The Economist Intelligence Unit

World economy: EIU global forecast – On course for a mid-year recovery

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FROM THE ECONOMIST INTELLIGENCE UNIT

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The new year has begun with improving fundamentals in many economies, supported by a heavy dose of policy stimulus. The euro crisis is less acute, investors are more adventurous and the industrial cycle is beginning to turn upwards in bellwether emerging markets. As a result, the outlook for global growth is improving. Gains will take some months to materialise, given the overhang from problems in 2012, but there should be a noticeable acceleration in economic activity from mid-2013. The Economist Intelligence Unit's overall forecast is little changed from a month ago, with the exception of our forecasts for Japan.

We forecast that world GDP will grow by 3.3% at purchasing power parity (PPP) exchange rates in 2013, equivalent to growth of 2.3% at market exchange rates. This is better than last year, although still exceptionally weak at such an advanced stage in an economic recovery. Many countries are still carrying the economic baggage of the 2008-09 global crisis. A number of other factors—most obviously, austerity and recession in the euro zone, and a slowdown in China—have weighed on growth in the past year.

This apparently subdued picture masks more positive underlying developments. We expect first-quarter data to be weak in many economies, which arithmetically reduces the chances of strong full-year growth. But trading conditions are improving or poised to do so in many countries. For example, in the US the investment- and consumption-dampening effects of fiscal negotiations should be mostly over by mid-year, and recoveries in the labour and housing markets better established. As a result, we expect US growth to average about 3% in the second half of 2013. China, which slowed markedly during 2012, should once again be achieving growth rates of close to 9% by the second and third quarters of 2013 as government stimulus kicks in. Even the beleaguered euro zone will be growing again (if only just) by the second half of the year.

A new addition to this picture of improvement is the prospect of stronger-than-expected Japanese growth. This is thanks to a new government that is committed to more aggressive stimulus. Shinzo Abe became prime minister in late December for a second time, after a brief, ill-fated stint in 2006-07. He has wasted no time in unveiling a US$122bn spending package aimed at reviving growth. He is also plainly determined to push the Bank of Japan

(BOJ) towards much looser monetary policy.

Should the 2013 recovery materialise as we forecast, this would set the stage for faster global growth (in the region of 4% at PPP rates) in 2014 and 2015. However, there remain a number of risks that could undermine any recovery well before then. Although the US narrowly averted the "fiscal cliff" at end-2012, a new debt and budget showdown awaits. In late February and early March the president, Barack Obama, and the Congress must negotiate a mandatory package of spending cuts, while also agreeing to an increase in the federal government's borrowing authority (the "debt ceiling"). This could create considerable uncertainty for businesses and significant turbulence in financial markets. At the same time, the debt crisis in the euro zone continues to endanger financial stability and weigh on global growth. A commitment by the European Central Bank (ECB) to potentially unlimited intervention in sovereign bond markets has calmed markets, but it is no panacea. Efforts to craft a long-term solution to the euro's design flaws, in part through greater fiscal and regulatory integration, remain a work in progress. Euro member governments are still prone to feuding over the terms of support for stressed economies. Political instability, fuelled by popular resentment of austerity, is also increasingly a complicating factor.

Developed world

Notwithstanding the problems posed by a fractious political climate, many of the US economy's fundamentals are improving. The long-moribund US housing market is on the mend, and the unemployment rate is at its lowest level in four years. The economy appears to have shrugged off any ill-effects from the approach of the fiscal cliff at end-2012, despite our concerns about a possible impact on business and household spending. Assuming that policy catastrophe is avoided in forthcoming fiscal negotiations, we forecast a pick-up in GDP growth in the second half of 2013, supported by the Federal Reserve's monetary stimulus. Growth will average 2.1% this year, accelerating to 2.4% in 2014.

In Europe, the ECB's new (albeit unused) sovereign bond-buying programme has now provided the longest period of financial calm since the euro zone debt crisis began in late 2009. By contrast, the crisis continues in the real economy. Unemployment in the currency union as a whole reached a record high of almost 12% in November (the rate remains much higher in struggling peripheral member states). GDP is set to contract for a second successive year in 2013 as budgets are tightened to make up for missed fiscal targets in 2012. However, core economies such as Germany will show some resilience, and external demand should pick up after a soft 2012.

Japan had a general election on December 16th, the result of which could prove something of a watershed for the economy. The new prime minister has ambitious plans to revive the economy and put an end to deflation. These plans include public works spending as well as calls for the BOJ to raise its inflation target—in itself a relatively recent innovation in Japan—from 1% to 2% and to pursue unlimited quantitative easing. We estimate that growth in 2012 was a robust 1.8%, but this was inflated by statistical effects and post-tsunami reconstruction. In the light of the new economic stimulus package, announced on January 11th, we are provisionally raising our 2013 GDP growth forecast from 0.6% to 0.9%. We are also raising our 2014 and 2015 growth projections.

