

DM-led growth to continue

The developed market (DM) consumer will be the engine of 2016 growth with emerging markets continuing to face significant headwinds. Diverging monetary policies will pose little threat to this outlook as official interest rates will rise only very slowly due to limited inflationary pressures.

GLOBAL ECONOMIC GROWTH TO REMAIN SUBDUED

Global economic growth will likely be relatively subdued in 2016 but the risk of recession remains low in an environment where developed markets' growth holds up well. Even though the headwind from generally weak global demand is likely to weigh on trade and manufacturing in 2016, the developed markets' consumer is likely to continue driving growth as improving labour markets across the board and low inflation combine to boost spending power. The US and the UK look set to grow at similar rates as in 2015 – a little above their respective growth trends - while we may see some acceleration in growth in Europe and Japan.

DIVERGING MONETARY POLICIES

Continued monetary accommodation in Europe and Japan throughout 2016 will contrast with the onset of tightening cycles in the US and the UK, resulting in policy divergence. The markets' obsession with the timing of the first US rate hike in 2015 reflected concerns about the impact of such divergence, and the readiness of the global economy for tighter financial conditions. However, the most important point in the current policy cycle is that the pace of rate hikes will likely be slow and the trajectory very shallow throughout 2016. This should allow the economies to continue to grow for now while simultaneously containing inflation, which I expect to remain subdued throughout the year.

IN EMERGING MARKETS, IT'S ALL ABOUT DIFFERENTIATION

Conditions in emerging markets will remain challenging due to the same set of headwinds that weighed on growth in 2015. Slowing demand from China continues to weigh on EM exporters, especially those who provide goods or services for China's 'old economy' industries. Structurally lower commodity prices are the cause of deteriorating external and fiscal balances in commodity exporting countries, often aggravated by currency depreciations. Finally, deleveraging and generally tighter financial conditions globally are particularly detrimental for emerging markets whose access to international funding has become more expensive in 2015.

In this environment it is particularly important to differentiate between those countries most affected by these headwinds, and those with stronger economic and financial fundamentals.

GROWTH, INFLATION AND CHINA ARE THE KEY RISKS

There are a number of risks to watch in 2016. A sharp slowdown in US growth would bring down interest rate expectations and undermine market sentiment, while a hard landing in China would be difficult to digest not only for emerging markets, but the wider global economy. On the other hand, an faster-than-expected acceleration in inflation globally, but particularly in the US, would force a reassessment of current monetary policy leading to a more aggressive timeline for monetary tightening than is currently priced in. A crisis in emerging markets, whether or not as the result of any of these headwinds, would lead to a further reduction in global growth from the expected path.

On the upside, any pick-up in commodity prices or a longer-than-expected stabilisation (or even a rebound) in economic growth in China could finally result in improving fundamentals for emerging markets economies, ending a long period of disappointing growth in the emerging markets universe.



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