TOP 10
Economic Predictions for 2017 How Accurate Were We?

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The top-10 predictions for 2017, shown below, were published in December 2016. The text in italics describes what actually happened.

The political earthquakes of 2016 have upended conventional thinking about the global economy and have—ironically—brightened the outlook. The expectation that the incoming Trump administration will enact sizeable fiscal stimulus has increased optimism about US and global growth. This, in turn, has pushed US stock indexes to record highs, while pushing up both interest rates (with a resulting rout in the bond market) and the dollar. A stronger dollar is mostly good news for Europe and Japan, helping to boost both export growth and inflation expectations. On the other hand, much higher US bond yields are bad news for the emerging world, where currencies have already taken a beating in recent weeks, significantly reducing the scope for further monetary easing. Fortunately, these financial market gyrations are occurring at a time when commodity prices are rising and both consumer and business sentiment have improved. IHS Markit believes that the balance of these trends will be moderately positive for global growth, which is expected to increase from 2.5% in 2016 to 2.8% in 2017 and 3.1% in 2018. That said, high levels of political and policy uncertainty could hurt growth in 2017 and beyond.

What actually happened: *Global growth did accelerate from 2.5% in 2016 to an estimated 3.2% in 2017, and 8 out of 10 predictions by IHS Markit were on the mark.*

1 The US economy will accelerate—even before any Trump stimulus.

US GDP growth was pushed down in 2016 (to 1.6%) by the combined impacts of a large inventory drawdown, the collapse in energy-sector capital spending, and the drag from net exports because of a strong dollar and weak global growth. The good news is that during the coming year, a much smaller drag from inventories and a rebound in energy-sector capital spending (the closely watched rig count is already moving up) will boost growth. IHS Markit expects that tax cuts (likely close to the more-modest House Republican version) and infrastructure spending (probably scaled back from the Trump proposal and phased in) will be enacted early next year. This means that the stimulus will not have much of an impact on 2017, but could boost 2018 growth by as much as 0.4 percentage point. Consumer and business confidence, which rebounded right after the election, are likely to be boosted further as growth improves. On the downside, the rise in both interest rates and the dollar, in anticipation of stimulus, will erode some of the positive effects of stimulus. IHS Markit currently predicts that US growth will accelerate to 2.3% in 2017 and 2.6% in 2018.

What actually happened: *US growth did increase from 1.5% in 2016 to an estimated 2.3% in 2017.*

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2 Europe's economic momentum will slow a little, primarily because of Brexit and political uncertainties.

Incoming data on the Eurozone economies point to a near-term rebound in growth, while the UK economy is proving resilient. In particular, consumer and business surveys (including the IHS Markit PMIs) underscore the better mood in Europe. Nevertheless, Europe faces daunting political challenges that could hurt confidence and growth next year. These include a potentially contentious Brexit, fallout from the recent referendum defeat in Italy, and upcoming elections in France, Germany, and the Netherlands. In particular, the political turmoil in Italy could trigger a crisis in the banking sector, which is already in dire straits. On the positive side, the European Central Bank has extended its bond-buying program (albeit at a more modest pace), and a weaker euro will help to lift export growth and (along with rising oil prices) raise inflation rates. IHS Markit continues to believe that these conflicting forces will weaken Eurozone growth from 1.7% in 2016 to 1.4% in 2017. Likewise, we expect UK growth to fall from 2.1% in 2016 to 1.3% in 2017. The good news is that the Brexit impact has been small, so far. The bad news is that it will likely get worse soon.has been small, so far. The bad news is that it will likely get worse soon.

What actually happened: *While UK growth has slowed from 1.8% in 2016 to around 1.5% in 2017, growth in the Eurozone has risen from 1.8% to 2.4%.*

3 Japan's growth will be low and steady, helped by a weaker yen.

Recent data on Japan have also been upbeat, although the source of much of the recent growth rebound has been net exports—domestic demand growth remains lackluster. The recent plunge in the yen is likely to accentuate these trends. The weak yen will fuel exports and tourism, support corporate profits (which are now around 11% higher than a year ago), lift capital spending, and encourage further increases in stock prices. On the downside, higher import prices (and overall inflation) will erode the purchasing power of consumers and suppress consumer spending. With inflation moving up, the Bank of Japan will probably hold off on any additional stimulus. Moreover, the likely demise of the Trans-Pacific Partnership diminishes the chances of meaningful structural reforms in Japan. On the other hand, the fiscal package passed by Japan's parliament in October, albeit modest, will provide earthquake relief and more infrastructure spending. On balance, IHS Markit believes that Japanese growth will stabilize at 1.0% in both 2016 and 2017.

