

Global GDP outlook

Forecasts cautiously revised up

- **Short-term outlook has improved.**
- **Caution prevails for 2010.**

Improved short term outlook

The global recession has been deeper than almost all commentators had anticipated, but it also looks to have been shorter than generally expected.

The earlier-than-anticipated exit from recession is illustrated by PMI business surveys, which have more or less consistently beaten consensus expectations in recent months. This was again evident in August, with the UK, Eurozone and US PMIs generally coming in ahead of forecasts. These surprisingly strong national PMI data helped boost the Global PMI to its highest level since December 2007 in August, suggesting global GDP returned to growth in Q3 after the deepest recession since the Second World War¹.

Other indicators from the PMI surveys suggest economic growth may continue to gain momentum in the short term.

First, the recession was characterised by manufacturers allowing sales to run ahead of output, meaning inventories fell sharply. Sooner or later, stock will need to be rebuilt, though further steep falls in PMI inventory indices suggest that this process has not yet really begun. When it does – most likely when companies grow more confident about the economic and financial outlook – it will inevitably boost production².

Second, the rebound is not confined to sectors which have benefited most from specific government stimulus packages, such as the car scrapping incentives. This is illustrated by the strong improvements in service sector business conditions around the globe. According to August PMI data, service sector activity is now rising at the fastest rates since 2007 in the UK, Germany and

China, quickest since 2008 in India, and returned to growth in the US. Anecdotal evidence from the surveys reveals that businesses and consumers are beginning, albeit cautiously, to spend again after many months of retrenchment.

Forecasts revised up

Economists have been revising up their forecasts for economic growth in light of the improved economic data flow and better near-term outlook. The consensus of opinion for GDP in the main industrialised countries, as polled by Thomson Reuters, improved markedly between July and August with the exception of the UK (see table 1).

**Table 1: Thomson Reuters poll of economists:
GDP (% change)**

Poll date:	2009		2010	
	July	Aug	July	Aug
US	-1.4	-0.8	2.6	2.5
UK	-4.1	-4.5	0.8	1.0
Eurozone	-4.4	-4.0	0.4	0.8
Japan	-3.6	-2.8	0.7	1.1

Source: Thomson Reuters

It is not just the investment bank economists that have been tweaking their forecasts. The OECD have also become more positive about growth in 2009 since their June predictions, and European Central Bank staff have upped their forecasts for 2009 and 2010 GDP growth for the Eurozone economy, though only by around half a percentage point for each year. Nevertheless, the Eurozone looks set to have exited recession almost a year earlier than the ECB had projected in its previous staff forecast.

But caution prevails

Although the outlook for the remainder of 2009 has brightened considerably, much uncertainty persists for next year, and it is generally thought that the recovery will be sluggish. The consensus view among

¹ http://www.markit.com/assets/en/docs/commentary/markit-economics/sept%2009/Global_GDP_09-09-04.pdf

² http://www.markit.com/assets/en/docs/commentary/markit-economics/sept%2009/Manufacturing_09-09-01.pdf

economists polled by Reuters is for GDP to rise 2.5% in the US, but by a mere 1.0% in the UK, 0.8% in the Eurozone and 1.1% in Japan. Tellingly, the consensus GDP predictions for the US and Japan have not improved since the spring, despite the better data in recent months. The rates for the UK and the Eurozone have risen only from very pessimistic levels in the spring (when the consensus was for growth of around 0.3-0.4%) to still lacklustre levels.

A year of sluggish growth, low inflation and low interest rates

A widely held view is that a combination of headwinds will act to subdue economic growth in 2010 and at the same time dampen inflationary pressures.

What are these headwinds? They include the natural phasing out of stimulus measures, subdued consumer spending due to historically high unemployment rates,

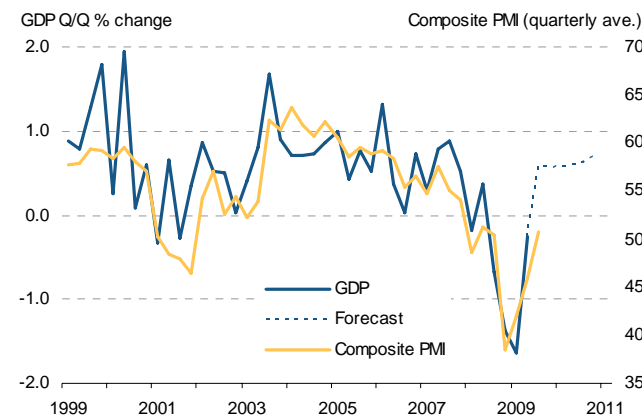
high oil prices, persistent tight credit conditions and ongoing balance sheet adjustment by governments, companies and households.

