The Global Economy: What's Ahead for '08?

(As this article was being developed, economic news was volatile and conditions were changing rapidly all over the world. Information contained herein comes from many different and reliable sources, but the views and opinions expressed are those of the various sources, at the time they were published, and do not necessarily represent those of TAMM.)

We've all heard about the sub-prime financial mess, the slow down of the economy, the meltdown of the stock market at the beginning of the year…what does it all mean? With individual national economies so linked to each other in this new global marketplace, if one is down, can others be up? What will 2008 look like when it comes to business? We know everyone is predicting a slower economy for the US…maybe even a recession…but China and India are still skyrocketing.

As far back as last October, the International Monetary Fund (IMF) had already lowered its global projection for GDP (Gross Domestic Production) growth by a half of a percentage point to 4.8% for 2008, with a projection for the US of only 1.9% growth on the year. Those projections will probably come down even further. While the IMF was less worried about Asia (China's GDP growth in '07 was +11% and India's was +9%), it still said its growth might moderate somewhat. And while they were cautiously optimistic about Latin America, the IMF said even it could see a moderate decline. So what does each of these regions look like for the year?

China

China is hot, and shows no signs of significant cooling down. Its growth rate was 11.5% in '07. But that doesn't mean those lofty increases will continue at that high of a rate. Continue they will; just not at that rate. While China set another record trade surplus with the world last year, exports to the West were already slowing down at the end of the year. Most people think Chinese exports to the world will continue to grow; probably 10-15% this year, but not the 20+% rate we've seen in recent years. Even if the US economy slips, emerging market trade already accounts for half of China's trade growth. It has shaken off its dependence on growth in the US market. The fastest growth destinations are the Middle East, Africa, Vietnam and Indonesia, with South America just beginning to take off.

The Chinese economy will be the biggest factor influencing both financial markets and the world economy this year. China's huge demand for commodities has pushed their prices up all around the world. But Chinese officials are now taking unprecedented steps to slow their economy down a bit to control inflation. Some observers think this should stop the spike in commodity prices, but it will also likely contribute to a slowdown in growth rates worldwide in '08. As the old saying goes, *"If China sneezes, the rest of the world gets pneumonia."*

To stem inflation, Chinese officials have moved to tighten domestic credit. Also, in a move meant to deflate the Chinese stock-market bubble, regulators have told Chinese mutual fund companies to stop buying Chinese stocks. The government is also reportedly very likely to stop subsidizing domestic prices of gasoline and diesel fuel. If prices for these fuels rise across the country, demand will fall, helping to curtail the worldwide rise of oil prices. Some observers see a slowdown in global growth purely because of the tightening of economic and financial policies in China, something many of them have been calling for, for the last several years.

But will the growth in the value of the yuan have much of an effect? Most people say, “probably not.” Even though it did rise last year against the US dollar and probably will continue to do so on a small “managed” basis, there are other forces taking place in China that many feel will off set this loss of competitive advantage. As the yuan appreciates, low-margin, labor-intensive and relatively low-value-added industries will be forced out of China, and enterprises will start upgrading themselves into higher-value-added businesses to meet global standards, and a growing domestic demand for higher-end, quality products.

But this will take time, of course. The biggest risk for China right now is inflation, with the actual inflation rate probably far exceeding the official number of 6.7%. Again, this is directly related to the increase in the value of the yuan pushing up all basic-everyday prices in China.

South Korea

Like China, South Korea’s economy is considered a bright spot this year…and without most of the downside risks. Even though trade with the US and Japan may be down because of their economies, domestic consumption is still strong and unhindered by financial restraints or high inflation. Their other ace-in-the-hole is China. South Korea has been building strong trading relations with China in many sectors, and as long as China keeps spending, particularly on infrastructure-related purchases, South Korea should have another good year. GDP growth was 4.8% last year and should be about the same this year.

Japan

Japan, however, is another story. So closely tied economically with the United States, it can’t escape the consequences of a downturn in the US. Japan also suffers the full brunt of worldwide raw materials and commodity price increases, since it has virtually none of its own. The graying of its population is also running slightly ahead of the US and the number of people entering retirement is outstripping the influx of young people into the marketplace. This and stagnant wages, coupled with higher expenses, especially food, will make for a rough road for Japan, not just in ’08, but beyond. If US GDP growth is in the 1-2% range, Japan’s will be also, but probably on the lower end of the range.

Latin America

As noted above, most observers feel that Latin America’s overall growth rate in 2008 will most likely face only a moderate decline. On a country-by-country basis, economists are the most optimistic for the Southern Cone countries of Argentina, Uruguay and Chile, and the least optimistic for Mexico, Central America and the Caribbean. Prices for raw materials remain high worldwide and those countries that supply them (like Peru and Bolivia) will continue to have demand, stimulating economic activity. Columbia and Uruguay have fueled their growth mostly by internal demand, whereas Argentina and Paraguay have grown with agricultural exports.

