



Global Economy Watch

Predictions for 2017: globalisation takes a backseat



Predicting what could happen in the future is fundamental for business planning. In this edition of the GEW, we present our view on the global economic themes we think could prevail in 2017.

Globalisation takes a backseat: In the absence of the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) being agreed upon, we expect world trade to grow more slowly than global output for the third consecutive year. The resurgence of economic nationalism in some parts of the world means World Trade Organisation (WTO) rules will be put to the test. The world's biggest bilateral trade route (US-China) is likely to come under pressure.

US monetary policy moves back towards normality: The Federal Reserve will continue to tighten monetary policy. Historically, the first 12 months of a tightening cycle have been associated with a 2.3pp increase in the Fed's target rate. The Fed's latest projections show a much more modest tightening. However, though this is not the most likely scenario for now, the Fed could tighten faster than currently suggested depending on the pace, size and implementation of the new administration's fiscal plans. On the flipside, economies which rely on the dollar for financing will come under pressure.

Politics will drive uncertainty and economics: The Eurozone may hold half a dozen elections. Germany, France, the Netherlands and potentially Italy and Greece (equivalent to more than 70% of Eurozone GDP) are expected to run general elections and could

experience disruption to their normal political cycle. Spain is likely to hold a referendum on the future of Catalonia. On the international stage, we will be monitoring US-Russian relations closely, which could have spillover effects in Eastern Europe, the Middle East and potentially East Asia, as well as on the Iran nuclear agreement.

Our detailed predictions have been compiled with input from our global team of economists.

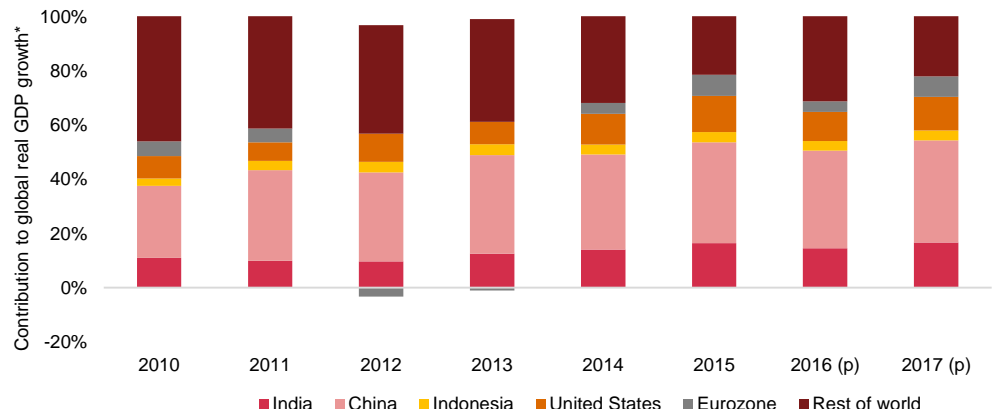
1. The US will drive growth in the G7

In our main scenario, we expect the US to grow by around 2%—the fastest in the G7— on the back of strong job creation and household consumption. It could surprise on the upside if the new administration lowers taxes and pursues plans to boost spending on infrastructure. Our analysis suggests the US will contribute to around 70% of G7 growth in our main scenario, despite making up half of G7 GDP in absolute terms.

2. Core Eurozone employment will hit an all-time high but periphery will create more jobs

We expect the 'peripheral' economies to grow faster than the 'core' for the fourth consecutive year. Irish GDP growth is expected to be the leader of the peripheral pack, expanding by more than 3% per annum, while France and the Netherlands will lead the core, growing at a rate of 1.5%. On the jobs front, employment in the core is expected to hit an all-time high of around 97 million. But this will be outperformed by the periphery, who will create around 100,000 more jobs than the core.

