Economic forecasts

December 2013

Summary

Positive but muted growth has continued in the developed economies with sentiment rebounding. Meanwhile, emerging economies have continued to have their growth prospects marked down.

Across the developed markets, structural headwinds will keep growth subdued from the long-term potential in 2014. In the US, the focus will be on the Federal Reserve's exit strategy and associated impact on monetary conditions. Whilst the Fed has been successful in delineating between tapering and tightening, the rise in yields has hurt one of the bright spots of the economy – the housing market – and we have yet to see the long-awaited return of investment due to continued political wrangling. In the eurozone, continued deleveraging in the banking system will constrain credit growth and must be met by proactive monetary easing, although the lagged effects of a reduction in fiscal tightening should also help.

In emerging markets, China has announced a substantial reform package, which should, if implemented, aid the transition to a more balanced composition of growth. However, timing remains vague and successful implementation would pose a drag on growth in the near term, having stabilised at around 7.5%.

GDP (year/year)	End 2013		End 2014	
	Threadneedle	Consensus	Threadneedle	Consensus
US	1.5	1.7	2.5	2.6
Euro Area	-0.5	-0.4	0.7	0.9
Japan	2.0	1.9	1.5	1.6
UK	1.3	1.4	2.25	2.3
Brazil	2.5	2.4	2.5	2.4
Russia	1.6	1.6	2.5	2.5
India	4.7	4.6	5.5	5.6
China	7.5	7.6	7.5	7.5

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US

	2011	2012	Current	(T) End 2013	(Cons) End 2013	(T) End 2014	(Cons) End 2014
GDP (year/year)	1.8	2.2		1.5	1.7	2.5	2.6
Headline Inflation (year end)	3.0	1.7	1.0	1.5	1.5	2.0	1.8
Core Inflation (year end)	2.2	1.9	1.7	1.5	-	1.5	-
Official Rates[1] (year end)	0.25	0-0.25	0-0.25	0-0.25	0.18[1]	0-0.25	0.15[1]
10-year bond yield	1.9	1.75	2.75	2.75	2.8	3.0	3.2
EUR/USD (year end)	1.30	1.32	1.35	1.32	1.32	1.15	1.28
USD/JPY (year end)	82	87	102	100	101	115	105
Earnings Growth		4.0		9.0	7.0	5.0	11.0

Updated 25 November 2013
Notes: (T) = Threadneedle forecast, (cons) = consensus forecast, [1]consensus = derived from market expectations
Changes to Threadneedle forecasts: 2013 Headline Inflation 1.5 versus 2.0, 2014 USD/JPY 115 versus 120, 2013 EUR/USD 1.32 versus 1.25.

Source: Threadneedle, Consensus Economics, Bloomberg, November 2013.

A brighter year ahead

The US economy has been resilient in the face of sizeable fiscal tightening, school yard antics in Washington, a jump in mortgage rates and a shambolic roll out of 'Obamacare'. As the year draws to a close, a growth rate of around 1.5% should be viewed positively. Moreover, assuming that the fiscal drag in 2014 is no more than 0.7%, one can look to a brighter year ahead. There will still be hurdles to negotiate of course. Another round of political scrapping comes into view as early as Q1, and then there is the small issue of weaning the markets off the current QE programme. Initial attempts to prepare the world for tapering did not go well, but the Fed has since been successful in breaking the link between less money printing and imminent rate hikes. Expectations for rate hikes have been pushed out into the future once more, while long-dated government bonds continue to hold higher yields in anticipation of less central bank participation. Mortgage rates also remain higher, slowing turnover in the residential market. Meanwhile, the stock market continues to push higher, and will likely continue on this path until QE is all but finished.

QE has once again been successful in lifting risk assets, increasing the wealth of those with cash to participate. The same has occurred in housing, with the steep incline in prices reducing the affordability for first time buyers and the less wealthy, keeping the home ownership rate at the lows. Less ownership helps to fuel the rental market, giving an income stream to those investors who sit on unrealised capital gains, further aiding the wealth divergence. Meanwhile, back on the ground, the small business community remains less than optimistic about the future, its displeasure directed towards Washington. Employment growth continues to rumble along at around 200,000 per month, and this pace is likely to be maintained over the coming quarters.

