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The global economy in 2015

Grant Thornton International Business Report

A recovery. But not as we know it.

Ed Nusbaum considers the global economic outlook for 2015

Cautiously optimistic: that is how I would describe the mood of business leaders heading into 2015. Our most recent quarterly confidence barometer found business leaders as positive as they have been since 2007.

That's not a surprise because, in many ways, 2014 was the year in which the recovery really took hold – and not just in the UK and US, but in some of the European economies hit hardest by the sovereign debt crisis. Ireland, Spain and even Greece showed nascent signs of recovery.

However, the recent economic, political and social turmoil is weighing heavily on business leaders' minds. Our research showed global business optimism dropping eight percentage points to net 35% in Q4. This is hardly disastrous – this time last year, global business optimism stood at just net 27%, for example – but it does reflect well-founded concerns about the unevenness of the global recovery.

The dramatic 50% fall in the oil price has caught the headlines, rocking markets and unnerving investors. While motorists and some manufacturers will be celebrating, it is clearly less good news for oil companies and major exporters whose government budgets may have forecast a much higher price. The viability of shale oil production in the US and global investment in renewables has also been thrown into doubt.

Perhaps the bigger issue is the eurozone with Greece once again at the centre of the storm. Greeks last month voted in the left-wing Syriza party which has pledged to renegotiate the terms of the €240bn bailout and reverse many of the austerity cuts. With Germany set to block any such moves, fears of a 'Grexit', with potentially damaging knock-on effects for the rest of the region, have risen again, although I expect an agreement will be reached. If this were not enough, Italy is back in recession, France is treading water, Germany has slowed and deflation threatens to choke off consumer spending and business investment. The region is in real danger of suffering a 'lost decade' of the kind Japan – itself back in recession after a poorly timed rise in the consumption tax – suffered in the 1990s. Taken together, this could then drag down the (currently) high-flying UK.

Add to this the continuing unrest in Ukraine, with sanctions directed at Russia sending the rouble tumbling and causing growth forecasts to be slashed; violent conflict in the Middle East turning the Arab Spring into a winter of discontent; and Latin America being stuck in the doldrums following the end of the commodity supercycle; and the outlook for 2015 certainly appears tricky, to say the least.

Despite this, confidence remains fairly buoyant and I too am optimistic that businesses, especially those dynamic enough to adapt to a rapidly changing environment, can still prosper.

The strength of the US economy is one reason. Its share of global output may have fallen over the past decade from 32% to 22%, but the strength of US consumer spending remains vital to the health of the world economy. Recent indicators look very promising: the addition of 2.7 million jobs in 2014 through November

Drawing on data and insight from the Grant Thornton International Business Report (IBR), the International Monetary Fund (IMF) and the World Bank, this report considers the outlook for the global economy in 2015.

2014 was the best since 1999 and growth in 2015 is forecast at a very healthy 3.3%.

China is another reason. There has been much talk of the growth rate slowing to 7.3% but this is expansion that would delight most governments and isn't far below the official target. Yes, levels of local government debt are a concern, but the managed transition away from investment towards consumption offers a more sustainable long-term growth path. Elsewhere, those other Asian giants, India and Indonesia, have both elected leaders who promise to be more business-friendly and unlock the potential of their millions of young people. Finally, there are welcome signs that growth in Africa is starting to decouple from the commodity cycle with output drivers diversifying and more broad-based growth to follow.

Clearly the global economy is not moving in lockstep and this is certainly a more uneven recovery than we have seen from previous financial crises. But there are growth opportunities out there for business leaders who are willing to take a risk: to make that acquisition, to launch that new product or to enter that new market. And the issue is not that business leaders are presented with a paucity of information, but rather how they cut through the white noise. If you're going abroad, find a local adviser with deep knowledge of the market - what looks on paper like an opportunity could easily end up giving you a headache and vice-versa. If you're looking to grow through acquisition, be sure (as you can ever be) that this technology or market access you are buying offers growth opportunities beyond the here and now.

I've just returned from India visiting our clients working in sectors from automotive to telecommunications where I have once again been struck by the ingenuity, resourcefulness and dynamism of local entrepreneurs. Some commentators may be disappointed by the slow pace of reforms but changing mindsets in the world's largest democracy was never going to be an overnight job. And Indian business leaders seem unconcerned: confidence for 2015 is running at 98%, the highest anywhere in the world.

I think there is a lesson here for all business leaders. Yes, this recovery is different; it is uneven and patchy. And yes, making bold decisions is tough in an uncertain world. But sometimes we need to take the plunge, to rely on our instinct and experience to know what the best course of action is, and remain hopeful of a good outcome. A positive attitude can help overcome even the steepest hurdles.

Ed Nusbaum

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Global CEO
Grant Thornton

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Economic growth

3.5%
FORECAST GLOBAL GROWTH IN 2015

The IMF has lowered its 2015 global growth forecast to 3.5% (from 3.8% in October) with managing director, Christine Lagarde, describing the outlook as "too brittle and too lopsided." This more modest growth outlook, combined with softer commodity prices and weakness is the eurozone and Japan - only partially balanced out by the increasing strength of the United States - is expected to weigh on trade. The IMF has slashed its trade growth forecast to 3.8% (from 4.9% in October) which is only slightly faster than 2014 (3.1%).