Fig 1: China and India will continue to drive global economic growth in 2017, while the Eurozone will see its contribution to global growth to grow relative to last year



Sources: PwC analysis, IMF

* measured in constant 2015 US\$ based on purchasing power parity (PPP). Global refers to the sum of 186 economies

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Predictions for 2017

3. Indonesia is set to become the world's 16th trillion dollar economy

Asia will remain the fastest growing region of the world, but the spotlight will shift away from China to India and Indonesia. We think Indonesia is on course to join the elite 'trillion dollar' economy club this year. In comparison, we project Chinese growth to remain at around the 6% mark. India's contribution to world GDP growth could reach almost 17% this year (see Figure 1). China's growth may be slowing, but if it manages to grow at 6.5% per year, it will add an economy the size of 'Turkey' to global output. We think Brazil and Russia will start growing again on an annual basis by 0.5% and 1% respectively, aided by a rise—albeit small—in commodity prices.

4. Population growth will put pressure on the Gulf (GCC) countries to reform public finances

In 2017, Saudi Arabia is projected to add two 'Iceland's' to its working age population. The other GCC countries are also expected to see strong growth of around 2% in their labour force. The challenge facing the GCC economies is to create employment opportunities while reforming public finances. In these economies, falling oil prices over the past few years have seen a deterioration in government finances e.g. from a government budget surplus in 2013, to a expected net public debt stock of 10% of GDP by the end of this year. Diversifying the economy towards the private sector will lessen the burden on government finances, as well as creating new jobs for a growing workforce.

For many economies, 2017 will be a year

of uncertainty. Although not an exhaustive list, these are some of the key macroeconomic risks businesses consider and plan for in the next 12 months.

Onshoring the greenback reveals cracks: Tighter US monetary policy could encourage a gradual repatriation of US dollars. Our risk matrix in Fig. 2 shows that Malaysia, Turkey and Chile are especially exposed to this risk as their foreign currency debt levels stand at 71%, 64% and 55% of their GDP. Banks with exposure in those economies could face some pressure if not well capitalised. But on the flipside, for some commodity reliant economies like Brazil and Russia, a higher oil (and other commodity) price outlook coupled with a flexible exchange rate regime could help to soften the impact of capital flowing back to the US.

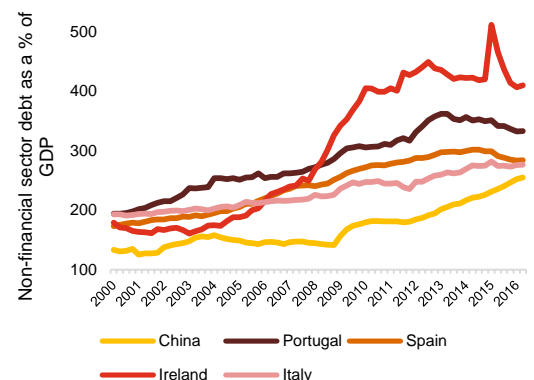
China will feel the costs of higher private sector debt burden: China's non-financial sector debt stands at more than 250% of GDP. If non-financial debt grows at the same average rate as it has since 2010, China could add over \$650 billion to its total debt pile by the end of 2017. China's relatively closed capital account means its risk rating in Fig. 2 is medium, reducing its exposure to foreign currencies. But as Fig. 3 shows, China's non-financial debt accumulation has accelerated since 2008, nearing the high debt to GDP ratios seen in the Eurozone's crisis countries. Last year, China's credit to GDP gap (the difference between the credit-to-GDP ratio and long-run trends, indicating unsustainable accumulation) surpassed levels which indicate a risk of crisis within the next three years. This risk will be heightened if property prices fall sharply, undermining the foundations of the debt pile.

