Global Economic Growth to Perk up in Mid-2013

The following forecast was released December 12

The new year will begin with heavy clouds suspended over much of the global economy, but with the prospect of brightening later in 2013.

Uncertainty over the "fiscal cliff" will weigh on U.S. growth in the short-term, but assuming this hurdle is safely negotiated, confidence should improve next year. By mid-2013 stimulus should also more visibly be boosting China's economy, and even the euro zone should be growing again.

The Economist Intelligence Unit's latest global forecast—largely unchanged from last month—is therefore for a limited pick-up in Gross Domestic Product growth next year, with improvements in key economies setting the stage for a stronger recovery in 2014.

World GDP will grow by an estimated 3.4% at purchasing power parity (PPP) exchange rates in 2013. This will mark a slight improvement on growth of around 3% this year, but is nonetheless extremely disappointing at this stage in the economic cycle. Operating conditions remain difficult, and in some respects the outlook has deteriorated in the past several months.

Our current 2013 growth forecast is a half-percentage point lower than projected in April, for example. This reflects not only weakness in the euro zone but also repeated downgrades in our forecasts for Brazil and India.

FISCAL CLIFF, EUROPE DEBT REMAIN CONCERNS

The U.S. fiscal cliff, the never-ending crisis in the euro zone and the recent slowdown in China are the main areas of concern for global growth. On all three fronts, however, there are some grounds for encouragement.

In the U.S., the big question is whether Republicans and Democrats can reach a deal to limit tax rises and public spending cuts that are scheduled to take effect January 1. If they fail to do so, a sharp fiscal contraction is in prospect, which would send the U.S. into recession. Although a comprehensive agreement on the long-term U.S. fiscal problems looks unattainable, we expect lawmakers to patch together a last-minute deal of narrower scope to keep the economy on track in the short-term.

In the euro zone, the bad news is that austerity will remain a severe drag on economic activity in 2013. A lack of growth is making it harder for governments to meet the already unprecedented budgetary adjustments demanded of them by financial markets, and this is feeding a vicious cycle of fiscal contraction and economic decline.

A further concern is that the euro zone's strongest economy, Germany, hitherto relatively unscathed by the regional downturn, is showing some signs of weakness.

EURO ZONE RISKS EASING

The good news is that, while a solution to the currency union's structural problems has eluded policymakers, the short-term risks of a disorderly disintegration of the euro have eased. This is largely due to the readiness of the European Central Bank (ECB) to provide unlimited support for sovereign bond markets. We consider this by far the boldest action yet from the ECB, and a significant step in addressing the euro crisis.

China, meanwhile, appears poised to emerge next year from what has been a difficult period both economically and politically. Growth slowed to just 7.4% year-over-year in the third quarter as weak demand in Europe and America hit Chinese exports.

The run-up to the country's once-a-decade leadership transition was also blighted by scandal and apparent factional turmoil, although the changeover seems to have passed off smoothly so far. Stimulus initiated in response to the slowdown of mid-2012 will support investment and consumer spending in 2013.

All these factors point to a distinct growth trajectory for the global economy in 2013 and 2014. We expect data for many countries to be weak in the first quarter, arithmetically reducing the chance of strong global growth in 2013 as a whole. But improving momentum from mid-2013 will carry over into the following year, paving the way for acceleration in global GDP growth to almost 4% at PPP rates in 2014.

DEVELOPED WORLD

The U.S. economy continues to expand at a moderate but uneven pace. GDP growth picked up sharply in the third quarter, to 2.7% at an annual rate. But this reflected one-off boosts from defense spending and inventory building, which are unlikely to be sustained.

Moreover, uncertainty surrounding the fiscal cliff will weigh on business and household spending in the fourth quarter and into 2013. As a result, we forecast at least two quarters of subdued expansion, before a pick-up in growth from the second quarter of 2013 onwards. The Federal Reserve's monetary stimulus known as QE3 should also be in full effect by then and help to boost the economy. GDP growth will average 2.1% in 2013, accelerating to 2.3% a year in 2014-17.

The euro zone's recession continued in the third quarter and leading indicators point to a contraction in the fourth quarter as well. Growth prospects for 2013 remain grim, exacerbated by the fact that a number of governments expect to miss their fiscal targets for 2012 and must therefore budget for more austerity next year than originally anticipated.

We expect real GDP in the euro zone as a whole to contract by 0.2% in 2013. Recent ECB policy has contributed to a relative calm—albeit an uneasy one—in financial markets. However, the underlying risks to the viability of the single currency have not gone away. Social unrest and political instability, particularly in countries like Greece, are of increasing concern.

We keep our Japanese outlook unchanged this month, following last month's downward revisions to our growth forecast. Like other countries in Asia, Japan is suffering from a lack of external demand. Domestic demand is also weak, and there was a sharp contraction in GDP in the third quarter of 2012.

The external environment should improve somewhat in 2013, but not enough to compensate for the end of post-tsunami reconstruction and for structural demographic and deflationary pressures. Real GDP growth will average a subdued 1% a year in 2013-17. A likely new government after the general election December 16 may promote more aggressive monetary easing, however.

EMERGING MARKETS

Emerging Asia, like most other regions, has been suffering from the effects of sluggish demand in the West. The region's two largest economies, China and India, have both decelerated. China's slowdown, in particular, has had ramifications for other countries given its size and role as a catalyst of regional and global growth.

But the tide may be turning. Data for Chinese industrial production, retail sales, fixed investment and lending have all improved. We therefore expect GDP growth to pick up to something close to 9% by the second and third quarters of next year. In 2013 as a whole, Chinese GDP will expand an estimated 8.5%.

