Global Forecasting Service

Global outlook summary

(Forecast closing date: June 18th 2012)

World economy

The global economy remains in precarious shape. Europe's debt crisis rages on, and although the euro appears to have survived its most recent test in the form of the Greek election on June 17th, austerity and financial-market uncertainty are depressing economic activity in Europe and, by extension, in much of the rest of the world. The Economist Intelligence Unit continues to expect global GDP growth to slow in 2012, and while our forecasts for the G3 economies—the US, euro zone and China—are essentially unchanged this month, we have cut our projections for Brazil and India.

We forecast that world GDP, measured at purchasing-power parity, will grow by 3.2% in real terms in 2012. This would be down from 3.7% last year and 5.1% in 2010, when extraordinary stimulus in response to the post-Lehman financial crisis fuelled a recovery that, in retrospect, proved all too brief and shallow. Yet policymakers now have substantially less firepower than they did four years ago, while past economic excesses (from housing bubbles to rises in public debt) have fundamentally weakened many countries' ability to withstand stress.

We have lowered our GDP forecasts for Brazil and India

Given these factors and the continuing fallout from the downturn in Europe, it is hardly surprising that immediate growth prospects are poor. Global growth essentially stalled in the second quarter of 2012, and the outlook for the rest of the year is hardly better. The continuity in our forecast for the US, the euro zone and China is less a vote of confidence *per se* than a reflection of the fact that our outlook was already cautious. In contrast, we have revised down sharply our 2012 forecast for Latin America, owing to subdued recent data in Brazil. India's growth prospects have also weakened markedly. In both countries domestic policy shortcomings are partly to blame. But, as in many other markets, the problems in Europe are also having an impact.

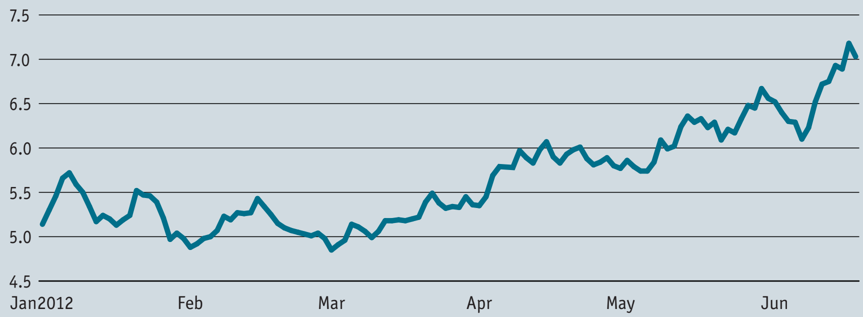
The trajectory of the euro crisis, and the effectiveness or otherwise of the policy response, will remain critical to global economic prospects. Fears of a break-up of the European currency union remain very real, even though the June 17th re-run of the Greek general election inspired widespread sighs of relief after political parties more likely to co-operate with creditors narrowly won the day. But the crisis in Greece is by no means over, while the deterioration of the banking crisis in Spain has raised fresh concerns about financial stability. Spain has become, in effect, the fourth country to need a European bailout, having announced that it needed as much as €100bn (US$125bn) to recapitalise its ailing banks. These funds would add to the country's public debt and thus increase the risk that the sovereign itself may need a bailout.

2012: AT A GLANCE

World GDP growth, at PPP	*3.2%*
World inflation (av)	*3.4%*
Oil/barrel (av, Brent)	*US$109.5*
US$:€ (av)	*1.28*

That an economy the size of Spain—which, with GDP of €1.1trn, is twice as large as the three other bailout countries combined—is in danger means that the euro zone has entered a potentially calamitous new stage. Our baseline scenario, which we consider most likely, is that no country will leave the euro zone in the next year. This assumes that Greece forms a coalition government that will do enough to satisfy creditors, and that the rescue fund for Spain's banks eases the worst of the crisis in that country. However, we also envisage a bleaker scenario that begins with the departure of Greece from the euro zone—which could happen if a new government failed to renegotiate its bailout pact. The impact on Greece would be devastating, and would include massive capital outflows, default on both public and private debt, and collapse of the banking system. At a global level, we would expect a massive response to such an emergency from governments and central banks, but it is unclear whether this would be enough to limit contagion.

