International Outlook for 2015

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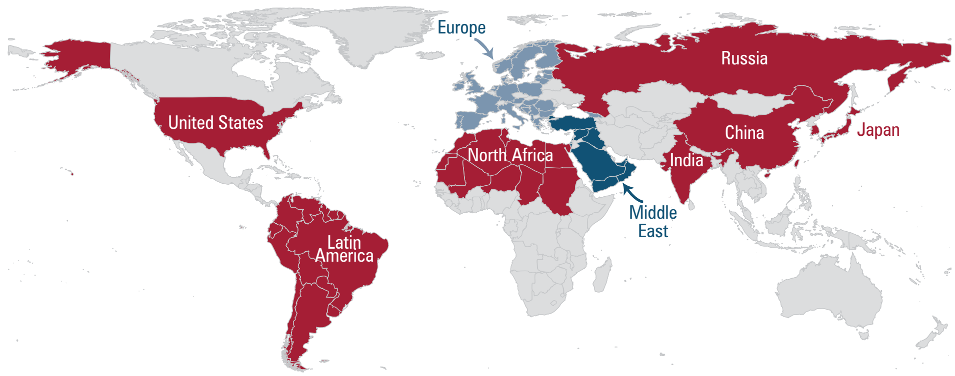
The latest release from the International Monetary Fund (IMF) forecasts that the size of the global economy will have increased by 3.3 percent by the end of 2014. For 2015, our Kelley School of Business panel is anticipating that the world will experience a slight rebound to 3.8 percent growth in global gross domestic product (GDP).

The global economy will show some strengths and weaknesses in 2015. It is reasonable to state that the eurozone is responsible for the disappointing outcome of global growth in 2014. Europe's growth was exceptionally weak at only 0.8 percent. The United States, on the other hand, was the engine of global growth, with very encouraging results in 2014.

Figure 1: Regions Discussed in the 2015 International Outlook



Source: Indiana Business Research Center

United States

U.S. growth is bouncing back but seems to be stuck below its potential.

After a setback in the first quarter of 2014 (a 2.9 percent drop in GDP), the U.S. economy bounced back. This was primarily due to the strengthening real estate market, greater household consumption and increased business spending. Furthermore, the recent pickup of wages, as the labor market tightens, suggests a more sustainable economic recovery for 2015, which we forecast to be slightly above 3 percent.

One possible threat to the U.S.'s stronger recovery is the end of the Federal Reserve's quantitative easing (QE3) and the financial market's reaction. The reaction of market participants right after the announcement didn't spark volatility in the stock market indexes, but then they had correctly anticipated the end of the Fed's massive purchase of Treasuries and asset-backed securities.

Additional threats to the U.S. economy in 2015? The aging population and the deceleration of labor productivity. The expansion of information technology that fueled rapid productivity during the 1990s continued in the first part of the millennium. However, more recent restrictions on occupational labor supply, wrongful discharge and anti-discrimination laws, and the preferential tax treatment of employer-provided health insurance have reduced labor market fluidity and, therefore, may be a factor in slowed labor productivity.

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Europe

Europe's recovery continues to be sluggish and the region is edging toward recession.

Growth continues to be weak in the eurozone and its GDP is rather optimistically forecasted to grow at 1.3 percent in 2015. The pace of economic recovery varies across countries, however. In particular, Germany, France and Italy have struggled to rebound from the eurozone's slump, while the Spanish and British economies have enjoyed modest but steady growth. Many countries in Europe suffer from productivity and competitiveness loss (the competitiveness of a country is measured by the prices their goods and services receive in the open markets and the efficiency with which they have been produced). Production and business investment are staying below what they were before the 2010 financial crisis and lending to households and businesses continues to decrease.

Recently, the IMF estimated that there is a 35-40 percent chance that the eurozone will experience a new economic downturn. Likewise, the 2014 German business survey that revealed a slump in confidence and the risk of deflation in the eurozone suggests that significant threats to growth remain in Europe. Unless Germany is willing to allow an increase in its wages (to boost consumer spending), as well as an increase in its budget deficit (to boost government spending), many economies in Europe will continue to struggle throughout the next year and eurozone growth will be adversely affected. Once again, we are looking to Germany to be the engine of European growth.

Russia

Russia's biggest threat is geopolitical, as the country's territorial expansions are further isolating the country from the rest of the world.

The Russian economy will continue to suffer from the crisis in Ukraine, as well as the collapse in oil prices. The economy is expected to grow by only 0.5 percent in 2015.

The European and U.S. restrictions on trade with Russia's defense, financial and energy sectors have, and will continue to have, significant negative impact on the Russian economy. Furthermore, the financial restrictions have raised the cost of borrowing for Russian firms, and the subsequent capital flight (like foreign direct investment outflow) has caused a decrease in the value of the ruble—pushing inflation close to 8 percent.

Japan

Japan's "Abenomics" (fiscal and monetary stimulus together with structural changes and named after Prime Minister Shinzō Abe) aims to revitalize the country.

