



Global economic outlook

What to expect in 2015 and beyond

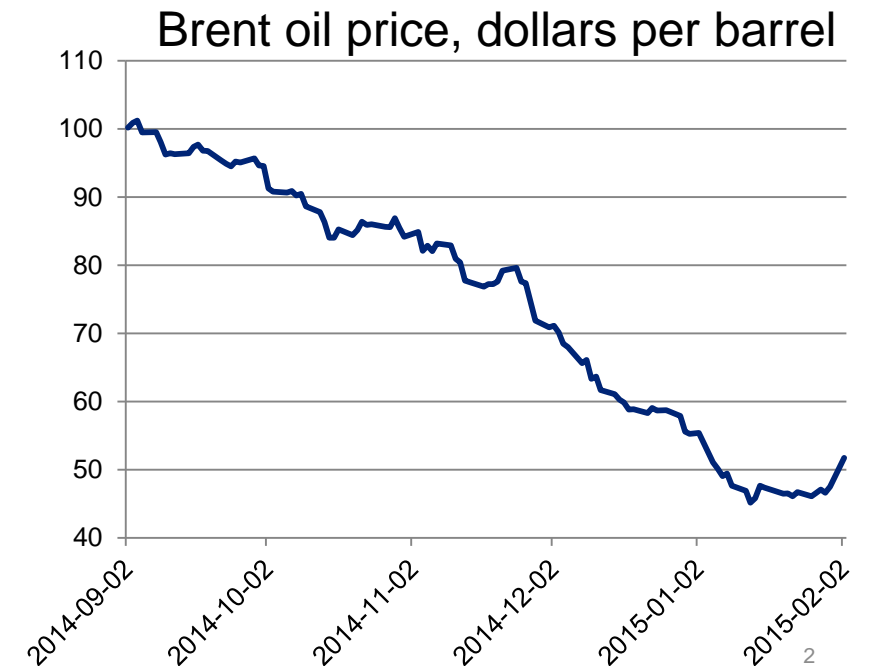
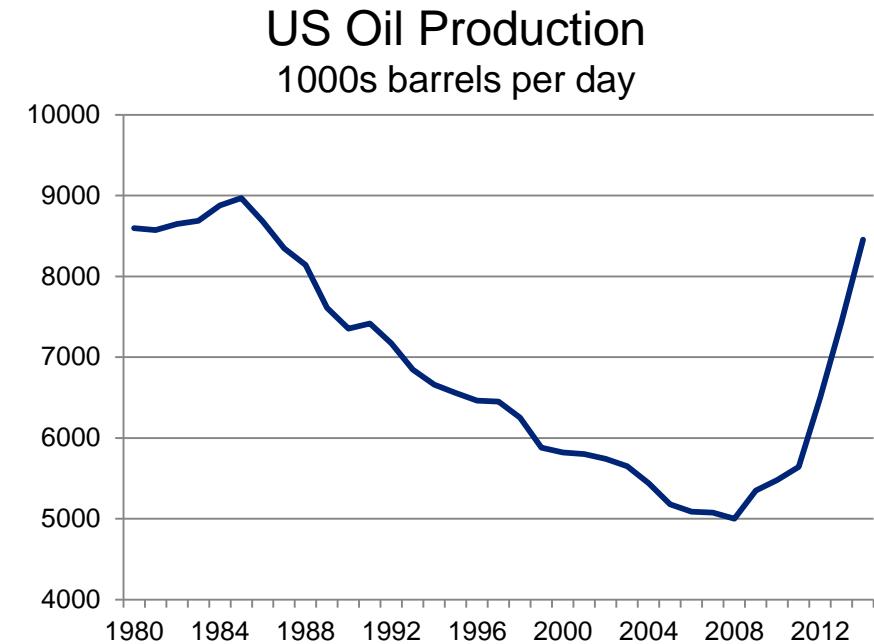
Presented by Dr. Ira Kalish
Chief Global Economist
Deloitte

April 2015

Big global issues

Lower oil prices

- Due to fracking, weak global demand, Saudi policy
- Boosts consumer spending globally
- Creates disinflationary pressure
- Hurts oil exporters (Russia, Iran, Venezuela)



Big global issues

Higher oil prices?

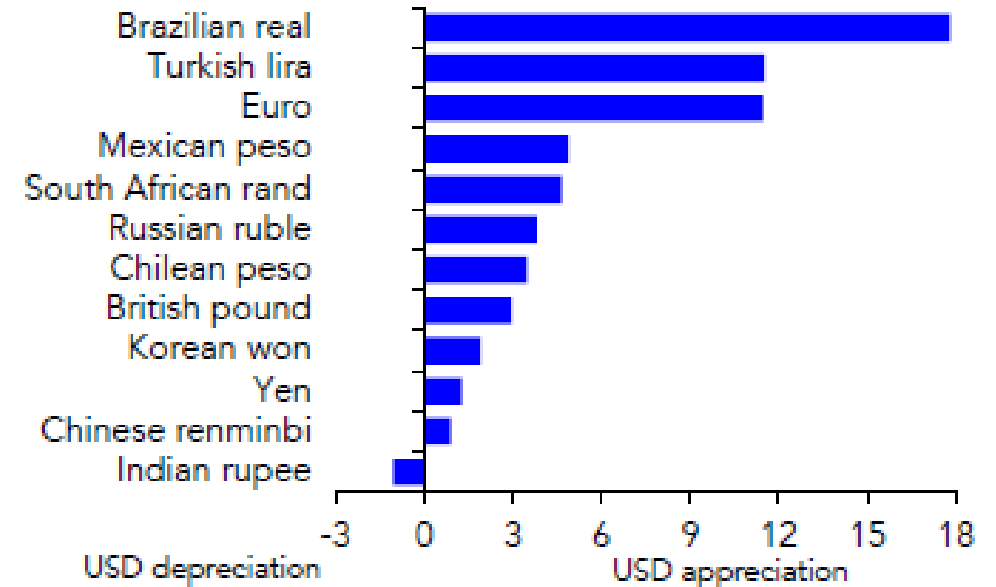
Yes	No	Likely scenario
<ul style="list-style-type: none">• Rig usage is down• Capital expenditures by energy companies is falling• Production will peak soon• Demand will pick up in Europe, China	<ul style="list-style-type: none">• Production rising despite drop in rig usage• Massive glut of inventories• If price rises modestly, production will pick up quickly	<ul style="list-style-type: none">• Prices mostly fall in 2015• Prices begin to rebound in 2016• Stabilize between \$50 and \$75• Wild cards: Iran, Saudi Arabia, China

Big global issues

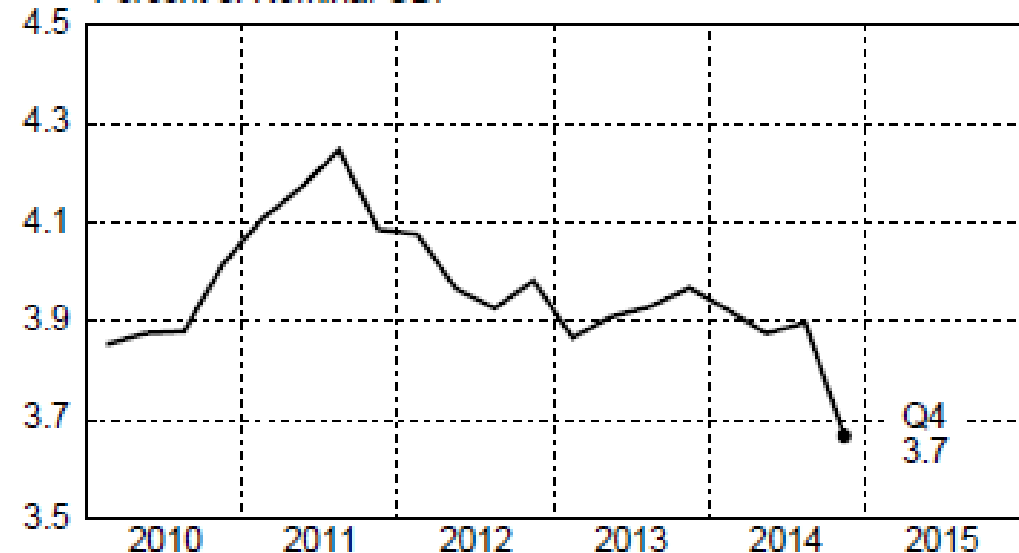
Rising US dollar

- Reasons:
 - Lower oil prices
 - Strong US economy, expected higher interest rates
 - Aggressive monetary policy in ECB, Japan, China
- Impact:
 - Lower inflation in US, compels Fed to wait
 - Hurts US exports, US corporate profits
 - Higher inflation in EMs, leads to higher interest rates
 - Hurts external debtors in emerging markets

Change in Value of U.S. Dollar
percent, 2015ytd



Corporate Profits: Receipts from Abroad
Percent of Nominal GDP



Big global issues

Has the dollar peaked?