Point of no return?
Spanish 10-year government bond yield, %



Sources: Financial Times; Haver Analytics.

Developed world

The US economy is doing relatively well compared with Europe, but recent data have been soft. GDP growth in the first quarter of 2012 was revised down slightly to 1.9% (at an annual rate) from 2.2% previously. A deceleration in jobs growth and an uptick in the unemployment rate in May have compounded the sense that the economy is going through a sluggish patch. We had already expected a mid-year deceleration in GDP growth, so we maintain our forecast for growth of 2.2% in 2012. However, if the weaker trend were to be sustained well into the third quarter, we would lower our forecast.

Euro zone GDP will contract by 0.7% in 2012

In the euro zone, a combination of austerity, financial turbulence and low confidence is wreaking economic havoc—and will continue to do so for some time. We maintain our forecast for a GDP contraction of 0.7% in 2012, but now expect an even weaker recovery next year, with growth of 0.3%. Both of these forecast numbers, it should be remembered, are contingent on the euro zone remaining intact; in the event of a break-up, the downturn would be much more severe.

Japan's growth outlook continues to be shaped by the tsunami, earthquake and nuclear crisis that occurred in March last year. This caused GDP to contract in

2011, but it also means that there will be a corresponding pick-up in growth to 1.7% this year. Post-tsunami reconstruction will partly support the recovery, although such work has proceeded slowly so far.

Emerging markets

The downturn in Europe is hitting emerging-market exporters

Emerging markets face headwinds from sluggish US growth and recession in Europe. Weak global demand poses a particular challenge to Asia's export-oriented economies, which must also adjust to slower growth in China. We expect Chinese GDP to grow by 8.2% this year, thanks to the government's efforts to avoid a hard landing. But an impending leadership transition poses political risks, and short-term stimulus may come at the cost of prolonging China's unbalanced growth model. In India, fiscal disarray and political paralysis have taken the shine off an economy until recently expected to sustain growth rates of 9% or so. We expect Indian GDP growth of just 6.4% this fiscal year.

Eastern Europe's economic links with the euro zone will make for a challenging operating environment in 2012. Trade, investment and bank financing will weaken. Compounding this, domestic demand remains generally anaemic and few governments have the fiscal wherewithal to splash out on stimulus. Although some countries are benefitting from robust commodity prices, GDP growth in eastern Europe as a whole will slow from 3.8% in 2011 to 2.5% this year.

Economic growth in Latin America will slow again in 2012, to 3%. Recession in the euro zone and below-par growth in the US will hurt the region's exports, although Chinese demand will continue to benefit South American commodity producers. Latin America's largest economy, Brazil, has had a poor start to the year. In light of recent data, we have cut our 2012 growth forecast from 3.3%to 2.2%, even though we expect the economy to pick up in the second half of the year. Latin America as a whole will gain some momentum from 2013, when GDP growth will accelerate to 3.9%.

Economic sanctions on Iran will drag down regional growth

The Middle East and North Africa are on course for recovery this year, thanks in part to still-high global oil prices. There will also be a bounce-back in some economies affected in 2011 by political upheaval and civil unrest. However, regional growth will be held back by lower oil production and economic sanctions in Iran, and by continuing instability in Syria (and, to a lesser extent, Egypt). Overall, the region will record GDP growth of 4% in 2012, up from 3% last year. In Sub-Saharan Africa, the dim outlook for the global economy poses risks ranging from a worsening of trade conditions to falling remittances and foreign investment. The region would also suffer in the event of a more significant slowdown in China, which has emerged as a crucial economic partner. GDP growth in Sub-Saharan Africa will slow slightly to 4.3% in 2012, but medium-term prospects are positive.