The eurozone sits bottom of the pile in terms of forecast growth rates with expansion of just 1.2% is expected in 2015 according to the IMF, although this would be an improvement from 0.8% in 2014. And little change is forecast over the short to medium-term suggesting the world's largest single market, which accounts for a quarter of global merchandise trade, will continue to act as a drag on global economic prospects.

The expected performance of the eurozone is also weighing on the forecast growth rate of the G7 economies (2.3% in 2015, up from 1.7% in 2014) but this masks a wide disparity between its members. Canada (2.3%), the United Kingdom (2.7%) and the US (3.6%) can all look forward to robust growth over the next 12 months, but the outlook is darker for three eurozone members - France (0.9%), Germany (1.3%) and Italy (0.4%) - and Japan (0.6%). That said, with Italy and Japan in recession and France stagnating, any growth would provide some welcome relief.

At the other end of the growth spectrum, the emerging economies of Asia-Pacific look set to expand fastest in 2015. China's growth rate is actually forecast to slow to 6.8% in 2015 as the economy rebalances, down from 7.4% in 2014. However, India (6.3%) and Indonesia (5.5%) are expected to enjoy post-election bounces in economic output.

Growth in sub-Saharan Africa is forecast to accelerate to 4.9% in 2015, from 4.8% in 2014, further highlighting that its economies are not as dependent on high commodity prices as they once were. It remains to be seen what longer term impacts the oil price drop will have, but while a series of mining strikes are weighing on South Africa (2.1%), Nigeria (4.8%), now officially the continent's largest economy, Kenya (6.2%) and Angola (6.0%) are all forecast to post robust growth.

Latin America is struggling to deal with the end of the commodity supercycle

By contrast, Latin America is struggling to deal with the end of the commodity supercycle which powered its economies over the past decade. The region is forecast to grow by just 1.3% in 2015, a marginal improvement from 1.2% in 2014. Brazil's economy was flat in 2014 and output expected to grow only marginally in 2015 (0.3%) as the government battles inflation. Argentina is likely to contract as it awaits a new administration. However, the region's more open, market-oriented economies - Chile (3.3%), Colombia (4.5%), Mexico (3.2%) and Peru (5.1%) - look set for an improved 2015.

The Commonwealth of Independent States (-1.4%) look set to struggle in 2015 due to the oil price drop and sanctions imposed on Russia as a result of the Ukraine crisis (although excluding Russia, the forecast is for growth of 2.4%). The Middle East and North Africa is forecast to expand by 3.3% in 2015, up from 2.8% in 2014. But with many parts of the region, such as Libya and Syria riven by civil war, and natural resources such an important element of many government budgets, the outlook is perhaps more uncertain than most.

Forecast real GDP growth rates (%)

Source: IMF 2015

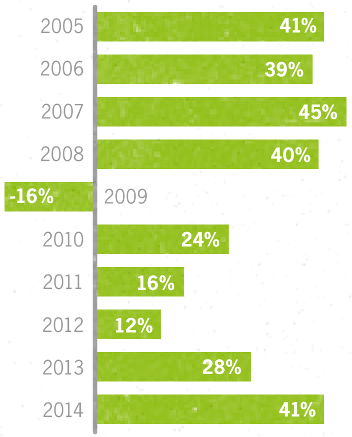
Business growth prospects

The strength of the recovery in 2014 was played out in the confidence levels of business leaders globally, which climbed to their highest level since 2007. At the start of 2014, net business optimism stood at just 27%, but averaged well over 40% from Q1 to Q3. However, with global uncertainties weighing on the economic outlook, optimism heading into 2015 stands at net 35%.

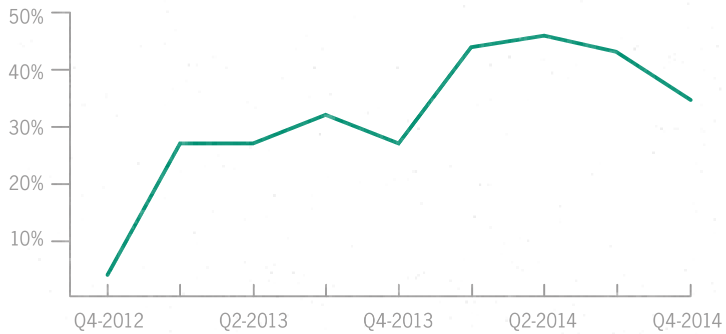
Just three of the top ten most optimistic business communities are found in emerging markets, highlighting the shift in global growth dynamics evident since the recovery found some traction. India (98%) is the most optimistic country globally - the business community clearly enthused by what they have seen from the new Nahendra Modi government - followed by Ireland and New Zealand (82%), two relatively small, advanced economies with strong agricultural sectors. Australia (70%) and the UK (68%) sit fourth and fifth while Canada (53%) and Mexico (58%) are benefitting from the renewed strength of the US economy (59%). Germany (51%) completes the top ten despite weakness in the eurozone.

