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Global Economic Review

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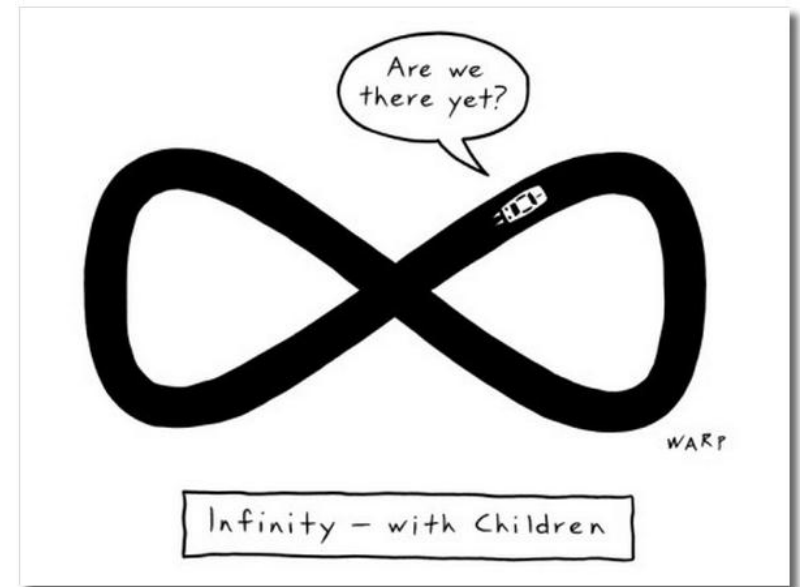


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The global economy in 2013

Surely this can't go on for ever?



Robin Bew, Editorial Director & Chief Economist

British Council, December 2012

2013—better than 2012, but it may not feel like it

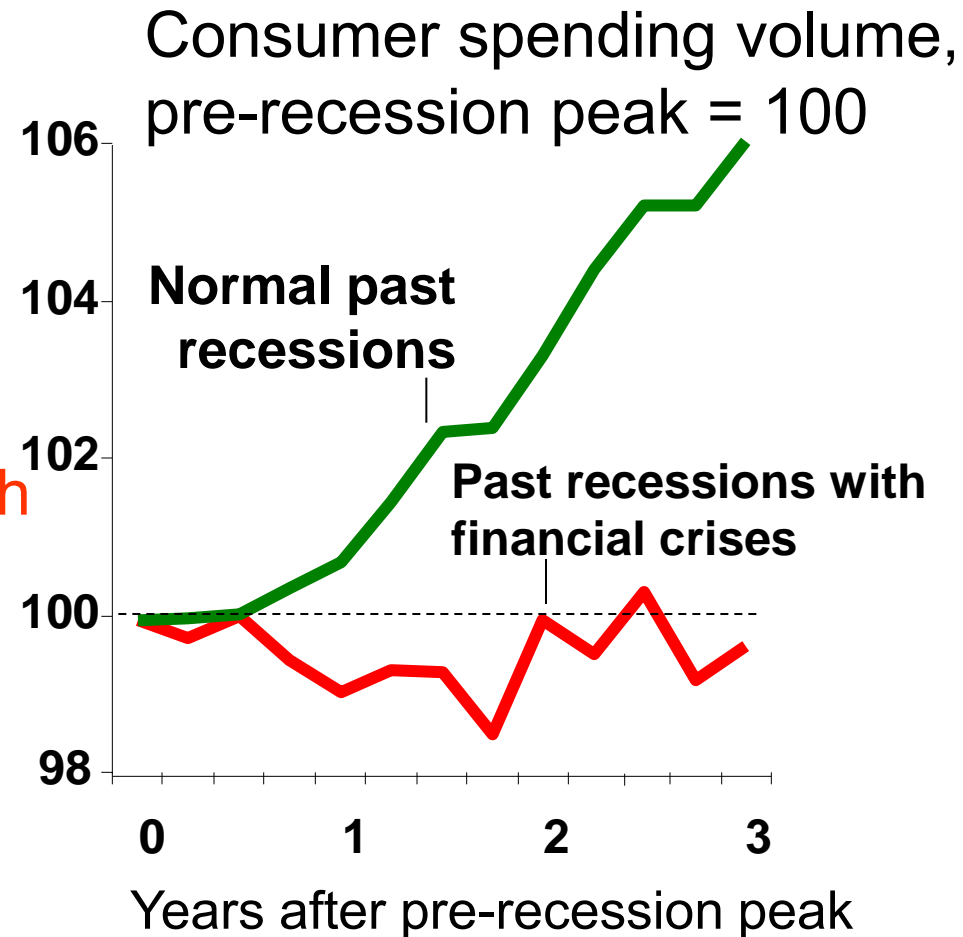
- Europe struggles will continue, but no collapse
 - Euro recovery anaemic—0.2% contraction
 - Parts of periphery in depression
 - UK growth remains subpar
- US recovery has modest momentum
 - Policy makers not helping
- China yoyo-ing—8.6%
 - Strongly outperforming the West
 - But experiencing growing pains as it moves to middle income status
- Rest of the world blowing in the breeze
 - Hanging on Chinese demand for raw materials or western demand for goods
 - Asia is the fastest growing-region



Why such a slow, volatile recovery?

