Global Economic Outlook and Implications for Trade

Nariman Behravesh
Chief Economist, IHS
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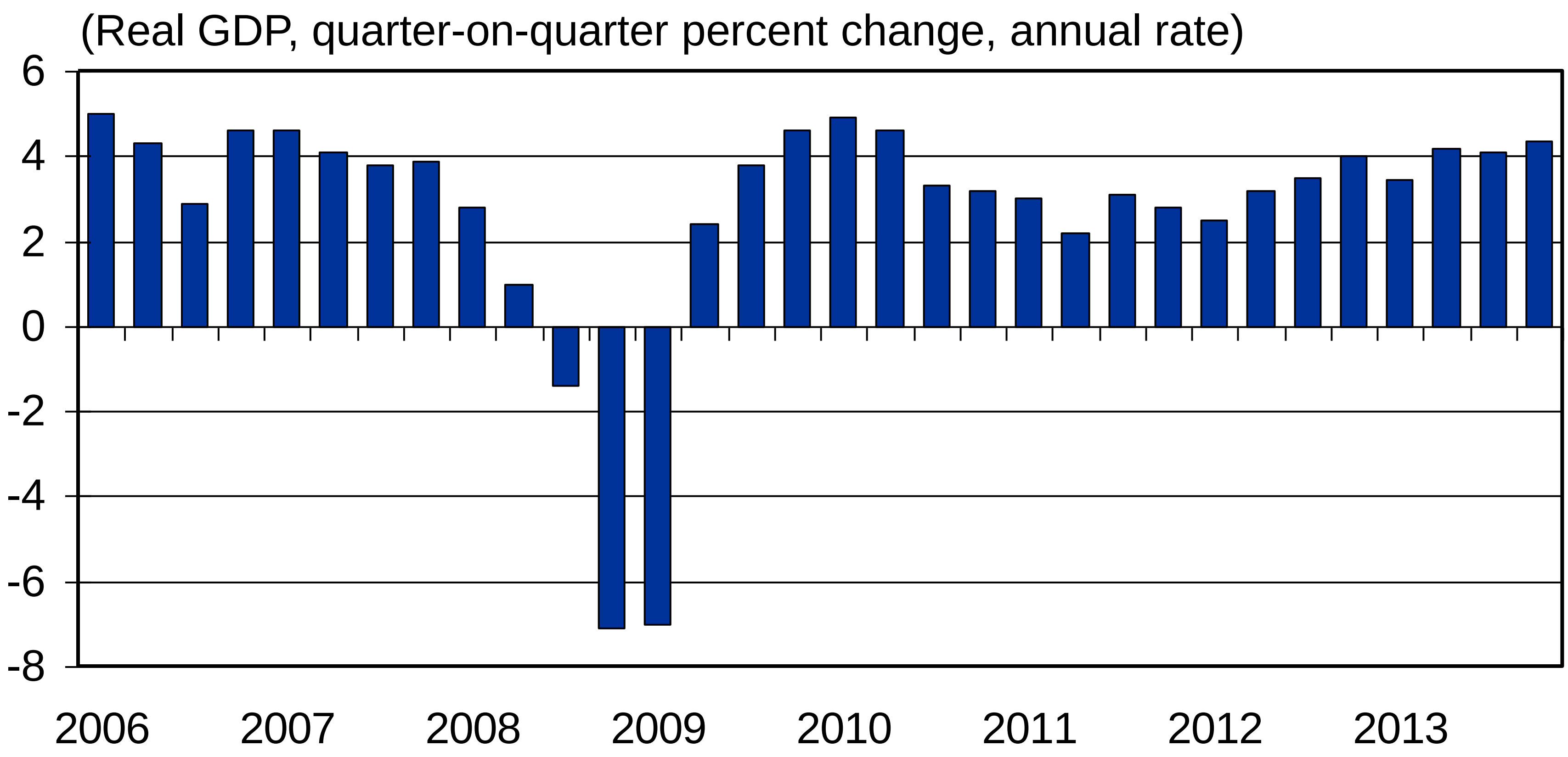
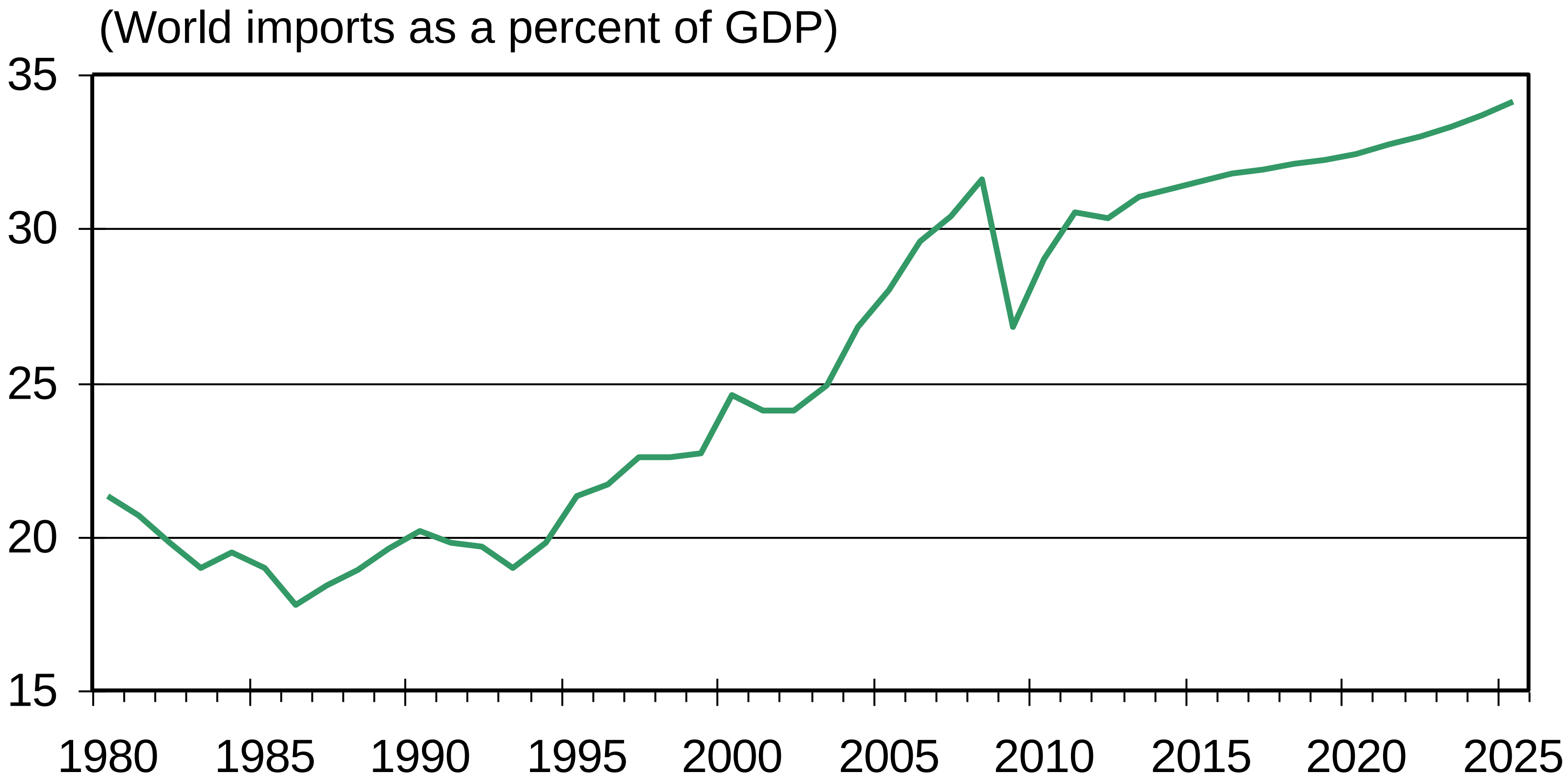
The Global Economy Is at a Dangerous Juncture

- De-leveraging, combined with a crisis of confidence about U.S. and European leaders, is at the heart of today's global malaise
- Europe is probably already in a mild recession or about to enter one
- U.S. growth is still very weak, but a second dip is avoidable
- Emerging markets have only partially de-coupled, and will suffer slower growth
- Inflation is easing and more central banks are on hold (or taking more unorthodox actions)
- Currency "wars" – real or imagined – are a dangerous distraction
- The Eurozone sovereign debt crisis is the single biggest threat to the world economy – the U.S. fiscal problems are more manageable
- While a double-dip can't be ruled out, a lost decade is more likely

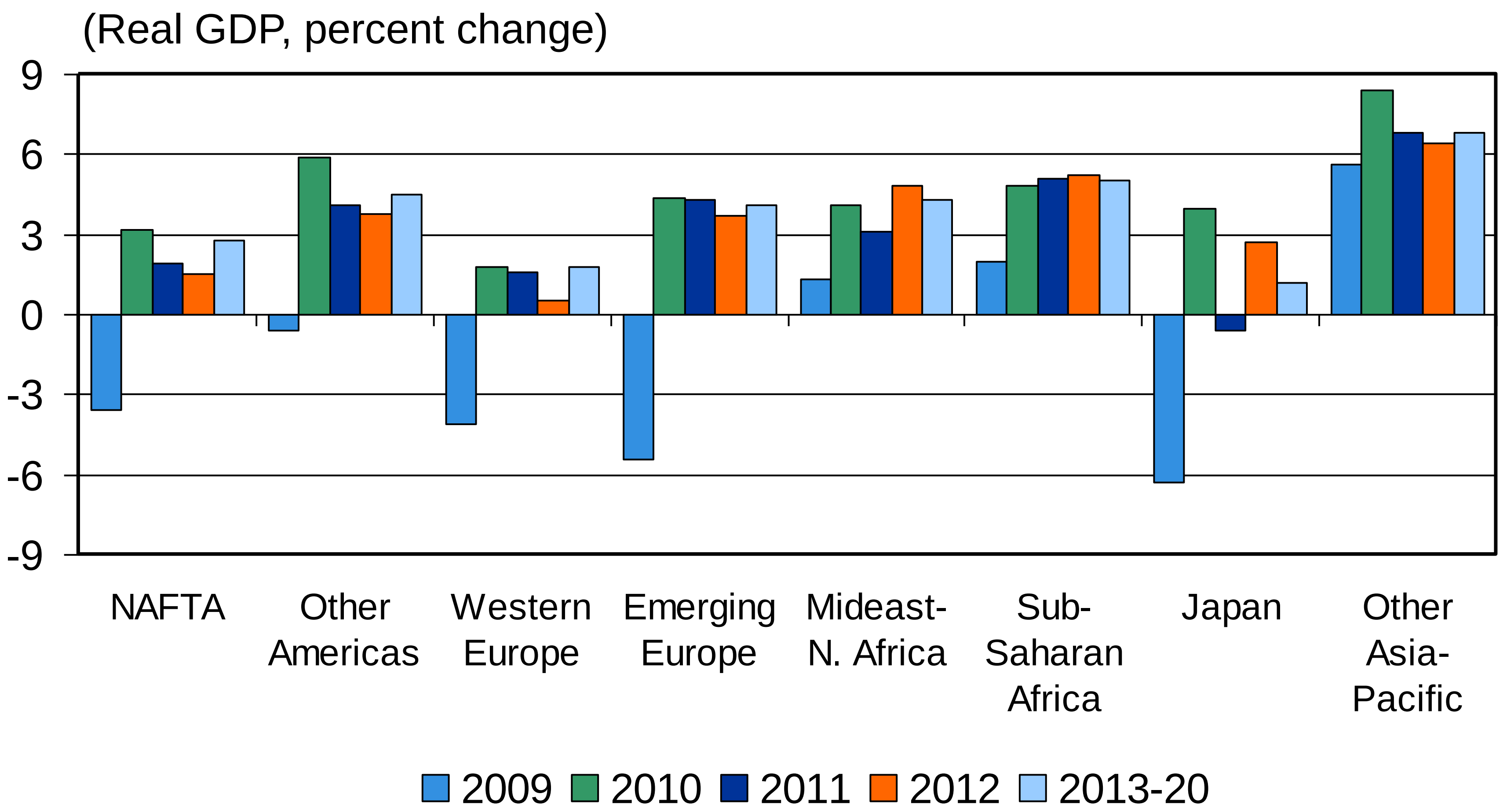
Global Growth Has Weakened Since Mid-2010



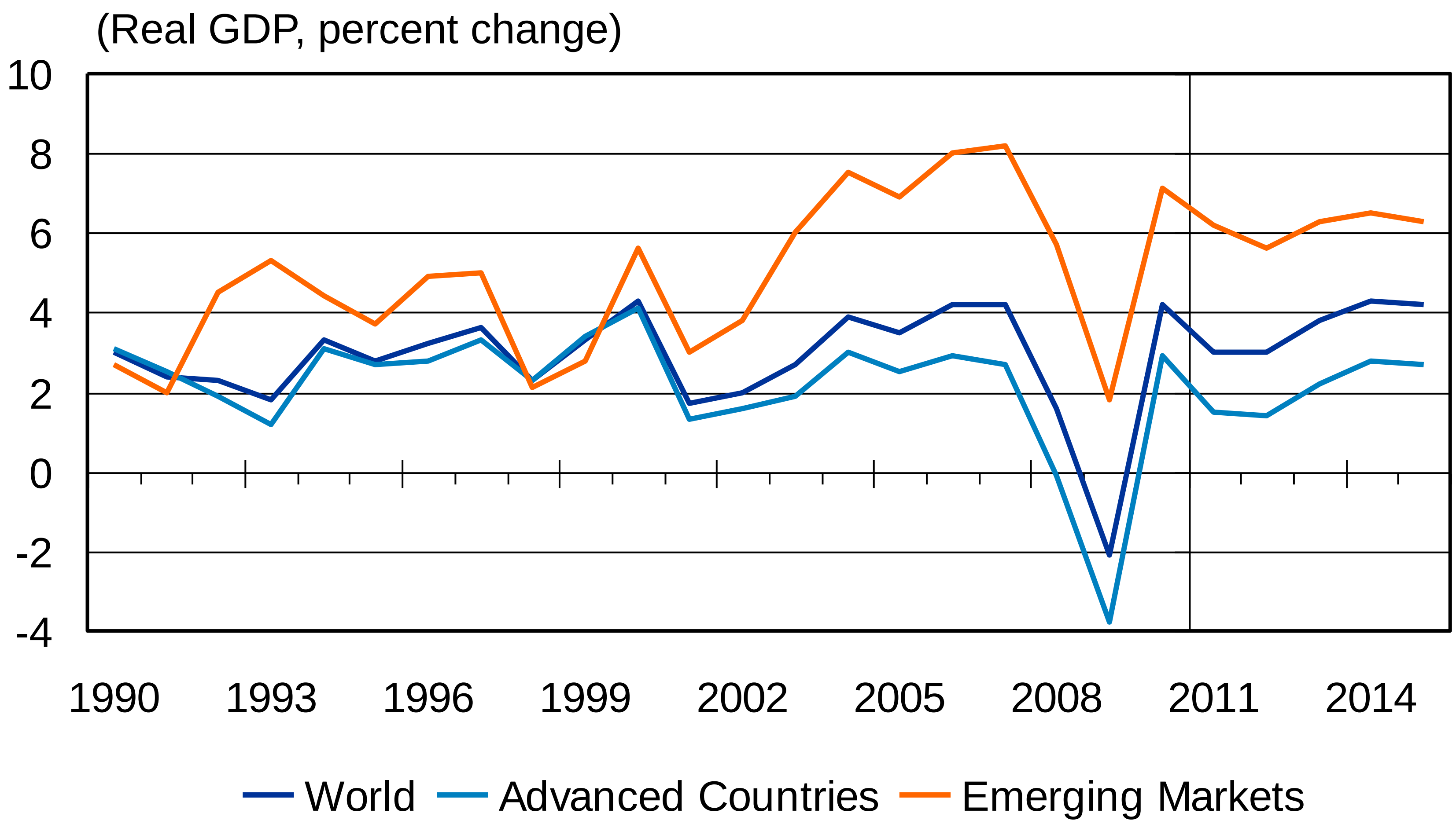
World Trade and Globalization on the Rise Again, But at a Slower Pace



