

The global economic outlook

Bracing for a slowdown, waiting for relief

Irene Mia
Regional Director, Latin America & the Caribbean
Economist Intelligence Unit

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Outline

- A look at the global economy: the challenges and opportunities ahead
- Focus on the Euro area, the US and emerging economies
- The outlook for Latin America and the Caribbean
- What about Puerto Rico?

Key points for 2012-13

- A difficult, dangerous period lies ahead for the global economy
 - Much of Europe will be in recession in 2012
 - Risk of a euro-zone catastrophe is real
 - Huge contagion effects worldwide...though this is not our main forecast
 - China's economy has slowed
 - Stimulus coming, but will take time
 - BRICs have hit a brick wall
 - US has lost momentum
 - Weak job growth is persisting
 - Risk of fiscal crisis will damage sentiment
 - Investors are waiting for central banks to save them; could be disappointed
- Don't expect a big rebound in 2013
 - Europe, US will continue to struggle, though China is poised for a rebound



Key points for 2014-16

- Recoveries from recessions with financial crises take four to six years
 - Housing markets reviving, but stronger growth is a year or two away
 - Banks are recapitalising (especially in the US) but have further to go in Europe
 - Consumer deleveraging is underway (again, especially in the US), freeing up funds to spend; but debt levels still high
- Euro zone crisis should be contained by 2014 (famous last words!!)
 - Solution to the crisis is more political than economic
 - Political solutions always take time, but progress has been made in 2012 and more is likely in 2013
- Domestic demand story in emerging markets will accelerate
 - Consumer spending strengthened during recession to ease export woes



Our key global scenarios

- **Slow, uneven growth**
 - High unemployment, weak demand in rich countries
 - Less government spending, fiscal drag
 - US economy mending, but slowly
 - Emerging markets will see less export demand
 - China will still grow by around 8%
- **Global shock; double-dip recession**
 - Serious stress in euro zone; break up
 - Financial panic from US, China slowdowns
- **Flood of liquidity leads to mini-boom**
 - US growth accelerates; euro zone stabilises; relief rally for investors, financial markets

60%

35%

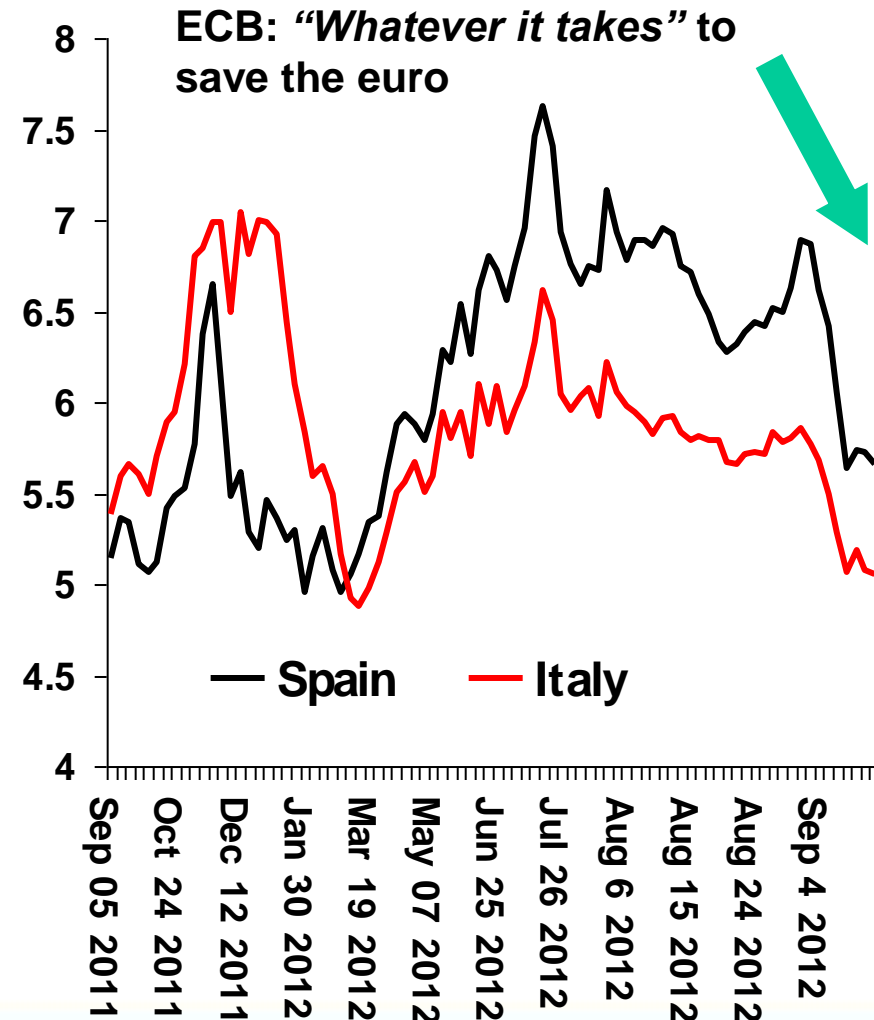
5%

Euro zone: Doomed to failure?



Euro zone: The crisis that never ends!!

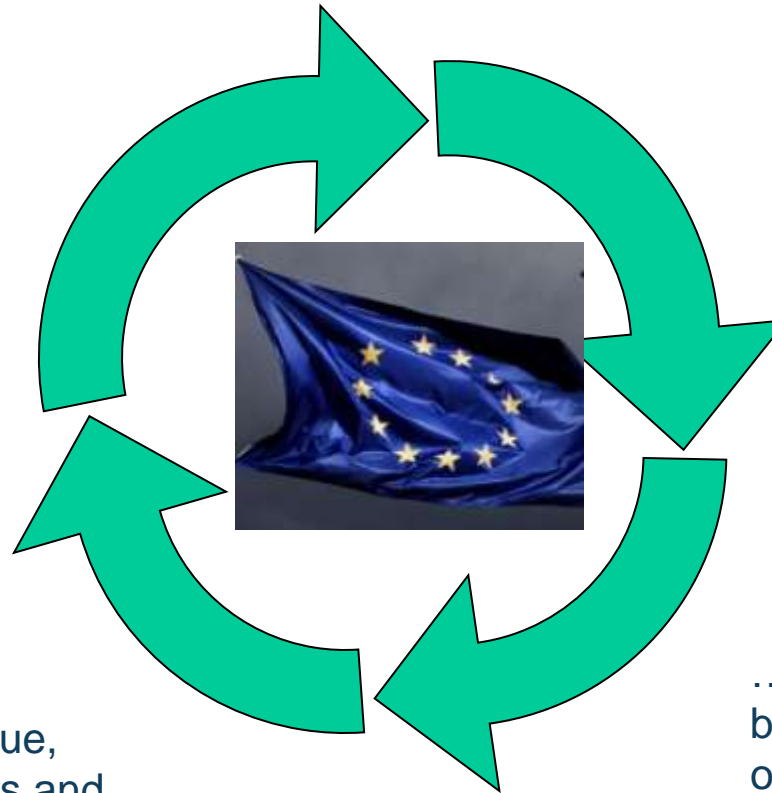
- Stresses everywhere...
 - Borrowing costs surge and fall
 - Short-term fixes that never last
 - Spain's banks: How bad, really?
 - Italy has already been drawn into the net
- ...and no quick solution in sight
 - Full integration will take years
 - Political pressures (Greece, Spain)
 - Voters resisting austerity
 - But the ECB is responding
 - Mr Draghi's new bond-buying plan
 - ▶ Will it work? Is it enough?



And the crisis goes round and round

Free-spending consumers and governments pile up mountains of debt...

...and can't re-pay banks, which become under-capitalised and can't lend...



...which deprives governments of revenue, pushing up bond yields and debt and requiring bail-outs.

...which starves consumers, businesses and governments of liquidity and slows economic growth...

Our short-term forecast for the euro zone

- Euro zone holds together; Greece stays
 - Too much at risk to allow disorderly exit
 - ECB is responding, if belatedly
 - “Whatever it takes,” says Draghi
 - Under new plan, both bail-out fund and ECB will buy bonds of distressed sovereigns
 - Should stem financial panic; potential turning point, but no guarantees
 - Slow progress on banking union
- Could the crisis yet get ahead of policymakers? Yes
 - Bank run in Spain; capital controls; 40%+ chance Greece leaves
 - Market response? Liquidity freeze; lending, borrowing stops as in 2007-08
 - Policy response? Massive injections of liquidity by ECB, Fed, others
 - Might not be enough if full contagion strikes Spain and Italy

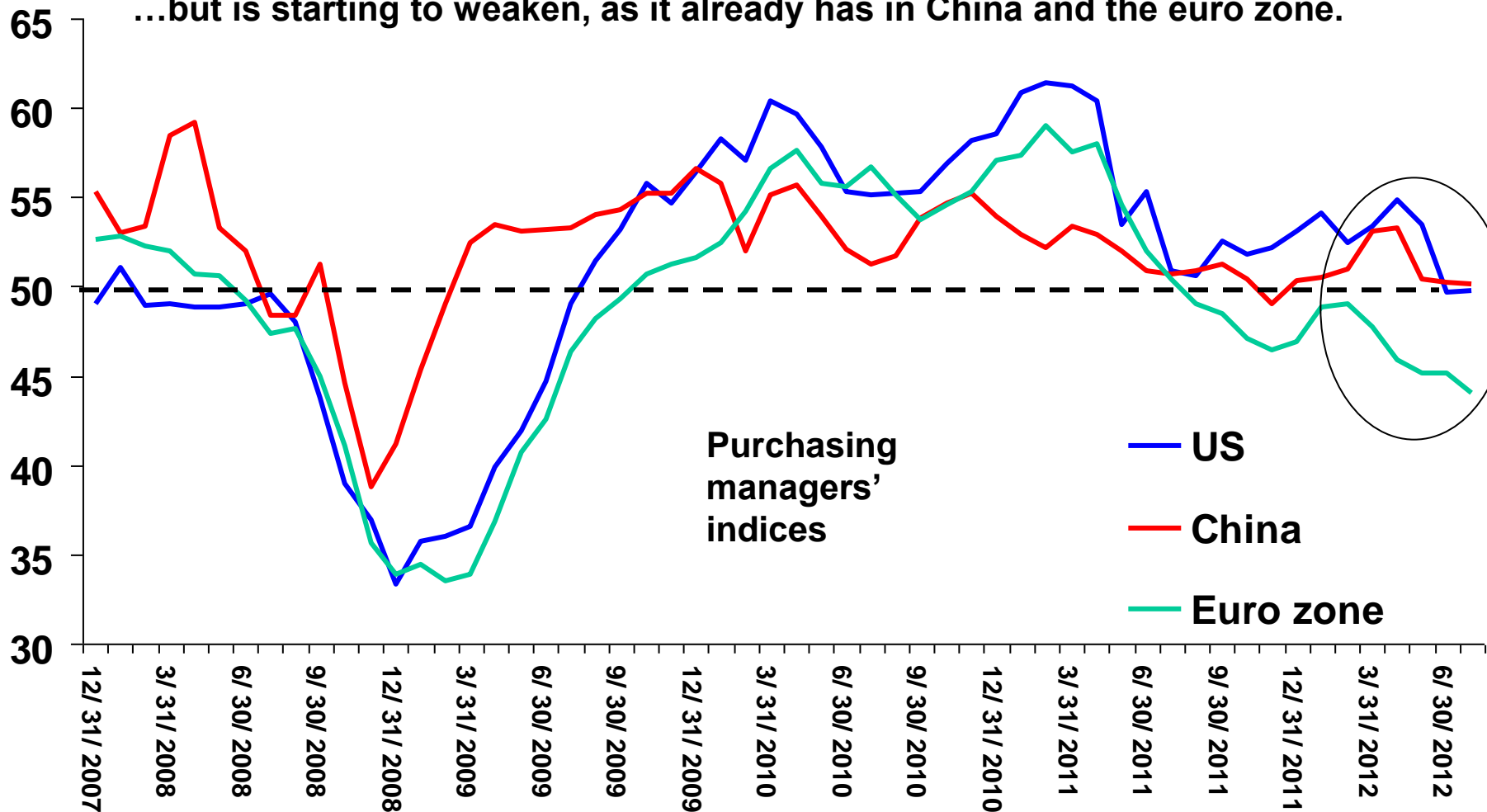


The US: The comeback kid?



Manufacturing was leading the US recovery...

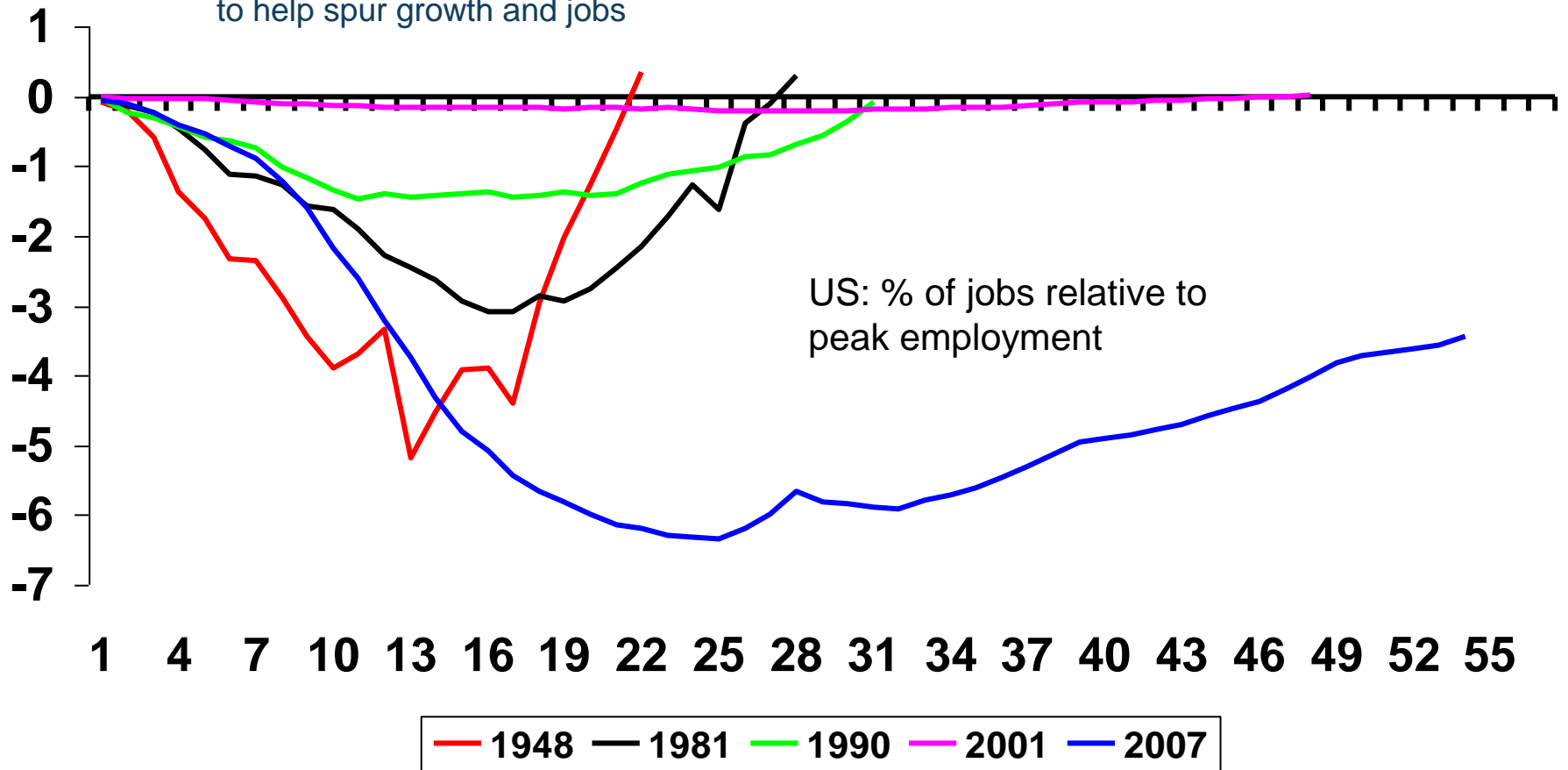
...but is starting to weaken, as it already has in China and the euro zone.