Exchange rates

The US dollar has strengthened significantly against most currencies in recent weeks as the euro crisis has deepened. This is a reversal from the pattern early in the year, when the European Central Bank's injection of over €1trn into the banking system boosted the "risk on" trade. We continue to believe that the euro will have little or no upward momentum this year, and now expect the dollar to be stronger on average than previously projected—at US$1.28:€1 in 2012. This does not rule out periodic bouts of euro strength, particularly if the US recovery disappoints or if euro-related risk aversion eases temporarily.

Commodities

After a relatively strong start to the year, commodity prices have been slipping since mid-March. This has reflected a number of trends, including: concerns about financial stability in the euro zone; more mixed data releases out of the US; and distinct signs of a slowdown in a number of the large emerging economies, including China, Brazil and India.

Oil prices have fallen but will remain high

Oil prices rose very sharply in the first four months of 2012, but have fallen as supply concerns associated with Iran's nuclear programme have been overtaken by the prospect of weaker global demand. To reflect these factors, we have slightly lowered our oil price forecast this month. We now expect a barrel of crude oil (dated Brent Blend, the European benchmark) to cost an average of US$109.5 in 2012, which is US$3 cheaper than in our previous forecast. However, we believe that risks to supply remain and that the market could recover some lost ground if investors' worst fears about dislocation in the euro zone or a sharp downturn in China's growth are not realised.

World economy: Forecast summary

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Real GDP growth (%)										
World (PPP* exchange rates)	5.2	2.4	-0.9	5.1	3.7	3.2	3.7	4.0	4.2	4.2
World (market exchange rates)	4.0	1.2	-2.4	4.1	2.5	2.1	2.6	2.8	3.0	3.0
US	1.9	-0.3	-3.5	3.0	1.7	2.2	2.1	2.1	2.3	2.3
Japan	2.2	-1.1	-5.5	4.5	-0.7	1.7	1.2	1.6	1.2	0.9
Euro area	2.9	0.2	-4.4	1.9	1.5	-0.7	0.3	1.2	1.5	1.5
China	14.2	9.6	9.2	10.4	9.2	8.2	8.4	8.1	8.0	8.0
Eastern Europe	7.5	4.6	-5.7	3.5	3.8	2.5	3.3	3.7	3.9	3.8
Asia & Australasia (excl Japan)	9.3	5.5	5.0	8.4	6.5	6.0	6.5	6.5	6.6	6.5
Latin America	5.7	3.9	-2.0	6.0	4.3	3.0	3.9	4.2	4.1	4.2
Middle East & North Africa	4.8	4.4	1.8	4.6	3.0	4.0	4.0	4.7	4.9	4.9
Sub-Saharan Africa	7.0	4.8	1.2	4.4	4.4	4.3	4.9	4.6	4.8	5.0
World inflation (%; av)	3.4	4.9	1.5	3.0	3.9	3.4	3.2	3.1	3.2	3.2
World trade growth (%)	7.1	2.8	-12.0	14.1	6.3	4.0	5.4	5.9	6.3	6.2
Commodities										
Oil (US$/barrel; Brent)	72.7	97.7	61.9	79.6	110.9	109.5	103.4	104.5	107.3	110.0
Industrial raw materials (US$; % change)	11.3	-5.3	-25.7	45.4	21.4	-15.9	7.7	-0.2	1.3	1.8
Food, feedstuffs & beverages (US$; % change)	30.9	28.1	-20.3	10.7	30.1	-11.2	-3.2	-0.7	-1.9	2.7
Exchange rates (av)										
¥:US$	117.8	103.4	93.6	87.8	79.8	80.1	83.6	86.8	89.0	92.2
US$:€	1.37	1.47	1.39	1.33	1.39	1.28	1.26	1.25	1.24	1.26

* PPP = Purchasing-power parity.
Source: Economist Intelligence Unit.

