Country Forecast

Global outlook

Key changes since May 15th

- The Economist Intelligence Unit has increased its forecast for global growth in 2017 to 2.7%, from 2.6% previously. The driver of the increase was an upward revision to our forecast for the euro zone, to 1.8%, from 1.6% previously, owing to a strong first quarter.
- We have raised the risk of the US president, Donald Trump, being forced from office through impeachment from low to moderate, following the appointment of a special counsel, Robert Mueller, to investigate potential links between Mr Trump's advisers and Russian intelligence and government officials. For this risk to be raised either Mr Mueller would need to uncover evidence of serious wrongdoing or the Republican Party would need to lose its majority in the House of Representatives (the lower house of Congress) at the 2018 mid-term elections.
- Brazil's president, Michel Temer, has come under pressure to resign amid allegations of corruption and obstruction of justice. In the short term the shock from the political crisis will undermine private consumption and business investment. We have therefore revised down our forecast for GDP growth in Brazil from 0.5% in 2017 to 0%, and we are reversing our decision made in last month's global outlook to raise GDP growth in 2018 from 2% to 2.5%.
- Following the snap election in the UK that failed to grant the ruling Conservative party a parliamentary majority, we now think that there is a higher risk of Brexit talks breaking down. Although not our central forecast, a government reliant on a confidence and supply agreement could easily collapse. It will also find itself under pressure from both sides of the Brexit debate.
- We have reduced our oil price forecast in 2018-21 to an annual average of US$55.5/barrel, from US$58.4/b previously. We believe that OPEC will be forced to keep limits on its production beyond the end of the current agreement in March 2018 in order to prevent a wave of oil from returning to the market and sending prices plummeting. The problem of plentiful supply coupled with mediocre demand is unlikely to be resolved in the next five years.

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The Economist Intelligence Unit

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Symbols for tables
"0 or 0.0" means nil or negligible; "n/a" means not available; "–" means not applicable

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World growth and inflation

(Forecast closing date: June 12th 2017)

World summary
(% change)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth (PPP exchange rates)										
World	**3.4**	**3.4**	**3.5**	**3.3**	**3.1**	**3.5**	**3.3**	**3.0**	**3.5**	**3.6**
OECD	1.4	1.5	2.1	2.3	1.8	2.0	1.9	1.3	1.8	2.0
Non-OECD	5.3	5.1	4.7	4.1	4.1	4.6	4.3	4.3	4.7	4.8
Real GDP growth (market exchange rates)										
World	**2.3**	**2.4**	**2.7**	**2.6**	**2.3**	**2.7**	**2.5**	**2.1**	**2.6**	**2.7**
OECD	1.3	1.4	2.0	2.2	1.7	2.0	1.8	1.3	1.7	1.9
Non-OECD	5.1	4.9	4.4	3.7	3.7	4.3	4.0	4.0	4.4	4.5
North America	2.2	1.7	2.4	2.5	1.6	2.1	2.1	1.0	2.0	2.0
Europe	0.2	0.8	1.8	1.9	1.8	1.9	1.7	1.6	1.8	1.8
Euro area	-0.8	-0.2	1.3	1.9	1.7	1.8	1.6	1.5	1.5	1.5
Asia & Australasia	4.4	4.6	4.1	4.2	4.2	4.4	3.5	3.4	3.7	3.9
Latin America	3.0	2.8	1.3	0.2	-0.8	1.0	2.1	1.8	2.6	3.0
Middle East & North Africa	4.1	2.1	2.6	2.3	2.8	2.1	3.6	3.0	3.7	3.8
Sub-Saharan Africa	4.2	4.7	4.5	3.0	0.9	2.3	3.0	2.8	2.8	3.6
Inflation (av)										
World	**4.0**	**3.8**	**3.6**	**3.2**	**3.8**	**4.5**	**3.9**	**3.4**	**3.1**	**3.0**
OECD	2.2	1.5	1.6	0.5	1.0	2.2	1.9	1.6	1.9	1.9
Non-OECD	6.2	6.7	6.1	6.7	7.4	7.4	6.6	5.7	4.7	4.5
Trade in goods										
World	**3.6**	**4.0**	**4.1**	**2.5**	**1.9**	**3.3**	**2.9**	**2.3**	**3.2**	**3.5**
OECD	2.1	2.4	4.2	4.4	2.4	3.2	2.8	2.0	2.8	2.5
Non-OECD	4.8	5.3	3.2	-0.9	1.0	3.8	3.0	3.0	3.9	3.6

Source: The Economist Intelligence Unit.