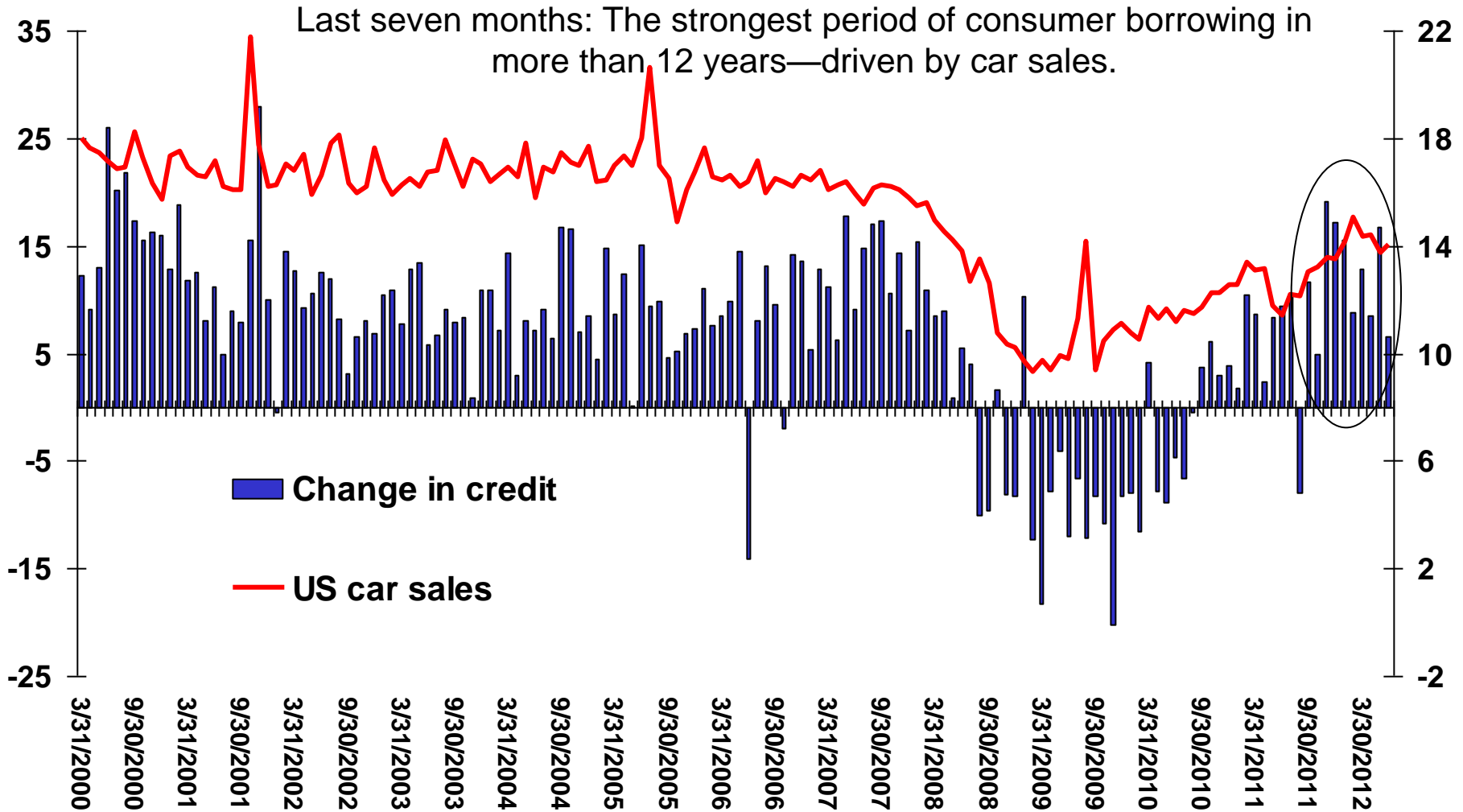
Diffusion index; 50 is dividing line between expansion and contraction. Source: Bloomberg

Post-recession US jobs? Long road ahead

The US Federal Reserve is under pressure to pump more money into the economy to help spur growth and jobs

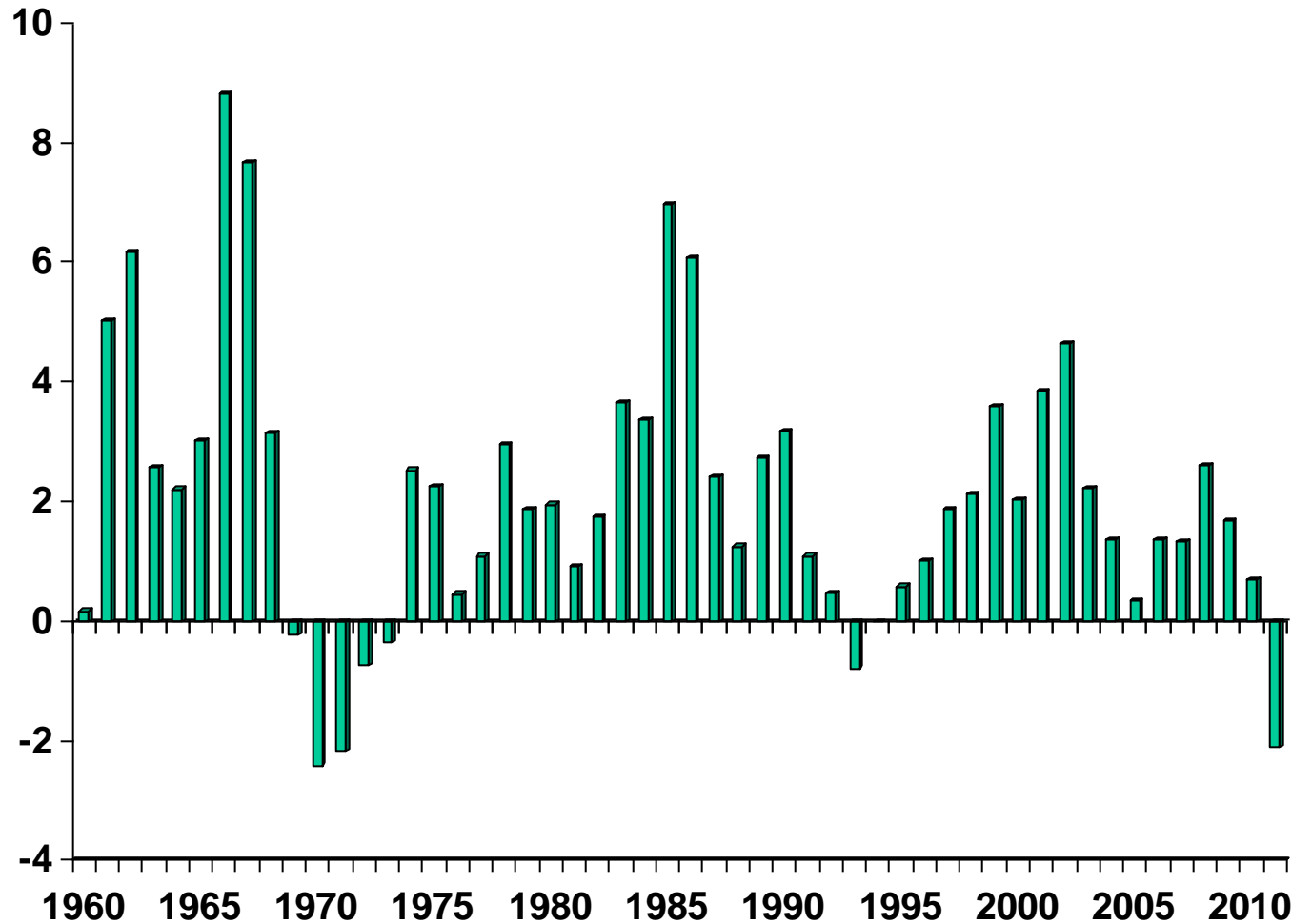


US consumers: Borrowing is rising, mainly for cars



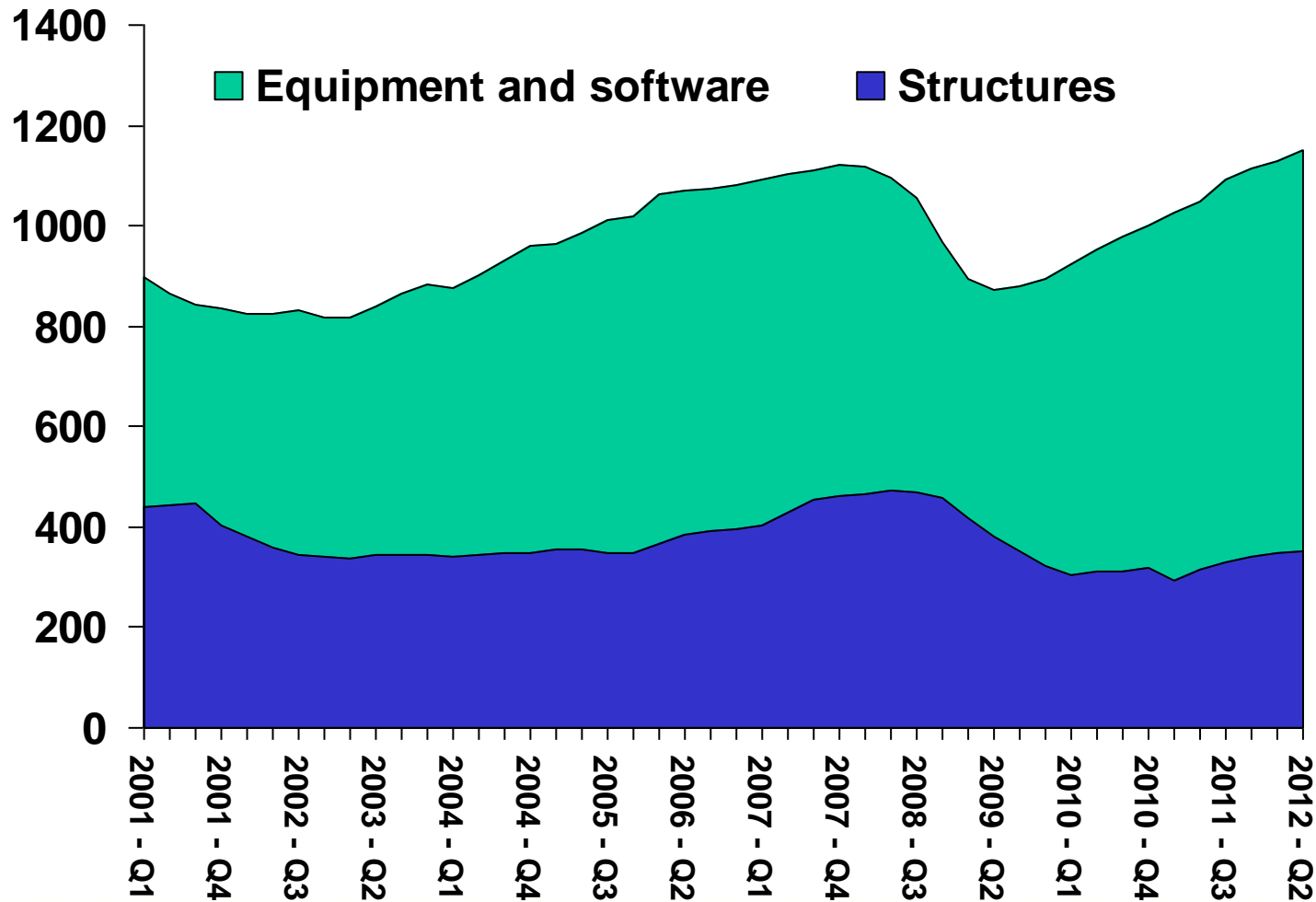
Consumer credit outstanding, US\$bn; monthly change. Auto sales: units, m, at annual rate. Source: US Federal Reserve, Bloomberg

US government spending? Get used to austerity



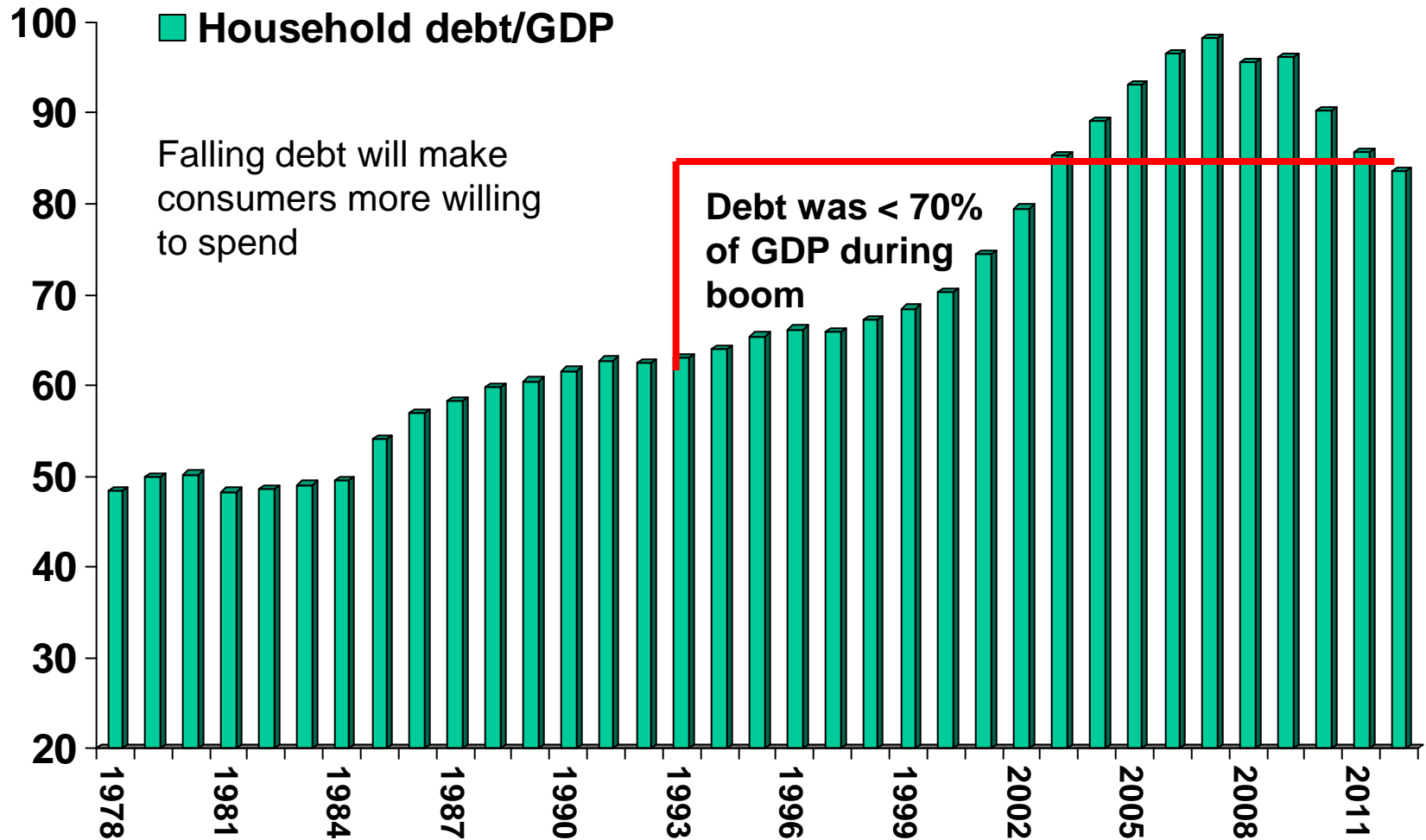
- Government spending fell the most in 2011 since the end of the Vietnam war
- State & local governments worst hit
- Feds need to find another \$1.2trn in cuts
- “Fiscal cliff” coming in early 2013