Still a Two-Speed World…



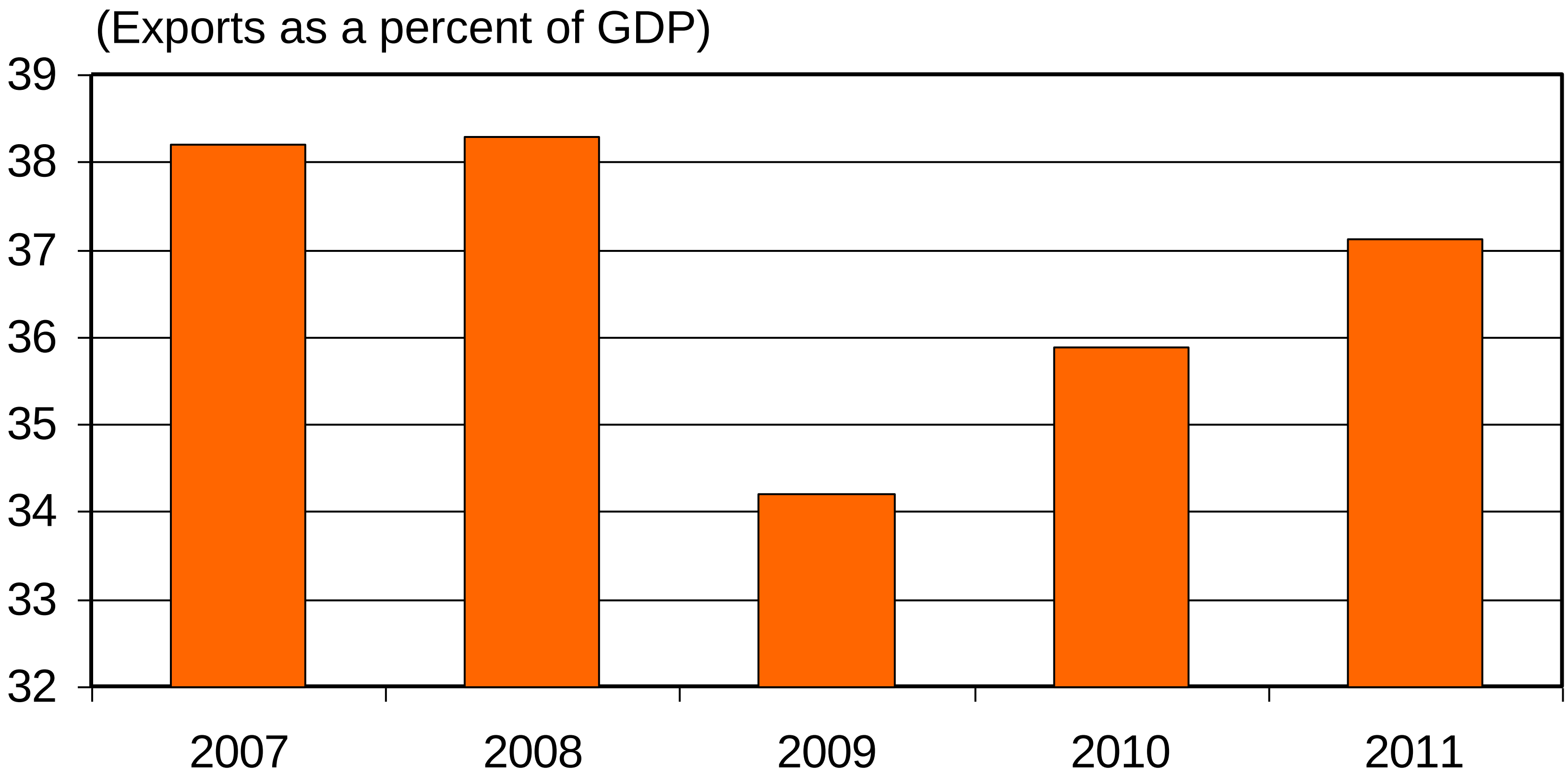
…But Emerging Markets Are Not Meaningfully De-coupled



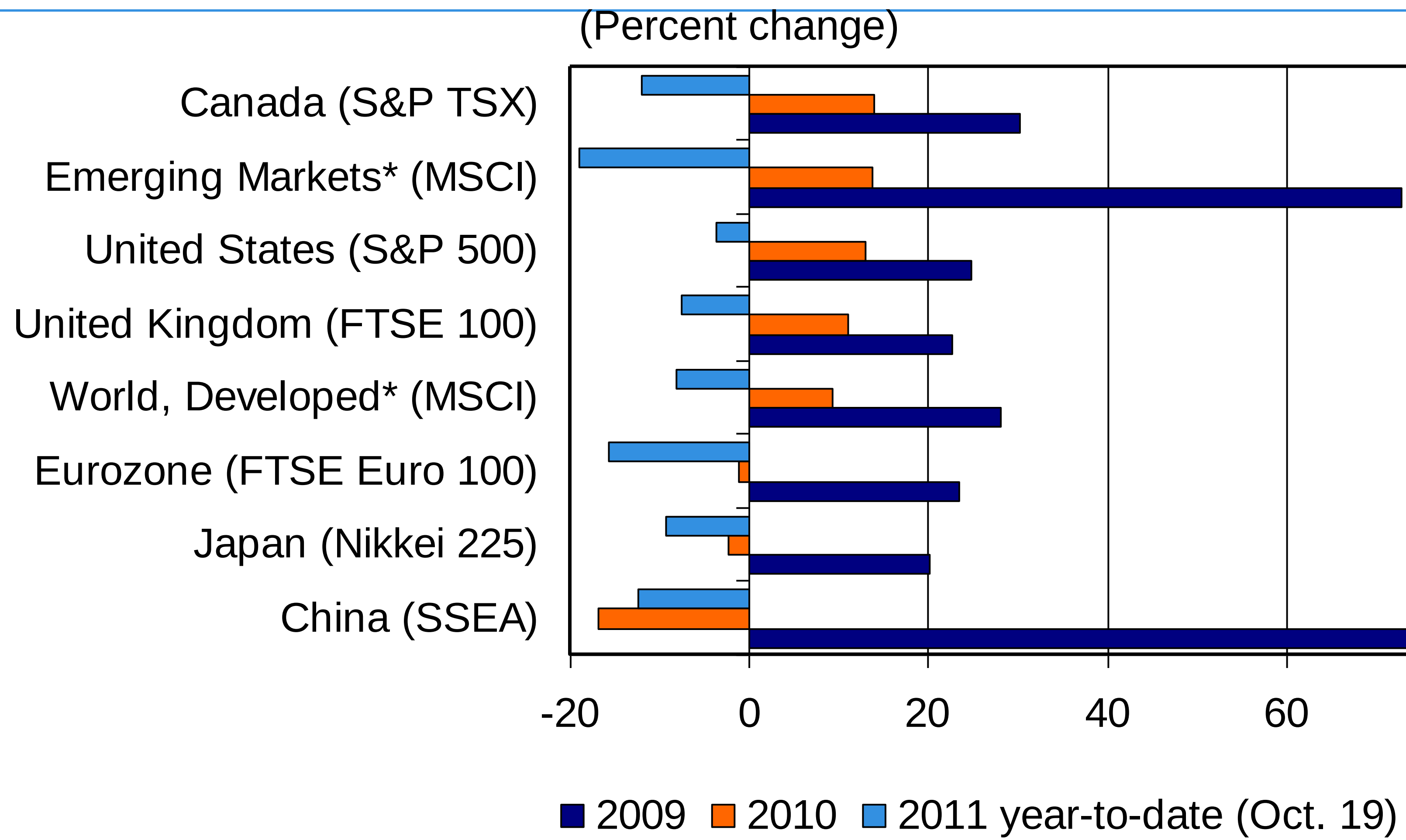
Only Limited De-coupling, So Far

- Most emerging markets are still too export-dependent …
- … And will be hurt by the slowdowns/recessions in the world’s two largest economies (EU and U.S.)
- The recent drop in commodity prices will also hurt export earnings and government revenues
- The bigger than average declines in emerging market stock indexes, suggest that investors are a long way from viewing these markets as safe havens
- Most worrisome of all, policy makers in the emerging world have less room to maneuver, since they have already used up much of their ammunition

Emerging Markets Are Still Export-Dependent



Global Stock Markets Re-Price for an Environment of Slower Growth

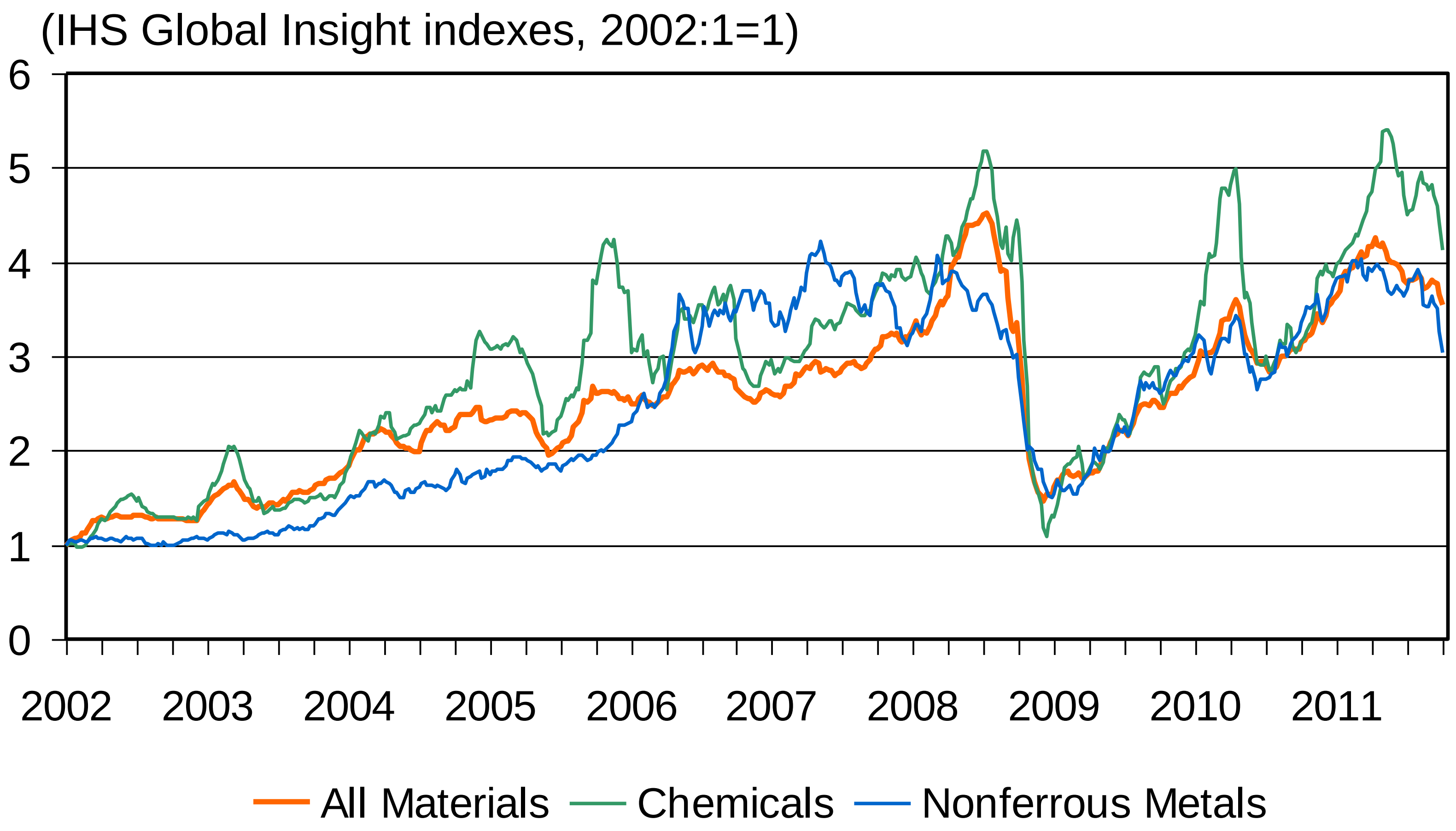


* In U.S. dollars

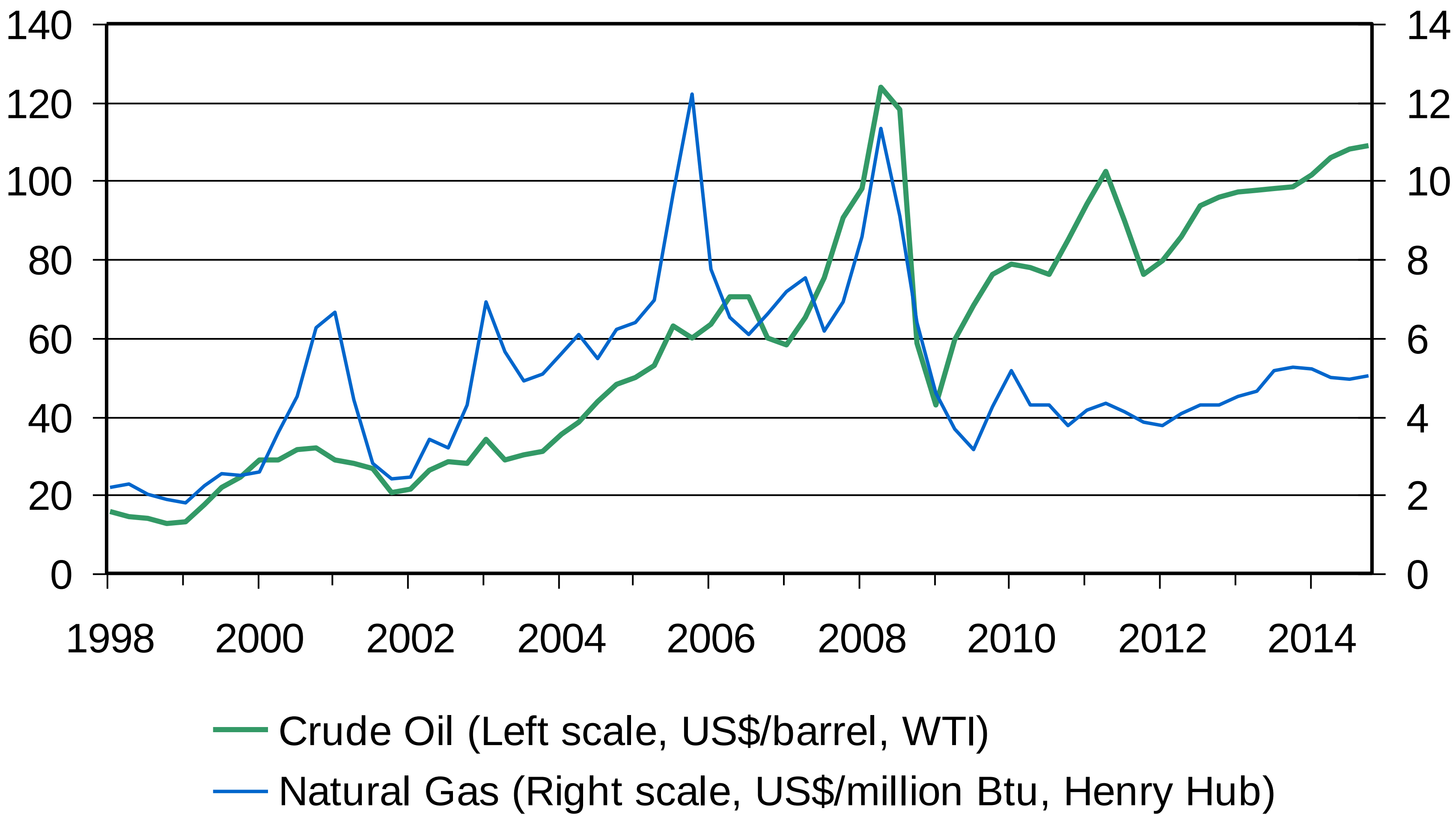
Oil and Other Commodity Prices – Less of a Threat?

- Commodity prices have retreated in response to a weakening global economy, decelerating demand, and a stronger dollar…
- …However, market fundamentals (including limited spare capacity) will support oil and other raw materials prices
- Increased production from non-conventional sources will limit oil price increases in the medium-term
- Will OPEC cut production in response to a significant price decline?
- China's growth and stockpiling will continue to be a major factor in the outlook for commodity prices
- At current levels, oil prices are not a big threat to the recovery – and may be even less so in the near future

Industrial Materials Prices Remain Volatile



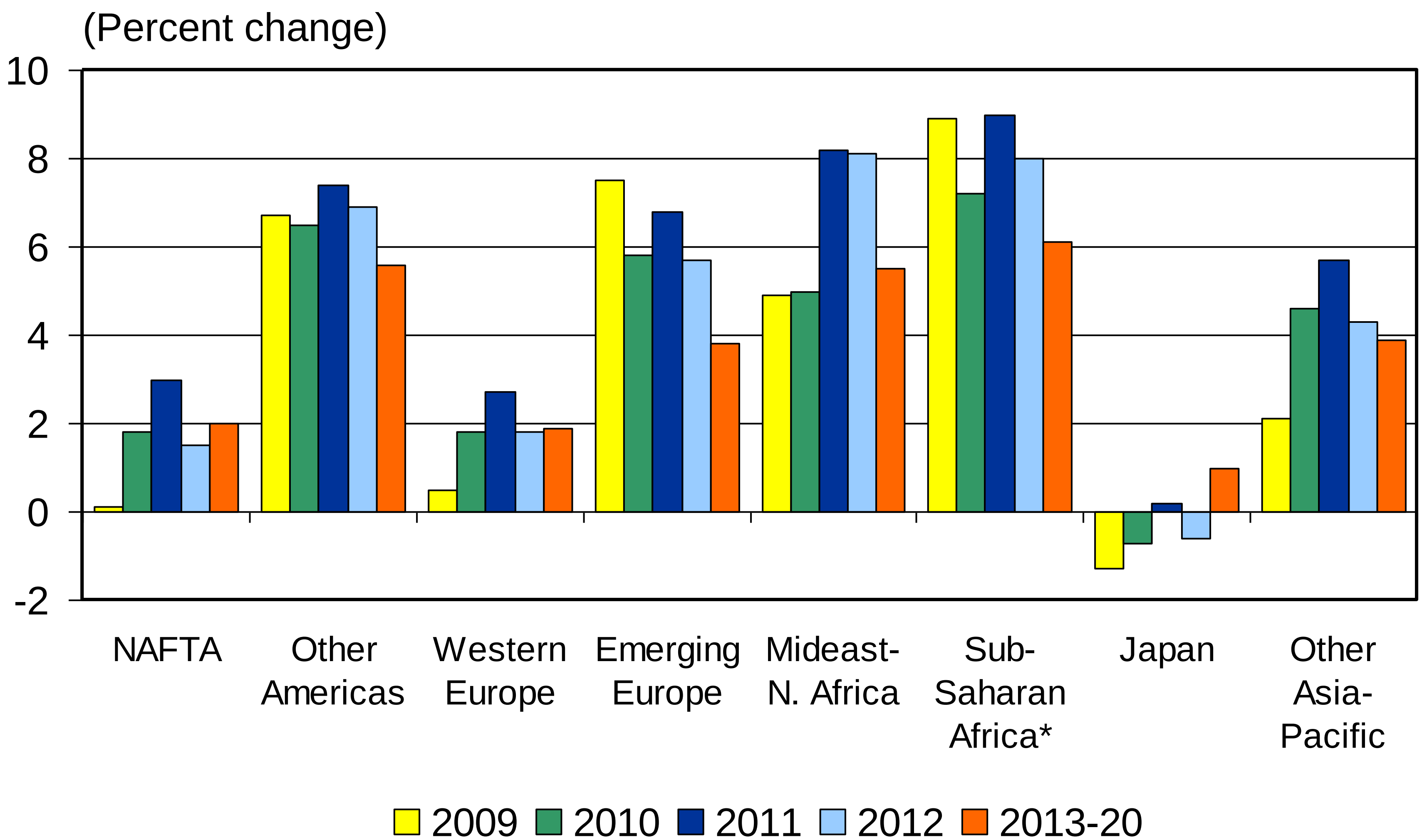
Crude Oil and Natural Gas Prices Have Diverged