At the other end of the scale, the bottom ten is dominated by Germany's neighbours, half of whom are in the single currency. Finland (-56%) sits last, ahead of France (-36%), Italy (-2%), Greece (4%) and Estonia (6%). Japan (-12%), which fell back into recession in late 2014, and Argentina (-28%), which defaulted on its sovereign debt and is suffering from rampant inflation, also rank low. Some other key emerging markets which have seen their growth rates plummet, such as Brazil (13%), Russia (11%), Turkey (8%) and South Africa (5%) also sit well in the bottom half.

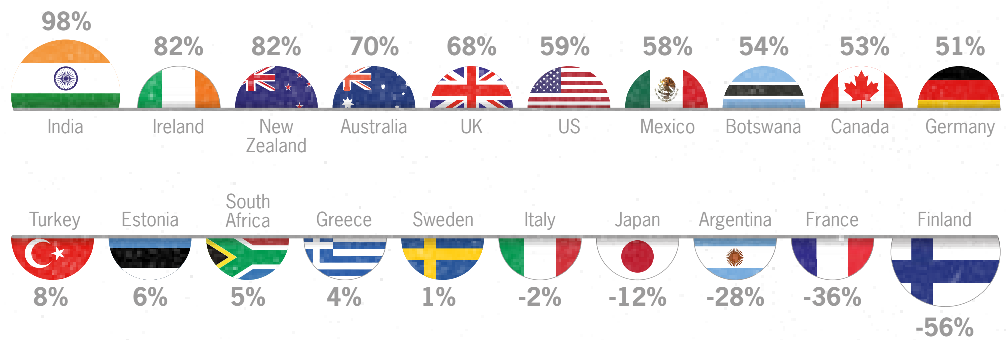
Net percentage of businesses optimistic for the economic outlook



Net percentage of businesses optimistic for the economic outlook (global)



Net percentage of businesses optimistic for the economic outlook (top and bottom ten)



Sales and profits

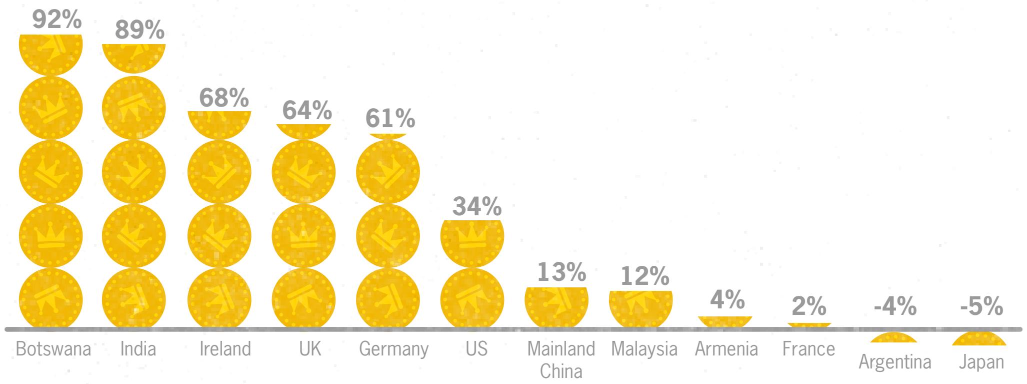
Business expectations for increased revenues remained fairly consistent throughout 2014, averaging net 51%, up marginally from net 50% in 2013.

However the global volatility of Q4 saw business leaders scale back their growth ambitions somewhat with net 43% expecting to increase revenues in 2015, the lowest since the second quarter of 2012.

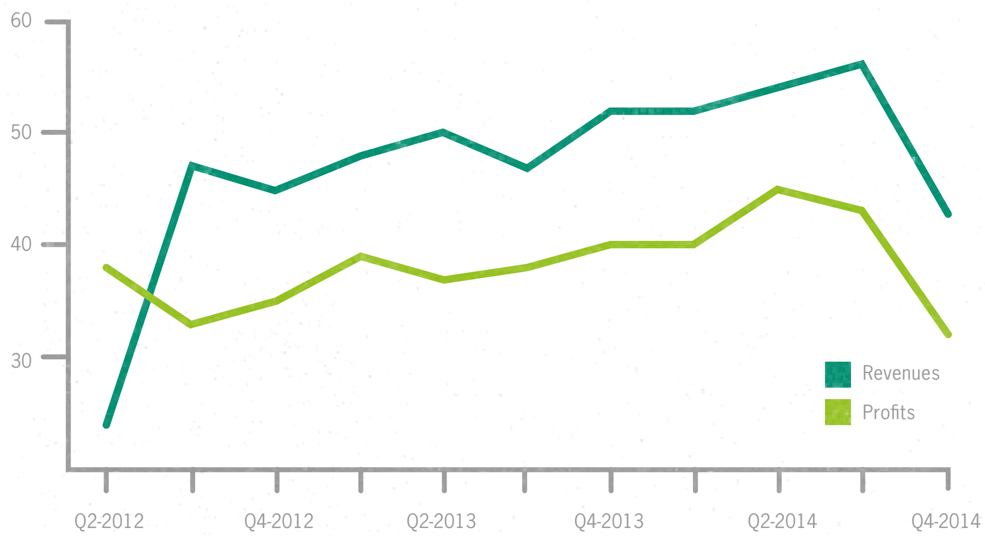
Business leaders in Botswana (96%), India (94%) and Turkey (84%) are most optimistic about increasing revenues in 2015. The most buoyant mature economies are Australia (72%), Ireland (70%) and the UK (67%). Brazil (65%) and Mexico (62%) are also in the top ten. The world's two largest economies both find themselves well in the bottom half with China (37%) slightly ahead of the US (35%). France (9%) sits bottom with Russia (29%) and Japan (30%) close by.