Fig 2: A stronger dollar could pose a risk to many emerging markets, including Malaysia and Turkey

Countries	Vulnerability	Foreign currency external debt (% of GDP)	Nov 15 – Nov 16 currency movement (%)	Current account balance (% of GDP)
Turkey	High	55%	-12.6%	-4.5%
Malaysia	High	71%	-0.1%	3.0%
Colombia	Medium	38%	-3.6%	-6.4%
Peru	Medium	34%	-2.0%	-4.4%
Argentina	Medium	28%	-37.4%	-2.5%
Mexico	Medium	28%	-17.0%	-2.9%
Chile	Medium	64%	5.8%	-2.0%
South Africa	Medium	21%	1.4%	-4.3%
Philippines	Medium	26%	-4.3%	2.9%
Brazil	Medium	39%	13.7%	-3.3%
Indonesia	Medium	38%	2.9%	-2.1%
India	Medium	17%	-2.2%	-1.1%
China	Medium	12%	-6.9%	3.0%
Russia	Low	32%	1.0%	5.2%
Thailand	Low	26%	1.4%	7.8%

Sources: PwC analysis, World Bank, IMF, Datastream

Fig 3: China's debt is rapidly approaching levels seen in the Eurozone's crisis countries



Sources: PwC analysis, BIS

Reflections on our 2016 predictions

Looking back on 2016, many of our predictions held true. Commodity prices have remained low, the US raised interest rates and geopolitics has come under the spotlight. Specifically, we correctly predicted that:

- The peripheral Eurozone economies would outpace core growth at 2% compared to 1.5%. In 2016, the periphery is expected to have grown by 2.2% and the core by 1.4%;
- Total unemployment in the Eurozone would fall to below 17 million, its annual lowest levels since 2011. Preliminary data suggest unemployment is almost at 16 million; and
- India would lead E7 growth at over 7.5%, while Chinese growth would slow to around 6.5% per annum. Last year, India is expected to have grown by 7.6% and China by 6.6%.

We also predicted strong US job creation at around 200,000 jobs a month; preliminary estimates suggest the US added on average 180,000 jobs a month in 2016. But we over-estimated US growth at 3%. Last year, US growth is expected to be relatively disappointing at around 1.5%.

Predictions for the UK economy in 2017 from John Hawksworth, Chief UK Economist, PwC UK



- The UK led the G7 rankings in 2016 with GDP growth of around 2%, but is expected to fall back to a middling position in 2017 as growth slows to around 1-1.5%. This reflects the gradual drag on business investment from Brexit-related uncertainty, as well as the squeeze on real household spending power from the weaker pound.
- We are not predicting a recession, however, and parts of the UK economy should remain relatively strong, particularly in the consumer services, tourism and technology sectors. But manufacturing and construction may continue to struggle and the City could suffer some loss of business to other EU countries due to the anticipated impact of Brexit.
- We expect a key feature of 2017 to be a re-emergence of inflation, which we expect to rise to around 2.5-3% by the end of the year, squeezing real earnings growth. This pay restraint should, however, also help to avoid any significant rise in unemployment.
- The housing market has shown signs of cooling recently, particularly in central London, and we expect average UK house price inflation to moderate to around 2-5% in 2017.
- We expect the Bank of England to keep interest rates on hold for at least the first half of 2017, waiting to see how the economic impact of Brexit unfolds. After boosting public investment in his Autumn Statement, the Chancellor is also likely to be in 'wait and see' mode in what could be a relatively boring Budget in March.

