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Global Economic Outlook 2016–2020

Prospects for Achieving Escape Velocity

With continued lackluster growth, what could reignite the global economy?

"The whole world," wrote *Financial Times* chief foreign affairs columnist Gideon Rachman in the final days of 2015, "is on edge."[1] He is absolutely right. Rachman pointed to a "generalized anxiety" that extends to all the world's major powers (with the partial exception of India)—a pronounced departure from a long period in which at least one global power had been "bullishly optimistic." At the end of 2015, however, the confluence of toxic risks—geopolitical, security, political, social, and economic—helps explain what Rachman calls the "global gloom" that has descended on us.

To be sure, an anemic global economy and continued uncertainty contributed to the state of affairs at the beginning of 2016. But it goes well beyond that. Part of the ennui may be attributable to uncertainties in the nature of the global economy itself. Can we expect the global economy to "snap back" to the pre-Great Recession trajectory of rapid globalization, or have we entered into a post-globalization period marked by renewed geopolitical tensions, the rise of political extremism, and flat-line economic growth? Will emerging markets recover the meteoric growth rates of years past, or are they doomed to a pronounced period of lower economic dynamism? Are we all at the precipice of a takeoff of "exponential" technologies, or have we arrived at a protracted period of declining productivity growth? How long will the current commodity slump cycle persist? How well prepared are governments to deal with future economic or financial shocks? These and other major questions certainly cast a long shadow over any attempt to forecast global economic trends.

Sixteen years ago, eminent British sociologist and academic Anthony Giddens published a compelling book entitled *Runaway World: How Globalization is Reshaping Our Lives*. His overarching conclusion? "We shall never be able to become the masters of our own history," wrote Giddens, "but we can and must find ways of bringing our runaway world to heel." Less than a generation later, we have reached yet another "runaway-world" moment—one decidedly different from and even more complex than the circumstances described by Giddens 16 years ago. But the same conclusion applies. Both the immediate and longer-range outlooks depend heavily on our capacity to address important structural questions.

This *Global Economic Outlook* addresses the short- and longer-range issues that are shaping—and will shape out to the year 2020—the global economic and business environment. It also envisions what conditions might serve to lift the current "global gloom"—what elements might enable the global economy to finally achieve the "escape-velocity" conditions of the pre-Great Recession period.

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[1] Gideon Rachman, "Battered, Bruised and Jumpy—The Whole World Is On Edge," *Financial Times*, 28 December 2015

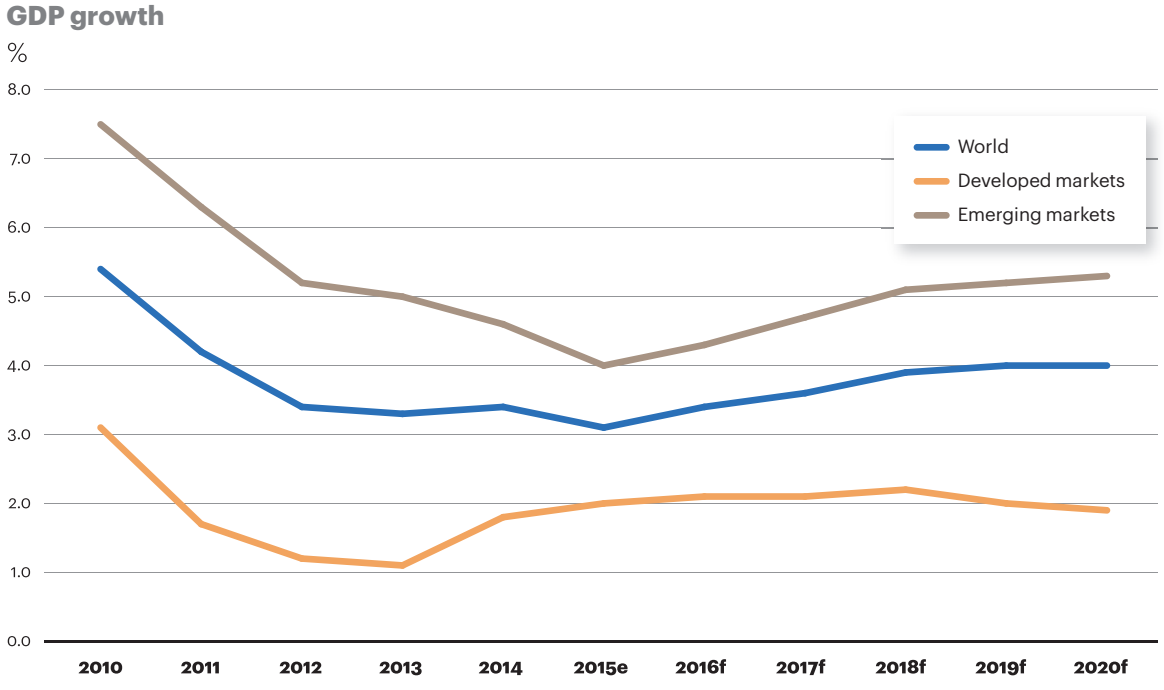
Executive Summary

- Global economic growth is expected to rise slightly in 2016, signaling a modest improvement in a still lackluster world economy. Over the 2016–2020 period, growth is forecast to average 3.8 percent annually (measured at purchasing power parity), as compared to 3.5 percent between 2011 and 2015.
- The Global Business Policy Council (GBPC) sees four key characteristics shaping the global economy: the continued resource slump cycle, U.S. economic resurgence, weak productivity growth, and a hiatus in globalization. The first two are mixed but may on balance be positive for the world economy, while the latter two are weighing on the prospects for stronger growth.
- The uptick in the global economic outlook is largely attributable to a limited improvement in developed markets, and in particular to renewed dynamism in the United States, which has reemerged as the primary driver of global growth. European economies are also performing somewhat better than in recent years, when they faced cascading economic and financial crises, and are expected to continue to gain traction in the next five years.
- Emerging markets, on the other hand, face an adjustment period through 2020 and beyond as their previous growth models are called into question, their policy makers deal with the effects of increasing U.S. interest rates, and global commodity demand remains weak. This represents a sharp contrast to the dynamism of these economies of just a few years ago. Still, pockets of next-wave growth exist among some emerging markets, as the economic prospects of emerging markets diverge.
- We identify five key opportunities that, if they were to occur, would enable global economic growth to achieve "escape velocity" in the short term and create sustainable economic growth and prosperity in the long term. They are, in declining order of potential impact on the global economy: (1) the normalization of monetary policy, (2) the rebalancing of the Chinese economy, (3) an exponential takeoff of technology, (4) a sudden acceleration of economic cooperation between the United States and China, and (5) the rise of Sub-Saharan Africa.

Introduction

The more things change, the more they stay the same—or so the saying goes. As true now as when she first used the term in 2014, International Monetary Fund (IMF) Managing Director Christine Lagarde has described the global economy as in a "new mediocre," in which economic growth is relatively stable but lower than in recent decades. Despite the many economic and political shocks and shifts of 2015—from the Iran nuclear deal and China's equity market jitters to Brazil's recession and the U.S. Federal Reserve's interest rate lift-off—the global economic outlook this year is largely the same. The IMF's five-year forecast has weakened slightly, from an average of 4.0 percent annual global economic growth (at purchasing power parity) in 2015–2019 to 3.8 percent in 2016–2020 (see figure 1).

Figure 1
Global economic growth is stabilizing



Notes: GDP is measured at constant prices and purchasing power parity. Developed markets are those the IMF characterizes as "advanced economies," and emerging markets are those the IMF characterizes as "emerging market and developing economies."

Sources: International Monetary Fund World Economic Outlook (October 2015 and January 2016); A.T. Kearney analysis

For all this continuity, though, the global economy is on somewhat sounder footing now than it was a year ago. The economic recovery in developed markets has gained momentum, leading to increased consumer and business confidence that should continue to propel these economies forward. Although emerging markets are still experiencing slower growth, they appear to be on an upward trajectory. There are still weaknesses in the global economy, however, and 2016 has kicked off with unsettling volatility in equity markets. So while risks remain that could weaken the economic outlook and are sure to spook investors at times, these risks seem relatively mild compared to those that have plagued the global economy in recent years.

The GBPC's analysis of the global economy highlights four key characteristics: low global commodity prices, a strengthening U.S. economy, weak productivity growth, and disappointing performance of global trade volumes and other measures of globalization. Each of these characteristics will shape the outlook for the global economy in the next five years, as well as the prospects for domestic growth in economies around the world. Low productivity growth and weakened globalization are acting as a drag on global economic growth. However, the economic implications of lower global commodity prices and the strengthening U.S. economy differ for national economies depending on their specific characteristics, such as whether they are net importers or exporters of commodities and whether their government and corporate debt is denominated in U.S. dollars. Taken together, these four key characteristics are contributing to the lackluster global economic outlook, as well as important divergences in economic prospects of markets around the world.