Global growth is accelerating, but will be limited by a lack of synchronicity

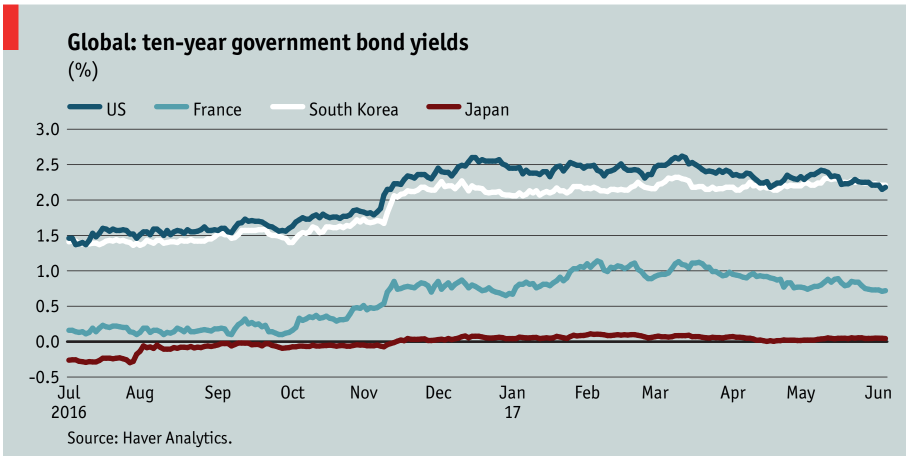
In recent months it has become clear that the global economy is strengthening. Two interest-rate rises in the past six months by the Federal Reserve (Fed, the US central bank), faster inflation in major economies, higher manufacturing purchasing managers' indices and falling unemployment rates in the developed world are all indicators of a likely acceleration in economic growth in 2017. The big concerns about the global economy in recent years—falling commodity prices, deflation, negative government bond yields and overly restrictive fiscal policies—have all become less apparent. Consequently, The Economist Intelligence Unit expects the world economy to expand by 2.7% in 2017, compared with a lacklustre 2.3% in 2016.

There are, nevertheless, a number of caveats to this upbeat story. Global growth is not synchronised, reflecting the fact that the world's leading economies are at very different points of their business cycles. We consider China to be the furthest through its expansion phase: there is evidence of capacity constraints in some sectors, and the government is tightening monetary policy through a gradual curbing of credit growth. In the US, the Fed is accelerating the pace of its interest-rate increases to combat an expectation of faster inflation and wage growth. The expansion in Europe is less well advanced. Although we have revised our 2017 GDP growth forecast for the euro zone this month, to 1.8%

from 1.6%, the regional economy is still in recovery mode. Unemployment in the euro zone reached an eight-year low in April 2017, at roughly 9.5%, but it remains high compared with the rest of the developed world (and compared with levels before the global financial crisis), and there is little pressure on wages. We believe that the European Central Bank is still around a year away from beginning to taper its quantitative easing programme. Deflation is still a cause for concern in Japan, and, among emerging markets, Brazil and Russia are likely to be in the final throes of recession. This lack of synchronicity in the global economy will prevent a surge in economic growth or major upward pressure on commodity prices. However, the fact that growth in the global economy will accelerate at a time when interest rates are gradually increasing and post-crisis stimulus is being slowly withdrawn represents a milestone in the world economy's recovery from the financial crisis of a decade ago.

Global inflation and market interest rates will rise modestly in 2017

Among the consequences of the strengthening economic outlook are rising bond yields and inflation. Bond yields in the US and other developed markets bottomed out in mid-2016 and were given a shot in the arm by the election of a Republican president, Donald Trump, at the end of the year. Yields have been essentially flat in 2017 in most developed markets as investors thought twice about the likelihood of Mr Trump reflating the US economy. However, they remain 50 basis points or more above where they were prior to the election. Higher bond yields have coincided with an increase in inflation in the developed world, in part but not wholly related to an improvement in oil prices from the lows plumbed in early 2016. We forecast global inflation of 4.5% in 2017, the highest rate since 2011.



A rise in market interest rates will cause some casualties among overleveraged borrowers, but on the whole this will be another welcome step in the rehabilitation of the global economy. It will provide relief to financial institutions whose profitability has been undermined by very low, and in some cases negative, interest rates. This process has progressed furthest in the US, where a tight labour market has been gradually exerting some upward pressure on wages for several quarters. Europe was the region that appeared to benefit most from low oil prices, but the recovery now appears to be sufficiently well established to withstand the current rising trend in energy prices, inflation and market interest rates. To the extent that inflation becomes entrenched and lifts nominal GDP, it should alleviate concerns about the sustainability of the heavy debt burdens faced by several countries in the euro zone periphery as a legacy of the crisis.

Nonetheless, we expect both bond yields and policy interest rates to remain low by historic standards. The Fed is likely to lift its funds rate by another 100 basis points over the next two years (which would take it no higher than 2%), but policy rates will remain at zero in both the euro zone and Japan in 2017-21. These forecasts suggest a benign interest-rate environment for emerging-market borrowers (notably corporates) with hard-currency debts to refinance.