Profitability expectations for the next 12 months hit a three year low in the last quarter of 2014. Net 32% of business leaders expect to see their profits go up in 2015, down from 43% in the previous quarter. Both the US (down 23 percentage points to 34%) and China (down 33pp to 13%) saw big drops in the proportion of businesses expecting improved profits in 2015. Business leaders in Japan (-5%) and Argentina (-4%) actually expect profits to fall while those in Botswana (92%), India (89%), Ireland (68%), the UK (64%) and Germany (61%) are more hopeful.

Net percentage of businesses expecting to increase profits (selected economies)



Net percentage of businesses expecting to increase revenues/profits (global)



Exports

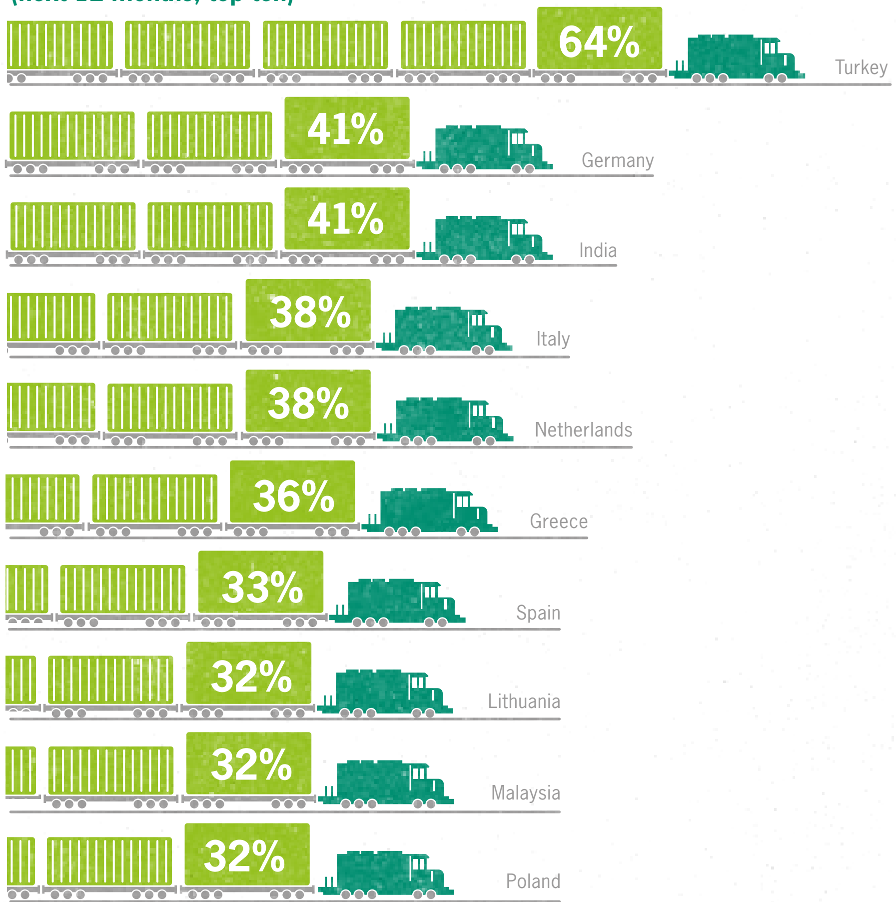
Exporting businesses benefitted from the mild recovery in global trade in 2014. It was the strongest year for export expectations since 2007 with 20% of businesses expecting to see their overseas sales increase. However the outlook has weakened somewhat over recent months.

Business leaders in Europe are increasingly hopeful about growing through exports, despite the problems in the eurozone, highlighting the underlying strength of the single market. Across the European Union, 29% of businesses expect to increase exports in 2015, led not just by traditional powerhouses such as Germany (41%) and the Netherlands (38%) but also by those economies which saw sharper (and more prolonged) downturns such as Italy (38%) Greece (36%) and Spain (33%). Turkey (64%) and India (41%) are also very optimistic as regards overseas sales over the next 12 months.

The contrast with Russia, suffering under EU and US-imposed sanctions following the annexation of Crimea and continuing unrest is clear: net 2% of businesses expect their exports to increase in 2015, down from an average of 14% in 2013. Botswana (4%) and Japan (6%) are similarly pessimistic.

The MINT (Mexico, Indonesia, Nigeria, Turkey) group of emerging economies look set to rely much more heavily on trade in 2015 (33%) compared with their BRIC (Brazil, Russia, India, China) counterparts (16%), perhaps suggesting that the latter are increasingly looking to domestic consumption to drive output.