US companies have invested heavily in capital goods



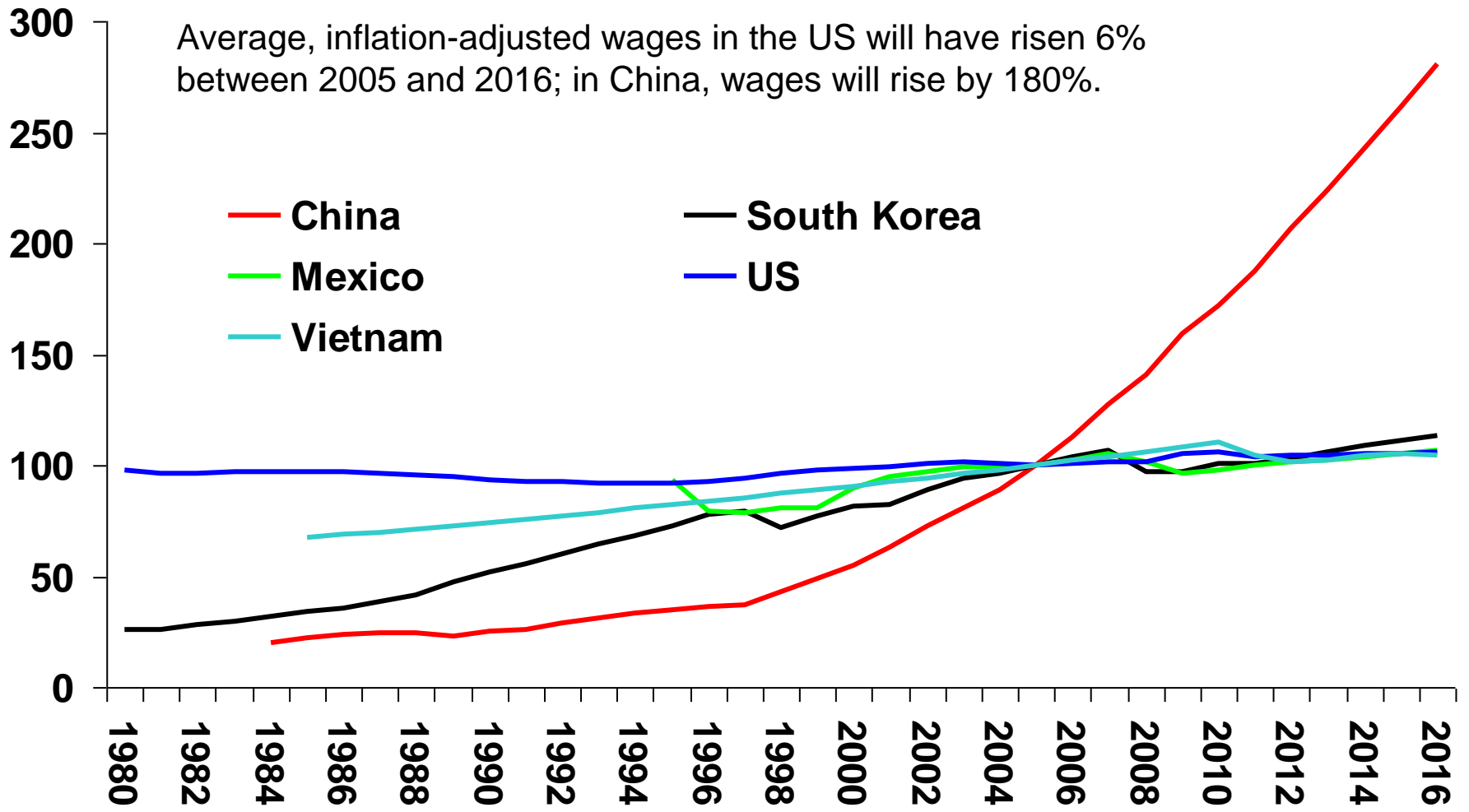
- With profits high, firms have capital to invest
- Investment in equipment & software has surpassed previous peak
- New investment (IT, capital goods, etc) will boost productivity
- But companies are not building new factories

US household debt is falling...but still has a way to go



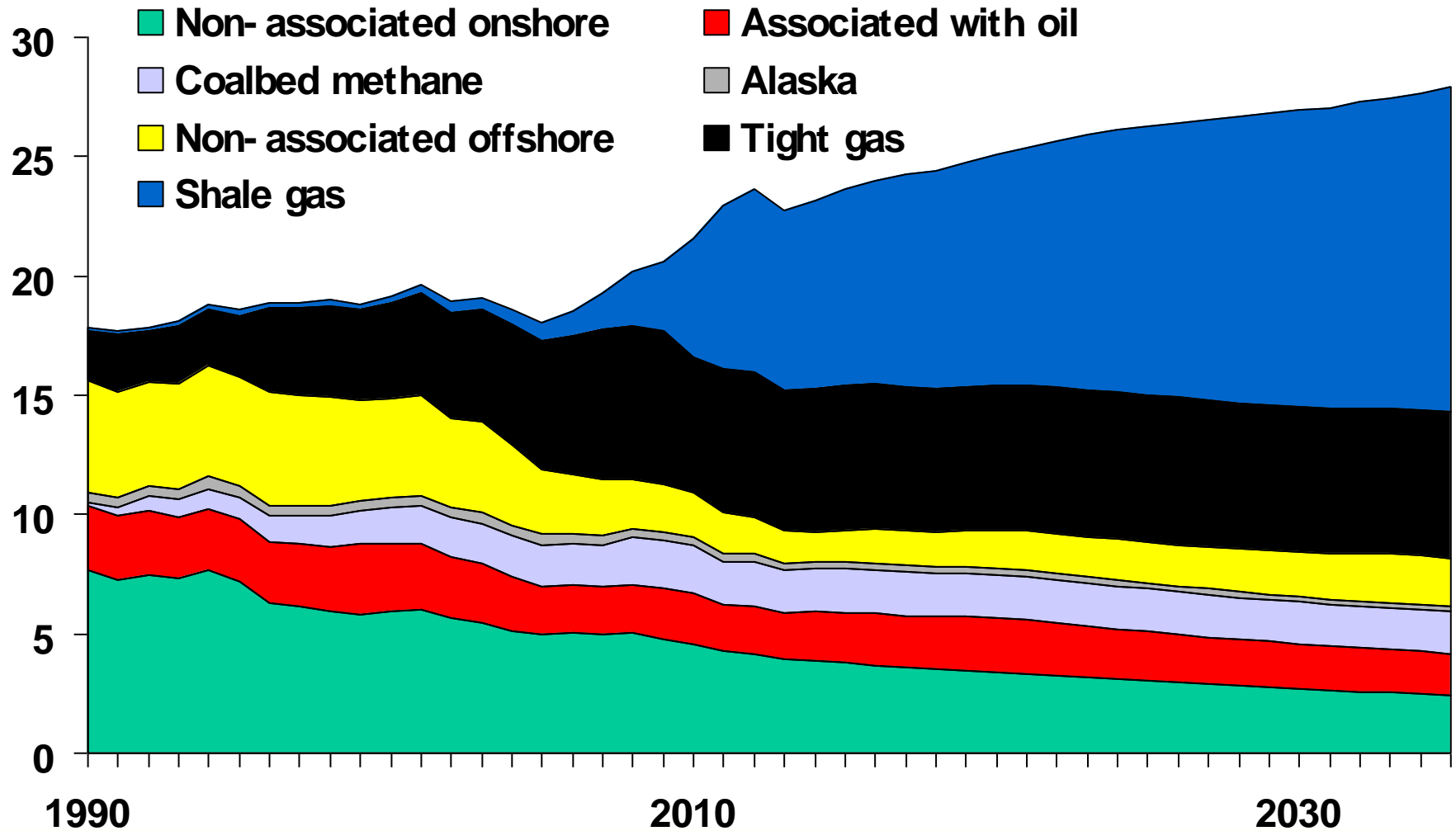
Household debt as a share of nominal GDP.
Source: Federal Reserve

Flat US wages have made the country more competitive



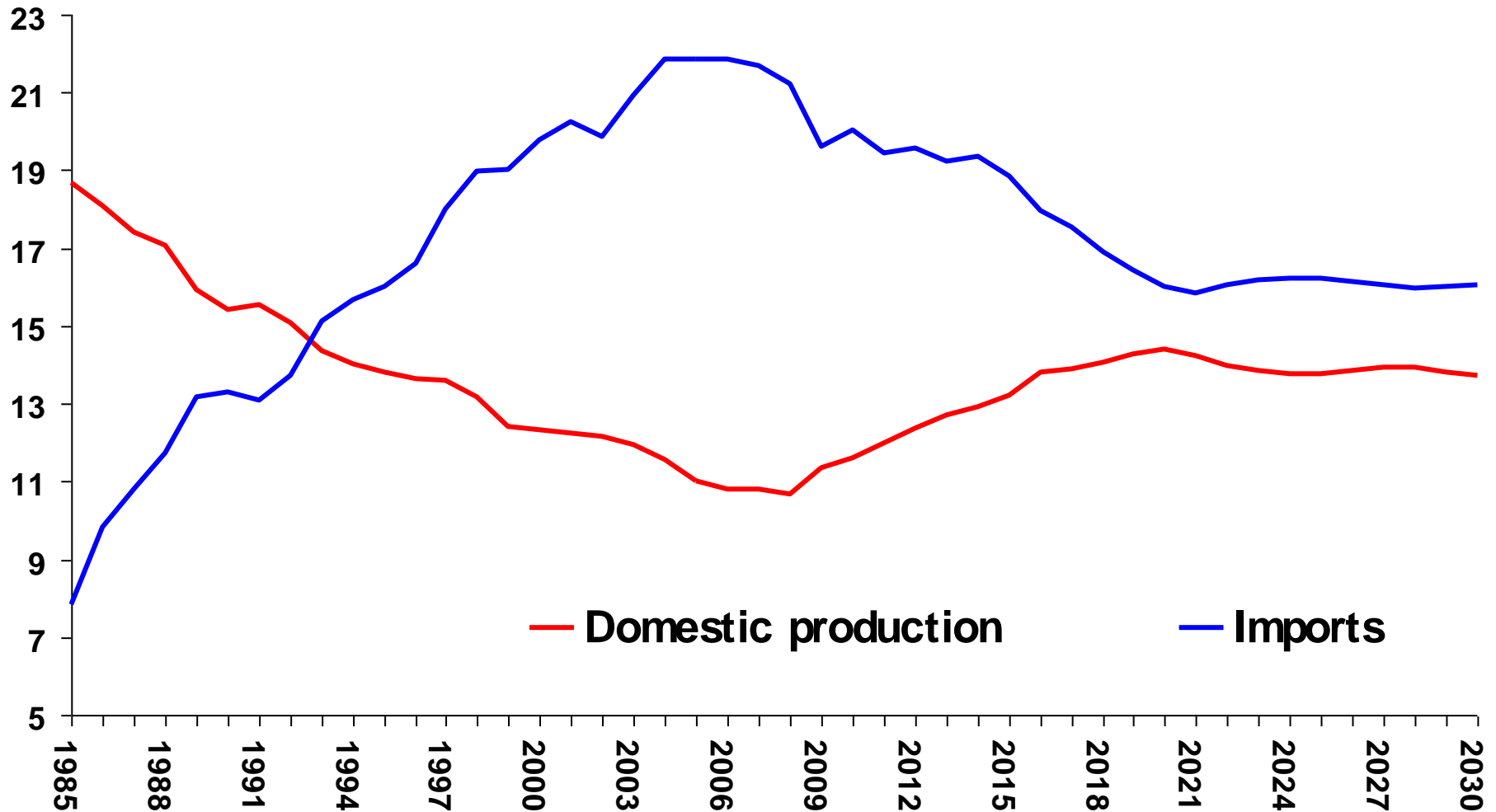
Average real wages, 2005=100. Source: EIU Country Data

US is enjoying a boom in shale gas production

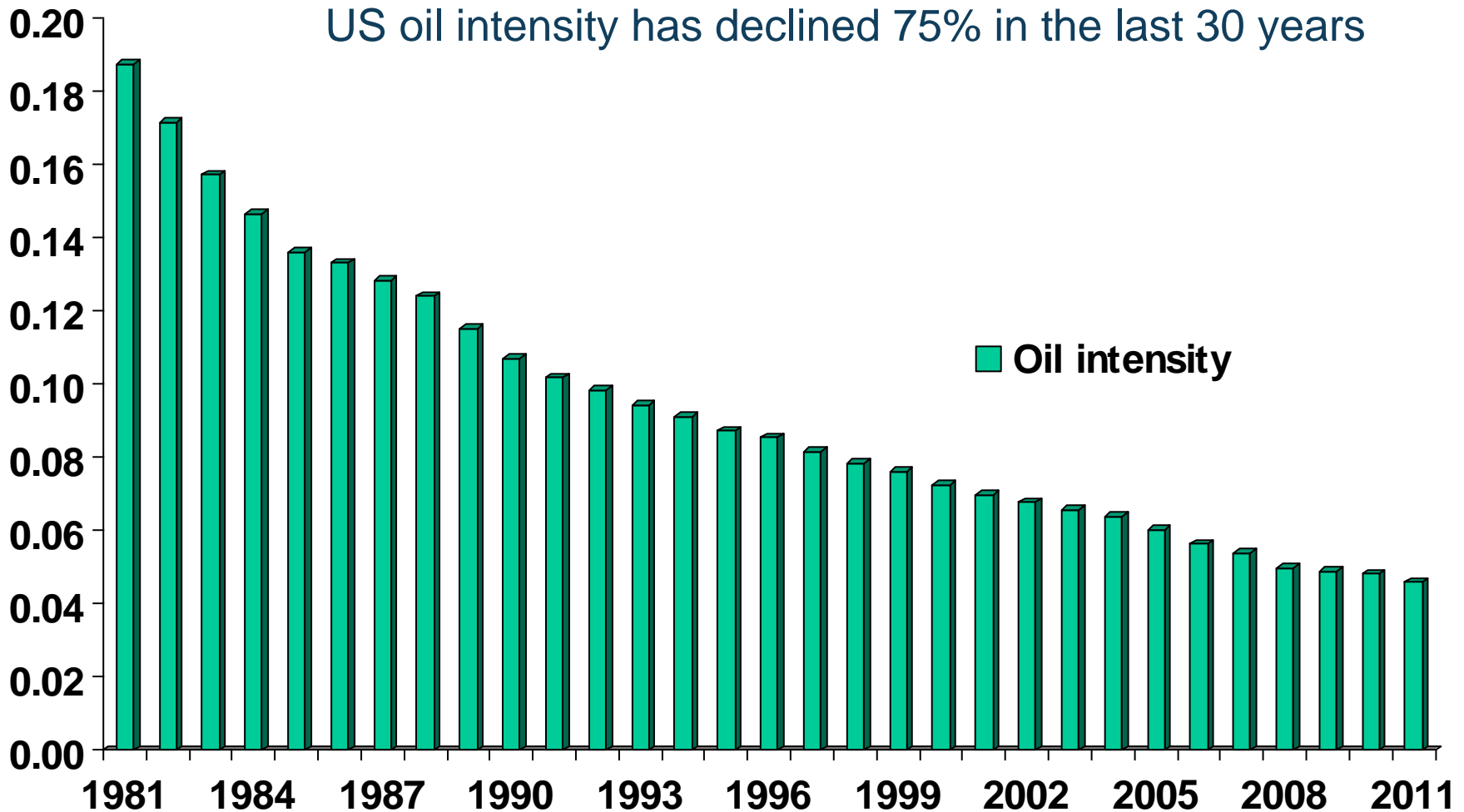


Source: US Energy Information Administration, June 2012

Less imported oil, more domestic production





Far less oil dependent than it was 30 years ago























Units of GDP/barrel of oil. Source: US Dept of Energy, EIU *Country Data*

World's 20 largest companies, by market cap (2007): 10 US

	Exxon Mobil		Bank of America
	General Electric		Gazprom
	Powerfin SA-Old		HSBC
	Ind & Comm Bank		BP
	Microsoft		Toyota Motor
	Petrochina		P & G
	China Mobile		Cisco
	AT&T		Chevron
	Royal Dutch Shell		Bank of China
	Citigroup		Berkshire Hathaway

World's 20 largest companies by market cap (2012): 14 US

 Apple	 China Mobile
 Exxon Mobil	 AT&T
 Microsoft	 Berkshire Hathaway
 Petrochina	 Ind & Comm Bank
 Wal-Mart	 Nestle
 Royal Dutch Shell	 Johnson & Johnson
 IBM	 P & G
 General Electric	 Wells Fargo
 Google	 Pfizer
 Chevron	 BHP Billiton

US Presidential election: Romney should be far ahead...