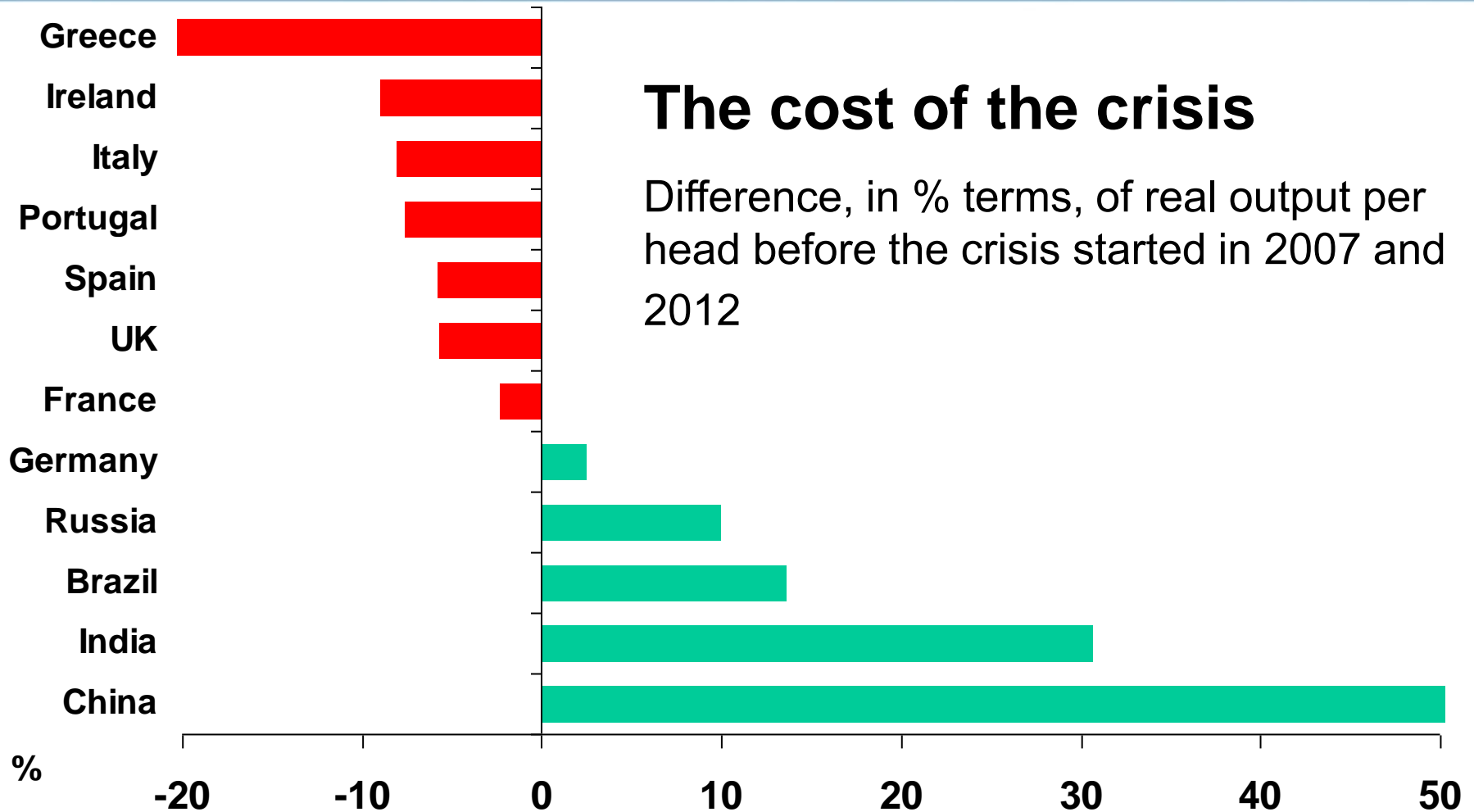
Features of a post-crisis decade

- Credit growth: **Weak**
- House prices: **Fall in real terms**
- Unemployment: **Stubbornly high**
- GDP growth: **Weak**
- Banks: **Financial repression**

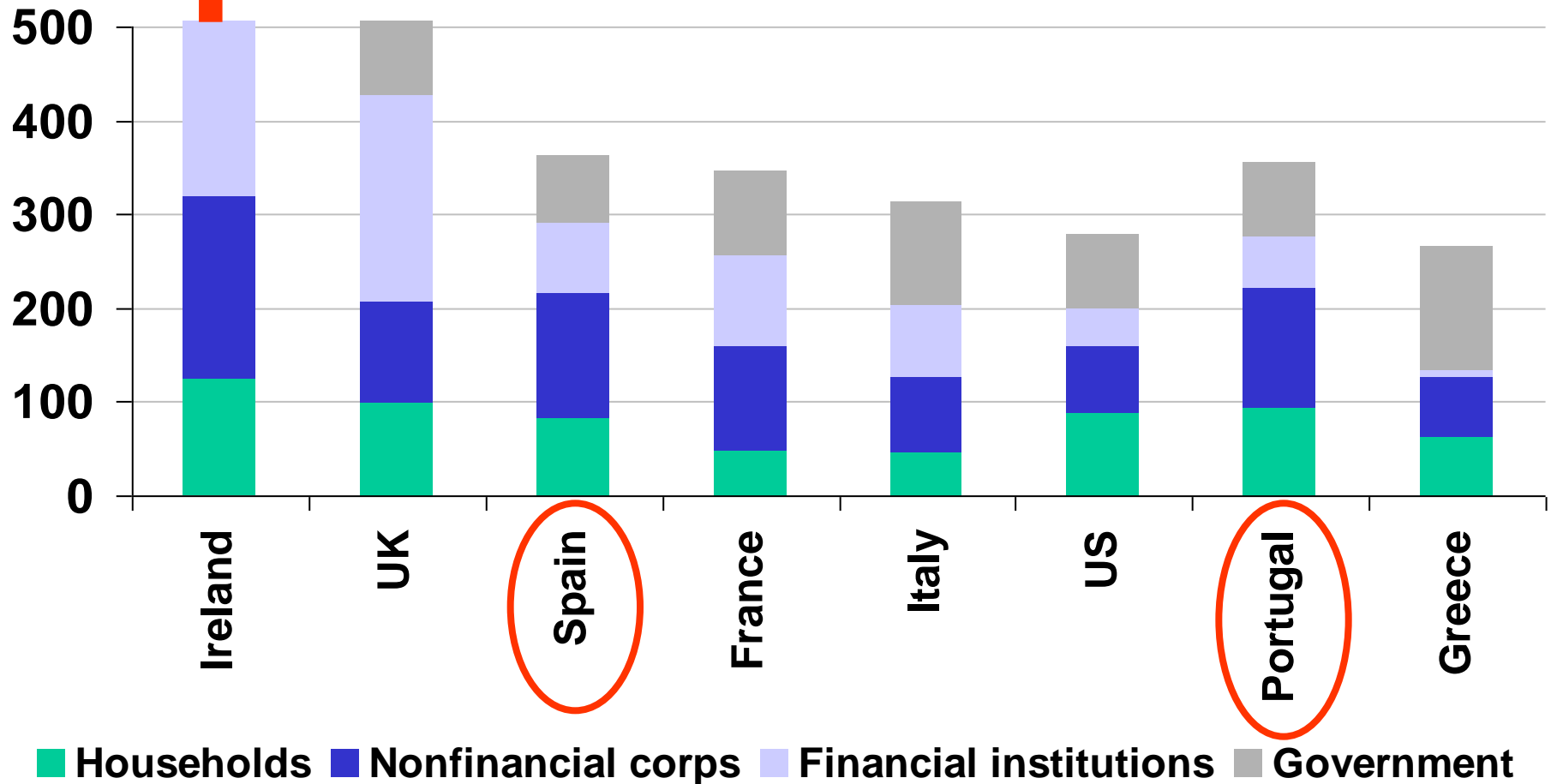


Western Europe

Euro zone: paying the price



Euro zone: A variety of debtors

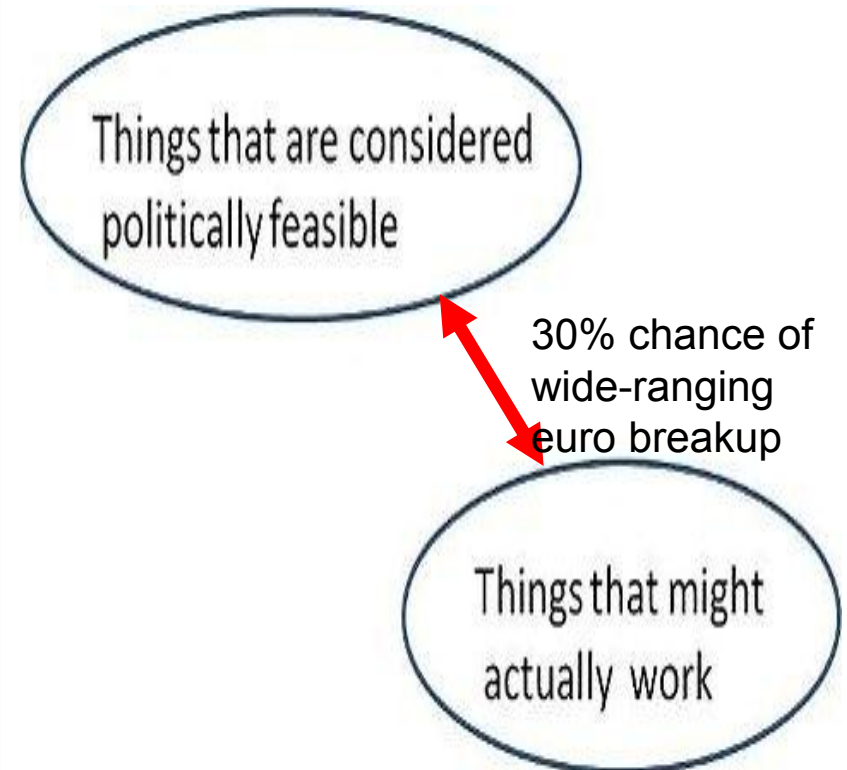


Total debt as a % of GDP. Sources: Haver, BIS, national central banks.

Have they done enough?

