Top-10 ECONOMIC PREDICTIONS FOR 2009

NARIMAN BEHRAVESH, IHS GLOBAL INSIGHT CHIEF ECONOMIST

The U.S. and world economies are about to suffer through some of the worst recessions in the postwar period. **Most measures of economic and financial activity look like they fell off a cliff in September and October, and have been deteriorating at an alarming rate ever since. The United States is now officially in a recession that started in December 2007. Japan and many European countries are in the same boat. At the same time, growth in most emerging markets is faltering. IHS Global Insight now believes that global growth will be in the 0.0–0.5% range during 2009, compared with 2.7% in 2008.**

1 THE U.S. RECESSION WILL BE ONE OF THE DEEPEST — IF NOT *THE* DEEPEST — IN THE POSTWAR PERIOD.

The current downturn is well on its way to becoming the longest in the past six decades. Based on the December IHS Global Insight baseline forecast for the U.S. economy, it will be the fourth deepest in the postwar period (the 1957 recession was the deepest, followed by the contractions of 1973–75 and 1981–82). Nevertheless, given the very negative tone of the incoming data (including the 533,000 drop in November payrolls), the recession could well be the worst in the postwar period. At the same time, the large back-to-back declines in real GDP predicted for the fourth quarter of 2008 and the first quarter of 2009 (down 5.0% and 3.8%, respectively) are the worst since the 1982 recession, and may easily be the worst in more than six decades. Overall, we expect the U.S. economy to shrink at least 1.8% in 2009.

2 THE DOWNTURN WILL BE THE WORST IN EUROPE OVER A COUPLE OF DECADES AND THE WORST IN JAPAN SINCE 1998.

Japan and some European countries (Ireland, Italy, and Germany) are already officially in a recession. The other economies of the European Union will follow them down. For Europe, this will be the biggest economic contraction since the early 1990s—and the first for the Eurozone. For Japan, it will be the nastiest recession since the depths of the Asian crisis in 1998, when its economy contracted 2.1%. In 2009, IHS Global Insight expects respective GDP declines of 1.0%, 1.3%, and 2.0% for the Eurozone, Japan, and the United Kingdom.

3 GROWTH IN EMERGING MARKETS WILL DECELERATE DRAMATICALLY.

The global scope of the current economic crisis has put to rest the notion that emerging markets have "de-coupled" from the economies of the developed world (something to which IHS Global Insight never subscribed). There are at least three transmission mechanisms to the emerging world: 1) the collapse in commodity prices, which is already hurting the oil- and commodity-exporting countries (e.g., Russia, Iran, Venezuela, and South Africa); 2) the drying-up of capital flows, which is harming economies with large current-account deficits (e.g., many countries in Emerging Europe, some of which have already sought help from the IMF); and 3) the precipitous decline in world trade, which will damage growth prospects for the major exporting countries (almost all of which are in Asia). As a result, GDP growth in most emerging markets during 2009 will be roughly half the rate of 2007 and early 2008. For example, the Chinese economy, which enjoyed 11.9% growth in 2007, is likely to expand only 6.9% in 2009.

4 THE FEDERAL RESERVE AND OTHER CENTRAL BANKS WILL KEEP CUTTING RATES.

The race to zero is on! The Fed has already cut the federal funds rate to 1% and is likely to take it all the way to zero by the end of January. Once the overnight rate is at zero, the Fed may have to engage in "quantitative easing" (direct purchases of long-term Treasuries). It is already engaging (massively) in unorthodox measures such as buying commercial paper, mortgage-backed securities, credit card debt, and loans to small businesses, students, and car buyers. On December 4, the European Central bank joined the fray by cutting the overnight rate by 75 basis points (to 2.5%), while the Bank of England cut by 100 basis points (to 2.0%). IHS Global Insight now believes that the ECB and BoE will push rates all the way to 1.0% and 0.5%, respectively—and could cut all the way to zero. Most central banks around the world have followed suit. Notably, on November 26, the People's Bank of China lowered rates by 108 basis points, the largest cut in 11 years and the fourth cut since mid-September.

