GLOBAL ECONOMICS 2016 YEAR AHEAD: Easy in, easy out

"We are not fans of the gloom-and-doom stories of a Chinese hard landing or looming recession in the U.S. or other developed markets… Chinese authorities have both the room and the incentives for further policy easing to preclude a more adverse deceleration in growth… The combination of a deep downturn and gradual recovery likely means there is still room for the U.S. economy to expand. We expect there will be a recession again at some point in the future, but it does not appear imminent to us."

– Ethan Harris, Co-head of Global Economics Research

Our view

Two roads diverging: Policy divergence should be a key theme for 2016, as the Federal Reserve, The Banco Central do Brasil and a few other central banks intend to tighten monetary policy, while most – including the European Central Bank and the Bank of Japan – take the opposite path. This split will occur against what we expect will be a backdrop of modestly rising global growth and inflation. As a result, we believe the risks of a hard landing or a recession will be low.

In the euro area, the same symptoms – and the same prescription: With modest further monetary and fiscal stimulus, we expect to see continued above-trend growth in Europe. Further weakening in the euro exchange rate should also help although most of the strength is coming from domestic demand. The coming year is likely to be the fourth in a row with inflation hovering around the 1 percent level.

Domestic demand to lead Japan's recovery: We expect that domestic demand will grow on continued strength in corporate earnings, low commodity prices, the dynamics supporting a tight labor market, and the Abe government's fiscal stimulus policies.

In China, a pause in the slowdown: China is struggling as it restructures away from exports and investment in favor of consumption and services. We expect the government to continue to implement monetary and fiscal stimulus until growth stabilizes. However, the longer-term outlook is for a gradual slowing in growth.

Key calls

- **Rates increasing:** We believe the U.S. economy is now strong enough to handle the Federal Reserve's finally raising rates, with a 0.25 percent hike in December 2015 and three or four 0.25 percent increases in each of the next two years. Conversely, we see further easing of policy by the European Central Bank and the Bank of Japan. Although the markets likely already have priced much of these developments in, some additional pressure is likely.

- **Modest growth:** We anticipate a rebound in global growth from 3.1 percent this year to 3.4 percent in 2016, with differences between developed and emerging economies. We see growth running 0.5 percent faster than trend in Japan, Europe and the U.S., but continuing below trend in emerging markets. The result probably will be another year of muddling through for the global economy.
- **Headline inflation picking up:** We see headline inflation increasing to about 2.8 percent globally, with oil prices flat or up, but do not expect any meaningful change in core inflation. In much of the world, growth will continue to be too low to close output gaps. The U.S. will be an outlier here, with a recovery in the labor market pushing core inflation up slightly to 1.6 percent.