The **resource slump cycle**, which the GBPC highlighted in *Global Trends 2015–2025: Divergence, Disruption, and Innovation*, is continuing to provide an overall boost to global economic growth. Oil is down dramatically from its 2008 high of $145 per barrel, with an average price of just $51 per barrel in 2015 and the IMF forecasting that it will remain below $65 per barrel through at least 2020. Most other commodities also have depressed prices, with the IMF's world commodity price index forecast to fall further in 2016. This is primarily driven by increased supply of oil on the market. Even as net global oil demand continues to rise in absolute terms, the International Energy Agency expects oil demand growth to weaken somewhat in 2016. These lower prices are putting money in the pockets of consumers around the world, boosting their purchasing power for other consumer goods. Although this pass-through effect has not led to as much growth in consumer spending as economists originally anticipated, it does explain much of the recent growth in consumer spending in many large economies, including India, China, the United States, and the United Kingdom. Of course, lower commodity prices are hurting the growth prospects of those economies that rely on resource exports, including many in the Middle East and North Africa, Latin America, Sub-Saharan Africa, and Eurasia. Economic growth has dropped most precipitously in Angola, Venezuela, Qatar, Libya, and Russia since 2007—and many of these economies are also experiencing domestic political and social instability.

U.S. economic resurgence—another trend in *Global Trends 2015–2025: Divergence, Disruption, and Innovation*—is largely a positive development after several years of weakness following the global financial crisis of 2008–2009. The strength of the U.S. economy, however, is also creating some headwinds for the global economy. After almost eight years of interest rates at essentially zero, the U.S. Federal Reserve finally began to normalize its monetary policy—raising its benchmark rate to 0.25–0.50 percent in December 2015. The tightening of U.S. monetary policy while the European Central Bank (ECB) and the Bank of Japan maintain ultra-low interest rates and quantitative easing programs—and while economic growth in emerging markets is slowing—creates an asymmetry that is strengthening the U.S. dollar and stimulating capital to flow out of emerging markets and into the United States (further boosting the value of the dollar). Although this makes imported consumer goods more affordable for American consumers, it makes imports in other markets more expensive and pushes up inflation. The depreciation of currencies against the U.S. dollar at the same time as strong capital outflows creates risks for those markets in which debt—particularly corporate debt—has grown most dramatically in recent years, such as Turkey and Brazil.

The **sustained decline in productivity growth** in recent years is more damaging to economic growth prospects. While country-level annual productivity growth averaged 2.4 percent

between 2000 and 2007, it has averaged a dismal 0.3 percent since 2008, according to data from the Economist Intelligence Unit. Importantly, this trend has been pronounced in the United States, Germany, and the United Kingdom, where annual productivity growth has been below 1.0 percent each year since 2012 in all three countries. And while China's productivity growth still tops 3.0 percent annually, it has slowed dramatically from its average of 6.0 percent annual growth from 2000 to 2007. Economists are vigorously debating the reason for this decline. Some argue that it is because recent technological advances (such as mobile phones and social media networks) are having less of an effect on productivity than previous technological advances (such as electricity and the internal combustion engine), while others argue that there is simply a lag between the introduction of a new technology and its impact on productivity becoming evident.[2] Another potential reason for declining productivity growth—particularly in developed markets—has been the low level of corporate investment in recent years. Whatever the reasons, it seems that declining productivity growth is dampening the economic prospects for a number of economies around the world.

While global growth may be fairly steady through 2020, **individual country performance will vary considerably.**

The **hiatus in globalization** is also weighing on worldwide economic performance. While the volume of global trade in goods and services grew at a mean of 6.7 percent annually from 1989 to 2008, it has averaged only 3.1 percent annual growth since 2009. The same trend is evident for other major indicators of economic globalization, as discussed in the GBPC's recent Council Perspective, *From Globalization to Islandization*. This slowdown in global trade is a result of a variety of cyclical and structural factors, including technology-fueled advances in automation on the one hand and the revival of geopolitical tensions on the other. Importantly, it is also a consequence of slower economic growth rates and lower demand for imports ranging from commodities to consumer goods. In particular, China's reduced demand for commodities is weighing on global trade growth. And while the U.S. economy is performing relatively well compared with recent years, it is not the world's consumer of last resort that it once was, as households continue to deleverage and the country produces more of its own oil and gas.

These four key dynamics point to the fact that while the overall global growth outlook has remained largely constant, dramatic shifts in the economic growth outlook have occurred at the asset class, regional, and commodity exporter levels. There are also significant differences between countries within these various groupings. So while global growth may be fairly steady through 2020, there will be both strong and weak performers at the country level. These differences in performance stem from both divergent economic growth models and government policy choices—all of which matter much more now than they did in the previous boom period.

On the one hand, developed markets are enjoying a slightly improved outlook, as their economies are on a more stable trajectory than in recent years. The economic resurgence of the

[2] See, for example, Robert J. Gordon, "The Demise of U.S. Economic Growth: Restatement, Rebuttal, and Reflections," NBER Working Paper no. 19895 (February 2014) and Erik Brynjolfsson, "The Productivity Paradox of Informational Technology: Review and Assessment," Communications of the ACM 36, no. 12 (December 1993): 66–77.

United States is a crucial part of this trend, as is the continued economic recovery in the United Kingdom, which has been among the top two G7 markets in annual economic growth since 2013. Importantly, the rest of the European Union also appears to finally be experiencing a modest economic recovery, thanks in part to monetary easing in 2015 by the ECB. In contrast, in spite of similar monetary easing by the Bank of Japan, the Japanese economy is still under-performing. And the large commodity exporters among the developed markets—in particular, Canada and Australia—are growing less strongly than when China's demand for their exports was voracious. Nevertheless, they are forecast to grow near or above 2.0 percent annually through 2020.

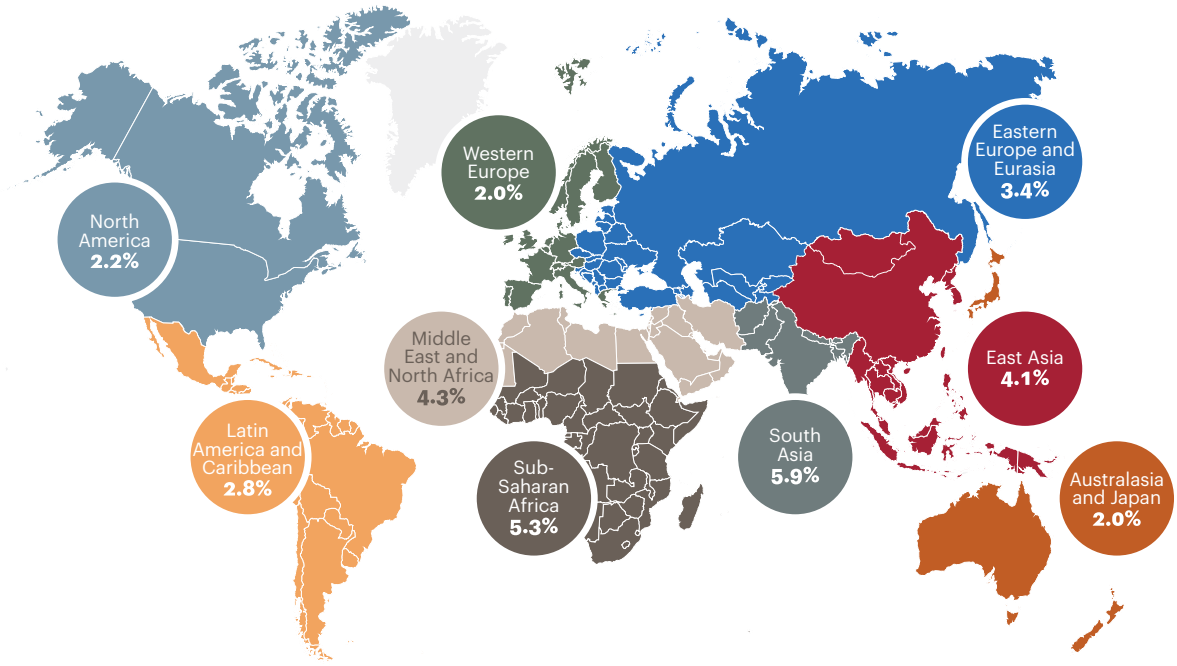
On the other hand, the current outlook for emerging markets is weaker than it was just a year ago. As a whole, emerging market economic growth has fallen each year since 2010, with an estimated growth rate in 2015 of only 4.0 percent. Forecasts from the IMF and others predict that emerging markets have seen the worst, however, with growth expected to rebound slightly to 4.5 percent in 2016 and to continue to increase gradually each year through 2020. Nonetheless, it is important to note that this does not represent a broad-based resurgence in economic activity in emerging markets, but rather an improvement in the economic prospects of large emerging markets that suffered recessions in 2015—notably Russia. Low commodity prices will continue to weigh on emerging markets, particularly in Latin America, which is expected to experience the lowest growth of any emerging market region through 2020 (see figure 2). In contrast, Asian emerging markets will continue to lead the pack, with India

Figure 2

Regional growth rates vary, with South Asia and Sub-Saharan Africa leading the pack

Real GDP growth

%, 2016–2020 annual average



Notes: GDP figures are the unweighted average of the forecast annual growth rates of the economies within each region between 2016 and 2020. GDP growth is measured at constant prices.