...amidst an 8%+ unemployment and the weakest economic recovery since the 1930s

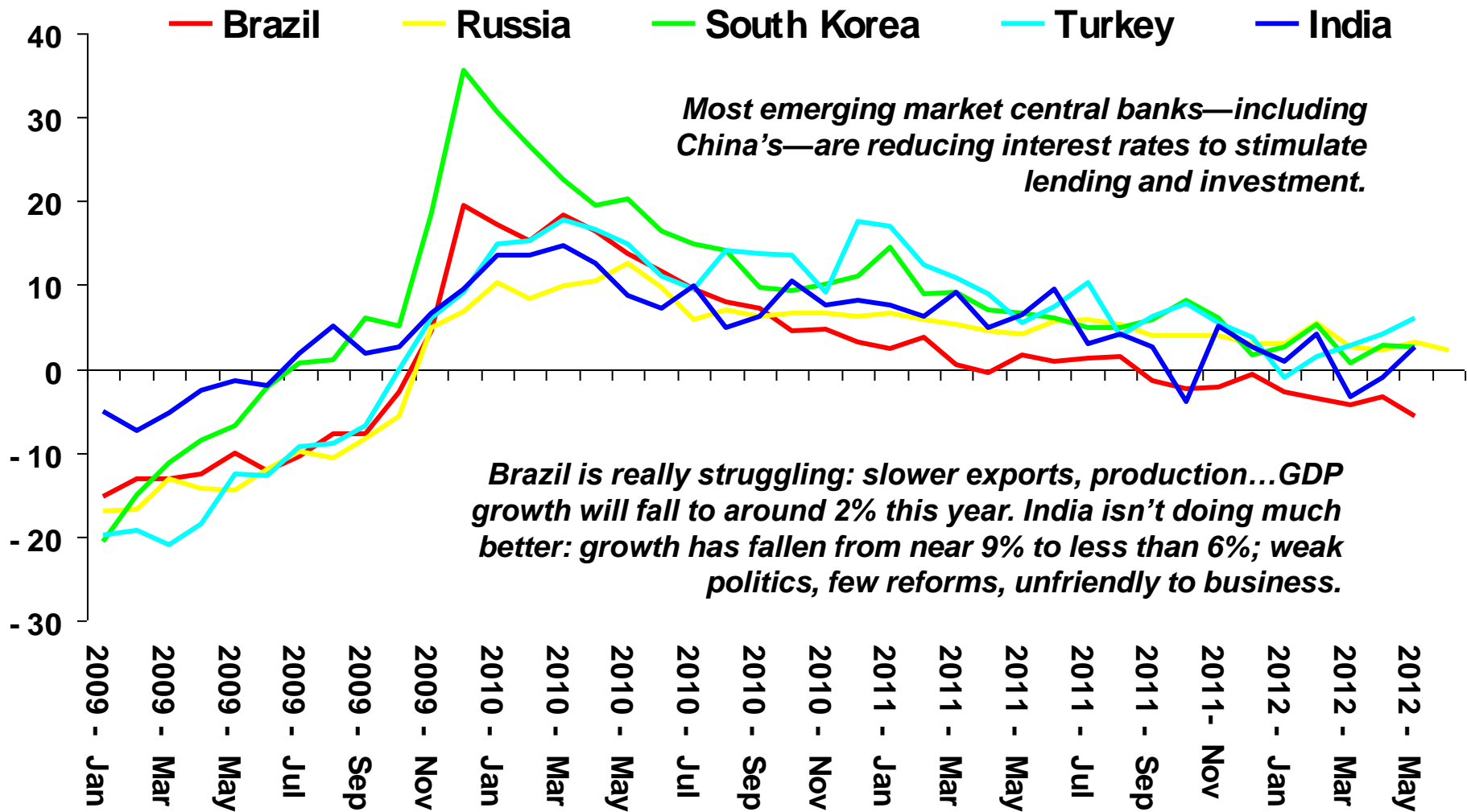
- But he's not...race is essentially tied nationally
- Obama is ahead in state-level polling, which is what really matters
- Obama's chances are improving
 - Romney looks wooden, opportunistic, unprincipled
 - But can't rule out a Romney victory
 - Obama has no answer for the lack of jobs
 - The debates will tell all...a decent Romney showing could tip the balance in his favour
- China is an issue, but not a major one, in the campaign
 - It's an applause line for Romney
 - Says he'll declare China a currency manipulator
 - ▶ If elected, he likely will, but it will mean little
 - ▶ Presidents have plenty of latitude to stall...US won't raise barriers on China



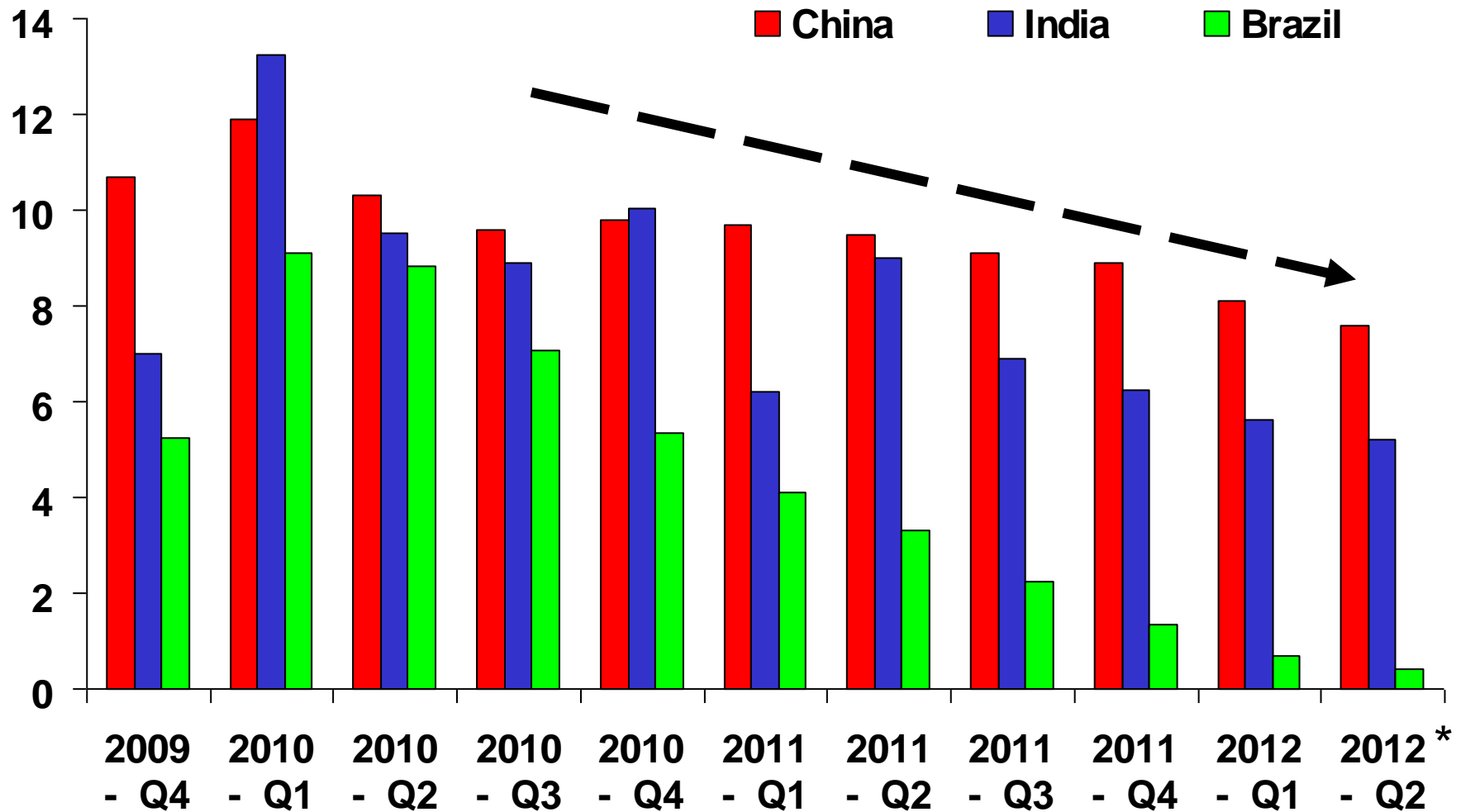
Emerging markets: An alternative growth engine?



Emerging market economies are slowing too

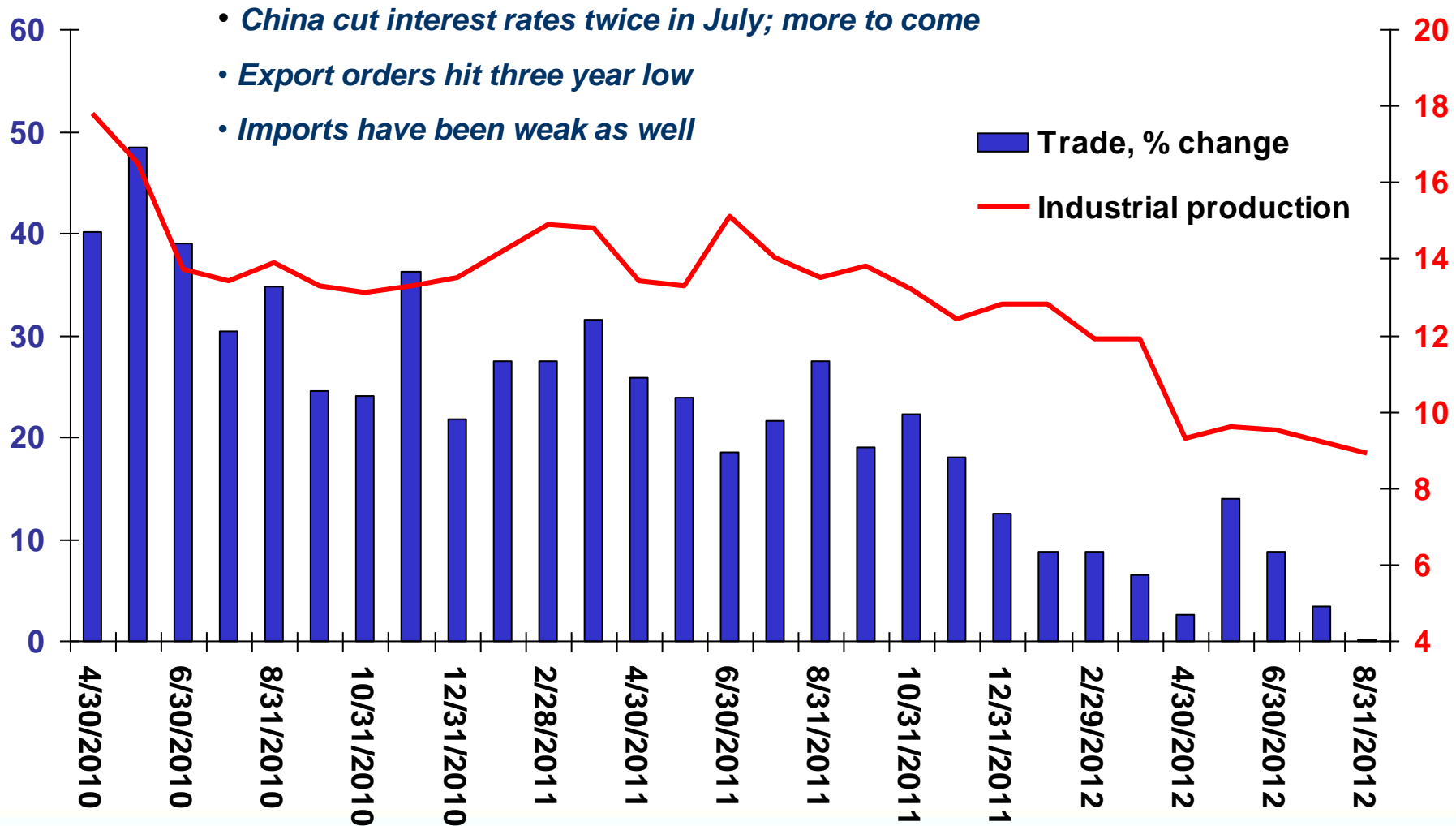


Hitting a BRIC wall? Cyclical and structural troubles



Quarterly real GDP growth % change year on year.
Source: Haver Analytics. *EIU Estimate