- Liquidity or solvency crisis
 - Bailouts, ECB action are sufficient if we face a liquidity crisis
 - Provided they are honoured
 - But if we face a solvency crisis then insufficient
 - Need fundamental change in growth picture
 - Need debt forgiveness
 - Remember liquidity crisis can become solvency crisis
 - Death spiral of austerity
- Immediate risks addressed
 - Long term risks remain

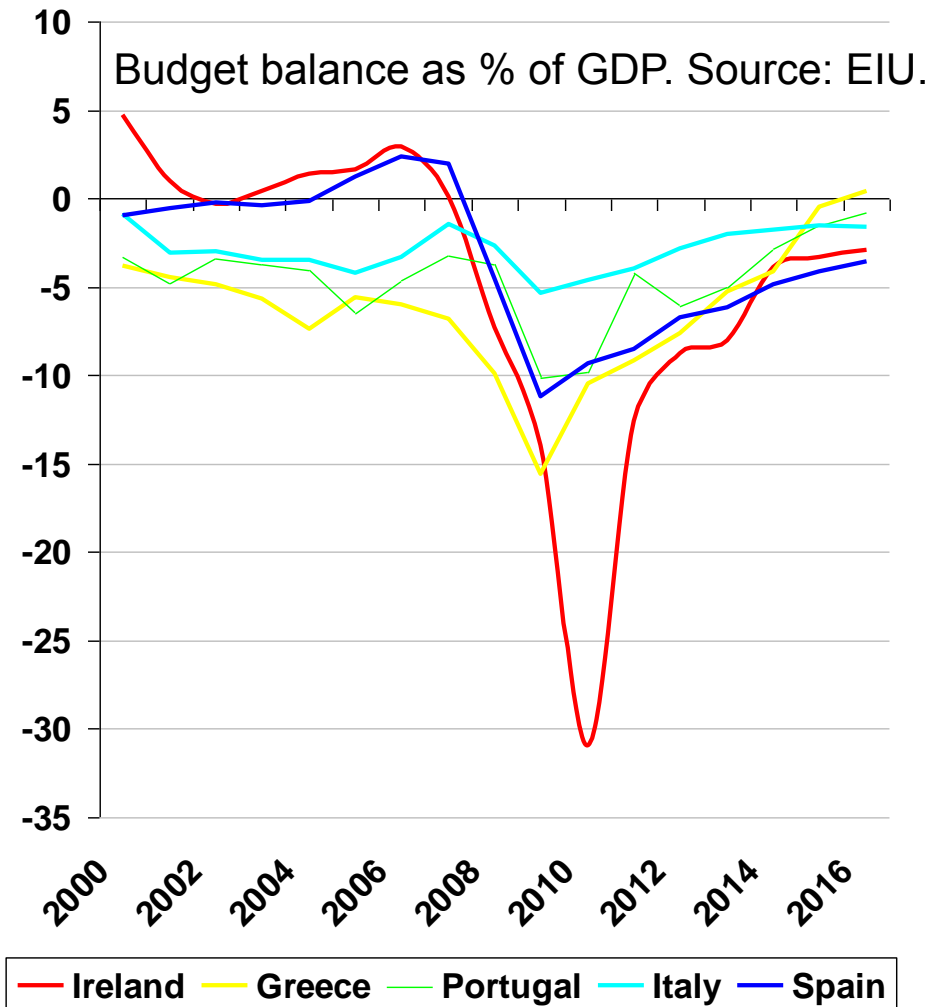
Venn diagram for the euro zone



Source: *New York Times*.

Euro zone: What to watch for

1. Greece political rejection of austerity
 - End of bailout, economic collapse
 - Political decision to exit from euro, mass default
2. Loss of confidence in long-run sustainability of public finances
 - Euro yields spike across the board
 - Spain and Italy cut out of capital markets
 - ▶ or access only at unaffordable rates
 - ECB intervention limited by political constraints
 - ▶ Especially if followed by reform backsliding
 - Fiscal solution required
 - ▶ Spain could be rescued, if there is the will; Italy too big?
3. Liquidity problem? Or, solvency problem?



The curse of the continent

60% chance euro zone remains intact

- Bailouts and ECB support provide essential liquidity, reducing short term risks
 - Single bank supervisor followed by single resolution system provides back door pooling of fiscal sovereignty
 - Structural reforms allow growth to recover in periphery, lifting tax receipts

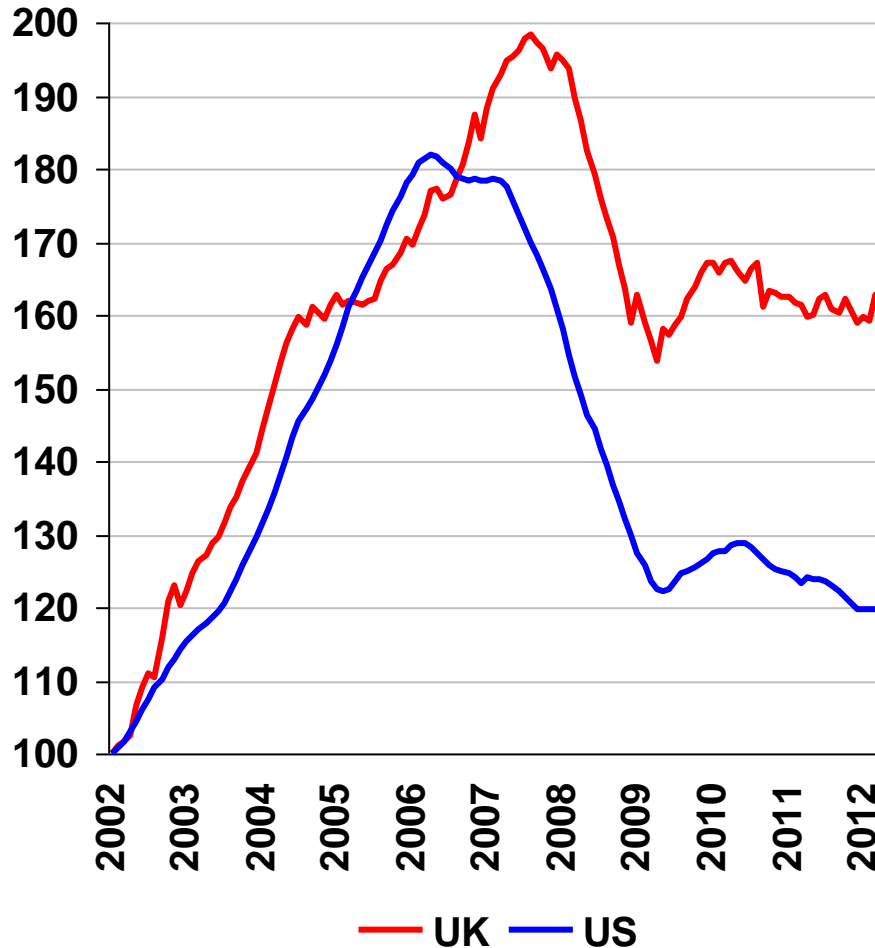
10% chance Greece comes out and rest of euro zone survives

- ECB galvanised into greater action by Greek exit
 - Although it will be tough to credibly intervene if Greece has left

30% chance the euro zone breaks apart

- Either: Greece leaves and contagion cannot be contained
- Or: Spain and Italy lose market access and ECB is constrained from extending unlimited support by Euro Zone hawks
 - Break-up, extending to at least Italy and maybe France
 - Global financial crisis,
 - Euro zone depression, dragging rest of world down (trade and financial links)
 - ▶ Hard to assess impact as unconventional policy will become the norm
 - Capital controls, travel bans, untrammelled monetisation

UK: Stabilising at a low level?