Yes	No
<ul style="list-style-type: none">• Oil cannot get much lower and will soon rise• High dollar is hurting US trade balance• US inflation is and will be higher than elsewhere• Foreign central banks are selling dollars	<ul style="list-style-type: none">• The dollar hasn't actually risen that much• Oil could still fall further• Monetary policy shifts are not yet finished• US growth is better than elsewhere

Trade Weighted Value of the Dollar
Index 1997=100

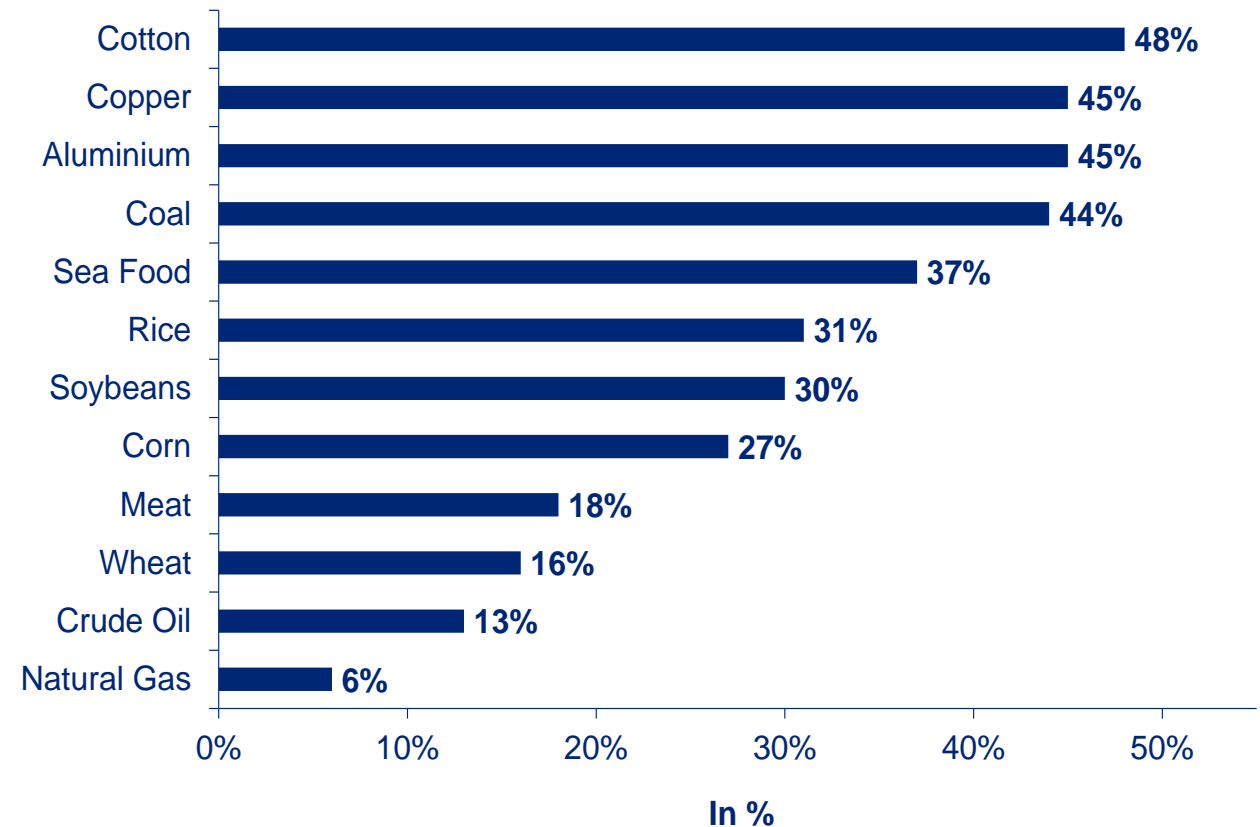


Big global issues

Chinese slowdown

- Chinese investment slows
- Weak commodity prices
- Negative impact on commodity exporters
- Negative impact on Asian countries that are in China's supply chain
- China is third largest export market for the US and EU