Inflation Pressures Are Moderating, and More Central Banks Are On Hold

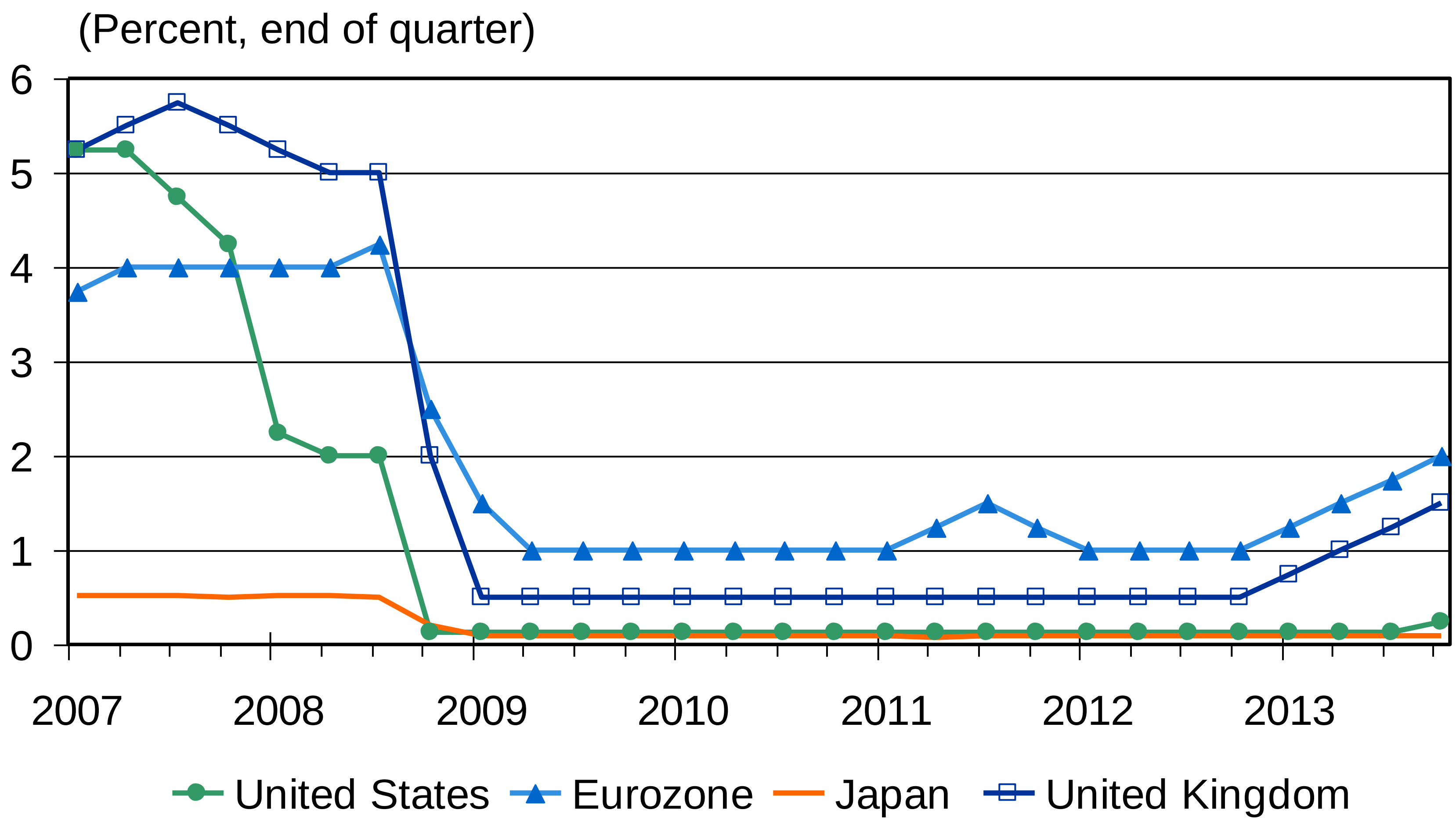
- With growth slowing and commodity prices falling, inflationary pressures are easing
- In the U.S. and Europe, headline and core inflation will decline, as output gaps and excess capacity are still substantial (and possibly growing)
- In Japan, deflation will persist for some time
- In the emerging world, the risk of overheating has lessened, but remains a challenge in some countries (e.g., India)
- The Fed and the Bank of England will be on hold for a long time – the ECB can be expected to cut soon…
- …All three are also engaging in unorthodox easing moves (once again), and are likely to do more in the coming year – although the potency of such moves is diminishing
- Meanwhile, many central banks in the emerging world have also put monetary policy on hold, and some (e.g., Brazil and Israel) have begun to cut rates
- Arguably, monetary policy in some emerging markets is too loose

Consumer Price Inflation Will Moderate Everywhere



* Excluding Zimbabwe

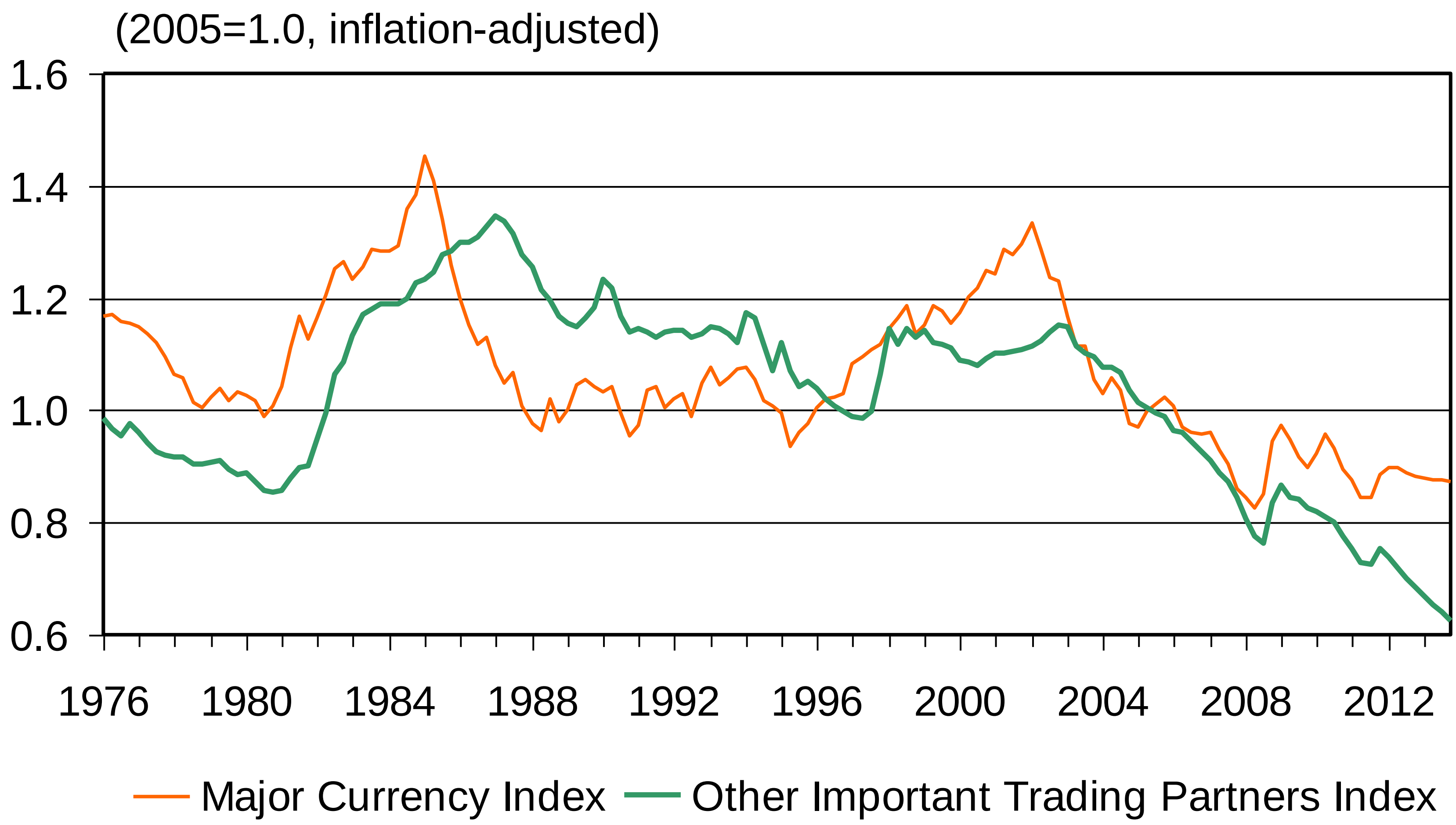
Policy Interest Rates in the Advanced Countries Stay Low for an Extended Period



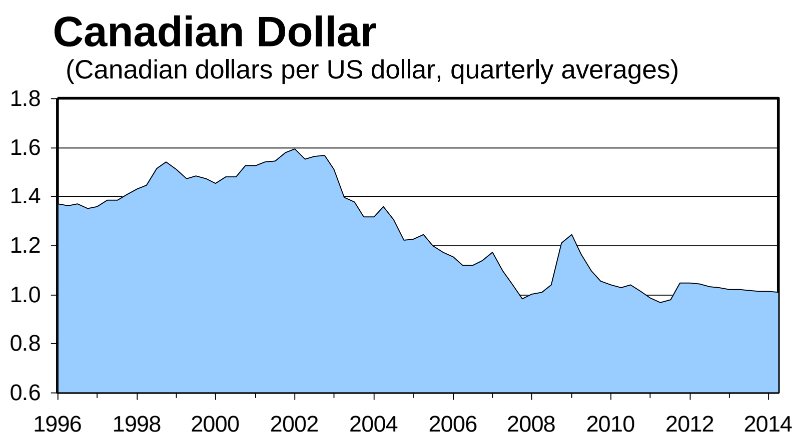
Currency “Wars” – Round II

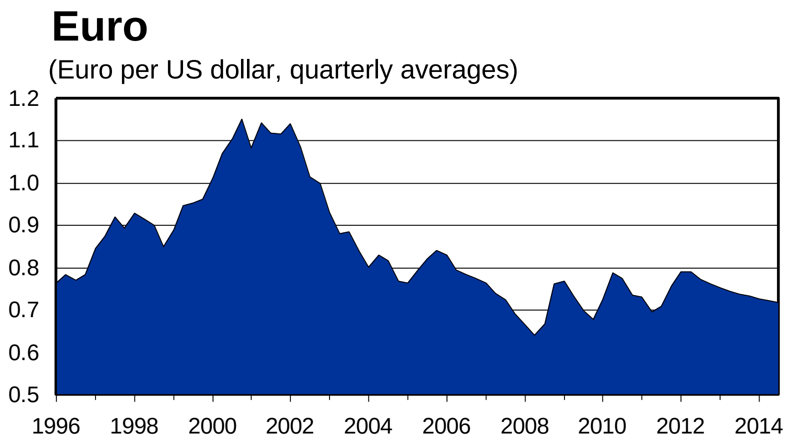
- A dangerous distraction
- Currency movements mostly reflect fundamentals – though the search for safe havens and higher returns have played a role
- More countries have joined the intervention fray (notably, Japan and Switzerland)
- The dollar is strengthening – as it almost always does during crises
- Real effective exchange rates point to the secular weakness of the U.S. dollar and the currencies of other developed economies – and the secular strength of emerging market currencies
- U.S. moves against China are mostly political posturing – but also very risky
- Big risk: sliding into 1930s-style protectionism

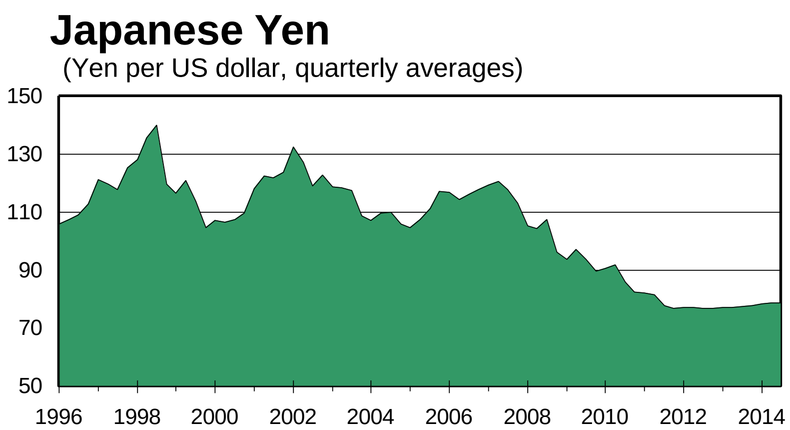
The U.S. Dollar: Secular Weakness Against Emerging Market Currencies