The troubles in the euro zone continue to overshadow economic prospects in Eastern Europe. The transition economies are also struggling with anemic domestic demand, partly as result of their own austerity programs. Our outlook this month is broadly unchanged. Growth in the region will average 2.6% in 2013. Stronger growth rates from 2014 onwards will still be slow by pre-crisis standards.

Latin American growth has weakened markedly in the past two years. Activity has been adversely affected by the turmoil in the euro zone, the slowdown in China and the sluggish performance of the U.S. economy. Recent data on Brazil have been poor, and we now expect its economy to expand by no more than 1% this year and by just 3.5% in 2013. Brazil is also being held back by weak investment and lagging competitiveness.

Our downgrade of Brazil, Latin America's largest economy, has negative implications for regional growth: We now expect Latin American GDP to expand by 3.6% in 2013, down from nearly 4% in our previous forecast.

A further contraction in Iran's economy will constrain economic growth in the Middle East and North Africa in 2013. We expect Iranian oil production to slip again next year; sanctions are also hampering non-oil economic activity. However, high oil prices and expansionary fiscal policies will sustain strong rates of growth in Saudi Arabia and the Gulf states. Regional growth will average only about 3.5% next year, but will pick up in 2014-17 thanks to rising oil and gas output and large infrastructure projects.

In Sub-Saharan Africa, global economic developments are the main threat to growth. South Africa, the region's largest economy, will see sluggish growth of 3.1% next year. Although an improvement on 2012, it will not be enough to significantly reduce very high unemployment. Regional GDP growth will accelerate to 4.6% next year, however, and the longer-term outlook for Sub-Saharan Africa remains positive.

EXCHANGE RATES

We have adjusted our U.S.-dollar exchange-rate forecast this month, and now expect the greenback to be slightly weaker against the euro in 2013, at $1.29, than we previously anticipated.

Even though U.S. economic fundamentals are improving, political uncertainty over the fiscal cliff in the short run and over broader tax and investment policy in the next year will cap any upward move by the dollar. We also expect, as 2013 progresses, to see generally better global economic growth. This may encourage investors to shift money out of the dollar and into riskier assets.

COMMODITIES

Commodity prices rose strongly in the third quarter as markets responded positively to U.S. quantitative easing, the intensification of efforts to save the euro and announcements of more Chinese stimulus.

Since then, however, prices have struggled to maintain their gains and in some cases have fallen back to where they were prior to the summer run-up. Prices now appear to be in holding mode, waiting for signs that policy easing and improving data (at least out of China) will either have a positive impact on physical demand or will lead to greater investor interest in commodities.

Oil prices rebounded strongly between mid-June and mid-September, before slipping to just under $110 a barrel in the first week in December. The market is being pulled in different directions by heightened political risk, weak European economic data and concerns about the U.S. fiscal cliff.

Based on our estimates of market fundamentals and the subdued outlook for global growth, the oil market will be in comfortable surplus in 2013, and we expect prices to weaken. Based on dated Brent blends, oil will cost an average of $103.80 a barrel next year, down from around $112 in 2012.

WORLD ECONOMY: FORECAST SUMMARY

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP growth (%)										
World (PPP exchange rates) [a]	2.4	-0.8	5.0	3.8	3.0	3.4	3.9	4.1	4.0	4.2
World (market exchange rates)	1.3	-2.3	3.9	2.5	2.1	2.3	2.8	2.8	2.9	2.9
US	-0.3	-3.1	2.4	1.8	2.2	2.1	2.3	2.3	2.4	2.4
Japan	-1.1	-5.5	4.6	-0.7	1.7	0.6	1.5	1.2	0.9	0.9
Euro area	0.2	-4.3	1.9	1.5	-0.5	-0.2	1.1	1.2	1.4	1.1
China	9.6	9.2	10.4	9.3	7.7	8.5	7.9	7.7	7.3	7.8
Eastern Europe	4.5	-5.6	3.4	3.8	2.6	2.6	3.3	3.7	3.8	4.2
Asia & Australasia (excl Japan)	5.5	5.0	8.4	6.5	5.5	6.2	6.4	6.4	6.2	6.4
Latin America	3.9	-1.9	6.0	4.3	3.1	3.6	4.0	3.8	3.9	4.0
Middle East & North Africa	4.4	1.3	5.3	2.2	3.6	3.5	4.4	4.7	5.1	5.1
Sub-Saharan Africa	4.8	1.2	4.4	4.4	3.9	4.6	5.0	5.0	5.4	5.7
World inflation (%; av)	4.5	1.5	3.0	4.2	3.5	3.5	3.4	3.3	3.2	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
Commodity prices										
Oil (US$/barrel; Brent)	97.7	61.9	79.6	110.9	111.9	103.8	104.5	107.3	110.0	115.0
Industrial raw materials (US$; % change)	-5.3	-25.7	45.4	21.1	-19.8	5.1	6.1	-0.2	2.8	2.4
Food, feedstuffs & beverages (US$; % change)	28.1	-20.3	10.7	30.1	-3.4	-1.9	-5.6	-0.4	1.1	1.5
Exchange rates (annual av)										
¥:US$	103.4	93.6	87.8	79.8	79.9	82.6	86.7	89.0	92.2	91.4
US$:€	1.47	1.39	1.33	1.39	1.28	1.29	1.27	1.24	1.26	1.26

[a] PPP = purchasing power parity

Source: Economist Intelligence Unit.