

The 2008-2015 outlook for the world economy

The Federal Planning Bureau presents its world macroeconomic projection for the 2008-2015 period in the August 2008 issue of "The NIME Outlook for the World Economy". This issue also contains a special focus analysing the evolution of the US housing market.

The scenario that is presented in this new world outlook was built on the basis of information available through mid-August 2008. The international economic environment underlying the Federal Planning Bureau's new economic forecasts for Belgium of 12 September 2008 is based on more recent international assumptions, of which those relative to euro area GDP growth in 2008.

The new world outlook sees world economic output growth reaching 3% in 2008, down from 3.8% in 2007. World output growth would thus fall below the yearly average growth rate of 3.2% that was achieved over the 1997-2007 period. World growth is projected to continue to weaken, falling to just 1.5% in 2009 as growth falls off in the euro area, Japan and the Rest of the World (area including, inter alia, China, Canada, Brazil, Russia and India). The relatively synchronised downturn in world growth should result mainly from normal movements in domestic business cycles, influenced by the negative terms-of-trade effects of the sharply rising prices of oil and other raw materials. World output is then slated to pick up in 2010, progressing at a yearly average rate of 3% over 2010-2015. World output growth is expected to be primarily underpinned by private consumption expenditure, coming on the back of employment and wage growth. Wages are expected to be bolstered by a continued rise in productivity. The projection also indicates that demographic developments will tend to crimp growth prospects in both the EU and Japan due to a trend decline in working-age populations.

The outlook for the euro area

Our baseline forecast is for real euro area GDP to grow by a low 1.5% in 2008, as private consumption moderates on the back of weak employment and income growth. In 2009, GDP growth is projected to fall between 0.1% and 1.8%, with a central forecast of just 1%. GDP growth should slow markedly in 2009 due to a significant negative contribution from net exports. The

euro area should see a temporary spurt in growth in 2010-2011, but GDP growth should thereafter be negatively affected by a declining working-age population and by private sector capacity constraints. The inflation resulting from the decline in potential output levels is projected to be contained only through increases in interest rates. The fiscal position of the euro area should show some slight improvement through 2011 but deteriorate slightly thereafter. The euro area's current account should swing back into deficit in 2008 and this shortfall should persist through 2015.

The outlook for the United States

Real GDP in the United States held up over the first half of 2008 but is expected to weaken significantly over the second half. We forecast that the US economy will skirt recession in 2008 but GDP should expand by no more than 1.8% on the year. We further expect the housing and financial crises to continue to unwind throughout 2009, limiting growth in 2009 to no more than 2.1%. US GDP growth is projected to rebound to 2.3% in 2010 and to average of 2% over the 2011-2015 period. Assuming that the tax cuts enacted by the current administration over the 2001-2005 period expire as currently scheduled, the US federal budget deficit should decline in 2011 and 2012 but rise again thereafter. The US current account position is projected to shrink only moderately from an expected shortfall of 4.9% of GDP in 2008 to a deficit of 4.1% of GDP by 2015.

The outlook for Japan

In 2008, Japan's economic growth is currently forecast to fall to just 1% due to a massive decline in residential investment and a slight fall in real export growth. GDP growth should fall to just 0.4% in 2009 as growth in exports declines and as business investment falls. Over the 2008-2015 period, falling business sector investment and waning export growth are projected to effectively limit the expansion of GDP to an annual

average rate of 0.9%. Working-age population is projected to decline at an annual average rate of 0.8% over the 2008-2015 period, dragging down employment by 1.4% per annum over the same period. Japan's current account surplus is expected to decline from 4.9% of GDP in 2008 to 3.2% of GDP by 2015. Finally, unless renewed efforts geared towards lasting fiscal consolidation are rapidly implemented, the government's fiscal deficit is projected to continue to deteriorate markedly over the projection period.

The outlook for the Rest of the World

Output in the Rest of the World (area including, inter alia, China, Canada, Brazil, Russia and India) is forecast to expand by 6.1% in 2008, but should plummet to just 1.9% in 2009. Growth is projected to rebound thereafter, averaging 5.1% over the 2010-2015 period. We project a trend decline in real import growth. Imports are expected to rise by a robust 8.5% in 2008, but should then decline in the wake of the moderation of real output growth over the 2008-2015 period. Exports are projected to expand at a modest pace of 2.5% in 2008. Exports should then expand slightly more vigorously, posting average increases of 3.2% per annum over the 2008-2015 period. In 2008, Rest of World inflation is forecast to edge up to a yearly average rate of 5.2%, up from 2007 on the back of strong increases in the prices of oil and other raw materials. Inflation should then stabilise at an annual rate of 5.2%.

Main uncertainties

A major short-term downside uncertainty lies in the ultimate unwinding of the current financial crisis. This crisis could prove to be more protracted, deeper and more widespread than currently assumed. This would lead to generally less resilient GDP growth than we currently forecast for 2008 and 2009. In the medium term, continued increases in the world price of energy would produce a significant supply-side shock, reducing world potential output growth below what is

indicated in our current projection. Finally, a possible underestimation of medium-term trend productivity growth, mainly for Europe and Japan, could lead us to have slightly conservative projections for medium-term growth in these two areas.

Focus on the evolution of the US housing market

Our new outlook contains an in-depth analysis of the evolution of and perspectives for the US housing market. We argue that the main factor behind the current US housing market downturn is the build-up of excess demand for residential assets over the 2001-2006 period, brought about by excessively loose monetary policy and accompanied by speculation on house prices. Our analysis expands on how we derive the housing market assumptions that underlie our projection results for the US, explaining why we see residential investment and house prices falling through 2009. Indeed, our current projection assumes that the price of residential buildings will fall by 15.8% in 2008 and by 12.4% in 2009. The price decline should be accompanied by a fall in residential investment, reaching 20.2% in 2008 and 3.8% in 2009. The US housing sector should only really rebound in 2010, with prices rising by 2.2% and investment increasing by 10.7%.

Inquiries and comments concerning the NIME Outlook for the World Economy

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