Sources: International Monetary Fund World Economic Outlook (October 2015 and January 2016); A.T. Kearney analysis

and China expected to remain the fastest-growing large emerging markets in the years to come. In addition, the "2020-Seven" emerging growth markets that we highlighted in the 2015 Global Economic Outlook entitled *Beyond the New Mediocre*? (China, Chile, Malaysia, Mexico, Peru, Philippines, and Poland) are all forecast to average growth of more than 3.0 percent annually through 2020. Other economies that are expected to grow strongly over the next five years include less developed markets such as Myanmar and Ethiopia. However, there is some uncertainty in all of these forecasts, depending on how global investors react to the U.S. Federal Reserve's interest rate tightening over the coming years, and whether the Chinese economy continues to grow strongly while transitioning to a more consumption-based economy.

The uncertainty inherent in these economic forecasts highlights a crucial point about the current global economy. Although the outlook is somewhat more positive than in recent years, the prospects for global growth remain below potential output levels, and downside risks remain that could dampen economic performance. In light of this, one of the most important but least recognized risks in the global economy is complacency. If policy makers in key countries around the world resign themselves to lower performance, their economies will stagnate. Similarly, if business leaders are complacent about their productivity levels and underinvest in their employees and capital stock, then global economic growth will remain weak. On the other hand, if policy makers and business leaders refuse to accept that lower growth is the new normal and instead invest in infrastructure and training while governments also implement structural reforms, then economic growth could be boosted in the short to medium term. As highlighted in the section below, both the specific challenges and the prospects for breaking out of this complacency vary among the world's largest economies.

Key Country Growth Paths

Despite slower global growth and uncertainty in international markets, economic performance continues to be strong in the **United States** thanks in large part to robust household consumption. According to the IMF, GDP growth is expected to average 2.5 percent over the next five years, compared to 2.1 percent in the previous five years (see figure 3 on page 8). Strong consumer spending has been driven largely by lower oil prices, falling unemployment, and a slight bump in household income. Unemployment rates have fallen to 5 percent, the lowest level since the financial crisis, and job creation is increasing. In addition, wages and salaries grew at an average of 2.1 percent in the year to September 2015, following a 2.3 percent increase in the previous 12-month period, according to numbers from the U.S. Bureau of Labor Statistics. These developments pushed the U.S. Federal Reserve to raise its target interest rate in December 2015 for the first time since 2006. In order for consumer spending to continue playing a vital role in the United States' economic growth, further labor market improvements will be crucial. In particular, slow and unequal wage growth could hamper economic growth. One reason that economists point to for sluggish wage growth since the financial crisis is low productivity growth. Labor productivity in the United States only grew an average of 0.6 percent from 2012 to 2014, compared to 2.2 percent during the previous three-year period. There is a lot of debate about technology's role in productivity growth, and whether it is being measured appropriately, but investments in education and worker training could help raise productivity in the coming years. For economic growth to continue in the medium term, the United States will need to address these and other long-term challenges, such as infrastructure deterioration and the long-term sustainability of its social safety net.

Interview with Michael Heise, chief economist at Allianz SE

GBPC: Do you think the global economic outlook is primarily a positive story or a negative story?

Heise: Overall I am positive on global growth, but there is a big divergence. We see a fairly stable expansion in the industrialized world, particularly in the United States and the European Union. It's not buoyant growth, but steady. On the other hand, there is a slowdown in emerging markets. I think there will be a bottoming out of growth in emerging markets in 2016, but some risks remain.

GBPC: How will changes in U.S. monetary policy affect global markets?

Heise: Markets usually anticipate and react before an event like this takes place. We probably have seen most of the adjustments baked in in terms of exchange rates, interest rates, and capital being retrieved from emerging markets. So further Fed interest rate hikes should not rattle the markets and will not create havoc in the world economy. The risks such as the capital outflow from emerging markets depend more on the problems in the markets themselves.

GBPC: What do you see as the biggest short-term risk that could derail global growth?

Heise: There has been a strong buildup of debt in emerging markets because a lot of liquidity has flown into these markets due to ultralow interest rates in the industrialized world. There will have to be some deleveraging in the next several years, which most economists think will be a rather slow and smooth process. However, there are risks that this transition could be more abrupt and radical.

I am quite optimistic about the Asian economies, although many of them have high private debt ratios—especially China. I think China will be able to manage its high debt because banks are under the control of the government. However, if capital continues to be pulled from emerging economies, Asian markets will have to adjust, meaning they may have to accept further devaluation of currencies and interest rate increases, which may harm their growth dynamics. Corporate debt-to-GDP ratios are not quite as high in Latin American and Eastern European markets, but they have a different set of risks, in particular the commodity price collapse.

GBPC: What is one development that would really unlock global growth?

Heise: I believe we are underestimating the positive global growth impact from low oil and commodity prices. Current prices are scaring many observers because they could signal recessionary tendencies. I do not agree. The weakness of our markets is due to oversupply rather than weak demand. So this is a positive shock for the world economy, especially industrialized economies, in terms of purchasing power. There will be strong consumer-driven growth in many economies in the next year. We already see this in Germany, the United States, and many other European countries. Low commodity prices will hurt oil producers and gas exporters, but for the overall global economy, they are a boon.

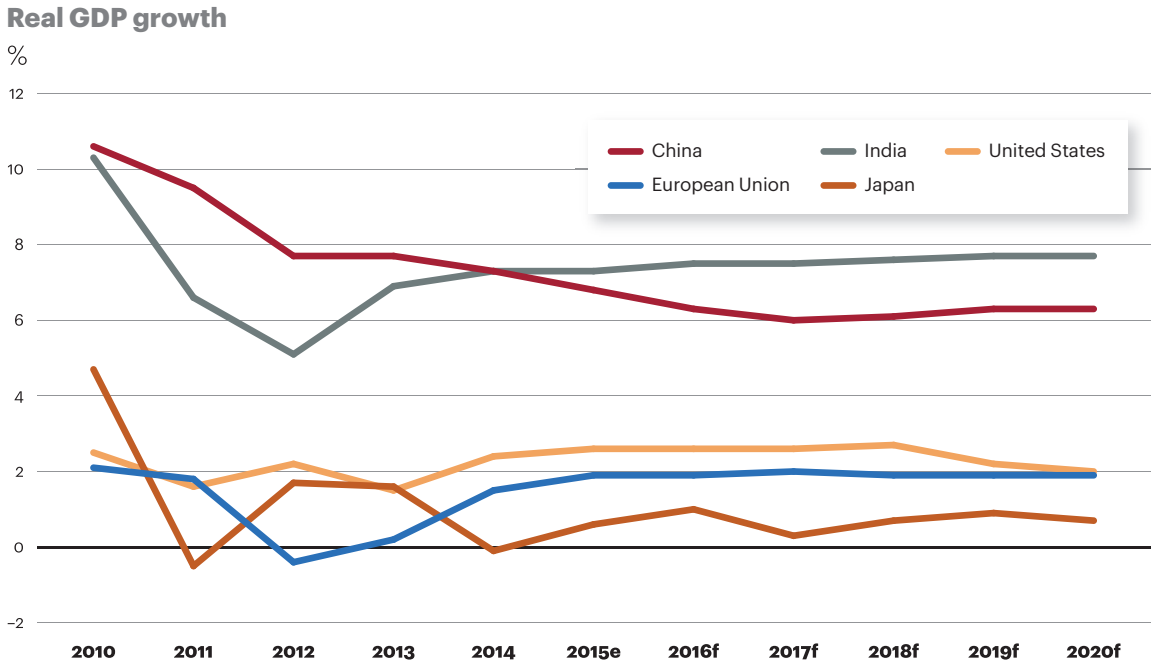
Michael Heise

GPBC: How do you see the structure of the EU and the eurozone playing out in the next couple of years?