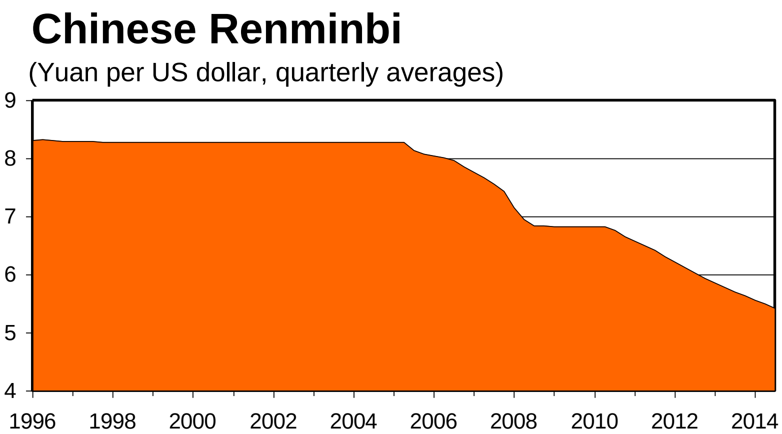


Exchange Rates per U.S. Dollar

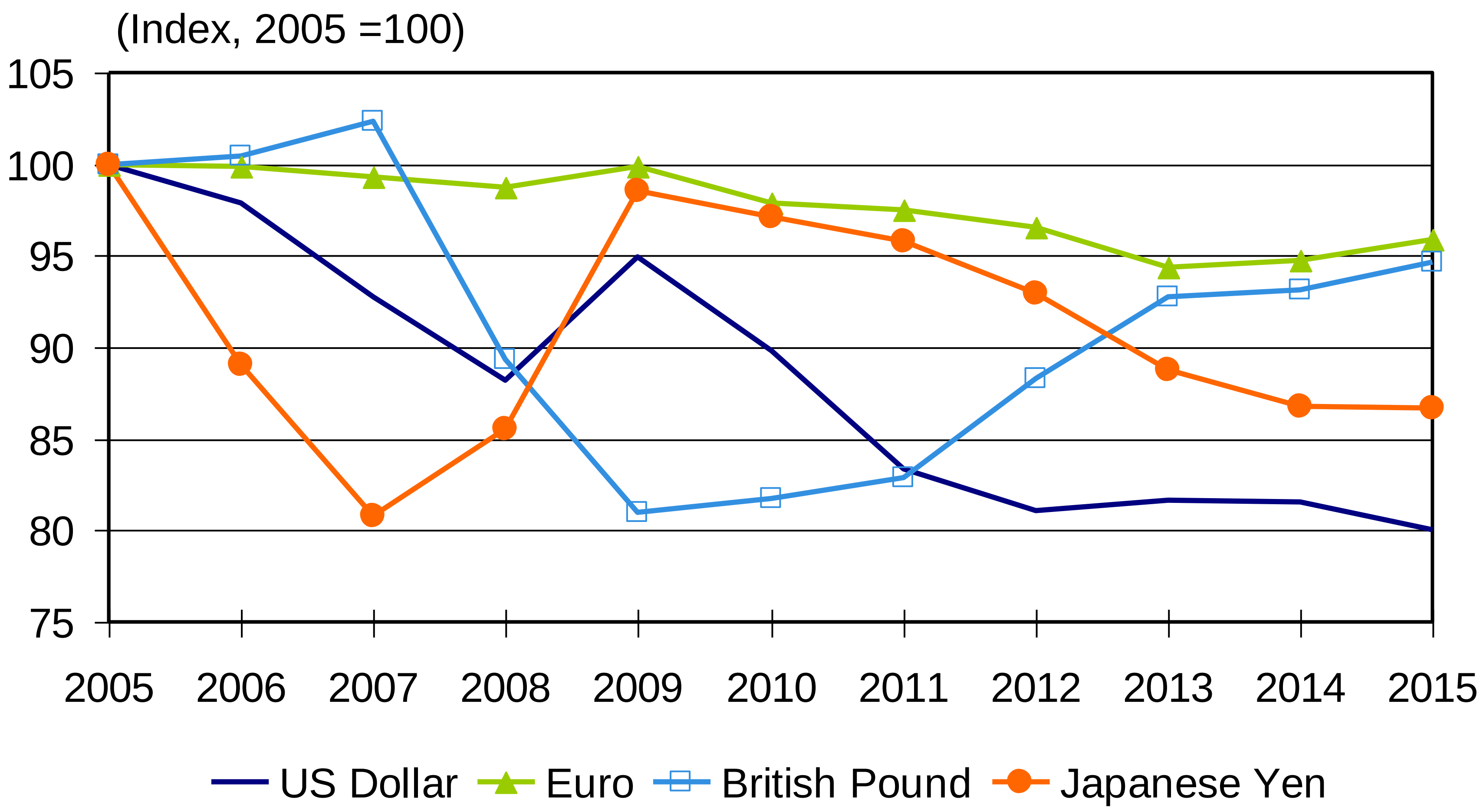




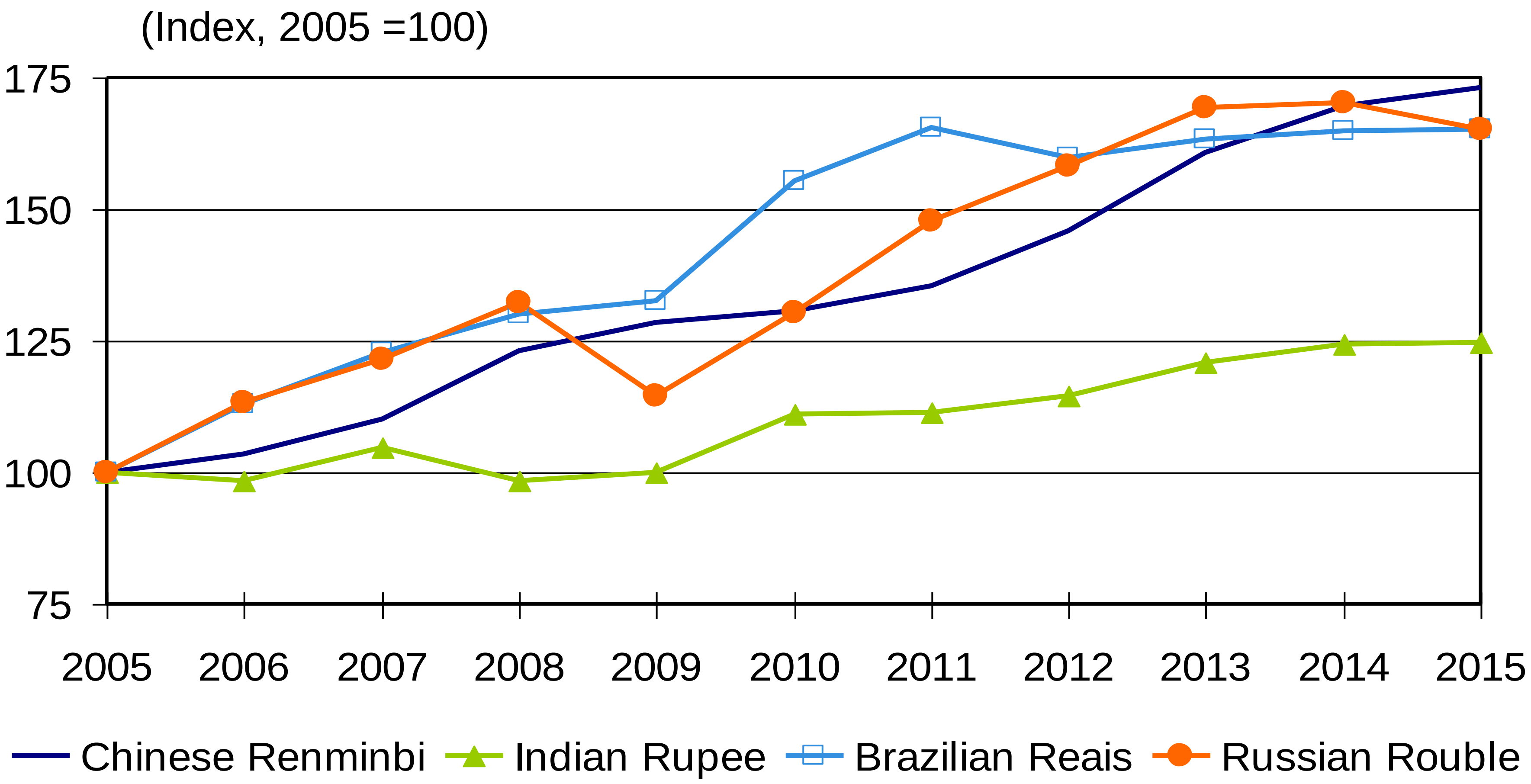




Real Effective Exchange Rates



Real Effective Exchange Rates



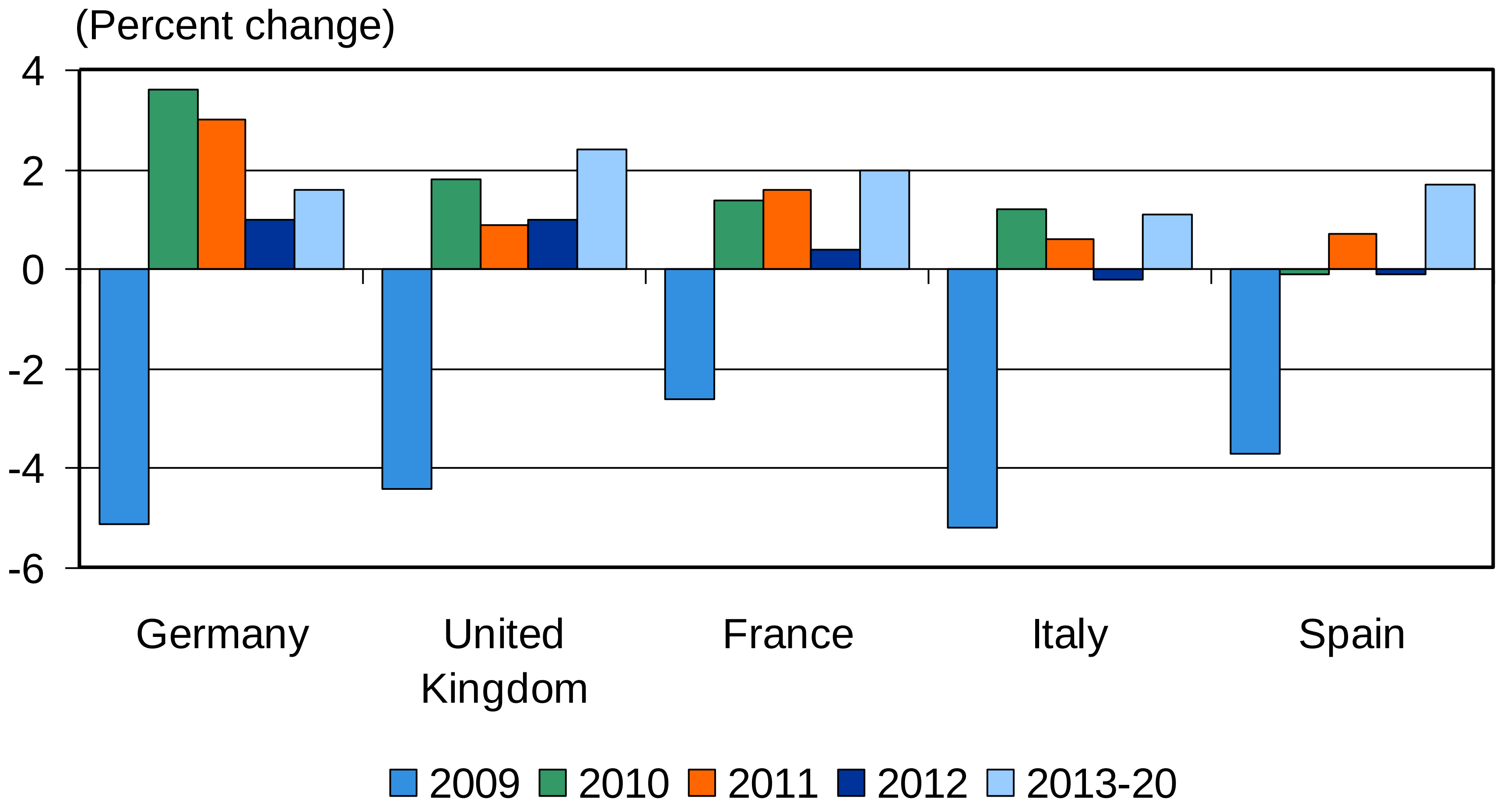
The Biggest Threat to the Recovery? A European Meltdown

- Unlike the U.S., the sovereign debt problems in Europe are systemic
- Long-term challenge: Southern Europe has had a dramatic loss in competitiveness
- Long-term challenge: An inherent problem in the Eurozone is that the members are neither sovereign states nor members of a federation—or why California is much better off than Greece
- Long-term problem: the Eurozone is probably in an “unstable equilibrium”—going backward is not an option, but going forward (fiscal and political union) is a huge political challenge
- Short-term challenge: Greece is bankrupt and its debt needs to be restructured without further contagion and damage to the European and world banking systems
- Short-term challenge: the bailout funds need to be much larger
- Short-term problem: To date, European leaders have engaged in the three Ds – denial, delay and dithering
- Like a train wreck in slow motion

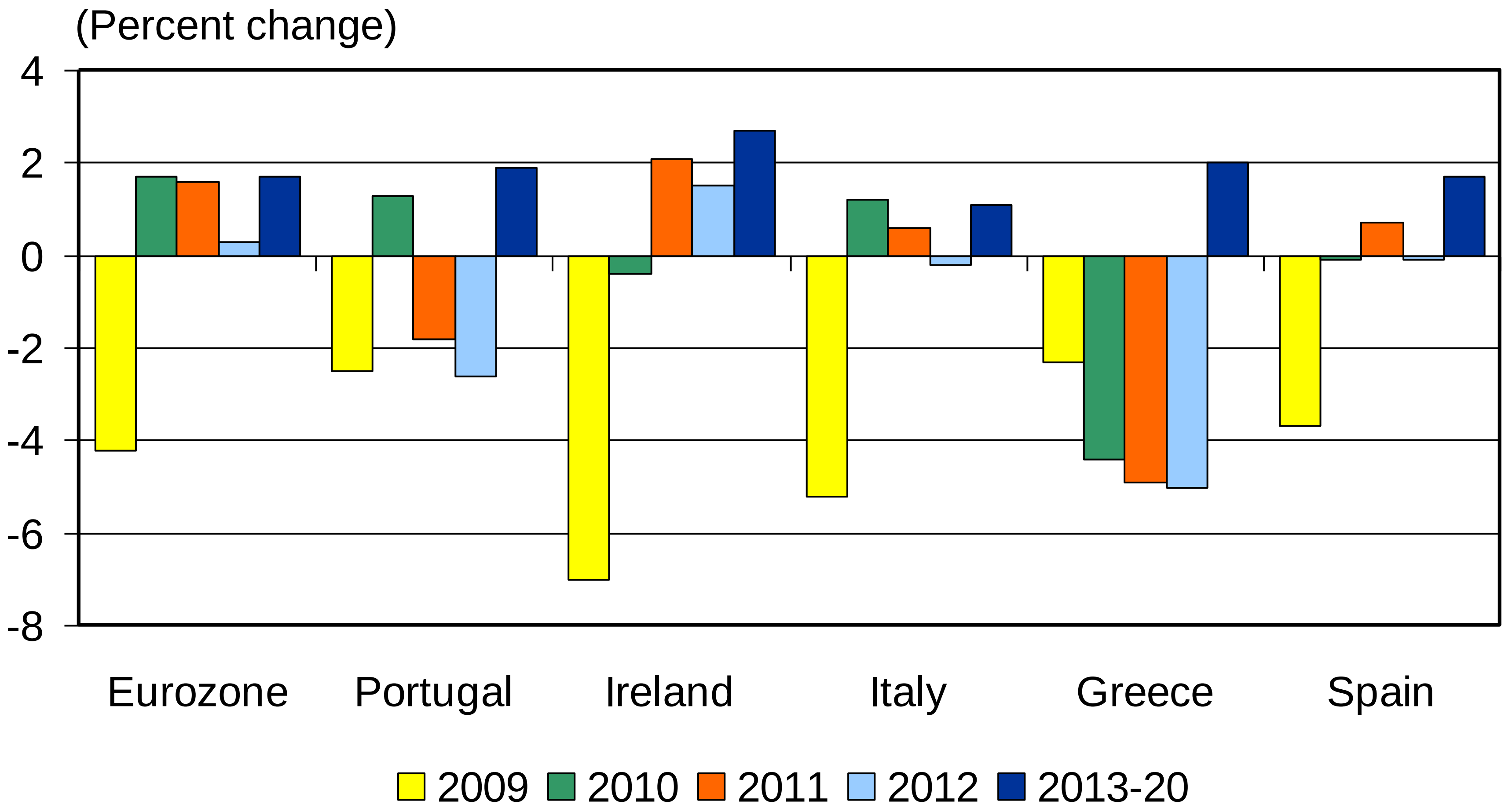
Eurozone Baseline – Muddling Along (75% Probability)

- Mild recession – two-speed Europe converges on lower speed
- Greek default in early 2012 – no exit from Eurozone
- The European Financial Stability Facility (EFSF) is leveraged and (possibly) expanded, so that contagion is limited and bank bailouts are provided, as needed
- The ECB will cut rates twice – in Q4 and Q1 – and provide (essentially) unlimited liquidity
- The euro will fall to $1.25 by March 2012
- Impact on the U.S., China and rest of world will be measurable, but limited
- Transmission mechanisms: trade, exchange rates, profits, tighter credit conditions

Real GDP Growth in Western Europe: Another (Milder) Recession Likely



Real GDP Growth in the Eurozone's Trouble Spots



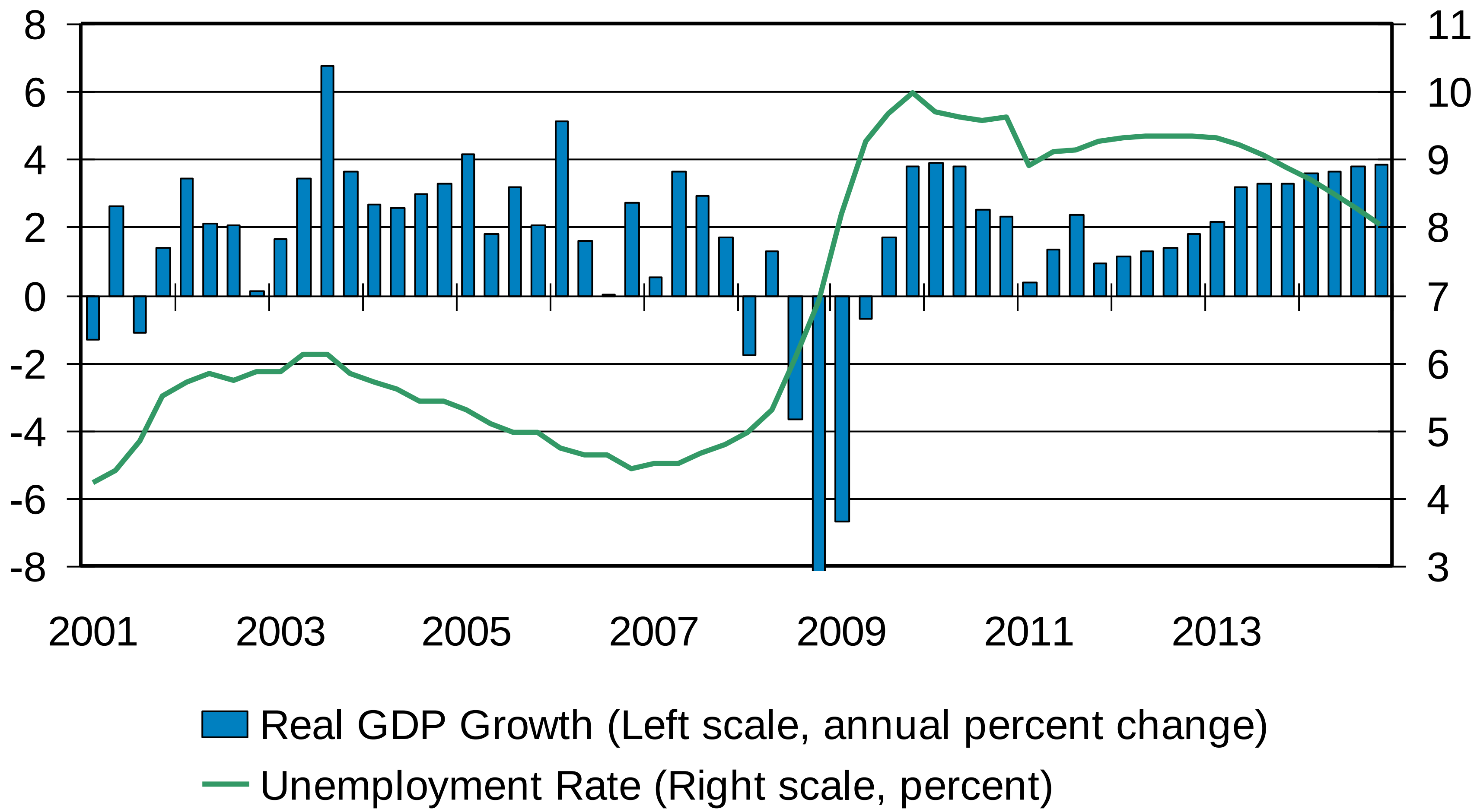
Eurozone Meltdown Scenario – “Lehman II” (25% Probability)

- European leaders either unwilling or too slow to leverage/expand the EFSF
- Unbearable pressure on high-debt countries
- Greece defaults and leaves the Eurozone
- Major financial panic
- European leaders finally act big and bold – preventing other countries from leaving the Eurozone
- Deep recession in Europe
- ECB cuts rates to zero – euro falls to parity against dollar
- Big impact on the US, China and rest of world – this is the double-dip

United States – Growth Is Dangerously Weak

- Recent data suggest the U.S. economy is not in recession – but growth is extremely sluggish
- Quintessential case of bad interaction between de-leveraging and crisis of confidence
- Consumers and businesses are super cautious – pent-up demand is building, but when will it get released?
- Fiscal policy is already tightening – but will it become even tighter?
- Operation “twist” and more quantitative easing by the Fed will not help a lot
- Unless there is another big shock (e.g., from the Eurozone) the U.S. economy is likely to stagger along

Sluggish U.S. Economic Growth and a Persistently High Unemployment Rate



Will We Fall Back Into Recession?

