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PwC economists reveal predictions for 2017, as globalisation takes a back seat

- *US will drive growth in the G7*
- *Core Eurozone employment to hit all-time high, but periphery will create more jobs*
- *Indonesia set to become world's 16th trillion dollar economy*
- *Population growth to put pressure on Gulf countries to reform public finances*

As we enter the New Year, PwC's economists have once again peered into their crystal ball to make their predictions for 2017. First, to set the scene, a look at the global economic themes that could prevail in 2017.

Globalisation takes a back seat: We expect world trade to grow more slowly than global output for the third consecutive year. The resurgence of economic nationalism in some parts of the world means World Trade Organisation rules will be put to the test. The world's biggest bilateral trade route (US-China) is likely to come under pressure. In the absence of the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership being agreed upon, this trend could continue into the longer-run.

US monetary policy moves back towards normality: The Federal Reserve will continue to tighten monetary policy. Indeed, it is possible that the Fed could tighten faster than currently suggested depending on the pace, size and implementation of the new administration's fiscal plans. On the flipside, economies which rely on the dollar for financing will come under pressure.

Politics drives uncertainty and economics: The Eurozone may hold half a dozen elections. Germany, France, the Netherlands and potentially Italy and Greece (equivalent to more than 70% of Eurozone GDP) are expected to run general elections and could experience disruption to their normal political cycle. Spain is likely to hold a referendum on the future of Catalonia.

Says Barret Kupelian, senior economist, PwC: "On the international stage, we will be monitoring US-Russian relations closely, which could have spillover effects in Eastern Europe, the Middle East and potentially East Asia, as well as on the Iran nuclear agreement."

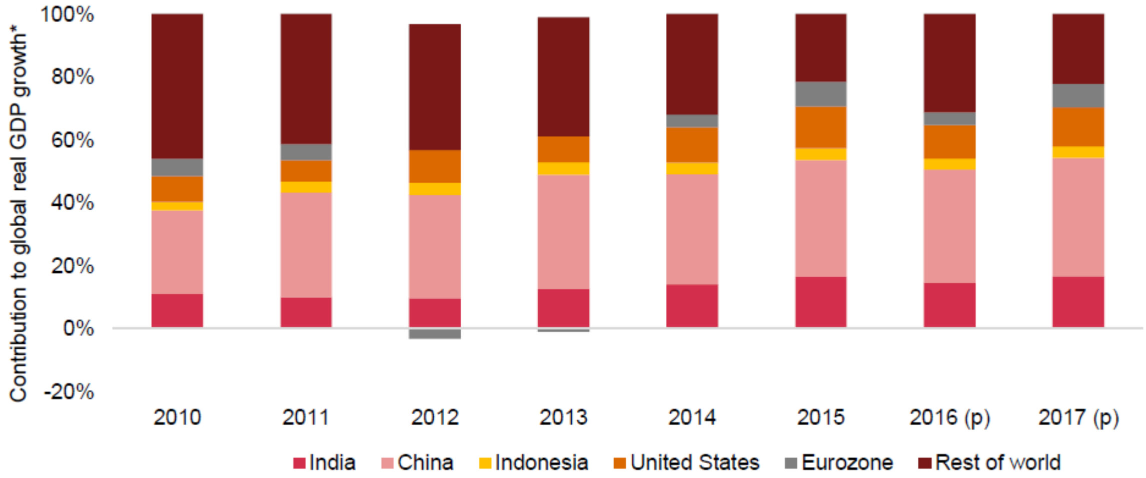
So here are four detailed predictions from PwC's global team of economists.

1. **The US will drive growth in the G7**
   In our main scenario, we expect the US to grow by around 2% - the fastest in the G7 - on the back of strong job creation and household consumption. It could surprise on the upside if the new administration lowers taxes and pursues plans to boost spending on infrastructure. Our analysis suggests the US will contribute around 70% to G7 growth in our main scenario, despite making up half of G7 GDP in absolute terms.

2. **Core Eurozone employment will hit an all-time high but periphery will create more jobs**
   We expect the 'peripheral' economies to grow faster than the 'core' for the fourth consecutive year. Irish GDP growth is expected to be the leader of the peripheral pack, expanding by more than 3% per annum, while France and the Netherlands will lead the core, growing at a rate of 1.5%. On the jobs front, employment in the core is expected to hit an all-time high of around 97 million. But this will be outperformed by the periphery, which will create around 100,000 more jobs than the core.

3. **Indonesia is set to become the world's 16th trillion dollar economy**
   Asia will remain the fastest growing region of the world, but the spotlight will shift away from China to India and Indonesia. We think Indonesia is on course to join the elite 'trillion dollar' economy club this year. In comparison, we project Chinese growth to remain at around the 6% mark. India's contribution to world GDP growth could reach almost 17% this year (see Figure 1). China's growth may be slowing, but if it manages to grow at 6.5% per year, it will add an economy the size of 'Turkey' to global output. We think Brazil and Russia will start growing again on an annual basis by 0.5% and 1% respectively, aided by a rise—albeit small—in commodity prices.