Heise: I am positive about the eurozone economy in the short term, but there is much work to be done in institutional reform. We have not seen major changes in the architecture of the euro because of other more pressing issues, such as the influx of migrants and the political crisis in Ukraine and the Middle East. However, the lack of institutional reforms is very risky in the long term. The EU made some strides toward integration in response to the financial crisis, but now a more permanent architecture is needed. The EU needs a fiscal institution that has disposable funds and power to interfere with governments that are not complying with the rules. We need an institutionalized, orderly process for sovereign insolvency—we must prevent a repeat of Greece. In order to achieve all this, the EU again needs more political and public support. It is a difficult task, but politicians need to regain some positive momentum within the population for EU integration. If the economy is put back on track, it will be easier and the popular support for the EU will rise again.

Figure 3

Economic growth rates continue to diverge among the world's largest economies



Note: GDP growth is measured at constant prices.

Sources: International Monetary Fund World Economic Outlook (October 2015 and January 2016); A.T. Kearney analysis

While the United States is enjoying relatively strong growth, the **European Union** appears to finally be slowly recovering, with growth forecast to average 1.9 percent from 2016 to 2020 according to the IMF. Economic output remains below potential, however, despite the ECB sustaining its monetary stimulus, the weaker euro boosting the competitiveness of European exports, and lower energy prices raising household spending power. EU economies have been hit by the slow growth in emerging markets, which receive about 58 percent of extra-EU exports according to data from Eurostat—with China alone accounting for about 13 percent of German exports to outside the EU. EU growth is also hindered by underlying fragilities and imbalances stemming from the financial and sovereign debt crisis. European banks have an estimated €1 trillion of nonperforming loans on their books—amounting to 5.6 percent of total loans as of June 2015, and 3.5 times the percentage of bad loans in the United States. In addition, high rates of private debt—nonfinancial firms and households hold an average of 205 percent of GDP in debt across EU member states—will continue to dampen consumption and investment. The EU also is currently facing its largest migration crisis since World War II. The estimated 1.5 million refugees that arrived in 2015 are sparking short-term political and social challenges, but the influx of migrants could help the regional economy in the long term. A widely cited Standard & Poor's report found that the migrants could have a "mild positive impact on growth in EU countries," especially those that are rapidly aging, such as Germany and Spain. However, ongoing geopolitical instability and terror attacks could dampen growth prospects for the EU, especially in countries that rely on tourism. In the wake of the Paris attacks in November 2015, economists also warned that the EU economy could weaken further due to lower levels of consumer spending and investment.

Among the five largest EU member economies, growth in Spain, Italy, and France strengthened the most in 2015. However, these countries' prospects will diverge in the years ahead. Growth in Spain is expected to be particularly strong over the next five years, averaging 2.1 percent according to the IMF. However, due to large amounts of nonperforming loans and a sluggish export market, Italy will only average 1.1 percent growth from 2016 to 2020—the lowest average rate among the 28 EU members—while France will be hindered by high unemployment and weakened business confidence, with the IMF forecasting average growth of 1.6 percent over the next five years. On the other hand, growth in Germany and the United Kingdom weakened in 2015. Hit hard by the slowdown in emerging markets, Germany's growth was weaker than expected at 1.5 percent. Its economy is expected to maintain an average growth rate of 1.5 percent over the next five years, in part due to weakened demand from emerging markets and the short-term challenges associated with addressing the influx of migrants. The United Kingdom saw its economic growth fall from 3.0 percent in 2014 to 2.2 percent in 2015—although this was still strong economic performance compared to the major EU economies. And the UK economy is expected to continue its steady expansion over the next five years with average economic growth of 2.2 percent, thanks to strong domestic demand, an improving labor market, and low oil prices.

The weaker growth outlook in China has already triggered a **chain reaction of slower growth in both emerging and developed economies.**

China's economy will slow from a stunning 8.3 percent average between 2010 and 2015 to a forecast average of 6.2 percent over the next five years, according to the IMF. While growth of more than 6.0 percent is an impressive achievement for such a large and diversified economy, the weaker growth outlook in China is already having a major impact on the global economy. It has caused a chain reaction of weakened growth in other emerging markets (such as Brazil and Angola) that have depended heavily on exporting metals and other natural resources to China, as well as for economies that rely on exporting consumer goods to China, such as Germany and Japan. Despite a slowing economy, Chinese consumption has remained robust with data cited by *The Economist* suggesting that retail sales increased 10.5 percent in real terms in 2015 thanks to steady income growth and a growing middle class. This is a positive sign for the government's planned shift toward a more consumption-driven economy. However, Beijing continues to delay economic liberalization measures that are needed to accelerate this transition. For instance, due to Chinese stock market volatility in the summer of 2015 and the slowdown in economic growth, Chinese authorities announced more infrastructure stimulus projects and cut interest rates six times in 2015. Beijing has made some progress on its economic reform agenda though. In September 2015, the State Council announced guidelines to reform state-owned enterprises (SOEs), of which there are currently more than 150,000, controlling approximately $17 trillion in assets. These guidelines foresee the opening of SOEs in key industries, such as telecommunication, electricity, oil and gas, military equipment, and civil aviation, to private investors. The next five years will be crucial for China to address its economic challenges and implement planned reforms.

More than three years after the start of the "Abenomics" economic agenda, **Japan** continues to struggle to boost economic growth. The economy grew only 0.6 percent in 2015, and the IMF projects average annual growth of only 0.7 percent over the next five years. The sharp slowdown in demand from China, sluggish private consumption, and lack of confidence in Prime Minister Shinzo Abe's economic reform agenda are major causes of the stagnation in the world's third-largest national economy. China is Japan's second-largest trading partner, accounting for 18 percent of Japan's total exports. In addition, private consumption, which accounts for about 60 percent of Japan's GDP, remains anemic due to sluggish wage growth and recent consumption tax hikes. Although the 0.1 percent growth in wages in September was welcome, higher levels are needed to boost consumer spending and stimulate growth. To address this issue, the government increased minimum wages by 2.4 percent in 2015, the first raise since 2002. Abe also called on the government to continue to increase the minimum wage by 3 percent every year for the foreseeable future. While the prime minister has been trying to push companies to increase wages, firms instead have been accumulating cash reserves to the tune of $2.9 trillion. Mr. Takeshi Niinami, an executive of Suntory and one of the main authors of Japan's new corporate-governance code, warned in an interview with *The Economist* that if Japanese companies do not reinvest their money in their employees and businesses by 2020, their competitiveness may be irretrievably damaged. The third arrow of Abenomics—the structural reform agenda including liberalization of the electricity industry and financial support to increase very low fertility rates—is key to boost Japan's long-term economic growth, but much work needs to be done. While the Abe government has tackled some of the country's structural challenges, such as cutting corporate tax rates by more than 3 percentage points to 31.33 percent and signing the Trans-Pacific Partnership (TPP) free trade agreement with 11 other countries, much work remains to be done to stimulate Japan's economy.

As the fastest growing major economy in the world, **India**'s economic outlook is still quite bright. In 2014, India surpassed China in terms of GDP growth and is projected by the IMF to average 7.6 percent growth over the next five years. India also has a growing services sector, which is the largest contributor to its economic growth, averaging 8.2 percent annually over the past five years according to the Economist Intelligence Unit. And while other emerging markets have been hurt by China's slowdown and the broader resource slump cycle, India has benefited from these developments since it imports 70 to 80 percent of its oil. As a result, India's current-account deficit fell to 0.2 percent of GDP in 2015 and consumer-price inflation dropped to 5 percent in October 2015, compared to double-digit rates in 2013. Although India is experiencing strong growth, economic reforms will be needed for this growth to be sustainable in the medium to long term. As highlighted in Finance Minister Arun Jaitley's 2015–2016 budget, India will need to prioritize land, power, labor, and tax reforms to boost the country's competitiveness. Prime Minister Narendra Modi plans to address these structural challenges but will find it difficult to secure approval for needed reforms. For instance, Modi announced a land acquisition bill to ease rules to acquire land, hoping to incentivize companies to invest in construction projects, fix crumbling or build nonexistent infrastructure, and build smart cities and industrial parks. However, the bill has been hampered by opposition political parties, who claim that it allows companies to grab land from poor or small landholders. Another crucial reform that Modi has proposed is a national goods-and-services tax (GST), which would replace state taxes that serve as protectionist barriers to internal trade and investment and stymie tax revenue collection—but this has also met with opposition by many parties in parliament. The political hurdles that the Modi government faces to remove existing bottlenecks and boost economic growth make the prospects for sustainable and inclusive long-term growth in India uncertain.