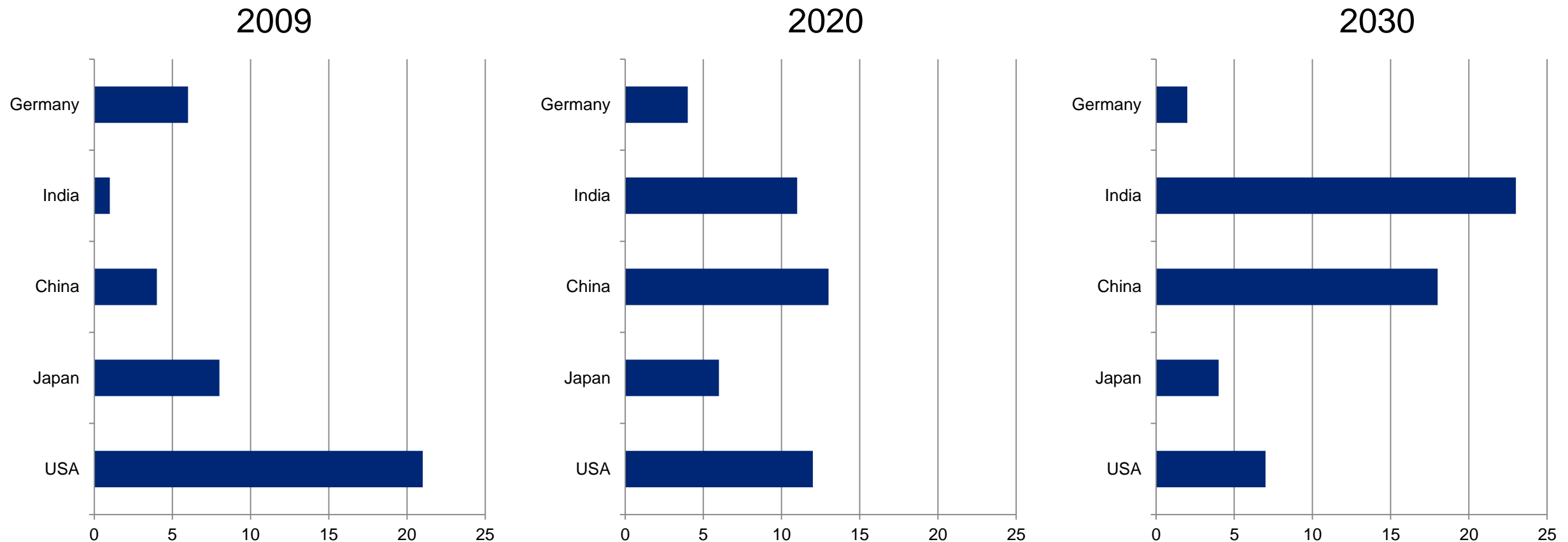
China share of commodity markets



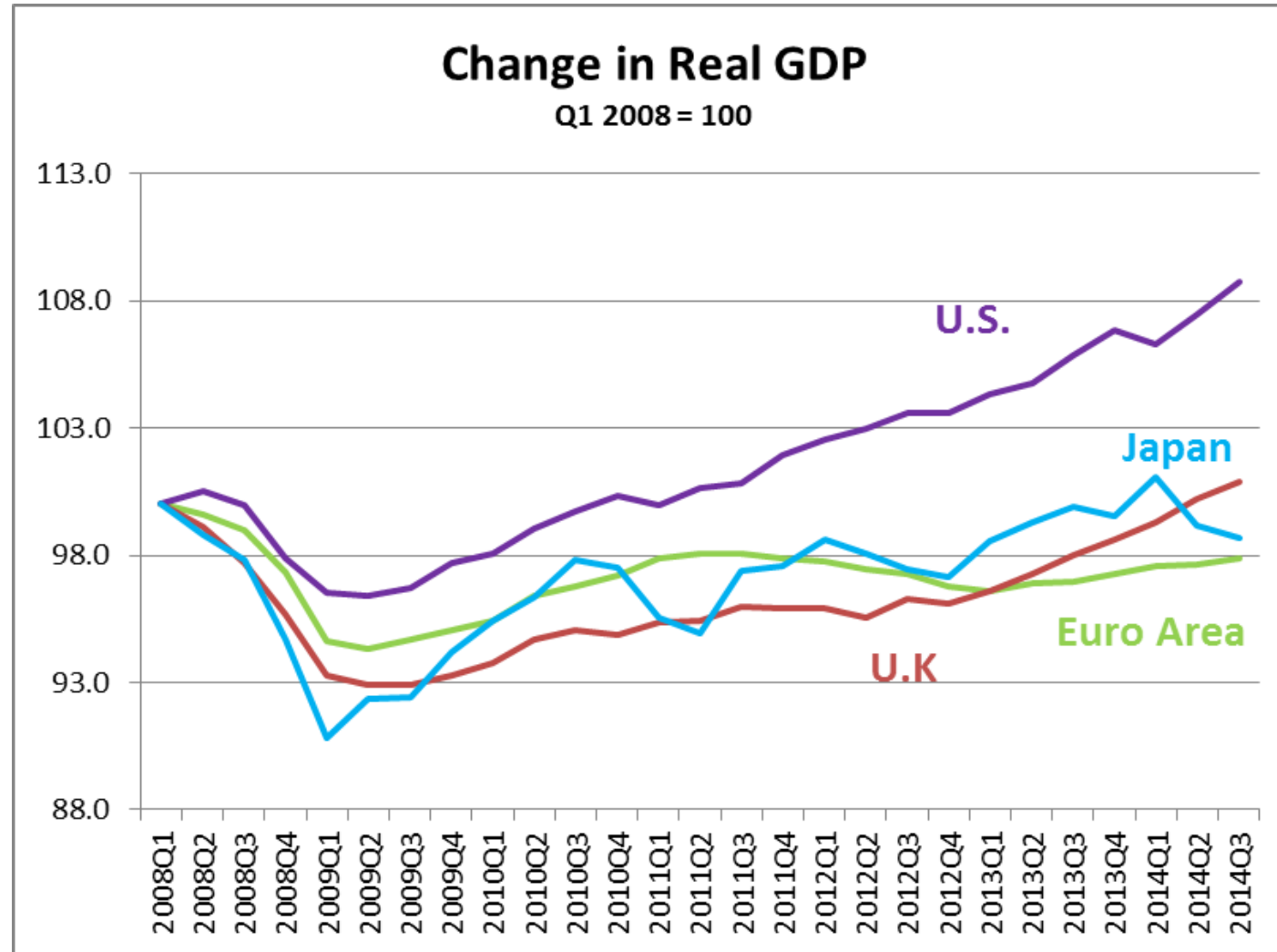
Big global issues

Rise of global middle class

Share of global middle class spending by country



USA

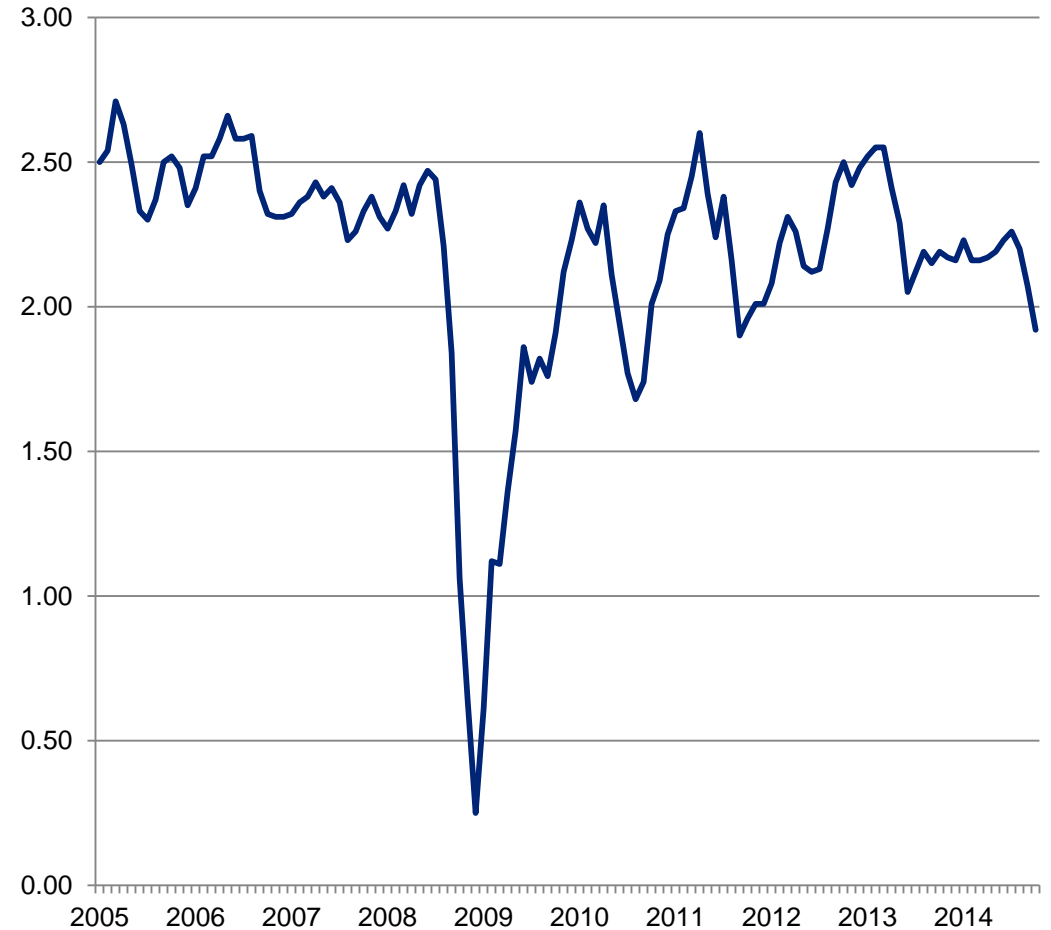


USA

Waiting for the Fed

- Fed targets inflation and unemployment
- Inflation expectations are declining
- Labor market retains slack, but job growth is strong
- Lower oil prices creating a temporary hiatus
- Expect increase in rates late in 2015

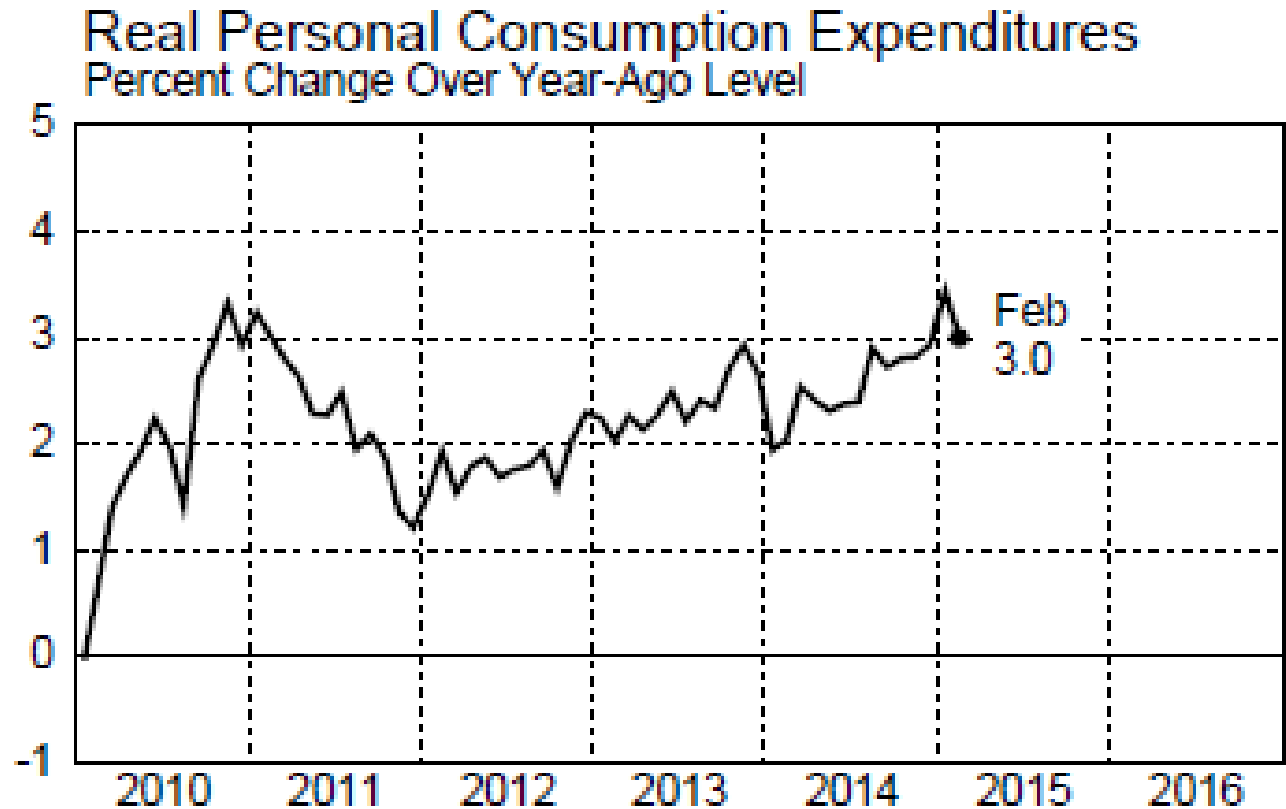
Inflation expectations
10 year bond yield minus TIPS yield



USA

Consumer spending

- Increased wealth
- Reduced debt
- Improved cash flow
- More jobs
- Lower energy prices
- Yet:
 - Worsening of income inequality
 - Consumers more prone to save

