Quarterly economic forecasts

Q4 2012

Summary

Since our last update, a number of factors have vindicated our cautious outlook for global growth. The US economy continues to outperform but looks to be slowing as the election and fiscal cliff come into view. Concerns continue to surface regarding the pace of Chinese growth, with momentum slowing in the first half of 2012 to a still respectable 7.5%. We feel that gradual loosening measures will continue to support growth but any improvement may be later than previously forecast.

After the euphoria that greeted the ECB's 'Outright Monetary Transactions' initiative, the lack of action from the Spanish politicians is starting to make the markets feel uneasy once more. A messy break-up of the euro, although less likely, would have severe consequences for the global economy, and make the post-Lehman recession look like a positive experience. Within the eurozone, Germany continues to stride ahead as the peripheral economies suffer, but this divergence is surely unsustainable.

Overall, the euro crisis and the impending US fiscal crunch will continue to hang like a dark cloud over the global economy, capping the pace of growth into next year.

US

				(T)	(Cons)	(T)	(Cons)
	2010	**2011**	**Current**	**End 2012**	**End 2012**	**End 2013**	**End 2013**
GDP (year/year)	3.0	1.7		2.0	2.2	1.5	2.1
Headline Inflation (year end)	1.6	3.1	1.7	2.0	2.0	2.0	2.0
Core Inflation (year end)	0.8	2.2	1.9	1.5		1.5	
Official Rates[1] (year end)	0.25	0.25	0.16	0-0.25	0.14[1]	0-0.25	0.15[1]
10-year bond yield	3.3	1.9	1.7	1.75	1.8	2.25	2.3
EUR/USD (year end)	1.34	1.30	1.30	1.25	1.23		1.23
USD/JPY (year end)	91	82	78	82	79		82

Updated 20 September

Notes: (T) = Threadneedle forecast, (cons) = consensus forecast, [1]consensus = derived from market expectations.

Changes to Threadneedle forecasts: None.

The captain has turned on the fasten seat-belts sign, please return to your seat

The US economy continues to outperform Europe, the UK and Japan. This is no surprise considering that the authorities chose the easy fiscal/monetary route i.e. support the recovery with masses of government borrowing and central bank money printing, then fix the fiscal mess when the economy is firing once more. So far, so good (sort of). Unfortunately, when cans were kicked, no-one seemed to realise that they had all come to a stand-still at the year end. A monumental fiscal tightening is coming into view, just weeks after another messy, underhand election. Without doubt, if all the cuts, hikes and expiries do come to fruition, the US will be back in recession. Whoever finds himself in power in the second week of November is facing the unenviable task of avoiding a collapse in the economy, whilst trying to appease the rating agencies with a credible programme for pulling the US off the path to fiscal oblivion. We can only hope that the warring parties, currently poles apart, can curb their animosity and work together on a solution that resets the fiscal profile over the next five years or so, avoiding the immediate pain.

Without the fiscal cliff, the gentle recovery could continue, and even gather a little pace, driven predominantly by the housing market. Bernanke’s change of tack to ‘Operation Twist’ flattened the curve, driving mortgage rates to historic lows. The latest QE programme is a far more aggressive policy, open-ended and focusing on the mortgage market (without the fiscal cliff, we probably wouldn’t have QE3). The initial response has been a collapse in yields on mortgage-backed securities. We now await the follow-through via rates available to borrowers. We may have to wait for the fiscal resolution.

Euro Area

				(T)	(Cons)	(T)	(Cons)
	2010	**2011**	**Current**	**End 2012**	**End 2012**	**End 2013**	**End 2013**
GDP (year/year)	1.9	1.5		-0.5	-0.5	-0.5	-0.2
Headline Inflation (year end)	1.6	2.7	2.6	2.0	2.4	1.5	1.8
Official Rates (year end)	1.0	1.0	0.75	0.5	0.5	0.5	0.5
10-year bond yield	3.0	1.8	1.6	2.0	1.6	2.5	1.9
EUR/USD (year end)	1.34	1.30	1.3	1.25	1.23		1.23
EUR/JPY (year end)	109	100	101	103	98		100

Updated 20 September

Notes: (T) = Threadneedle forecast, (cons) = consensus forecast.

