

World Economic Outlook for 2007-2009

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Summary

The serious correction in the U.S. housing market decelerated the global economic growth, particularly in the advanced economies. Rising delinquencies on the U.S. subprime housing loans has led to difficulties of mortgage financing institutions and extend worldwide adverse effects. Since August, market concerns on the value of securitized financial instruments has been spread and followed by turbulence in the U.S. and European financial markets.

While corporate investment and exports have remained strong in the United States, downside risks on private consumption have clearly increased. The recent turmoil in financial markets will trigger slowdown in real activities through 2008. The Federal Reserve reacted to such risk by lowering the federal funds rate.

In the advanced economies of the EU, personal consumption growth slightly slowed in the first half of 2007, while corporate activities sustained strongly. Business investment and exports maintained steady growth. Japan's economy has gained healthy corporate profit and labor condition in spite of somehow weak growth. However, faced by global financial turbulence, the ECB and BoJ also provided additional liquidity. Turbulent financial markets remain a major source of downward risks particularly on European growth.

Meanwhile, emerging economies show no significant changes in real activities. China maintains a strong momentum mainly led by fixed investment and exports. In Russia and the Middle East, strong growth also continues supported by high energy prices. In many emerging Asia and other regions, their current account surplus rises due to strong exports as well as remittances from overseas workers.

As a result, the global imbalance has widened further and generated excess liquidity in financial markets through increase in foreign currency reserves of those emerging countries. Loose discipline in managing foreign exchange risks and credit risks has encouraged preference in high return investment. The momentum of yen-carry trades, sovereign wealth funds and subprime mortgages appear to be derived from such proactive investment attitude. However, the recent turmoil origin to subprime difficulties has changed investors to look for safe havens. Such a backlash from excessive investment behaviors could be assessed favorably, unless the changing investment tide brings any further market disruptions.

Price hike in crude oil and agriculture crops such as wheat raises another concern in inflation. More-than-four-years boom has generated excess demand in emerging economies including China, India, and Eastern Europe. Monetary tightening is likely in these countries.

It should be noted that geopolitical risks around Iran, Iraq, Palestine, and North Korea are not negligible.

1. Economic Outlooks for Major Industrial Countries:

	Real GDP Growth (Annual change, %)			GDP Deflator (Annual change, %)			Current Account (US\$ Bil.)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Japan	2.1	2.0	2.0	-0.3	0.5	0.7	195.0	205.0	210.0
USA	2.0	2.0	2.5	2.5	2.0	2.0	-780.0	-825.0	-840.0
Euro Area	2.5	2.3	2.2	2.0	2.0	2.0		5.0	10.0
UK	2.8	2.8	2.5	2.5	2.2	2.1	-95.0	-85.0	-80.0

(1) Overview

Growth in the advanced economies slowed in the first half of 2007, suffering from the protracted problems in the U.S. housing market. JCIF forecasts that economic slowdown will continue for some time in the major advanced countries besides Japan and the U.K. The drag of the U.S. housing sector together with turmoil of subprime mortgage market has raised concern on deterioration of global credit market. Recent turbulence in financial markets seems to last and extend worldwide.

Since last year the U.S. and advanced European central banks have maintained vigilant monetary policy toward underlying inflation risk. Their policy stance would continue in principle under medium-term trend of rising prices of oil and commodities as well as high utilization of resources. At present, however, these central banks adopt monetary easing in order to avoid a further pullback in lending and protracted turmoil in financial markets. In addition, downside risk will support their policy change.

(2) The United States

In the United States, increase in private consumption, corporate investments, and exports counterbalanced drop in residential investment during 2006. The nationwide growth decelerated moderately and maintained over 2% at annualized rate in the first half of 2007, although housing investments continued to be the origin of the economic slump.