Interview with Uri Dadush, senior associate in the International Economics Program at the Carnegie Endowment for International Peace

GBPC: Do you think the global economic outlook is primarily a positive story or a negative story?

Dadush: It's a mixed story. Overall growth rates are projected near the average rate of the last 25 years, which is a good thing, since it signals continued recovery. But there is quite a bit of risk, especially the weaknesses in emerging markets and in world trade. Countries that wanted to rely on the pickup in world trade to boost their economic growth, particularly emerging markets, will be disappointed. Related to this is the weakness in commodity prices, which is hurting not just middle-income countries like Brazil, but also low-income countries in Africa. But at the same time there is gradually improving growth in the world, largely due to the United States and Europe.

GBPC: What is the outlook for the U.S. economy? Do you see growth continuing in the United States?

Dadush: The U.S. economy is in a pretty solid position now, thanks to strong domestic demand, increases in real wages, and solid investments. Moreover, the housing market is recovering and still has a ways to go. The dollar is strong, which is good for consumers but bad for exports. Importantly, markets responded well to the Federal Reserve's hike in interest rates—partially from relief and partially because the Fed did a good job in preparing the ground. This is taken as a sign of confidence in the U.S. economy and that whatever follows will not divert the recovery.

GBPC: Do you have a view on why productivity growth has slowed so dramatically in recent years?

Dadush: I'm more puzzled by the long-term productivity trend than by the trend of recent years. In the midst of the Great Recession and its aftermath, it is difficult to disentangle business cycle effects, which tend to depress investment and productivity, and structural changes in the system. The question should focus more on long-term productivity growth. I suspect that the productivity slowdown has been overplayed. There are big measurement issues related to the new IT economy: for example, is your smartphone just a more expensive phone, or a replacement for your stereo system, camera, GPS, and newspaper? What is the value of carrying pretty much all of the world's knowledge in your pocket? I am not confident that we are properly measuring the quality of what we are producing and, by implication, productivity. I remain optimistic that the spread of IT and other new technologies will continue to provide us with quite rapid productivity growth, when properly measured. In developing countries, which account for more than 80 percent of the world's population, productivity is a fraction of that in advanced countries, so even if it were true that the globe had somehow reached the technological frontier, there would still be huge aggregate productivity gains to be had.

GBPC: What do you think is the biggest risk that could derail global economic recovery? And on the other hand, what is one opportunity that could really unlock global growth?

Dadush: I do not think there is one factor that could actually derail the global economy. Instead, the risk is that growth could be slightly

Uri Dadush

weaker than anticipated and that current forecasts will be shaved by a quarter of a point or so. That would still be significant for the global economy, but would not be another crisis. The biggest risk now lies in emerging markets, as I mentioned. Several countries face uncertain prospects in the next year or two: China, Brazil, Russia, Turkey, Ukraine, Venezuela, and Argentina; and nearly all countries in the Middle East and North Africa. I am among the least worried about the effects of the Fed's interest rate hike, but I recognize that in a bad scenario, U.S. rate hikes could make it worse for emerging markets. This is a rough patch, but I remain optimistic about the growth prospects of emerging markets over the next decade or two.

In terms of upside potential, I do not think there is one particular development that could really boost growth in the next year or two. There are markets that could help support a stronger global economic recovery, such as the United States. There is a little upside in Europe, as well. Germany, the United Kingdom, and Spain could all do a little bit better than anticipated next year. So while I think the odds are against it, in a good scenario, we could see the global growth rate increase slightly.

Top Five Opportunities for Global Growth

Seven years after the global financial crisis, the global economy appears to be stabilizing, albeit at somewhat lackluster growth rates. Modest growth in developed markets is supporting the global economy, but many of them continue to perform below their potential. At the same time, slower projected growth among emerging markets, especially in China and in large commodity exporters, is weighing on global economic growth prospects. And key vulnerabilities remain in all of the world's five largest economies—even those with stronger near-term economic growth forecasts. So although the global economy has put the 2008–2009 global financial crisis and recession fully behind it and is on a stable trajectory, serious roadblocks remain to unlocking more solid global growth.

Given the somewhat mediocre outlook, we wondered **what developments could put the world on a path toward our desired Globalization 3.0 future.**

In our Council Perspective *From Globalization to Islandization*, we analyzed the current global economic order and developed four potential futures where the global economy is headed. Our brightest future for global economic growth—which we named "Globalization 3.0"—not only marks a return to a more dynamic global economy, but also features a reduction in geopolitical tensions and a renewal of global political and economic integration and cooperation. Given the somewhat mediocre five-year global economic outlook, we wondered what developments could enable the global economy to achieve escape velocity and put the world on a path toward our Globalization 3.0 future.

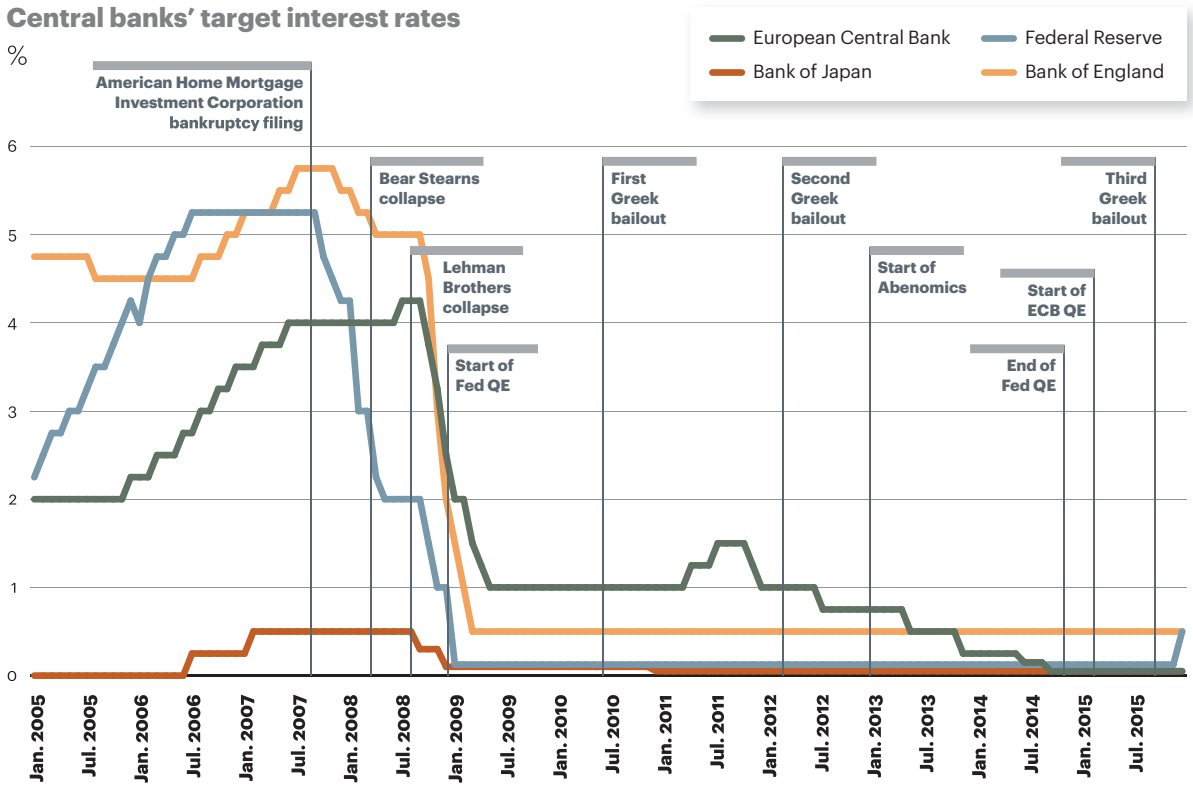
Below are the five breakthrough events that we argue could reignite global growth and successfully transition to a Globalization 3.0 world, in which increasing trade and investment boost household incomes in both developed and emerging markets and the global economy fires on all cylinders once more. While some of these—such as monetary policy normalization in developed markets—would likely be able to independently provide the global economy with escape velocity, others—such as Sub-Saharan Africa joining the global value chain—would likely be insufficient on their own to achieve this. They are listed below in declining order of likely global economic impact. Of course, the biggest boost to global growth would come from these five events acting in concert.