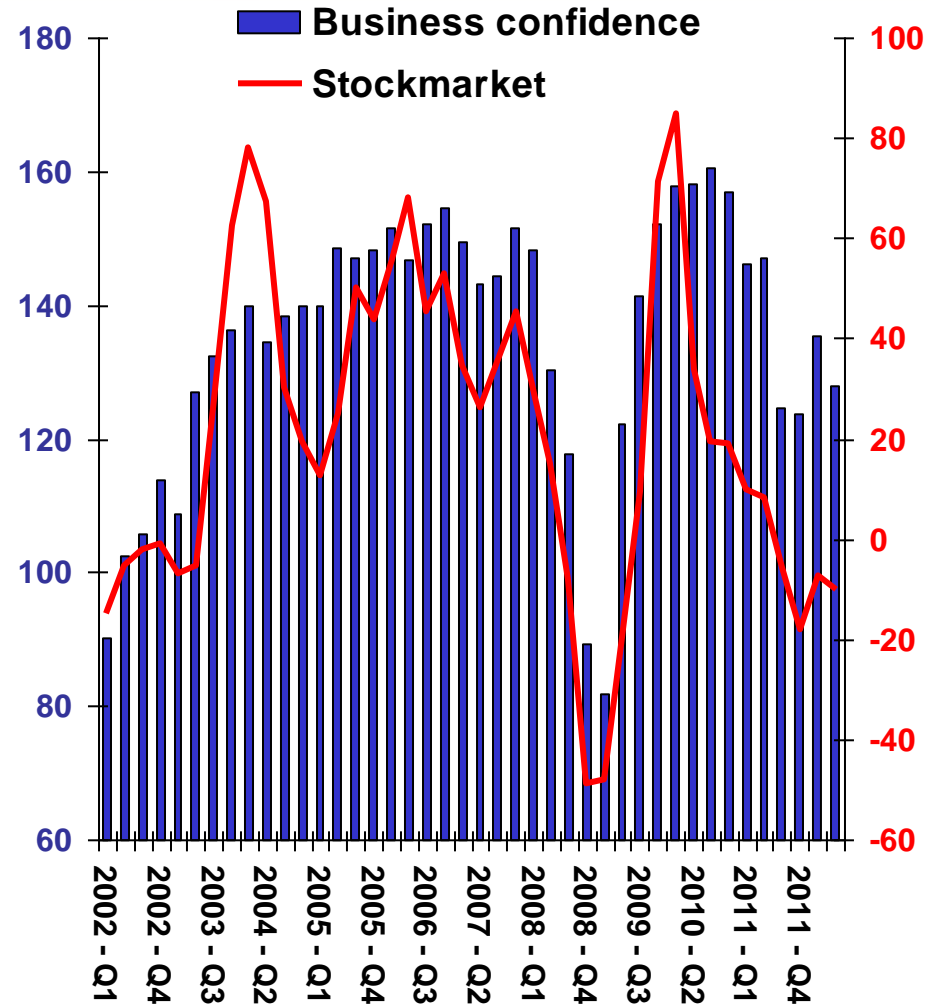
China: Economy slowing; external demand very weak



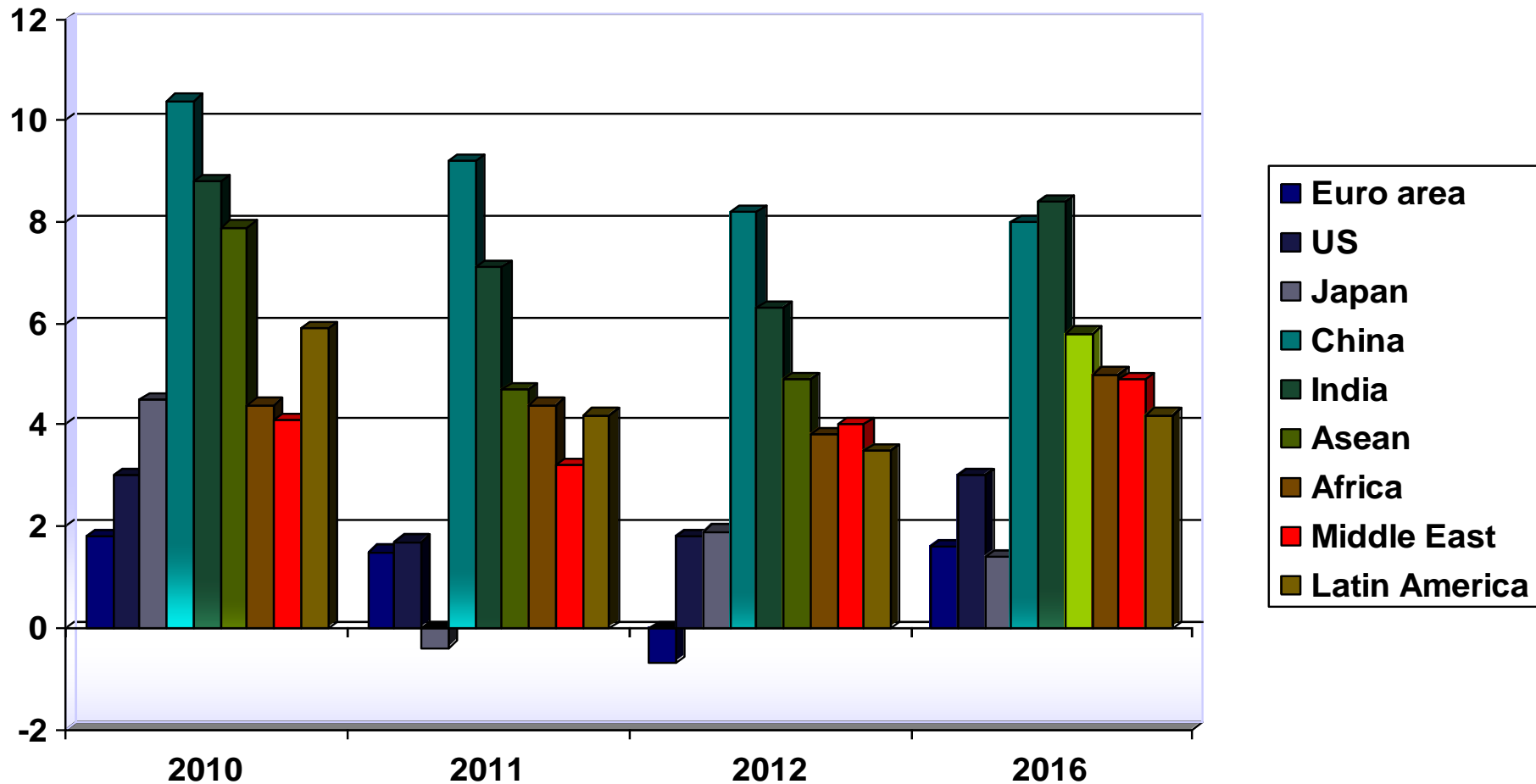
Import and export trade, combined % change year on year, averaged. Source: Haver Analytics

India: The party is over...for now

- Weak external demand is rapidly slowing economic growth
- Poor harvest will hurt consumer spending
- Don't expect a return to 8-9% GDP growth in the next five years
 - Pre-recession boom, which India rode, isn't coming back any time soon
- India still has major structural weaknesses, but no stomach for reform
 - Anti-reform regional parties are becoming more dominant
 - We're not expecting any major reforms



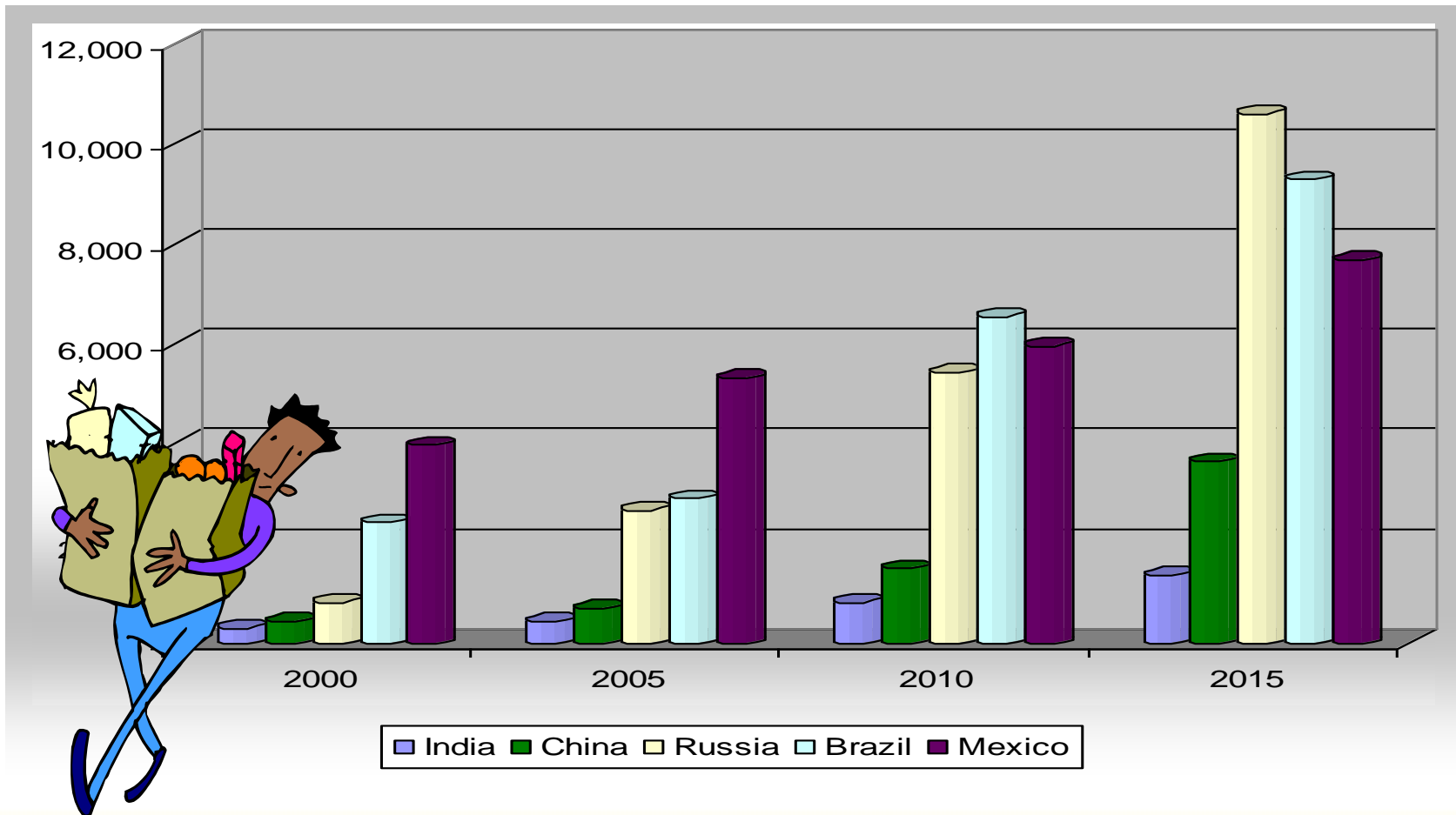
But global growth is moving South..



Real GDP growth; % change, year on year. ASEAN = Association of South East Asian Nations. CIS = Russia, Ukraine etc.
As of October 2011. Source: Economist Intelligence Unit, CountryData.

Domestic demand is picking up

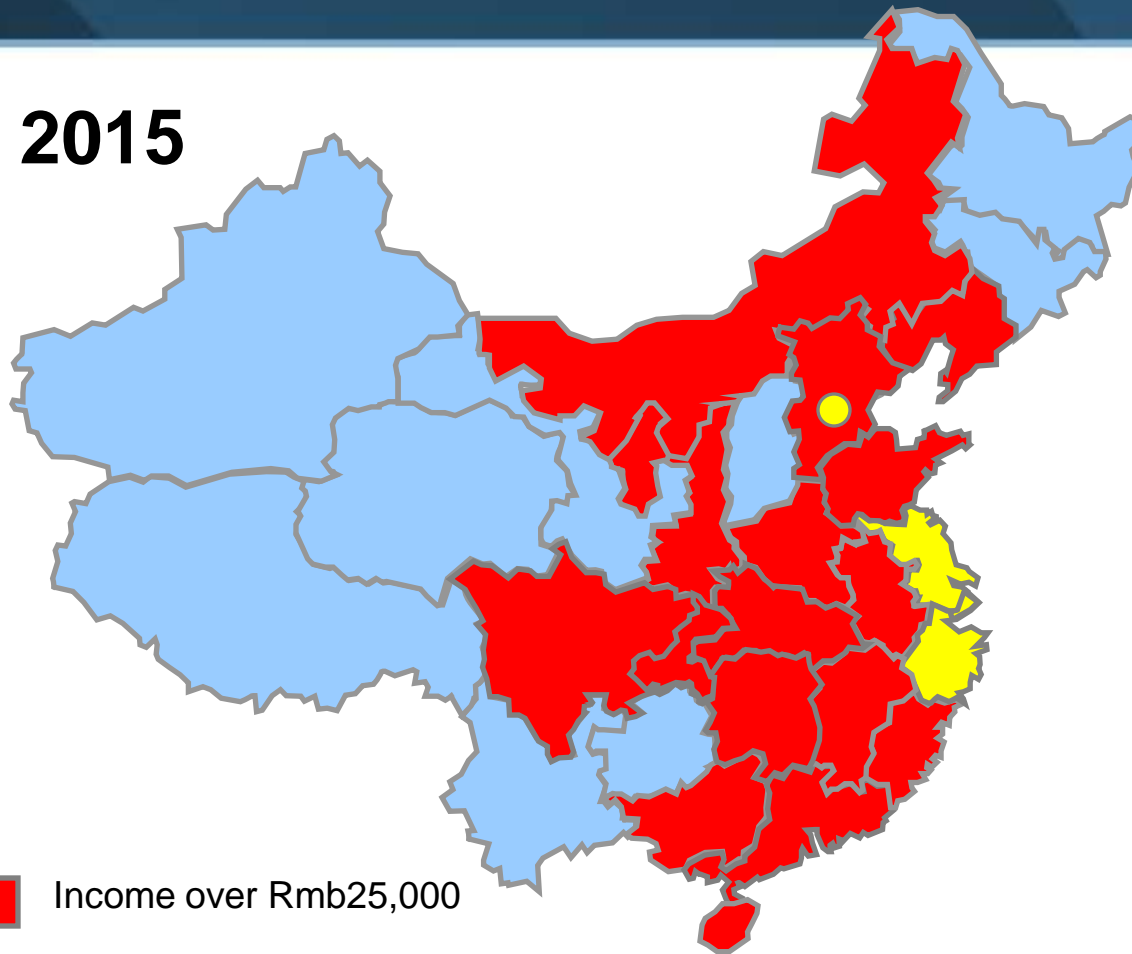
Household consumption per head (US\$)




Source: Economist Intelligence Unit, CountryData.