Euro Area

				(T)	(Cons)	(T)	(Cons)
	2011	2012	Current	End 2013	End 2013	End 2014	End 2014
GDP (year/year)	1.5	-0.5		-0.5	-0.4	0.7	0.9
Headline Inflation (year end)	2.7	2.2	0.7	1.0	1.4	1.0	1.3
Official Rates (year end)	1.0	0.75	0.25	0.25	0.25	0.25	0.25
10-year bond yield	1.8	1.5	1.73	1.8	1.9	2.25	2.2
EUR/USD (year end)	1.30	1.32	1.35	1.32	1.32	1.15	1.28
EUR/JPY (year end)	100	114	137	132	133	132	134
Earnings Growth		-5.0		5.0	9.0	10.0	15.0

Updated 25 November 2013
Notes: (T) = Threadneedle forecast, (cons) = consensus forecast
Changes to Threadneedle forecasts: 2013 10-year bond yield 1.8 versus 2.0, 2013 Inflation 1.0 from 1.5, 2013 EUR/USD 1.32 versus 1.25, 2013 EUR/JPY 132 versus 125, 2014 EUR/JPY 132 versus 138.

Source: Threadneedle, Consensus Economics, Bloomberg, November 2013.

Signs of growth but challenges remain

Soft data and leading indicators continue to point to positive, albeit low, growth as the eurozone exits a multi-quarter recession. Driving this are an improvement in trade balances, thanks to much-needed reforms that have increased competitiveness, as well as the return of domestic demand as austerity measures have been pushed back.

However, stubbornly high levels of unemployment have created significant slack in the labour markets, which is keeping wage growth subdued. This has played a role in propagating the next problem in the eurozone – deflationary fears, which, whilst improving the competitiveness of exports, will prove burdensome in the context of debt/GDP levels in excess of 90%. At the moment, disinflation is being experienced but the threat of peripheral countries such as Italy and Spain (following the experience of Greece and Portugal, where high unemployment has led to deflation) slipping into deflation is not too remote a prospect.

Evidently, monetary policy has not been accommodative enough. Despite cuts to the Main Refi rate, core yields are up as well as Euribor, which point to a tightening of monetary conditions. Euro Area balance sheets continue to contract and are likely to continue to do so in even greater magnitude over the coming years, to come into line with increased regulation. In tandem, lending to the real economy will continue to suffer. Further policy easing is needed.

In summary, growth will be positive, if sluggish, in the near term as sentiment rebounds but will be capped by structural headwinds. Disinflationary pressures are likely to intensify as unemployment remains high and balance sheet deleveraging continues.

Japan

	2011	2012	Current	(T) End 2013	(Cons) End 2013	(T) End 2014	(Cons) End 2014
GDP (year/year)	-0.5	2.0		2.0	1.9	1.5	1.6
Headline Inflation (year end)	-0.3	-0.1	1.1	0.0	0.2	2.0	2.3
Official Rates (year end)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
10-year bond yield	1.0	0.8	0.64	0.7	0.8	1.0	0.9
USD/JPY (year end)	82	87	102	100	101	115	105
EUR/JPY (year end)	100	114	137	132	133	132	134
Earnings Growth		20.0		32.0	46.0	26.3	13.0

Updated 25 November 2013
Notes: (T) = Threadneedle forecast, (cons) = consensus forecast
Changes to Threadneedle forecasts: 2013 GDP 2.0 versus 2.5, 2014 USD/JPY 115 versus 120, 2013 EUR/JPY 132 versus 125, 2014 EUR/JPY 132 versus 138, 2013 10-year bond yield 0.7 versus 1.0, 2014 10-year bond yield 1.0 versus 1.25.

Source: Threadneedle, Consensus Economics, Bloomberg, November 2013.

Expect (even) more policy support

Nominal growth is improving as inflation continues to pick up. However, the inflation is largely imported following QE-induced currency weakening and the increased reliance on energy imports with nuclear offline. Deflationary mind-sets have typically been prevalent amongst Japanese businesses and are a key obstacle towards generating an inflationary environment. Thus far, boosts to take-home pay have come largely in the form of overtime and bonuses with employers expected to increase wages next. The determinants of nominal wages – profitability, prices and output gaps – have improved in recent months, which could lead to a seachange in wage negotiations and the mind-set of management could be swayed further by corporation tax sweeteners from the government to those that do raise wages.

Expectations of further easing from the Bank of Japan are mounting as there is still a significant way to go to meet the 2% inflation target. The next BoJ outlook report in April next year will be a key driver as we see how far CPI has diverged from the Bank’s forecast. It has been suggested that the BoJ could aggressively step up purchases of riskier assets such as REITs, which have already attracted strong investor interest due to high yields, as well as begin purchases of the stock market through ETFs.