1. Monetary policy normalizes in developed markets

The U.S. Federal Reserve recently adopted its first interest rate hike since 2006, after holding rates within the historically low range of 0.0-0.25 percent for almost seven years (see figure 4 on page 13). While higher U.S. interest rates will have some negative spillover effects on economies around the world, it signifies something very positive: American policy makers believe the U.S. economy is strong enough to warrant an increase in interest rates. The unemployment rate has fallen to its long-run "natural" level, wages have started to increase,

Figure 4

Interest rates are near zero in all major economies



Notes: Where a range of target interest rates has been set, the midpoint is shown. QE is quantitative easing.

Sources: Federal Reserve of New York, Bank of Japan, European Central Bank, Central Bank Rates, Oanda; A.T. Kearney analysis

consumer spending is growing, and inflation is in low but positive territory. All of this bodes well for continued U.S. economic growth and demand for imports from the rest of the world, thus stoking global growth as well.

If the central banks of the other large developed economies that govern the world's reserve currencies—the ECB, the Bank of England, and the Bank of Japan—also view their economies as strong enough to warrant the normalization of monetary policy, that would signify their belief that the weak growth and uncertain economic prospects that have plagued these economies has come to an end. Thus, if the central bankers are right, rising interest rates in the United States, the eurozone, the United Kingdom, and Japan would be a harbinger of a great improvement in global economic growth rates, as these four economies account for about 35 percent of the global economy at purchasing power parity.

The normalization of monetary policy would also put the world firmly back on stable ground by reducing the high levels of uncertainty, especially those involving the U.S. economy, that have plagued the global economy since the global financial crisis. The years immediately after the crisis saw relatively strong growth in emerging markets while developed markets contracted or stagnated. This disparity in growth rates, along with historically low interest rates in major developed economies, led to large capital inflows to emerging markets. In more recent years,

as developed economies' growth rates have improved while many emerging markets' growth rates have deteriorated, that flow of capital has started to reverse. Building expectations of a U.S. interest rate hike in 2015 caused the outflow of capital from emerging markets to grow—triggering uncertainty around the stability of emerging markets' current and capital accounts, as well as their corporate debt levels and banking systems. However, the anticipation of rate hikes may prove to be more damaging than the actual hikes, as the interest rate changes have already been "baked in" to markets. If other major central banks follow the Fed in normalizing their monetary policy, then this growth-debilitating uncertainty will be lifted. Although some less well-positioned emerging markets would likely suffer from financial instability in the short term, the medium- and long-term outlook for the vast majority would improve thanks to reduced risk and uncertainty surrounding eventual developed-market interest rate hikes.

A smooth transition in China to a consumption-led economy could provide the boost the global economy needs.

2. China rebalances its economy

The global economy could receive a huge shot in the arm if policy makers in China are able to transition their economy from investment- to consumption-led growth. As discussed in the "Key Country Growth Paths" section above, China currently faces a weaker economic outlook than it has in recent years, but there are some signs that the country is beginning to rebalance its economy. If China is able to smoothly shift to a more consumption-driven economy, this transition could provide the boost that the global economy needs to enter Globalization 3.0.

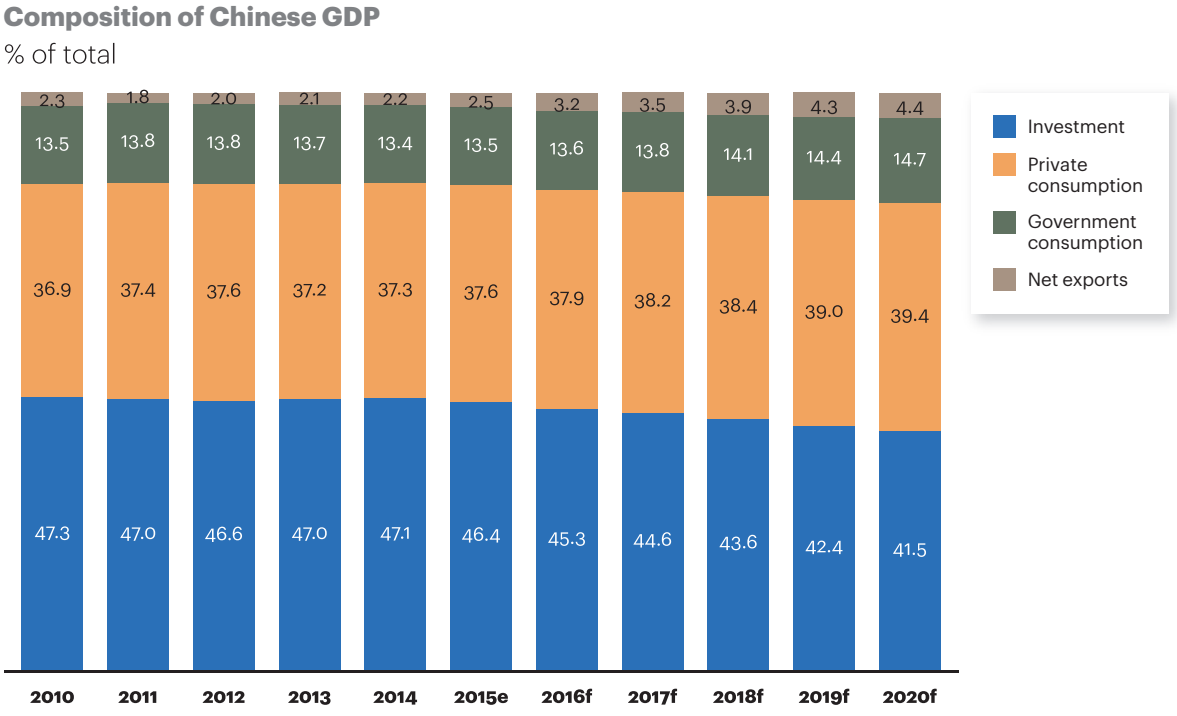
The investment- and export-led economic model that China employed throughout the 1990s and 2000s was an overwhelming success. The Chinese economy grew from just 4.1 percent of the global economy at purchasing power parity in 1990 to 17.2 percent in 2015. That astonishing economic growth translated into improved living standards for its population, with GDP per capita rising from just $975 to $14,190 over the same time period. During China's rapid economic rise, it powered a great deal of global economic growth. Its relatively cheap exports helped raise the purchasing power of consumers in the United States, Japan, Europe, and other markets. At the same time, China's investment boom drove up global demand for a wide array of commodities—including oil, iron ore, and copper—which boosted the economies of resource exporters throughout Latin America, Africa, and the Middle East.

However, in recent years it has become evident that China needs a new economic model in order to sustain growth as its labor force becomes more skilled and more costly at the same time as it is aging and shrinking. Beijing recognizes this, prioritizing in its 12th Five-Year Plan (2011–2015) the transition from an export- and investment-led to a consumption-led growth model. This rebalancing appears to be underway, albeit more slowly than Beijing may have intended. In October 2015, China's middle class became the largest in the world, with more than 109 million people with wealth between $50,000 and $500,000 according to Credit Suisse Research Institute's Global Wealth Report 2015. As a result, Chinese GDP growth in 2015 was sustained by strong household consumption, with Trading Economics reporting that retail sales grew 11.1 percent

year on year in December 2015, following 11.0 and 11.2 percent growth in October and November. Private consumption is expected to continue to increase its share of Chinese GDP in the coming years (see figure 5).

A successful transition to a consumption-led economy could once again make China one of the primary drivers of global growth. A consumption-led China would lift the economies of manufacturing, consumer goods, and agricultural exporters around the world. Given its large population of nearly 1.4 billion people and the growing purchasing power of its expanding middle class, China has the potential to become the world's new "consumer of last resort," stoking global demand and revitalizing the global economy.