Donald Trump is driving the highest level of political risk in years

Against the backdrop of a steadying global economy lies the highest level of political risk in years. At the centre of this is Mr Trump's administration in the US. Mr Trump is an unpredictable, thin-skinned and impulsive leader. This makes him a difficult ally, both for Republicans at home and the country's allies abroad. It is also leading to a chaotic foreign policy, which, given the US's international reach, has consequences all around the globe. In recent weeks the administration has bombed a Syrian government airfield (without a broader strategy in place); attempted to build a Sunni Muslim coalition to isolate Iran and its allies (while also extending sanctions relief to Iran following Iranian compliance with the nuclear deal); implored other NATO members to spend more money on defence (while at the same time refusing to publicly confirm support for a policy of collective defence); and hosted senior Russian officials at the White House (immediately after sacking the director of the Federal Bureau of Investigation (FBI), who was in charge of an investigation into potential links between Mr Trump's campaign and the Russian government).

It is hard to discern the outline of Mr Trump's "America First" foreign policy through the fog of these decisions. Nevertheless, his first overseas trip as president yielded some clues. His top priority in foreign affairs is likely to be trade and investment deals that favour the US's commercial interests. Human rights issues and the concerns of traditional US allies will take a back seat to the perception—justified or not—that he is creating jobs for Americans. He is prepared to abdicate much of the US's international leadership to focus on this aim. We believe that this (combined with an element of personal frustration at his administration's inability to achieve some early successes) was behind his decision to withdraw from the Paris climate agreement. The shift in US foreign policy poses enormous downside risk, given its inherent unpredictability and the many actors whose own policies could move in response. Were the US to withdraw from the North American Free-Trade Agreement (NAFTA), or worse, North Korea to launch intercontinental missiles under the impression that US military action was inevitable, the consequences for the global economy would be broad and severe.

Mainstream political parties are waking up to the threat of populism

Mr Trump's election victory was part of a broader trend in Western democracies. Like the UK's decision to leave the EU and a referendum in Italy in which parliamentary reform was rejected, it saw voters rebel against the political establishment. Some of these political changes were the culmination of a long-term decline of popular trust in government institutions and political parties. They also signify unhappiness with stagnant incomes. Above all, they demonstrate that society's marginalised and forgotten voters are demanding a voice—and if the mainstream parties will not provide this, they will look elsewhere.

So far, 2017 has been a better year for the political mainstream than was 2016. A former Green leader, Alexander van den Bellen, saw off the nationalist Norbert Hofer in the Austrian presidential election in January. The populist Party for Freedom, led by Geert Wilders, performed poorly at the legislative election in the Netherlands in March, and Emmanuel Macron defeated Marine Le Pen of Front national at the French presidential election in May. In the UK, the share of the vote held by the UK Independence Party (UKIP) fell from almost 13% in 2015 to less than 2% in 2017. Similarly, we expect the Alternative for Germany to win far fewer seats at elections later this year than their poll ratings in mid-2016 implied.

These results suggest that the populist wave has crested. We are sceptical. Populists have largely been kept from power as a result of electoral systems designed to be unfriendly towards them and by alliances built by the mainstream to keep them out. Nonetheless, wider public support for these groups is causing some populist policies—including a tougher stance on immigration and national security—to be absorbed into mainstream manifestos. The disappearance of UKIP as a political force in the UK can be attributed to the fact that the Conservative prime minister, Theresa May, campaigned on the promise of delivering the very sort of departure from the EU that UKIP was advocating in 2015. These ideas will remain attractive while there is widespread anxiety about job security and living standards.

Chinese growth will slow in 2018 as the government reins in credit

The health of the Chinese economy remains the biggest risk to the global economy. In 2016 it grew by 6.7%, despite persistent inefficiencies in the state sector and recessionary conditions in the industrial north-east. However, this was achieved at the cost of a further increase in indebtedness. The build-up in debt, particularly in the corporate sector, is unsustainable, and we think that once the president, Xi Jinping, has consolidated his power at a party conference in late 2017, he will sanction policies to rein in credit growth. Firms in the construction and real-estate sectors will be hit hardest. As a result of these policies, we forecast that growth will slow sharply in 2018, to 4.6%, from 6.6% in 2017. This kind of shift is unprecendented in modern China and will come at a time when the global economy is still weak and central banks have very limited scope to react.