The rise of the Chinese consumer

2015



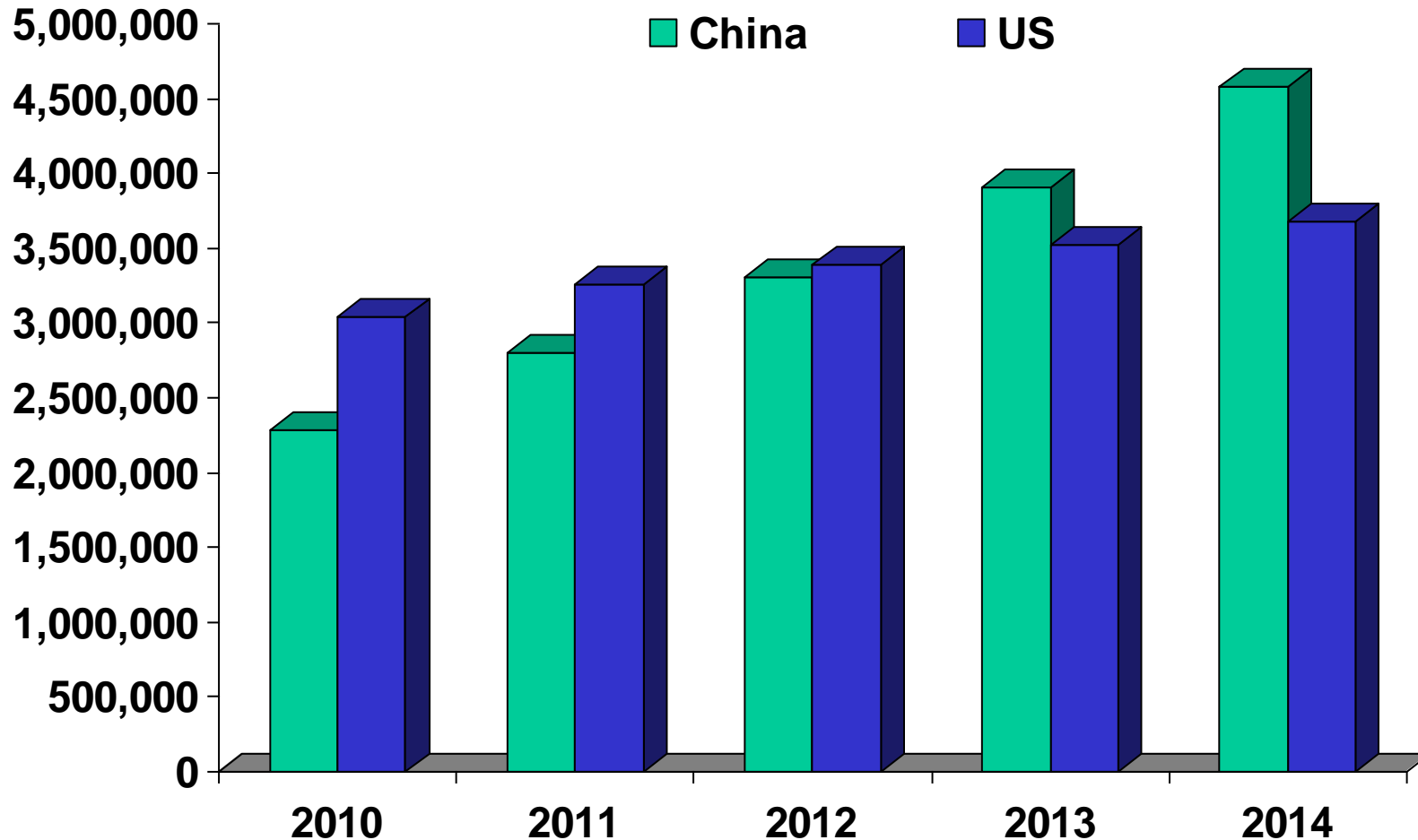
- New consumer markets being created
- E-commerce also booming
- Logistics network improving, but still lags market needs
- Quality control issues & rising compliance costs

 Income over Rmb25,000

 Income over Rmb40,000

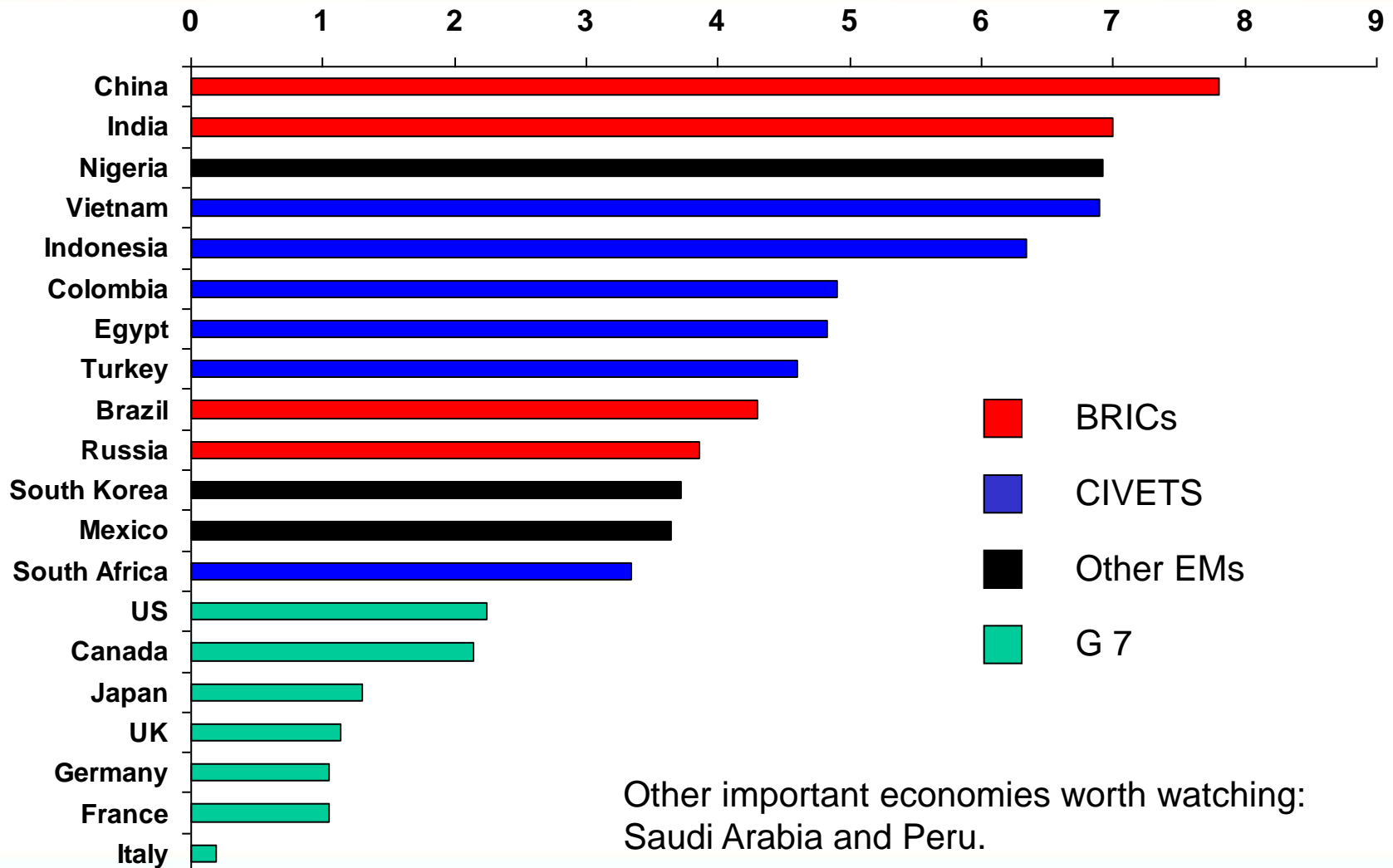
➤ Urbanisation feeds continued need for construction and government spending but longer-term phenomenon

China has already matched the US in retail sales



Retail sales, US\$ millions. Source: EIU Market Indicators and forecasts

Fastest-growing economies: Next five years



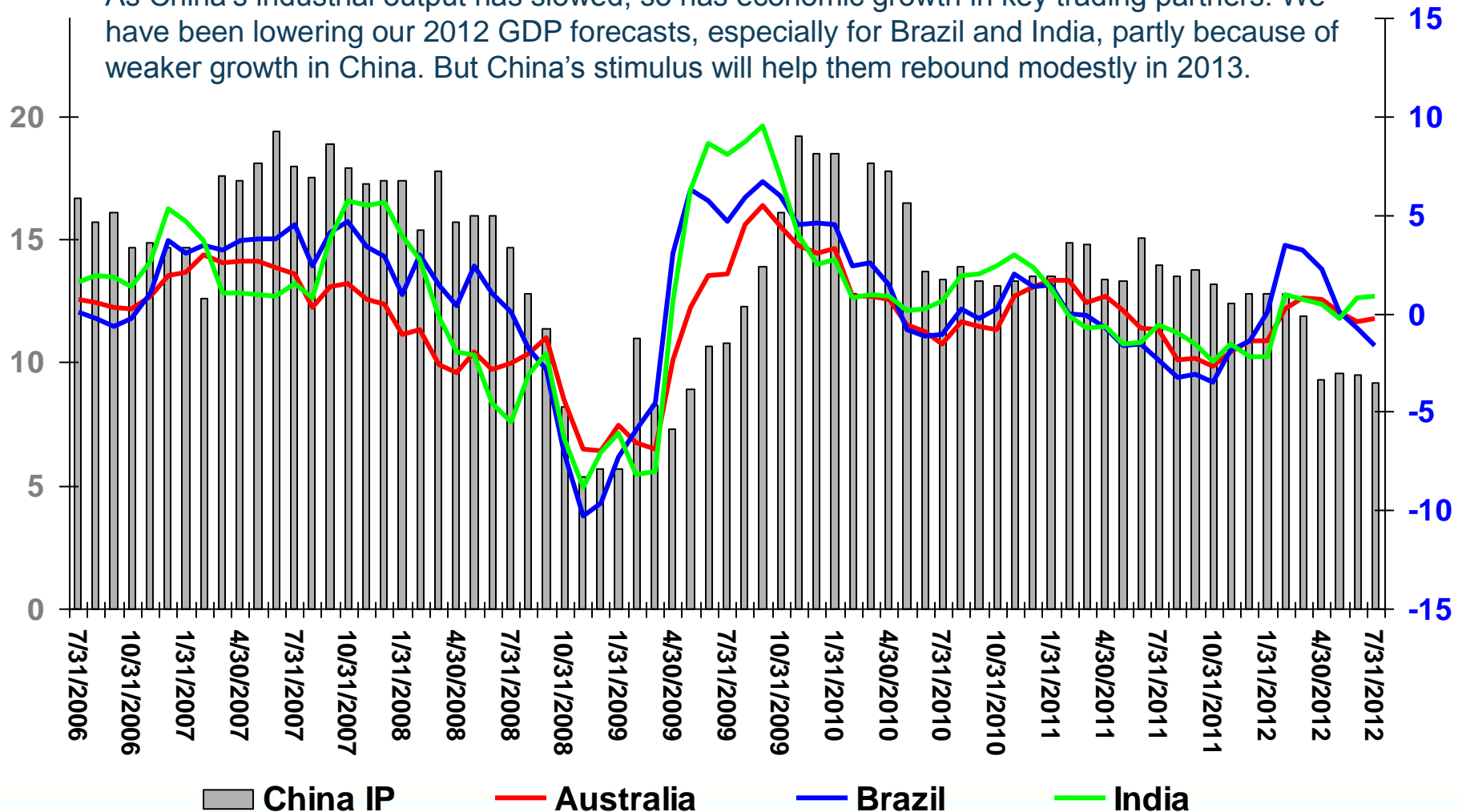
Real GDP, average annual % change, 2012-2016. Source: Economist Intelligence Unit

Watching for trouble—and relief



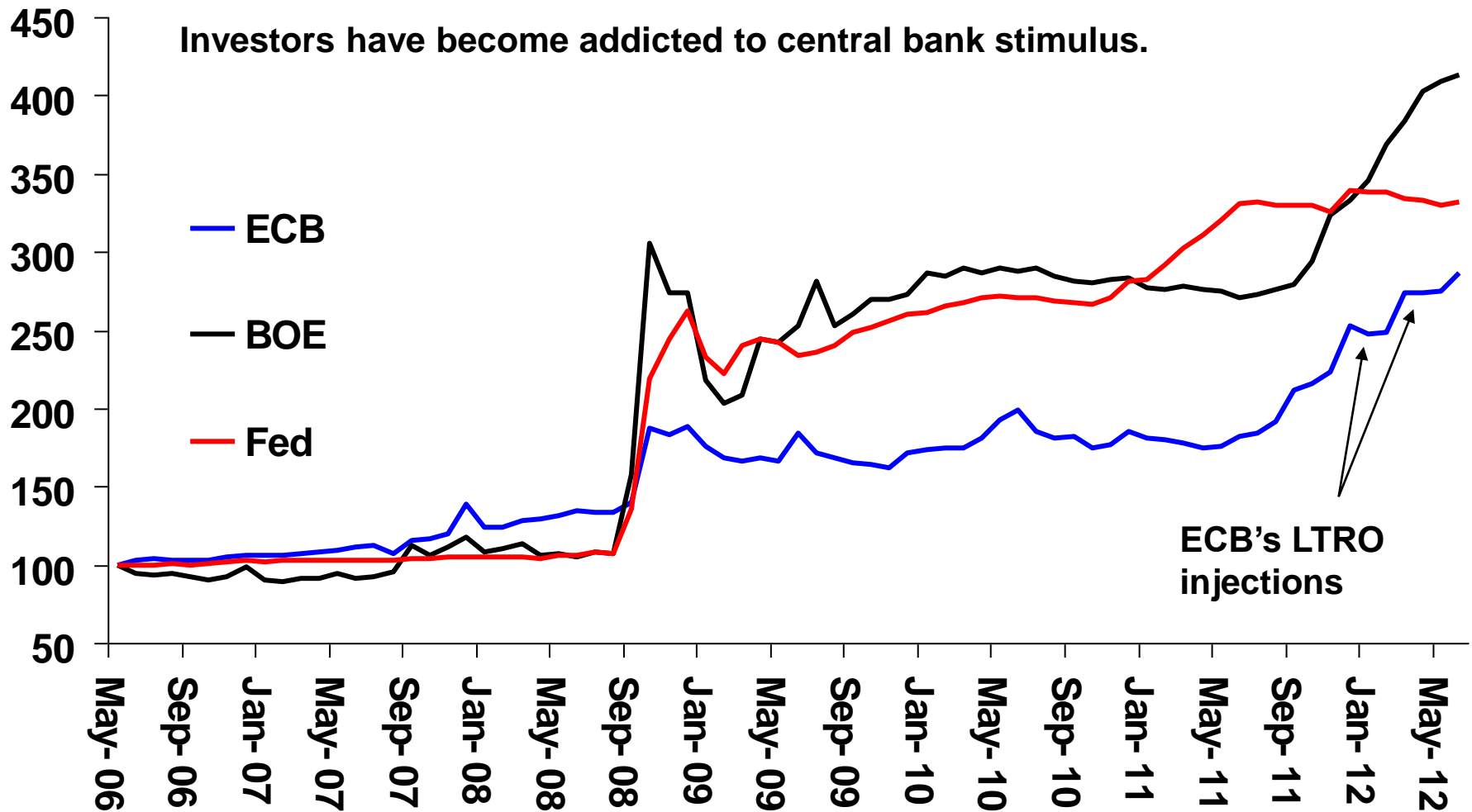
As China goes, so does Australia, Brazil, India...

As China's industrial output has slowed, so has economic growth in key trading partners. We have been lowering our 2012 GDP forecasts, especially for Brazil and India, partly because of weaker growth in China. But China's stimulus will help them rebound modestly in 2013.