Figure 5
China's economy is slowly transitioning from investment to private consumption



Sources: Economist Intelligence Unit; A.T. Kearney analysis

3. Technology takes off exponentially

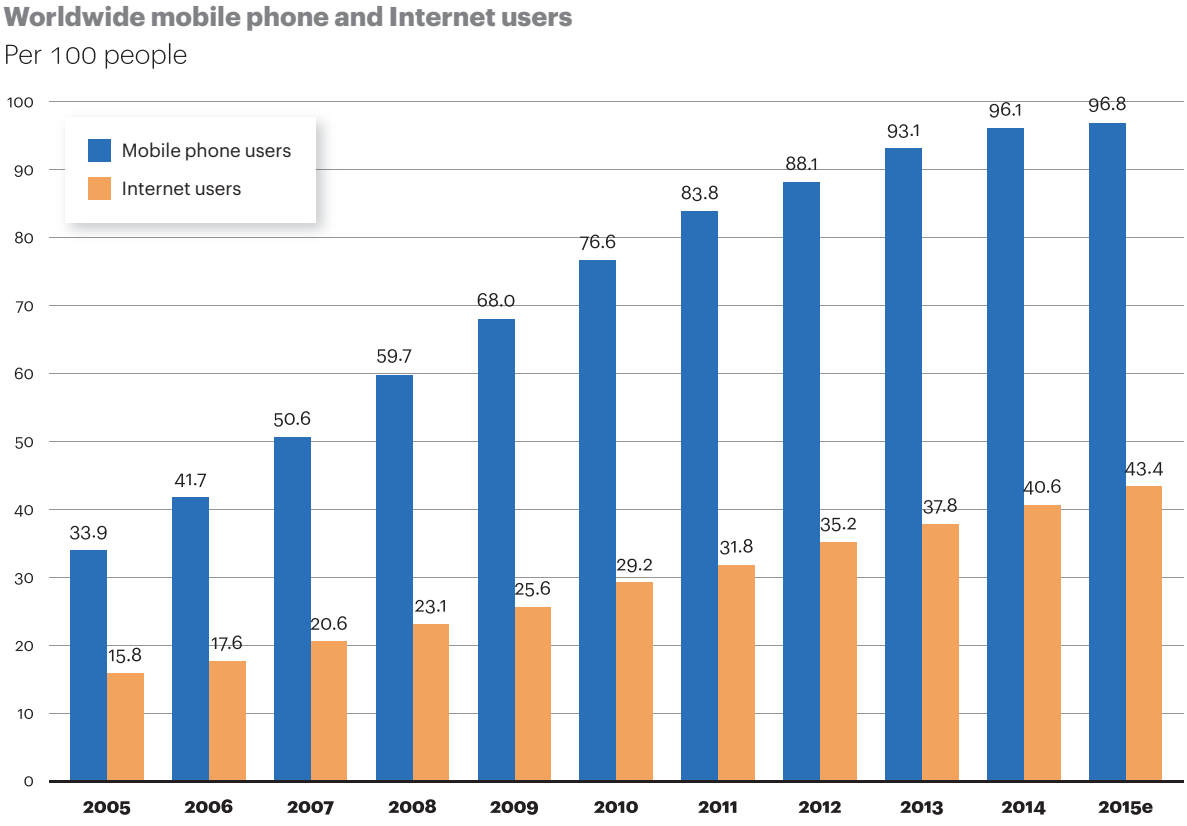
Technology has long been a driver of economic growth, higher productivity, and increased prosperity. Today, technology continues to evolve at unprecedented rates in many fields, including information and communications technology (ICT). And smart devices, virtual reality, and artificial intelligence—all considered to be science fiction a few decades ago—are now becoming reality. If businesses can harness the power of technological advances, especially mobile technology and the Internet of Things (IoT), it could reignite global economic growth and help the world transition to Globalization 3.0.

Mobile technology could be key to unlocking greater global growth in the next five years. The number of mobile phone users increased more than 220 percent in the past decade and an estimated one billion unique mobile subscribers will be added by 2020, bringing the total to 4.6 billion people (see figure 6). The industry is also expected to contribute $3.9 trillion to the global economy, or 4.2 percent of global GDP in 2020, according to GSMA Intelligence. Furthermore, mobile technology fuels higher productivity and economic growth in indirect ways, for instance by making it easier for rural residents to obtain information. Farmers can use mobile phones to access market prices for their crops, micro-insurance, seed and fertilizer prices, and weather information—all of which could greatly improve their odds of a successful harvest.

IoT could also dramatically boost economic output in the coming years. These "smart devices"—including drones, autonomous vehicles, and industrial robots—are forecast by Gartner to grow from 4.9 billion in 2015 to more than 25 billion by 2020. Autonomous vehicles could increase productivity in car-centric economies. For instance, Morgan Stanley estimates that Americans, who spend approximately 75 billion hours driving annually, could see productivity gains up to $507 billion if autonomous vehicles are adopted. Industrial robots—of which China is forecast to be the leading user by 2017 according to the International Federation of Robotics—could boost labor productivity in markets that are experiencing population decline. And drones could help improve households' access to consumer products and medicines, particularly in poorer countries.

Figure 6

Mobile phones are used globally, but Internet use is still relatively low



Sources: International Telecommunication Union; A.T. Kearney analysis

Of course, technological progress often gives rise to previously unimagined breakthrough inventions that spark dramatic increases in economic growth. So while mobile phones and IoT hold vast promise for boosting global productivity and economic growth, some unexpected technology may be invented in the next couple of years that does far more to reignite the world economy.

4. The Sino-American economic partnership accelerates

The United States and China are the world's two largest national economies—together accounting for fully one-third of the global economy at purchasing power parity and more than one-fifth of the global population. These two economies also have strong ties to one another. The United States is the primary destination for Chinese merchandise exports, and China is the fourth-largest market for U.S. merchandise exports. The United States is also one of the largest sources of foreign direct investment (FDI) in China, while Chinese FDI in the United States has grown markedly in recent years.

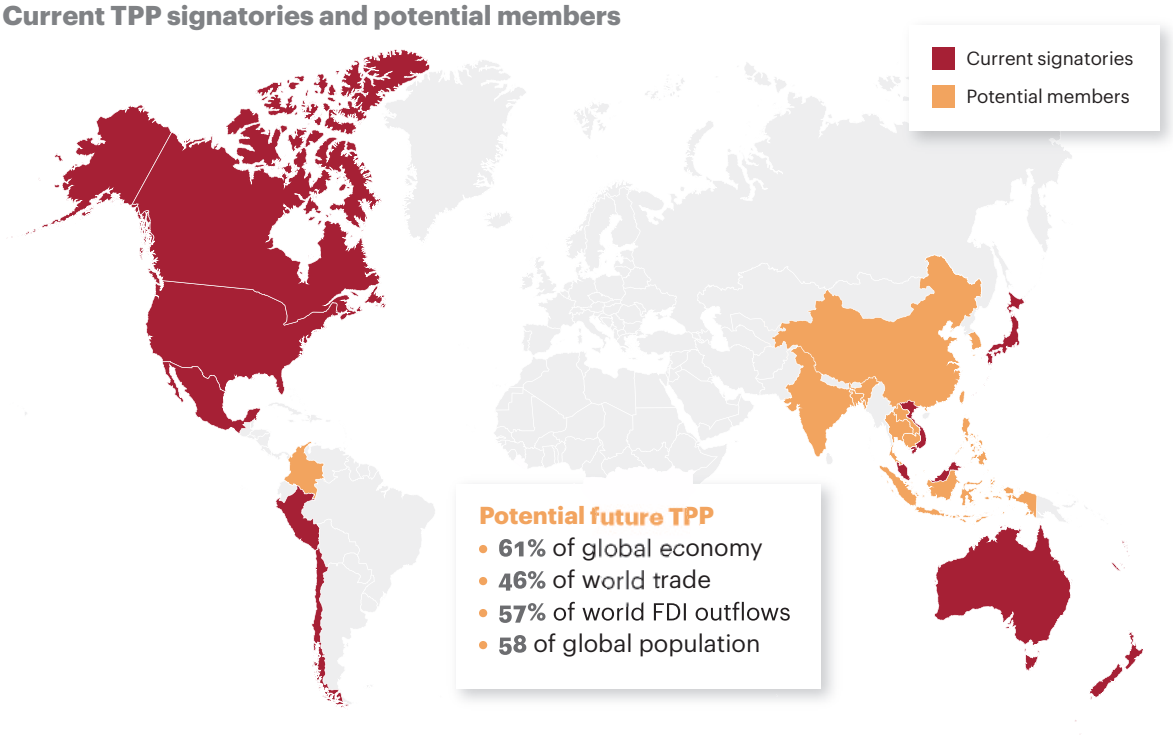
If China and the rest of the countries that have expressed interest were to join the TPP, it would account for **61 percent of the global economy and 46 percent of world trade.**

This bilateral economic relationship, however, is also strained at times. The United States and China currently have 26 WTO dispute cases against one another. In addition, the U.S. government has long bemoaned what it sees as currency manipulation to keep the yuan's value low relative to the U.S. dollar and other global currencies, thus giving Chinese exports an "unfair" competitive advantage. And American companies have recently complained that they are being unfairly targeted by the Chinese government's anticorruption campaign. In fact, 47 percent of companies said they felt less welcome in China than a year ago in a 2015 survey by the American Chamber of Commerce. On the other hand, Chinese companies have complained about the process and outcomes of Committee on Foreign Investment in the United States (CFIUS) reviews of Chinese FDI in the United States. For instance, CFIUS blocked the purchase of wind farms off the coast of Oregon by Ralls, a Chinese company, in 2012, which led to a lawsuit over the lack of due process in the review and an eventual settlement with the U.S. government in October 2015.

