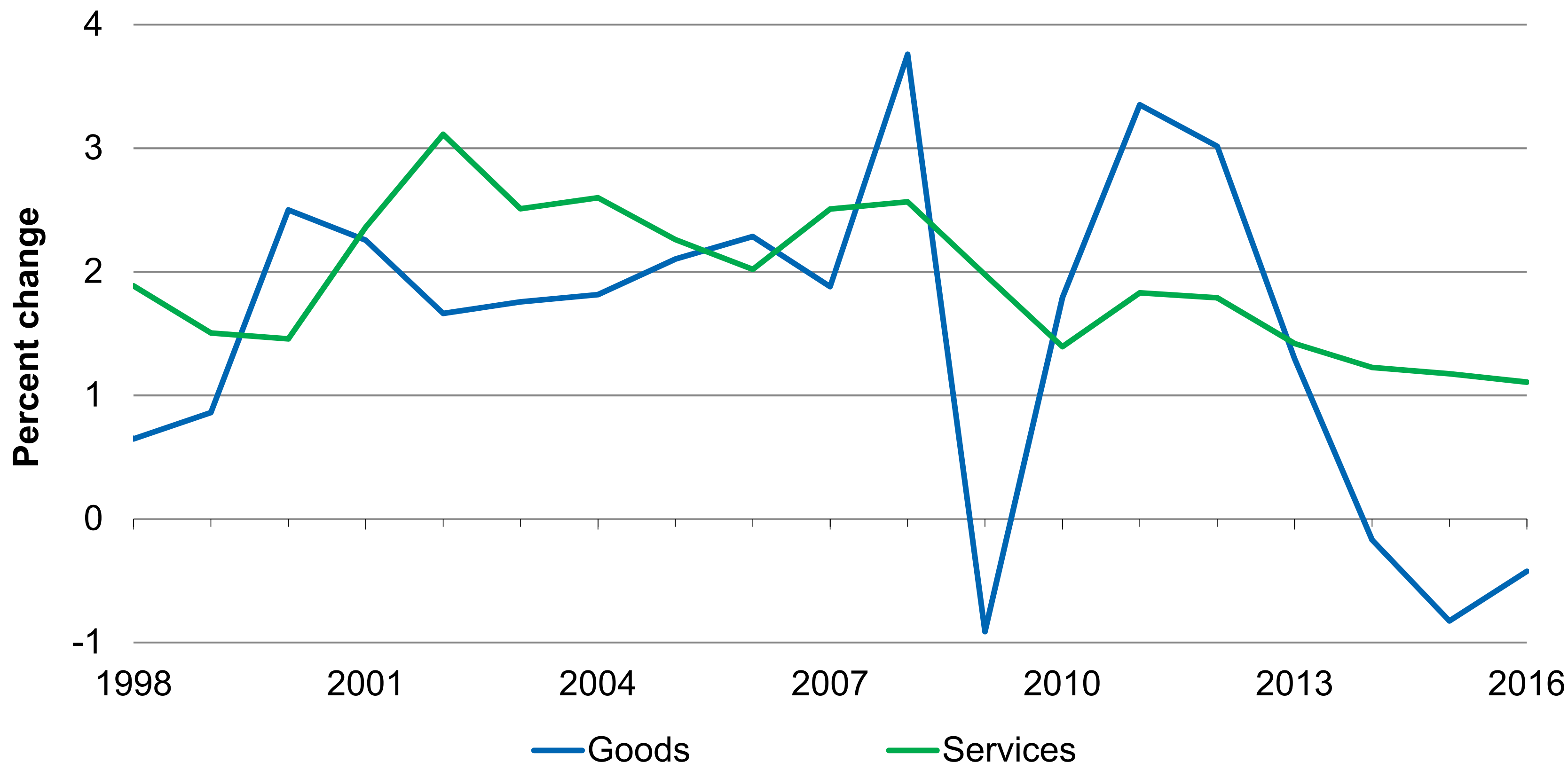
Core inflation (excludes food & energy)



Source: IHS Markit

Weak core goods inflation—Eurozone

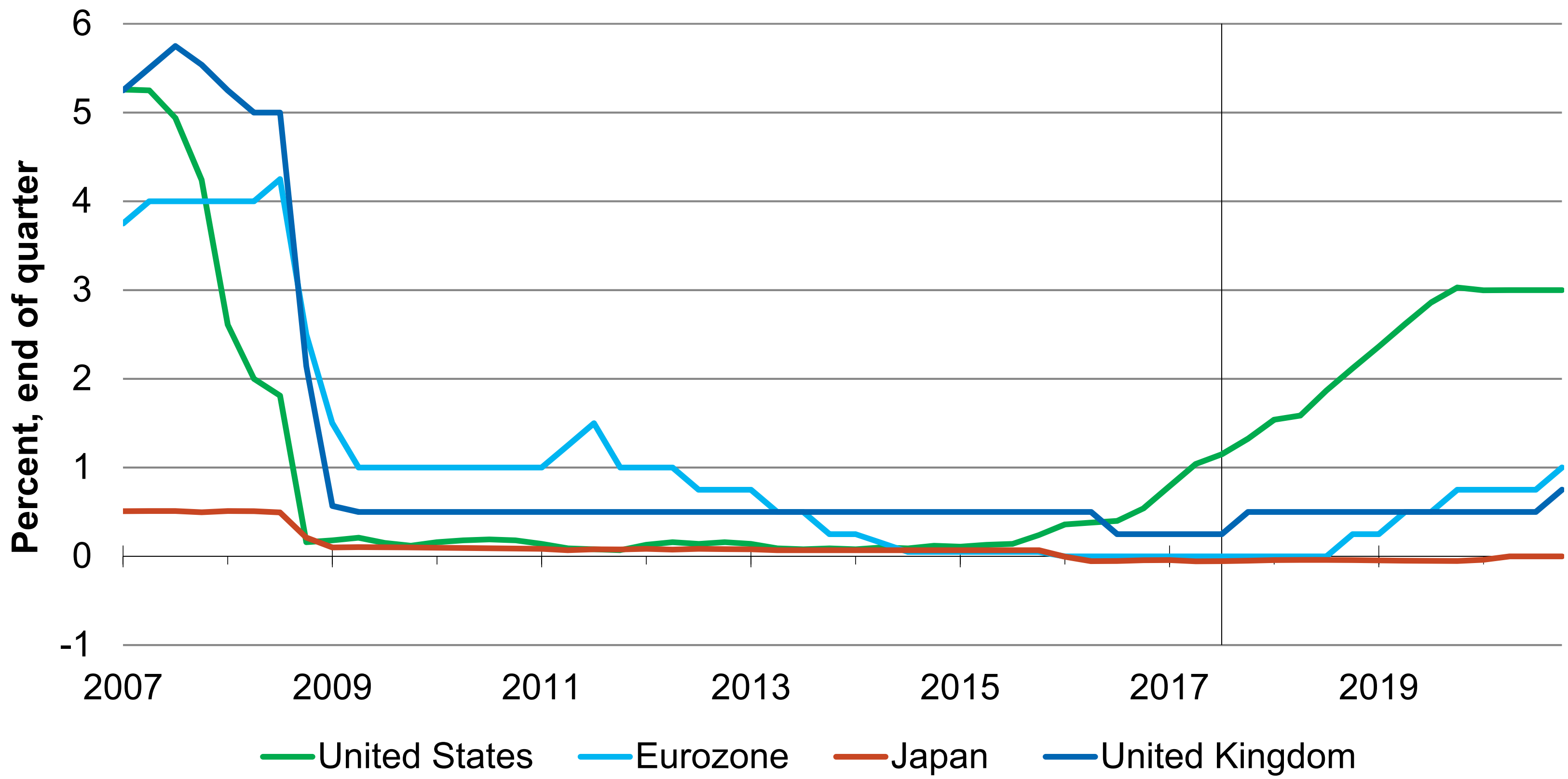
Core inflation (excludes food & energy)



Source: IHS Markit

The US Federal Reserve is leading major central banks in raising interest rates, but policy is still not tight