- Consumers are enduring the biggest squeeze on real incomes since the 1940s
- Euro contagion to Spain, Italy and France could trigger financial-sector stress in the UK
- More QE is likely in 2012-13, with total rising to £450bn by 2013; no rate rises before 2015
- Large companies are hoarding cash--£80bn in 2011, £72bn in 2010
- Private sector is not offsetting job losses in the public sector

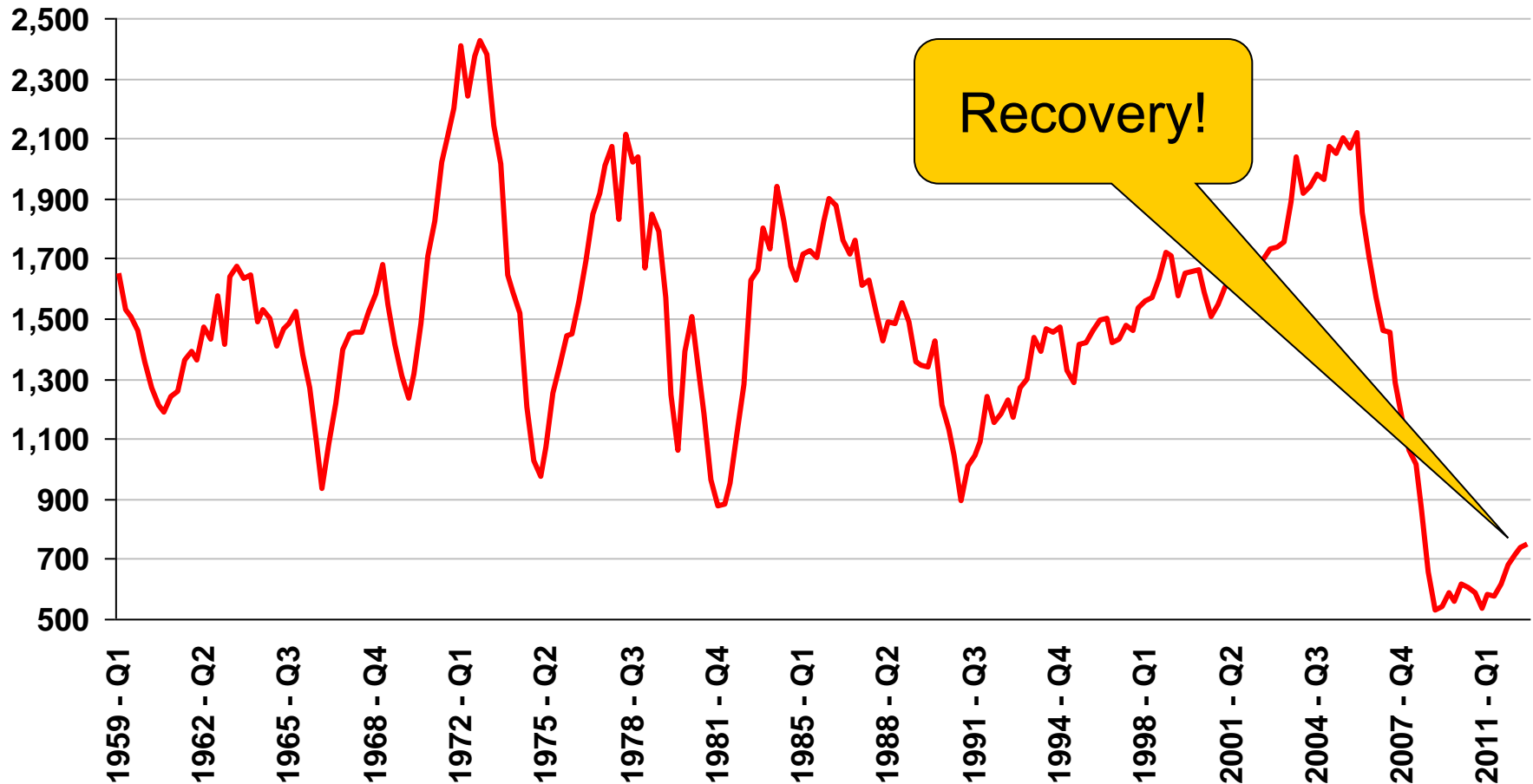
Jan 2002=100. Sources: Case-Shiller (US), Halifax (UK).

United States

The US election

- No change at the top
 - Same President, Democrats retain Senate, Republicans retain House
- Country still very divided
 - Popular vote vs electoral college
 - So don't read too much into victory
 - Not much of a mandate for change (lost share)
- Why did he win?
 - Improving economy (housing, equities, confidence)
 - Although still pretty poor in absolute terms
 - Also Romney gaffs
- Policy
 - Big issue is long-term fiscal reform
 - May be opportunity to push forward?
 - But events will be the big driver
 - Little consensus on policy direction, so policy will be reactive

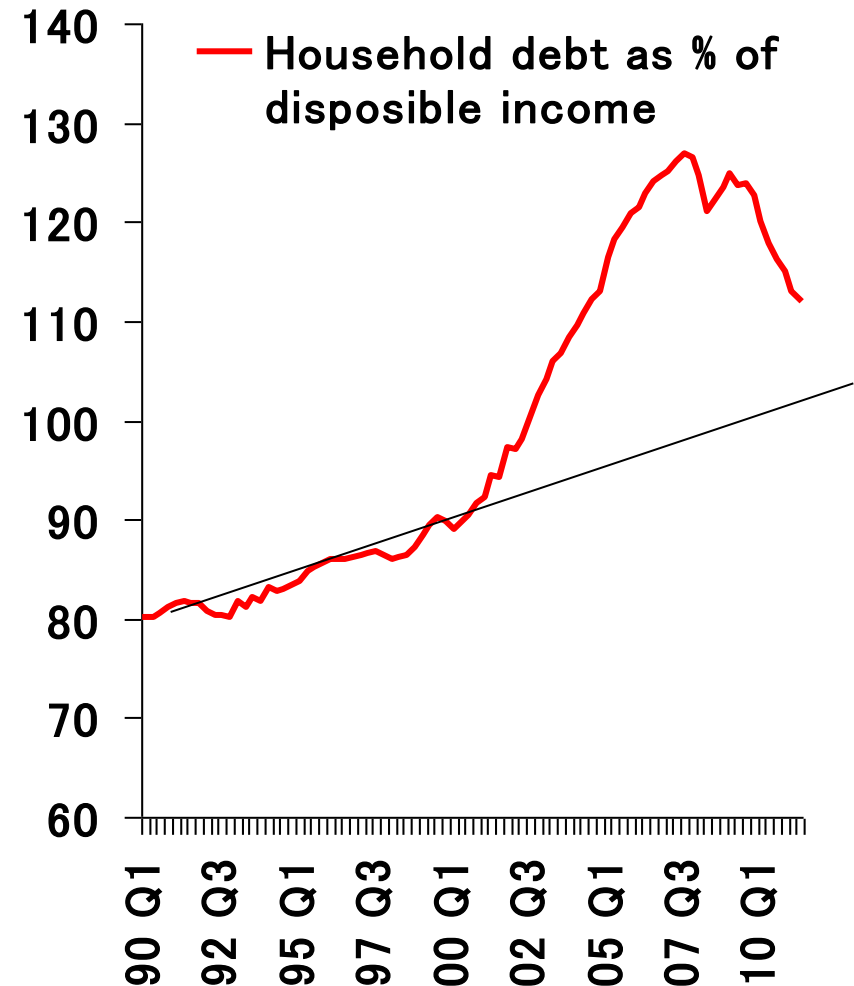
US: Green shoots?