Given China's importance as an engine of global growth and demand, the ripple effects will be felt around the world. Worst-hit will be those countries that depend on exporting hard commodities to China, such as Australia, Chile and Mongolia. Next will be countries that have deep and broad trading relationships with China, such as South Korea and Taiwan. The rest of the world will feel a chill through turbulence in financial markets and declines in consumer and business confidence. Our forecast represents a relatively benign outcome, given China's extreme level of indebtedness. Other economies whose paths China is tracking, such as Japan in the 1980s and Spain in the 2000s, were brought to their knees by systemic crises. We do not foresee this for China, partly because state involvement in the banking sector will ensure that no major lenders go under. Moreover, the slowdown will be policy induced, so the credit bubble will deflate rather than burst. However, the balance of risk is still tilted to the downside, and it is possible that the government may not be able to exert the level of control over the economy that it would like. With the economy entering uncharted waters, a range of responses is plausible.

The first US recession in a decade will arrive in 2019

The slowdown in China will contribute to the first US recession in a decade in 2019 by weakening consumer and business sentiment. These confidence factors, together with higher interest rates, will bear down on private consumption and investment, leading to two quarters of contraction. The Fed will cut rates back down to the zero lower bound, but overall growth will be limited to 1% and demand for imports will hit the US's main suppliers. Consequently, global growth will be limited to 2.1% in that year.

We forecast stronger growth for both emerging markets and the developed world in 2020-21. The US will rebound from recession and growth in China will strengthen, although, at an average of 5%, it will be some way below current rates, reflecting the economy's transition to one in which consumption rather than investment is the main driver of growth.

Risk scenarios

Events may diverge from The Economist Intelligence Unit's forecast in ways that affect global business operations. The main risks are represented by the following scenarios.
Very high risk = greater than 40% probability that the scenario will occur over the next two years; high = 31-40%; moderate = 21-30%; low = 11-20%; very low = 0-10%.
Very high impact = change to global annual GDP compared with the baseline forecast of 2% or more (increase in GDP for positive scenarios, decrease for negative scenarios); high = 1-1.9%; moderate = 0.5-0.9%; low = 0.2-0.5%; very low = 0-0.1%.
Risk intensity is a product of probability and impact, on a 25-point scale.

Negative scenario—China suffers a disorderly and prolonged economic slump

High risk; Very high impact; Risk intensity = 20
We expect China to experience a policy-driven economic slowdown in 2018, with growth slowing to 4.6 %, from 6.6% in the previous year. The political reshuffle in the upper echelons of the Chinese Communist Party scheduled for late 2017 will enable the president, Xi Jinping, to authorise tighter monetary policy in 2018. The primary focus of this shift will be to slow the rapid growth in credit that has been a feature of government policy since the global recession in 2008-09 and has caused the country’s debt stock to surge to over 200% of GDP. Despite the scale of the economic slowdown, we anticipate that it will be deliberately induced and therefore easier for the authorities to manage (reflecting in part the state's deep integration with China's banking system). As a consequence, we do not expect it to result in a rise in unemployment and social unrest on a scale that would threaten the established order. However, this is a relatively benign outcome, and the consequences could be much more severe. There are risks that the government tries and fails to put the economic adjustment off, or the economy slumps before the authorities are fully prepared to manage it. Even if there is the expected policy-induced slowdown, there is a notable risk that it runs out of control. In any of these more malign scenarios the Chinese and global economies would be badly hit. The bursting of credit bubbles elsewhere has usually been associated with sharper decelerations in economic growth, and, if accompanied by a house-price slump, the government may struggle to maintain control of the economy—especially if a slew of China’s small and medium-sized banks, which are more reliant on wholesale funding, hit the wall. If the Chinese government is unable to prevent a disorderly downward economic spiral, this would lead to much lower global commodity prices, particularly in metals. This, in turn, would have a detrimental effect on the Latin American, Middle Eastern and Sub-Saharan African economies that had benefited from the earlier Chinese-driven boom in commodity prices. In addition, given the growing dependence of Western manufacturers and retailers on demand in China and other emerging markets, a disorderly slump in Chinese growth would have a severe global impact—far more than would have been the case in earlier decades.

Negative scenario—The rising threat of jihadi terrorism destabilises the global economy