The Japanese economy has not been able to extract itself from stagnation (flat GDP growth) and deflation. The persistent decrease in prices continues its damaging effects on the economy, particularly lowering consumer spending and injuring producer confidence.

The recent round of unprecedented quantitative easing by the Bank of Japan, which jolted the global markets, is an ultimate attempt to increase the inflation rate through a decrease in the value of the Yen. However, some downward price pressures, such as the general price decrease in international commodities, will counteract the Central Bank–induced inflationary pressures. The outlook for 2015 growth will stay low at around 0.8 percent.

China

The growth outlook for China, the world's second-largest economy, is one of the biggest question marks hanging over global growth.

From the early 1980s through 2011, China grew at an average annual rate of 10.2 percent. Since 2011, growth has been in the single digits. In 2014, China's economy grew 7.4 percent, and the country's single-digit growth is expected to continue in 2015—with growth averaging just a little over 7 percent. Our forecast is dependent on the Chinese government's ability to follow through on their commitment to long-term economic reforms. Our worry is that the macroeconomic policies will shift to short-term stimulus rather than the necessary long-term reforms.

We believe policies supporting the reforms will give the economy a stronger long-term foundation by letting market forces play a much larger role. Indeed, the liberalization effort of the financial system includes modernizing the People's Bank of China, which is not an independent central bank like the Federal Reserve. The bank officials have to juggle financial reform with political demands for growth. The liberalization effort also includes the government refraining from instructing China's giant state-owned banks on how to conduct their lending practices, the creation of bank deposit insurance, and implementation of policies that will allow inefficient firms (including state-owned enterprises) to fail.

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India

India has great potential and substantial risks.

India, the second most populous country in the world, continues to be an Asian economic powerhouse with great potential; however, the country has the possibility to stay tangled in challenges. As we have seen on regular occasion over the past decade, India's accelerated growth forecast for 2015 has the potential to face domestic constraints like terrible infrastructure and an unpredictable business environment. Domestic constraints have often set in and caused growth to slow, inflation to skyrocket and investment to flee in periods that were forecasted to be high growth.

A recent report from the World Bank ranked India, the third-largest economy in Asia, at 142 among 189 countries based on how favorable the regulatory environment is to set up and operate a business. Its neighbors, such as Pakistan, Sri Lanka, Indonesia and other smaller nations are far ahead, and India seems to provide only a slightly better business environment than places like the war-torn West Bank/Gaza and Iraq.

Latin America

Latin America will grow, but will be at the mercy of global economic forces.

Latin America will grow but its dependence on commodity exports and U.S. remittances means that its fortunes rise with mineral and commodity prices, but then fall hard with global downturns. Latin America and the Caribbean Islands should show better performances than in 2014 and grow at about 2.2 percent in 2015. The better prospects for 2015 are an effect of the recovery in the U.S. as more remittances will be sent from Latinos working in the U.S. to their families in Central America, the Caribbean Islands and Mexico. However, the decrease in natural resources, particularly from China, and the difficulty that Europe is facing to get out of its crisis will affect the Latin American economies through global trade channels.

The leading economy in the region, Brazil, fell into recession in 2014. Thanks to a big domestic market of 200 million people and a growing middle and consumer class that offer opportunities to businesses, Brazil will continue to attract foreign investments. However, state-centric, interventionist policies, a ballooning debt and the stubbornly high inflation level (6.75 percent) are slowing Brazil's growth potential and its competitiveness. Furthermore, the recent reelection of Dilma Rosseff, from the leftist Workers' Party has shattered the trust of the business community. The trust divide comes from Brazil's red tape and heavy leaning on state-owned institutions to extend credit and subsidies to consumers, which are not sustainable.

Middle East and North Africa

In the Middle East and North Africa, safety concerns will weigh on confidence and economic activity.

In the Middle East and North Africa in 2015, we are expecting a slight increase in the growth rate relative to 2014. The region is expected to grow at 3.9 percent next year. The recovery is due to large government spending by the oil-exporting economies that will help stimulate their non-oil sectors and make them less vulnerable to the global oil price decline.

However, there are serious threats to the region's forecast. Chief among them are the brewing conflict with Islamic State extremists in Syria and Iraq and the political instability in Libya. Also, many oil-importing economies, such as Egypt, Jordan, Morocco and Tunisia, have some of the highest jobless rates in the region, especially among young people, which will continue to weigh on their economic and political stabilities.

Outlook

Global economic growth is unstable, weak and is not uniform across regions.

Global growth is unstable because of the many geopolitical risks that threaten both our social fabric and our economic channels. In the Middle East, an estimated 11 million displaced persons are putting pressure on budgets, labor markets and social cohesion in the region. The crisis in Ukraine and the subsequent economic embargo on Russia are creating secondary effects in many European countries because of the trade linkages, energy reliance and financial dependences of those economies with Russia.

Global growth is weak because it continues to fail to create enough jobs, and the 200 million unemployed individuals in the world are constantly reminding us of this unresolved weakness in our economies.

Global growth is not uniform across regions as some countries restart faster than others, quickly changing from contraction to expansion. For example, the United States and the United Kingdom are showing some sustainable growth earlier than their peers.

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