5 MORE FISCAL STIMULUS IN THE PIPELINE.

The incoming Obama administration has been talking about a fiscal-stimulus package of between $500 billion and $700 billion (or between 3% and 5% of GDP). Our December baseline forecast assumes a package of $550 billion, which consists of tax cuts, infrastructure spending, and other provisions. Given how quickly the economy is deteriorating, the fiscal package is likely to end up much bigger than current estimates. The only other country that is considering a big stimulus program is China, which has announced a two-year program worth about $586 billion (or 16% of GDP). Even if only half of this is "real," it would add substantially to growth. Without it, we estimate that Chinese GDP growth would only be 5%. The fiscal-stimulus plans announced for other major economies are much smaller. In particular, the plans being discussed for the United Kingdom and the Eurozone are only between 1.0% and 1.5% of GDP.

6 COMMODITY PRICES WILL REMAIN AT DEPRESSED LEVELS FOR MUCH OF NEXT YEAR.

The steep collapse of commodity prices over the past few months (60–80%) has been unprecedented—and the worst is probably yet to come. With the economic outlook deteriorating by the day, futures markets for commodities have not priced in the full extent of the "demand destruction" taking place. IHS Global Insight now believes that oil prices will (easily) fall below $40 per barrel in the next year, and could tumble all the way to $30. The good news is that the drop in energy prices is like a tax cut for households and businesses. In the United States, the drop in gasoline prices is, so far, the equivalent of a $230-billion tax cut.

7 INFLATIONARY FEARS WILL BE REPLACED BY CONCERNS ABOUT DEFLATION.

Only a few months ago, there was a lot of hand wringing over inflation. Such fears have evaporated, and concerns about deflation are on the rise. IHS Global Insight now expects that headline consumer and producer price inflation will remain in negative territory through next summer. For calendar-year 2009, headline CPI and PPI will fall 1.5% and 6.3%, respectively. At the same time, core inflation will fall from a little over 2% to just over 1%. A similar, though perhaps less-pronounced, pattern will be evident in Europe. Japan, which barely shrugged off deflation, is likely to suffer a relapse. At the same time, fears about overheating in China have given way to the possibility that deflation will rear its ugly head again.

8 GLOBAL IMBALANCES WILL IMPROVE MARKEDLY.

The long-awaited correction of the gaping global imbalances is happening with a vengeance. The U.S. current-account deficit, which was $731 billion in 2007 and likely to come in at $660 billion this year, will plummet to $282 billion in 2009. The large deficits in the past two years belie a significant improvement in the non-oil deficit—which was, nevertheless, overwhelmed by the sharp rise in the oil import bill. With the collapse in oil prices, the current-account deficit will plummet about 50%, both in absolute terms and as a share of GDP. The big drop in commodity prices also signals a major shift in the terms of trade, in favor of the developed economies, and represents a "re-balancing" of growth and current-account deficits, with commodity-importing countries being the major beneficiaries.

9 THE DOLLAR WILL REMAIN RELATIVELY STRONG AS LONG AS THE FINANCIAL CRISIS CONTINUES.

The joke is that the dollar is the "best-looking horse in the glue factory." This means that in the midst of the ongoing crisis, the safe-haven/principal-reserve-currency status of the U.S. dollar has trumped all other fears. As long as the crisis continues, the dollar is likely to remain strong. Moreover, the markets seem to have a little more confidence that the United States may be able to pull out of its recession sooner and faster than other parts of the world. That said, once the crisis is over, the downward pressures on the dollar are likely to return. For example, the euro/dollar rate will probably stay at its early-December levels of $1.26 – 1.28 for some time (and may even strengthen a little), before very gradually appreciating to the low $1.30s by the end of next year.

10 THE SINGLE-BIGGEST RISK FACING THE U.S. AND WORLD ECONOMIES IS A TIMID RESPONSE TO THE CRISIS.

The policy response to this crisis needs to be big, bold, and rapid. The good news is that both the United States and China are taking the crisis very seriously. The not-so-good news is that the policy responses in other large economies, especially Japan and Eurozone, seem to be much more timid. This could well mean deeper and longer recessions in those countries, which could mean even weaker world growth in 2009.