Moderate risk; High impact; Risk intensity = 12

The threat of jihadi terrorism has moved up the international policy agenda after recent attacks in the UK, France, Sweden, Belgium, Turkey, Lebanon, Egypt, Indonesia and the Philippines by individuals or groups who claim to have acted on behalf of the jihadi group, Islamic State (IS). The spread of IS and its influence poses a dilemma for global policymakers, who are under pressure to intervene militarily to suppress the group in its strongholds in the Middle East. However, they risk reprisals in their home countries by radicalised sympathisers of IS, which is seeking to retain influence via more terrorist attacks abroad. Indeed, despite losing considerable territory in Iraq and Syria, IS remains an especially challenging group to counter. First, this is because of its self-declared, albeit diminishing, "caliphate" in Syria and Iraq, which provides both an operational base and a propaganda tool; and second, because of the ease with which it can recruit and motivate attackers around the world. Taking advantage of its decentralised nature, which allows individuals to operate under its banner anywhere in the world without prior contact with the group, IS has been able to strike a wide variety of targets across multiple continents. Besides its ability to win new adherents, IS's other success has been to garner the backing of internationally established jihadi organisations such as Ansar Beit al-Maqdis in Egypt, Boko Haram in Nigeria and more recently the Maute and Abu Sayyaf groups in the Philippines. Should this spiral of attack and counter-reprisal escalate, it would begin to dent consumer and business confidence, which in turn could weigh on US and European stockmarkets. IS attacks risk diverting Western governments to focus on security rather than economic reforms, risking further setting back global growth prospects. Furthermore, by spreading to emerging markets such as Indonesia and the Philippines, IS-inspired groups risk lowering levels of investment, both domestic and foreign.

Negative scenario—Oil prices slump in 2018 after the OPEC deal to keep production down breaks apart

High risk; Moderate impact; Risk intensity = 12

The oil price rally seen in early 2017 ran out of steam, as US production recovered quickly and modest consumption growth failed to make significant headway into large global stockpiles. OPEC producers have pledged to extend production cuts until the end of March 2018 for fear of erasing all the modest gains achieved since the initial agreement. However, there is a notable risk that the OPEC deal breaks down earlier than that. The organisation will have lost market share to non-OPEC producers over the course of 2017 as their output ramps up, particularly in the US. Towards the end of 2017 or the start of 2018 OPEC producers may well then calculate that their strategy has not worked, choosing to revert to their previous policy of preserving market share, come what may. If the taps are turned back on, roughly 1.8m barrels/day of additional production would come back on the market. This would cause prices to plummet. Although this would support slightly higher consumption, it would not be enough to offset the influx of new production, and prices could fall back to previous troughs, of around US$30/barrel. Cheaper oil will support economic activity in countries that rely heavily on energy imports or energy-hungry industries, although the shockwaves of the impact on producers would be felt globally. Oil producers (including the US and Canada) would suffer greatly from a downturn in investment, feeding through to economic demand. Countries that rely heavily on oil exports—primarily the Gulf, but also Russia, West Africa and some parts of Latin America— face a second round of spiralling current-account and fiscal deficits. Coming closely on the tail of the 2014-16 downturn, they are less capable of weathering the storm, and some countries would face serious balance-of-payments shocks. Developing nations, including Nigeria and Angola, would face serious debt distress and possibly also political and social instability.

Negative scenario—There is a clash of arms in East Asia

Moderate risk; High impact; Risk intensity = 12

The numerous competing territorial claims in the South China Sea and the attempts of North Korea to ramp up its nuclear programme are notable threats to peace in East Asia. The foggy position of the US administration on the various issues adds a complicating factor. The president, Donald Trump, initially wavered on maintaining US support for the "One China" policy on Taiwan, and his tougher rhetoric on North Korea has not been accompanied by a shift in strategy. Given that we expect US foreign policy to prioritise trade and investment over global diplomatic leadership, there is a risk that China may take an even more aggressive approach to exerting its claimed historical rights to the sea areas demarcated by its so-called nine-dashed line, which encompasses around 85% of the South China Sea. This could include an acceleration of its island reclamation measures or declaring a no-fly zone over the disputed region. Although we expect a resumption of inter-Korean talks following the election of Moon Jae-in as South Korean president in May, these are likely to slow, rather than stop, the advancement of North Korea's nuclear development programme. Given the multitude of military forces in the region, there is a risk that an accident or miscalculation (or even deliberate action on the part of the unpredictable North Korean regime) will lead to a wider military escalation. This would undermine intra-regional economic ties, interrupt global trade flows and depress global economic sentiment.

Positive scenario—Global growth surges

Low risk; Very high impact; Risk intensity = 10

Economic data in the first half of 2017 has been positive in many parts of the world, including Europe and a number of emerging markets. Although first-quarter growth in the US was weak, China's growth remains robust, vital monsoon rains have arrived in India, where the banking sector is also strengthening after a period of struggle. Brazil posted its first economic expansion for eight quarters in the first three months of 2017. A political crisis threatens to undo much of the gain, but the country looks like escaping its two-year recession, as does Russia, which has seen strengthening industrial output in recent months. There is also the possibility that government stimulis efforts in China will enable the economy to continue to defy gravity. Although various geopolitical risks pose a threat to this more positive picture, there is a possibility that these trends will propel global growth at market-exchange rates as high as 4% in 2017-18. This would be the highest level since 2010, when the global economy was awash with post-crisis stimulus. A broad-based acceleration in growth would not only provide welcome relief to slow-growing countries elsewhere, but could also assist in any future economic rebalancing in China, making the whole process less painful. An improvement in global demand would provide further support for commodity prices, adding to an economically virtuous circle for commodity exporters in Latin America, the Middle East and Sub-Saharan Africa.