What actually happened: *Japanese growth was a low and steady 1.8% in 2017, but a little higher than predicted.*

4 China's growth will grind down further, led by a housing construction slowdown.

China's economic condition remains fragile in late 2016, as the growth divergence in key sectors of the economy has intensified. Industrial production was stable, but retail sales and investment have worsened, in inflation-adjusted terms. Exports have also continued to contract rapidly. Most concerning, corrections in the housing and automotive sectors are under way, and will worsen in coming months. Worried about a housing bubble, the government has begun to remove stimulus. This will hurt construction further. One counterweight is the recent improvement in the performance of some heavy industries and mining, as manifested by the ability of these sectors to raise prices, after years of deflation. China also faces another source of stress because of capital flight. Foreign exchange reserves are at a five-year low and the renminbi is back to 2008 levels. In response, the government has already imposed some capital controls and will likely do more soon—in an attempt to relieve pressure on the currency and limit annual depreciation to no more than 5%. IHS Markit believes that China's policy contradictions will result in growth slowing from 6.7% in 2016 to 6.4% in 2017.

What actually happened: *Chinese growth over the four quarters of 2016 averaged 6.9%, while so far over the three quarters of 2017 it has averaged 6.7%.*

5 Emerging markets will do better, despite recent financial market pressures.

The results of the US election are something of a good news/bad new story for emerging markets. On the plus side, moderately stronger growth in the US and global economies is good news for emerging markets whose economies are export-oriented. Moreover, the expected continuing rise in commodity prices will help to bring in more export revenues and replenish government coffers. On the downside, plunging currencies are unwelcome for at least two reasons. First, to prevent further capital flight, central banks have to pursue more restrictive policies than they would like. Second, dollar-denominated debt in the emerging world has risen rapidly in recent years, reaching around $3.5 trillion. As the value of the dollar goes up, so does the burden of these debts. The good news is that the economic fundamentals (e.g., current-account deficits) in most emerging markets have improved in the past couple of years. Also, with the exception of China, overall debt ratios (domestic and foreign) are mostly down. This means that these economies will be able to enjoy the fruits of a more upbeat global outlook.

What actually happened: *Growth in emerging markets rose from 3.9% in 2016 to an estimated 4.8% in 2017.*

6 Commodity prices will continue their upward trend.

Between, January and September of 2016, commodity prices (as measured by the IHS Markit Industrial Materials Index) rose more than 40%. Subsequently, they retreated a little through early November and then surged after the US election. Earlier, expectations of a slight pickup in growth and better supply management were important factors. In the past few weeks, anticipation of even stronger growth and, in particular, more infrastructure spending by the United States has buoyed commodity markets. The euphoria may be overdone, as US commodity consumption is only about one-fifth that of China. Nevertheless, IHS Markit does expect commodity prices to continue to move up. In this regard, the recent OPEC agreement to cut output (by about 2% of world liquids production) will help by turning a small surplus in production into a deficit. As a result, IHS Markit has nudged up the average oil prices forecast for 2017 by a few dollars, to $54/barrel (dated Brent). Here again, market optimism should be tempered. OPEC members have a long history of less than 100% compliance with output cuts. Perhaps even more important, rising oil prices will encourage more US production, which will dampen any future prices increases.