Net percentage of businesses expecting to increase exports (next 12 months; top ten)



Innovation and investment

Investment plans have remained steady over the past four years as the global recovery has taken hold. However, they remain well below levels seen before the financial crisis, suggesting that business leaders are still waiting for greater certainty in the economic outlook before investing in the long-term growth prospects of their operations.

Just over a third (35%) of businesses plan to increase spending on plant and machinery in 2015, no change from 2014. Similarly, a fifth (20%) plan new investment in buildings, again level with the figure for the previous 12 months.

Businesses in southern Europe (54%) and Latin America (45%) are most likely to invest in new plant and machinery in 2015. In southern Europe, this is a marked increase from 2013 levels (25%), whereas in Latin America it represents a marginal decline (47%). Close to two in five businesses across Europe (40%), Africa (39%) and North America (37%) are also looking to boost spending in this area, dropping to just 27% in Asia-Pacific, with little difference between emerging (28%) and developed (27%) nations in the region.

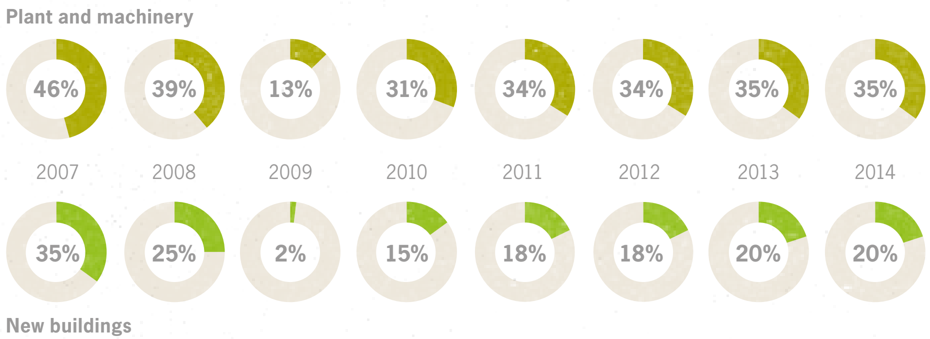
North America (37%) leads the way in terms of investing in new buildings in 2015, well above the 2013 (24%) and 2014 (28%) averages. Business in Africa (29%) are also planning additional office or factory space with Botswana (60%) and Nigeria (30%) both in the top five on this measure.

While investment levels have remained stable, there is some evidence of a growing focus on research and development (R&D) which bodes well for sustainable future growth. The proportion of businesses planning to increase R&D investment averaged net 26% in 2014, up from 21% in 2013 and climbed to 30% in Q4.

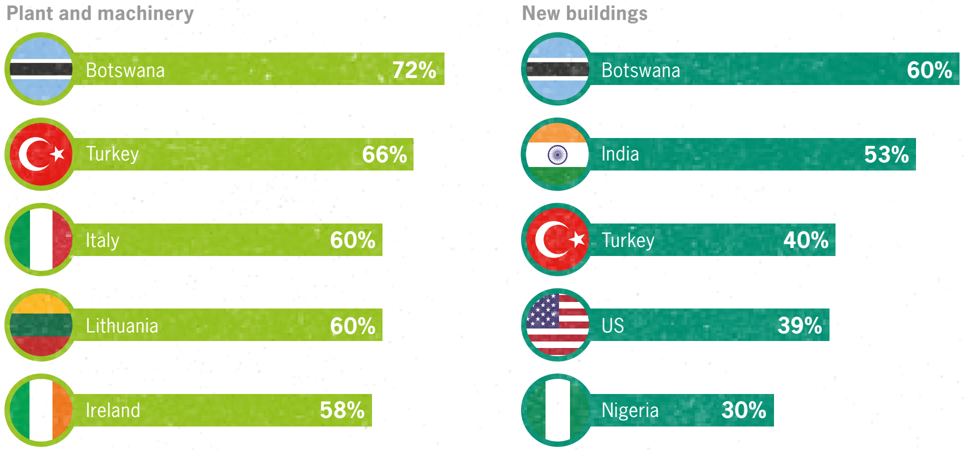
There is evidence of increased business investment in R&D

Businesses in the US in particular are looking more closely at R&D: net 37% are planning increased activity in 2015, up from just 14% this time last year. This brings the US figure into line with that of China (also 37%) which remained stable. Businesses in Germany (42%), Greece (40%) and Italy (38%) have all approximately doubled their R&D focus over the past 12 months, perhaps all the more surprising given prevailing uncertainty in Europe. Botswana and Turkey make the top five for each of the three measures of investment.

Net percentage of businesses planning to increase investment (next 12 months; global)



Net percentage of businesses planning to increase investment (next 12 months; top five)



Business growth constraints

Given the volatility of global markets, it is perhaps unsurprising that economic uncertainty remains the most pressing constraint on business expansion prospects.