Negative scenario—The US introduces a border adjustment tax

Low risk; Very high impact; Risk intensity = 10

In the US, the Republican Party, which has majorities in both houses of Congress, is working to pass the largest programme of tax reform in more than three decades. It wants to eliminate the 35% federal corporate income tax and replace it with a 20% destination-based cashflow tax. Among the options under consideration to help to fund this is a border adjustment tax (BAT), under which US exports would not be subject to the tax but imports would, and imported raw materials would not be tax deductible. Overall, tax would be levied on goods and services where they are sold rather than where they are produced. Supporters of the BAT argue that destination-based taxation is better suited to the modern economy, where patents and software represent a growing share of assets and can be moved across borders to avoid taxes. Such a big change, however, comes with a great deal of risk. A tax on imports would raise the price of petrol, clothes and food in the US, and this inflation would hurt those who are economically vulnerable. Advocates maintain, however, that the US dollar would appreciate to offset the BAT, and this would prevent an increase in imported inflation. Nonetheless, a stronger US dollar would have significant consequences for the rest of the world; some studies project that the BAT would lead to an appreciation of 20-25%. This would increase the cost of servicing dollar-denominated debt and could trigger financial instability in emerging markets. In addition, it is possible that the BAT would run afoul of World Trade Organisation (WTO) rules. It could also incite retaliatory measures by those countries most affected, such as Mexico and China.

Negative scenario—A nuclear arms race between the US and Russia re-emerges

Low risk; High impact; Risk intensity = 8

In the past 15-20 years a number of the nuclear armaments treaties and confidence-building measures agreed in the latter stages of the cold war and its aftermath have been either set aside or weakened. The attitude of Mr Trump's administration towards the nuclear question is difficult to parse, given his contradictory statements about the desirability of disarmament and the imperative of the US having nuclear superiority vis-à-vis all rival powers. Mr Trump has also suggested that South Korea and Japan could develop their own nuclear weapons programmes as a means to offset a downgrade in US military support. For their part, Russian defence planners are concerned that ongoing developments in US conventional military capabilities and the expansion of the US ballistic missile defence system could neutralise Russia's nuclear arsenal, undermining the principle of mutual deterrence. This would undermine Russia's own nuclear deterrent. At present there is little evidence that the US is willing to engage with Russia to address its concerns. Bilateral relations remain extremely poor, and recent events in Syria and multiple ongoing investigations into potential ties between Mr Trump's advisers and Russian officials will prevent any improvement in US-Russia relations. If Russia becomes more concerned about the US's improving nuclear capabilities, it may decide that the only way to restore its deterrent power relative to the US is to significantly increase its own nuclear capabilities, precipitating a headlong dash to rearmament. If the US and Russia resume a nuclear arms race, this would have repercussions beyond Europe and the North Atlantic. Changes in the arsenals and postures of the US and Russia will affect China, and in turn India and Pakistan, as well as states in north-east Asia that have the potential to acquire nuclear weapons but have so far chosen not to do so. Such an increase in geopolitical risk would then have negative repercussions for global capital flows, openness to trade and economic prospects more generally.

Negative scenario—Currency depreciation and higher US interest rates lead to an emerging-market corporate debt crisis

Low risk; High impact; Risk intensity = 8

The possibility of a more rapid monetary tightening cycle in the US following the election of Mr Trump, coupled with the renewed strengthening of the US dollar and our expectation of a Chinese hard landing in 2018, raises the risk of large outflows of capital from emerging markets to safer investments. Although the risk of such a chain of events occurring has lessened in recent months, as it has become evident that expectations for significant US stimulus have been lowered and many emerging-market currencies have regained ground against the US dollar, were it to occur the impact would be significant on a global level. The countries most vulnerable to tighter US monetary policy are those with wide fiscal and current-account deficits; those viewed as lacking political and policy credibility; and those heavily reliant on commodity exports. (In the case of Venezuela, all three, combined with policy shortcomings, have raised the prospect of hyperinflation and default.) Those countries most exposed may be forced to raise their own policy interest rates in order to avoid destabilising capital outflows and currency depreciation. Also vulnerable are emerging-market corporates, especially in Asia, which in recent years have eagerly taken advantage of the hunt for yield. Since the global financial crisis in 2008, emerging-market corporate debt has risen from 50% of GDP to close to 75%, and Chinese private-sector credit is still growing at three times the rate of nominal GDP growth. This exposure to rising interest rates would be exacerbated if local currencies were to weaken, which would push up the cost of corporates' foreign-currency borrowings. Any rolling emerging-market debt crisis would cause panic across global capital markets and may require governments to step in to shield their banks from the fallout.