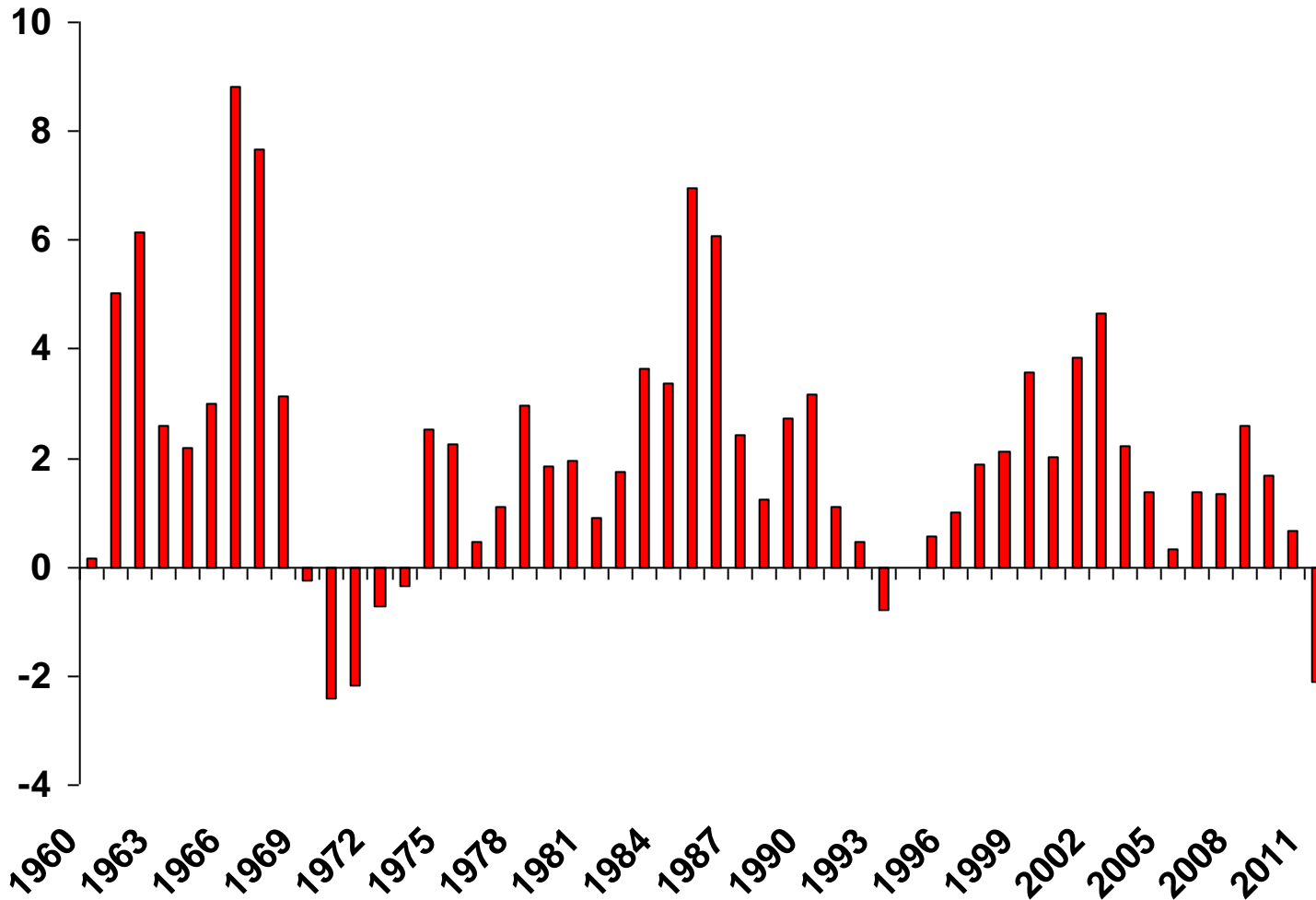
US: Housing starts, '000s, SAAR. Source: Bureau of the Census.

US clawing out of the hole

- Subprime created similar problems to Europe
 - Hit banking sector hard
 - Government bailouts
- But having an independent monetary policy and currency makes all the difference
- Debts still too high
 - But growth has improved
 - Helped by the Fed
 - And despite Congress



No “fiscal cliff” diving, but fear of heights



- 2011: largest decline in gov't spending since Vietnam war
- Spending has contracted for eight straight quarters
- If “fiscal cliff” happens, GDP will contract by 0.5%
- Worst will be averted, but fears are weakening economy in 4th quarter

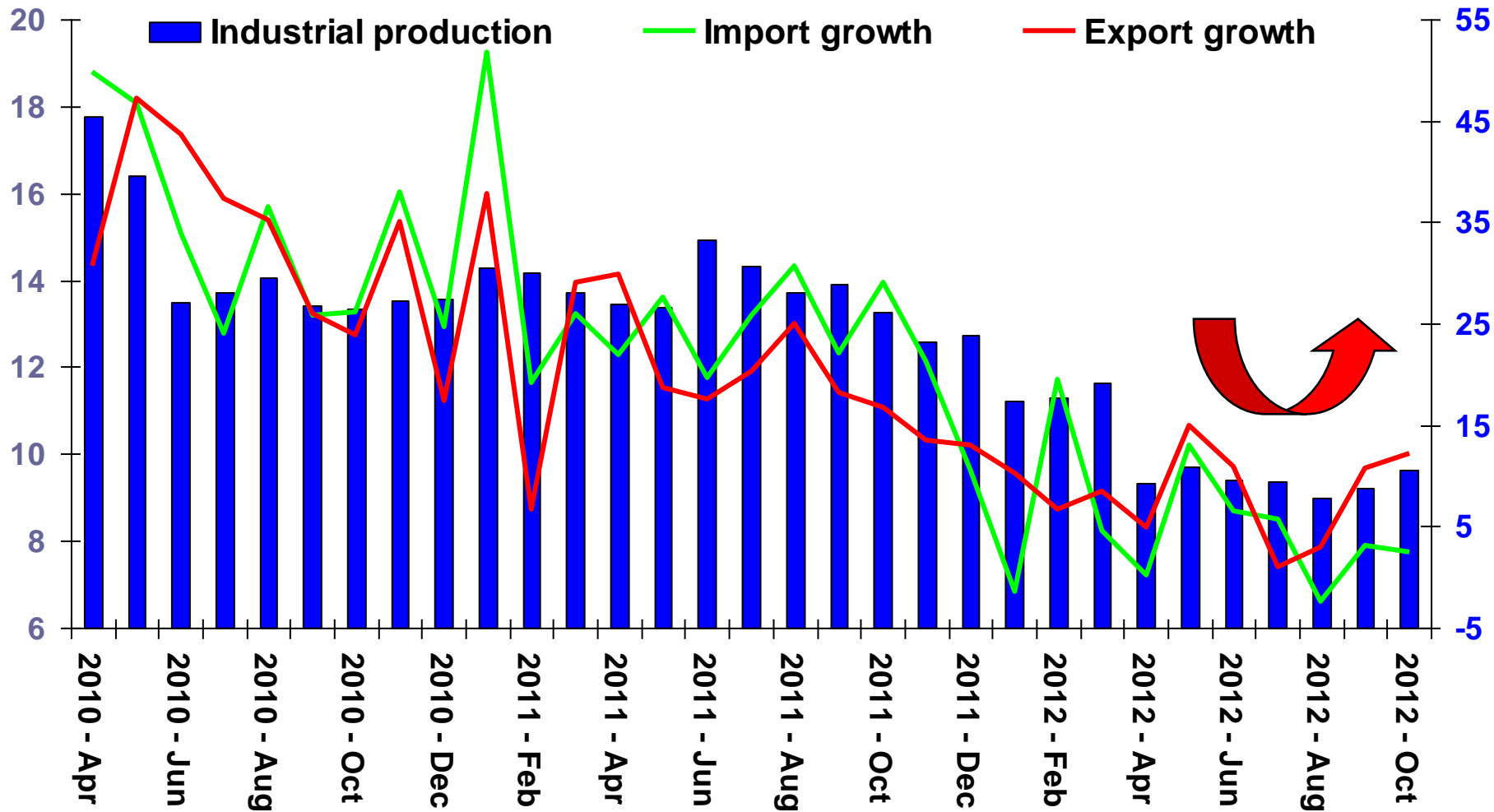
The big reset

- Need to recalibrate long-run expectations
 - It's not all over for the US
 - But it will take time to return to normality
 - Aging population
 - Fiscal problems
 - ▶ Although not like peripheral Europe
 - Long-term unemployment
 - Slowing productivity growth
 - High debt burdens