Emerging markets

Prospects for emerging-market regions are mixed in 2013, but we expect growth in Asia to pick up. China will lead the way, with GDP growth accelerating to 8.5% on average for the year as the effects of earlier stimulus increasingly flow through into the economy. Recent industrial production and export data have been encouraging, while earlier worries that political factionalism ahead of a tricky leadership transition would disrupt the economy seem to have proven unfounded. China's recovery will support GDP growth in Asia and Australasia in 2013, although India will disappoint again.

Growth will be flat at 2.6% in the transition economies of eastern Europe in 2013. The region continues to feel the effects of the troubles in the euro zone, its most important market and source of investment. However, we expect conditions to improve as the year progresses, given our assumption that the situation in the euro zone will stabilise. Growth in eastern Europe will accelerate to 3.3% in 2014.

Latin America suffered a slowdown last year, as the region was adversely affected by a triple-whammy of recession in the euro zone, the slowdown in China and the sluggish performance of the US economy. However, we maintain the view that the downturn in Latin America has been cyclical rather than structural, and we expect growth to pick up to 3.6% in 2013. The upturn will draw on an expected improvement in the Brazilian economy (aided by construction ahead of the 2014 World Cup and 2016 Olympics), and by stronger growth in China, which will benefit commodity producers.

Growth in the Middle East and North Africa (MENA) will be constrained in 2013 by a further contraction in Iran's economy. We expect Iranian oil production to decline again, and 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. Average GDP growth for the MENA region will slow slightly to 3.4% this year, before accelerating to 4.3% in 2014.

Sub-Saharan Africa, meanwhile, will see a pick-up in growth to 4.5% this year and 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.

Exchange rates

We have made several changes to our currency forecasts this month, most notably for the Japanese yen. This reflects in large part the election of a new government in December. Mr Abe, the new prime minister, has cited the overvalued yen as one factor behind the economy's weak performance in recent quarters, and is keen that the BOJ keep the yen within a range of ¥85-90:US$1 in the short term. Against this backdrop, we are lowering our yen:dollar forecast to an average of ¥88 for 2013, down from ¥82.6 previously. Although the yen is already weaker than what we forecast, the sell-off in the Japanese currency may be overdone. It is unclear, for instance, how much support Mr Abe will actually receive from the BOJ. It is also by no means certain that the government can engineer the inflation it seeks.

We have also this month adjusted our forecast for the key dollar:euro rate. We now expect the US dollar to average US$1.31:€1 in 2013, compared with US$1.29:€1 in our previous forecast. The dollar has been falling in fits and starts against the euro since its recent high of nearly US$1.20:€1 in mid-July.

Commodities

Commodity prices responded strongly to the fiscal deal reached in Congress on January 1st 2013, but the relief does not seem to have sparked a sustained rally. Signs of stronger growth in China will be positive for the energy and metals markets, but stocks of metals generally are high and mine supply is rising, which will dampen the scope for price rises.

Oil prices ended 2012 at US$111.97/barrel for dated Brent Blend, having rebounded in the second half of the year. In 2013 we expect the oil market to be pulled in different directions. Ongoing concerns over the weak economy in the euro zone and the threat of another stand-off over US fiscal policy, coupled with a fundamentally oversupplied market, will subdue prices; we expect Brent to average US$104.5/b. But political risk premiums related to the possibility of conflict in the Middle East will add upside volatility to prices at times throughout the year.

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	3.3	3.9	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	2.9
US	-0.3	-3.1	2.4	1.8	2.3	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	1.9	1.5	-0.5	-0.2	1.0	1.3	1.4	1.0
China	9.6	9.2	10.4	9.3	7.7	8.5	7.8	7.6	7.3	6.4
Eastern Europe	4.5	-5.6	3.4	3.8	2.6	2.6	3.3	3.7	3.8	4.0
Asia & Australasia (excl Japan)	5.5	5.0	8.4	6.5	5.5	6.2	6.3	6.3	6.2	6.2
Latin America	3.9	-1.9	5.9	4.3	3.0	3.6	4.0	3.8	4.0	3.9
Middle East & North Africa	4.4	1.3	5.3	2.2	3.5	3.4	4.3	4.7	5.1	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	4.2	3.5	3.5	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
Commodity prices										
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	-19.9	4.9	5.9	0.7	2.3	2.4
Food, feedstuffs & beverages (US$; % change)	28.0	-20.3	10.7	30.1	-3.7	-3.9	-5.4	-0.4	2.4	1.7
Exchange rates (annual av)										
¥:US$	103.4	93.6	87.8	79.8	80.0	88.0	90.3	92.8	95.1	94.0
US$:€	1.47	1.39	1.33	1.39	1.29	1.31	1.28	1.24	1.26	1.26

[a] PPP = purchasing power parity

Source: Economist Intelligence Unit.

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