Negative scenario—UK fails to reach agreement with the EU and reverts to WTO rules

Moderate risk; Low impact; Risk intensity = 6

Following the UK's referendum in June 2016, the government, led by Theresa May, is facing the thorny task of attempting to negotiate a departure from the EU. In order to control immigration from the EU and end the jurisdiction of the European Court of Justice, the UK will leave the single market. In order to negotiate bilateral trade deals with other countries, it may also have to leave the customs union and pursue a comprehensive free-trade agreement (FTA). An FTA will aim to retain some access to the single market on a sector-specific basis and will be phased in over a number of years in order to ensure a smooth transition to the new EU-UK trading arrangement. However, time is not on the UK's side, as a two-year countdown began with the triggering of Article 50 in March. This will put pressure on the ability of both sides to deliver an amicable divorce. There are a number of potential points of contention, including the size of the UK's financial obligations upon leaving. If negotiations break down and no extension of the deadline is offered, the UK would leave the EU in 2019 without any arrangement in place—the so-called "WTO option", under which the UK's trading rules would be aligned with those of the WTO. This would probably result in an abrupt depreciation in the value of the pound and a sharp economic slowdown in the UK. A weaker British economy would also harm the EU itself, given that it is an important trade partner for countries such as Ireland and Spain. Globally, UK investment (and aid) would be expected to take a hit, providing a notable impact in the emerging world.

Negative scenario—Multiple countries withdraw from the euro zone

Very low risk; Very high impact; Risk intensity = 5

Greece leaving the euro zone in the coming years is already part of our core forecast. The prospect of more countries following it is not, but further departures would be highly damaging to the European and global economy. Greece's problems are largely country-specific, such as the ingrained corruption of its oligarchy, a lack of foreign investment (resulting from closed sectors, protectionism and hostility to foreign ownership) and a resultant lack of competitiveness. As such, Greece's withdrawal would not pose a systemic risk to the bloc, especially as the European Central Bank would intervene to limit the contagion. Nevertheless, this does not mean that there is no prospect of Greece's exit leading to other euro exits. For example, political and economic ructions in Italy threaten to derail the country's fragile economic recovery. Uncertainty over the outcome of the next general election, which is likely to be held in early 2018, and the poor health of the local banking system are compounding popular disaffection. Economic and political malaise is also boosting support for populist parties such as Movimento 5 Stelle, which has called for a referendum on Italy remaining in the euro zone. As institutional constraints would be likely to prevent such a referendum from taking place, the risk of Italy unilaterally leaving the euro zone is very low, but could rise if the government does not adequately manage to tackle the economy's structural problems, which undermine competitiveness and make controlling the public finances difficult. Indeed, the economic difficulties across southern Europe have illustrated the fundamental difficulties posed by a single currency zone without a concurrent fiscal union. If more countries were to leave the euro zone, the global economy would be destabilised. Countries leaving the zone under duress would suffer large currency devaluations and be unable to service euro-denominated debts. In turn, banks would suffer huge losses on their sovereign bond portfolios, and the global economy could be plunged into recession.

Regional summaries

North America growth and inflation
(% change)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth										
US	2.2	1.7	2.4	2.6	1.6	2.0	2.1	1.0	2.0	2.0
Canada	1.7	2.5	2.6	0.9	1.4	2.4	2.0	1.0	1.8	2.0
Inflation										
US	2.1	1.5	1.6	0.1	1.3	2.3	2.0	1.3	1.7	1.9
Canada	1.5	0.9	1.9	1.1	1.4	1.9	1.8	1.3	1.8	1.9

Source: The Economist Intelligence Unit.

The American right wing has the mandate, but not the unity, for change

In the US, the executive, legislature and judiciary are aligned along conservative principles for the first time since 2008, but this does not mean that unity, or indeed policymaking, will proceed smoothly. The president, Donald Trump, is unpredictable, non-ideological, impulsive and thin-skinned. He also has the lowest net approval rating of any other post-second world war president at the equivalent point in their administration. This makes him a difficult ally for senior Republicans, Congress and the US's allies overseas.

The Republican Party will dominate most levels of the American political landscape for at least the next two years. It will have more power than the Democrats in state legislatures, state governorships and Congress. However, there are major ideological differences between moderate and libertarian Republicans in Congress that are already complicating the creation of policy. These differences were brutally exposed by the failure of the American Health Care Act to even reach a congressional vote in March. (A lightly revised version was passed by the House of Representatives in May, but this was mainly because the pressure on the party to make some progress proved unbearable to some previous dissenters. The bill will still face major opposition in the Senate.) The Economist Intelligence Unit expects that the administration will continue to find it hard to pass legislation and that other items on its agenda, such as major tax reform and border security, will prove similarly tough to crack, owing to the lack of a shared vision for the role of government. Factions within the executive and the legislature are likely to deepen and hostilities to become more entrenched in the coming years.