If these two economic giants were to resolve their various economic and political issues and establish a closer partnership, even more trade and investment could be unlocked between them. More importantly for global growth, a Sino-American "special relationship" could entice China to join the TPP—the trade deal that promises to link economies on both sides of the Pacific Rim more closely together. China joining the TPP could inspire many other countries throughout the region to follow suit. And if China and the rest of the countries that have expressed some interest in the TPP were to join it, the expanded TPP would account for an overwhelming 61 percent of the global economy and 46 percent of world trade (see figure 7 on page 18).

Figure 7

A potential expanded TPP could include China, India, and other key markets



Notes: TPP is Trans-Pacific Partnership. FDI is foreign direct investment. Potential members are those countries that have publicly expressed interest in further exploring membership or in actually joining the TPP in the future.

Sources: International Monetary Fund World Economic Outlook (October 2015), United Nations Population Division, United Nations Conference on Trade and Development; A.T. Kearney analysis

Such a development, along with the elimination of U.S.-China tensions hanging over Southeast Asia, could reinvigorate world trade and unlock global economic growth.

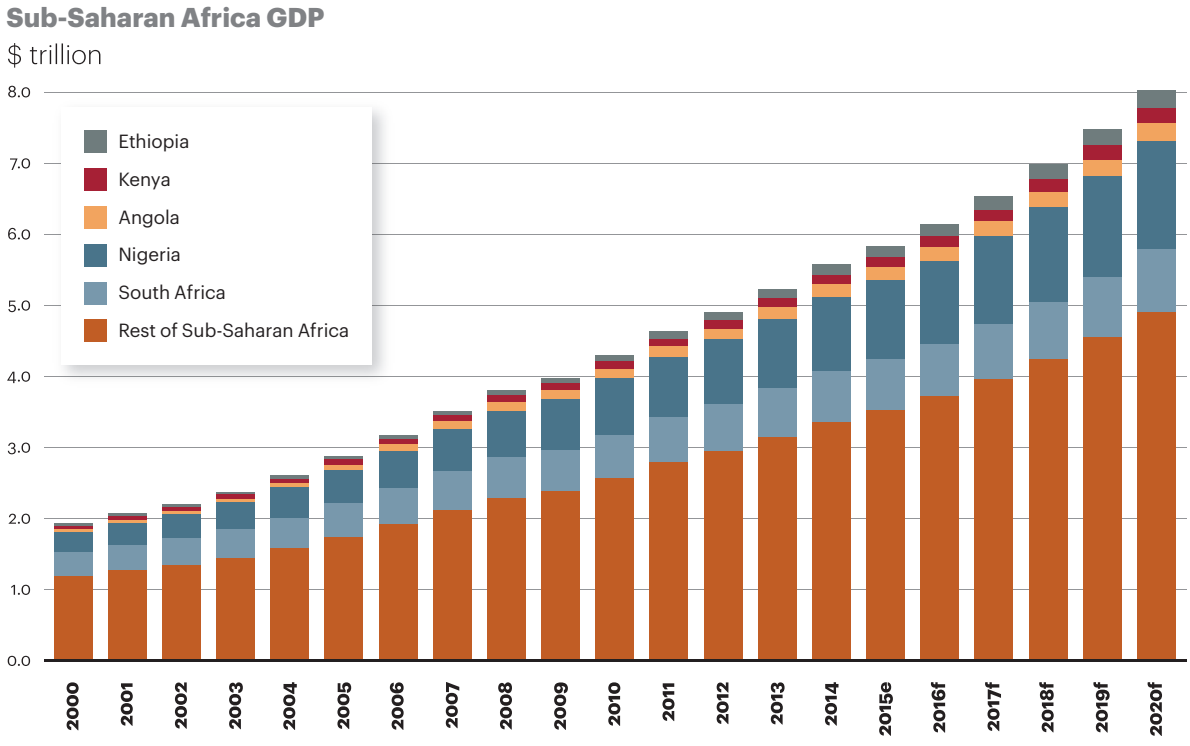
5. Sub-Saharan Africa joins the global value chain

While Sub-Saharan Africa still faces challenges of poor infrastructure, corruption, a weak business environment, and low labor productivity, it also shows potential for an economic boom in the next few years. In fact, Sub-Saharan Africa has been one of the best-performing regional economies in recent years and is forecast to continue to grow relatively robustly (see figure 8 on page 19). Current global economic and demographic trends could help growth in the region take off, potentially following in the footsteps of the industrialized economies of East Asia. If Sub-Saharan Africa economies liberalize their business operating environments, capture the potential from their rapidly rising workforce populations, and integrate more fully with the global economy, the region could help push the world toward Globalization 3.0.

Sub-Saharan Africa will be the primary source of global population growth in the coming decades. At the same time, fertility rates in the region have been in decline the past several years, which will lead to a demographic dividend—a period of time when the dependency ratio falls and the workforce grows as a share of the total population, freeing up resources to invest in economic development. An estimated 11 million young Africans under the age of 25 are expected to join

Figure 8

Sub-Saharan Africa's economy is growing, although it is still dominated by several large markets



Note: GDP is measured based on power purchasing parity in current international dollars.
Sources: International Monetary Fund World Economic Outlook (October 2015); A.T. Kearney analysis

the labor market every year for the next 10 years. While this could spark social unrest if employment opportunities are scarce, this youth bulge could alternatively enable Sub-Saharan Africa's economy to grow rapidly, similar to what East Asia experienced in the 1980s when the working age population was increasing while fertility rates were falling. The World Bank estimates that the rising working age population in Sub-Saharan Africa could boost GDP by 1.9 percent in 2030; and if the larger workforce also attained high education levels, the regional economy could be more than 22 percent larger in 2030 than in the baseline scenario.

If Sub-Saharan Africa is able to capitalize upon its demographic dividend and invest in the necessary infrastructure and education to support business activity, it could become the world's next major manufacturing hub. Labor in today's large manufacturing countries, such as China and Southeast Asian economies, is becoming more costly. As a result of its cheaper labor and extensive natural resources, Sub-Saharan Africa is already becoming an attractive region for multinational companies' investments. For example, fDi Intelligence reports that greenfield investment in Sub-Saharan Africa rose from $42 billion in 2013 to $61 billion in 2014—45 percent growth in a year when greenfield FDI investments grew only 1 percent globally. Top destinations included Angola, Nigeria, and Mozambique. Investors are primarily interested in the oil and gas sector, but are also investing in real estate, communications, financial services, and agriculture.

Conclusion and Business Implications

The global economy will maintain stable growth rates over the next five years, although there will be considerable variation at the country and regional levels. Developed markets will likely be among the primary growth markets for multinational firms in the near to medium term. However, many opportunities for sales and investment exist in emerging markets. It will be important for business leaders to be selective in which emerging markets they target for new opportunities, as structural economic growth models and the policy agenda diverge greatly and will translate into winning and losing economies.

There are risks to the global economic outlook on both the upside and downside that business leaders should monitor in order to anticipate changes in the growth trajectories of the markets that are key for their businesses. Downside risks include financial instability in emerging markets due to U.S. interest rate hikes, global terrorism disrupting business operations and damaging business and consumer confidence, and yet another resumption of the eurozone crisis. Upside risks include quicker than expected growth in the eurozone, successful structural reform agenda implementation in Japan, China, and India, and additional boosts in worldwide consumer spending due to lower oil prices.

While the five key opportunities for global growth identified above may not be particularly likely to occur, each represents further dramatic upside risk for the global economy and the business operating environment—particularly if all five of them occur together. None of these opportunities for global growth will be easy to achieve, however, as they all require strong and visionary leadership among both policy makers and business executives. What will be necessary in order for the global economy to achieve escape velocity is for both government policy makers and business leaders to shake off the complacency that risks stifling economic growth and instead work together to make the necessary investments and reforms to kick-start stronger and more resilient global growth.

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A.T. Kearney's Global Business Policy Council, established in 1992, is dedicated to helping business and government leaders worldwide anticipate and plan for the future. Through strategic advisory services, regular publications, and world-class global meetings, the Council is committed to engaging in thoughtful discussion and analysis of the trends that shape business and government around the globe.

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