Projections: January 2017

	Share of 2016 world GDP		Real GDP growth				Inflation			
	PPP	MER	2016e	2017p	2018p	2019-2023p	2016e	2017p	2018p	2019-2023p
Global (Market Exchange Rates)		100%	2.5	2.9	2.1	3.0	2.2	2.4	2.0	2.5
Global (PPP rates)	100%		2.9	3.4	2.2	3.5	2.8	2.9	2.1	2.9
G7	31.5%	46.4%	1.4	1.7	1.3	1.9	0.9	2.0	1.6	1.8
E7	36.2%	25.9%	4.6	5.2	3.9	5.0	1.5	3.5	2.8	3.3
United States	15.8%	24.5%	1.6	2.2	2.2	2.3	1.3	2.3	2.4	2.0
China	17.3%	15.2%	6.5	6.5	6.1	5.7	2.0	1.8	2.5	2.8
Japan	4.2%	5.6%	0.6	0.5	0.7	0.8	0.1	1.3	1.5	1.5
United Kingdom	2.4%	3.9%	2.0	1.2	1.6	2.1	0.6	2.3	2.7	2.3
Eurozone	12.0%	15.8%	1.6	1.5	1.7	1.5	0.2	1.3	1.2	1.4
France	2.3%	3.3%	1.4	1.5	1.6	1.6	0.3	1.2	1.1	1.2
Germany	3.4%	4.6%	1.6	1.4	1.4	1.4	0.3	1.5	1.6	1.7
Greece	0.3%	0.3%	-1.0	0.5	1.3	1.6	-0.3	0.5	0.8	1.1
Ireland	0.3%	0.4%	4.0	3.3	3.0	2.6	-0.1	0.8	1.3	1.5
Italy	1.9%	2.5%	0.9	1.0	1.1	1.2	0.2	1.1	1.2	1.4
Netherlands	0.7%	1.0%	1.6	1.6	1.8	1.8	0.8	1.5	1.2	1.3
Portugal	0.3%	0.3%	1.2	1.2	1.1	1.1	0.6	1.0	1.2	1.4
Spain	1.4%	1.6%	2.6	2.3	1.9	2.0	-0.4	1.3	1.1	1.2
Poland	0.9%	0.6%	3.6	3.4	3.2	3.5	-0.3	1.2	1.7	2.4
Russia	3.3%	1.8%	-1.6	0.9	1.0	1.5	7.3	6.3	5.1	4.0
Turkey	1.4%	1.0%	3.1	3.2	3.2	3.4	8.0	7.8	7.2	7.0
Australia	1.0%	1.7%	3.1	2.7	2.8	2.7	1.5	2.5	2.4	2.5
India	7.0%	2.8%	7.3	7.3	7.0	6.5	5.1	5.0	5.1	5.0
Indonesia	2.5%	1.2%	5.0	5.1	5.5	5.4	3.6	4.5	4.4	5.1
South Korea	1.6%	1.9%	2.7	2.6	2.8	3.3	1.0	1.6	2.8	3.3
Argentina	0.8%	0.9%	-2.2	1.9	2.4	2.5	30.0	-	-	-
Brazil	2.8%	2.4%	-3.6	0.1	1.5	3.0	9.0	5.0	5.0	5.0
Canada	1.4%	2.1%	1.3	1.9	2.1	2.2	1.5	1.9	2.0	2.0
Mexico	2.0%	1.6%	1.9	2.1	2.3	3.0	2.8	3.4	3.1	3.0
South Africa	0.6%	0.4%	0.7	1.4	1.6	3.0	6.3	6.0	5.7	5.5
Nigeria	1.0%	0.7%	-1.0	1.0	2.3	4.2	15.2	16.5	15.0	12.0
Saudi Arabia	1.5%	0.9%	1.2	1.7	2.3	3.5	4.0	3.2	3.0	2.5

Sources: PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Argentina has recently launched a new CPI measure, which only contains data from April 2016. We therefore do not report an inflation measure for 2017, and will provide 2018 and 2019-2023 projections once a longer series is available. Ireland's GDP growth in 2015 was boosted by some very high investment figures by subsidiaries in Ireland. Note that the tables above form our main scenario projections and are therefore subject to considerable uncertainties. We recommend that our clients look at a range of alternative scenarios.

Interest rate outlook of major economies

	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	0.5-0.75% (December 2016)	Further gradual tightening over the next year	31 January – 1 February
European Central Bank	0.0% (March 2016)	No rate rise for the foreseeable future	19 January
Bank of England	0.25% (August 2016)	No change in rates expected in the short-term	2 February



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Chart of the month

Before the financial crisis, we were used to seeing global trade grow 1.5-2 times faster than world GDP growth. Since 2008 this pattern has reversed.

Cyclical factors have contributed, but structural factors are also at play. China's transition away from an export-led economy, increasing automation and difficulties in achieving new global trade deals are key factors which explain this pattern.

Chart of the month: World trade is expected to continue growing slower than global output



Sources: PwC analysis, IMF

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