Changes to Threadneedle forecasts: 2012 GDP growth -0.5% from -1.0%, 2013 GDP growth -0.5% from 0.5%, 10-year bond yield 2.0% from 2.5%.

Economic misery to continue into 2013

The ECB's recent commitment to intervene in sovereign bond markets appears to have removed one of the tail risks from the eurozone economy, and the recent trend of moderate declines in GDP looks set to continue. The overall decline for this year is not as extreme as we had expected, as the German and French economies have not been hurt by the crisis as much as we had thought likely. However, a return to positive growth now appears further away. Fiscal tightening and dwindling bank loan growth will continue to put downward pressure on the peripheral economies into 2013, and the recent signs of slowing global growth may reduce the positive impact from the external sector, which has acted as an offset thus far. We also see downside risks to the French economy as the government attempts to tackle the budget deficit. The performance of the German economy continues to be a bright spot. All-in-all, another year of negative growth will maintain the pressure on policy makers to provide support and continue the move towards a more sustainable union.

Risks to the forecast

Negative

- Politics – stalling banking union, fiscal union, ECB infighting, Spanish government collapse.
- Social upheaval.
- Italian elections see rise of anti-euro sentiment.
- Greek exit.

Positive

- Stronger global growth.
- ECB intervenes more aggressively.
- Banking union brought forwards.

Japan

				(T)	(Cons)	(T)	(Cons)
	2010	2011	Current	End 2012	End 2012	End 2013	End 2013
GDP (year/year)	4.5	-0.7		2.0	2.4	1.0	1.3
Headline Inflation (year end)	-0.7	-0.3	-0.4	-0.2	0.1	0.0	0.0
Official Rates (year end)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond yield	1.1	1.0	0.8	1.0	0.9	1.0	1.1
USD/JPY (year end)	91	82	78	82	79		82
EUR/JPY (year end)	109	100	101	103	98		100

Updated 20 September

Notes: (T) = Threadneedle forecast, (cons) = consensus forecast.

Changes to Threadneedle forecasts: None.

2012 started solidly but much uncertainty into 2013

Growth momentum in early 2012 exceeded our expectations, as strong global auto sales aided exports alongside solid domestic consumer demand. Accordingly, we had raised our 2012 forecast. However, we remained below consensus as it seemed counter-intuitive to embrace the optimism fully, given the concerns relating to Japan's two biggest export destinations of the US and China.

Since then, the concerns over China have become more prevalent, leading consensus for Japan's GDP to move back towards our forecast. In addition, the Japanese government's measures to stimulate domestic consumption have expired and momentum here will slow. Whether or not the GDP growth number for calendar 2012 comes in higher than 2%, it is extremely clear that the underlying growth rate for late 2012 and early 2013 will be much lower than this.

Previously, we have highlighted a number of potential developing events that could have repercussions for economic growth, and these remain very much in play. The political situation remains fluid and it is almost certain that there will be a change of government at the next election, which must take place before summer 2013. The opposition LDP have only just elected a leader to fight the election, so policies remain unclear but they may oppose the planned introduction of higher consumption taxes. It is unclear how much power the newly formed and reforming Japan Restoration Party could gain.

Uncertainty still surrounds the question of who will become the new governor of the Bank of Japan following the end of the term of current governor Shirakawa. If we assume the LDP regain power in an election, it may be possible to raise hopes of more proactive policy setting, but it would be very early days to assume any major changes.

The direction of Japan's long-term energy policy remains an important debate, with the major political parties lining up behind opposing views of whether or not nuclear generation should play any part.