The dampening of economic growth and inflation due to these headwinds will allow central banks to maintain historically low interest rates for some time. US, UK, Eurozone and Japanese central banks are not expected to begin raising policy rates until mid-2010 at the earliest, and central banks continue to indicate that they are committed to keeping interest rates at record lows for the foreseeable future to nurture a sustainable economic recovery. The Swedish Riksbank has even explicitly stated that it will maintain its rate at 0.25% over the next year.

Downside risks to the forecasts clearly exist due to the possibility of stronger than expected effects of these headwinds. Notably, strong gains in commodity prices (especially oil) could cause a build up of inflation

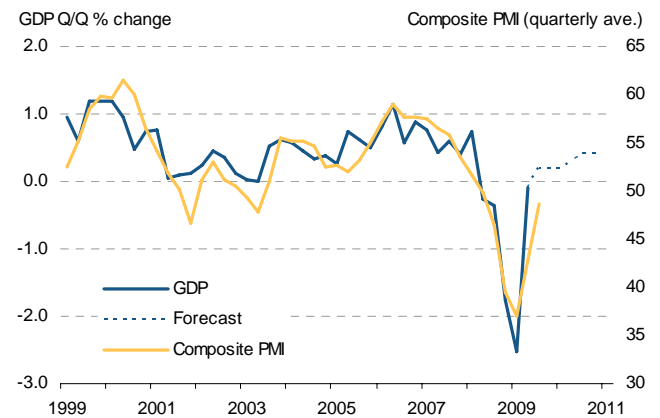
PMIs and Thompson Reuters consensus GDP forecasts

Chart 1: US PMI (ISM) and GDP



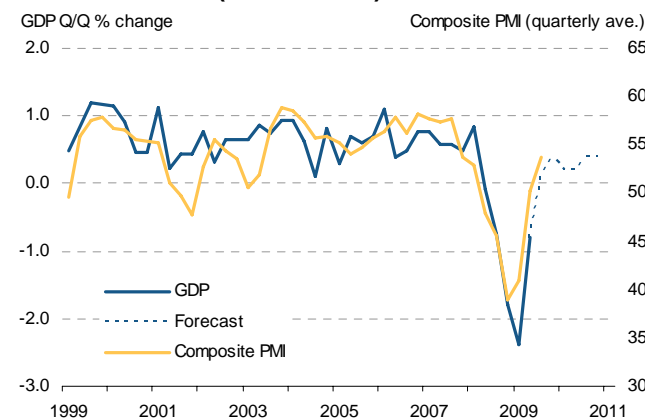
Sources: ISM, Thomson Reuters.

Chart 2: Eurozone PMI (Markit) and GDP



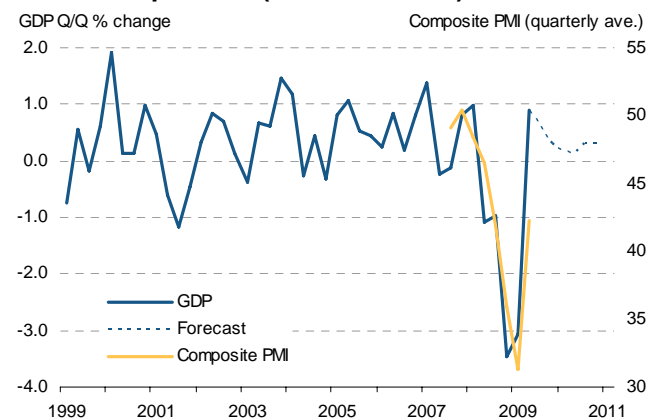
Sources: Markit, Thomson Reuters.

Chart 3: UK PMI (CIPS/Markit) and GDP



Sources: Markit, Thomson Reuters.

Chart 4: Japan PMI (Nomura/Markit) and GDP



Sources: Markit, Thomson Reuters.

pressures, meaning rates are hiked by inflation-prioritising central banks sooner than might otherwise have been the case, quashing economic growth. Similarly, governments may have difficulties financing debt levels, causing further financial market turmoil. Government spending may be reined in more sharply than forecasters are expecting, particularly in Germany after elections at the end of September.

On the other hand, upside risks cannot be altogether ignored. For example, job losses are easing. Employment tends to lag output, and the recent recovery in output is consistent with employment stabilising in most industrialised economies by the end of the year. This should help to raise consumer morale and household spending higher than most forecasters appear to be anticipating. Similarly, house prices are showing signs of stabilising, and even rising, in the US and the UK far earlier than most had considered likely, which should again support consumer spending.

At the moment, the recovery path has been as good as can have been hoped: a strong 'V-shape' which is currently showing little sign of losing momentum. Given that economic forecasters were generally caught out by both the severity of the recession and the strength of the rebound, it is perhaps not surprising that a cautious approach is being taken to estimating growth in 2010.

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