GLOBAL VIEWS

SECURE ASSET MANAGEMENT
LIMITED

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As we head into the new year, there are factors that are bound to have a substantial impact on the path of the global economy. Among these are the decisions that will be made by the US Federal Reserve, the European Central Bank, the Bank of Japan, the People's Bank of China, and the petroleum authorities of Saudi Arabia. Policy decisions by these and other governments, including those of the big emerging markets, will affect the path of exchange rates, commodity prices, inflation, and, ultimately, economic growth.

For now, the world seems to be characterized by relatively strong growth in the United States, disappointing but improving growth in Europe and Japan, slowing growth in China, and weakness in many other emerging markets—the one big exception being India, where growth is actually quite impressive. The world is also characterized by very low inflation in the developed world, strengthening consumer spending in oil-importing countries, rising private sector debt in emerging countries, and weak business investment almost everywhere.

Recent Developments

In 2015, global economic activity remained subdued. Growth in emerging market and developing economies—while still accounting for over 70 percent of global growth—declined for the fifth consecutive year, while a modest recovery continued in advanced economies. Three key transitions continue to influence the global outlook: (1) the gradual slowdown and rebalancing of economic activity in China away from investment and manufacturing toward consumption and services, (2) lower prices for energy and other commodities, and (3) a gradual tightening in monetary policy in the United States in the context of a resilient U.S. recovery as several other major advanced economy central banks continue to ease monetary policy.

Oil prices have declined markedly since September 2015, reflecting expectations of sustained increases in production by Organization of the Petroleum Exporting Countries (OPEC) members amid continued global oil production in excess of oil consumption.[1] Futures markets are currently suggesting only modest increases in prices in 2016 and 2017. Prices of other commodities, especially metals, have fallen as well.

Monetary easing in the euro area and Japan is proceeding broadly as previously envisaged, while in December 2015 the U.S. Federal Reserve lifted the federal funds rate from the zero lower bound. Overall, financial conditions within advanced economies remain very accommodative. Prospects of a gradual increase in policy interest rates in the United States as well as bouts of financial volatility amid concerns about emerging market growth prospects have contributed to tighter external financial conditions, declining capital flows, and further currency depreciations in many emerging market economies.

Headline inflation has broadly moved sideways in most countries, but with renewed declines in commodity prices and weakness in global manufacturing weighing on traded goods' prices it is likely to soften again. Core inflation rates remain well below inflation objectives in advanced economies. Mixed inflation developments in emerging market economies reflect the conflicting implications of weak domestic demand and lower commodity prices versus marked currency depreciations over the past year.

The Updated Forecast

Global growth is projected at 3.4 percent in 2016 and 3.6 percent in 2017.

Advanced Economies

Growth in advanced economies is projected to rise by 0.2 percentage point in 2016 to 2.1 percent, and hold steady in 2017. Overall activity remains resilient in the United States, supported by still-easy financial conditions and strengthening housing and labor markets, but with dollar strength weighing on manufacturing activity and lower oil prices curtailing investment in mining structures and equipment. In the euro area, stronger private consumption supported by lower oil prices and easy financial conditions is outweighing a weakening in net exports. Growth in Japan is also expected to firm in 2016, on the back of fiscal support, lower oil prices, accommodative financial conditions, and rising incomes.

Emerging Market and Developing Economies

Growth in emerging market and developing economies is projected to increase from 4 percent in 2015—the lowest since the 2008-09financial crisis—to 4.3 and 4.7 percent in 2016 and 2017, respectively.

- Growth in China is expected to slow to 6.3 percent in 2016 and 6.0 percent in 2017, primarily reflecting weaker investment growth as the economy continues to rebalance. India and the rest of emerging Asia are generally projected to continue growing at a robust pace, although with some countries facing strong headwinds from China's economic rebalancing and global manufacturing weakness.

- Aggregate GDP in Latin America and the Caribbean is now projected to contract in 2016 as well, albeit at a smaller rate than in 2015, despite positive growth in most countries in the region. This reflects the recession in Brazil and other countries in economic distress.

- Higher growth is projected for the Middle East, but lower oil prices, and in some cases geopolitical tensions and domestic strife, continue to weigh on the outlook.

- Emerging Europe is projected to continue growing at a broadly steady pace, albeit with some slowing in 2016. Russia, which continues to adjust to low oil prices and Western sanctions, is expected to remain in recession in 2016. Other economies of the Commonwealth of Independent States are caught in the slipstream of Russia's recession and geopolitical tensions, and in some cases affected by domestic structural weaknesses and low oil prices; they are projected to expand only modestly in 2016 but gather speed in 2017.

- Most countries in sub-Saharan Africa will see a gradual pickup in growth, but with lower commodity prices, to rates that are lower than those seen over the past decade. This mainly reflects the continued adjustment to lower commodity prices and higher borrowing costs, which are weighing heavily on some of the region's largest economies (Angola, Nigeria, and South Africa) as well as a number of smaller commodity exporters.

Forecast Revisions

Overall, forecasts for global growth have been revised downward by 0.2 percentage point for both 2016 and 2017. These revisions reflect to a substantial degree, but not exclusively, a weaker pickup in emerging economies than was forecast in October. In terms of the country composition, the revisions are largely accounted for by Brazil, where the recession caused by political uncertainty amid continued fallout from the Petrobras investigation is proving to be deeper and more protracted than previously expected; the Middle East, where prospects are hurt by lower oil prices; and the United States, where growth momentum is now expected to hold steady rather than gather further steam. Prospects for global trade growth have also been marked down by more than ½ percentage point for 2016 and 2017, reflecting developments in China as well as distressed economies.

Risks to the Forecast

Unless the key transitions in the world economy are successfully navigated, global growth could be derailed. Downside risks, which are particularly prominent for emerging market and developing economies, include the following:

- A sharper-than-expected slowdown along China's needed transition to more balanced growth, with more international spillovers through trade, commodity prices, and confidence, with attendant effects on global financial markets and currency valuations.

- Adverse corporate balance sheet effects and funding challenges related to potential further dollar appreciation and tighter global financing conditions as the United States exits from extraordinarily accommodative monetary policy.

- A sudden rise in global risk aversion, regardless of the trigger, leading to sharp further depreciations and possible financial strains in vulnerable emerging market economies. Indeed, in an environment of higher risk aversion and market volatility, even idiosyncratic shocks in a relatively large emerging market or developing economy could generate broader contagion effects.

- An escalation of ongoing geopolitical tensions in a number of regions affecting confidence and disrupting global trade, financial, and tourism flows.

Commodity markets pose two-sided risks. On the downside, further declines in commodity prices would worsen the outlook for already-fragile commodity producers, and increasing yields on energy sector debt threaten a broader tightening of credit conditions. On the upside, the recent decline in oil prices may provide a stronger boost to demand in oil importers than currently envisaged, including through consumers' possible perception that prices will remain lower for longer.