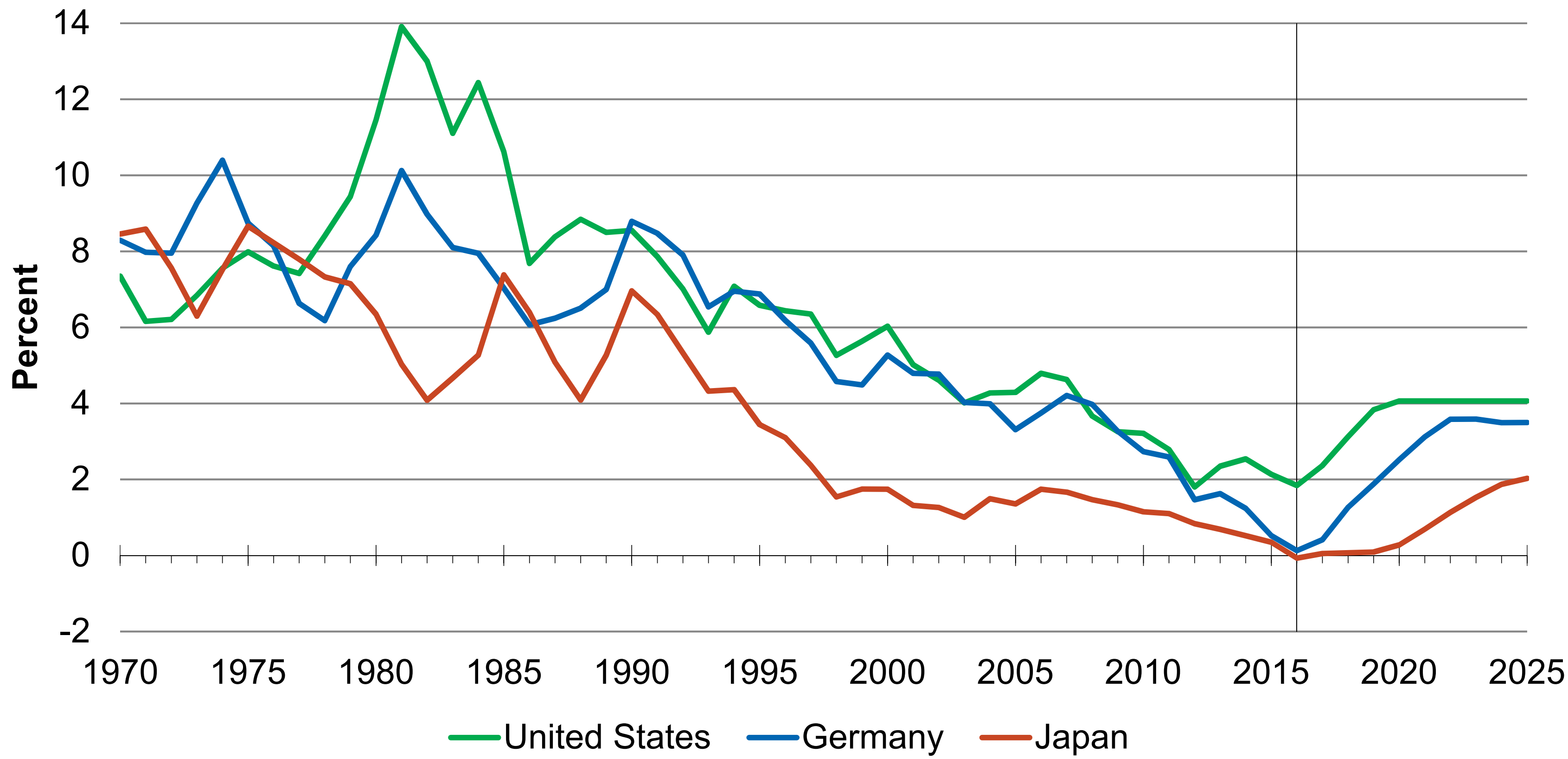
Policy interest rates



Source: IHS Markit

Long-term government bond yields will rise from exceptionally low levels

Ten-year government bond yields



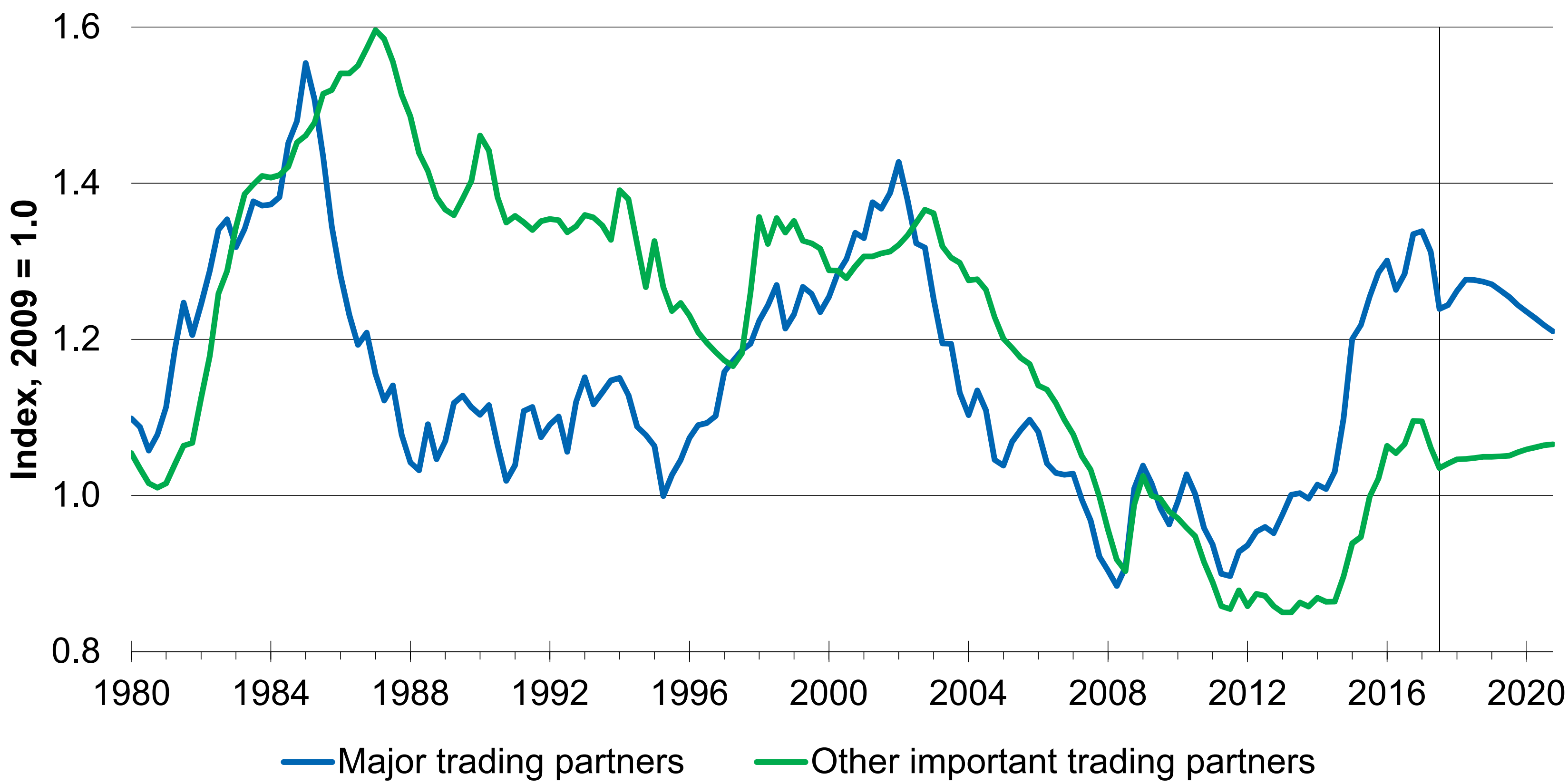
Source: IHS Markit

The causes and consequences of recent forex swings

- Since 1980, the US dollar has seen three very large swings, but the share of the dollar in foreign-exchange (forex) reserves has been remarkably stable.
- The strength of the dollar in recent years was attributable to stronger US growth, expectations of higher US interest rates, and volatility elsewhere in the global economy.
- However, in the past few months the dollar weakened as investors began to focus on stronger growth in the rest of the world, the unpredictability of US politics, the rising US current-account deficit, and diminished worries about China.
- Because of rising European political uncertainty, though, the dollar is rising again.
- The consequences of a weaker dollar include stronger US export growth, a boost in the dollar value of the overseas profits of US corporations, and less pressure on central banks in the emerging world.

The dollar's real exchange value will depreciate against major currencies in the medium term

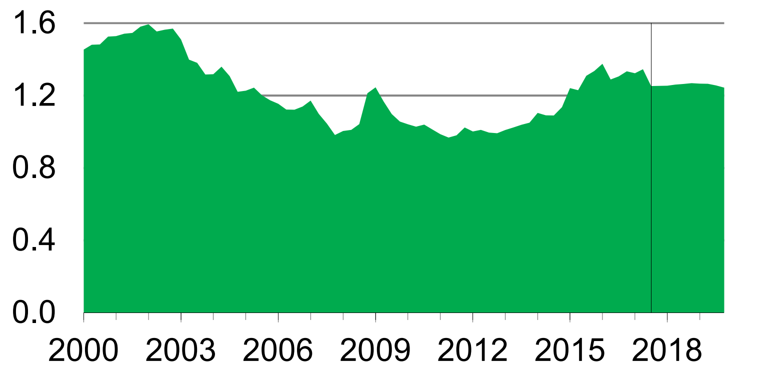
Real trade-weighted dollar index



Source: IHS Markit

Exchange rates per US dollar

Canadian dollar



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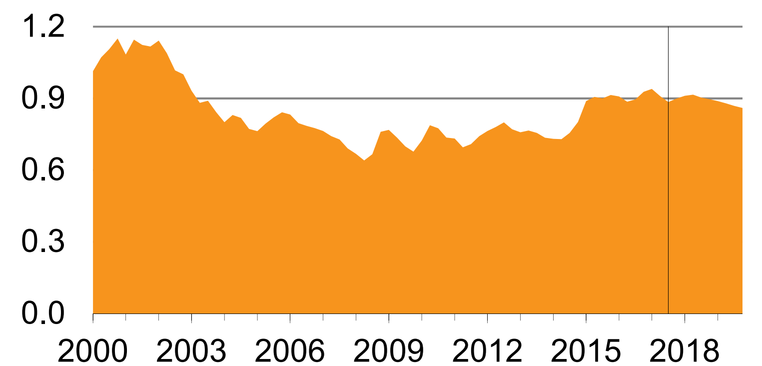
Euro



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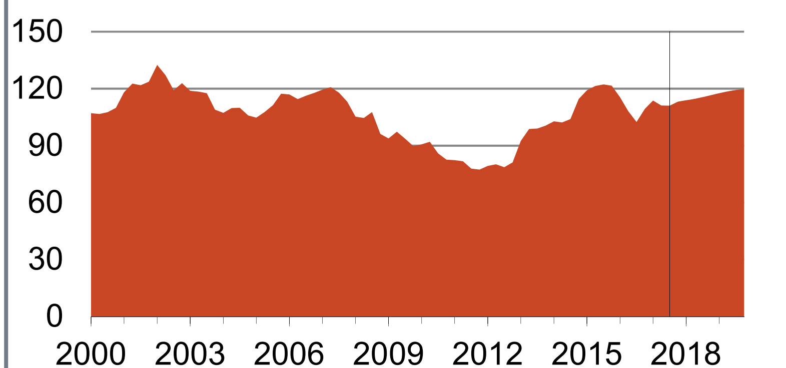
Japanese yen



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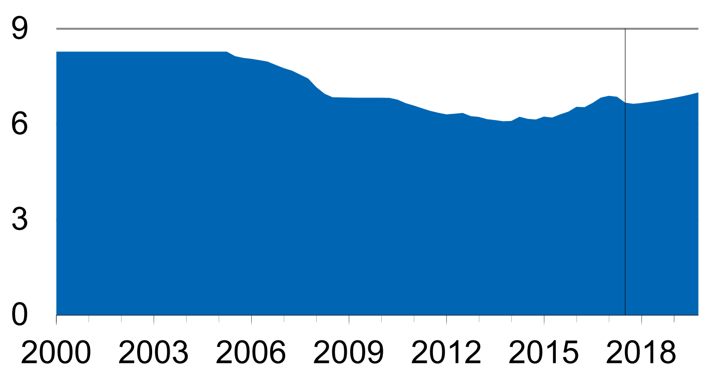
Chinese renminbi



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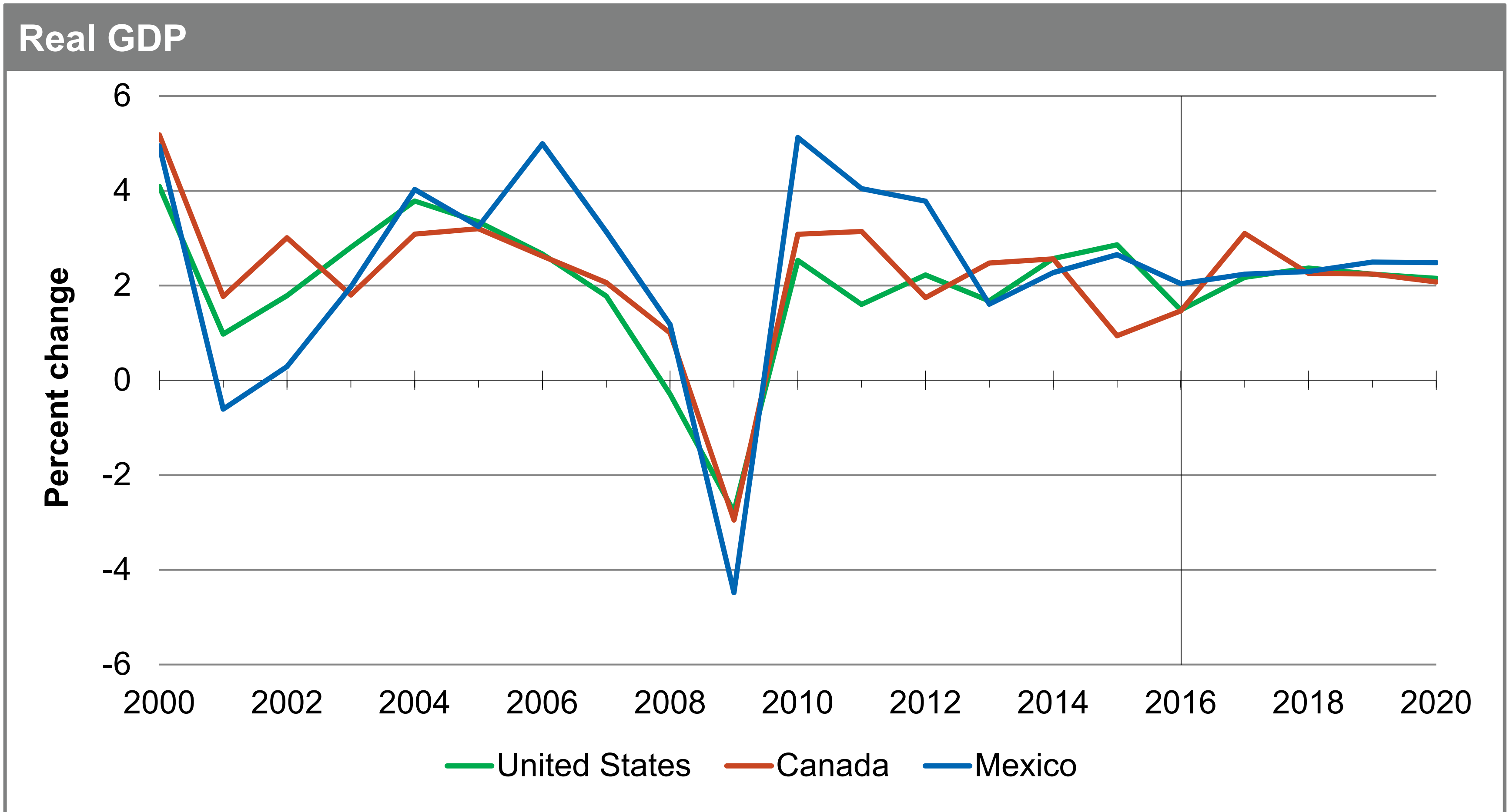
Quarterly averages

The US economy: Near-term volatility, but above-trend growth through 2019

- Real GDP growth picked up from an annual rate of 1.2% in the first quarter to 3.1% in the second quarter as consumer spending accelerated.
- Even without stimulus, US growth will be decent (2.0–2.5%); second-half growth this year will be even stronger.
- The recent hurricanes disrupted economic activity in the third quarter, but recovery and rebuilding will boost growth in subsequent quarters.
- Consumer spending continues to drive US economic growth, supported by rising employment, real incomes, and household wealth.
- Business fixed investment will benefit from strengthening global markets and an easing of regulatory policies, although commercial building is slowing.
- Increasing demand, low inventories of homes for sale, and rising prices will encourage more homebuilding, even as interest rates rise.
- The Federal Reserve will gradually raise interest rates (taking the federal funds rate to 3.00% in late 2019) and reduce its asset holdings—notwithstanding the low inflation “mystery”.