The direct shocks of the housing sector have already been reflected throughout the U.S. economy during the past five quarters. In addition, concerns of further negative effects on private consumption are raised, which may lead the U.S. economy to recession. The U.S. monetary authorities adopted rescue measures for financial markets, including lowering the federal funds rate by the FRB as well as protection package for the borrowers of subprime mortgage. Real GDP growth is now forecast to slow down to around 2% in both 2007 and 2008, mainly due to prolonged drag of housing sector.

(3) European Countries

The euro area economy maintained high growth in 2006, owing to robust capital investments, exports mainly shipped to intra-EU countries, and private consumption. In the first half of 2007, corporate investment and exports supported to steady growth, while private consumption showed slight decline.

The German economy has contracted slightly since the beginning of 2007. While corporate investment and exports continue to underpin the growth, private consumption has hardly recovered because of the value-added tax hike. Real GDP growth will ease in 2007 and 2008.

In France, signals of a moderate decline have observed since the beginning of 2007. Short-term outlook foresees marked slowdown due to weak business investment and increase in import under steady growth of private consumption.

The United Kingdom is enjoying its good economic performance. Service sectors, including financial industry, transportation, warehousing, telecommunications, have continued to provide a significant boost to growth. Private consumption grows at steady pace and is expected to achieve stable growth.

The adverse effects of the U.S. subprime loans would probably worsen European business and consumer sentiment, in route of turbulence of global financial markets and difficulties of some financial institutions in the region.

(4) Japan

Japan's economy is expanding moderately, although some weakness has been observed since the beginning of 2007. GDP statistics of the second quarter recorded negative growth. It implies that the economy is temporarily stall. However, strong corporate profitability and improvements in the labor market will underpin the momentum of sustainable growth.

It is expected that turbulence of the U.S. subprime mortgage has limited effects on Japan's economy. Alternative scenario will be such a case that turbulence of the U.S. housing sector will extend to drag of private consumption, and exports of automobiles and other durable consumer goods from Japan to the United States will be inevitably reduced.

2. Economic Outlooks for Emerging and Developing Countries:

(1) Asia

Most Asian countries have been enjoying their favorable economic performance. Besides in China, inflation rate has moderated. Many Asian countries have reduced their policy rate. Exports are main driver of the Asian economy. In addition, domestic demand is continuing solid expansion. Against the background of these factors, it is expected that the Asian economy will maintain strong growth for the near term.

Asian currency and stock markets cooled in July and August, explicitly affected by the turbulence in the U.S. subprime loan market. However, most of those markets have turned upward since the latter half of August and recently retained stable.

In China, the Hu Jintao government has pushed to strengthen its political foundation and intensified its originality in terms of both personnel and economic policies. Among others, the Hu Jintao administration is highlighting its policy for shifting from the growth-oriented agenda of the past to the constructing a harmonized society. Since 2003, China's economy has continued to achieve double-digit growth for the fourth consecutive year. Since the beginning of 2007, economic growth has likely shown further acceleration. Real GDP of the first half of 2007 grew at annualized rate of 11.5%. Fixed investments provided a boost to growth particularly in local regions. Strong external demand also contributed favorably to Chinese growth and led to large trade surplus. Consumer spending increased as long as income growth. In view of these factors, short-term outlook prospects that China will unlikely face a large downturn in its economic growth.

However, environmental pollution as well as energy problems is gradually imposing serious constraints on its supply side. Price fluctuations beginning with sharply rising food price warrant no optimism. The problem of excess liquidity stems from the foreign exchange intervention, with tremendous funds poured into markets to reduce appreciation pressure on the Renmi-bi. It is clear that a series of gradual measures of monetary policy will only have marginal effects. Although it will be vital for China to make its foreign exchange system more flexible, the Chinese government has unlikely intent to implement any bold institutional reforms in near future.

In South Korea, private consumption is losing its momentum toward recovery, so we expect that the growth rate for 2007 will remain at a level of about 4.5%. In Taiwan, external demand continues to serve as the driving force for economic growth. However, Taiwan's economy will come under the influence of the modest economic slowdown in advanced countries. We expect that the growth rate for 2007 will be about 4.5 percent, down from a year ago.

