

International Outlook for 2016

Elham Mafi-Kreft, Ph.D. Clinical Assistant Professor of Business Economics and Public Policy, Kelley School of Business, Indiana University Bloomington

In 2016, we expect world output to grow at an annual rate of 3.6 percent, not much of a change compared to 2015 and 2014. The economic contrast between the United States and most of the rest of the world will continue to intensify. On one side, the U.S. should enjoy continued growth in the new year, sustaining its 2.5 percent growth from 2015. On the other side, many developed countries and emerging economies will continue to struggle, as they have for much of 2015.



United States

Despite the end of the Federal Reserve's five-year quantitative easing programs in late 2014, the U.S. economy has continued to receive help from the Fed. U.S. monetary policy has remained particularly accommodating by keeping interest rates between 0 and 0.25 percent to incentivize spending. However, with the strength and stability of the domestic market, we believe in the imminent end of the zero rate policy. The ultimate effect of this imminent rise in interest rates is uncertain, but it should have limited consequences on the domestic economy. The limited impact stems from the fact that the increase in rates should be minor and also because market participants have already been anticipating such increases for some time now. The largest effect of a change in U.S. interest rates will be felt by emerging economies, which may further experience an outflow of capital as foreign investors will be attracted to the higher returns in the United States.

One of the interesting aspects of the U.S. economy, and what makes it unique, is its ability to rely on endogenous factors to stimulate growth and its resiliency to grow internally. The U.S. is not as vulnerable to global shocks as many

other developed countries. In 2015, our dollar was strong and our major trading partners (China, eurozone members, Japan, Mexico and Canada) were weak economically leading to weak exports, so the health of the U.S. economy almost completely stemmed from private spending.

The driving force behind U.S. GDP growth has been our domestic household spending. Consumer confidence was encouraged by a constantly improving labor market, exceptionally low oil prices and an exceptionally low cost of borrowing. Furthermore, the surge in household spending has had a positive spillover effect on the U.S. automobile industry and the residential housing industry (construction and sales). However, the collapse of oil prices, and more generally commodity prices, has and will continue to adversely affect the mining and oil industry in 2016. Overall, after seven years of moderate growth, it looks like 2016 may be the year when we will reach our business cycle peak.



Eurozone

The economic environment at the beginning of 2015 looked very promising for the eurozone. A weak domestic currency, very low oil prices and a brand new round of quantitative easing by the European Central Bank were offering an optimal environment for a bounce-back economy. Then, a new chapter of the Greek crisis commenced, monopolizing the attention of European leaders and further eroding foreign investors' confidence in the stability of the eurozone.

Although Europe showed great resilience to the Greek crisis, the events of the summer—geopolitical crises as well as the generalized slowdown in the emerging markets (especially Russia, China and

Brazil)—uncovered Europe's high vulnerability to exogenous shocks.

While some peripheral countries of the eurozone, such as Spain and Italy, are growing more rapidly thanks to their enactment of significant structural reforms, overall a modest growth of 1.6 percent is expected for the eurozone in 2016. Contrary to the U.S., Europe's private spending has yet to be sufficient to drive its growth. The sustained levels of very low inflation have given consumers some purchasing power, but the lack of confidence about their future prospects (as the labor market is still very weak) has proven to be insufficient to boost business investment. Furthermore, long-term trends such as an aging population and the declining productivity of its labor force have further contributed to weakened business investments.

In 2016, a weaker currency (triggered by an anticipated new round of quantitative easing in December) will allow the eurozone to gain competitiveness. Furthermore, the lasting lower commodity prices, which will help maintain lower productive costs, should provide an environment in which many of the policymakers can tackle their inherent structural problems regarding their regulation of labor, business and capital. This round of structural reform is necessary if eurozone members want to continue to be relevant. Finally, the migrant crisis and the clearly uncoordinated efforts of the eurozone members further outlined the weaknesses of Europe as a unified economy. Without fiscal and political integration and coordination, Europe will never reach its potential for growth and will continue to lag behind other developed economies.



Brazil

In 2015, Brazil fell deep into recession, with a 3 percent decline forecasted before year's end and a continued decline expected for the first half of 2016. It is the hope of the outlook panel that the summer Olympic Games will bring relief to the country. However, the overall picture looks gloomy as the most optimistic forecasts show a 1 percent decline in real GDP for 2016.