Economic growth rates are converging in North America



Source: IHS Markit

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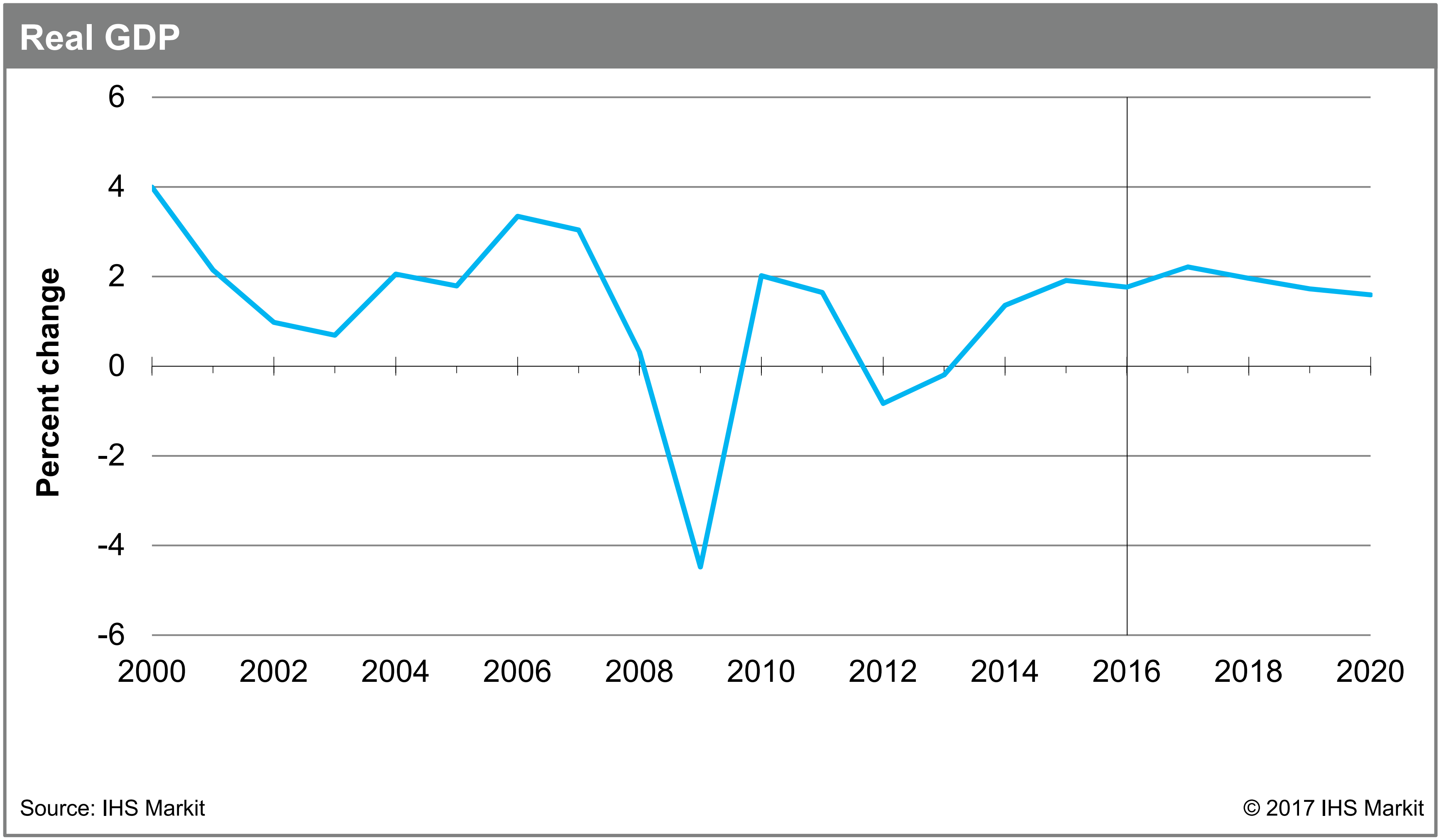
Have the Eurozone and Japan finally turned the corner?

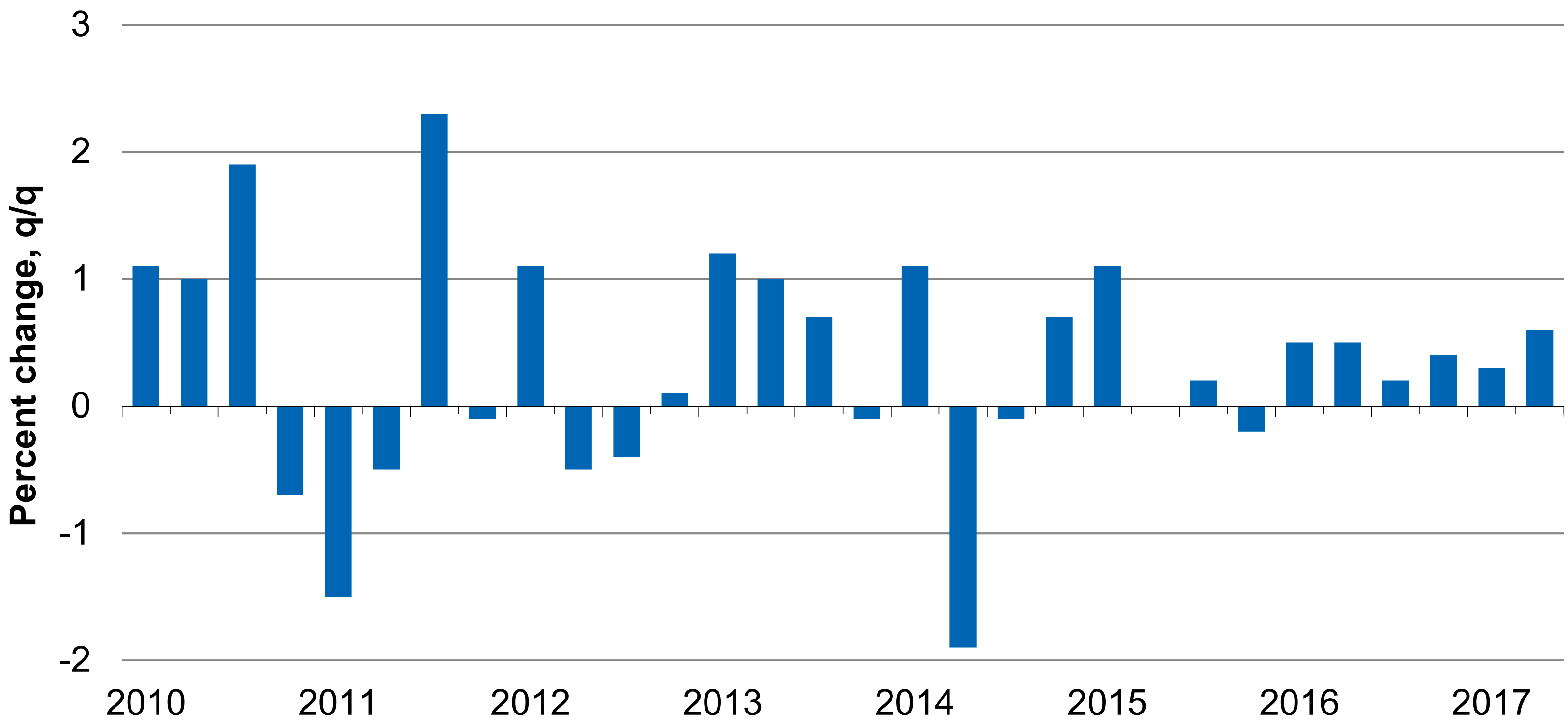
- Between 2011 and 2016, the growth in the United States and United Kingdom averaged 2.0%, while growth in the Eurozone and Japan averaged only 1.0%.
- The Eurozone suffered through a two-year recession in 2012 and 2013, while Japan had three (shorter) recessions between 2011 and 2014.
- The key factor accounting for this poor growth was a combination of tight fiscal *and* monetary policies.
- On the other hand, in the United States and United Kingdom, tight fiscal policy was accompanied by ultra-loose monetary policy.
- The better growth performance of the Eurozone and Japan since 2014 can be explained in large part by a shift in fiscal policy into neutral and a shift in monetary policy into high gear.
- Unless this policy stance changes significantly, the Eurozone and Japan will continue to grow at (or slightly above) trend for the next couple of years.