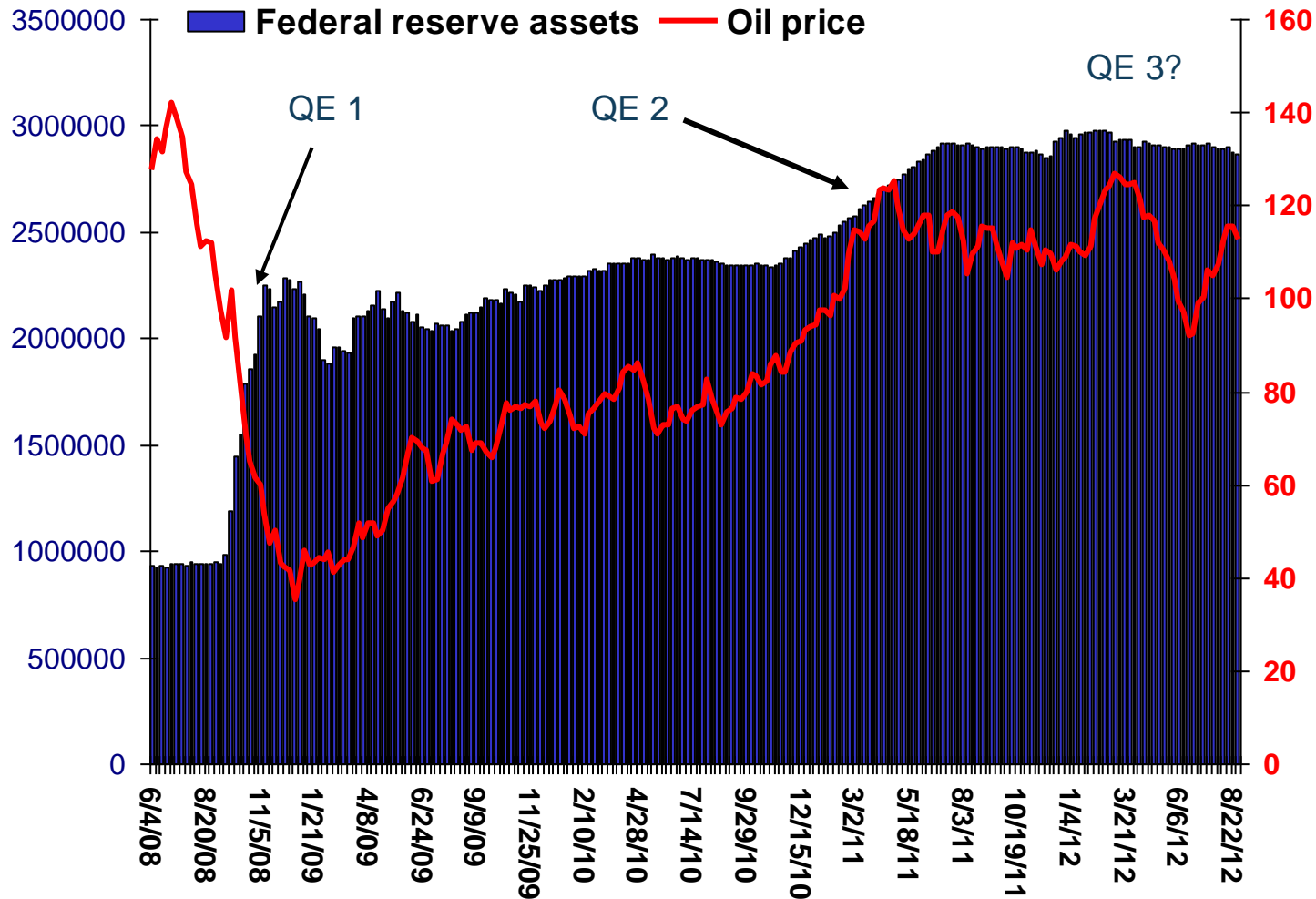
China industrial production, % change YoY; Australia, India, Brazil, equity indices, % change MoM, 6m moving average.

Central bank balance sheets: Bigger and bigger



Total assets on central bank balance sheets. May 2006=100.
Source: Bloomberg, central banks

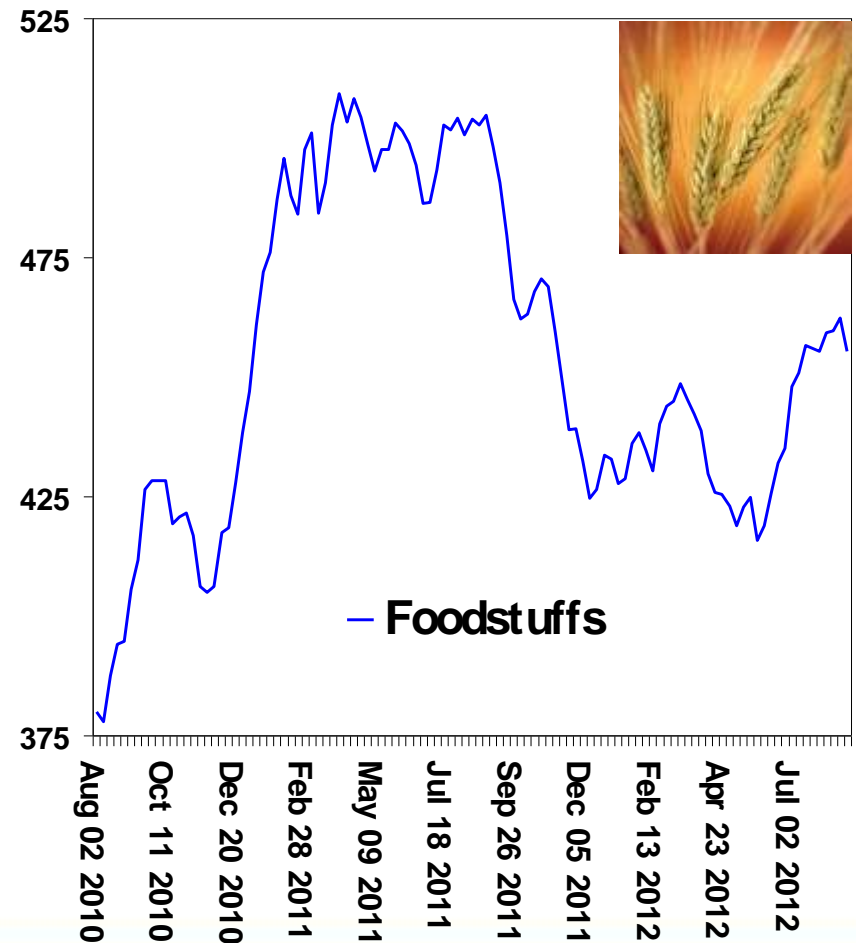
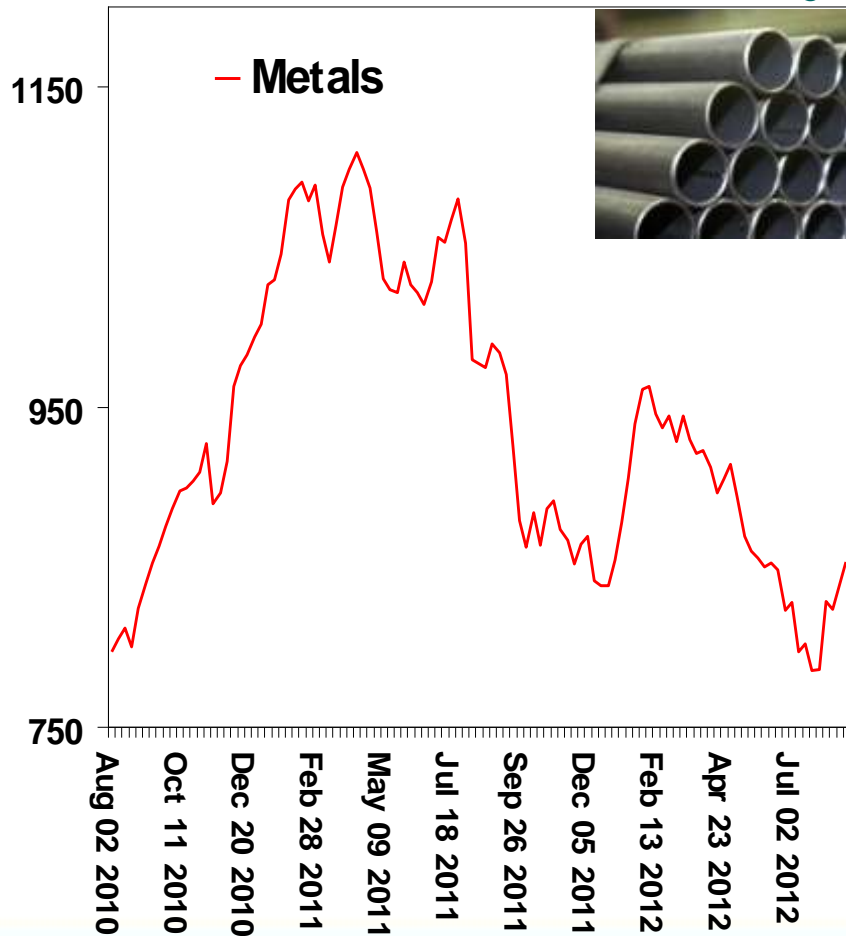
China and QE: What are the effects?



- Oil price rises on *rumours* of Fed easing; increases China's import bill
- Typically weakens US currency; forex issues for China
- Boosts US confidence & markets, but offset by costlier oil

Commodity prices have been volatile...

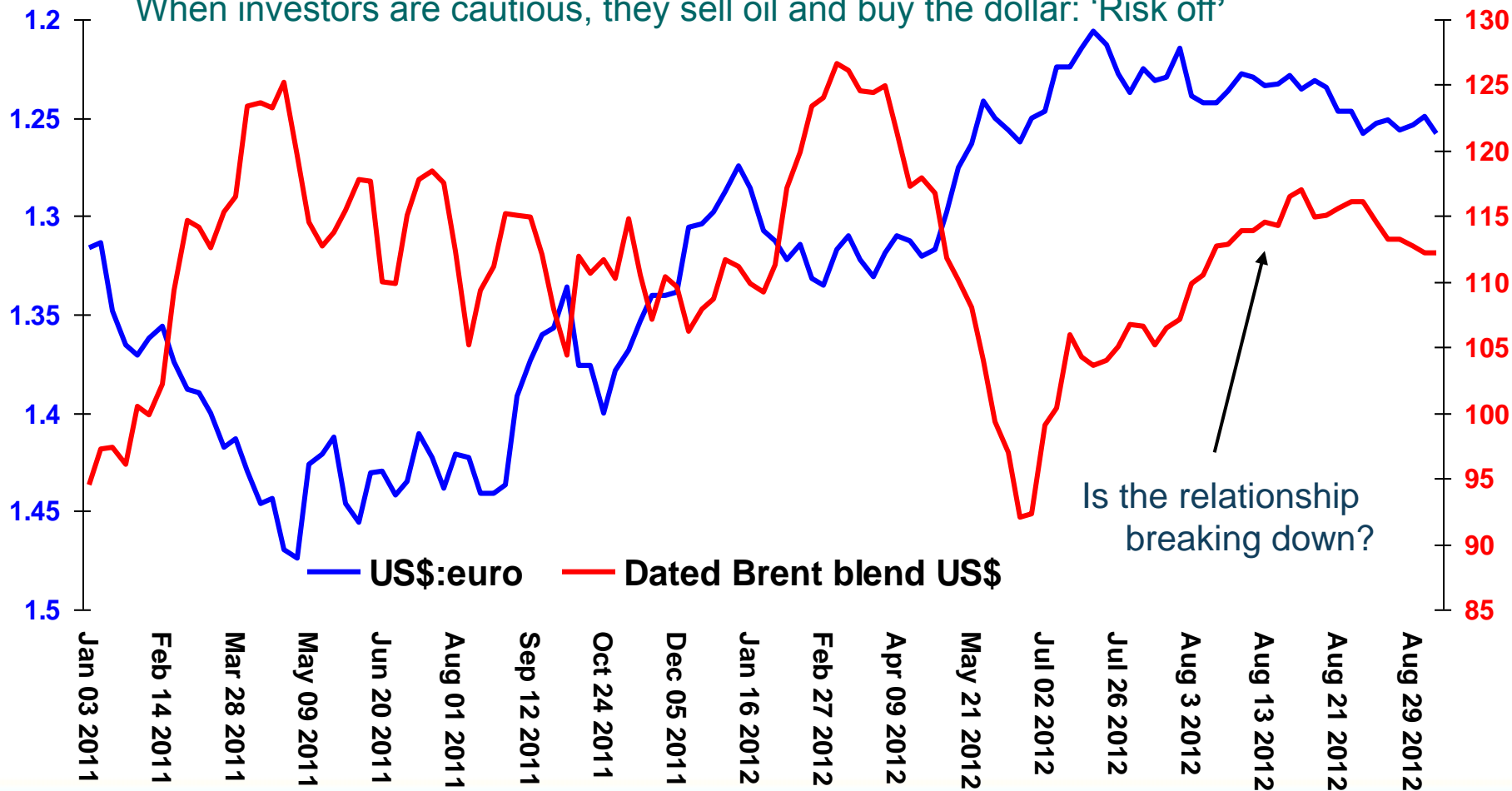
...and metals prices have fallen as China's economy has slowed. Food prices, though, are rising following a drought in the US heartland.



It's mostly about "risk on, risk off" sentiment

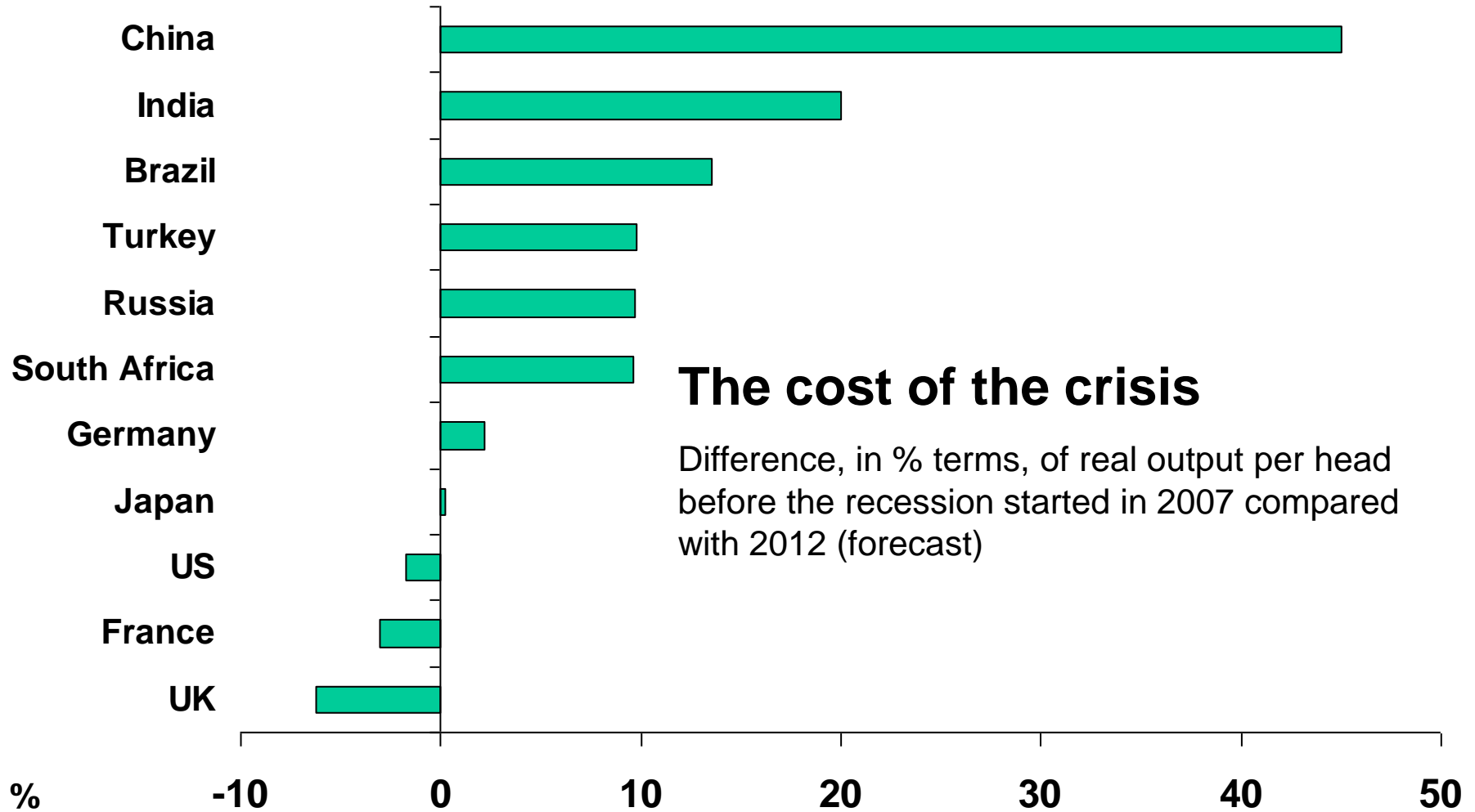
When investors are primed for risk, they sell the dollar and buy oil: 'Risk on'

When investors are cautious, they sell oil and buy the dollar: 'Risk off'



Left hand scale: US\$:euro exchange rate, inverted; right hand scale, Brent oil price. Source: Haver, Bloomberg

Surging ahead...or still digging out?