In ASEAN countries, Indonesia has been maintaining steady business expansion partly due to recovery in private consumption since the latter half of 2006. The Philippines has been accelerating economic growth supported by increasing remittances from Overseas Filipino Workers since the beginning of 2007. Malaysia has sustained favorable growth mainly driven by external demand. In January 2007 Vietnam successfully acceded to the WTO, so expectations for its industrialization are growing. In Thailand, however, since the latter half of 2006, domestic demand has been sluggish due to drops in consumer sentiment and investor confidence following the coup d'etat. Looking ahead, we project that the overall economic growth rate in ASEAN will remain steadily both in 2007 and 2008.

In South Asia, India maintained its high economic growth. Owing to rapid growth of information and communication technology industry and favorable expansion of manufacturing sectors, India's economic growth will be forecasted as high as eight percentage both in 2007 and 2008, after 9.4% record in 2006. Pakistan also enjoys favorable economic growth, but political conflicts over the reelection of President Musharraf have grown into a serious problem, leading unavoidably to the deterioration of public security.

	Real GDP Growth (Ann. Change:%)			GDP Deflator (Ann. Change:%)			Current Account (US\$ Bil.)			External Debt (US\$ Bil.)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
ASIA												
China	11.4	10.5	10.0	3.5	3.5	3.0	349.1	392.7	398.9	339.5	350.4	359.8
South Korea	4.6	4.9	4.5	1.5	1.5	1.7	3.2	3.5	1.7	309.9	341.5	363.0
Taiwan	4.5	4.3	4.0	-1.0	-1.1	-1.2	25.3	26.4	25.9	69.6	67.1	65.1
Indonesia	6.2	6.2	6.3	9.0	6.0	5.5	10.5	10.9	10.6	120.8	109.1	98.1
Thailand	4.1	5.0	4.9	3.3	3.5	3.6	9.1	8.1	7.1	55.4	50.3	43.7
Philippines	6.7	6.2	6.0	4.4	4.1	4.1	5.3	5.9	6.6	51.3	48.9	46.1
Malaysia	5.7	5.8	5.5	4.0	3.9	3.8	20.8	16.1	12.3	51.3	53.0	55.1
Vietnam	8.3	8.1	7.7	8.0	7.0	6.0	-0.9	-1.8	-2.5	22.8	24.9	27.6
India	8.5	7.9	7.7	5.2	5.2	5.1	-18.1	-19.1	-21.6	176.8	198.7	221.9
Pakistan	6.8	6.5	6.3	7.0	6.8	6.6	-5.9	-5.1	-5.4	36.0	36.0	36.1
LATIN AMERICA												
Argentina	8.0	6.0	4.0	12.0	11.0	8.0	5.3	1.9	1.0	135.1	135.7	137.5
Brazil	4.2	4.1	4.0	5.0	5.0	4.9	10.7	8.5	7.3	195.6	195.4	191.0
Chile	6.0	5.0	4.5	6.0	5.0	4.5	8.6	9.2	5.7	47.7	48.5	50.0
Colombia	6.4	5.5	4.0	6.0	5.5	4.5	-3.5	-5.1	-5.7	41.2	41.8	42.0
Peru	7.2	5.7	5.0	3.0	3.0	3.0	1.9	1.1	0.5	26.9	26.6	26.2
Mexico	3.0	3.5	3.5	3.8	3.5	3.0	-10.7	-15.4	-18.9	119.4	121.5	124.8
Venezuela	8.0	5.0	3.0	18.0	20.0	18.0	16.9	8.2	6.0	43.4	42.7	43.4
MIDDLE EAST												
Iran	4.5	4.3	4.3	16.0	15.0	14.5	13.6	7.8	6.7	22.8	21.9	21.4
Saudi Arabia	3.3	5.9	6.0	-1.7	-5.4	0.1	74.4	72.5	67.3	NA	NA	NA
Turkey	5.5	6.0	5.3	8.0	6.8	4.7	-31.2	-31.9	-31.0	222.7	235.7	255.2
EASTERN&CENTRAL EUROPE												
Poland	6.5	5.5	5.4	2.2	2.5	2.4	-9.2	-8.8	-8.8	170.2	171.6	174.1
Hungary	2.2	2.6	3.0	6.4	3.4	3.2	-5.9	-6.0	-6.1	109.8	113.8	118.2
Czech Republic	5.5	5.0	4.5	2.5	3.0	2.5	-3.3	-2.5	-3.9	59.1	60.3	62.8
Romania	6.0	5.5	5.2	7.0	6.0	5.2	-15.7	-17.0	-18.1	54.1	64.3	75.3
Russia	7.0	6.0	5.5	12.0	10.0	9.0	84.8	61.7	48.8	382.2	412.1	445.4
South Africa	4.8	4.5	4.7	8.0	6.5	5.9	-20.0	-20.2	-22.1	70.4	83.7	97.9