What actually happened: *The IHS Markit Materials Price Index has risen 17% since the beginning of 2017.*

7 Inflation rates will move up in many parts of the world.

After many years of facing the threat of deflation, the world economy is poised on the threshold of an increase in inflation. With the US economy at or near full employment, wage inflation is already beginning to rise and is set to climb even faster with the implementation of fiscal stimulus. Along with increases in commodity prices, this will translate into faster price inflation (exceeding 2% in the coming two to three years). A similar upward trend is also evident in other parts of the world. Consumer price inflation is at a 31-month high in the Eurozone (although still low at 0.6%) and deflationary pressures in Japan are beginning to ease. Even more promising is that after many years of falling, China's industrial prices have risen recently. Rising inflation in the US economy, accompanied by a stronger dollar, means that the United States will be "exporting" inflation. Specifically, falling currencies in other parts of the world mean higher imported and headline inflation. For example, IHS Markit believes that Japan's consumer price inflation will rise from around zero in 2016 close to 1% in 2017. UK inflation could well end 2017 around 3.0%, compared with 0.9% currently.

What actually happened: *During 2017 inflation rates have risen in the United States, Europe, Japan, and parts of the emerging world.*

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8 US interest rates will keep rising—also pulling rates up in some emerging markets.

Even before the recent US presidential election, financial markets expected the Federal Reserve to raise interest rates later this month and twice next year. After the election, with expectations of a larger US budget deficit and higher growth and inflation, IHS Markit predicts that the Fed will raise interest rates even more next year (at least three times) and keep raising rates until the overnight federal funds rate reaches 3.0% by the end of 2019. In anticipation of more rate hikes, markets pushed the 10-year Treasury yield roughly 50 basis points higher soon after the election. Elsewhere, anxiety among central banks has risen recently. Both the Bank of England and the European Central Bank have warned that higher interest rates in the United States and political uncertainty on both sides of the Atlantic could "reinforce existing vulnerabilities" in the global financial system, especially in the emerging world and Europe. Higher US interest rates have triggered a run on emerging-market currencies, forcing some central banks (e.g., Mexico and Turkey) to raise interest rates and others to halt any further rate cuts (e.g., India, Indonesia, and Malaysia). In Europe, there are concerns about banking problems and a new round of sovereign-debt pressures.

What actually happened: *The Fed did raise interest rates three times during the past year, in March, June and December; central banks in a few other countries have followed suit, including Argentina, Canada, and the United Kingdom.*

9 The US dollar will appreciate more.

An already-strong dollar climbed even higher in the wake of Donald Trump's victory. By the end of November, the dollar had risen to an 8-month high against the yen and a 20-month high against the euro. Some of this was because of the US election, but some was also due to anxiety about the Italian referendum. Emerging-market currencies were also hit hard. In Asia, exchange rates fell between 2% (offshore Chinese renminbi and Thai baht) and 7% (Japanese yen). In light of expected stronger growth in the US economy and higher interest rates, IHS Markit predicts that the greenback will keep appreciating over the next year. On an effective (trade-weighted) basis, we expect the dollar to rise another 2-3% against key trading-partner currencies in 2017. The advance of the US dollar will not be uniform. The biggest increases are likely to be against the euro and the yen, as monetary policies in the Eurozone and Japan will be more accommodative than in the United States. We forecast that by the fourth quarter of 2017, the euro will briefly touch parity and that the yen will fall to around 120 per dollar. On the other hand, emerging-market currencies will fall much less, because they have already seen large declines.

What actually happened: *The US dollar had a wild ride in 2017, but toward the end of the year, its value is a little lower against a basket of currencies versus a year ago.*

10 The level of uncertainty has risen, but the risks of recession remain low.

IHS Markit estimates that the risk of either a US or global recession in 2017 is no more than 25%. The usual "recovery killers" are in abeyance. To begin with, even with the Fed expected to raise interest rates over the next year, global monetary conditions remain extremely accommodative. Thus, chances of central banks killing off the recovery are slim to none. Second, despite the recent OPEC agreement to cut production, global oil markets are well supplied. This means that the risk of an oil shock is low. Finally, notwithstanding the recent euphoria in US equity markets, there is little (if any) evidence of asset bubbles in most parts of the world. In other words, the odds of a repeat of the 2008-09 financial crisis are also pretty remote. Unfortunately, political and policy uncertainties (and risks) are higher now than they were a year ago. The rise of anti-globalization movements in the United States and Europe could result in policies that hurt growth. In particular, a trade war could push the US and global economies into recession. On the other hand, business-friendly policies (including lower corporate taxes and a roll-back of regulation) could boost both short-term and long-term growth.

What actually happened: *There was no recession in 2017, and the risks remain very low at the end of the year.*