Fig 1: China and India will continue to drive global economic growth in 2017, while the Eurozone will see its contribution to global growth to grow relative to last year



Sources: PwC analysis, IMF
* measured in constant 2015 US$ based on purchasing power parity (PPP). Global refers to the sum of 186 economies

4. **Population growth will put pressure on the Gulf (GCC) countries to reform public finances**
   In 2017, Saudi Arabia is projected to add two 'Icelands' to its working age population. The other GCC countries are also expected to see strong growth of around 2% in their labour force. The challenge facing the GCC economies is to create employment opportunities while reforming public finances. In these economies, falling oil prices over the past few years have seen a deterioration in government finances e.g. from a government budget surplus in 2013, to an expected net public debt stock of 10% of GDP by the end of this year. Diversifying the economy towards the private sector will lessen the burden on government finances, as well as creating new jobs for a growing workforce.

For many economies, 2017 will be a year of uncertainty. Although not an exhaustive list, these are some of the key macroeconomic risks businesses should consider and plan for in the next 12 months.

Onshoring the greenback reveals cracks: Tighter US monetary policy could encourage a gradual repatriation of US dollars. Our risk matrix in Fig. 2 shows that Malaysia, Turkey and Chile are especially exposed to this risk as their foreign currency debt levels stand at 71%, 64% and 55% of their GDP. Banks with exposure in those economies could face some pressure if not well capitalised. But on the flipside, for some commodity-reliant economies like Brazil and Russia, a higher oil (and other commodity) price outlook coupled with a flexible exchange rate regime could help to soften the impact of capital flowing back to the US.

Fig 2: A stronger dollar could pose a risk to many emerging markets, including Malaysia and Turkey

Countries	Vulnerability	Foreign currency external debt (% of GDP)	Nov 15 – Nov 16 currency movement (%)	Current account balance (% of GDP)
Turkey	High	55%	-12.6%	-4.5%
Malaysia	High	71%	-0.1%	3.0%
Colombia	Medium	38%	-3.6%	-6.4%
Peru	Medium	34%	-2.0%	-4.4%
Argentina	Medium	28%	-37.4%	-2.5%
Mexico	Medium	28%	-17.0%	-2.9%
Chile	Medium	64%	5.8%	-2.0%
South Africa	Medium	21%	1.4%	-4.3%
Philippines	Medium	26%	-4.3%	2.9%
Brazil	Medium	39%	13.7%	-3.3%
Indonesia	Medium	38%	2.9%	-2.1%
India	Medium	17%	-2.2%	-1.1%
China	Medium	12%	-6.9%	3.0%
Russia	Low	32%	1.0%	5.2%
Thailand	Low	26%	1.4%	7.8%

Sources: PwC analysis, World Bank, IMF, Datastream

China will feel the costs of higher private sector debt burden: China's non-financial sector debt stands at more than 250% of GDP. If non-financial debt grows at the same average rate as it has since 2010, China could add over $650 billion to its total debt pile by the end of 2017. China's relatively closed capital account means its risk rating in Fig. 2 is medium, reducing its exposure to foreign currencies. But China's non-financial debt accumulation has accelerated since 2008, nearing the high debt to GDP ratios seen in the Eurozone's crisis countries. Last year, China's credit to GDP gap (the difference between the credit-to-GDP ratio and long-run trends, indicating unsustainable accumulation) surpassed levels which indicate a risk of crisis within the next three years. This risk will be heightened if property prices fall sharply, undermining the foundations of the debt pile.

Notes:

So how did we do with our forecasts for 2016?

Reflections on our 2016 predictions

Looking back on 2016, many of our predictions held true. Commodity prices have remained low, the US raised interest rates and geopolitics has come under the spotlight. Specifically, we correctly predicted that:

- The peripheral Eurozone economies would outpace core growth at 2% compared to 1.5%. In 2016, the periphery is expected to have grown by 2.2% and the core by 1.4%;
- Total unemployment in the Eurozone would fall to below 17 million, its annual lowest levels since 2011. Preliminary data suggest unemployment is almost at 16 million; and
- India would lead E7 growth at over 7.5%, while Chinese growth would slow to around 6.5% per annum. Last year, India is expected to have grown by 7.6% and China by 6.6%.

We also predicted strong US job creation at around 200,000 jobs a month; preliminary estimates suggest the US added on average 180,000 jobs a month in 2016. But we over-estimated US growth at 3%. Last year, US growth is expected to be relatively disappointing at around 1.5%.