Note: GDP rates of respective regions are weighted averages of GDP rates of individual countries within the respective regions described in the table, above.

(2) Middle East

Political and diplomatic issues have developed a stream of risks in the Middle East. First, with regard to Iran's nuclear development, the United Nations Security Council adopted resolutions of imposing sanctions on Iran in December 2006 and in March 2007. However, Iran has been continuing its uranium enrichment activities. Future development of this issue is uncertain. In Iraq, terrorist bombings and incidents by armed groups have been further intensifying. There is no sign of an improvement in public safety as yet. Meanwhile, the Israeli-Palestinian peace process has been put under complex conditions, mainly because Hamas occupied the Gaza Strip in June, and the Palestinian side has undergone internal divisions. The international community is generally ready to support the new government under the initiative of Fatah. However, it is highly likely that future peace talks between Palestine and Israel will require a considerable time. In Turkey, President Gul of the ruling AKP, Islamic party, was elected in August. This country's secularism, that is separation between political and religious interests, cited as the national policy will not be shaken. In this context, however, many sources tend to keep a close watch on the Gul administration.

At economic scenes, despite favorable progress in non-petroleum sectors, the real growth in Saudi Arabia and Iran for 2006 slowed, a year-on-year decrease, due to reduction of oil production. It is expected that both countries will also see some sluggishness in their economic growth for 2007. Nevertheless, oil-producing Gulf countries have improved

their international balance of payments and fiscal balance favored by higher oil prices, leading to further expansion of the presence of oil money in the global economy. Based on the premise that political stability will be ensured in this region owing to the efforts made by individual countries for economic development by nurturing non-petroleum industries, by promoting construction projects and by other means, it is possible that their business will expand strongly for the time being. It would be important to pay attention to inflation and aggravation of fiscal conditions in Iran.

(3) Latin America

The Latin American economy has entered the fifth consecutive year of business expansion. The driving force for the growth has shifted from exports to equipment and construction investments as well as private consumption. We expect that the average growth pace in the region will decelerate because the U.S. economic growth will decelerate in 2007 and 2008. A slowdown in Mexico's growth is expected due to the slowing of the U.S. demand. Peru and Colombia will maintain growth at a rate above the trend line owing to strong domestic demand. We project that Brazil will accelerate its economic growth against the background of a continued reduction of interest rates and increases in real wages. In 2007, Chile has made a recovery in private consumption due to the favorable effects of the interest rate cut in the previous year. We forecast that Chile will maintain stable economic growth in 2008 and subsequent years. Meanwhile, we project that Venezuela and Argentina, both of which have continued their economic growth at high rates, will slow by a large margin due to decreases in net exports and to the limited domestic supply capacity in 2008 and subsequent years.