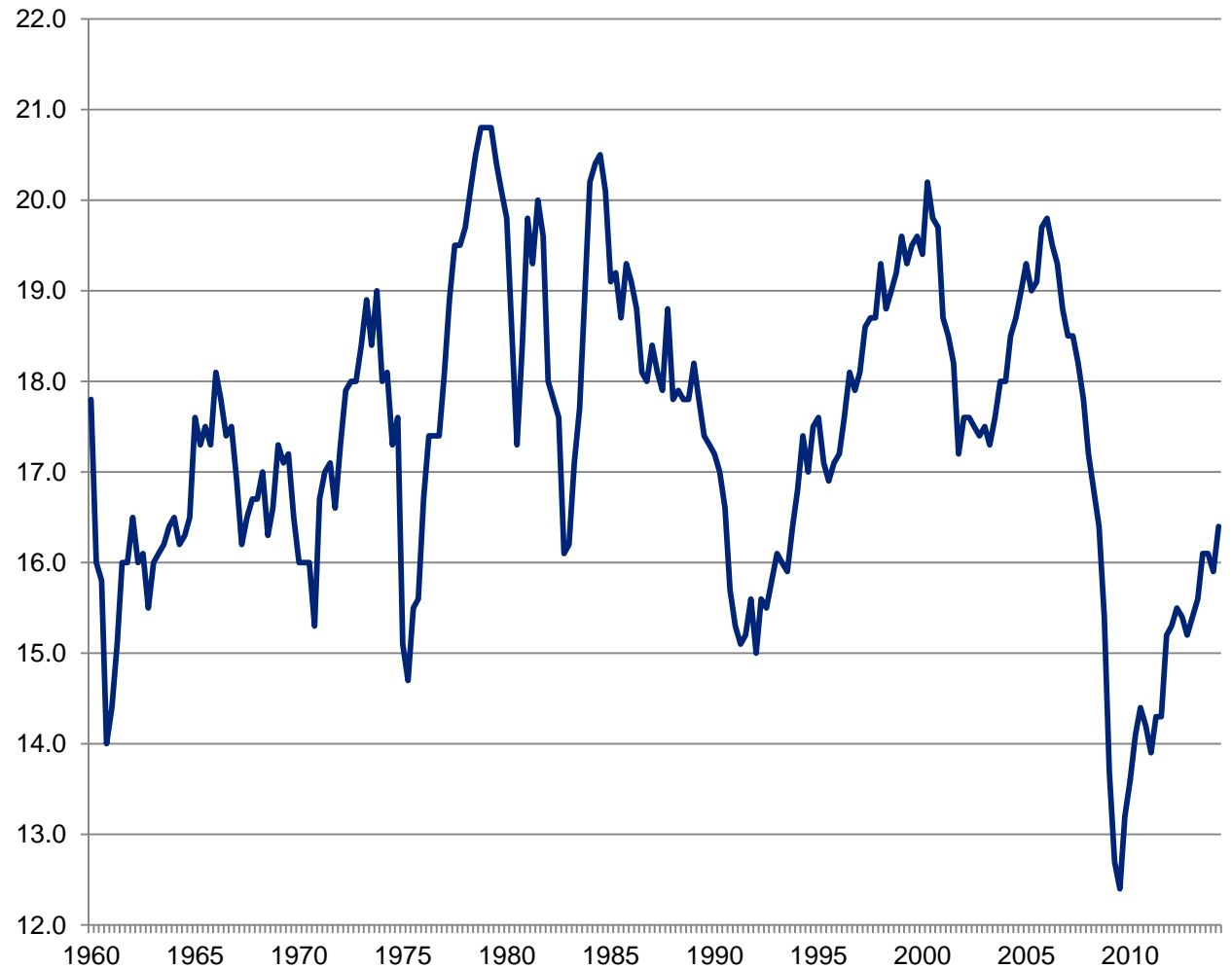


USA

Business investment

- Investment collapsed during financial crisis
- Strong rebound still leaves investment low as share of GDP
- Hoarding cash as profits soar
- Weakness due to:
 - Fears of deflation
 - Excess capacity in some industries
 - Weak overseas demand
 - The cloud

Domestic investment as share of GDP



USA

Financial conditions are better

- Banks holding fewer bad assets
- Partly due to rise in property prices
- Lending to the private sector has accelerated
- Credit availability for small businesses is up considerably
- This partly explains the strength of employment growth

Loan Performance at FDIC-insured Institutions*

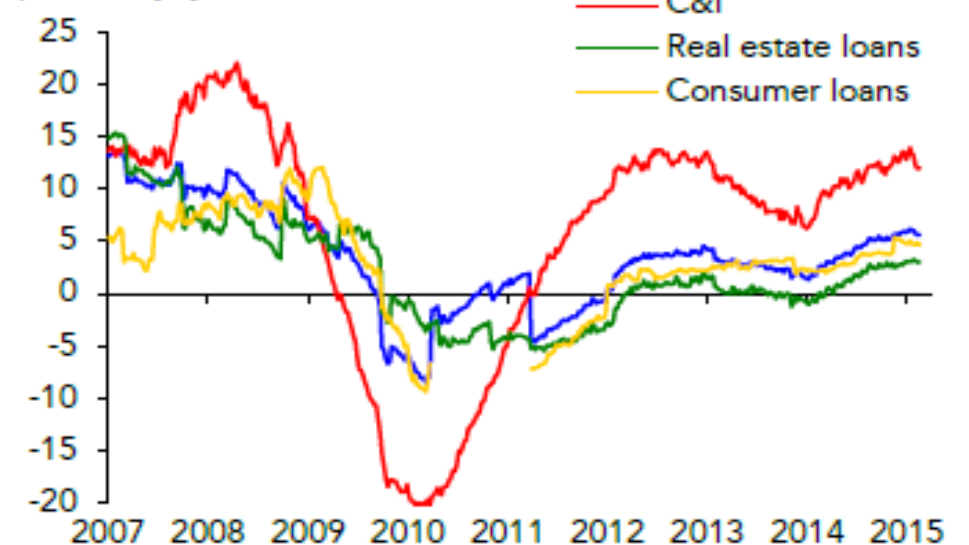
percent of loans outstanding



Source: FDIC; IIF calculations. * Total loans and leases. ** Loans 90 days or more past due or in nonaccrual status.

U.S. Banks: Loan Growth

percent, yoy



USA

Outlook

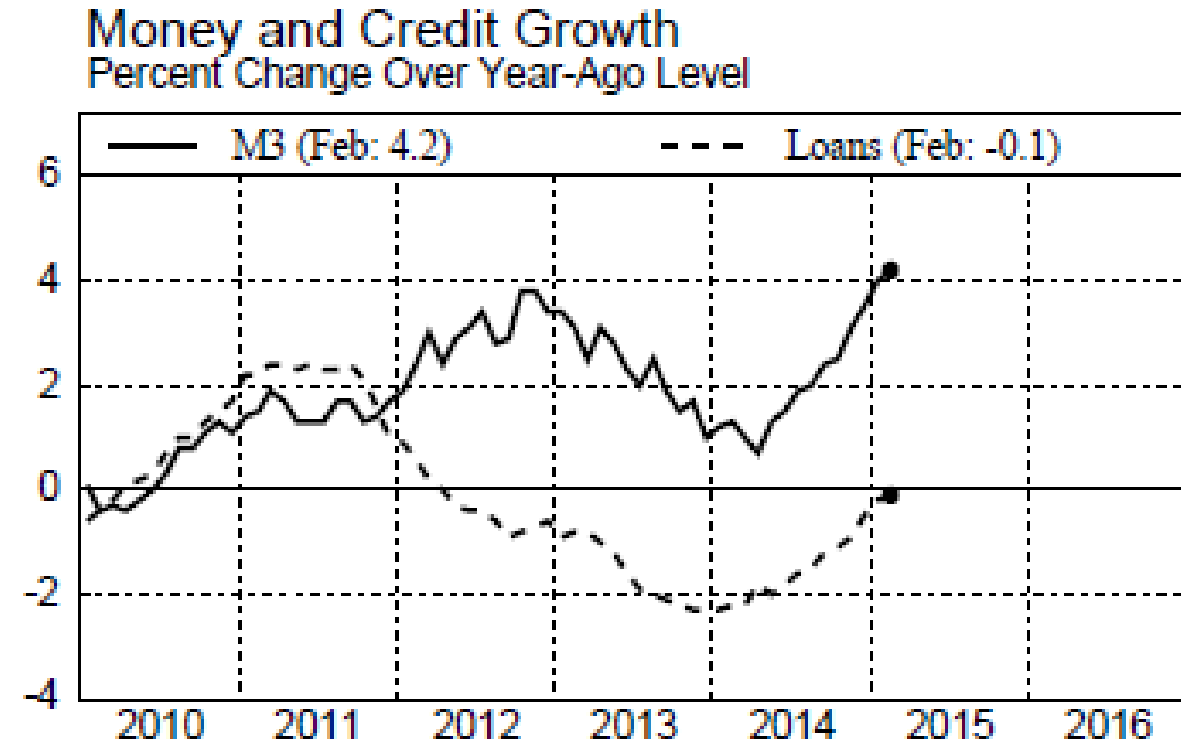
- No headwinds from fiscal policy
- Fed has limited impact this year
- Low energy prices
- Pent up demand for new homes
- Improved credit markets
- Risk comes from Europe/China



Eurozone

Why are credit markets weak?