Eurozone real GDP growth



Japan’s real GDP growth

Real GDP



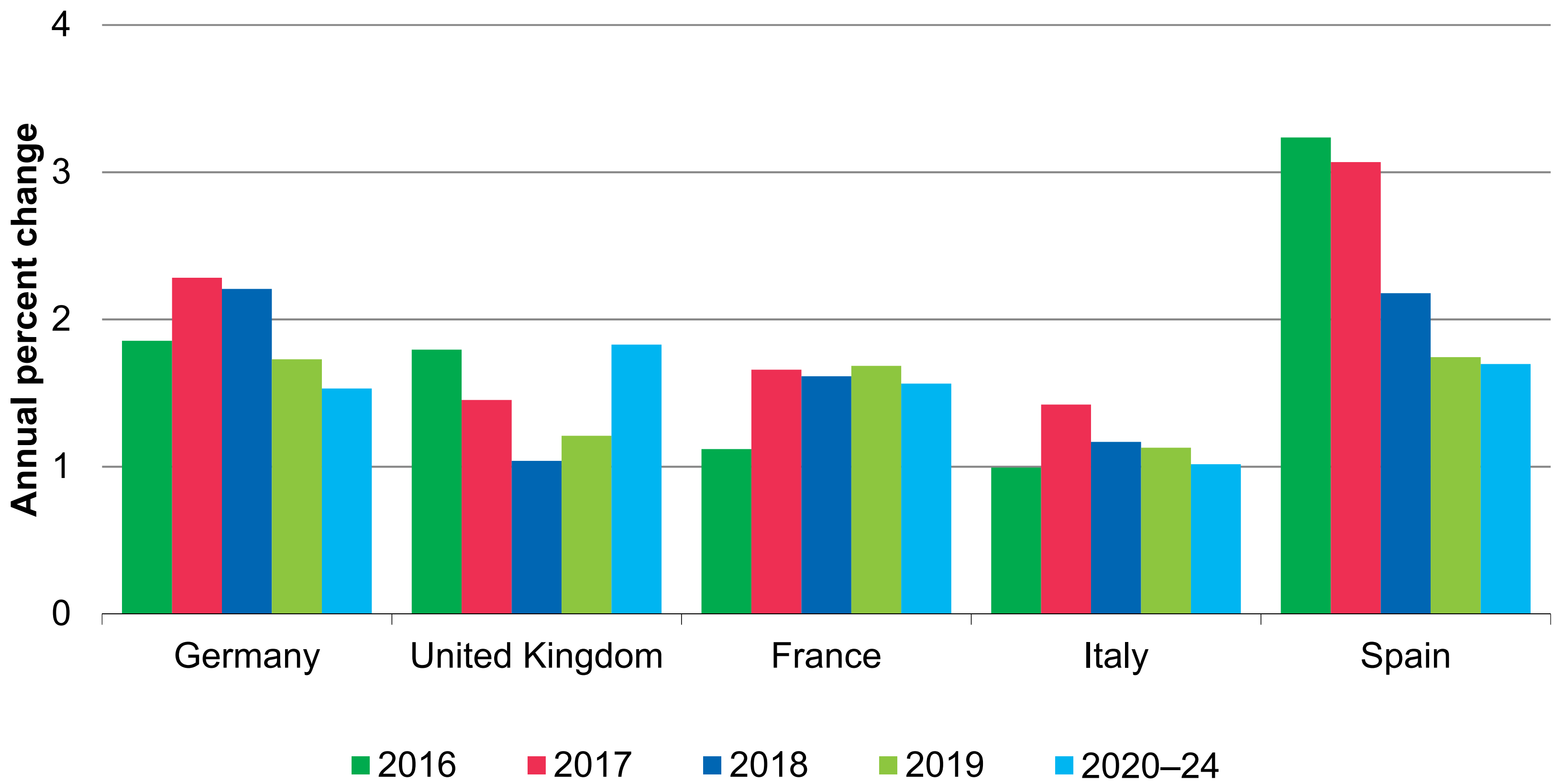
Source: IHS Markit

Western Europe on a steady growth path

- After a solid performance in the first half of 2017, the Eurozone economy is expected to grow 2.2% this year and 2.0% in 2018.
- Monetary stimulus, reduced fiscal headwinds, low oil prices, and rising consumer and business confidence will help sustain growth.
- Election results in the Eurozone have improved business prospects, although challenges remain; in particular, the banking and political situations in Italy are fragile.
- The rising popularity of nationalist parties in Germany and Austria and the separatist pressures in Spain are sources of concern.
- Underlying price pressures remain subdued.
- An appreciating currency could become a drag.
- Monetary policy remains accommodative; the European Central Bank is not expected to raise interest rates until the third quarter of 2018.
- Fallout from Brexit will hurt UK growth in the next couple of years.

Real GDP growth in Western Europe

Real GDP



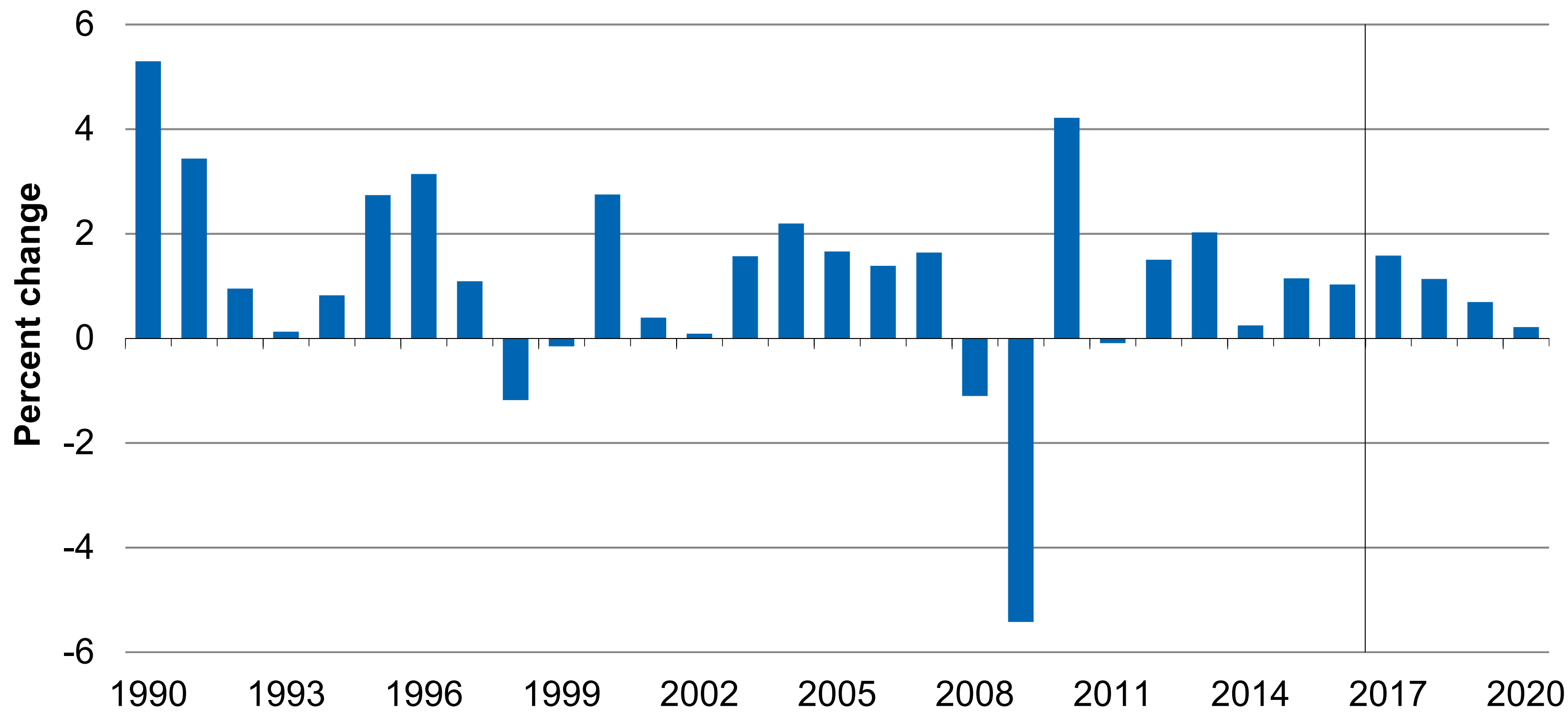
Source: IHS Markit

Japan's economy will stay on a slow growth path

- Real GDP grew at a 2.5% annual rate in the second quarter, led by gains in consumer spending and public fixed investment.
- With the unemployment rate below 3%, wages should accelerate, supporting moderate growth in consumer spending.
- A strengthening global economy and solid increases in corporate profits will sustain moderate growth in capital expenditures—although an appreciating currency could hurt.
- Prime Minister Shinzo Abe faces some of the toughest political headwinds since he took office five years ago.
- A consumption tax increase in October 2019 will lead to buy-in-advance behavior, causing an economic setback in late 2019.
- A declining, aging population limits growth potential, and high government debt may become a serious challenge.

Japan’s economy has limited growth potential

Real GDP

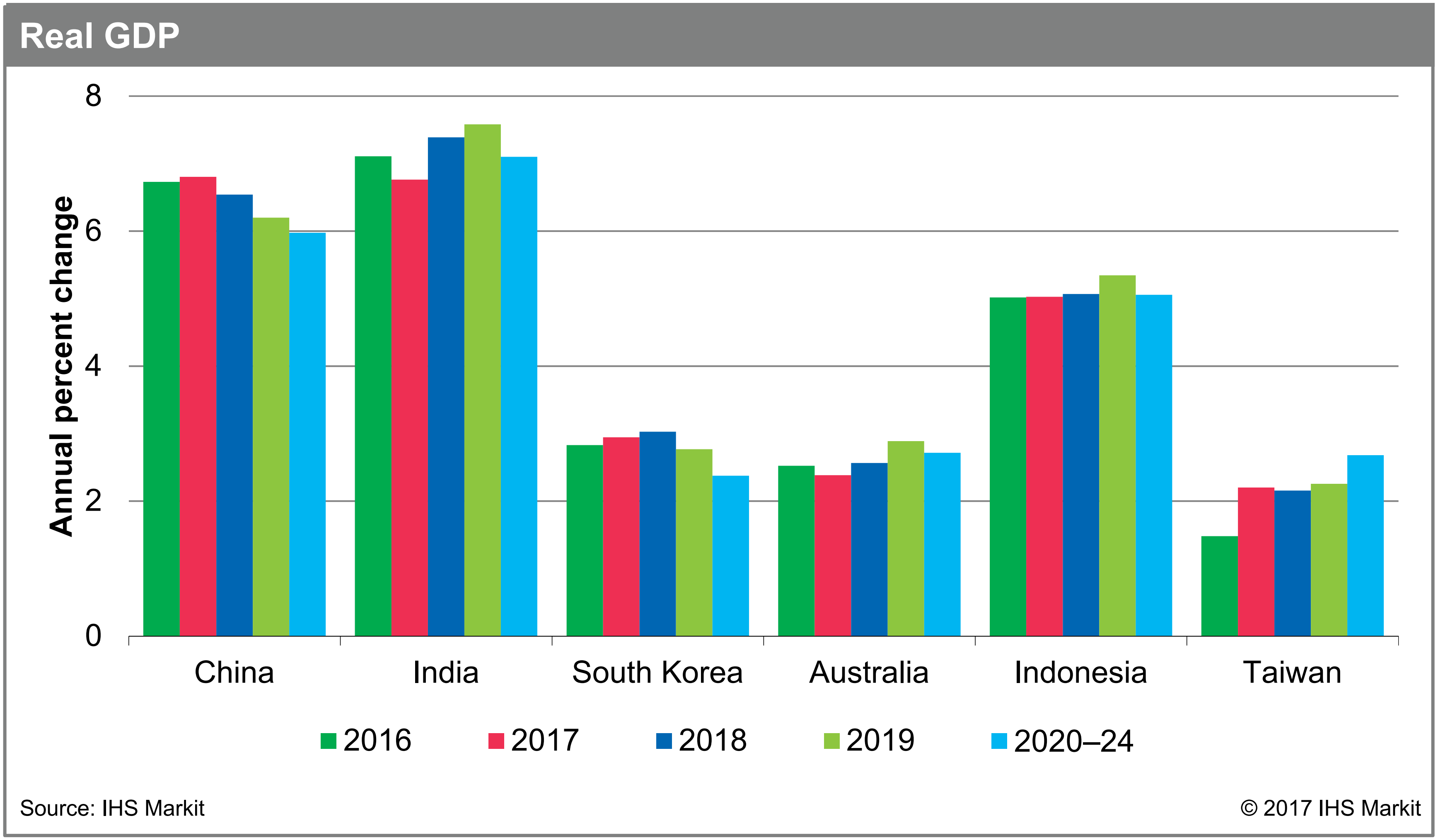


Source: IHS Markit

Asia-Pacific will lead all regions in growth

- China's economic growth will slow as tightening financial conditions lead to a correction in real estate markets.
- India's economy has struggled in 2017 but should achieve 7.0–7.5% growth during the next five years as economic reforms attract foreign investment.
- Indonesia's growth is holding near 5.0%, led by robust gains in fixed investment, including much-needed infrastructure development.
- Despite a retrenchment in mining investment, Australia is maintaining 2.5% growth with rising exports of minerals and energy.
- New manufacturing hubs such as Vietnam are emerging in Southeast Asia and South Asia as China loses cost competitiveness.
- The information technology–business process outsourcing industry is set for continued rapid growth in India, Malaysia, and the Philippines.