Regarding external aspects, trade surpluses of most countries in the region have shrunk in the first half of 2007, since the growth of exports slowed to a great extent compared with the previous year, and, incidentally, imports centering on those of capital goods increased in reflection of strong domestic demand. We expect that both the trade and current account surpluses will be narrow by the end this year.

In August, concerns related to the deterioration of global credit market origin to the U.S. subprime loans triggered a tentative but spontaneous decline in stock prices of emerging economies, with foreign exchange rates fluctuating wildly. Although the markets have later regained stability to some extent, the problem of credit risks still remains unsettled. It appears that the markets need time to stabilize. Any tightening of international capital flows may also affect Latin American countries adversely at some extent, but Latin American countries are said prepared for external shocks more than ever before. The reason is that they have reduced the vulnerability of their macroeconomy over the last three years through the following means; expansion of current account surpluses and fiscal surpluses, accumulation of foreign reserves, reduction in external debts, implementation of flexible foreign exchange policies, and achievement of the controllability against inflation.

(4) Central and Eastern Europe

While the major countries of Central and Eastern Europe have some political instability due to their coalition administration, their economies are generally following a favorable path in the course of deepening their relationship with the European Union. The turbulence in financial terms emerging in the United States and advanced European countries since August have had no remarkable negative effects on the economies of Central and Eastern Europe until the middle of September. Rumania, which has a high share of borrowings from German and French banks, likely draw any attentions whether the recent financial turmoil will have adverse effects on the capital inflow.

It is expected that Poland and the Czech Republic will continue their high growth in 2007 and subsequent years, mainly helped by favorable production in their manufacturing sectors. While the unemployment rate is declining in both countries, the inflation rate is increasing to some extent, which is recognized as a risk factor for their economies. At any rate, in pursuit of the introduction of the euro scheduled for as early as 2012, both countries are managing to maintain fiscal discipline and are continuing prudent management of monetary measures.

Meanwhile, in Hungary, foreign business entry of European manufacturing sectors has peaked. In addition, Hungary

has implemented fiscal austerity measures to reduce its fiscal deficits, which is the worst among the EU member countries at present. Due to these factors, Hungary's economy is apparently shifting to a stable growth path at a somewhat low level.

Since the beginning of 2007, at time of which Rumania joined the European Union together with Bulgaria, receipt of foreign direct investments has increased, and intra-EU trades have expanded in Rumania. As a result, Rumania has enjoyed a boost in economic growth. However, concerns on an overheated economy are emerging with Rumania. Major tasks for the future will be the policy responses to the deterioration of the current account and to the acceleration of inflation. Both problems have prolonged because of increases in imports particularly of capital goods.

(5) Russia

Russia's economy has been maintaining high economic growth since exports of natural resources have played the key role. The ruble follows a tendency toward gradual appreciation supported by accumulated current account surpluses. Due to the foreign exchange intervention as part of efforts to reduce appreciation pressures on the ruble, the total money supply continues to increase at a high rate. Additionally, the central bank of Russia is taking proactive actions to further increase the monetary aggregates. The bank has been required to block adverse effects imported through the turbulent capital markets in the United States and European since August, because those foreign markets are the Russia's major investing vehicles. Pressures of inflation are also growing partly because Russia refrains from raising interest rates. Thus, Russia is carrying out difficult monetary and foreign exchange policy management.

In the medium-and-long term prospects, several issues of Russian economy are controversial. One of the major questions is the future scenario of technical and capital alliances with foreign countries, which seem to be prerequisite for the prevention of cutbacks in oil and natural gas production and have been invited intervention of Russia's government. The promotion of new oil and natural gas development projects will be focal points. Russia will also draw our attention to its political and economic management after the presidential election scheduled for March 2008.

(6) South Africa

South Africa maintains high economic growth led by construction investments including those in preparation for hosting the World Cup soccer in 2010. Domestic demand is rather overheated and the inflation rate is gradually rising. A key question in the future is whether South Africa can maintain stable economic growth under the policy mix of tight monetary measures and fiscal expansionism as required for infrastructure development.

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