- Banks are selling assets and cutting back on lending to recapitalize
- Businesses reluctant to invest due to fear of deflation, weak demand
- Risk spreads due to fear of Eurozone failure
- Yet, things are clearly improving



Source: Federal Reserve

Eurozone

ECB aims to reflate

- Very low interest rates
- Charge banks for holding cash
- Lend euros to banks (although banks are not very interested)
- Purchase securitized assets
- Quantitative easing (with some restrictions)



Eurozone

Signs of improvement

- Employment starts to grow
- Rising retail sales
- Stronger consumer confidence
- Positive impact of cheap oil
- Credit market conditions improve
- Rebound in industrial sector
- Strength in Germany, Spain, Ireland
- Still a long way to go



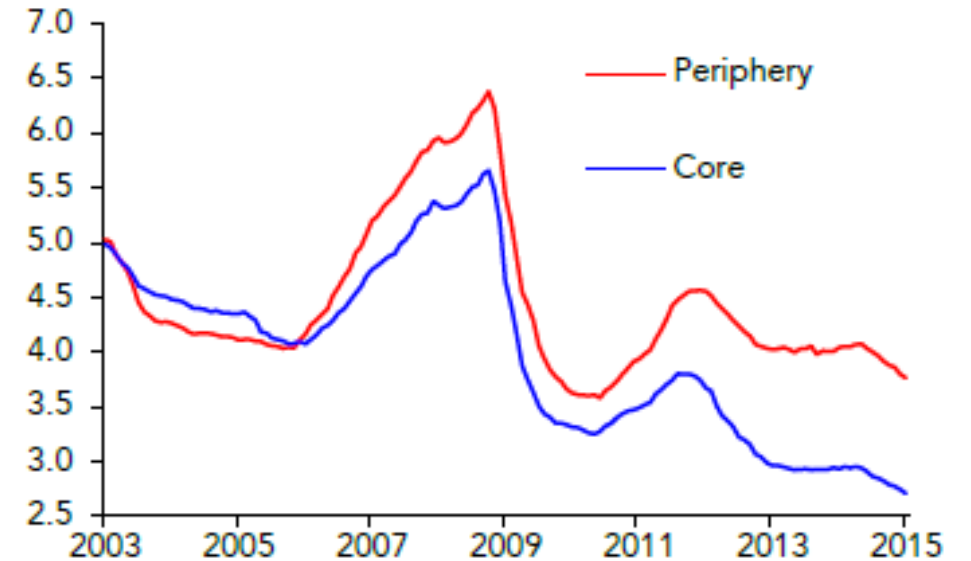
Source : Oxford Economics/Haver Analytics

Eurozone

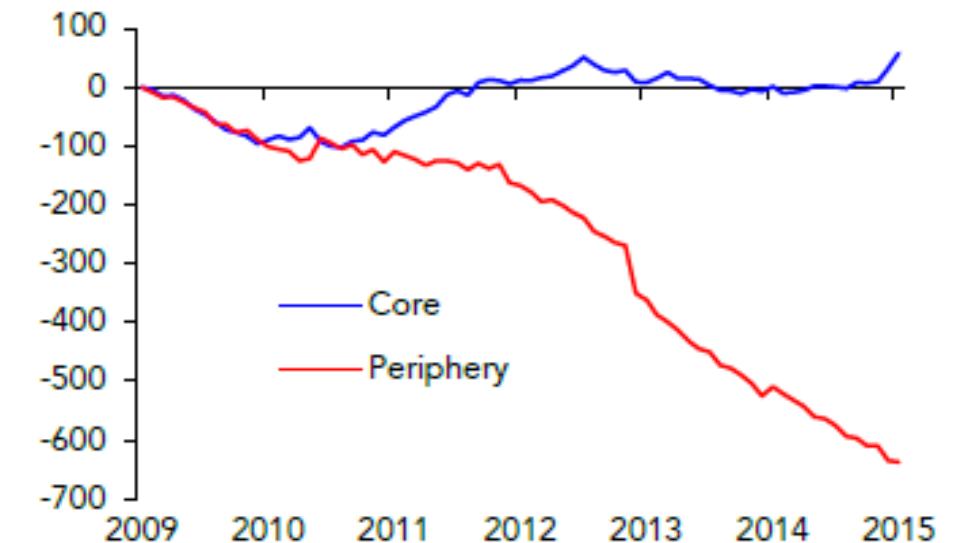
Europe still divided

- Risk spreads remain elevated, even as borrowing costs decline
- Reflects fear of Eurozone failure. Greek situation doesn't help
- Bank lending in periphery continues to decline
- QE alone will not solve this problem

Euro Area Bank Interest Rates on Corporate Loans
percent, loans over one year



Euro Area: Bank Lending to Non-financial Corporates
\$ billion, cumulative change since Jan 2009



Eurozone Outlook

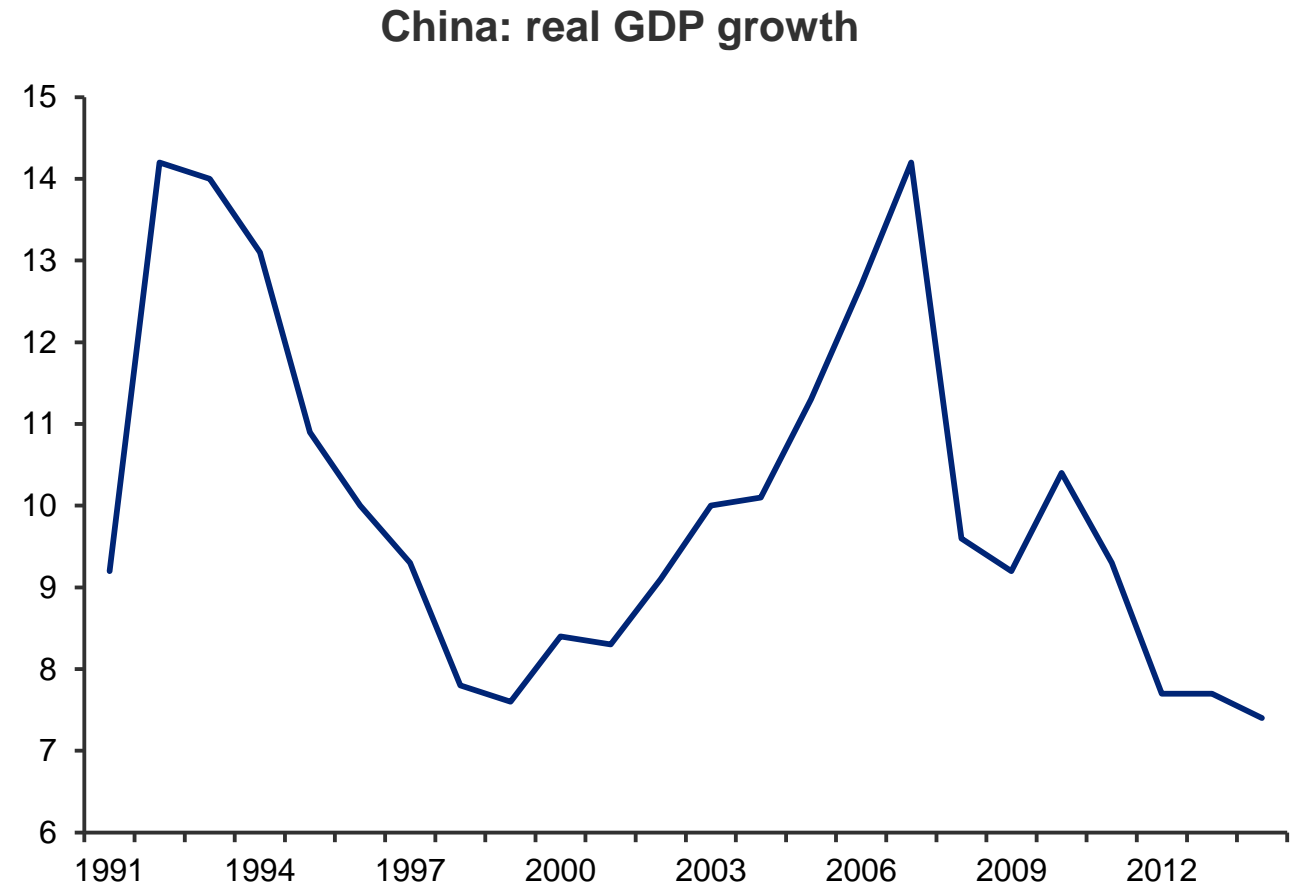
- Modest growth likely in 2015
- Risks:
 - Greece
 - Russia
 - Rise of anti-euro and anti-EU parties in France, Spain, UK
 - Failure to reform in Italy and France
 - Failure of ECB to halt deflation