The recurring problem within the Brazilian economy is political. The country's elite have lost all credibility after a series of corruption cases (the partially state-owned oil giant Petrobras is thought to have lost \$2 billion in bribes alone). The loss of confidence in the country's institutions has resulted in a large capital outflow that has weakened the real (Brazil's currency) and drove inflation to new heights (8.9 percent in 2015—expected to decrease to 6.3 percent in 2016). These events have contributed to a decrease in private spending as access to credit has decreased, cost of borrowing has increased and real wages have collapsed. The unemployment rate boomed and is forecasted to be at 8.6 percent in 2016 (it was as low as 4.8 percent in 2014).

Brazil's weakened position has only gotten worse because of its depressed export revenue. This drop in export revenue has largely been driven by the slowdown of China, one of Brazil's major trading partners, and the collapse in commodity prices.

While the central bank of Brazil has pledged to keep rates high, the government is not credible in its effort to discipline its federal budget and the sovereign bond has been downgraded to junk status, which in turn could result in further capital outflow. Political inertia has the potential to greatly hurt this economy that is composed of competitive multinationals (in the energy, agrobusiness, construction and aviation sectors), extraordinary natural

resources and a large population with a growing middle class.



Russia

The recession in Russia will end up having been quite severe in 2015 and will continue in 2016 as Russia is expected to contract at a rate of 0.6 percent. The good news is that the recession will not get worse as Russia has reached its business cycle trough. However, with the continued drop in the price of oil (Russia's principal revenue source), 2015 saw the ruble hit a new low and inflation peaked at 15 percent in 2015 (forecasted at 9 percent for 2016). Even if the central bank decreases interest rates, household consumption will stay depressed, and we cannot count on any internal factors to jump-start the economy.

In 2016, it is likely that the current account will continue to show a surplus, but mostly because of a large drop in imports rather than a rise in revenue generated through exports.

The one piece of good news is that we should see a further slowdown of capital outflow compared to 2014 and 2015, which will create some more financial stability within the Russian banking sector. In 2016, the principal weakness of Russia will be low oil prices, which will continue to keep foreign investors away from the Russian market and prevent Russia from building up the productive capacity that is crucial to reach its economic potential.



India

The dichotomy of India's economic development (through weak agricultural but strong service industries) is forecasted to persist, but the net forecast is optimistic that the business environment in India will continue to improve in 2016. The majority of the Indian population is employed in the country's agricultural sector, where revenues are very low. However, the greatest contributor to India's

GDP is the service industry, where workers are earning high revenues—especially in the IT sector.

Overall, the GDP per capita in India is \$5,708 (while China is more than double that), and inequality is persistent. India's human development (ranked at 135), as measured by the World Bank, is far behind its Asian counterparts like China (ranked at 91). Furthermore, this inequality is the reason why India is still not the engine of growth for Asia. If India wants to become a bigger global player, it needs to continue to transform its economy to a more industrial one, with a stronger middle class and fewer citizens in poverty.

2016 should be a good year for India's economy, with growth forecasted at an enviable rate of 7.5 percent. The slump in commodity prices will help this commodity net-importer and help control its inflation rate. The future of India's economic vitality will depend on the government's ability to conduct important reforms, such as agro-industrial land transfers, which are not very popular politically.



China

In its quest to liberalize its capital market and further transition toward a consumption- and service-based economy, China surprised the world in 2015 by devaluing the CNY/USD rate by 2 percent. The capital outflow that followed the devaluation, as well as the second Shanghai stock market crash, showed how a loss in foreign investors' confidence can affect a country even when it has ample reserves to buffer the shock. This economic instability, which we believe will stay contained, has the potential to slow down the liberalization rate of the Chinese economy.

Compounding the issues in China, a series of infrastructure investments have led to overcapacity in production. These overcapacity

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problems will continue to dampen domestic business investment and at the same time hurt other countries that enjoyed privileged trade relations with China—especially those who sell their natural resources to China. Unless China’s fiscal policy tries to fill in the lack of private spending, the Chinese economy will further decelerate. Nevertheless, we believe that the overall economic conditions are quite good, and that the economy will grow by 6.3 percent. The big issue is that China’s growth transition, and its relative slowdown, will have spillover deceleration effects on the global economy—especially with those countries that are dependent on exporting to China.

Summary

Commodity exporters (even the more advanced ones, such as Canada, Norway and Australia) will be facing risks as the unfavorable terms of trade, triggered by China, may also impact their investment sector—

much like the one experienced by the U.S. energy sector. Meanwhile, the commodity importers (e.g., India) and more closed economies (such as the U.S.) will fare quite well in 2016. The bliss of a coordinated and uniform global robust growth is unfortunately not expected for 2016. ■

Data Sources

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