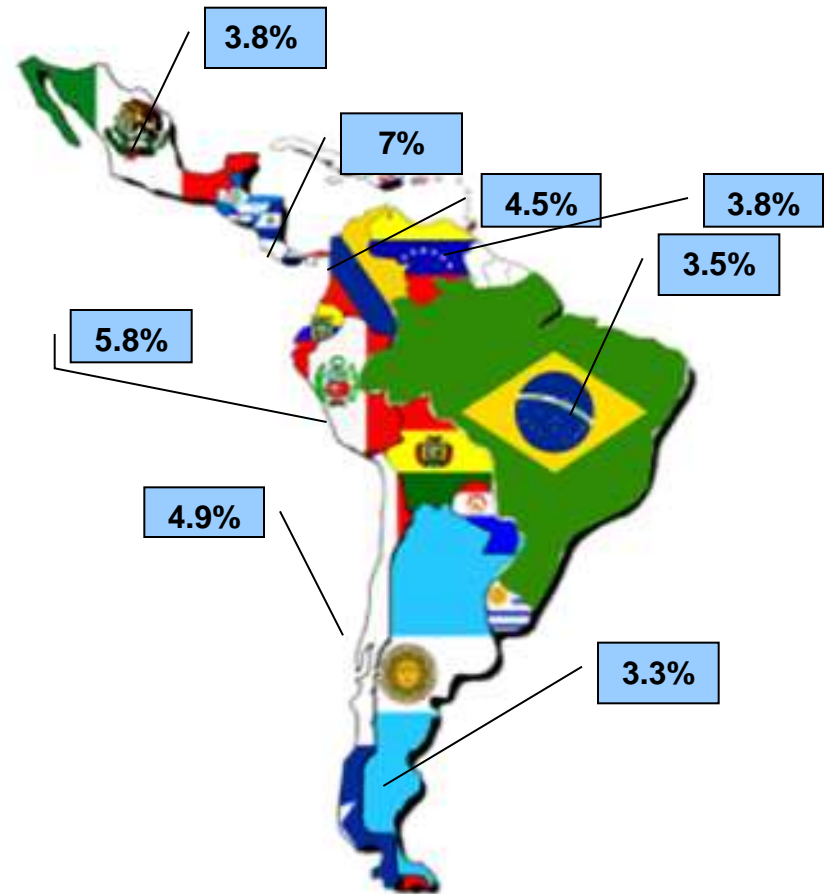


What about Latin America?



Mapping growth in 2012-16

- Region is expected to grow at an annual average of 4% in 2012-16
- Panama, Peru, Ecuador and Chile among the top performers, with annual average rates of 5% to 7%
- Most other countries to grow faster than the global annual average (2.7%)
- Mexico and Brazil to grow at an annual average of 3.8% and 3.5% respectively



Source: Economist Intelligence Unit, CountryData.

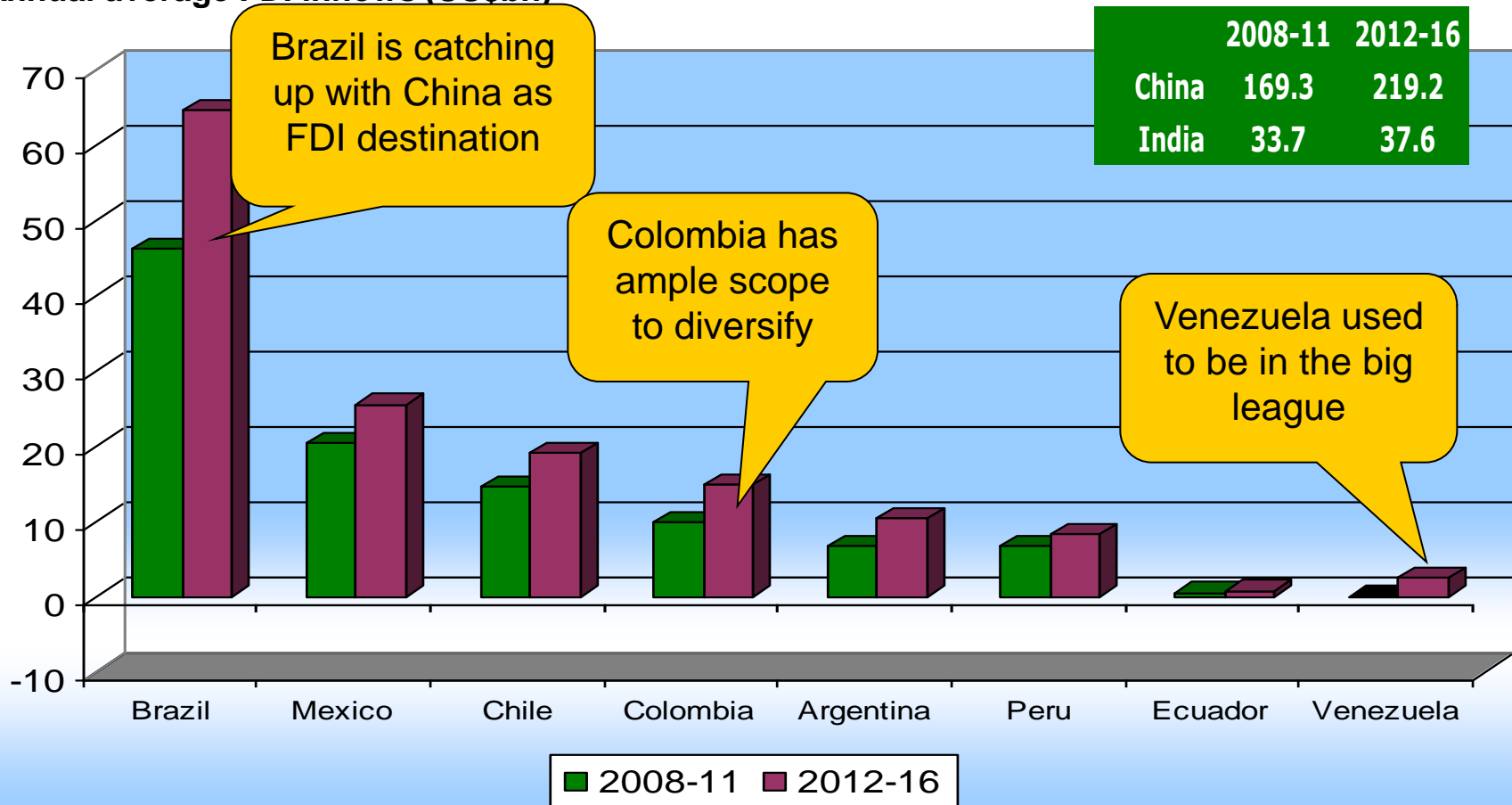
Latin America at a glance

- Stable growth with relatively contained inflation
- Sound macroeconomic fundamentals
- Sound and profitable financial systems
- Combined market of almost 600m people
- Favourable demographics with a booming middle class (supported by strong credit growth) feeding into growing domestic demand
- Abundance of strategic natural resources
- Strategic location + access to diversified export markets thanks to extended network of trade agreements
- Record FDI inflows (US\$196.5bn forecast for 2016)



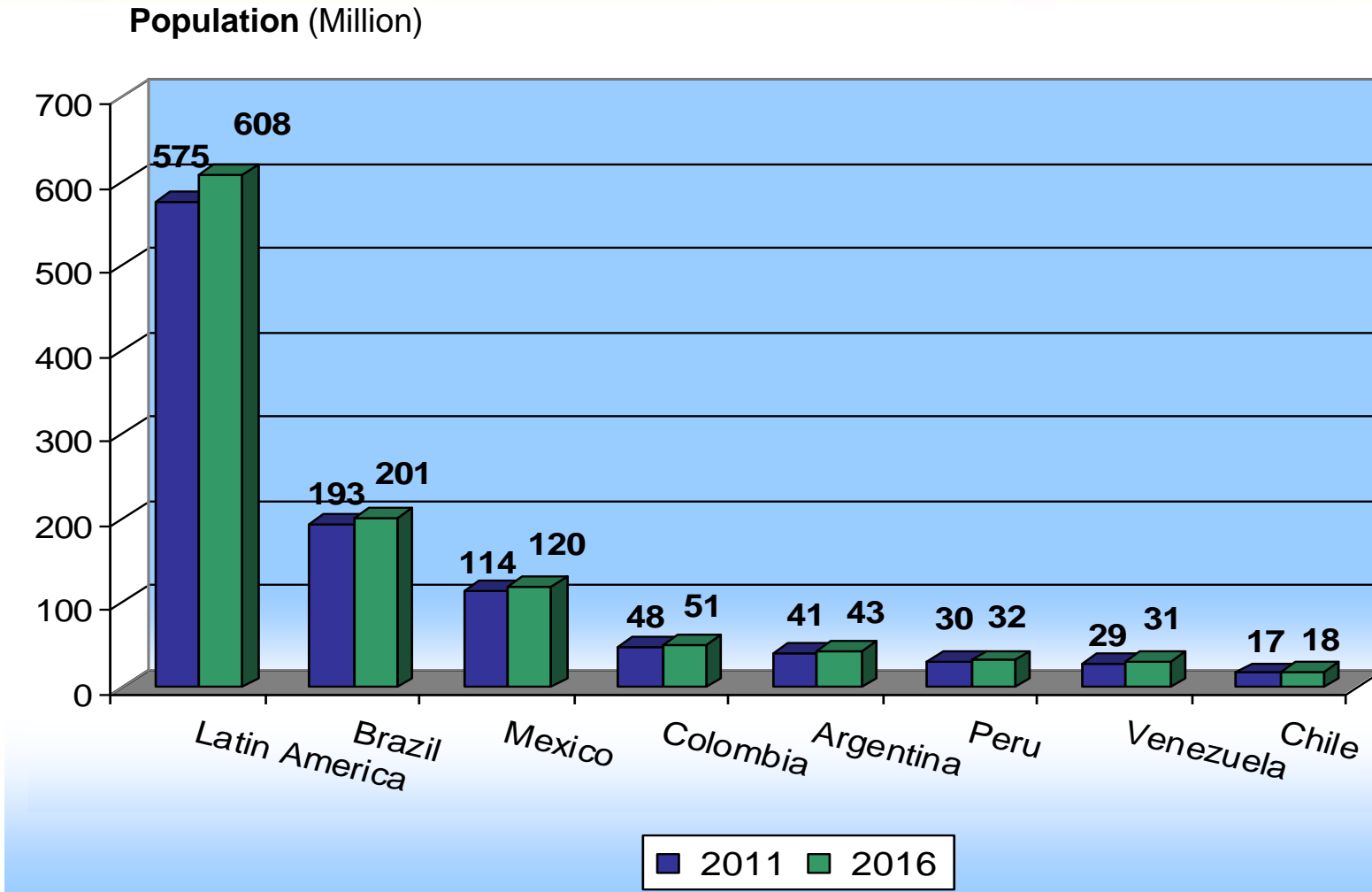
An increasing important FDI destination

Annual average FDI inflows (US\$bn)



Source: Economist Intelligence Unit, CountryData.

The demographic dividend



Source: Economist Intelligence Unit, CountryData.

Large and expanding domestic market

- Solid GDP growth rates in the last few years, together with increasing public transfers to the most vulnerable segments of the population, have also helped in reducing income disparity and lifting more and more people out of poverty
- Gini coefficient fell from 55 to 52 between 2002 and 2008. Poverty and extreme poverty fell from 43.8% and 18.6% in 1999 to 30.4% and 12.8% respectively in 2011, with a total of 41m and 18m people lifted out of poverty and extreme poverty respectively.
- Meanwhile, one of the most promising trends observed lately in the region is the **rise of the middle class**, on the back of greater economic stability, increases in minimum wages and conditional cash transfer programmes geared towards human capital development → 48.7m Brazilians have moved into the upper and middle class categories since 2003, with 13.3m people ascending to the middle class over the past two years or so



Integrated regional market and diversified export markets...

➤ Latin American markets increasingly integrated by a series of trade agreements (Mercosur, Andean Community, the newly signed Pacific Alliance, Caricom)

➤ And stretching out to other regions using its strategic location close to the US and with a Pacific outreach:

▪ US (NAFTA, CAFTA-DR, trade agreements with Chile, Colombia and Panama)

▪ Asia (APEC, Trans-Pacific Partnership Agreement, several bilateral agreements between Mexico, Chile and Peru notably with Asian countries)



New players to watch: China, a growing relationship

- China has increased its share in Latin America's trade from 1% in 1880 to 11% in 2011, becoming third trading partner after the US (21%) and the EU (13%)
- Trade between Latam and China expanded by 51.2% in 2010 (vs. 31% and 22% increase in Latam trade with the EU and the US)
- China was the third investors in the region in 2010 (mostly extraction and natural resources but also diversifying in infrastructure and manufactures)
- China is also an increasing source of funding: Chinese banks have lent more than USD 75bn from 2005 on to the region



Business environment: Lagging behind in reforms

	2007-11	2012-16	Improvement
	(out of 10)	(out of 10)	
North America	8.13	8.24	0.10
Western Europe	7.45	7.59	0.13
Eastern Europe	5.98	6.35	0.37
Asia	6.52	6.91	0.39
Latin America	5.83	6.02	0.19
Mid. East & Africa	5.49	5.82	0.34
World average	6.57	6.82	0.25



Among the problematic areas: poor infrastructure, rigid labour markets, insufficient financing, cumbersome fiscal systems, availability of skilled labour, poor competition, red tape

The EIU business environment rankings measure the attractiveness of the business environment in 82 countries worldwide, based on the market opportunities, policy toward enterprises and FDI, foreign trade and exchange controls, taxes, financing, infrastructure among others.

Investment pros and cons

- Prudent fiscal and monetary policies
- Growing domestic market
- Heavy investment in infrastructure in many countries
- Sounder and well functioning banking systems
- A dynamic private sector
- Deeper south-south trade and investment links



- A shortage of skills
- Rigid labour market
- Crime and corruption
- Inefficient bureaucracy
- Underdeveloped infrastructure



What about Puerto Rico?

- Despite some progress in stabilising economy, the new administration will face a daunting array of problems, including high unemployment and crime rates, a fragile fiscal outlook and a weak recovery after five years of contraction
- We expect the economy to stagnate in 2012 (0.5%) to then pick up to 1.4% in 2013 supported by improvements in domestic credit conditions, tourism and constructions
- November election will be close, but we expect opposition Partido Popular Democratico to win under leadership of Alejandro Garcia Padilla
- Challenges to address include also infrastructure and education system upgrading, reinforcing macroeconomic stability and improving government efficiency



Thanks, Gracias!

irenemia@eiu.com