Why?

- An economy near stall speed is vulnerable to shocks
- Fed can't help much
- Risks of policy mistakes
  - Premature fiscal tightening
  - Policy paralysis
- Eurozone is the immediate risk
- Greek Eurozone exit could be a "Lehman moment"
- Oil shocks are a perennial threat

Why Not?

- US banks in better shape than 2008
- Nonfinancial corporations balance sheets are strong
- Exposures to Eurozone sovereign debt are better understood than exposures to sub-prime debt were
- Europe unlikely to allow a major institution to collapse a la Lehman

US Economic Growth by Sector

(Percent change unless otherwise noted)

	2010	2011	2012	2013
Real GDP	3.0	1.7	1.4	2.4
Final Sales	1.4	1.9	1.4	2.3
Consumption	2.0	2.1	1.9	1.8
Light Vehicle Sales (Millions)	11.6	12.5	13.2	14.7
Residential Investment	-4.3	-2.1	4.3	17.9
Housing Starts (Millions)	0.58	0.59	0.67	0.94
Business Fixed Investment	4.4	8.7	4.3	5.8
Federal Government	4.5	-1.9	-2.7	-3.6
State and Local Government	-1.8	-2.4	-2.7	-0.9
Exports	11.3	6.7	3.4	7.5
Imports	12.5	4.6	2.4	3.8

Other Key Indicators

(Percent unless otherwise noted)

	2010	2011	2012	2013
Industrial Production (% growth)	5.3	3.6	1.6	3.2
Employment (% growth)	-0.7	0.9	0.6	1.3
Unemployment Rate	9.6	9.1	9.3	9.1
CPI Inflation	1.6	3.0	1.3	1.9
Oil Prices (WTI, $/bbl)	79	91	89	98
Core PCE Price Inflation	1.4	1.5	1.4	1.6
Federal Funds Rate	0.18	0.11	0.10	0.11
10-year Government Bond Yield	3.21	2.76	2.32	2.84
Dollar (Major Currencies, 2005=1)	0.90	0.85	0.88	0.86

Consumer Finances: Too Many Negatives

Negative Forces

- High Unemployment
- Heavy Wealth Loss
- Tight Credit Conditions
- High Debt Burdens
- High Prices – esp. Gasoline, Food
- Future Tax Increases Likely

Positive Forces

- Fiscal Stimulus (temporary)
- Pent-Up Demand
- Gasoline Prices Should Fall, Food Inflation Should Ease

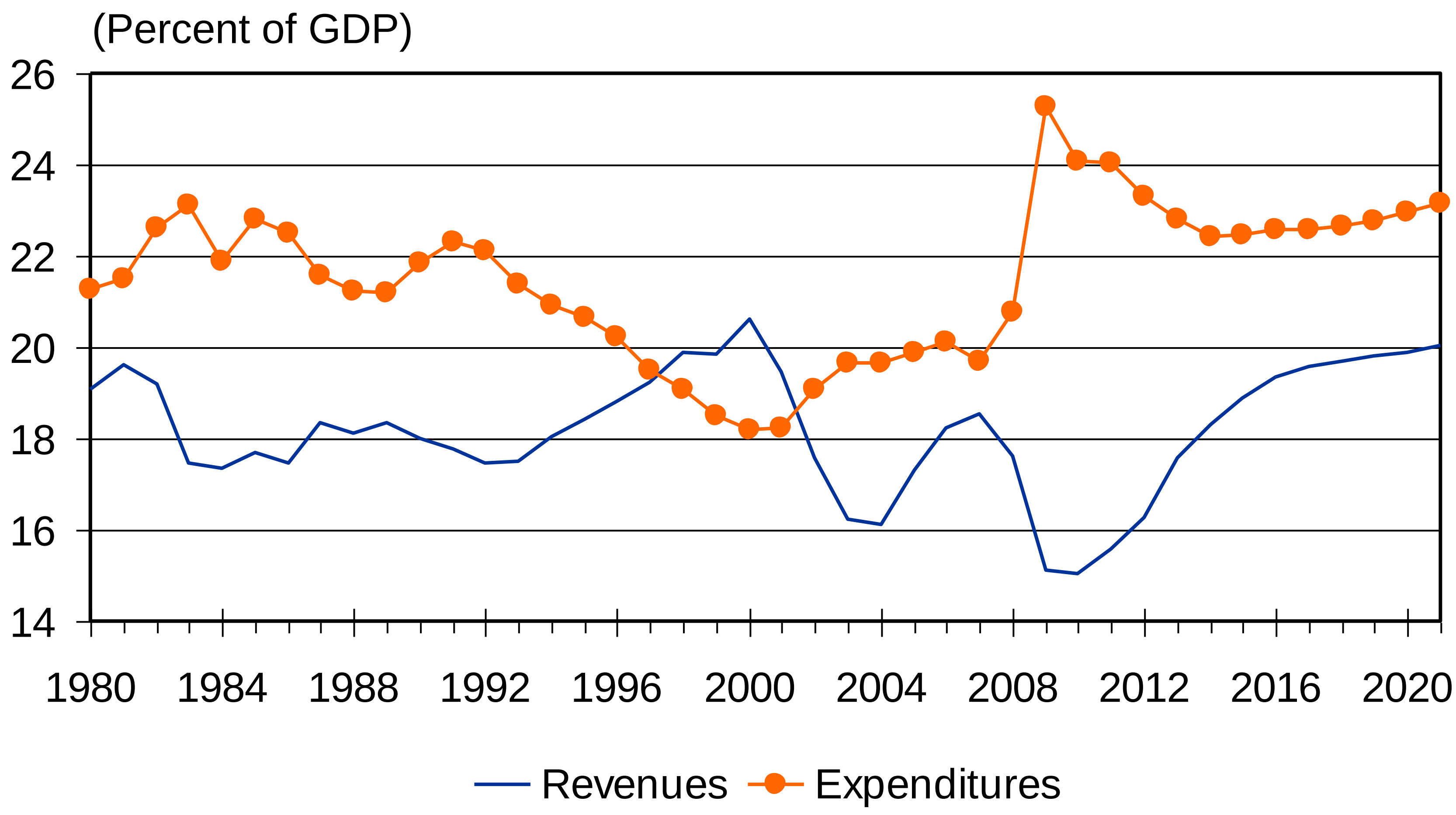
Housing:
Still Bumping Along the Bottom

- Positives
  - Housing affordability is at record highs
  - Supply excess is unevenly distributed
  - Multi-family indicators edging higher – renting reviving
  - Pent-up demand is building
- Negatives
  - Credit access still much harder than before
  - Foreclosure rate still high
  - Still a huge overhang of empty homes
  - Household formation way below trend
  - Employment support is missing

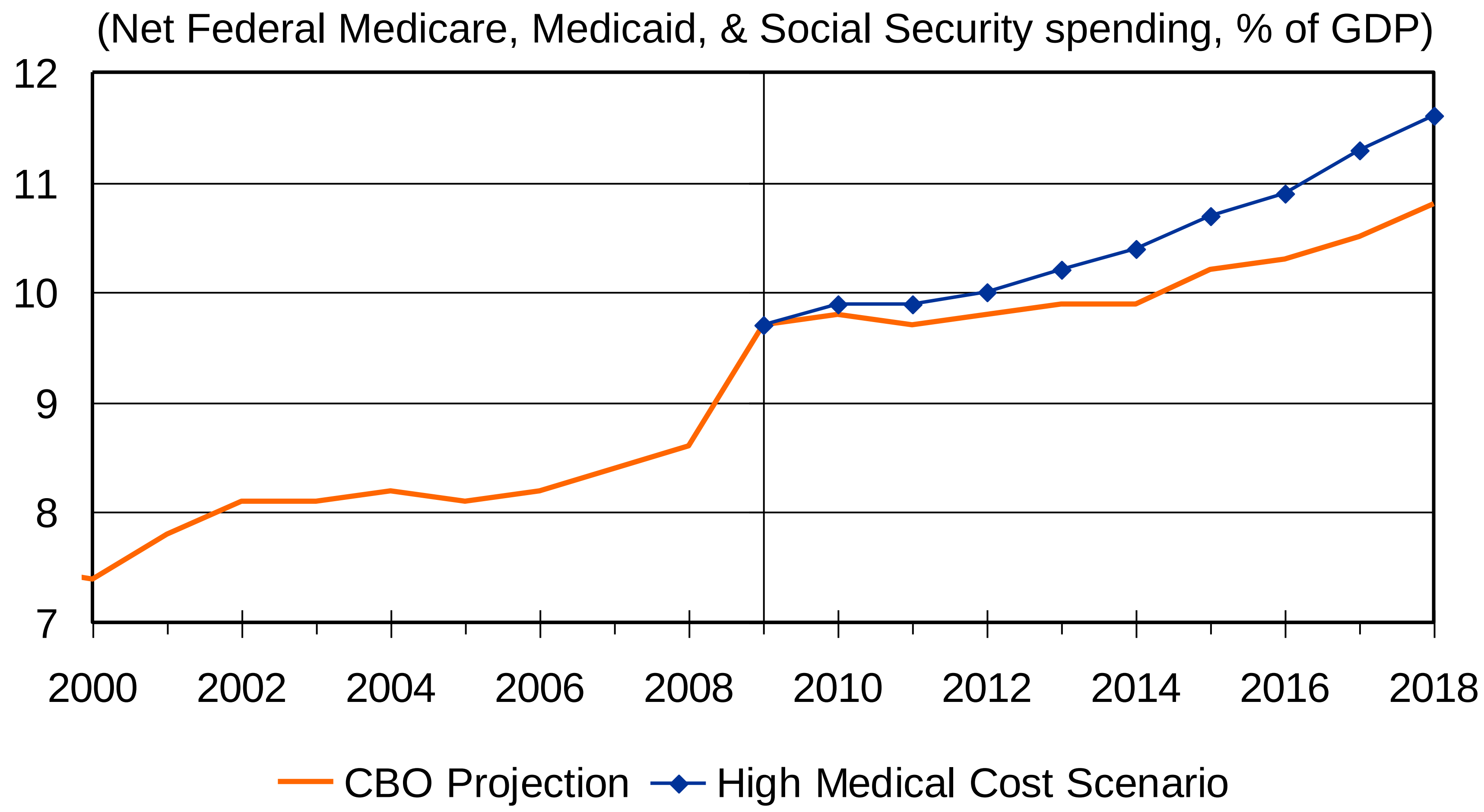
U.S. Fiscal Problems Are Less Intractable Than Europe’s

- The U.S. does not have a fiscal crisis (yet) – it has a political crisis...
- …In other words, it has a manageable problem that is being very poorly managed
- Despite the shameful farce over the summer, financial markets are giving the US the benefit of the doubt
- No shortage of good plans (notably Simpson-Bowles)
- Comprehensive solutions to the U.S. fiscal problems will have to include cuts in entitlement programs (especially Medicare) and increases in taxes (not just for the rich)
- No break in the political logjam is likely until after the 2012 elections – everyone has, once again, retreated to their partisan corners

The U.S. Federal Budget Gap:
The Problem Is On Both Sides of the Ledger

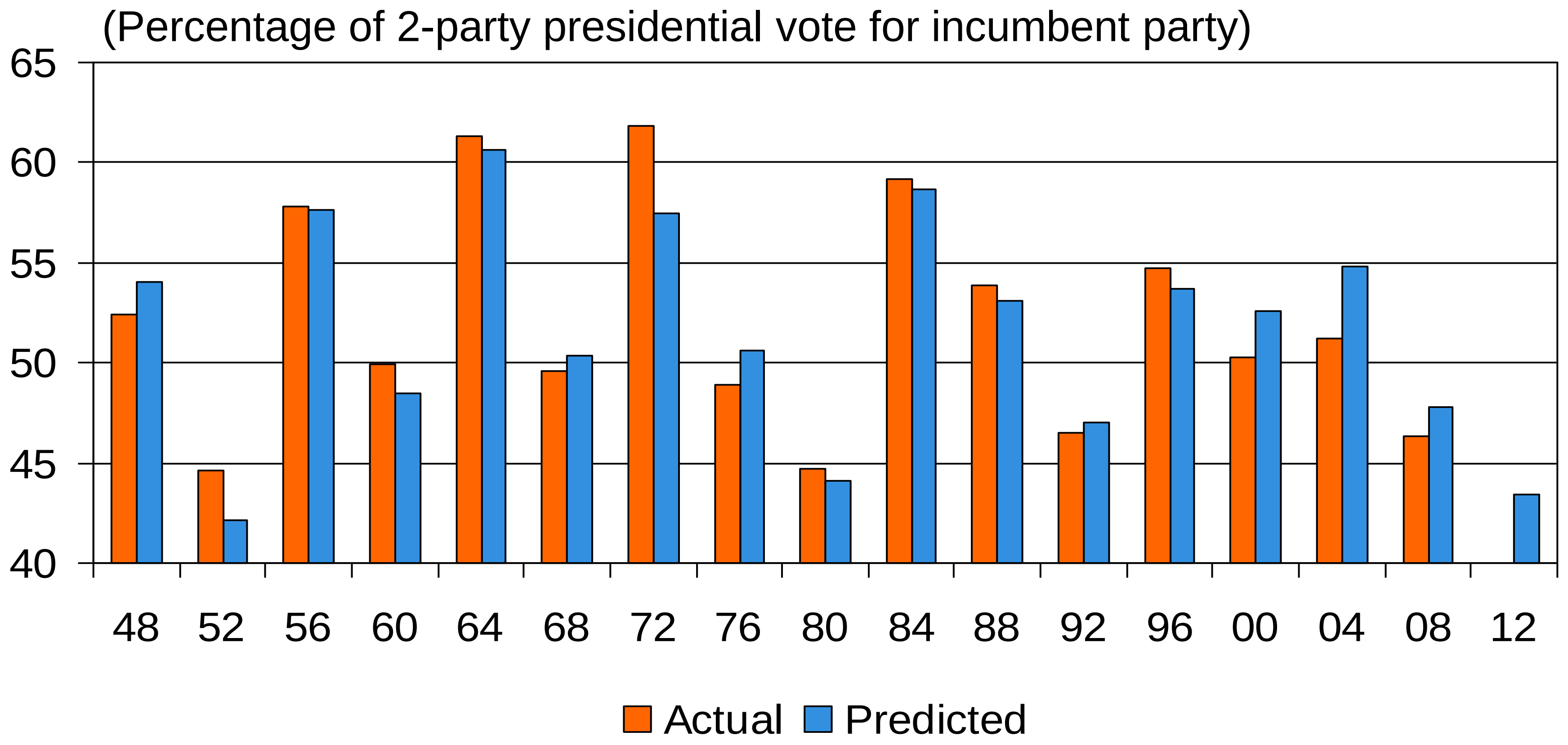


Entitlements Are the Biggest Budget Problem for the U.S.

