



Global Economic Outlook

April 24, 2014

by Team
of Northern Trust

UNITED STATES

The fundamentals of the U.S. economy suggest a strong performance in the rest of the year after a weather-related setback in the first quarter. The absence of a drag from cutbacks in federal government spending adds to the optimism. The Fed will complete its asset purchases by year-end, with labor market and inflation developments driving the timing of any tightening. A likely increase in the labor force participation rate should result in a measured decline of the unemployment rate. The current subdued trend of inflation is predicted to approach the Fed's target of 2% as economic momentum gathers steam. The dollar's relative position is expected to strengthen in light of the projected growth. The shaky status of economic conditions in Europe and China are a risk to the outlook of the U.S. economy.

EUROZONE

The Eurozone as a whole continues to edge toward recovery, but the pace of growth remains very uneven across the region. Germany's real GDP growth will likely reach 2% or more this year, up from 0.5% in 2013, but growth in France will likely be no more than 0.5% in 2014 after a nearly steady reading in 2013, and Italy is expected to remain mired in recession. Spain's headline growth of around 0.8% will not do much to diminish unemployment that remains higher than 20% and a youth jobless rate around 50% – levels that risk deep social dislocation and a “lost” generation of young workers.

Inflation will remain very subdued across Europe, burdening the European Central Bank (ECB) with a considerable policy dilemma. It is not clear that cutting the refi rate even lower than the current 0.25% will do much to stimulate credit growth. Eurozone banks are focused on boosting their capital accounts as the ECB's first asset quality review and stress test gets underway. Further, businesses and households alike are still deleveraging. Some form of quantitative easing could kick-start moribund economies, but crafting such a program across 18 separate countries with diverse asset markets and differing macroeconomic priorities would take time. High rates of unemployment will continue to be a challenge, with the rate for the Eurozone as a whole remaining just above 12% through 2014.

Sovereign debt yields in “peripheral” economies have fallen back to levels last seen in 2007, but there is a perennial risk that renewed debate over an issue such as Greek debt sustainability, political turmoil in Italy or French policy clashes could trigger another round of market volatility.

UNITED KINGDOM

Economic recovery continues in the United Kingdom, with real GDP growth headed toward 3% this year. Inflation continues to abate and should be just below 2% by the end of the year. The Bank of England (BoE) has modified its forward guidance policy to include a range of indicators, not just the unemployment rate, but continues to signal that policy rates are unlikely to increase until the first half of next year (and then only gradually). Signs that the housing market recovery has spread outward from London has raised concern that another housing bubble could be in the making. The BoE's Monetary Policy Committee will not hike interest rates to curb house prices, but its Financial Policy Committee (formed last year) is likely to toughen up affordability tests and to look into other options to take the froth out of the market.

JAPAN

Economic performance in the second quarter is expected to be dismal, as consumers adjust to the 3% VAT increase that took effect at the beginning of April. However, the economy is expected to get back on track in the third quarter as consumer sentiment improves and spending increases. Private consumption is vital for the fledgling recovery as government stimulus begins to taper off and export growth continues to disappoint.

While the government could add more fiscal stimulus in the second half of the year or delay the planned 2% VAT increase next year, the prospects for export-led growth are murkier as continued soft demand in the United States and European

Union and a weakening Chinese economy combine to pressure exporters. Real GDP is forecast to expand 1.5% in 2014 as fiscal stimulus offsets weaker consumer spending due to the consumption tax hike.

The Bank of Japan (BOJ) will likely maintain the current 0.1% target policy rate while adding to its massive quantitative easing program this summer to foster economic activity. After missing last year, the BOJ is expected to reach its 2% inflation goal this year as the consumption tax increase push prices up by 2.1%. Meanwhile, the yen is expected to continue weakening moderately to 104¥/US\$ by the end of 2014 while unemployment remains benign at 3.8%. Risks to Japan's outlook include the collapse of Chinese import demand, a sustained decline in domestic consumer demand and a loss in patience with Abenomics and the absence of blockbuster announcements regarding the structural reform arrow.

CHINA

China's economy expanded at an annualized pace of 7.4% in the first quarter, below the official 2014 target of 7.5%, and the government renewed its claim that GDP growth was not as important as the current job creation target. Beijing has implemented a series of short-term measures to shore up the economy, the most notable and controversial being an expansion of the currency trading band in March, which was followed immediately by the yuan falling about 3%. While the government has not spoken about currency competitiveness directly, this move provided a boost to exporters struggling in the first months of 2014.

Inflation is slowing on the year, suggesting only weak price pressures at best from the domestic economy. The government has dismissed talk of fiscal stimulus, though public spending measures designated for 2014 have been fast-tracked. There is a significant concern that slowing growth and rising credit figures are creating an imbalance that cannot be easily reconciled without a sharp shock to the economy. GDP growth appears set to remain just below the official target level this year, though investment spending will remain at a worrisome level. If economic growth continues to be bolstered primarily by excessive and potentially unproductive lending, the excess capacity and overvalued assets created will only expedite a painful rebalancing.

Global Economic Forecast – April 2014

	2012	2013	2014F	2015F
United States				
Real GDP (% change)	2.8	1.9	2.7	3.3
Unemployment Rate (%)	8.1	7.4	6.5	6.2
Inflation (%)	2.1	1.5	1.7	2.1
Policy Rate, EOP (%)	0.15	0.15	0.15	0.50
Eurozone				
Real GDP (% change)	-0.6	-0.4	1.0	1.4
Unemployment Rate (%)	11.3	12.0	12.1	11.3
Inflation (%)	2.5	1.4	0.8	1.5
Policy Rate, EOP (%)	0.75	0.25	0.25	0.25
United Kingdom				
Real GDP (% change)	0.3	1.7	3.0	2.6
Unemployment Rate (%)	7.9	7.5	6.5	6.0
Inflation (%)	2.8	2.6	1.9	2.0
Policy Rate, EOP (%)	0.50	0.50	0.50	1.25
Japan				
Real GDP (% change)	1.4	1.5	1.5	1.3
Unemployment Rate (%)	4.3	4.0	3.8	3.7
Inflation (%)	0.0	0.4	2.6	1.7
Policy Rate, EOP (%)	0.10	0.10	0.10	0.10
China				
Real GDP (% change)	7.7	7.7	7.2	7.1
Unemployment Rate (%)	4.1	4.1	4.1	4.1
Inflation (%)	2.6	2.6	1.8	1.7
Policy Rate, EOP (%)	3.50	3.50	3.50	3.50
Exchange rates (EOP)				
	Mar-2014	Jun-2014F	Sep-2014F	Dec-2014F
EUR/USD	1.37	1.35	1.33	1.31
GBP/USD	1.67	1.65	1.63	1.62
USD/JPY	101.91	102.00	103.00	104.00
USD/CNY	6.22	6.25	6.28	6.30

F: Forecast
EOP: End of period

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

© 2014 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. Incorporated with limited liability in the U.S. Products and services provided by subsidiaries of Northern Trust Corporation may vary in different markets and are offered in accordance with local regulation. For legal and regulatory information about individual market offices, visit northerntrust.com/disclosures.