China

Recovery has started



Industrial production, % change YoY, lh scale; Trade, % change YoY, rh scale. Source: Haver

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China: Mega-urbanisation

Year in which average disposable income per capita exceeds RMB30,000

2009

Dongguan

2011

Hangzhou
 Guangzhou
 Ningbo
 Suzhou
 Shenzhen
 Shanghai

2012

Beijing
 Jinan
 Nanjing
 Wuxi
 Xiamen

2013

Baotou
 Hohhot
 Qingdao
 Taizhou
 Tianjin
 Yantai

2014

Changsha
 Dongying
 Maanshan
 Wuhan
 Xi'an
 Yangzhou
 Zhongshan
 Zibo

2015

Fuzhou
 Langfan
 Harbin
 Hefei
 Jining
 Linyi
 Nanchang
 Shenyang
 Shijiazhuang
 Tai'an
 Tangshan
 Weifang
 Xiangtan
 Xiangfan
 Xuzhou
 Zhengzhou
 Zhuzhou

2016

Anyang
 Changchun
 Chengdu
 Dalian
 Guilin
 Huainan
 Jiaozuo
 Kunming
 Luoyang
 Nanning
 Pingdingshan
 Wuhu
 Zhangjiakou

2017

Anshan
 Datong
 Hengyang
 Liuzhou
 Panzhihua
 Qinhuangdao
 Xiangfan
 Zhaozhuang
 Zhuhai
 Zunyi