China

Growth

- Growth in 2014 was the lowest since 1990
- Deceleration due to weak exports and weakening investment. FDI declining
- True growth may be lower
- Outlook is for further slowdown. Government target is 7.0 percent

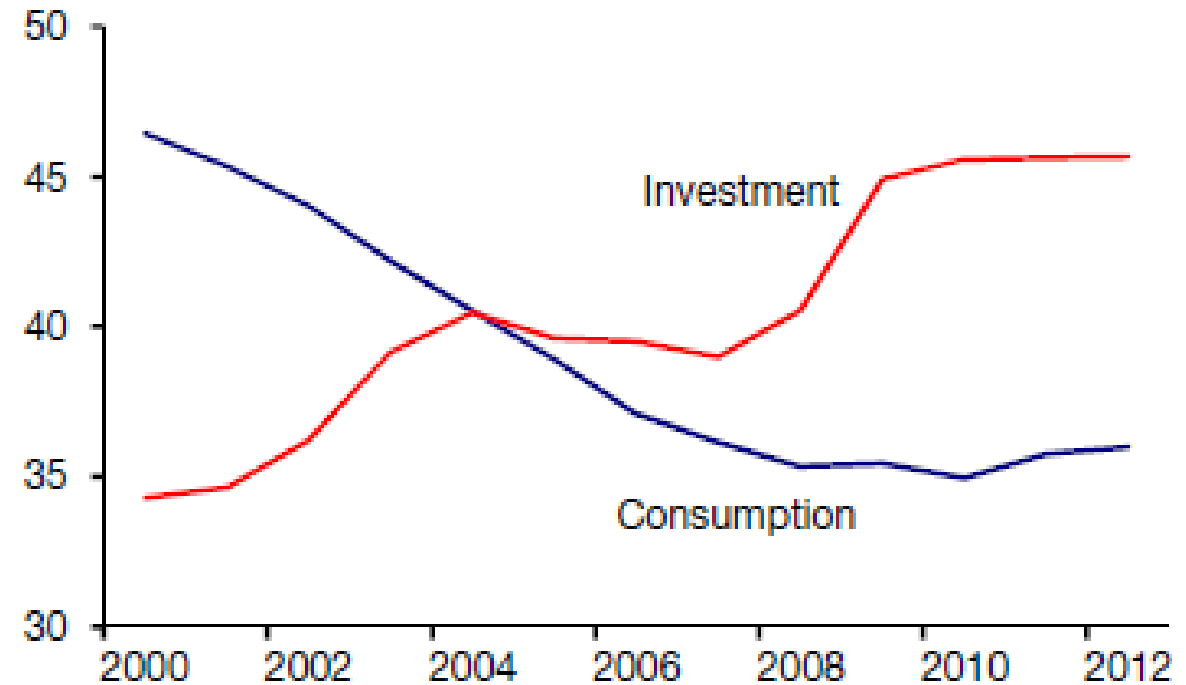


China

Unsustainable imbalances

- Excessive investment driven by debt
- \$6.8 trillion in waste
- Possible collapse of property market
- Could lead to financial crisis
- End result would be slower growth
- Reforms can help

Economic Rebalancing Needed
share of GDP



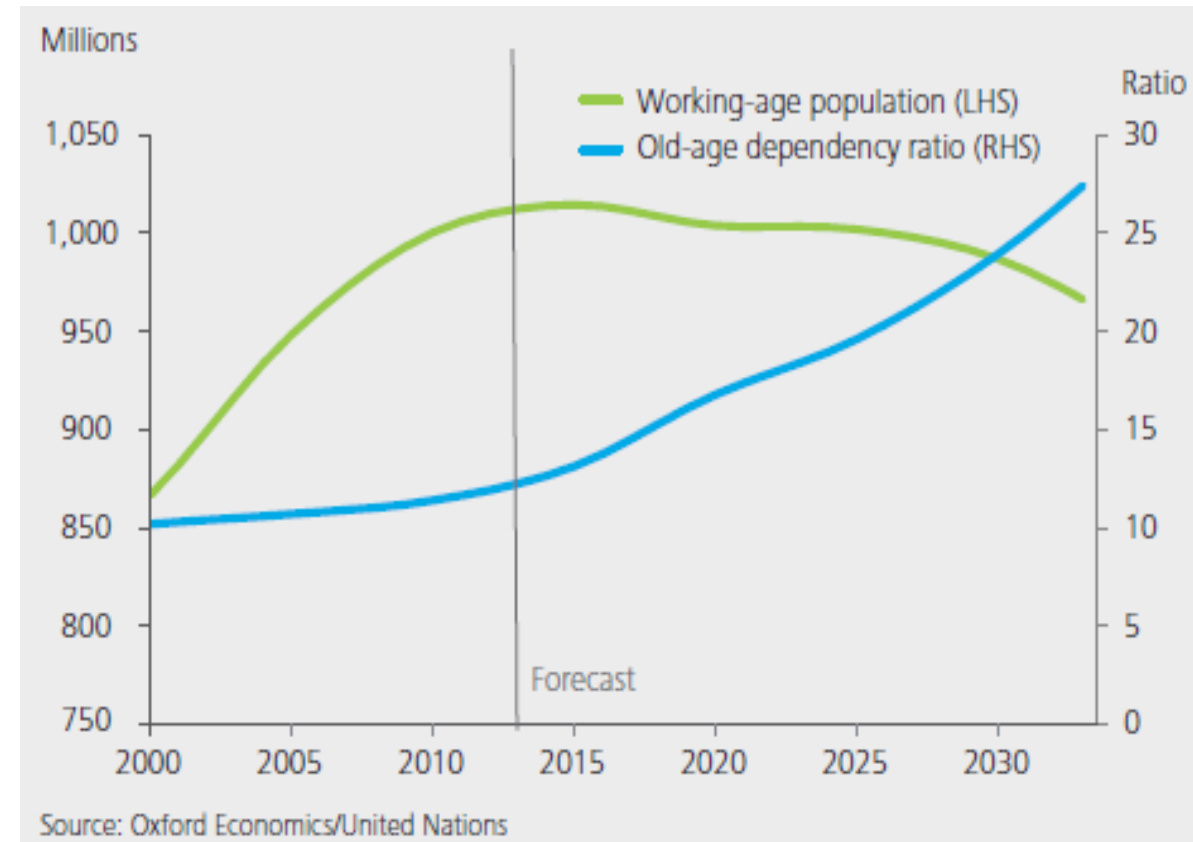
Source: NBS.

China

Demographics

- Declining working age population boosts wages, reduces competitiveness, reduces growth
- Creates demographic imbalance in the future
- Boosts importance of internal migration