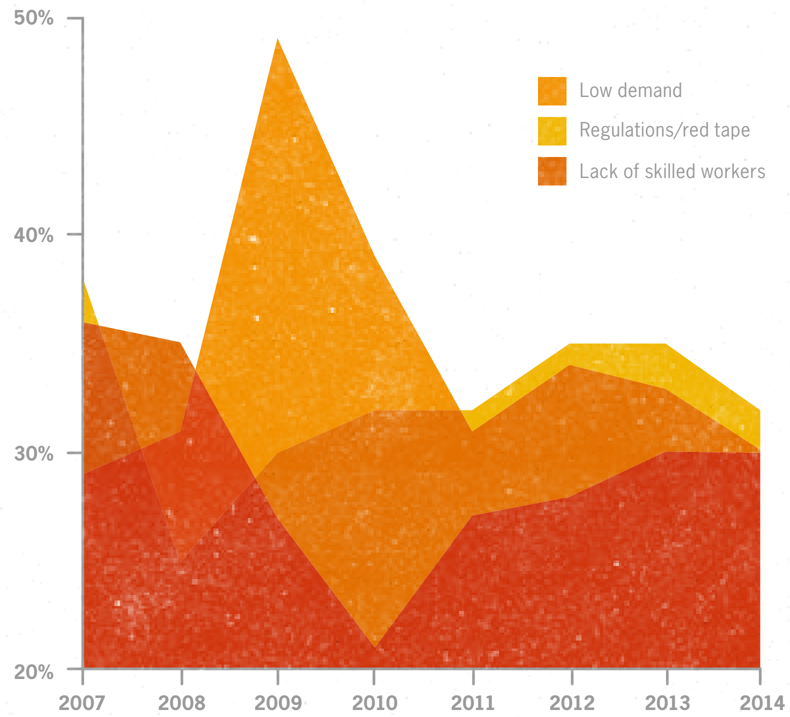
However, the proportion of businesses citing uncertainty actually fell from 42% in 2013 to 38% in 2014. Business leaders in southern Europe (56%) - led by Greece (72%) - and Latin America (51%) - led by Argentina (82%) - are most likely to cite uncertainty, although Armenia (84%), perhaps fearing further fallout from the conflict in Ukraine, is the most concerned heading into 2015. The contrast with North America (29%) and even the European Union (37%) is sharp.

Electricity transmission systems remain poor in many parts of the world

Rising energy costs are the second greatest concern for business leaders (34%). The falling oil price has seen this constraint fall back slightly over the past three months (30%) but electricity transmission systems remain poor in many parts of the world, hampering attempts to deliver products and services efficiently. This is most evident in Africa where 56% of businesses cite rising energy costs as constraint on growth, rising to rising to 59% in Nigeria. In post-Fukushima Japan, the grid is also struggling to meet business needs (71%). Expensive fuel subsidies in India (66%) and Indonesia (51%) may slowly be disappearing but energy remains a key concern.

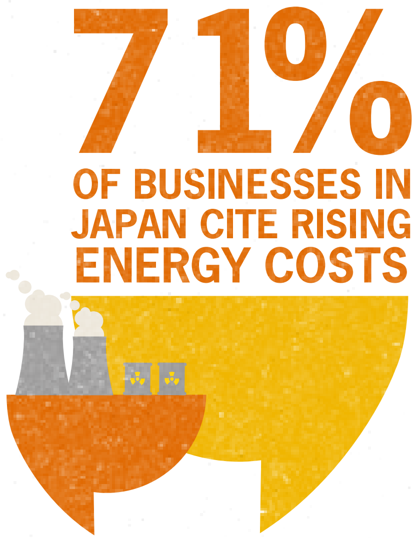
Bureaucracy tends to rise as a constraint on business growth at times of greater economic prosperity according to IBR historical data. The proportion of business leaders citing regulations and red tape dropped from 38% in 2007 to just 25% in 2008 as companies battled more pressing challenges such as low demand and a lack of access to credit. However, in the intervening years, it has stayed in the 32-35% range, averaging 32% over the past 12 months, reaffirming the idea that the global economy has been in something of a 'holding pattern' over recent years. The countries most concerned with bureaucracy are India (68%), Greece (64%) and Italy (52%), interestingly all economies with fairly low tax takes (as a percentage of GDP) but relatively high levels of corruption.

Proportion of businesses citing shortage of orders/reduced demand as a constraint on growth (global)

