RSM
Audit • Tax • Advisory

Talking Points

Prospects for the World Economy 2013

David Bartlett
Economic Advisor, RSM

Introduction

The previous edition of *RSM Talking Points 'Prospects for the World Economy'* in September 2011 noted the following trajectory of the global economy: Weak GDP growth in the advanced industrialised countries burdened by the overhang of public and private debt left by the global financial crisis; robust growth in emerging markets that came out of the global downturn with stable finances and strong economic fundamentals.

The current economic landscape indicates a continuation of this pattern in 2013. As shown in *Exhibit 1*, the emerging markets of Developing Asia, Sub-Saharan Africa, Latin America/Caribbean, and Middle East/North Africa are projected to outpace the U.S., Japan, and the European Union in the coming year. Developing Asia (led by China and India) will enjoy a growth premium of 7 percent over the EU, which is forecast to grow by just 0.2 percent following an economic contraction in 2012.

European Union: Economic Stagnation

In September 2012, the European Central Bank launched a new facility (OMT: Outright Monetary Transactions) that permits unlimited ECB purchases of government bonds with maturities between one and three years. The programme marked a departure from the ECB's traditional caution toward sovereign debts and relieved fears of a Euro collapse whose effects would reverberate worldwide. The bond purchase programme aims to lower the borrowing costs of heavily indebted countries and provide breathing room for national authorities to enact the structural reforms needed for sustainable economic growth.

But while the OMT initiative dampened the sense of crisis pervading the Euro zone, the economic prospects of member countries remain grim. Italy and Spain (the foremost beneficiaries of the ECB's bond purchase programme) are projected to contract by 0.7 and 1.3 percent respectively in 2013. Portugal (which has not yet qualified for the OMT facility) is expected to contract by 1.0 percent. The ongoing economic calamity in Greece will continue with a contraction of 4.0 percent. The fiscally stable Euro countries (Austria, Benelux, Finland, France, Germany) will barely achieve positive growth in 2013. Estonia, which grew by 7.6 percent in 2011 stands as the 2013 growth champion of the Euro area at 3.5 percent. Non-Euro EU countries fare little better than the core Euro zone members: United Kingdom (1.1 percent), Denmark (1.2 percent), Sweden (2.2 percent).

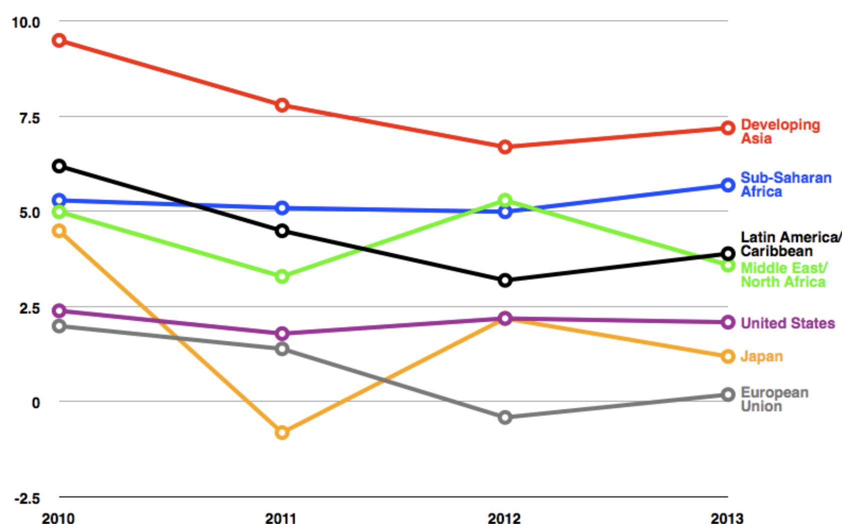

Exhibit 1 **Source:** International Monetary Fund, *World Economic Outlook*, October 2012

The EU's persistent economic stagnation illustrates several factors:

- The regional spillover of the fiscal imbalances in Southern Europe, which will take years to unwind under even optimistic assumptions
- The high share of intra-EU trade, which exerts a drag on the growth potential of small, open countries dependent on regional exports (e.g., the Baltic Republics)
- The slowdown of the world economy, which limits the growth possibilities of large EU countries that do extensive trade outside of Europe (e.g., Germany)

United States: Beyond the "Fiscal Cliff"

World markets rallied on news of the 1 January agreement between Congress and President Obama on the U.S. "fiscal cliff". The New Year's Day compromise averted automatic tax increases and spending hikes totaling $645 billion, a fiscal jolt that raised the specter of a U.S. recession and imperiled global economic recovery.

While the U.S. fiscal deal assuaged the immediate anxieties of global investors, America's economic outlook in 2013 remains guarded. The Obama Administration and Congress must still negotiate an agreement on budget sequestration, which will trigger across-the-board spending cuts of $110 billion annually from 2013 to 2022. The expiration of the two month reprieve on sequestration coincides with the impending clash over the U.S. debt ceiling, which threatens a replay of the summer 2011 crisis that led to the first-ever downgrade American sovereign debt.