China: demographic trends



China

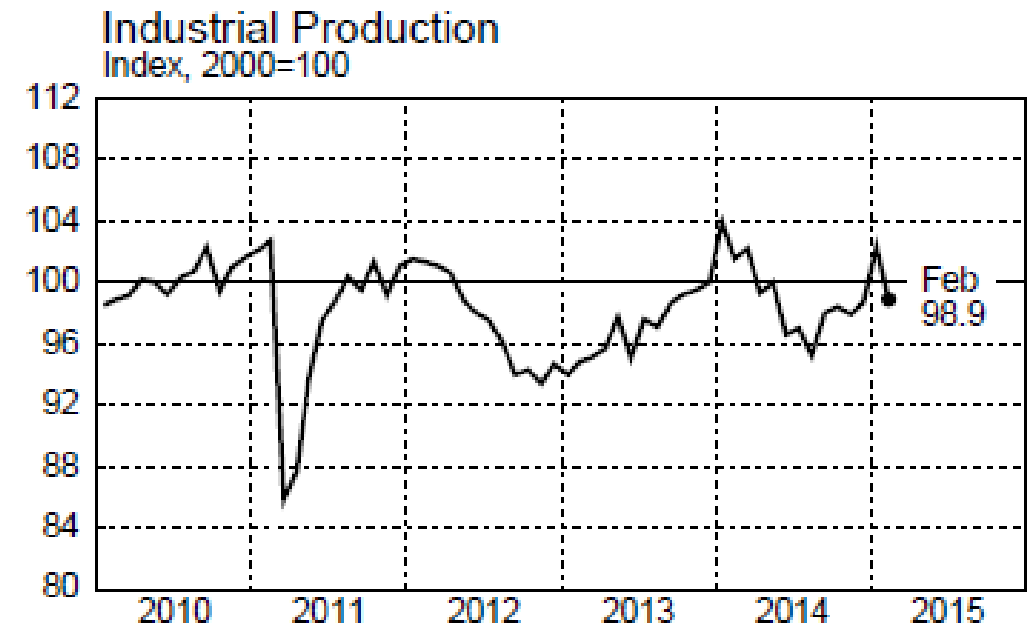
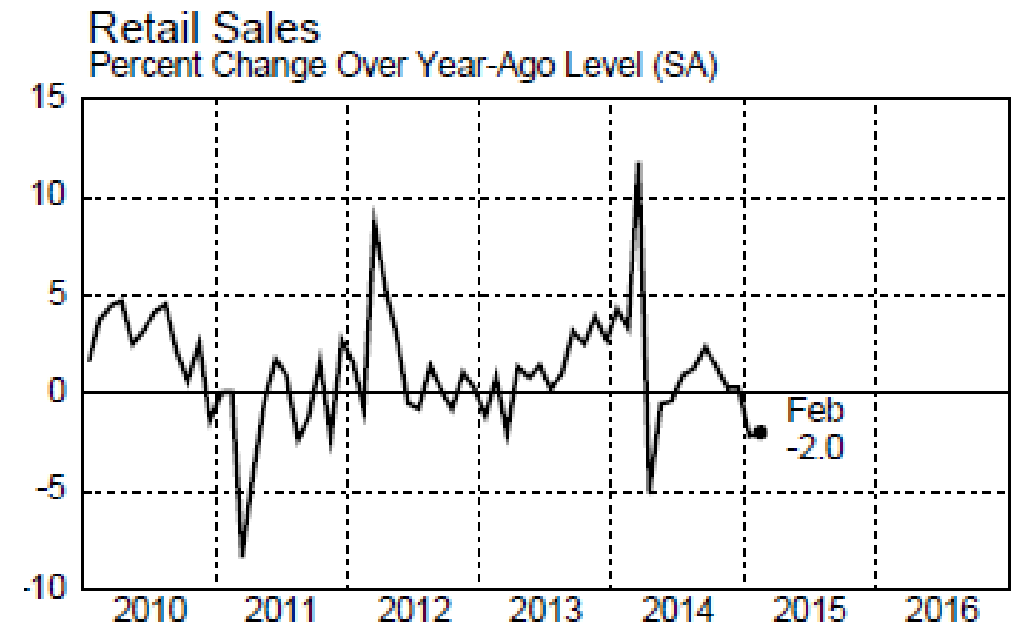
Challenges and opportunities

Challenges	Opportunities
<ul style="list-style-type: none">• Excess supply of residential property leading to declining prices• Excess supply of heavy industry leading to producer price deflation• Rising capital outflows leading to downward pressure on the currency• Rising wages leading to exit of manufacturing capacity	<ul style="list-style-type: none">• Plenty of room to continue easing of monetary and fiscal policy• Growing global profile, including setting up AIIB• Acceleration of financial market liberalization• World's largest reserves of shale

Japan

QE is not enough

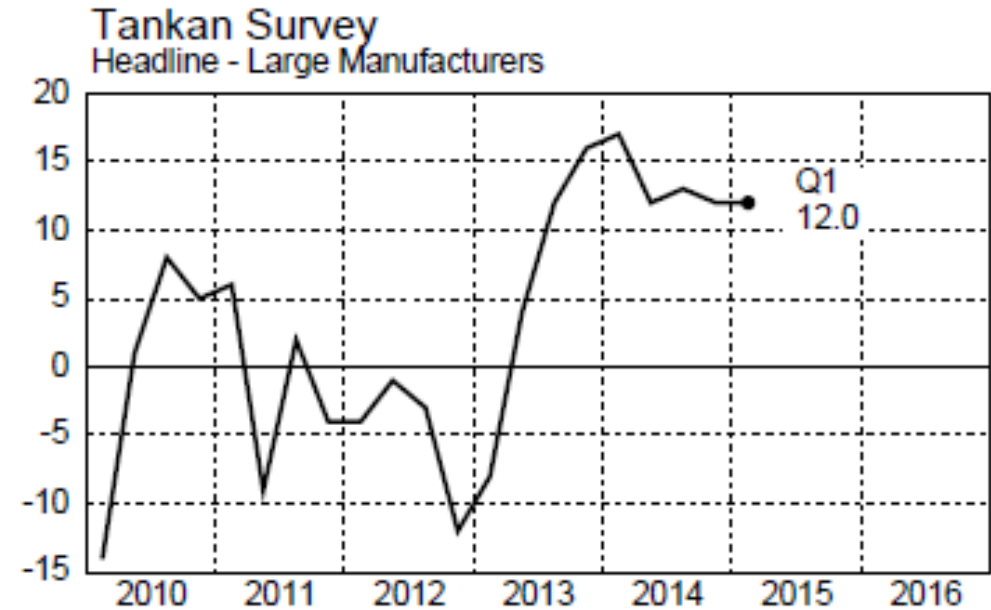
- Lower yen helps exporters, but hurts domestic producers
- Inflation is up, but wages are not
- Business investment fell in the last three quarters
- Deflationary psychology remains
- Retail spending stagnant



Japan

On the other hand...

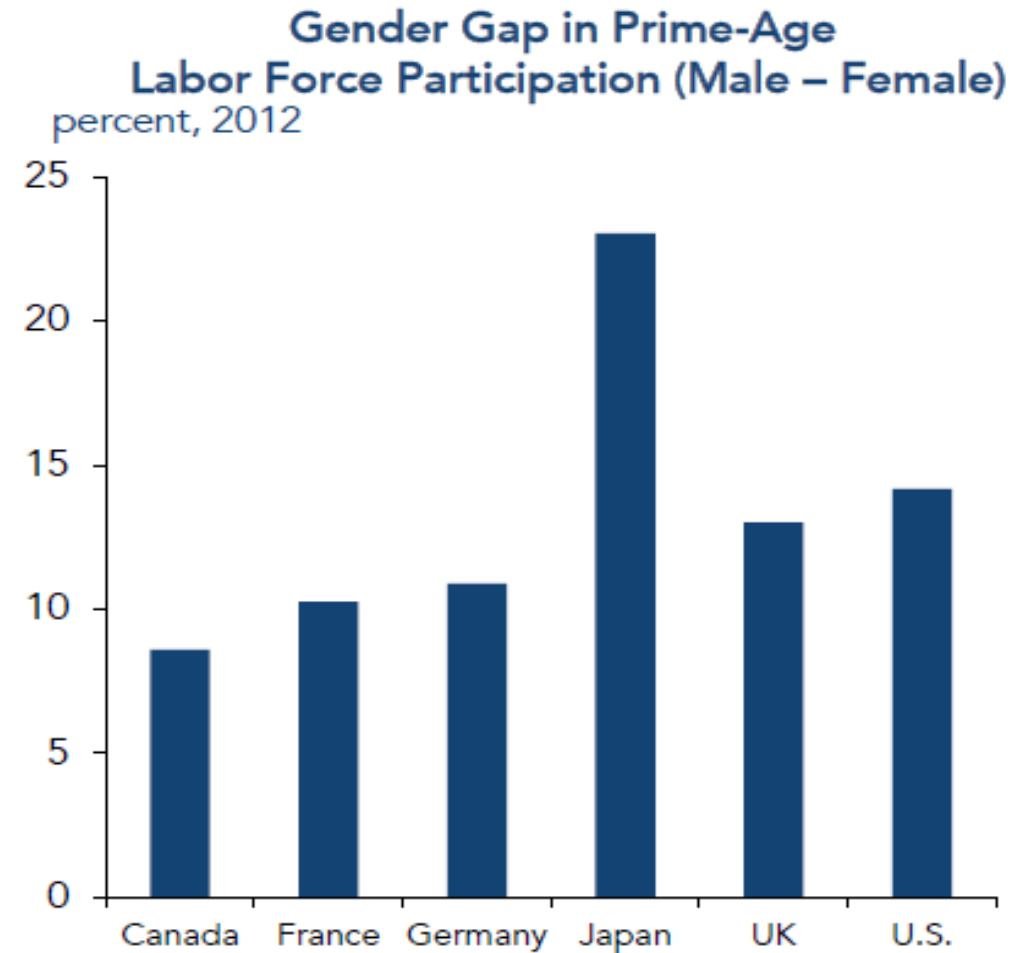
- Business confidence is way up
- Lending conditions have improved
- Unemployment is down
- Wealth has increased



Japan

What will the government do?