One of the key uncertainties in 2014 will be the effect of the consumption tax, which is likely to spur consumption in Q1, prior to the imposition, whilst seeing potentially significant payback in Q2. We hope this may be offset in part from the wealth effect of a booming stock market as well as an improvement in the housing market.

UK

				(T)	(Cons)	(T)	(Cons)
	2011	2012	Current	End 2013	End 2013	End 2014	End 2014
GDP (year/year)	1.0	0.3		1.3	1.4	2.25	2.3
Headline Inflation (year end)	4.2	2.7	2.2	2.0	2.7	2.5	2.6
Official Rates (year end)	0.5	0.5	0.5	0.5	0.5	0.5	0.56
10-year bond yield	2.1	2.0	2.79	3.0	2.8	3.5	3.1
USD/GBP (year end)	1.55	1.63	1.62	1.59	1.58	1.53	1.56
EUR/GBP (year end)	0.84	0.81	0.83	0.83	0.84	0.75	0.82
Earnings Growth		-2.9		2.6	0.0	6.2	11.0

Updated 25 November 2013
Notes: (T) = Threadneedle forecast, (cons) = consensus forecast
Changes to Threadneedle forecasts: 2013 EUR/GBP 0.83 versus 0.81, 2013 USD/GBP 1.59 versus 1.55, 2014 EUR/GBP 0.75 versus 0.79, 2014 USD/GBP 1.53 versus 1.45.

Source: Threadneedle, Consensus Economics, Bloomberg, November 2013.

Carney in control of the curve

The UK economy has maintained strong momentum into the fourth quarter with business surveys holding on to elevated levels and the employment picture brightening further. Concerns, however, remain around the re-balancing effort with the majority of the growth so far coming from consumer spending, bolstered by controversial initiatives to stimulate the housing market. The severe weakness in investment spending has been the biggest disappointment and seems at odds with buoyant business confidence and the supportive easing in credit conditions. GDP data is notoriously unstable and subject to revision and recent pointed comments from Governor Carney made it quite clear that the Bank of England does not trust the ONS data series for this component.

The quarterly inflation report contained a very significant revision to the MPC's unemployment forecasts, but the vague construct of the policy-setting framework has so far been successful in heading off adverse market reactions. In reality, as with the Federal Reserve, the policy-setting framework will subtly become more broadly conditional on a range of indicators such as average earnings and credit demands. The nature of the UK mortgage market means that any back up in gilt yields to reflect greater risk premia will not have a destabilising impact as Governor Carney should be able to keep short yields locked down with his intellectual promises.

Recent declines in inflation and a good chance of a move to a lower range for consumer prices will add welcome marginal support to depressed real incomes in the coming quarters and other good news stories around the construction and production sectors are also easy to find. Nevertheless, the statistical absence of recoveries in investment and net exports, together with ongoing fiscal retrenchment, suggests that it is probably too early to lift the 2014 growth forecast.

Emerging Markets

GDP (year/year)	2013		2014	
	Threadneedle	Consensus	Threadneedle	Consensus
Brazil	2.5	2.4	2.5	2.4
Mexico	1.5	1.2	4.0	3.2
China	7.5	7.6	7.5	7.5
India	4.7	4.6	5.5	5.6
South Korea	2.5	2.7	3.5	3.5
Taiwan	2.5	2.1	3.7	3.4
Russia	1.6	1.6	2.5	2.5

Updated 25 November 2013
Changes to Threadneedle forecasts: 2013 Taiwan 2.5% from 2.9%, 2013 Russia 1.6% from 2.6%, 2014 Brazil 2.5% from 3.0%, 2014 Russia 2.5% from 2.8%.

Source: Threadneedle, Consensus Economics, November 2013.

A grand plan for China

The latest consensus forecasts show further downgrades to EM growth prospects, as economists come to terms with the fact that potential growth is likely to be lower than in previous years.

Chinese growth appears to have stabilised in recent months, but longer-term the authorities face challenges in adjusting the economy to a consumption-driven growth model. A significant step in this direction is the release of 'The Decision', a 60-point reform package which paves the way for easing the State's grip on the economy while promoting private sector led innovation. The most significant proposals include land reforms, equal rights for migrant workers in small and medium-sized cities, financial market liberalisation and the further relaxation of the one child policy. The total package is ambitious and lacks clarity in terms of a time frame, but has been received positively by commentators. The implementation of the package over the medium term could act as a drag on growth, but reform is desperately needed for the economy's future prospects towards a more consumer-driven economy.

Important information