Real GDP growth in Asia-Pacific

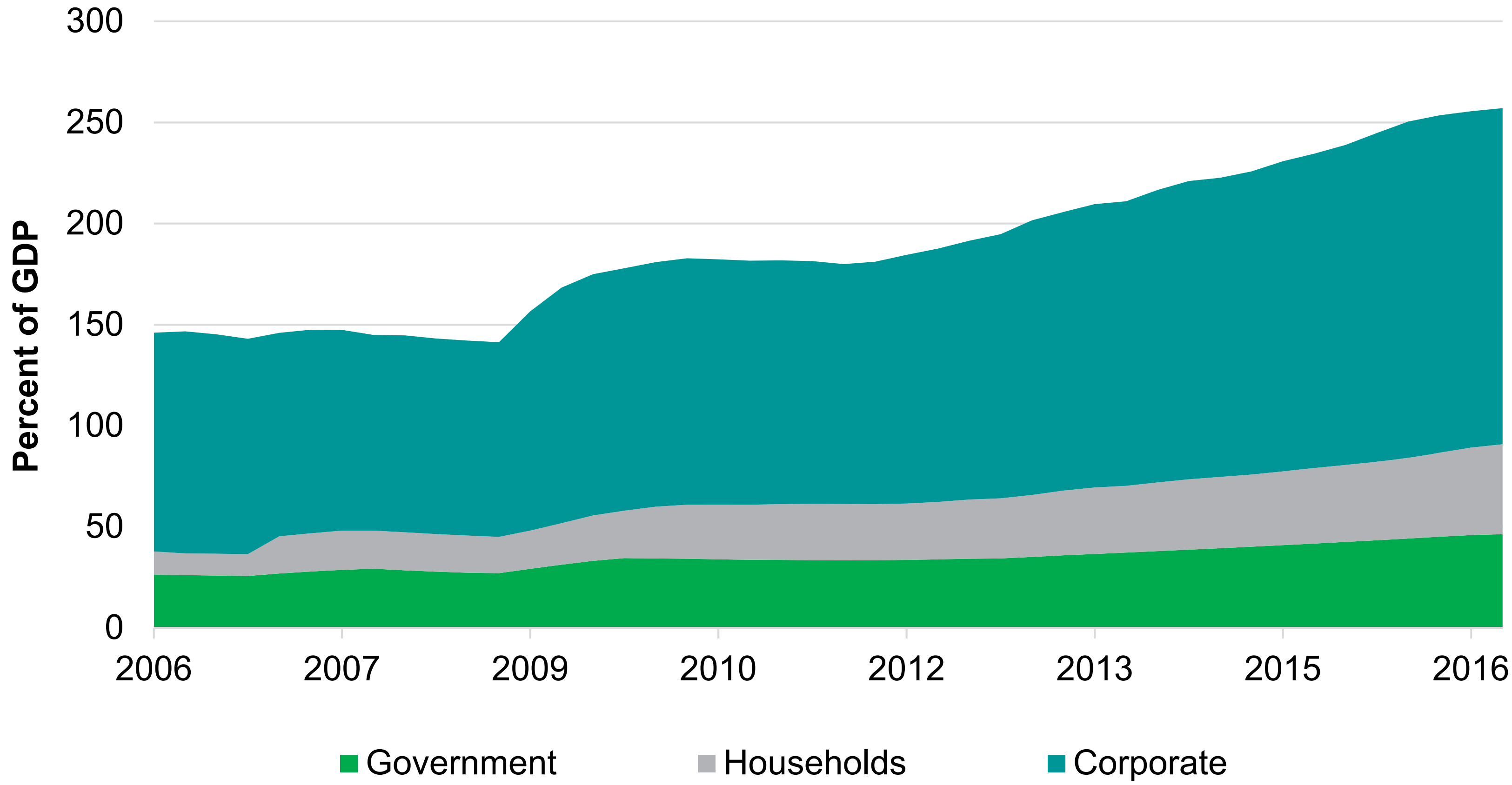


China's economic growth will slow gradually

- Real GDP increased 6.9% year-on-year in the first two quarters of 2017, supported by policy stimulus to ensure stability ahead of the 19th Party Congress.
- Meanwhile, policymakers are trying to reduce the high levels of leverage in the economy through tighter financial supervision and regulation.
- Headwinds from excess industrial capacity and a housing-market correction will trim real GDP growth from 6.8% in 2017 to 6.5% in 2018 and 6.2% in 2019.
- A reorientation toward a consumer-driven economy stalled in 2016 as households saved 28% of income, one of the highest saving rates in the world.
- Progress on reducing excess capacity has been extremely slow.
- The renminbi is expected to depreciate gradually against the US dollar through 2019, and capital controls may be tightened to prevent large capital outflows.
- Under China's 13th five-year plan, services will account for 70% of incremental growth in 2016–20, up from about 60% in 2011–15.

China's massive debt will constrain future monetary policy, credit growth, and investment

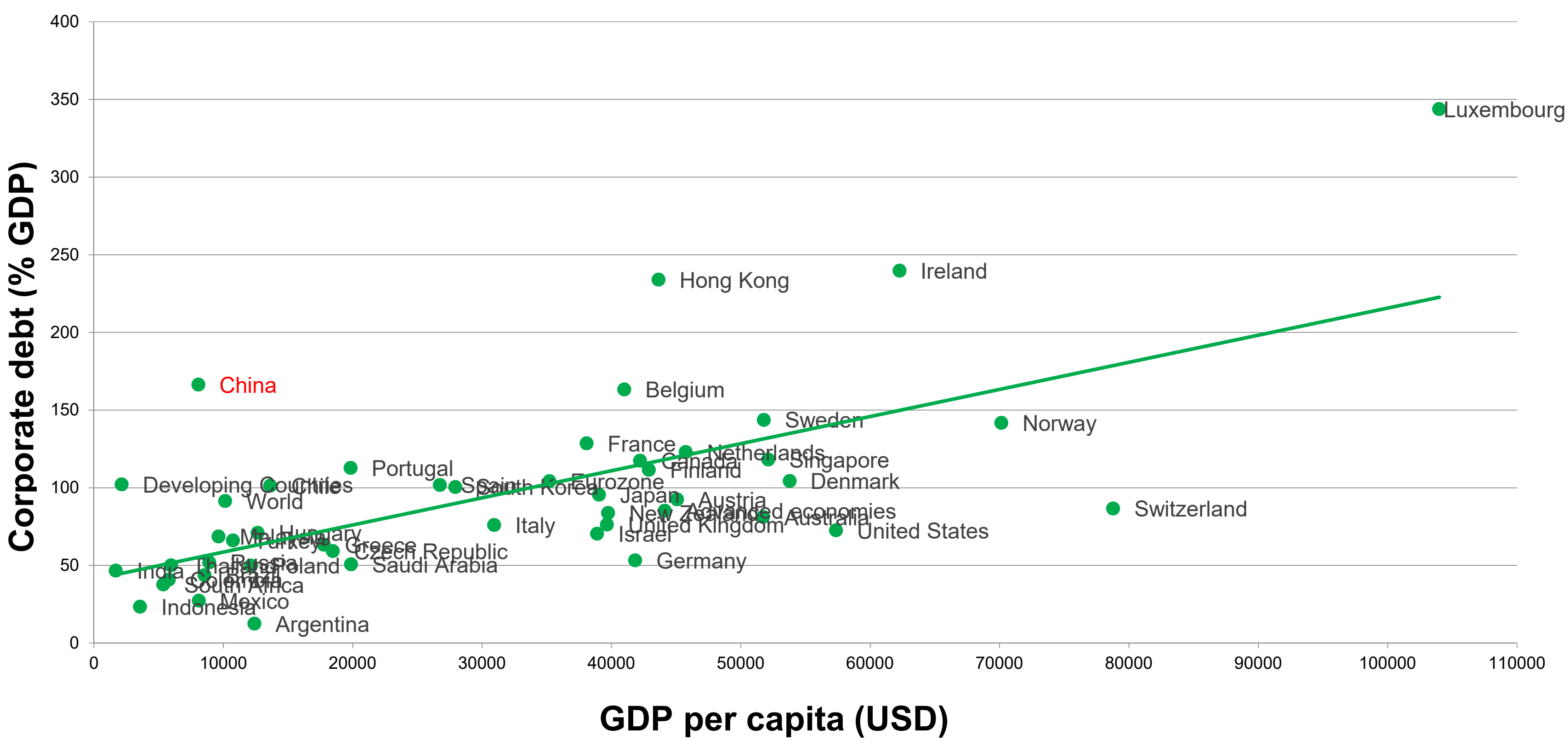
Debt stock by sector



Source: Bank for International Settlements (BIS)

Corporate debt is unusually high for China's level of development

Corporate debt vs. GDP per capita (2016)



Source: BIS, IHS Markit

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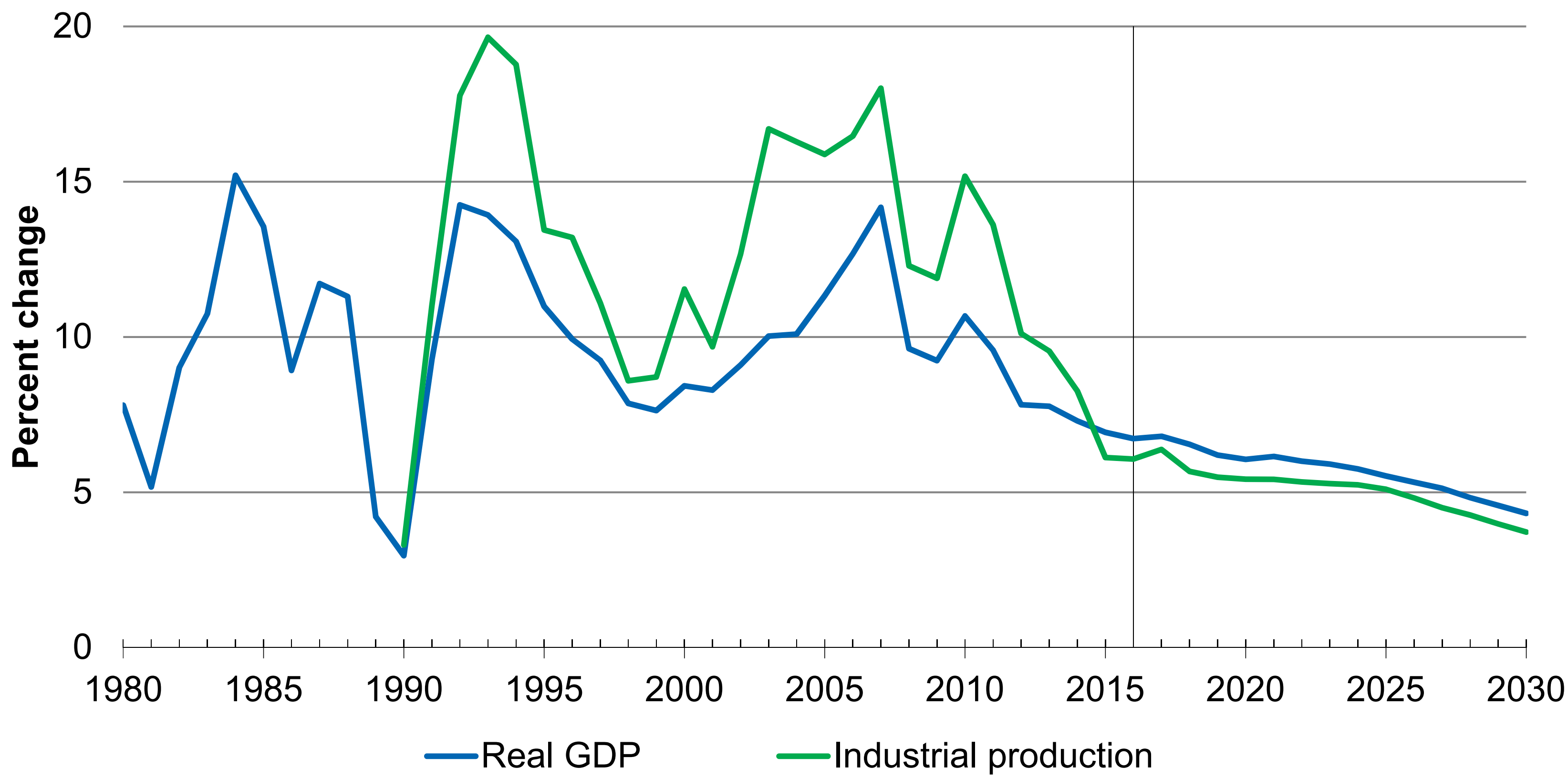
China's economic growth will downshift in the long run

Real GDP and industrial production



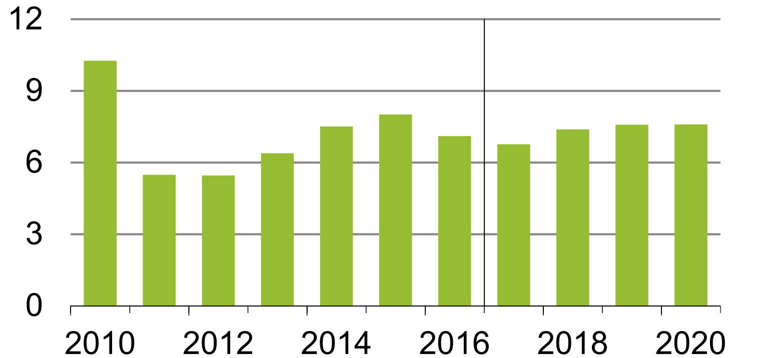
Source: IHS Markit

India’s economy has underperformed in 2017

- Real GDP growth slowed to a three-year low of 5.7% y/y in the April–June quarter as consumer spending growth eased and imports surged.
- The unified Goods and Services Tax (GST), introduced in July, is creating economic disruptions, especially for small businesses.
- By reducing double taxation and logistics costs, the GST should improve competitiveness and encourage foreign direct investment.
- Domestic demand growth remains uneven. Consumption growth is led by urban demand; investment is led mostly by public spending.
- With inflation picking up, no further interest rate cuts are expected. The next central bank move will be a rate hike in mid-2018.
- Policy reforms will slowly move forward. Much remains to be done to open markets, upgrade infrastructure, and raise productivity.