- Focused on female labor force participation
- Negotiating TPP with US and 10 other countries
- Looking at reforms of labor market, agriculture, other industries



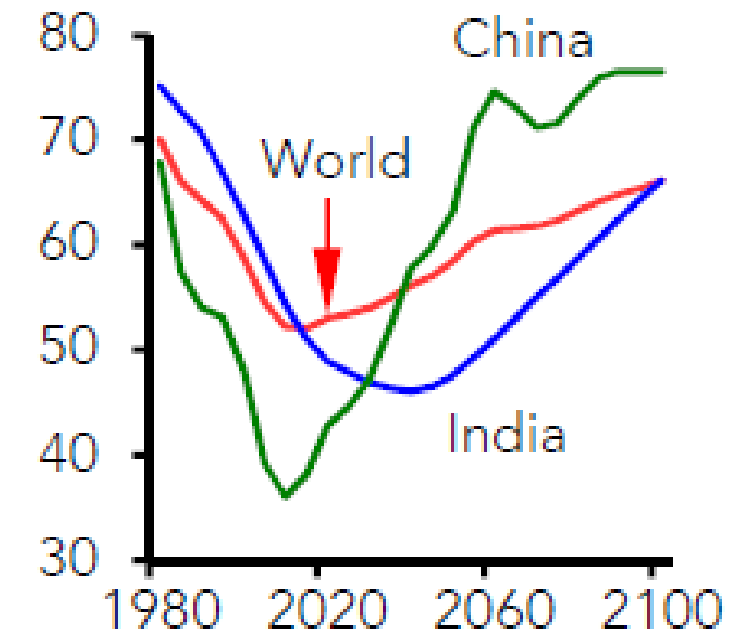
India

A positive story

- Lower oil prices, combined with tight monetary policy, bring down inflation
- Central bank eases policy and government eases fiscal policy
- Government reduces subsidies
- Investors boost confidence
- Growth accelerates this year
- Longer term, favorable demographics bode well for growth

Dependency Ratio

dependents as percent of working-age¹ population



Source: UN. ¹Age 15-64 years.

Southeast Asia

A mostly positive story

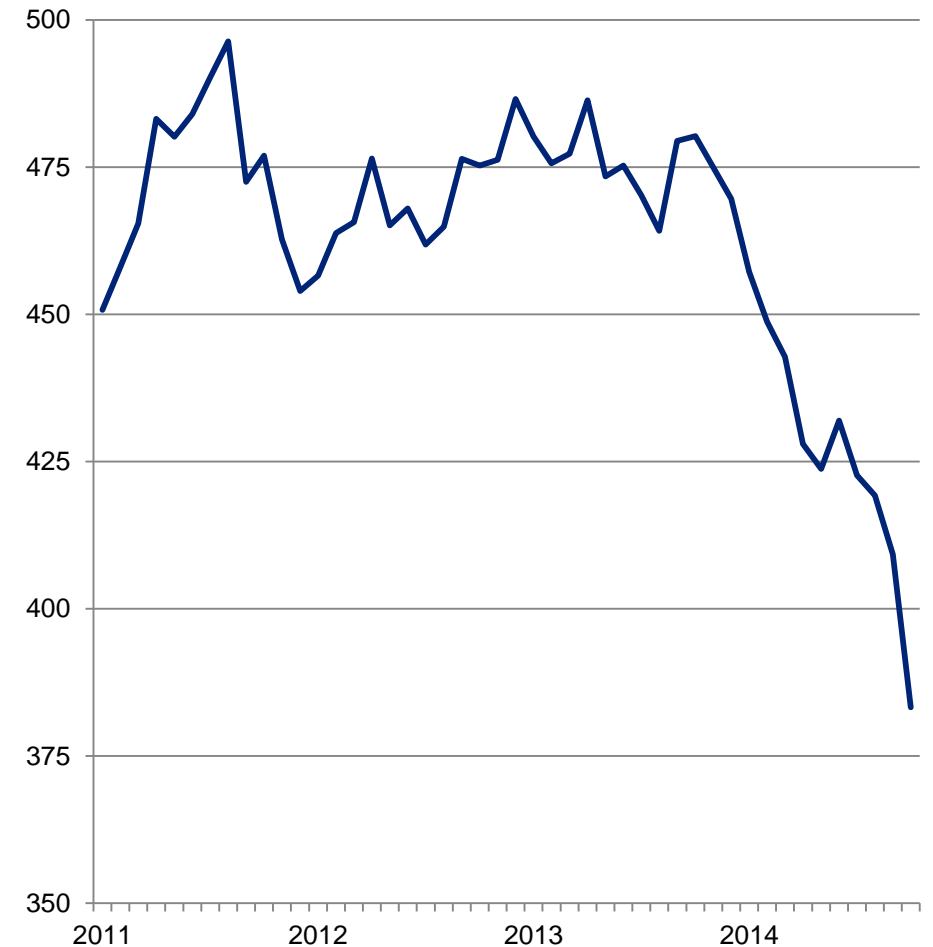
- Philippines
 - Strongest economy in region. Off-shored services show promise
- Indonesia
 - Commodity revenues diminish, but lower oil prices give the government room to cut subsidies
 - Manufacturing shows promise, especially with cheaper currency
- Malaysia
 - Lower oil price creates challenges, domestic demand remains strong
- Thailand
 - Political instability hurts investment, tourism strong due to Chinese visitors. Exports weak due to Chinese slowdown

Russia

A negative story

- Sanctions limit investment, contribute to downward pressure on ruble
- Decline in oil prices exacerbates currency depreciation
- Central bank raised, then lowered, interest rates. Sold foreign currency reserves
- Inflation is high, investment is declining, capital is flowing out, and real GDP is shrinking
- Outlook: rebound in oil will help, but unless sanctions are lifted, growth will be slow

Russian foreign currency reserves
Billions \$US

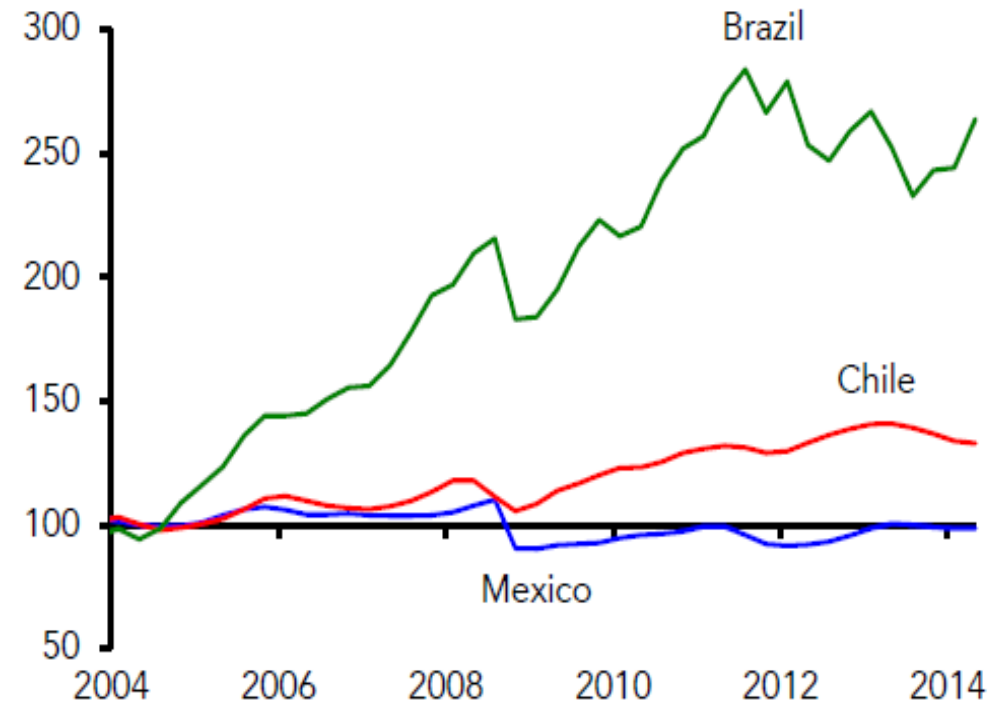


Latin America

A mixed picture

- Mexico is promising
 - Wage restraint, productivity gains
 - Liberalization of energy, telecoms
- Brazil is in trouble
 - Loss of competitiveness
 - Declining commodity prices
 - High inflation, high interest rates, fiscal tightening, ossified labor market
 - Growth outlook is poor

Unit Labor Costs
index (2004=100)



Impact of global economy on Japan

Region/country	Impact on Japan
China	<ul style="list-style-type: none">• Slow Chinese growth hurts Japanese exports• China moves up value chain, attempts to develop global brands that can compete in Japan
Europe	<ul style="list-style-type: none">• European revival could boost Japanese exports• Instability in Europe could boost yen
USA	<ul style="list-style-type: none">• Strong US economy will fuel Japanese exports• TPP could compel Japan to accelerate domestic reforms

Expectations

The world in 2020

- Eurozone could start to come apart
- US economy overheating, on path toward next recession
- China at crossroads with slower growth, inadequate reforms
- Strong markets: India, Southeast Asia, Mexico, Andean region, Africa
- Weak markets: Russia, Brazil, Central Europe, Middle East, Japan