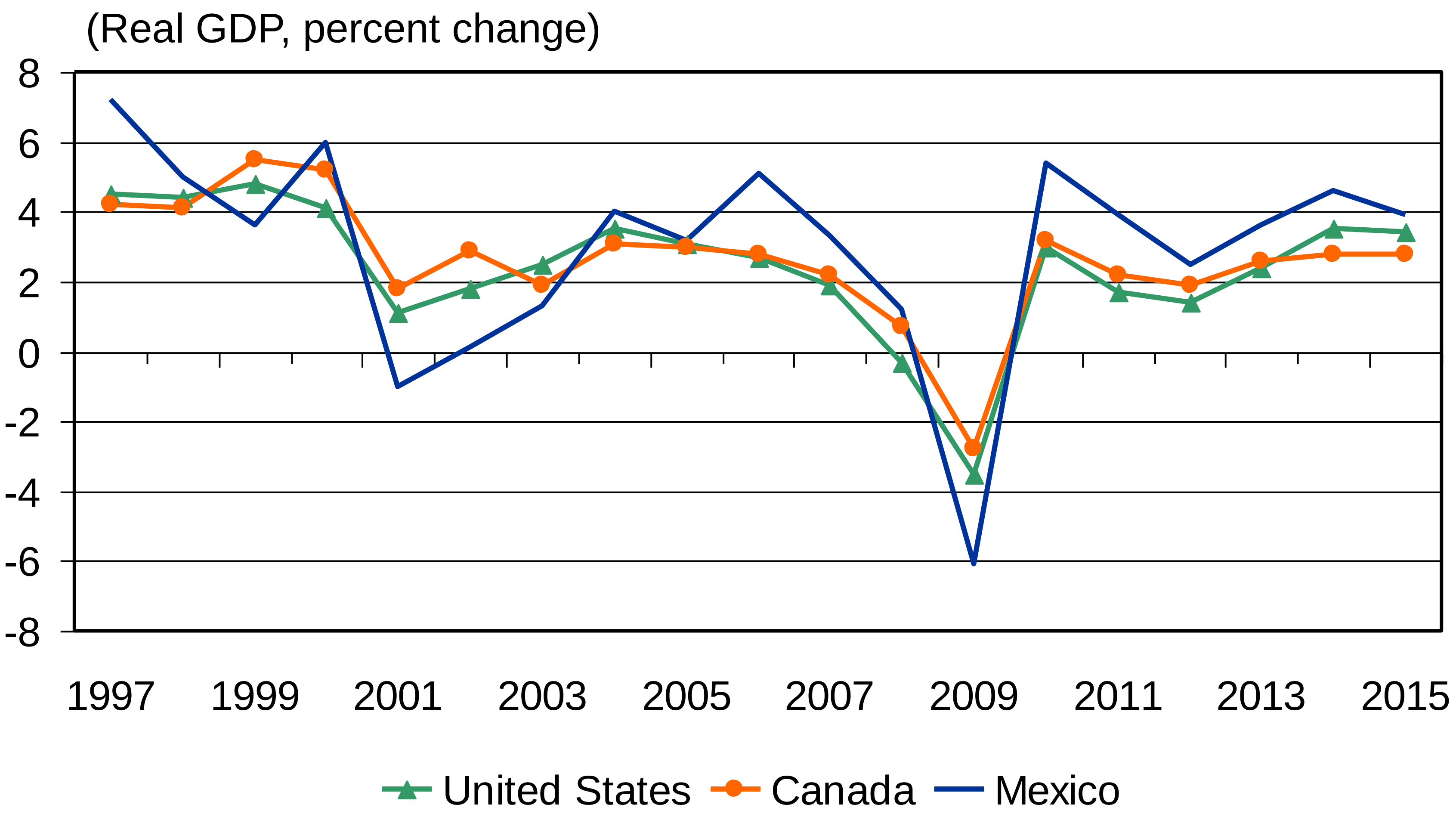


Source: CBO Long-Term Budget Outlook, June 2009

IHS Global Insight Election Model Says the President Has an Uphill Battle



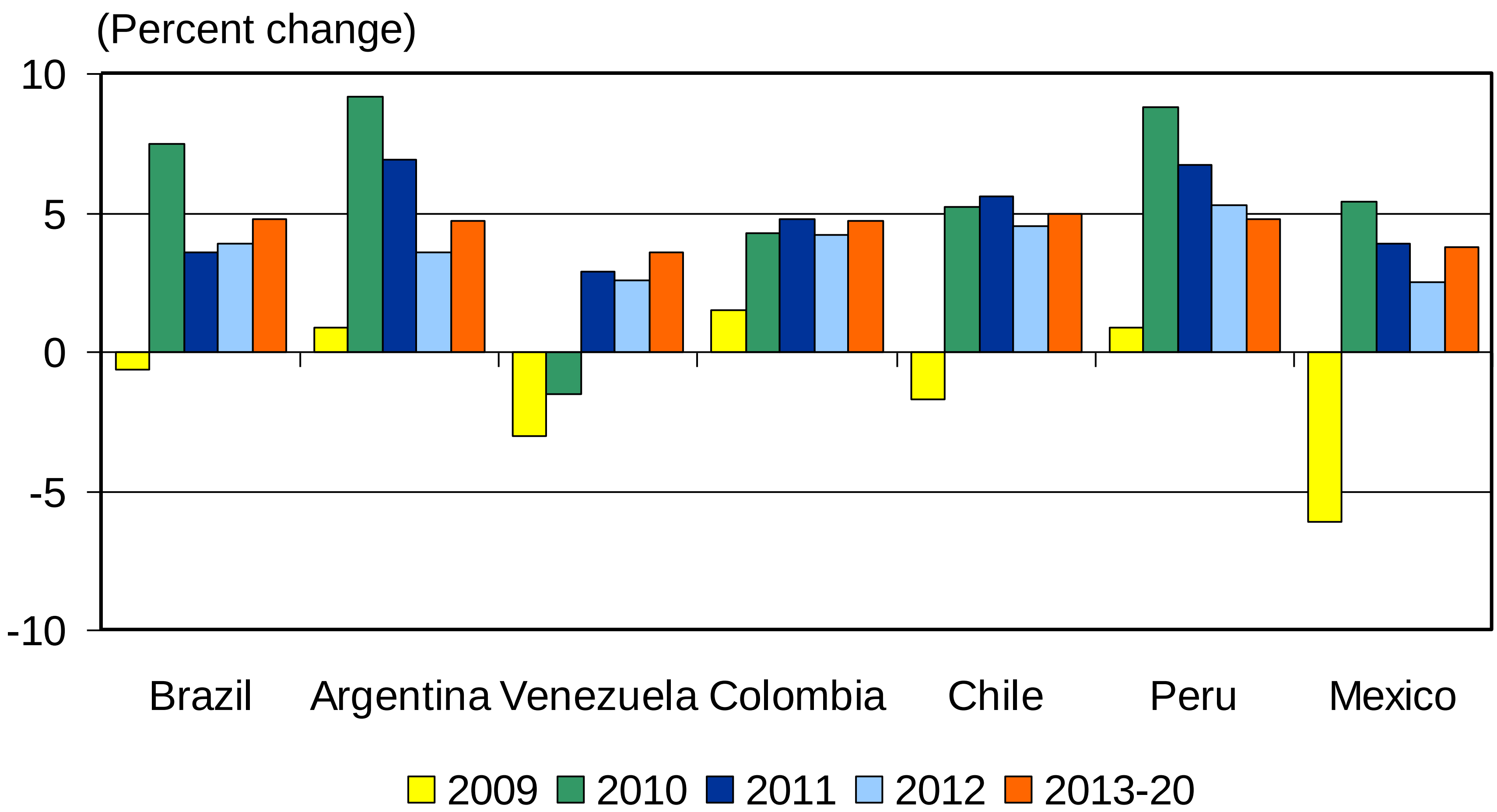
North American Business Cycles Are Synchronized



Latin America Is Preparing for Another Shock

- Most countries have sound macroeconomic fundamentals, improving debt profiles, and stable financial systems
- The region is set to grow 4.0% in 2011 and 3.3% in 2012 as another global slowdown will hurt external demand
- Policy makers have room to maneuver – monetary policy and, to a lesser extent, fiscal spending may be used to help economies counteract the impact of the slowdown in industrial economies
- Many currencies are relatively strong – a sudden correction or sharp devaluation may occur under a panic scenario
- Solid external accounts serve as a buffer to reduce the impact of global crisis
- Inflation mostly remains muted

Real GDP Growth in Latin America



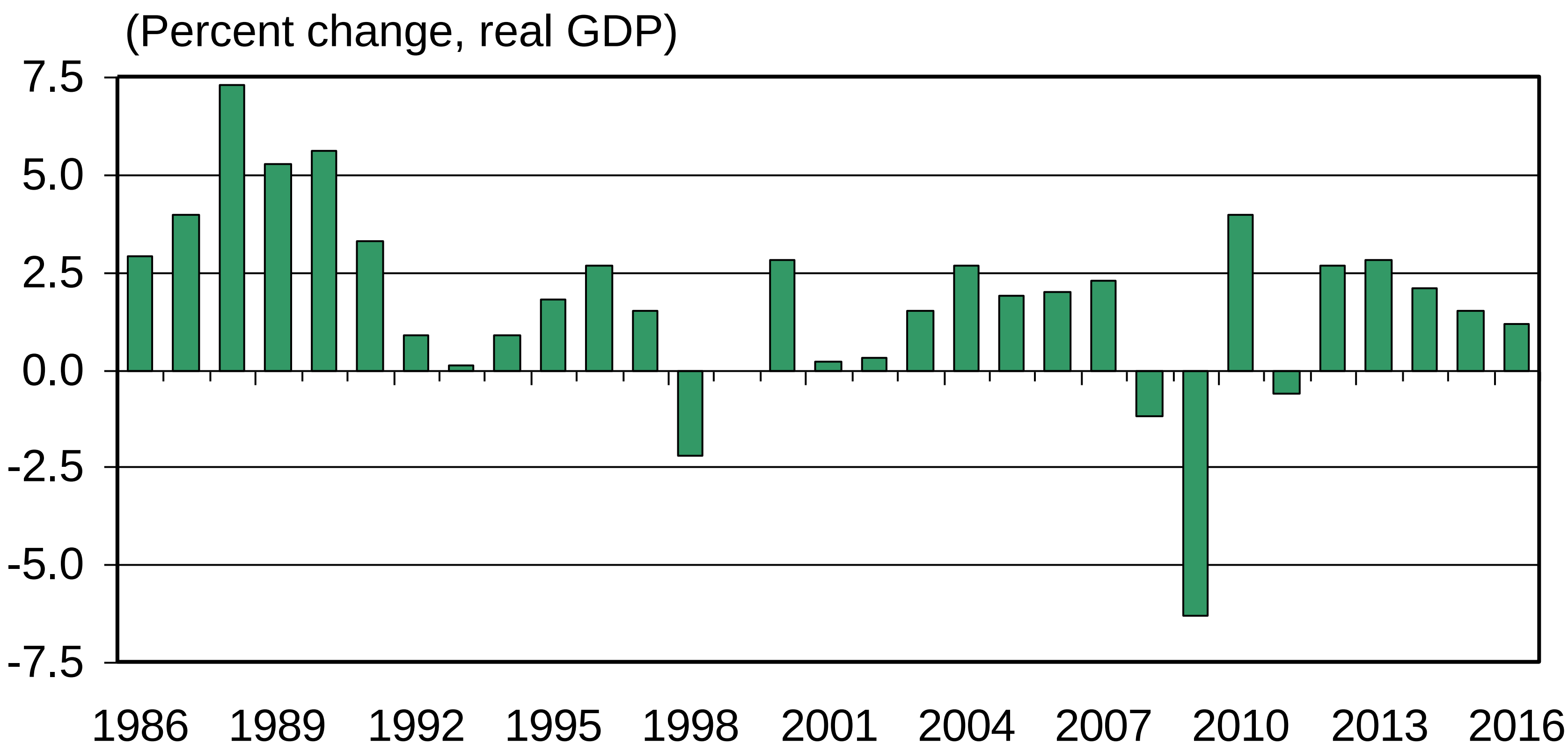
Asia Will Slow, But Not As Dramatically as in 2009

- Recovering Japan and resilient China anchor regional growth
- Global slowdown facilitates decline in inflation
- Room for fiscal and monetary policy response – tightening has likely ended for now
- Asian growth will slow, but not dramatically
- The Eurozone crisis is a potentially big risk for the region
  - Broad-based currency depreciation in September shows contagion can be swift – profit taking may accelerate that process
  - Re-energizing consumer spending will be harder given less pent-up demand
  - Smaller economies particularly dependent on foreign capital for investment

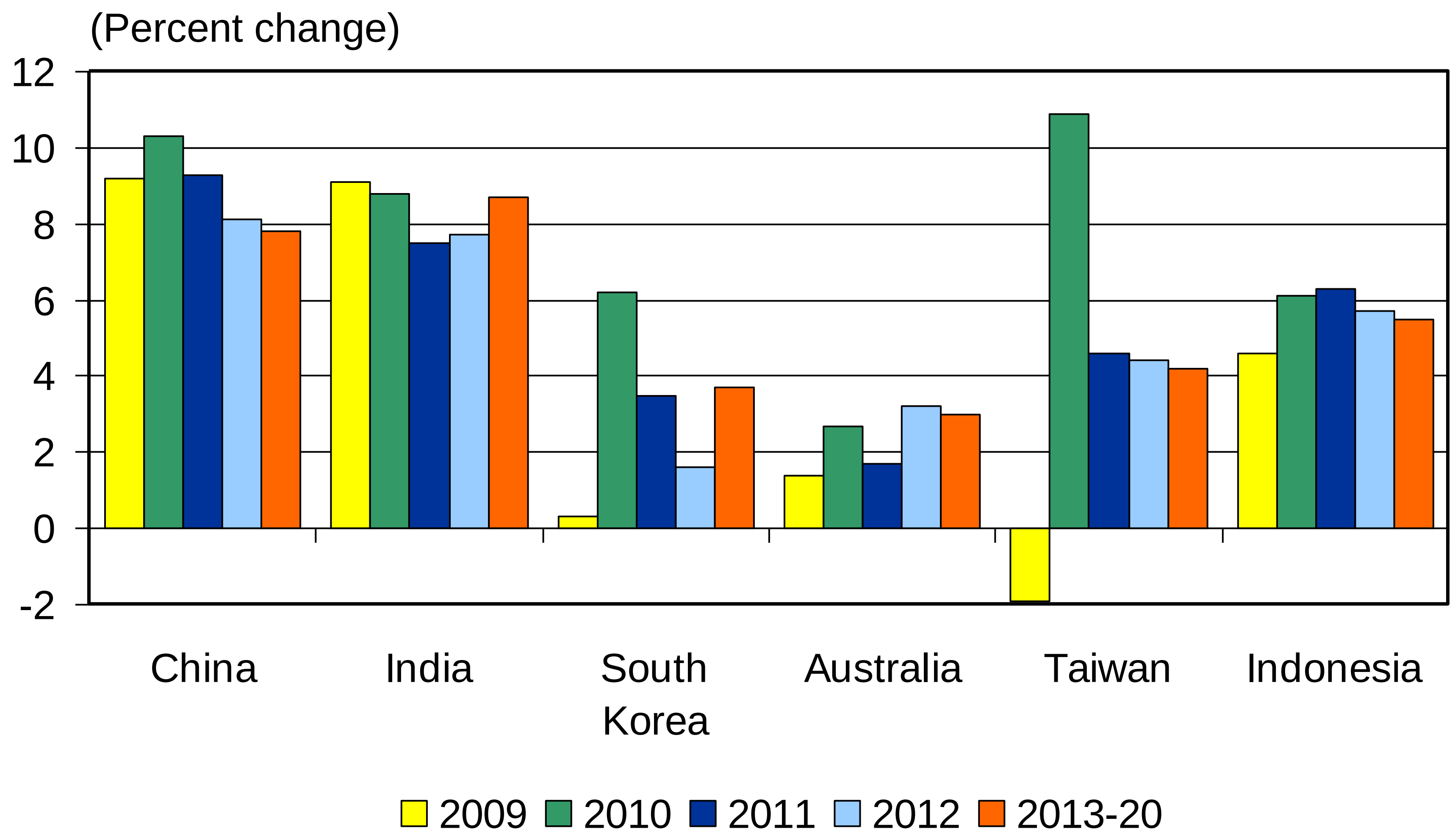
Japan's Economy Is Proving Its Resilience

- Industrial production is rebounding strongly from the March 11 earthquake, although electricity supply is still down 20%
- Consumer spending has recovered quickly, suggesting the March disaster had little permanent impact on confidence
- Construction activity will pick up in late 2011 and 2012
- Relief and reconstruction spending will strain government finances, adding to a heavy debt burden
- Exports will continue to drive long-run growth – but a strong currency is hurting
- Japan will also underpin Asian growth in 2012

Japan's Economy Has Limited Growth Potential



Real GDP Growth in Asia-Pacific Economies



China Outlook Summary

- Overheating pressure eased but not ceased
  - Economic growth deceleration has stabilized
  - Inflationary pressures continue across the board
  - Heavy dose of government admin controls have slowed liquidity expansion
  - But credit growth pressure remains high, as banks sit on huge piles of reserves
- Soft-landing is still the more probable scenario
  - Consumer inflation should ease as volatile food price inflation retreats
  - Policy will be “cautiously accommodative”, including RMB appreciation
  - The new 5-Year Plan should keep investment slowdown modest
  - Consumer demand should remain stable
- But risks of hard-landing are non-negligible
  - Monetary tightening policies are squeezing the dynamic private sector
  - Demand in the U.S. and EU could take another dive
  - Credit binge and housing bubble since 2009 raise risks of banking crisis – recent bank troubles are worrisome
  - Investment and consumption will likely be hit hard if banking crisis erupts

India – Not Immune to Global Downturn

- India’s large internal market should help insulate it from external demand swings and weaker U.S. and European growth – the impact will be felt through multiple channels:

- Exchange Rate Depreciation
  - The rupee depreciated by over 10% vis-à-vis the US dollar over the last two months
  - The rupee is on course to depreciate around 1.7% in 2011 and 0.7% in 2012 on average

- Declining Foreign Capital Inflows
  - After rising to USD7.5 in Q1 FY2011, FDI contracted by 38% in July; weaker FDI inflows expected in 2012
  - Portfolio inflows into India’s are relatively small and will not have a drastic impact on BOP

- Widening Trade Deficit
  - Exports orders in PMI already showed 3 months of continuous contraction
  - The US and EU combined account for around 30% of India’s total exports, suggesting a sharp decline in India’s total exports growth in 2012

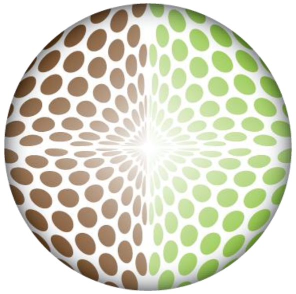
Risk Scenarios

- For the time being, the distribution of risks is skewed to the downside
- The 40% (mild) recession probabilities for Europe and the United States translate into about a 25% to 30% probability of a world recession
- Sluggish growth increases the vulnerability to shocks
- The “Perfect Storm”:
  - Eurozone fiscal/financial crisis
  - U.S. policy mistakes
  - Hard landing in China
- A confluence of these risks could result in another global recession – are we headed for Vortex?
- Such a scenario would be bad news for emerging markets and commodity prices

IHS Global Framework Scenarios

GLOBAL REDESIGN

The Global Redesign scenario portrays a future defined by a transition to a multi-polar world and is based on the current "base case" long-term macroeconomic outlooks by IHS Global Insight.