India outlook summary

Real GDP growth (%, fiscal years)



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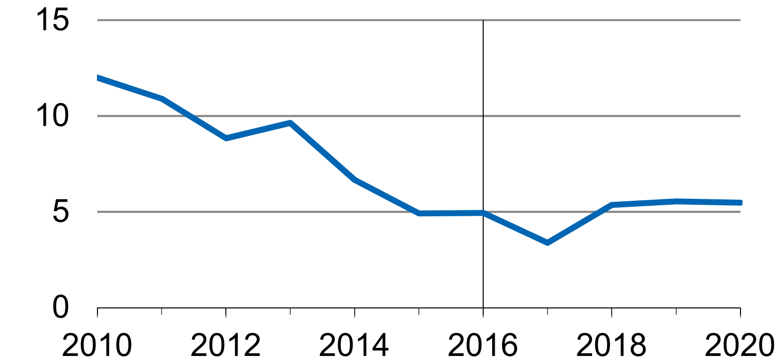
Consumer price inflation (%)



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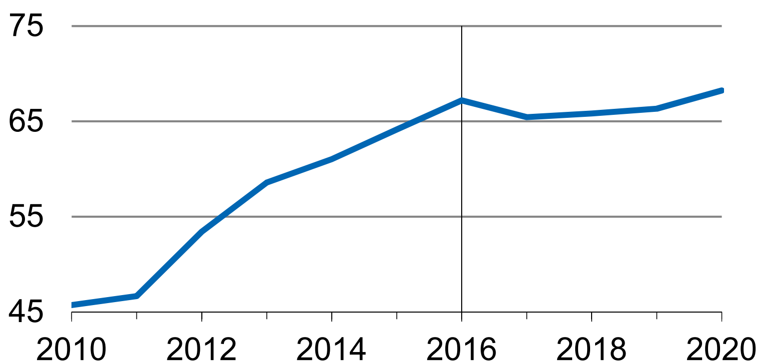
Exchange rate per US dollar*



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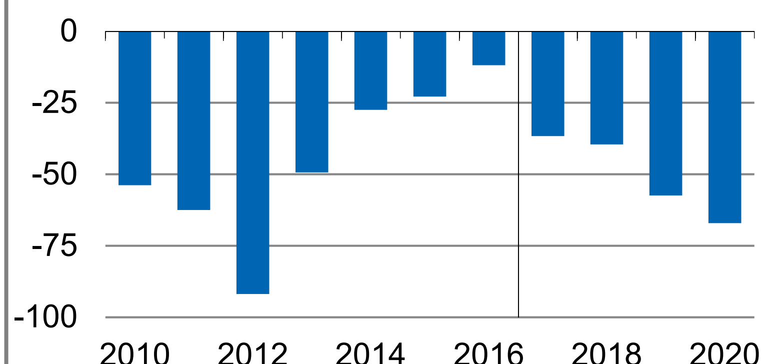
Current-account balance**



Source: IHS Markit © 2017 IHS Markit

*Annual average, **Billions of US dollars

India's business climate is difficult

- Infrastructure: Remains inadequate, despite a surge in funding
- Corruption: Highly entrenched, especially at the state and local levels, despite a relatively independent judiciary
- Red tape and regulatory morass: A legacy of past regimes
- Inflation: Protectionism, poor infrastructure, and price controls
- Access to finance: Banking system held back by dominance of inefficient state-owned banks; asset quality has deteriorated
- Taxes: Highly inefficient, burdensome, and a source of corruption
- Poor education: Education system is inefficient, despite the presence of excellent elite schools

Forces that restrained emerging markets' growth and conditions leading to improved performance

Restraints on growth

- Excess capacity after investment booms
- Slowdown in world trade
- Low commodity prices
- Capital flight and downward pressure on currencies
- Debt accumulation

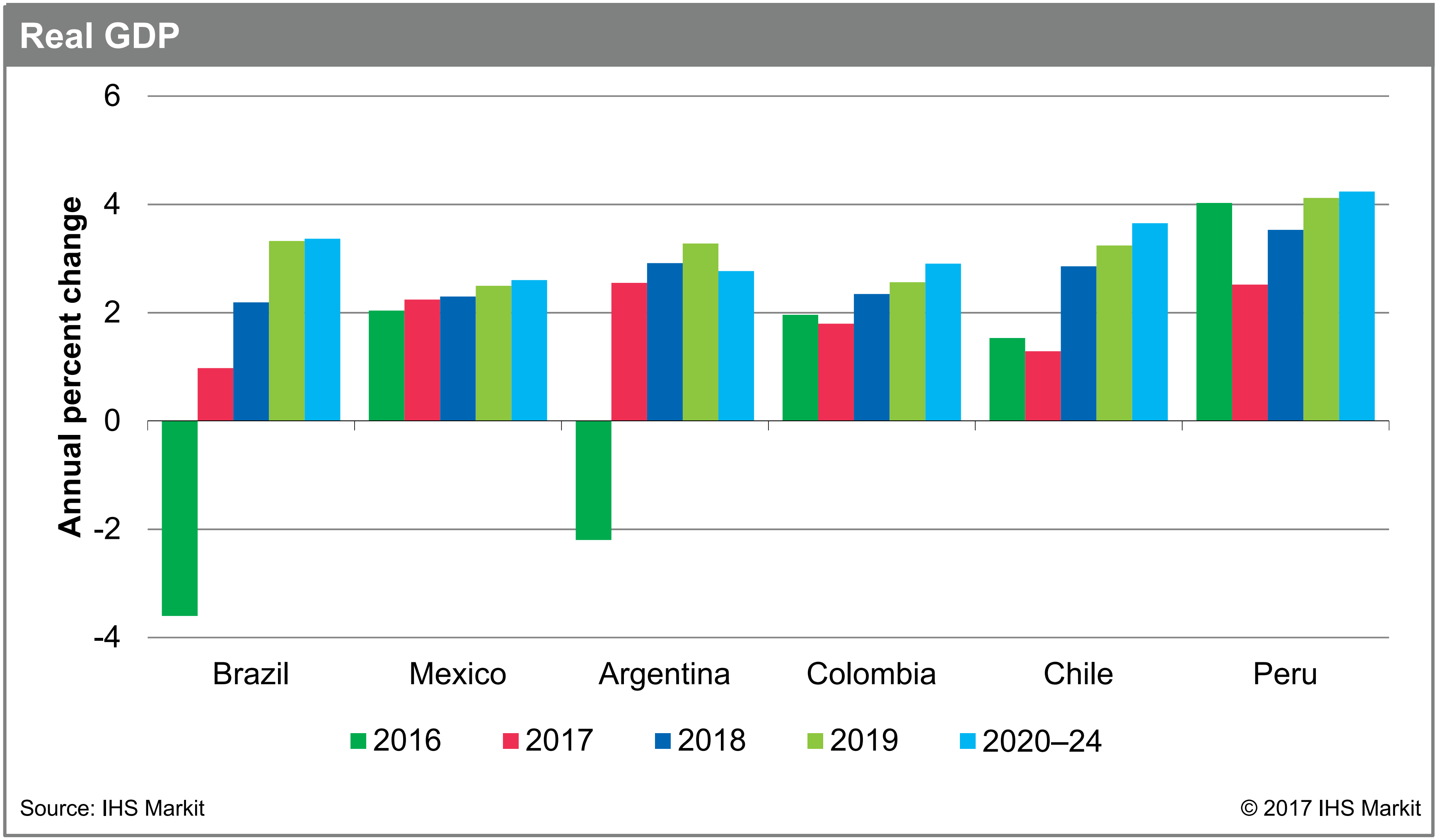
Turnaround conditions

- Rising consumer demand
- Strengthening exports
- Recoveries in commodity prices and stock markets
- Return of risk capital
- Market and fiscal reforms to improve resource allocation

Economic performance varies across Latin America

- After two years of contraction, the region's economy has stabilized.
- Brazil is beginning a slow recovery, helped by lower inflation and interest rates, together with reduced political turmoil.
- Mexico's growth has been sluggish, and uncertainty about NAFTA is hurting investment.
- Peru, Colombia, and Chile will benefit from sound fiscal and monetary policies, trade alliances, and a rise in commodity export revenues.
- In Argentina, President Macri's reforms are creating a better investment climate, although inflation and fiscal deficits remain uncomfortably high.
- Venezuela is in a downward spiral. The new constituent assembly poses further regulatory, expropriation, and tax risks for businesses.
- The region's long-term challenges include inadequate infrastructure, restrictive business environments, and income inequality.