But even a resolution of the political impasse in Washington will not diminish the macroeconomic constraints facing the United States. The effects of Obama's 2009 American Recovery and Reinvestment Act are dissipating,

and the current environment precludes additional fiscal stimulus in the foreseeable future. The Federal Reserve has pledged to keep U.S. interest rates low until unemployment reaches 6.5 percent (recorded at 7.8 percent in December 2012). But with the Federal Funds Rate already near zero, U.S. authorities enjoy limited means of stimulating the economy via monetary instruments.

On the positive side of the American ledger, the shale gas boom constitutes an important (and potentially disruptive) shift in the U.S. economic landscape that boosts the country's growth prospects. The sharp decline in natural gas prices confers a competitive advantage to American companies, particularly energy-intensive manufacturers. This development has spurred a mini-renaissance of U.S. manufacturing (driven by the "reshoring" of manufacturing operations previously outsourced to China) and bolstered Obama's National Export Initiative (which seeks to double U.S. exports by 2014). Economists estimate that the shale gas revolution could augment U.S. GDP by $100–230 billion annually by 2035.

Emerging Markets: Accelerated Growth

The major emerging markets are poised for increased economic growth in 2013 following the deceleration of 2011-12: China (8.2 percent), India (6.0 percent), Brazil (4.0 percent), Russia (3.8 percent) and South Africa (3.0 percent) are expected to register more modest gains in GDP growth (*see Exhibit 2*).

While public discourse over emerging markets continues to emphasise the BRICS, the robust growth performance of "second tier" emerging markets like Indonesia (6.3 percent), Thailand (6.0 percent), Vietnam (5.8 percent), and Kazakhstan (5.7 percent) is noteworthy. Similarly, the strong growth rates of African countries outside of South Africa, namely Kenya (5.6 percent), Nigeria (6.7 percent), Tanzania (6.8 percent), Ghana (7.8 percent) and Mozambique (8.4 percent) signal the rising prominence of "frontier" emerging economies in the Sub-Saharan.

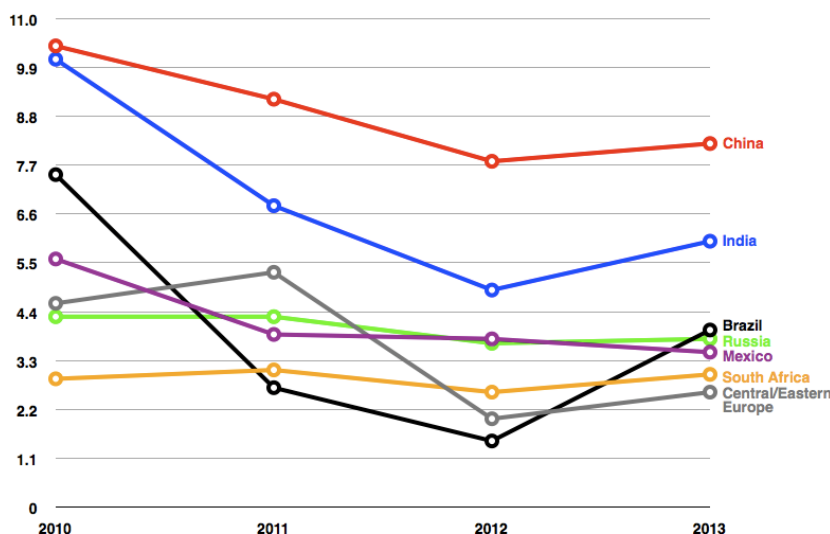

Exhibit 2 **Source**: International Monetary Fund, *World Economic Outlook*, October 2012

Central and Eastern Europe is an exception to the emerging market story. Poland (2.1 percent), Romania (2.5 percent), and Slovakia (2.8 percent) still enjoy a small growth differential over the EU-15 countries. But the other CEE countries are converging toward Western European growth levels: Czech Republic (0.8 percent), Hungary (0.8 percent), Bulgaria (1.5 percent). Turkey, which posted Europe's highest growth rate, 8.5 percent, in 2011, is projected to decelerate to 3.5 percent in 2013. The comparatively weak growth performance of the CEE countries demonstrates the regional spillover of the Euro crisis, a liability that does not burden other emerging markets.

Conclusion: The Slow Growth Trap in Developed Economies

The basic pattern described above – slow growth in developed economies, strong growth in emerging markets – is likely to be the defining feature of the world economy in coming years. While the forecast for 2013 is mildly friendlier than 2012, the advanced industrialised countries of North America, the European Union, and Developed Asia confront economic headwinds that impede their GDP growth paths.

The prospects of the developed economies breaking out of the slow growth trap hinge on (1) the capacity of national governments to reconcile the imperatives of fiscal austerity and economic growth ("growth-friendly fiscal consolidation"), (2) the ability of developed market-based companies to capitalise on commercial opportunities in faster growing emerging markets, and (3) the capacity of the developed economies to boost productivity, the key driver of long-term growth and global competitiveness.