

## Where is the world economy heading?

2015 was an eventful year for many global markets. Equities fluctuated heavily in developed and developing economies, and the junk bond market has all but crashed. This year has also started with quite heavy market turbulence. The question remains, where we head from here?

Predicting the turning point of a business cycle is notoriously difficult. It may well be the most failed effort of everything economists have set their minds into. What makes situation even more challenging now are the near zero interest rates of several major central banks, which have tendency to mix signals of the financial markets. Thus, in the current situation, the best guide for what lies ahead is the signals from the real economy.

One of the biggest recessionary signals is the current very low level of oil price, but with a potential silver lining. Low price signals the lack of demand for oil (global production has risen some, but not that much), which signals lackluster global industrial production. However, as the price of one of the raw inputs and energy is lower, firms and households should have more money, in theory, to spend. Still demand in many categories is lacking. The price of copper has also fallen of the “cliff”. Copper is a key part in many infrastructure projects (cables, phone lines, etc.) and thus the decline in its price signals for decline in infrastructure construction, a key driver of economic growth worldwide. There is less need or willingness to commence infrastructure projects or investments in new production capacity when some excess capacity exists.

Transport does not look much rosier. Rail freight is declining in the world’s largest economy US. Also the volume and the price of sea transport is in multiyear lows. Net capital flows to developing countries have fallen to zero, which has not happened since the crisis of 2008-2009. World

trade is slowing and thus, at the very least, world economy seems to in the brink of a deflationary period.

Financial markets are also flashing warning signals. The default rates and yields of corporate debt have reached levels not seen since 2009. Debt service ratios of the BRICS (Brazil, Russia, India, China, and South Africa) have reached levels that are generally associated with the outbreak of financial crises. Some developing countries facing multiple challenges are basically imploding, especially very oil dependent ones (Venezuela). Countries like Russia and Brazil have somewhat better financial buffers, but those are not indefinite. Even rich Middle Eastern oil exporters are facing serious budget deficits due to falling oil revenue. Quick fix for the low oil price would be escalating Middle Eastern conflict, which is precisely what Saudi Arabia and Iran have been busy doing.

Considering the evidence, we estimate that the likelihood of a new global economic crisis is 45 % for the next 12 months.

In Table 1, we present the *nowcasts* and the growth forecasts for the real GDP of the Eurozone, Finland, and the United States under a consensus scenario. They show that the Eurozone would finally be in recovery mode. According to our forecasts, real GDP of the U.S. will grow by 1.4 percent this year. The real GDP of the Eurozone is expected to have grown 1.7 percent last year.

Table 2 present the *nowcasts* and the growth forecasts for the real GDP of the Eurozone, Finland, and the United States under a crisis scenario.

Table 1. *Nowcasts* (nc) and forecasts for the growth rate of real GDP in the US, Eurozone and Finland. Source: OECD, Bureau of Statistics and GnS Economics.

Quarter	Finland	Eurozone	USA
2015:1	0.18	0.52	0.16
2015:2	0.41	0.36	0.91
2015:3	-0.54	0.42	0.44
2015:4 (nc)	0.38	0.36	0.47
2015	0.4	1.7	2.0
2016	0.6	1.0	2.2
2017	1.6	1.2	2.4

Table 2. *Nowcasts* (nc) and forecasts for the growth rate of real GDP in the US, Eurozone and Finland in a crisis scenario. Source: OECD, Bureau of Statistics and GnS Economics.

Quarter	Finland	Eurozone	USA
2015:1	0.18	0.52	0.16
2015:2	0.41	0.36	0.91
2015:3	-0.54	0.42	0.44
2015:4 (nc)	0.38	0.36	0.47
2015	0.4	1.7	2.0
2016	-5.3	-2.7	-1.2
2017	-5.3	-2.2	-0.4

All in all, evidence from several economic indicators implies that the peak of the global business cycle may already have been passed or it may be at hand. That is why numbers presented in Table 1 should be taken with a grain of salt and be prepared that growth figures will be something between those presented in Tables 1 (normal) and 2 (crisis). Although we do not consider that a global financial crisis is imminent (see above),

## Process descriptions

The forecasts reported in this Q-review are based on the statistical modeling methods from the most recent academic research on predicting business cycle fluctuations. Nowcasts refer to the forecasts of the growth rates of the real Gross Domestic Product (GDP) for the current quarter. Nowcasts are needed because the standard measures for the GDP are published after a considerable lag and are typically subject to subsequent revisions, indicating that the coincident state of the economy is always uncertain. Our nowcasts for the current quarter are based on statistical models where all relevant information available at the time of nowcasting is utilized.

there is a fair chance that emerging markets will face financial crisis starting this year. That would have serious repercussion on the global economy.

The US has been a power house of global economy during the last few years and its economy seems to be humming along without major obstacles. However, the economic upturn of the US turns 7 years this year, which exceeds the average duration of upturns (around 6 years) in the US after the Second World War. If the US economy would turn the corner this year, global economy would surely follow it into recession. Still, considering that two of the main contributors to the economy of the US, household debt to income (GDP) and household debt service payments to disposable income have fallen to levels not seen in this millennium, there is room for definite growth improvements in the US. The only problem is that if people do not want to consume, there are very little conventional ways to force them to do so. As a side note, central banks have been quite creative past few years. Thus, uncertainty in the direction of the US and the global economy remains high.

One of the big question for 2016 is, how the Europe and the Eurozone cope if global economy enters to a recession. If there is a downturn in the global economy, tensions within the Eurozone are likely to increase again, because economy will sputter and country differences emerge strong once again. In that case, the likelihood of an Eurozone breakup will increase considerably.

The GDP forecasts for longer horizons (over the current quarter) are based on the dynamic forecasting models where forecasts are constructed iteratively. This means, for example, that the three-quarter forecast is essentially based on the two-quarter forecasts and so on. Forecasts are constructed for all three economic areas (eurozone, Finland and the US) indicating that they depend on each other. Finally, note that the forecast scenarios considered in this Q-review are based on the expert view of GnS Economics.

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