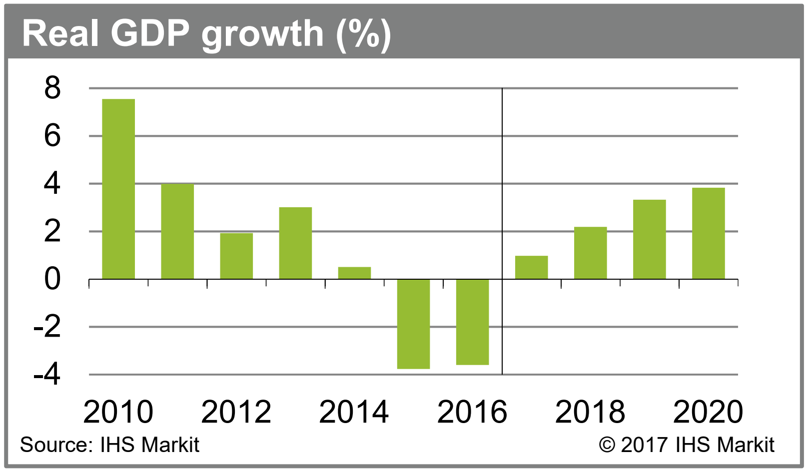
Real GDP growth in Latin America

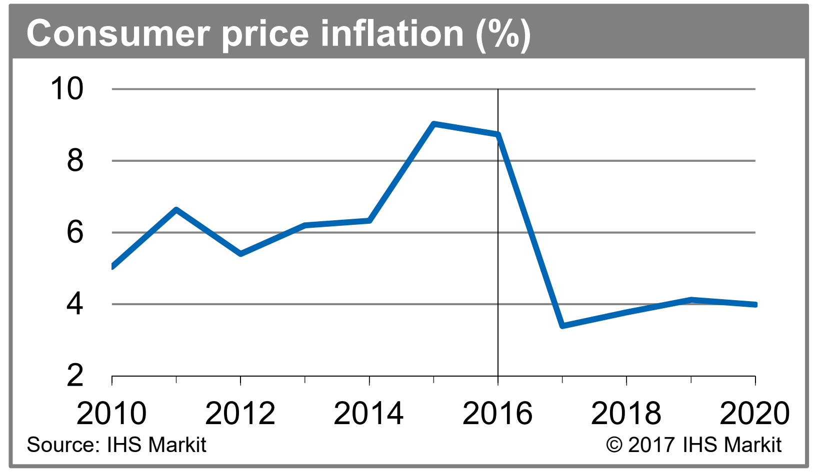


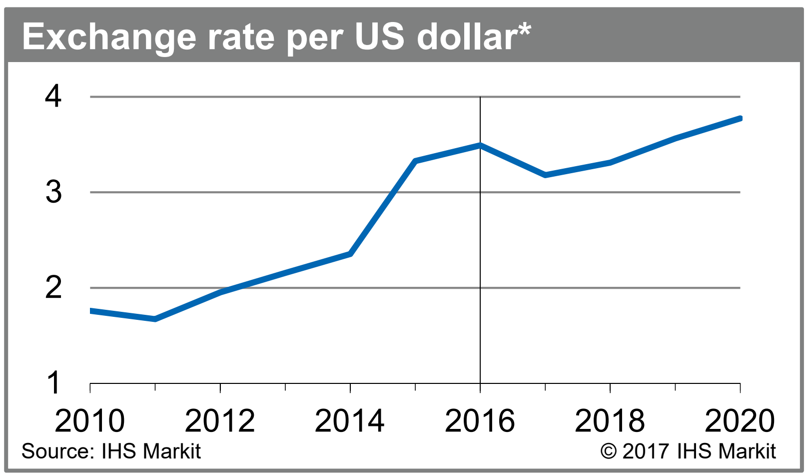
Brazil's economy is stabilizing

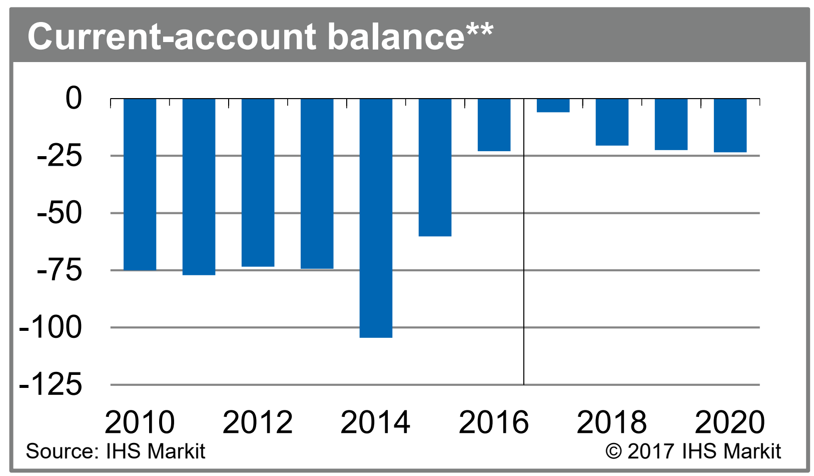
- Real GDP increased modestly in the second quarter as a strong acceleration in consumer spending and rising net exports were offset by declines in investment and government spending.
- President Temer will likely remain in office through 2018 and may be able to pass legislation to fix public finances; a key test will be pension reforms.
- Consumer price inflation eased to 2.5% year on year (y/y) in September. Mild inflation leaves room for more interest rate cuts.
- Investment will drive the recovery: firms need to replace equipment and restock inventories. Consumers are deleveraging after a 2007–14 credit boom.
- Surging exports of vehicles (mainly to Argentina) have fueled a rebound in automotive production. Agricultural production has also risen sharply this year.
- High taxation, local-content regulations, administered prices, and infrastructure bottlenecks continue to hurt competitiveness.

Brazil outlook summary









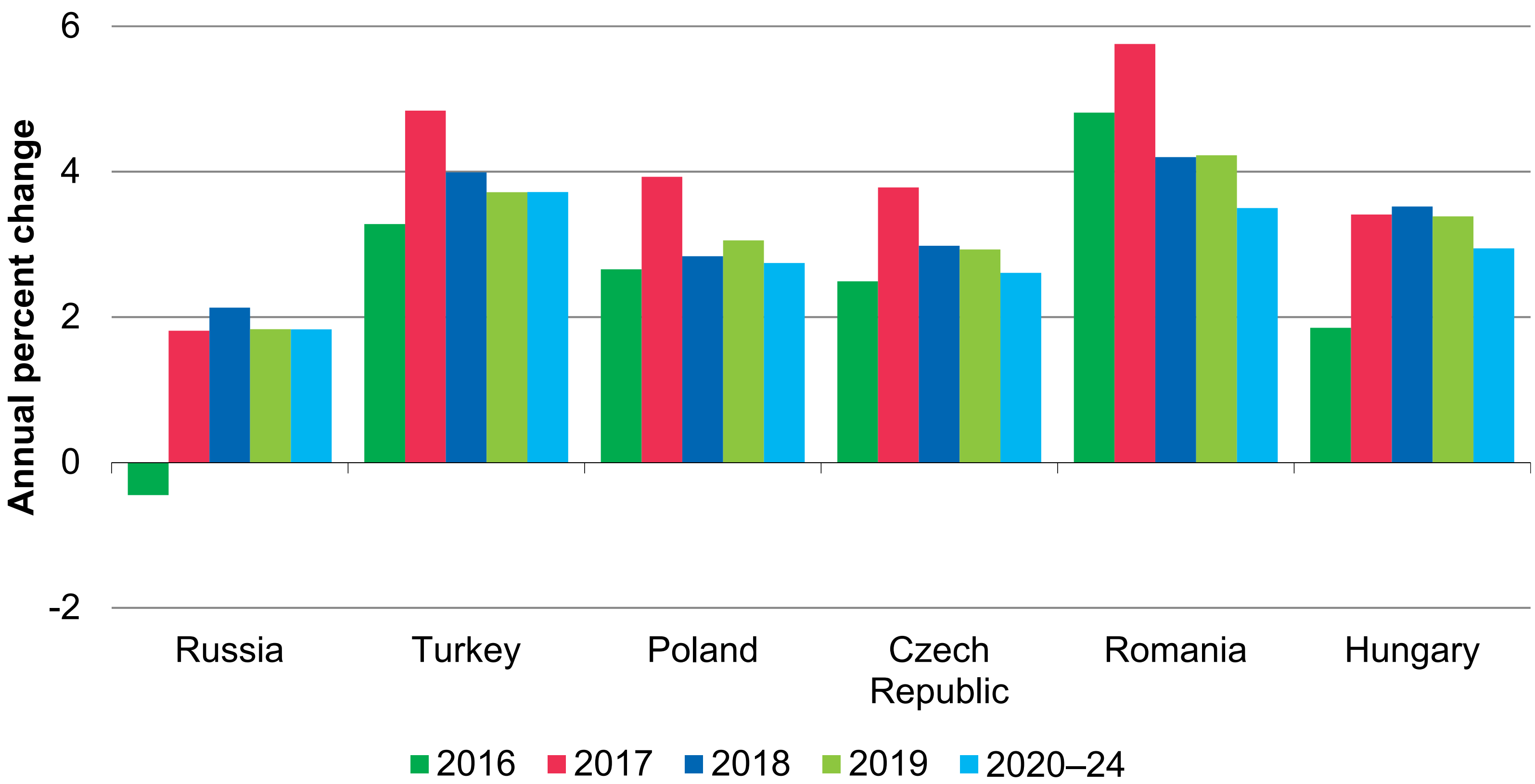
*Annual average, **Billions of US dollars

Emerging Europe: Varying risks and growth prospects

- Adverse demographic trends, including labor shortages in several countries, will restrain growth in emerging Europe.
- Turkey's expansionary policies are fueling economic growth and inflation but raising risks of destabilization.
- Poland's economy is accelerating in 2017, led by a revival in fixed investment and steady growth in consumer and government spending.
- With their well-educated workforces and low risk profiles, the Czech Republic and Slovakia are attractive investment destinations.
- Russia's economy is gradually recovering, but domestic demand remains weak. The central bank is lowering interest rates.
- Ukraine's economy resumed growth in 2016, but the ongoing conflict with pro-Russian separatists in east Ukraine limits near-term potential.

Real GDP growth in Emerging Europe

Real GDP



Source: IHS Markit

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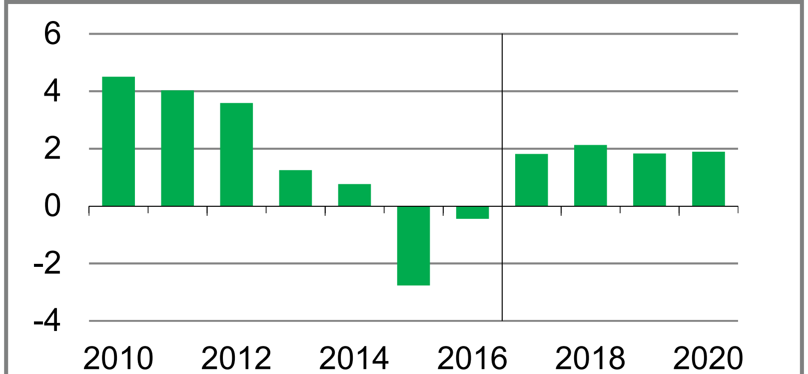
Russia's economy is recovering but still fragile

- Russian economic growth will be restrained in the near term as domestic demand only gradually recovers.
- With the rouble appreciating, consumer price inflation has eased.
- The central bank cut its policy rate by 50 basis points, to 8.50%, in mid-September. We expect further cuts to 6.50% by mid-2019.
- As real interest rates decline and demand revives, investment will begin to rebound later this year.
- The economy will be boosted in 2018 by World Cup–related investment and tourism and social spending ahead of the presidential election.
- US sanctions targeting Russia's lucrative energy infrastructure projects in Europe pose a downside risk to the medium-term forecast.
- Unfavorable demographics, outmoded manufacturing capacity, and an overburdened infrastructure will limit long-term growth.

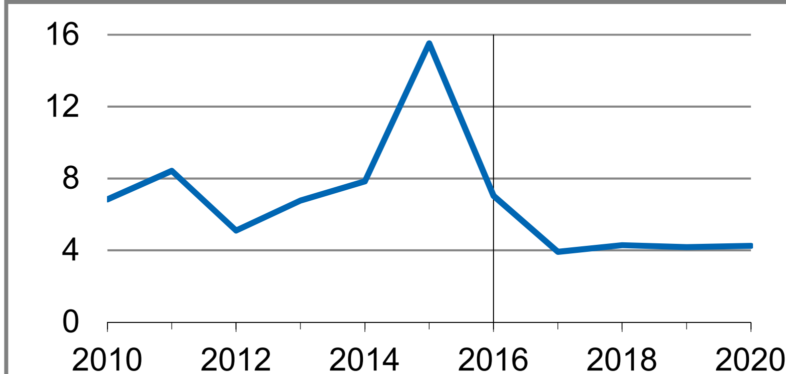
Russia outlook summary

Real GDP growth (%)



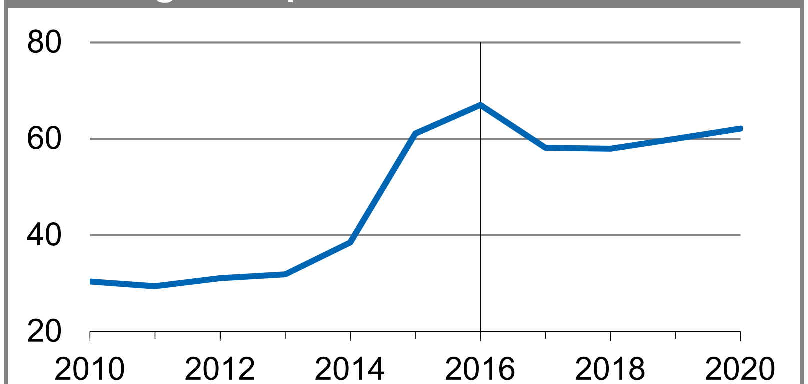
Source: IHS Markit © 2017 IHS Markit

Consumer price inflation (%)