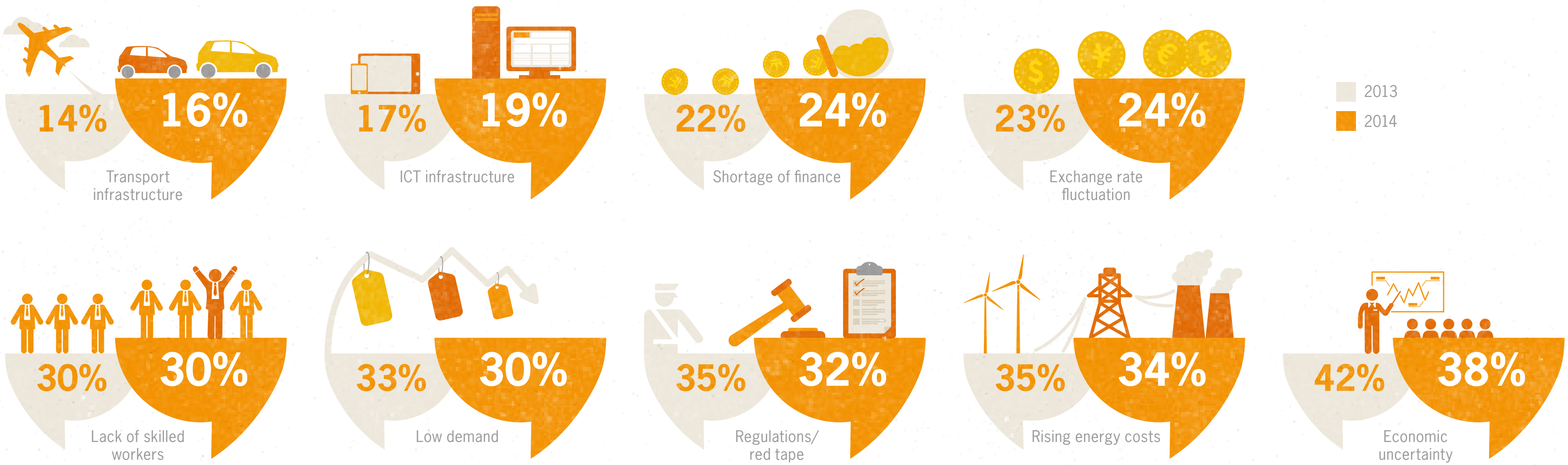


Despite unemployment running high in Europe and global fears that new technologies could squeeze workers out of full-time employment, almost a third of business leaders are struggling to find the talent to grow their operations (30%), unchanged from this time last year. This is a particular problem in many Asia-Pacific economies (40%), particularly Japan (54%), which has a rapidly ageing population and low female participation, Singapore (52%), where this constraint had doubled in importance over the past three years, and perhaps most strikingly in India (52%) which had a young, technologically-savvy population that could boost the economy's potential growth rate if properly utilised.

A lack of demand peaked at 49% during the financial crisis but has since fallen back, dropping to 30% in 2014, only marginally higher than the 29% recorded in 2007. However, this rises to 45% in Asia-Pacific, led by Japan (70%), India (53%) and Thailand (40%).



Proportion of businesses citing constraint on growth (global)



Employment

This is an important moment in time for job creation at the global level, with a recent study from the University of Oxford[1] suggesting jobs in 47% of employment categories, including economists and auditors, could be at risk from automisation over the next decade. On the flip side, new technologies can also provide opportunities for people to work flexibly, as evidenced by the rise of apps such as Uber, increasing the productivity of spare assets - in the case of Uber, drivers and cars.

The outlook for employment around the world is fairly nuanced. As shown in the previous section, almost a third of business around the world are struggling to their job vacancies with the right people. Incredibly this includes 24% of eurozone business leaders despite unemployment running at a record high at more than 10%.

Businesses globally are creating more jobs than this time last year.

With unemployment linked to social unrest and skills atrophy, a lack of job opportunities for young people is worrying for long-term growth prospects in the region.

However, businesses in Europe (and globally) are creating more jobs than this time last year, another sign of improved growth prospects (job creation tends to lag recoveries as businesses wait for signs of sustainable demand before taking on extra people as wages can be a difficult and expensive cost to shed in tougher times). Globally, the proportion of businesses planning to add workers rose from 27% in 2013 to 32% in 2014, although this remains well below 2007 levels (45%). In the eurozone, the increase was 6% to 16%, although the rise in Asia-Pacific was even more impressive (26% to 35%). Businesses in Latin America saw a sharp fall over the 12 months, from 42% to 30%. North America ticked upwards from 34% to 38% on this measure.

Over the next 12 months, businesses in India (73%), Botswana (68%), Ireland (54%), Turkey (46%) and the UK (44%) are most likely to increase their staff headcount; peers in Indonesia (0%), France (2%), Russia (11%), Argentina (12%) and Finland (13%) are the least likely.

[1] 'The future of employment' - Oxford Martin School; Carl Benedikt Frey and Michael Osborne

Net percentage of businesses planning to add jobs (global)

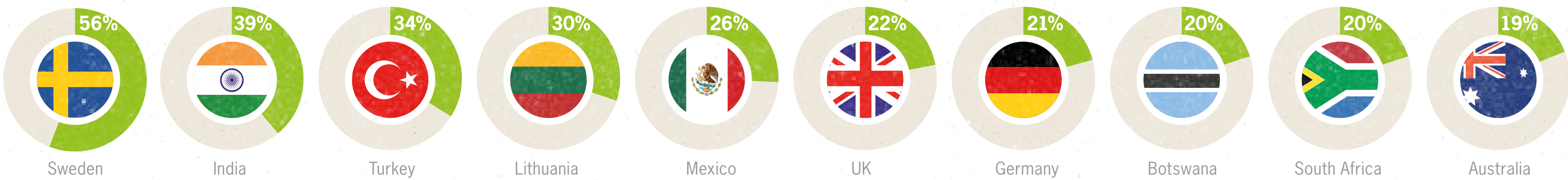
Falling inflation rates around the world (see next section) do provide some relief for workers who, especially in the West, have had to deal with declining real incomes over recent years.