2018

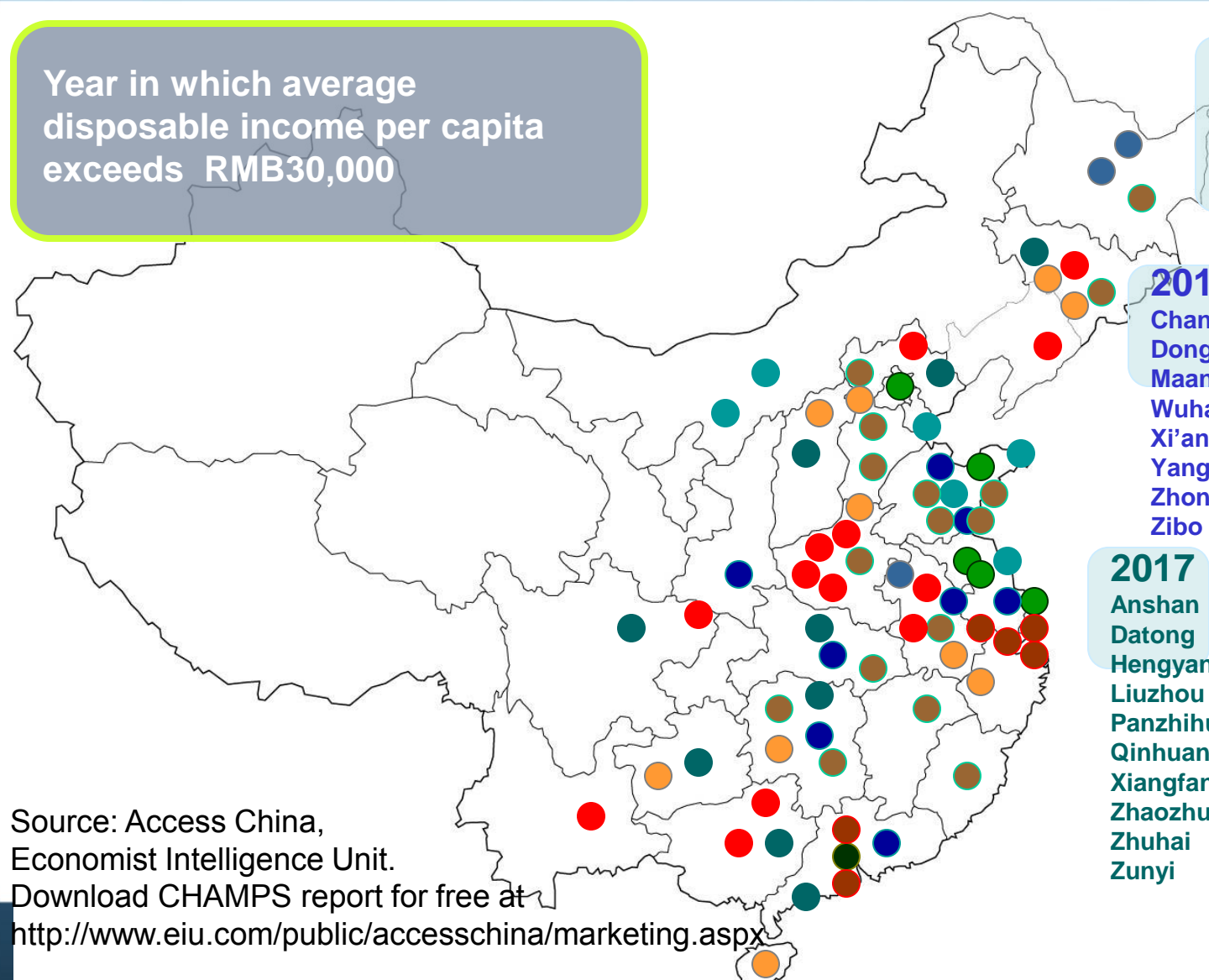
Changde
 Guiyan
 Huaihua
 Huainan

Jilin

Chaoyang
 Taiyuan
 Xingtai
 Luoyang

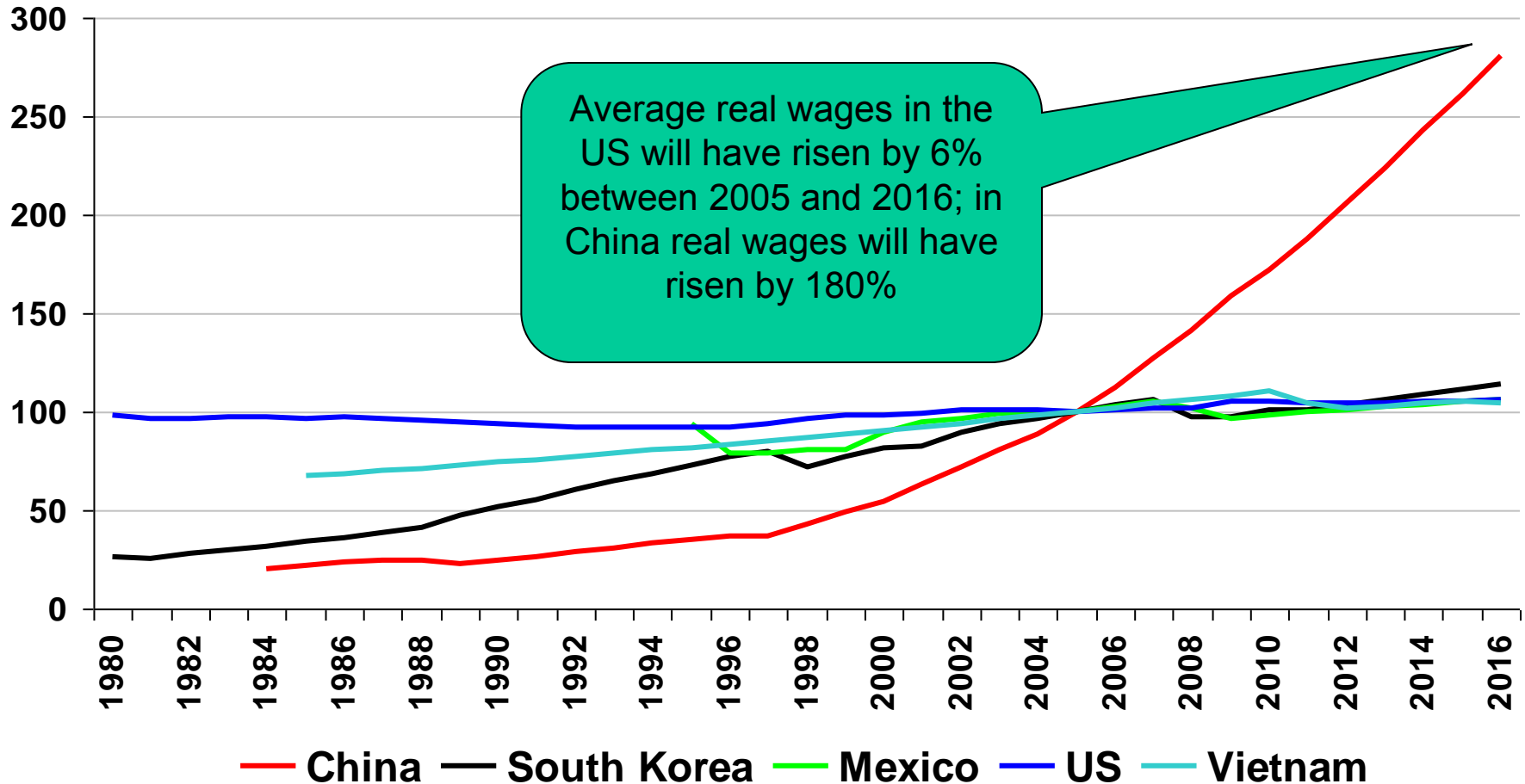
2019

Daqing
 Huaibei
 Qiqihar



Source: Access China, Economist Intelligence Unit.
 Download CHAMPS report for free at <http://www.eiu.com/public/accesschina/marketing.aspx>

Chinese challenges



Average real wages, 2005=100.

Source: Economist Intelligence Unit, CountryData.

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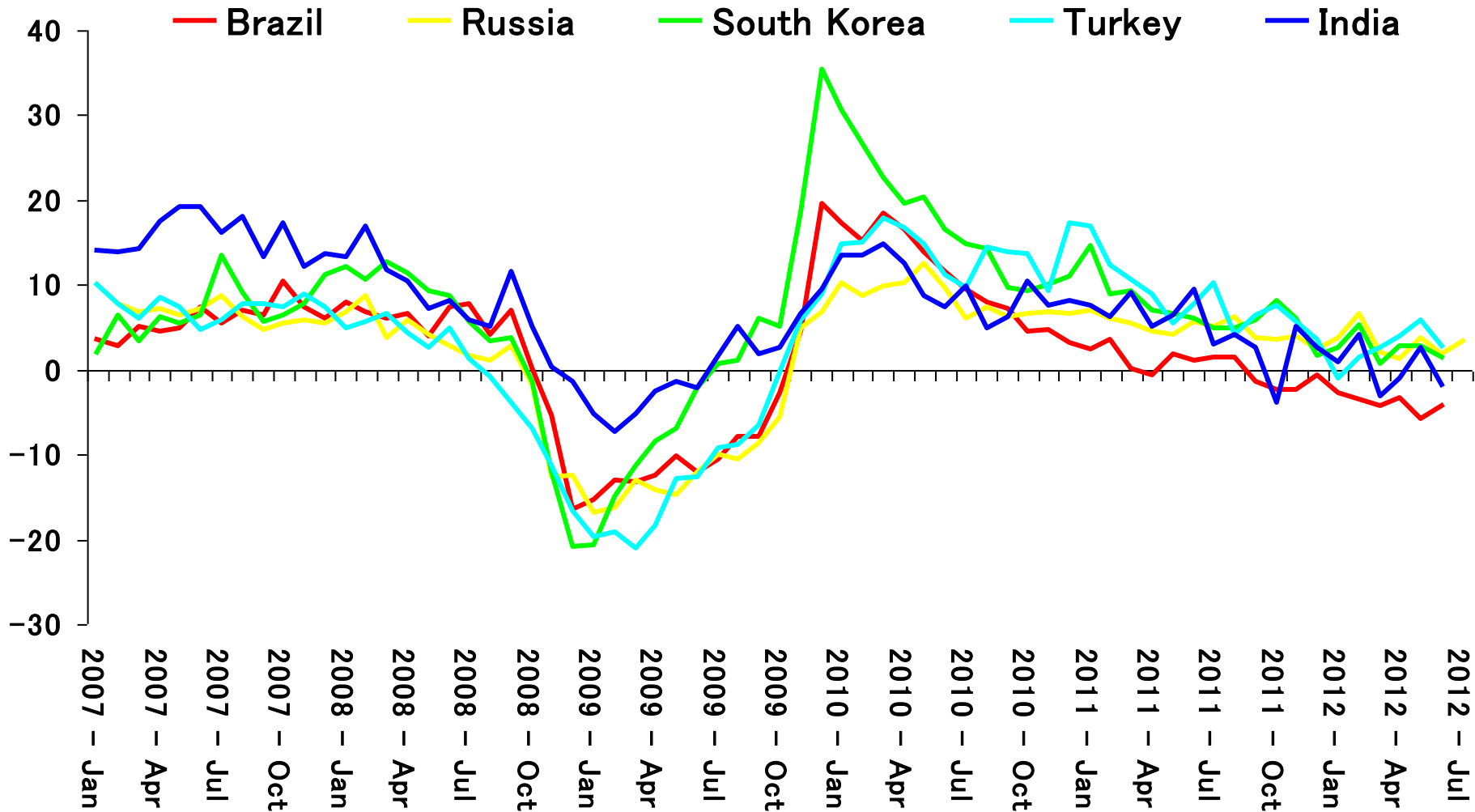
And rising to them.....

- Great Wall Motors
 - opened a production facility in Bulgaria in February 2012
- Geely Motors purchased Volvo
 - Aims to enter UK market under Geely brand in 2013
- Chery Autos has joint venture with Italian DR Motors
 - Purchased Fiat production facility in Sicily
- Beijing Automotive Industry Holding (BAIC)
 - Purchased Saab's production technology



