Global Economic Outlook

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by Carl Tannenbaum
of Northern Trust

Economists and the financial markets have been almost exclusively focused on events in Greece and China over the past several months. These situations merited attention but pushed more-positive economic developments into the background.

Event risk is still present as we contemplate the second half of the year, but the outlook for growth is brighter than it was three months ago. And as a consequence, two of the world's leading central banks are contemplating life after zero.

UNITED STATES

The U.S. economy has bounced back after the first-quarter setback driven by bad weather, seasonal adjustment challenges, and a West Coast port strike. Incoming data suggest that the pace of economic activity is likely to exceed trend growth in the second quarter. The fundamentals are in place for a promising second half of the year.

The U.S. economy is gaining steam in the seventh year of economic recovery.

The recent improvement in household spending growth indicates the lagged impact of lower oil prices and positive labor market developments. Housing sector data are indicative of a pickup in activity, and fiscal policy is less of a drag. On the down side, the weakness in business equipment spending stemming from lower oil prices and a strong dollar are headwinds.

The Federal Reserve is on track to commence tightening monetary policy in September, barring something unforeseen. There has been substantial progress on the employment front, and inflation is predicted to approach the 2.0% target as economic growth advances. Federal Reserve policy actions will be data-dependent, and a measured approach to normalizing interest rates is the Fed's preferred path.

EUROZONE

The eurozone recovery appears to be broadening, although risks to the downside are ever present. Our forecasts assume that Greece remains in the single currency area and that any further problems would be appropriately managed, allowing the economy to move on.

The ECB's asset purchase program has helped to lift growth.

Consumer spending has been important to the eurozone recovery this year, with the 0.5% quarterly rise in the first quarter likely to be sustained as shoppers continue to feel the benefit of low oil prices. Additionally, robust industrial numbers and strong business survey results in France, Italy and Spain suggest the recovery is widespread. Along with continued strong exports from Germany, we expect all of this to result in a 1.5% increase in real gross domestic product (GDP) for the eurozone this year and 1.9% in 2016.

The overall unemployment rate will continue to vary widely among eurozone members. The eurozone average jobless rate should come in at 11.0% this year and improve to 10.5% in 2016.

Inflation will remain muted for the remainder of 2015, driven down by low oil prices, with the annual rate averaging 0.1% before picking up to 1.3% next year. The European Central Bank (ECB) will continue with its asset purchase program, which we anticipate will be completed in full with a possibility of an extension if economic fundamentals deteriorate. Because of this, the main policy rate is likely to stay at 0.05% until the end of 2016.

UNITED KINGDOM

Our outlook for the United Kingdom remains positive in spite of a disappointing first- quarter performance. Strong consumer spending will underpin growth, supported by business investment that does not appear affected by election uncertainty. We should see an expansion of around 2.7% this year and next.

The United Kingdom should be one of the top G7 performers again in 2015.

An early referendum in 2016 on EU membership would present downside risks if it caused companies to delay hiring decisions or threatened London's standing as a financial center.

As expected, inflation briefly turned negative earlier this year. Low oil-price effects will eventually work their way out of the system; however, the average inflation rate will be subdued at 0.2% for 2015. In 2016, we expect an increase to 1.6%. Unemployment is forecast to fall to 5.5% this year and 5.3% next as labor-market normalization continues.

Despite recent hawkish comments from the Bank of England's rate-setting committee, its first hike is more likely than not to come in the first quarter of 2016. The bank will continue to "look through" temporary low inflation effects and is expected to tighten at a rate of 50 basis points per year, taking the policy rate to 1.0% by the end of 2016.

JAPAN

The past year for Japanese policymakers has been challenging, to say the least. The economic project that looked so promising in early 2013 appeared to have jumped the rails after an early 2014 consumption tax increase leveled an unexpectedly heavy blow to domestic demand. However, a recovery seems to be taking hold, as first-quarter GDP growth surprised to the upside.

For now, there is no need for additional monetary stimulus in Japan.

Tankan survey results put investment intentions among all companies at the highest level since 2006, raising hopes that the solid contribution to first-quarter growth from inventories will be sustained. Buoyant exports and improving consumer demand will also provide momentum for the rest of the year.

Inflation readings remain weak and, depending on energy prices, may trend negative at some point this year. However, the Bank of Japan can take solace in noting that inflation expectations are positive among consumers and businesses alike. The central bank will likely place a heavier emphasis on expectations than actual price increases in the near team. That sentiment, combined with a preference for currency stability and signs of a nascent economic recovery, argue against any additional monetary stimulus in the short term.

CHINA

We have moved our forecast for 2015 Chinese GDP growth upward, as second-quarter GDP surprised to the upside at 7% year-over-year. Anecdotal evidence seems to contradict the official measurement; however, the reading points to Beijing achieving its stated growth target for 2015 of "approximately 7%." There are headwinds, however, including the low likelihood that the financial sector can continue contributing nearly 2% to growth, as it did in the wake of the second-quarter equity correction.

China is facing economic headwinds, but official growth will register 7%.

Fiscal policy will remain accommodative. Second-quarter data point to a "mini-stimulus," as government spending expanded rapidly. More of the same is expected, as officials in Beijing appear to be fretting about life below 7%.

The People's Bank of China (PBoC) will continue to do its part to encourage growth by maintaining its loose monetary policy, which probably includes more rate cuts in the next 12 months. The bank has already pumped a great deal of liquidity into the system, but stubbornly high real interest rates and wobbly transmission mechanisms have worked against the PBoC.

The yuan is expected to weaken by the end of the forecast period. However, the PBoC's push to have the currency included in the International Monetary Fund's Special Drawings Rights basket of reserve currencies and currency stability should ensure an orderly descent.

Global Economic Forecast – July 2015

	2013	2014	2015F	2016F
United States				
Real GDP (% change)	2.2	2.4	2.4	2.8
Unemployment Rate (%)	7.4	6.2	5.4	5.1
Inflation (%)	1.5	1.6	0.3	2.2
Policy Rate, EOP (%)	0.15	0.15	0.50	1.50
Eurozone				
Real GDP (% change)	-0.4	0.9	1.5	1.9
Unemployment Rate (%)	12.0	11.6	11.0	10.5
Inflation (%)	1.4	0.5	0.1	1.3
Policy Rate, EOP (%)	0.25	0.05	0.05	0.05
United Kingdom				
Real GDP (% change)	1.7	2.8	2.7	2.7
Unemployment Rate (%)	7.6	6.2	5.5	5.3
Inflation (%)	2.6	1.5	0.2	1.6
Policy Rate, EOP (%)	0.50	0.50	0.50	1.00
Japan				
Real GDP (% change)	1.6	-0.1	0.9	1.3
Unemployment Rate (%)	4.0	3.6	3.6	3.5
Inflation (%)	0.4	2.7	0.6	1.0
Policy Rate, EOP (%)	0.10	0.10	0.10	0.10
China				
Real GDP (% change)	7.7	7.4	7.0	6.9
Unemployment Rate (%)	4.1	4.1	4.1	4.1
Inflation (%)	2.6	2.1	1.4	2.0
Policy Rate, EOP (%)	3.00	3.00	1.75	1.50

Exchange rates (EOP)	Jun-2015	Sep-2015F	Dec-2015F	Mar-2016F
EUR/USD	1.07	1.08	1.06	1.04
GBP/USD	1.46	1.56	1.54	1.53
USD/JPY	120.1	123.0	124.0	125.0
USD/CNY	6.20	6.22	6.24	6.26

F: Forecast
EOP: End of period