Few businesses are planning major wage increases.

This is especially important as businesses do not seem to be planning any major wage increases over the next 12 months. People in 63% of businesses can expect a salary increase in 2015, down from 68% on average in 2013. The proportion who can expect an above inflation rise is just 13%. People in Sweden (56%), India (39%) and Turkey (34%) can expect the most generous increases.

Net percentage of businesses planning to add jobs (2014 average)

Net percentage of businesses planning to increase worker salaries above inflation (next 12 months; top ten)



Inflation

The dramatic fall in the oil price has spurred on an emerging and potentially damaging trend that many economists have been discussing of late: deflation. Falling prices may not appear to be a particular worry to cash-strapped consumers, but the dangers of deflation are highlighted by the travails of the Japanese economy over the past couple of decades.

Lower prices might be a boon to consumers in the short-term but in the long-term, they may delay purchases (as goods will be cheaper in future), constraining demand. Inflation also lowers the real (price-adjusted) cost of borrowing, so deflation actually increases the value of the money to be repaid in the long-term, raising the debt burden on businesses and consumers, strangling investment and consumption. Most central banks have a mandate to keep inflation at a certain level to prevent this happening.

News that the eurozone has slipped into deflation (-0.2%) was not a surprise and the European Central Bank (which aims to keep inflation across the eurozone 'close to 2%') has finally introduced quantitative easing. Stripping out energy, prices across the region actually climbed by 0.6%, but Japan was growing fairly quickly and had low unemployment when it slipped into deflation. The danger for the eurozone is that this will further exacerbate the economic downturn.

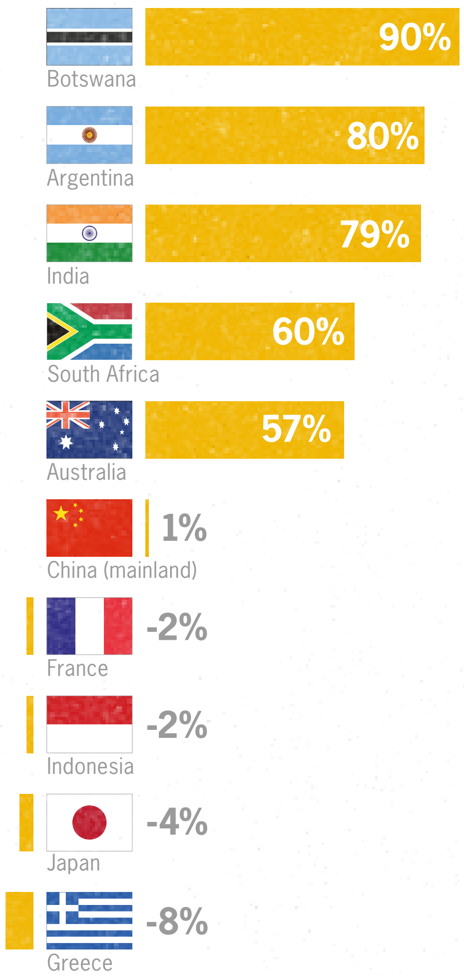
But the oil price drop and global uncertainty have had impacts well beyond the single currency. The US posted annual of inflation of 0.6% in January, the lowest since 2009 when the economy was struggling out of recession. China posted just inflation of just 1.5% in December. Prices in the UK rose only 0.5% over the past 12 months. Even India, which has been battling double-digit inflation over recent year, felt able to lower interest rates, with prices set to rise by less than the central bank 6% target over the next 12 months.

Most central banks have a mandate to keep inflation at a certain level.

That the Reserve Bank of India was able to boost the economy in this way suggests that not all the effects of falling inflation are negative. UK Chancellor George Osborne has likened the drop in inflation to a "giant tax cut for the economy." And economists have been quick to point out that when prices of staples (such as food and fuel) are falling, consumers are not able to delay purchases - moreover their spending power increases.

The key consideration for businesses is whether they can maintain their margins under falling inflation or even deflation. Consumer prices may fall, but so might the costs businesses pay for specific inputs. That said, the majority of businesses are still planning to increase prices over the next 12 months (23%) although at a slightly slower rate compared with three months ago (28%). In the eurozone, the majority of businesses in Greece (-8%) and France (-2%) are expecting to lower prices and they are expected to remain low or stable in some of east Asia's major economies such as Japan (-4%), Indonesia (-2%) and China (1%).

Net percentage of businesses expecting to increase selling prices (top and bottom five)



How Grant Thornton can help

Combined global revenues US$4.7bn

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Named global employer of the year 2014 by the International Accounting Bulletin

38 M&A deals in 2014 adding revenues of $86m

Ranked in the top 6 in major markets

40,000 people in over 130 countries

Around 725 offices worldwide

Best managed international firm in 2014

MPF Awards For Management Excellence 2014 Winner

IBR 2015 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in over 35 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from more than 10,000 interviews with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 35 economies conducted between February and November 2014. Data for 2015 is drawn from 2,500 interviews conducted in November 2014.

The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1000 employees; in the United States, those with US$20m to US2bn in annual revenues; in Europe, those with 50-499 employees.

More information:

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