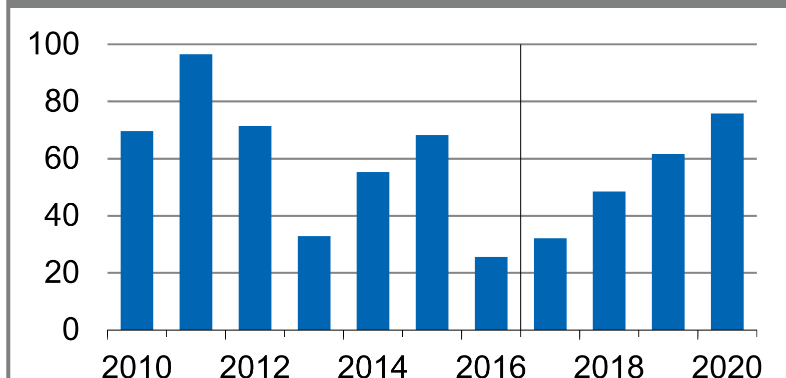
Source: IHS Markit © 2017 IHS Markit

Exchange rate per US dollar*



Source: IHS Markit © 2017 IHS Markit

Current-account balance**



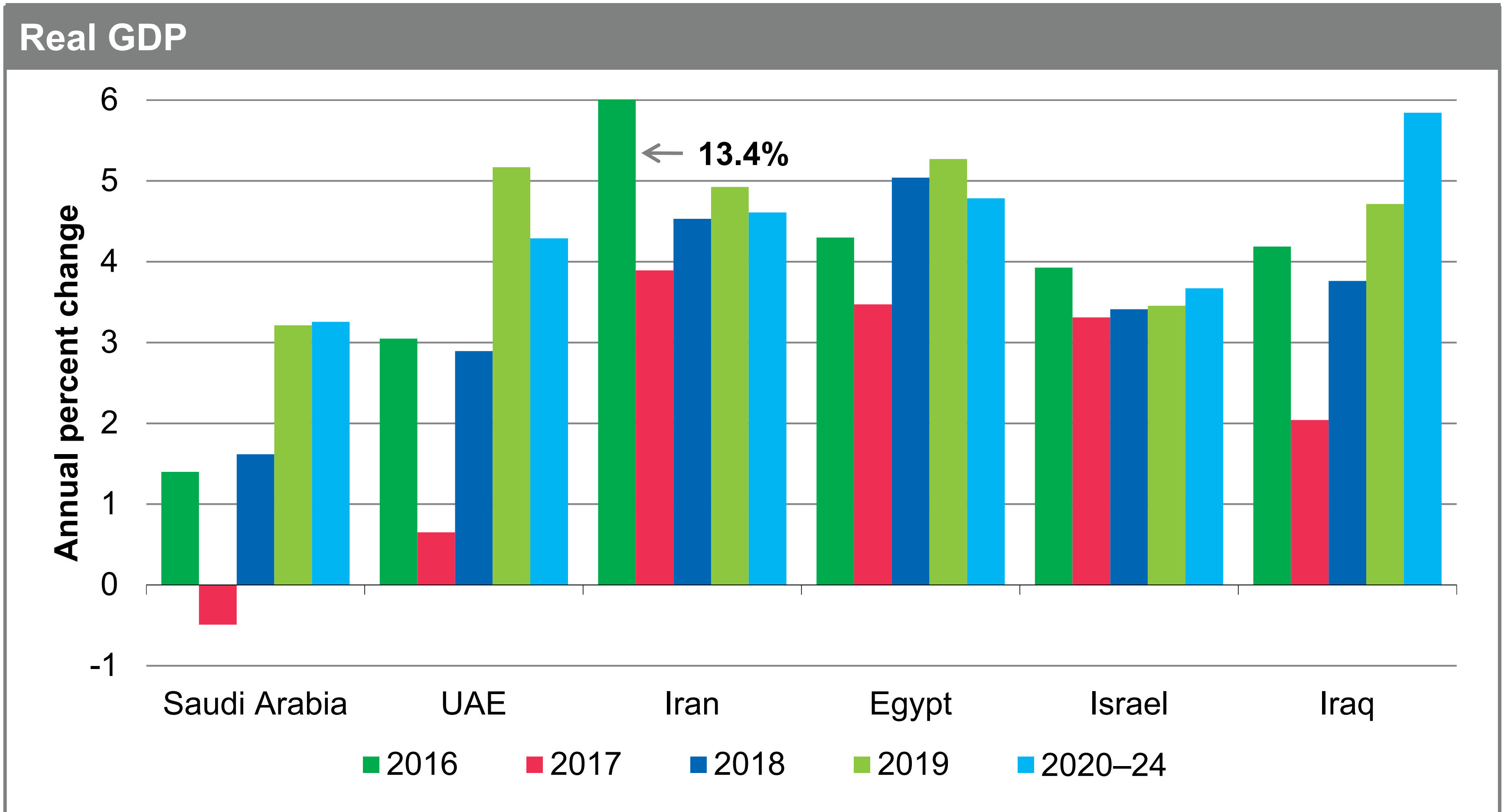
Source: IHS Markit © 2017 IHS Markit

*Annual average, **Billions of US dollars

The Middle East and North Africa

- Low oil prices, fiscal tightening, and regional political instability have hurt growth, causing a mild recession in Saudi Arabia.
- Saudi Arabia, Kuwait, the United Arab Emirates, and Qatar have restrained oil production, consistent with OPEC’s supply agreement.
- Saudi Arabia’s nonoil growth will strengthen in the medium term with a pickup in infrastructure and development projects.
- The region shifted from current-account surpluses to deficits in 2015; a return to surplus is expected by 2019 as oil prices recover.
- Most of the six Gulf Cooperation Council (GCC) countries will follow the Federal Reserve’s interest rate moves, since all except Kuwait peg their currencies to the US dollar.
- Addressing job growth, economic diversification, and competitiveness will be critical to regional stability in the long run.

Real GDP growth in the Middle East and North Africa



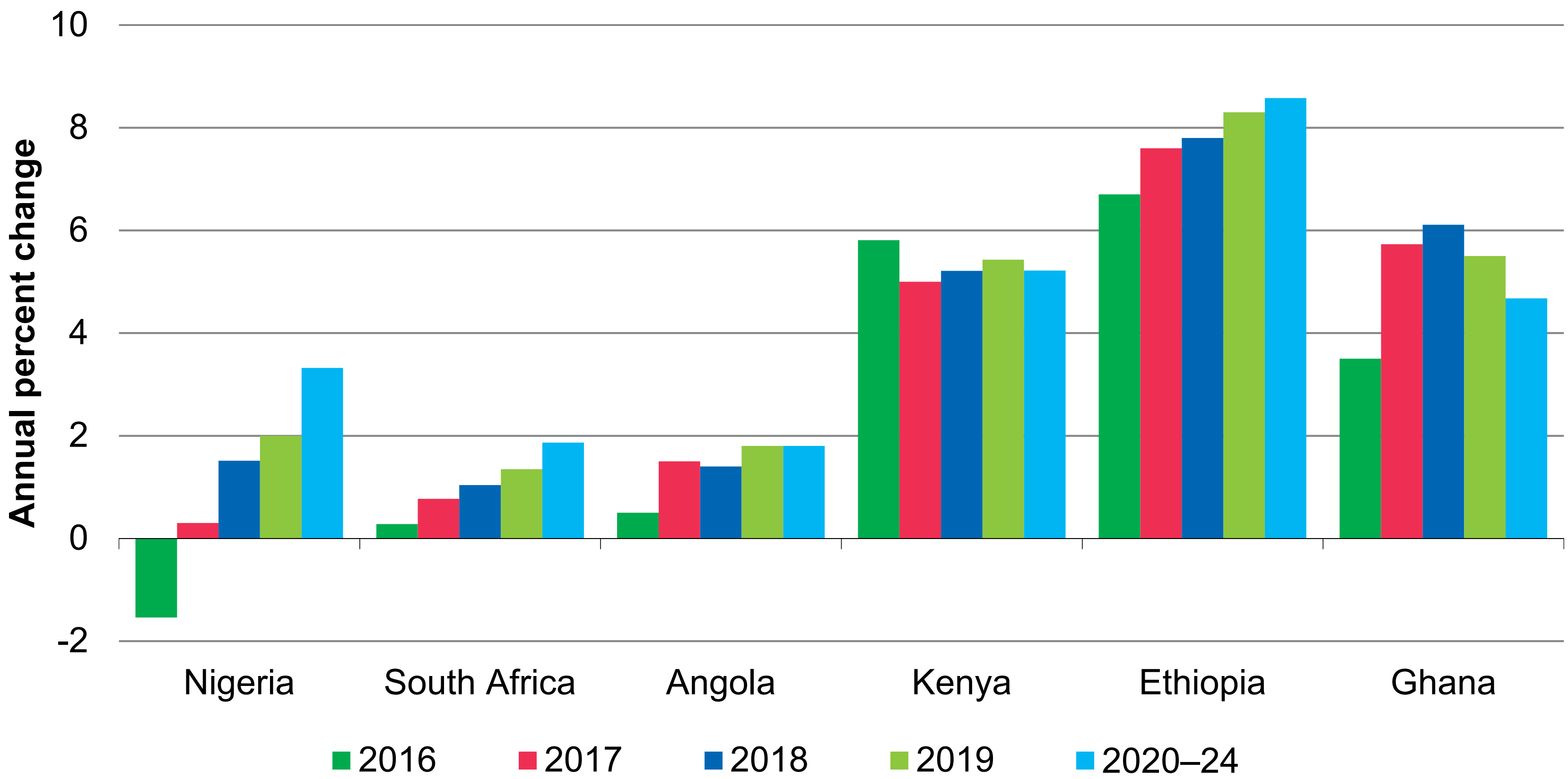
Source: IHS Markit

Sub-Saharan Africa depends on commodity exports

- Firmer commodity prices and rising exports will help boost growth.
- Nigeria will emerge from recession, but foreign-exchange scarcity, high inflation, and dampened capital inflows will restrain growth.
- South Africa's growth is limited by an insufficient electricity supply, deteriorating business environment, and inflexible labor market.
- Poor infrastructure, political instability, and corruption remain obstacles to regional economic development.
- In the long run, expanding domestic markets, growing middle-class populations, and regional integration will support economic growth.
- Several countries have strong growth prospects, including Ethiopia, Kenya, Mozambique, Tanzania, and Uganda.

Real GDP growth in Sub-Saharan Africa

Real GDP



Source: IHS Markit

What could darken this bright picture?

- The average duration of an expansion does not tell us much—and neither does low unemployment
- The usual suspects are low-level threats for the moment…
  - Monetary (over) tightening
  - Oil shocks
  - Bursting asset bubbles
- …and not all shocks cause recessions…
- …but policy mistakes are possibly the biggest threat now
  - A central bank mistake
  - Fiscal debacle
  - Trade war
  - Mismanaged China debt crisis
- Geopolitical threats (North Korea, Syria, Ukraine, etc.) are low probability but potentially high-impact events
- Bottom line: Left to its own devices, the global expansion could go on for another couple of years—breaking the longevity record

Risks to the global economy

Risk	Signposts
China hard landing	• Loan defaults by developers and local governments trigger a banking crisis and a credit squeeze. • Declines in asset prices hit consumer spending. • The government responds with only limited fiscal stimulus.
European setback	• The Brexit process proves difficult for the United Kingdom. • Greece defaults on its debt and exits the Eurozone. • Banking problems intensify, reducing credit availability. • More terrorist attacks undermine confidence.
Wars in Middle East and North Africa	• Conflicts in the Middle East and North Africa escalate. • Saudi Arabia and Egypt are destabilized. • Oil production and transportation are disrupted. The Strait of Hormuz is temporarily closed, causing a surge in oil prices. • An influx of refugees to Europe causes social unrest.
Stalled US recovery	• Businesses and households spend more cautiously. • Rising interest rates and supply constraints restrain homebuilding. • Trade wars lead to higher inflation and reduced exports.

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