TOP-10

ECONOMIC PREDICTIONS FOR 2011

NARIMAN BEHRAVESH, IHS CHIEF ECONOMIST

A two-speed recovery is likely to remain a salient feature of the global economy throughout 2011. **The deceleration in growth that manifested itself in the latter half of 2010 will extend into the first half of 2011—for nearly every region and country in the world. However, the global recovery should pick up steam in the second half of the year, as some of the worst-hit sectors (housing and autos) rebound and as consumer and business confidence improves. Arithmetically, this means that growth in calendar-year 2011 (3.3%) will be a little weaker than in 2010 (4.0%), but then followed by a bounce-back in 2012 (3.7%). While there is no shortage of downside risks, global growth has been revised up in recent months, which means that the distribution of risks may be more symmetric than a year ago.**

1 THE U.S. RECOVERY WILL PICK UP STEAM AS THE YEAR PROGRESSES.

In 2011, the U.S. economy is likely to be firing on more cylinders—especially during the second half. In particular, the housing correction will be far enough along that the sector will no longer be a drag on GDP growth, and is likely to make a positive contribution. Similarly, thanks to a weaker dollar, the United States will enjoy export-led growth. This means that GDP growth will average 2.7% in the second half, compared with 2.1% in the first half.

2 EUROPE AND JAPAN WILL ALSO SEE SLIGHTLY STRONGER GDP GROWTH IN THE SECOND HALF OF 2011.

The pace of growth in Europe is slowing, mostly because of fiscal tightening and jitters about sovereign debt. As a result, growth will decelerate through the early part of 2011, before stabilizing and picking up—assuming that the recent euro crisis does not evolve into something much worse. As a result, the EU will grow by about 1.6% in 2011. Despite recent strength, Japanese growth is also likely to hit a nadir in early 2011, averaging only 0.7% over the year.

3 EMERGING MARKETS WILL SLOW, BUT CONTINUE TO GROW THREE TIMES FASTER THAN THE DEVELOPED WORLD.

Economic growth in almost all of the emerging world is also likely to be affected by the slowing trends in the developed economies. Among the big emerging markets, China and Brazil will see the most pronounced slowing trends, while growth in India and Russia will not suffer much (if at all). As a result, the emerging world is likely to grow about 6%, compared with 2% for the developed world.

4 INTEREST RATES WILL REMAIN ON HOLD IN THE G-7, BUT KEEP RISING IN THE BRICS.

The Federal Reserve, the European Central Bank (ECB), the Bank of England, the Bank of Japan, and the Bank of Canada are all going to keep policy rates on hold for at least the first half of the year, and in some cases (the Fed and the ECB) through the fourth quarter and beyond. In contrast, central banks in many of the large emerging markets and a few developed countries (e.g., Australia and Norway) will likely continue raising interest rates in 2011.

5 FISCAL POLICY WILL BECOME TIGHTER IN MANY LARGE ECONOMIES.

Most countries in Europe will be tightening fiscal policy—some of their own accord (e.g., the United Kingdom) and some under duress (e.g., Greece, Ireland, Portugal, and Spain). Fiscal contraction will be quite large in the countries that have suffered the most intense market pressure. Even in the United States, where significant fiscal contraction is unlikely in 2011, the expiration of some stimulus programs (e.g., the "Making Work Pay" tax credit) will result in a de-facto fiscal tightening.

6 COMMODITY PRICES WILL MOVE UP GRADUALLY.

The rollercoaster ride of commodity prices could continue into 2011. Nevertheless, as growth (re)accelerates in the second half of the year, the upward pressure on commodity prices will increase. By the end of next year, most commodity prices can be expected to be 5–10% higher than levels at the end of this year. Factors other than demand growth (e.g., inventories, exchange rates, and speculative activity) will also affect the extent to which commodity prices rise.

7 INFLATION WILL NOT BE A PROBLEM IN THE DEVELOPED ECONOMIES, BUT WILL RISE IN MANY EMERGING MARKETS.

Consumer price inflation in the advanced economies will average around 1.5% in 2011, compared with 5.5% in the developing world. In the United States, core PCE inflation will likely hit bottom in 2011, before edging higher in 2012. Meanwhile, inflation in large emerging markets, such as China and Russia, will creep upward. Strong growth and, in some cases, fixed or managed exchange rates will contribute to upward price pressures.

8 GLOBAL IMBALANCES WILL NEITHER WORSEN NOR IMPROVE BY MUCH.

After improving during (and mostly because of) the Great Recession, global imbalances worsened again in 2010. Nevertheless, in 2011 and 2012, the U.S. current-account deficit is likely to stabilize around $500 billion. A weaker dollar and strong emerging markets' growth will help exports, but rising oil prices will increase the import bill. At the same time, the current-account surpluses of other key economies, including China and the Eurozone, will hold steady for a while.

9 THE DOLLAR WILL SLIDE AGAINST MOST CURRENCIES, WITH THE POSSIBLE EXCEPTION OF THE EURO.

A two-speed world and still-large global imbalances will have a predictable impact on exchange rates—downward pressure for the "crawling" economy currencies and upward pressures for the "galloping" economy currencies. This means that the U.S. dollar will keep falling against most currencies, especially those of emerging markets. On the other hand, further sovereign debt problems in Europe could strengthen the dollar relative to the euro.

10 NO SHORTAGE OF "BLACK SWANS"—NOT ALL BAD.

With the better tone of recent data and as the momentum of growth accelerates during 2011, the risks to the forecast will become correspondingly more balanced. There continue to be substantial downside risks—policy mistakes (including premature fiscal tightening), sovereign debt problems, and deeper housing corrections. Nevertheless, these will be increasingly matched by numerous upside risks—more rapid release of pent-up demand and stronger growth in the emerging world.

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