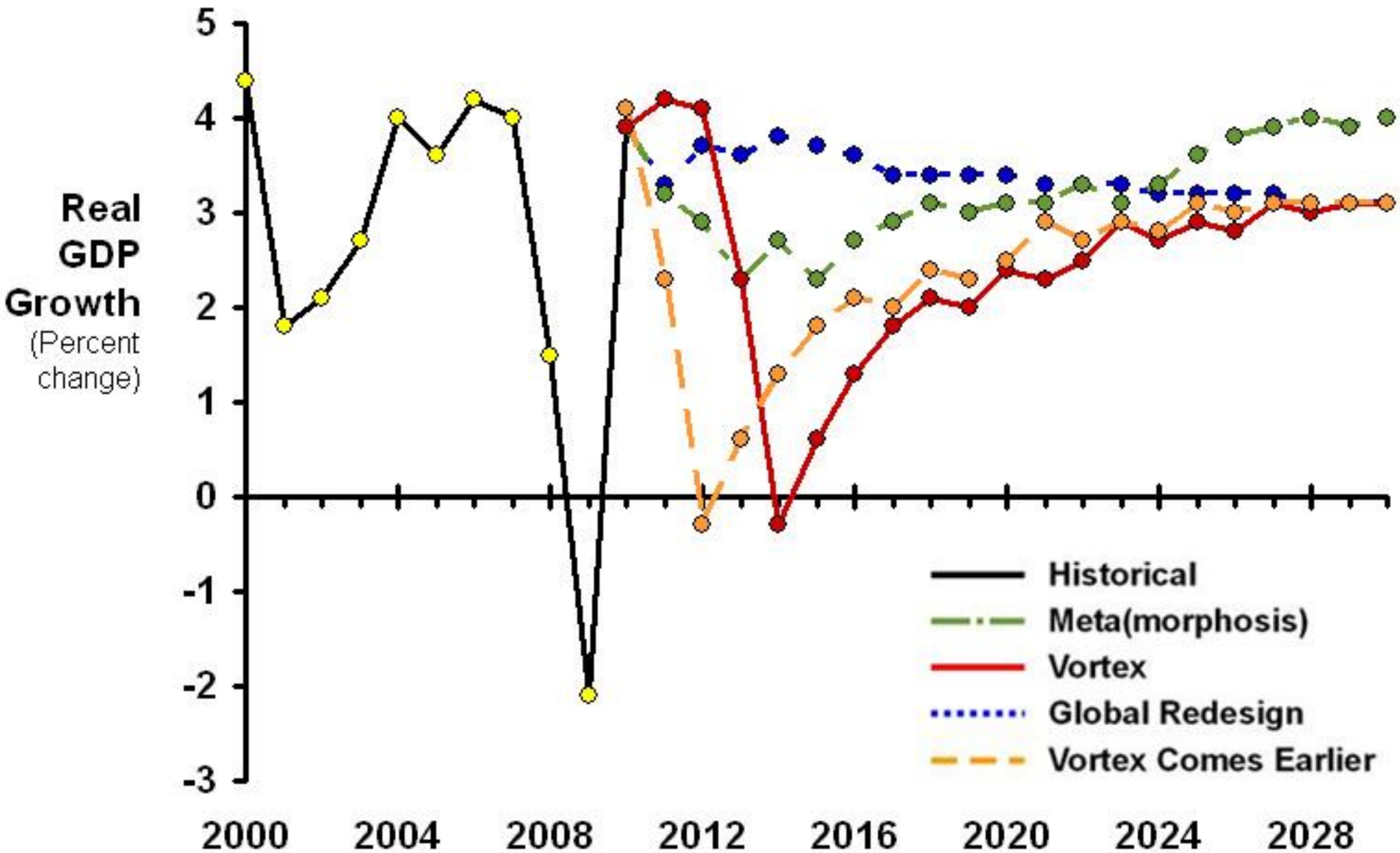
META(MORPHOSIS)

In Meta, there is a strong move toward a lower-carbon energy economy across much of the world, catalyzed in part by high sustained oil prices and spurred on by technological innovation.

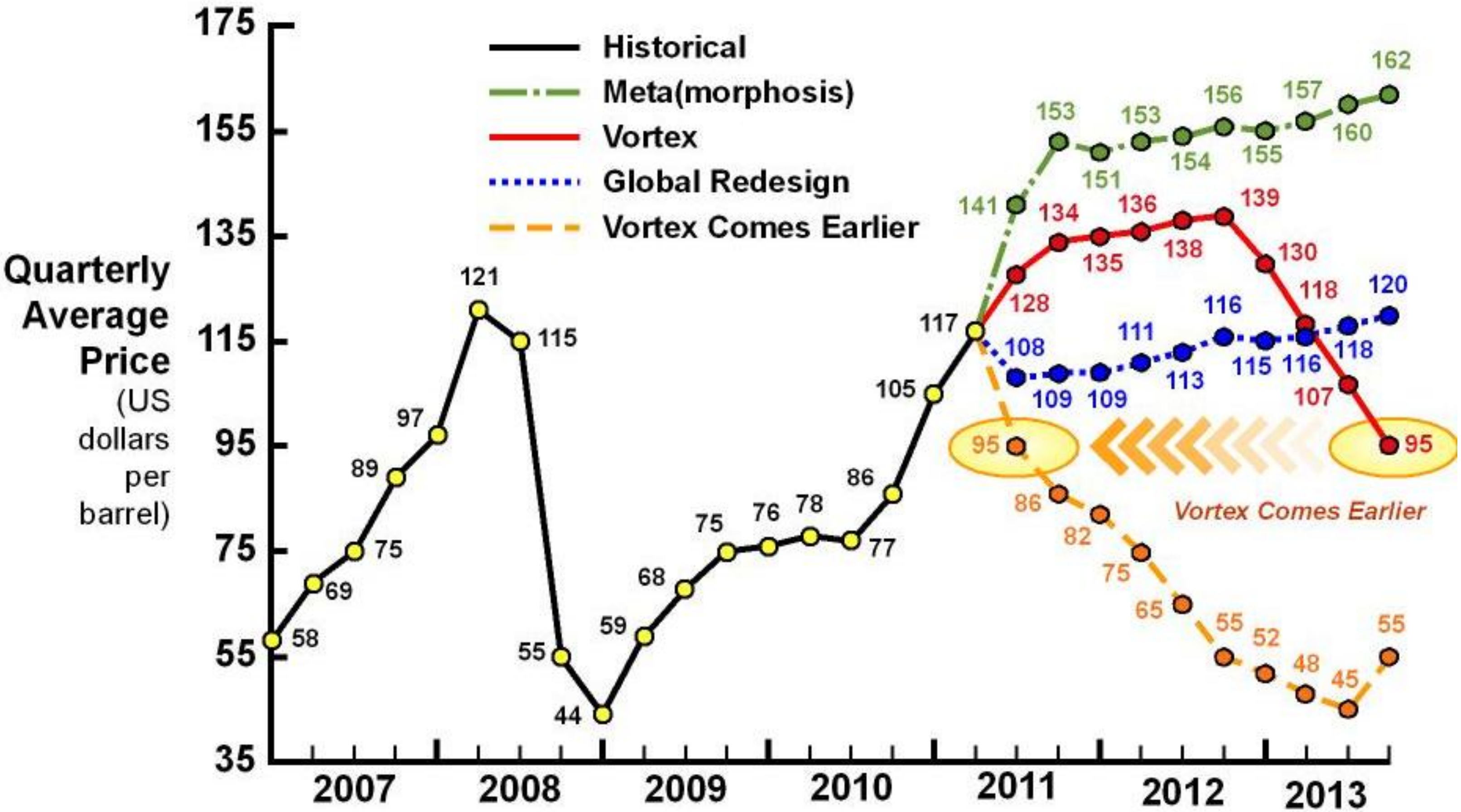
VORTEX

The Vortex world is characterized by severe volatility in economic growth and poor global cooperation, resulting in a long global economic slowdown.

World Growth



Brent Crude Oil Price Outlook



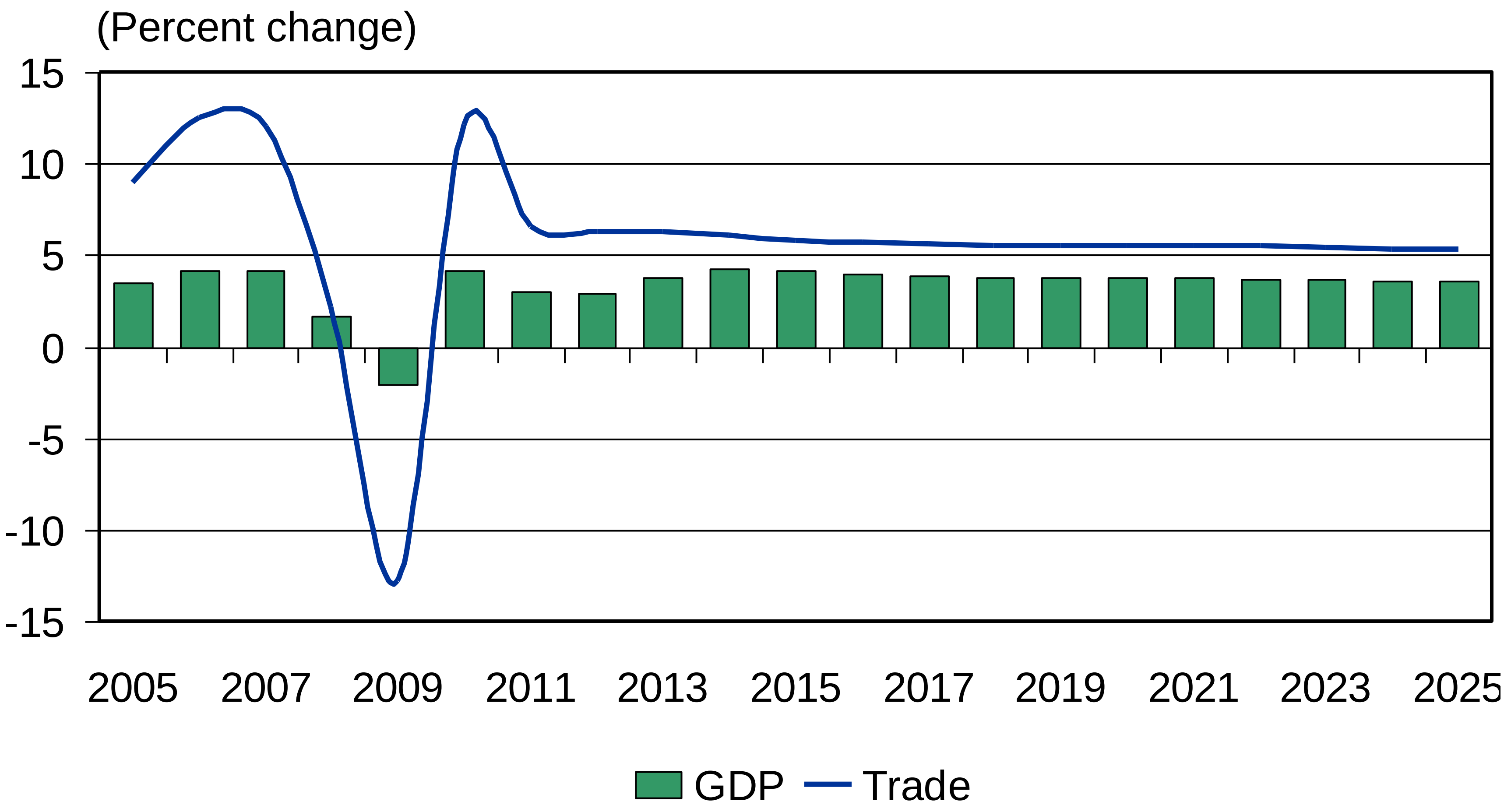
Source: IHS CERA.

Implications

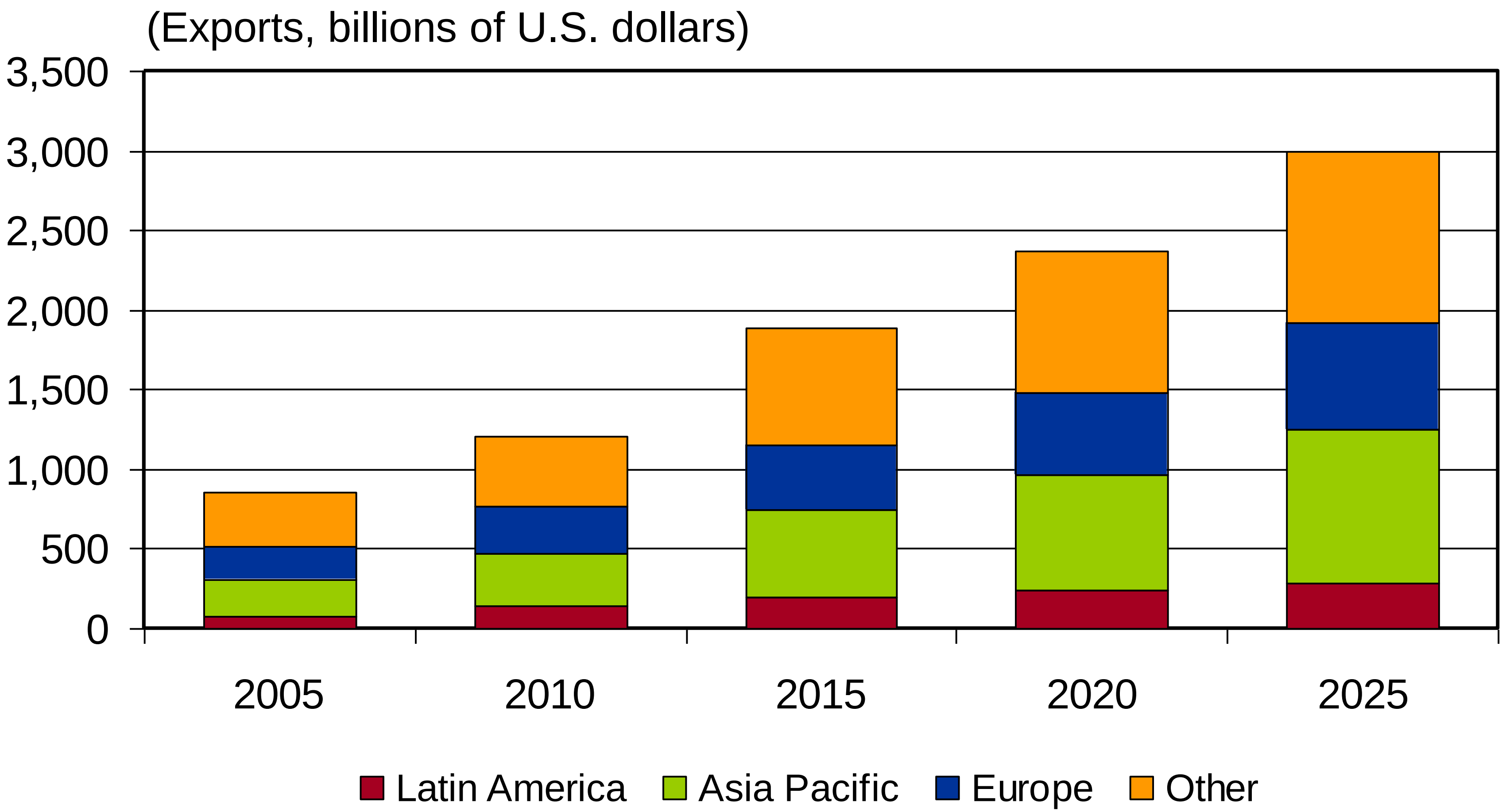
- The world economy is in the danger zone
- The U.S. expansion is proceeding at a sluggish pace, restrained by consumer and business caution and fiscal tightening
- Europe's sovereign debt crises and political bungling will lead to an extended period of very weak growth – if we are lucky – and possibly much worse – if we are not
- Emerging markets continue to offer the best growth prospects – but the bloom is off the rose
- Asia will lead global growth, while Latin America and Africa will also do relatively well – but all are vulnerable to recessions in the EU and U.S. and a hard landing in China
- Volatility in commodity prices is likely to continue
- Bottom line: plan for a lost decade, but be prepared for a second dip