UK

				(T)	(Cons)	(T)	(Cons)
	2010	**2011**	**Current**	**End 2012**	**End 2012**	**End 2013**	**End 2013**
GDP (year/year)	2.1	0.7		-0.5	-0.3	1.0	1.3
Headline Inflation (year end)	3.3	4.5	2.5	2.3	2.7	2.0	2.1
Official Rates (year end)	0.5	0.5	0.5	0.5	0.5	0.5	0.5
10-year bond yield	3.4	2.0	1.8	2.0	1.7	2.5	1.9
USD/GBP (year end)	1.56	1.55	1.62	1.52	1.56		1.55
EUR/GBP (year end)	0.86	0.84	0.80	0.82	0.79		0.79

Updated 20 September

Notes: (T) = Threadneedle forecast, (cons) = consensus forecast.

Changes to Threadneedle forecasts: 2012 GDP to -0.5% from 0.0%.

A lighter shade of grey?

Although the economy is still feeling the negative forces of public and private sector de-leveraging, there are reasons to expect a slightly better GDP performance in the coming quarters. Real incomes are edging towards positive territory for the first time in three years and recent actions by the Bank of England seem to be having some success in improving the monetary transmission mechanism. A range of economic indicators also suggest that the GDP data series is overstating the degree of economic weakness. Employment growth, business surveys and retail sales all suggest that the true underlying pace of growth is in the 1-1.5% range. In the absence of extreme risk events, it seems likely that this pace of activity will be maintained in the coming quarters.

Risks to the forecast

Negative

- Eurozone.
- Fiscal policy.
- Housing market.

Positive

- Lower imported inflation which boosts real wages.
- Credit mechanism unclogged by Bank of England policy.

Emerging Markets

GDP (year/year)	2012		2013	
	Threadneedle	Consensus	Threadneedle	Consensus
Brazil	1.5	1.6	3.5	4.0
Mexico	3.8	3.9	3.8	3.5
China	7.6	7.7	7.6	8.1
India	5.6	5.9	6.6	6.9
South Korea	2.6	2.6	3.5	3.5
Taiwan	1.7	1.7	3.5	4.0
Russia	3.8	3.8	3.8	3.7

Updated 20 September

Changes to Threadneedle forecasts: China – 2012 GDP changed to 7.6% from 8.0-8.5%, 2013 GDP changed to 7.6% from 8.0-8.5%; South Korea – 2012 GDP changed to 2.6% from 3.0-3.5%, 2013 GDP changed to 3.5% from 3.0-3.5%; Brazil – 2012 GDP changed to 1.5% from 2.0-2.5%, 2013 GDP changed to 3.5% from 4.0-4.5%; Mexico – 2012 GDP changed to 3.8% from 3.5-4.0%, 2013 GDP changed to 3.8% from 3.0-3.5%; India – 2012 GDP changed to 5.6% from 6.0-6.5%, 2013 GDP changed to 6.6% from 6.5-7.0%; Taiwan – 2012 GDP changed to 1.7% from 3.0-3.5%, 2013 GDP changed to 3.5% from 4.5-5.0%; and Russia – 2012 GDP changed to 3.8% from 3.0-3.5%.

China focus

The last three months have seen further downgrades to 2012 GDP forecasts for most of the major economies in the Asia Pacific region and global emerging markets, with those economies having the greatest linkage into global trade being most impacted. By contrast, the ASEAN economies of Thailand, Indonesia and the Philippines are enjoying more resilient growth due to relatively robust domestic demand. In Latin America, growth in Mexico has remained stable on the back of investment and net trade, while the Brazilian economy has so far failed to respond to aggressive monetary easing and stimulus measures. Within EMEA, growth in Russia and Turkey remains stable.

Expectations of a rebound in China's economic growth rate in the second half of this year have been considerably dampened with the release of weaker-than-expected data across many areas of the economy in August. Industrial production growth is weak as a result of poor export momentum, weak construction activity and ongoing de-stocking. This, in turn, is hurting profits of both the state-owned enterprises and private manufacturing companies. Fixed asset investment is holding up reasonably well, as the slack from a slowdown in residential investment is being taken up by a pick-up in infrastructure investment as the authorities have accelerated the roll-out of projects. The transition to a new leadership in China next year is delaying the policy response to combat the domestic slowdown. Consequently, the weaker external environment combined with lacklustre policy initiatives domestically have caused us to lower our GDP forecasts for China for both 2012 and 2013.