Rest of the World

Emerging market industry has slowed in last year



Industrial production, % change, YoY.
Source: Haver Analytics

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Emerging world round-up

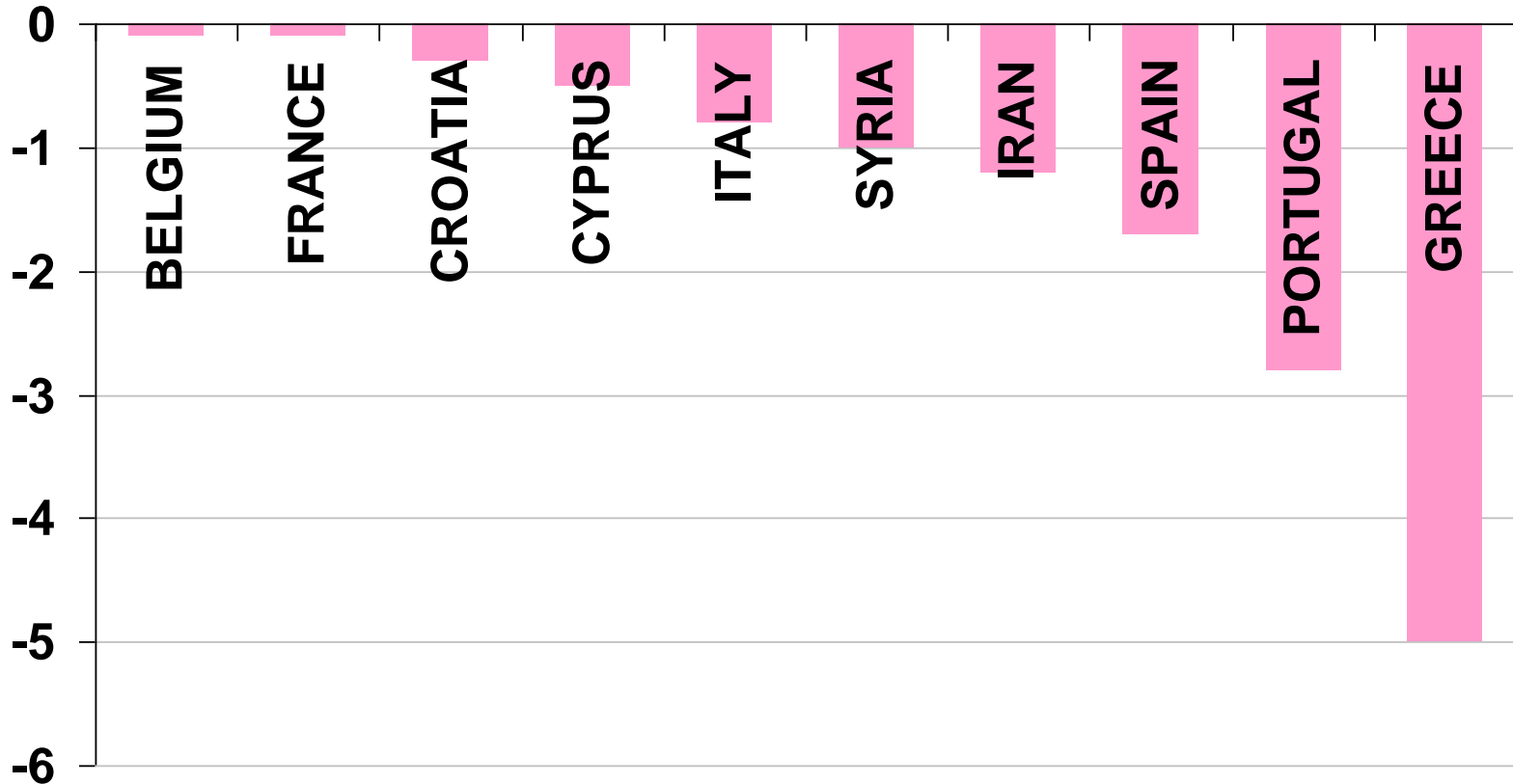
- Middle East: Ludwig Von Mises was right
 - War and revolutions are bad for business.....
- Africa: brightness in the gloom
 - Population trends, business environment, growth
- Asia: so much about China
 - India in a hole, and trying to stop digging
- Latin America: the giant disappoints
 - The return of Mexico? Plenty of bright other spots.
- East Europe: long faces all round
 - Central Europe like W Europe, only with less money and weaker institutions
 - Russia 2.0? We don't think so.

So what?

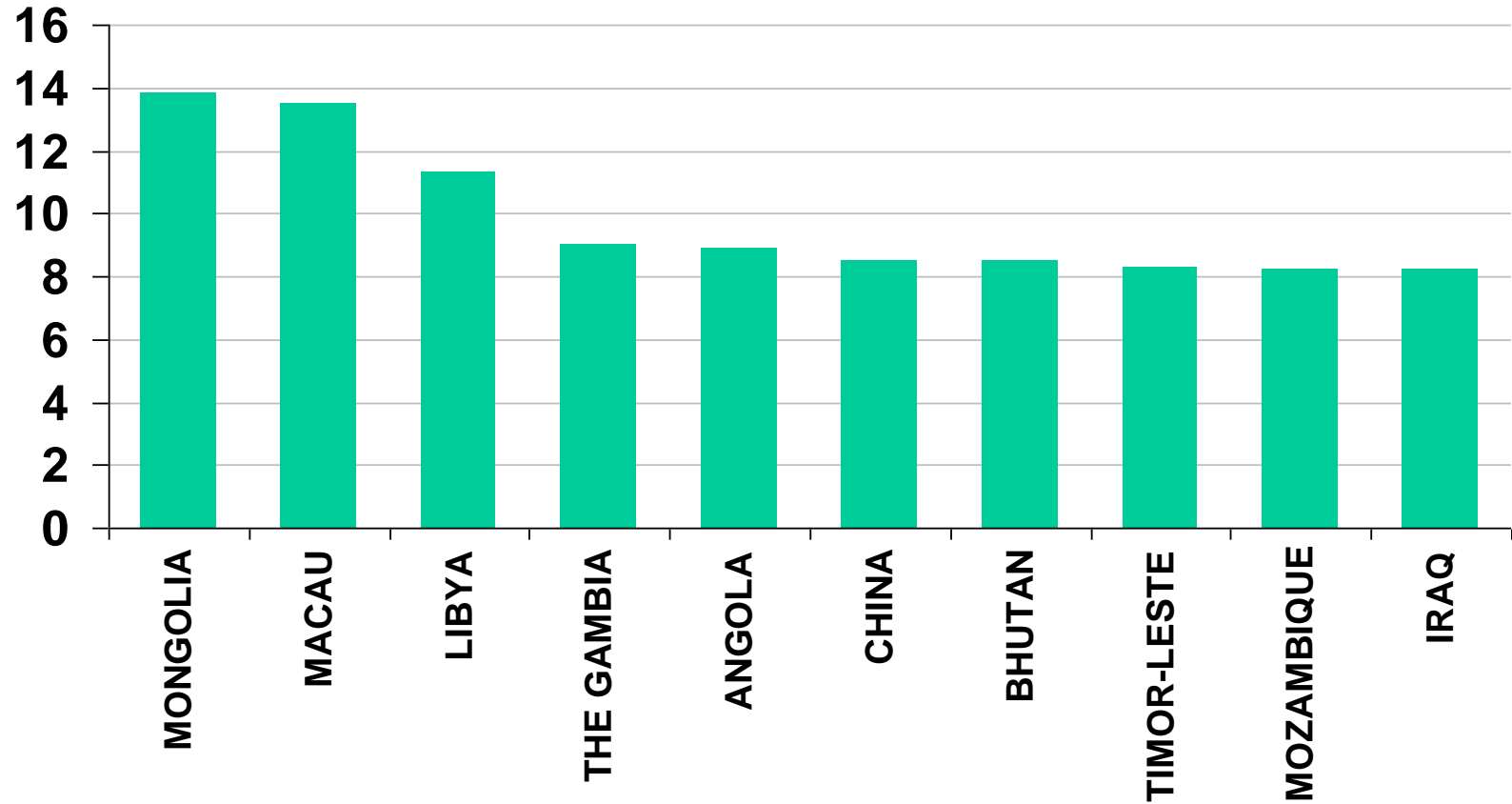
Key takeaway

- Rich world likely to struggle for many years
 - Europe in real trouble
 - US also has big problems, and is likely to disappoint
- Emerging world set to outperform
 - Have their problems, such as weak western demand, but:
 - Growing importance of local demand
 - South-south trade
 - Demographic trends
 - ▶ Populations, urbanisation,
 - Many countries at key point in income scale
 - ▶ Burgeoning middle class

GDP growth in 2013: The losers ...



... and the winners



Education-the 6 things to watch

- Fees
 - Not helpful
- FX
 - Modestly favourable against many Emerging markets, but not against euro
- Visas
 - No relief
- Competition
 - FX likely to help Australia, US
- Foreign incomes
 - Broadly good in emerging markets
- Foreign instability
 - Expecting political instability to increase

Questions?

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