Trade Implications

World Trade Typically Grows Faster Than Real GDP

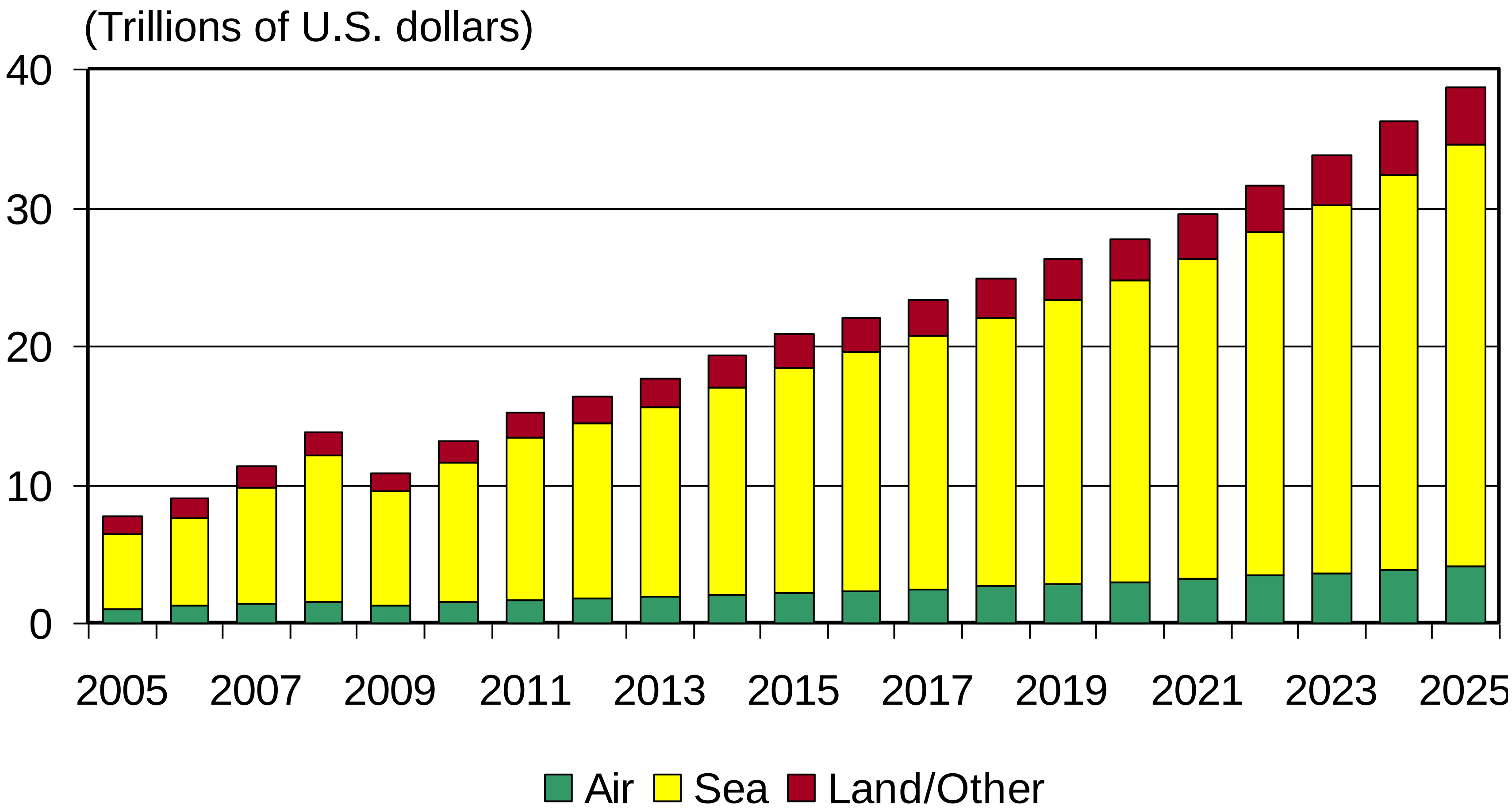


U.S. International Trading Partners Are Shifting



Source: Global Insight World Trade Service

Growth in Global Merchandise Trade



Source: Global Insight World Trade Service

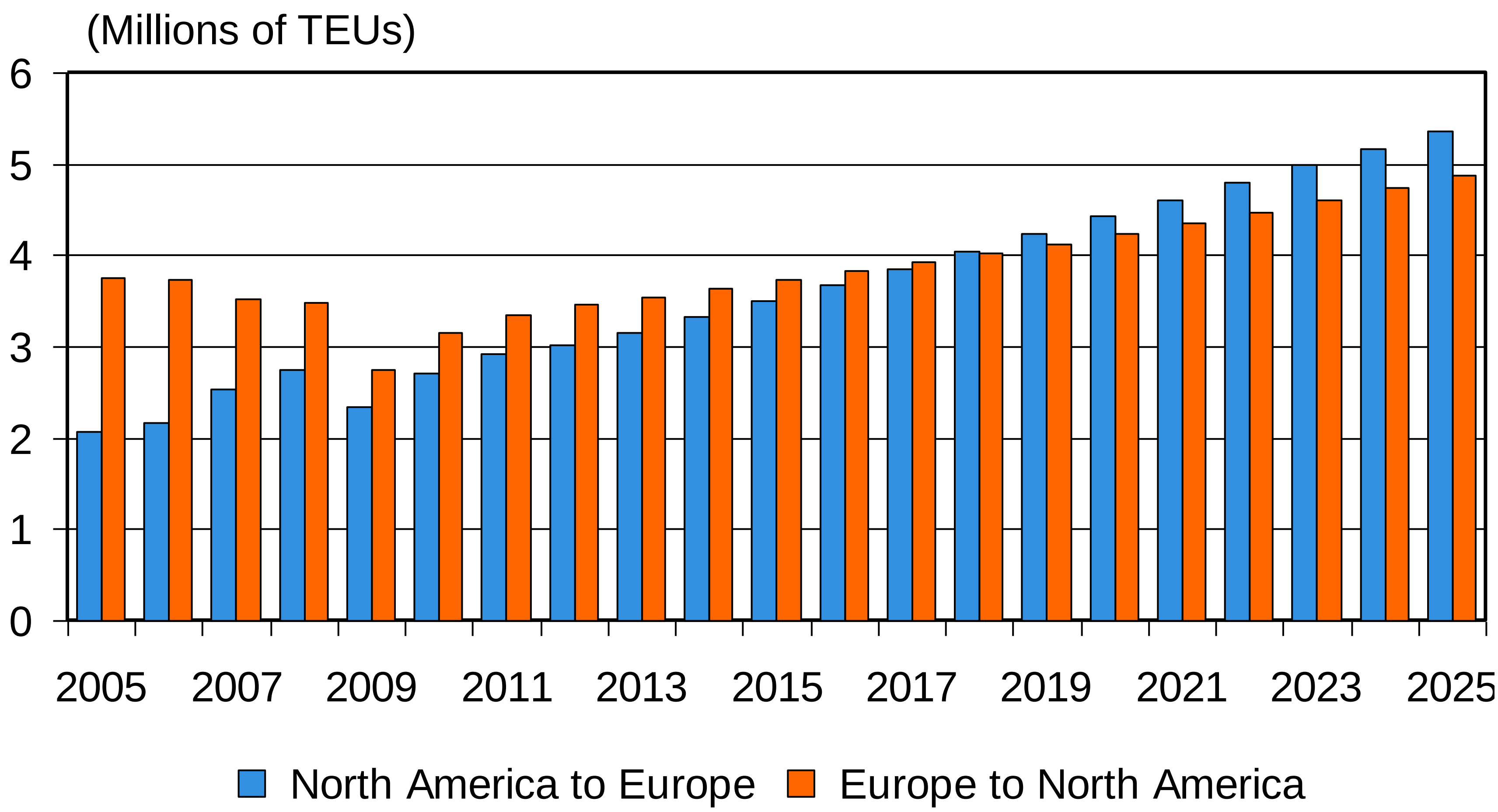
Note: Intra-Europe trade excluded

Containerized Trade Movements

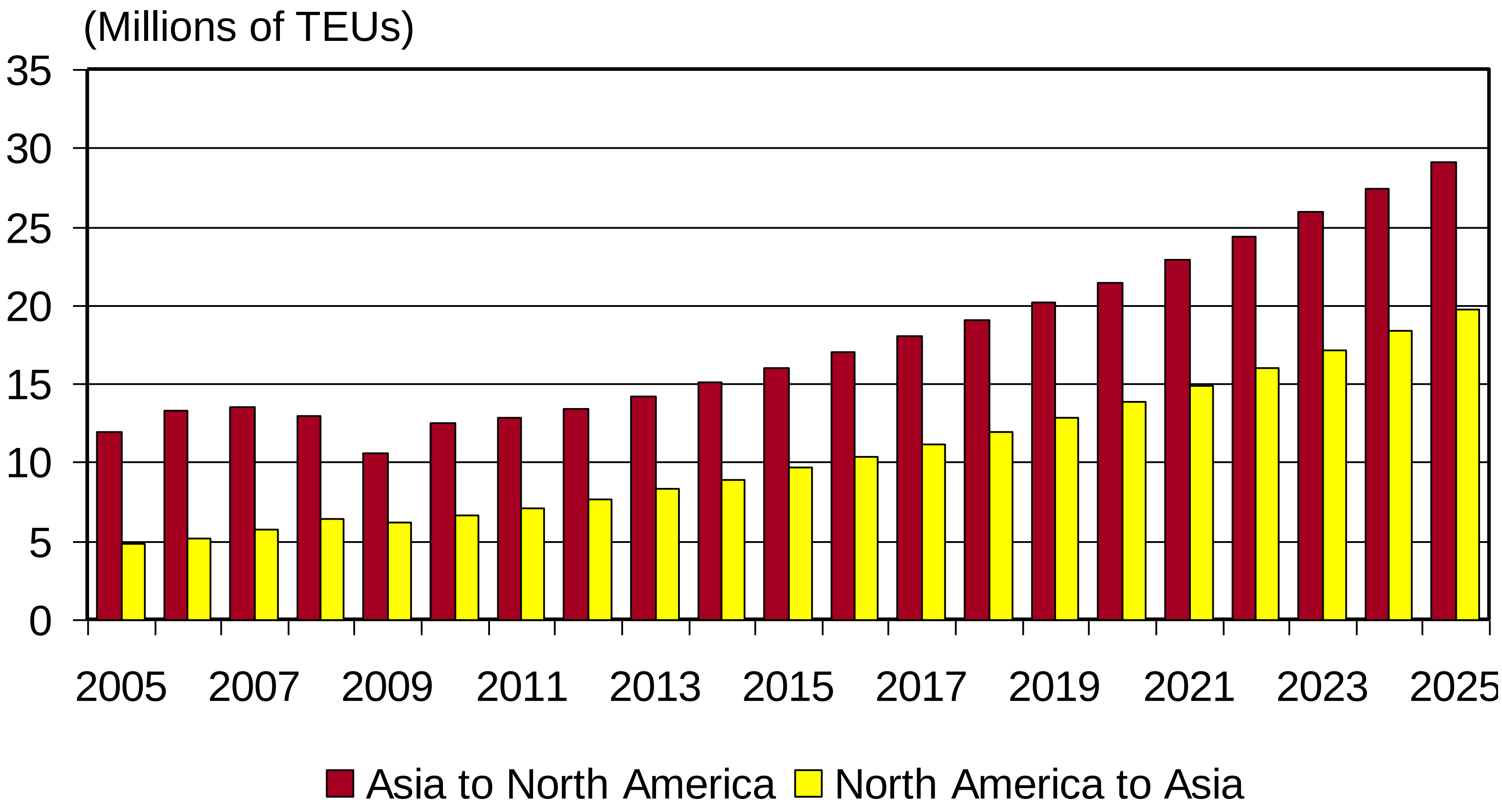
(Thousands of TEUs)

	2005	2010	2015	2020	2025
Transatlantic	5,827	5,867	7,227	8,656	10,247
Transpacific	16,853	19,203	25,750	35,353	48,909
U.S. Atlantic/Asia	3,659	4,907	6,668	9,228	12,903
Europe/Asia	13,977	19,411	26,602	36,087	48,371
Intra-Asia	18,169	22,064	32,311	43,435	57,453
World Total	87,124	112,715	154,653	204,493	268,392

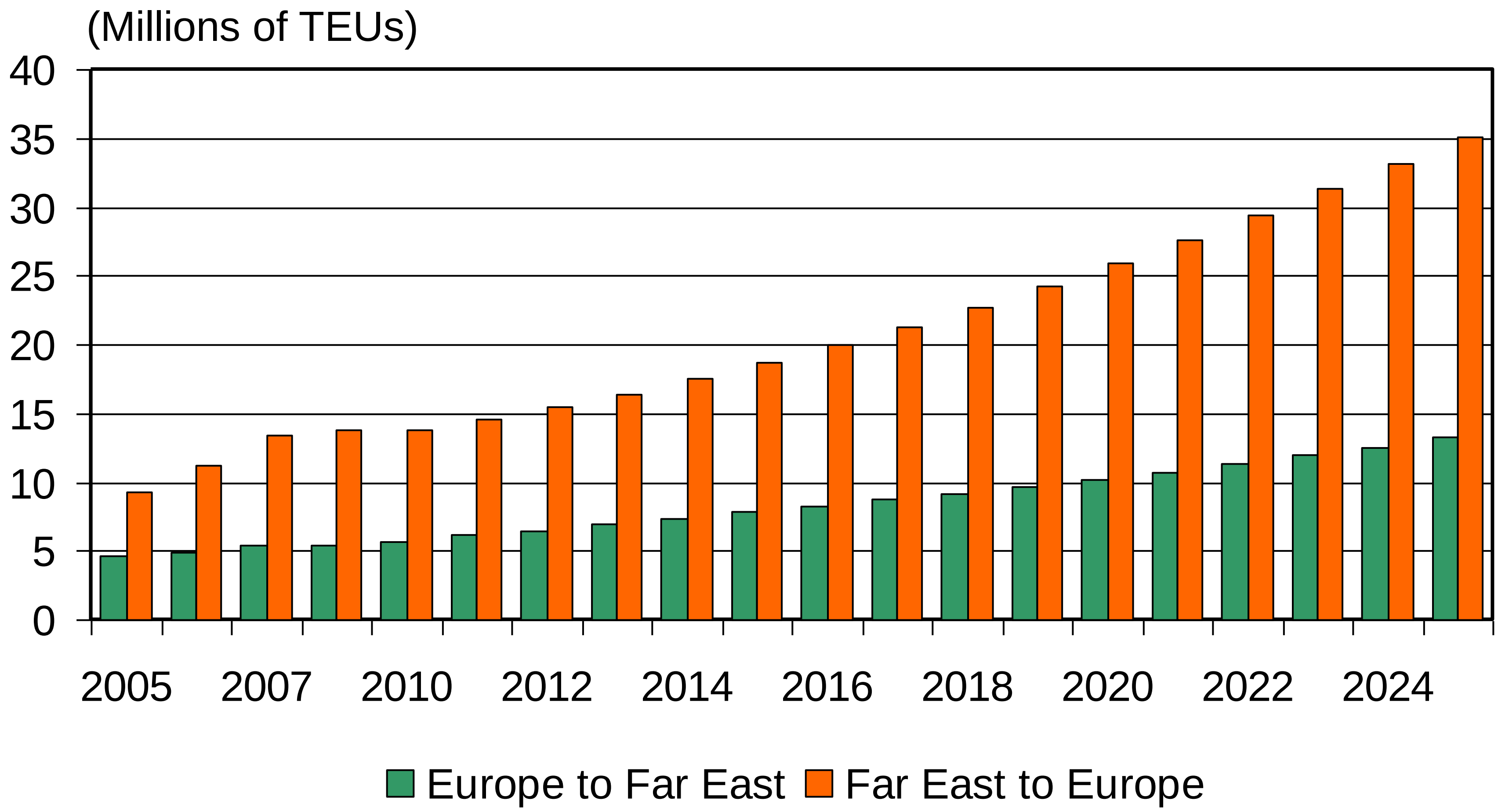
Transatlantic Container Trade



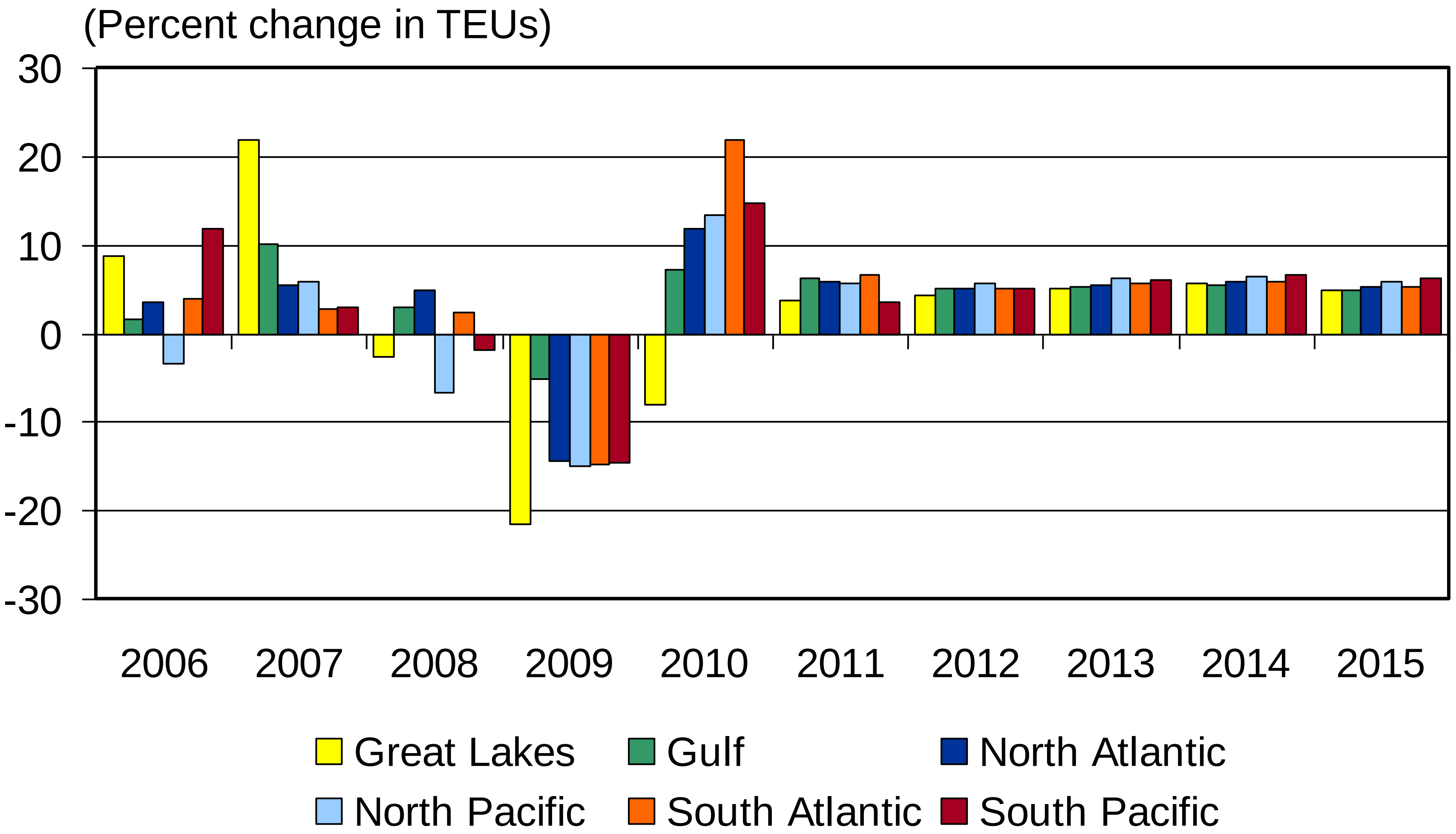
Transpacific Container Trade



Europe to Far East Container Trade



Container Growth Rates by U.S. Coast



Implications for the Port

- Trade will remain an engine of global growth in the long-term …
- … But activity is slowing dramatically in the near-term
- Transatlantic trade growth is likely to significantly slow in 2012 – and maybe turn negative
- U.S. Atlantic/Asia trade is expected to expand a little faster than Transpacific trade over the next several years
- U.S. Atlantic/Asia trade volumes will exceed Transatlantic trade volumes starting from 2018
- Intra-Asia trade will grow faster than Transatlantic, Transpacific, and Europe/Asia trade over the next several years
- Downside risks to short-term trade projections are very high

Thank you!