Overall, Latin America depends less on demand for its products in the US than in the past, so a US slow-down won't hurt quite as bad as in years past. Latin America's exports to the US have declined from 57% of all Latin American exports in 2000, to 47% in 2006. However, to-the-US export sales still remain extremely high for Mexico (85%) and some other countries in Central America.

The region overall grew by an average of about 5.5% in 2007, and the expansion rate is predicted to drop to about 4.25% in '08. The growth rate was 5.8% in 2006, so this will be the third year in a row of growth rate decline. While that is a downward trend, if 2008 comes in at 4.25% as predicted, it would still be the fifth consecutive year in which growth exceeded 4%, hence the optimism for the region. The reason for the downward trend is the decline in external demand for many products, and increases in international interest rates over the last few years, which has slowed investment and production expansion in several countries in the region, but not all of them.

According to economists in each country, Argentina looks like it could grow 6% this year, well below the 7.5% recorded in 2007. Chile should grow about 5.5%, the same as Uruguay. Paraguay will probably be around 3.5%, 7.3% in Peru, 4% in Bolivia, 3% in Ecuador, 4.3% in Brazil and 5.8% in Columbia. Venezuela will grow about 7%, but largely for inflationary reasons based on huge salary increases and large government spending. Mexico and Central America will drop to around 4% annual growth, primarily because of their dependence on the US market.

Brazil, considered a South American economic juggernaut by many, will face some problems in '08, making a 4.3% growth rate in GDP challenging. Inflation is returning as a problem. The consumer price index (CPI) jumped 0.74% in December, reaching the highest rate for the year, and nearly doubling the November rate of 0.38%. That put the CPI for the year at 4.46%, more than a full point (1.32%) above 2006. Food (+10.8%), personal expenses (+6.5%) and health care (+4.5%) shot up the most. This is a sharp up-tick in what had been a five-year downward trend. The CPI in 2002 was 12.5%; 9.3% in 2003; 7.6% in 2004; 5.7% in 2005 and 3.1% in 2006. Unemployment for the year stood at 8%.

Overall, despite such mixed forecasts, confidence in the long-term economic progress of the region still exists. The competitiveness of the region has been permanently increased, through such measures as tariff reductions and trade agreements, as well as the influx of international investors in recent years.

Spain

Spain is in a unique position and deserves a special look (see separate article on Spain under "Research Reports" on the TAMM website). Spain is a country with a growing economy (+3.8% in '07), major global companies and an outward looking investment mentality. While it is in close proximity to Europe and has strong economic ties there, it shares a culture and language with Latin America. It maintains close economic relationships with the region, so Latin American markets are as important to Spain as European ones.

2008 will probably see GDP growth slow to 2.8-3.0%. December data showed an inflation rate of 4.3%, the highest in a decade. Unemployment increased to 5.3% and consumer confidence fell to historic lows.

India

Whether India can maintain last year's 9% increase in GDP is questionable, probably dependant upon internal domestic decisions as much as anything, taxes being one of them. Direct tax collections have been soaring in recent years to due to the phenomenal growth of the economy. They jumped 40% in 2006 and close to 42% last year. The next annual budget may very well contain income tax cuts, which should help fuel internal domestic spending, at a time when global markets are cooling.

However, inflation triggered by higher food prices could put a damper on that scenario. Inflation is triggering continuous signals from the national Reserve bank that it will be adopting a tighter interest rate policy. The increasing cost of capital is already beginning to sap retailer and corporate borrowing.

All of this is not to say that the Indian economy and its impressive growth rate won't also feel some of the pain from a global slow down, particularly in the US. India's fortunes are certainly getting increasingly "decoupled" from the US economy, led by rapid growth in Asia and increasing business relations in that area. Observers feel that India is clearly on the path to a market-based and geographically diversified economy long-term. Even the union-dominated left is on-board with long-range policies in that direction.

United States

The bottom-line is, the US economy will slow significantly this year. Whether it hits the technical definition of a recession or not is irrelevant, as is the economic impact of whoever becomes President…at least in the short-term.

Even though the IMF cut its forecast for US growth to 1.9%, others say it could be anywhere between 1 and 2%. The reason is there is no quick fix for the problems the economy faces. A stimulus package will provide a boost in morale, but tax rebates won't hit the streets until spring. Lower interest rates (a prime rate of 6% by mid-year is predicted) won't have an impact until fall, since business will only expand based on projected sales, plus big investments take time to plan. The overhang of unsold new houses will take well into 2009 to clean out. Housing sales are predicted to be down another 10% this year. And while credit problems in the sub-prime market are actually approaching some semblance of resolution, defaults are spreading to other sectors like credit cards and automobile payments.

All of this means lower retail sales (about 2.5%, though the National Retail Federation is predicting 3.5%), with the first half of the year being very slow, and only gaining some momentum in the second half. While the trade deficit will continue to fall, so will the rate of job growth.

So, there you have it. Most prognosticators say it will be a tepid year at best. None of them predict any magically scenarios that might suddenly appear, creating an exhilarating upward surprise. In fact, the only alternative scenarios are in the other direction. Manage closely this year and pay diligent attention to what's going on; watch inventories, and watch accounts receivables, very closely.