Relations between the Republicans and the Democrats are likely to remain very poor for at least the rest of the current presidential term. The Republicans succeeded in appointing Neil Gorsuch to fill the vacant seat in the Supreme Court in March, but only after invoking the so-called nuclear option, which changed the rules on Senate votes for Supreme Court justices, so that approval required only a simple majority rather than the 60 votes that were previously necessary. The Republicans refused to hold hearings for the choice of the then president, Barack Obama, to fill the vacancy in 2016—an unprecendented move—and this tactic has enraged Democrats. It is also likely to have long-term consequences. Given that Supreme Court judges can now be elected without any co-operation from the minority party in the Senate, it is possible that judges with extreme views could be elected to future vacant seats, reducing the credibility of the US's highest legal authority.

The prospect of impeachment has risen, but remains unlikely

The administration has wandered into a genuine crisis following Mr Trump's sacking of James Comey, the director of the Federal Bureau of Investigation (FBI) in May. Mr Trump has since admitted that Mr Comey's probe into potential links between the president's advisers and Russian intelligence and government officials was the reason for Mr Comey's dismissal. Mr Comey is also believed to have taken notes in which he describes how Mr Trump put pressure on him to end an investigation into Michael Flynn, the former national security adviser. The deputy attorney-general's appointment of a special counsel, Robert Mueller, to conduct an official investigation demonstrates the depth of the crisis. In the short term, Mr Mueller's presence in Washington will calm temperatures in Washington. This is partly because it will reduce concerns among Democrats that the investigation will be compromised and partly because Mr Mueller's work is likely to take at least a year. But if the investigation uncovers wrongdoing sufficiently serious to turn Republican sentiment against Mr Trump, the president would become very vulnerable.

As a consequence of the Comey crisis, we have raised the risk of Mr Trump being forced from office through impeachment from low to moderate. However, there are three reasons why it has not become part of our central forecast. First, Mr Trump will continue to be useful to the Republican Party. Congressional Republicans are focused on advancing their policy agenda, especially on tax reform and healthcare. Given that the party has majorities in both chambers of Congress, 2017-18 represents a huge opportunity to make major changes. Mr Trump will be acquiescent on these issues, and therefore keeping him in the presidency would benefit Republicans. Second, Congress is highly polarised. By some measures, the two parties now sit further apart than at any point since the 1870s. Polarisation matters because it means that the parties are less likely to co-operate on any given issue, including impeachment. In our view, this means that House Republicans are less likely to vote Mr Trump out. (It also means that Democrats are more likely to push for impeachment, but we do not believe that they will have this opportunity.) Third, we expect Republicans to hold on to their House majority at the November 2018 mid-term elections. Gerrymandering and redistricting mean that few House seats are genuine contests. Political polarisation also makes it less likely that seats will shift from one party to the other, as the ideological change required would be greater. Unless there is a major, broad-based swing against the Republican Party over the next 18 months, the Republicans will be in a strong position to keep the House and, in doing so, resist calls for Mr Trump to be removed.

The US's international relations are subject to broad downside risk

We generally expect the US's foreign relations to deteriorate under Mr Trump. The president is disdainful of multilateralism, as embodied by the Paris climate change agreement and NATO, which irritates many of his contemporaries in the West but plays well with his support base in the US. He has been consistently warmer to foreign leaders with a tenuous (or non-existent) relationship to democracy, such as Turkey's Recep Tayyip Erdogan and the Saudi Arabian king, Salman bin Abdel-Aziz al-Saud. We believe that the president's unpredictability and impulsiveness will cause some allies, most notably Germany, to strengthen other ties as insurance against US insularity. The speed with which Mr Trump ordered an airstrike on a Syrian airbase in April, seemingly without any broader strategy in place, demonstrates the shift in the US's international behaviour since Mr Trump succeeded Mr Obama.

The crucial relationship between the US and China is likely to weaken in the next five years. Mr Trump has softened his previously aggressive rhetoric on China (in the hope of encouraging Chinese assistance in containing North Korea) and there were several concessions on trade made by both countries in May. However, we would caution against drawing any strong conclusions from these moves. We doubt that he has changed his view on the US's merchandise trade deficit with China, Chinese trade practices or the impact of Chinese economic growth on the US labour market. A number of Mr Trump's senior advisers are highly suspicious of China, and the two countries are often on opposite sides of international disputes. Similarly, the countries are now moving in very different directions on environmental policy.

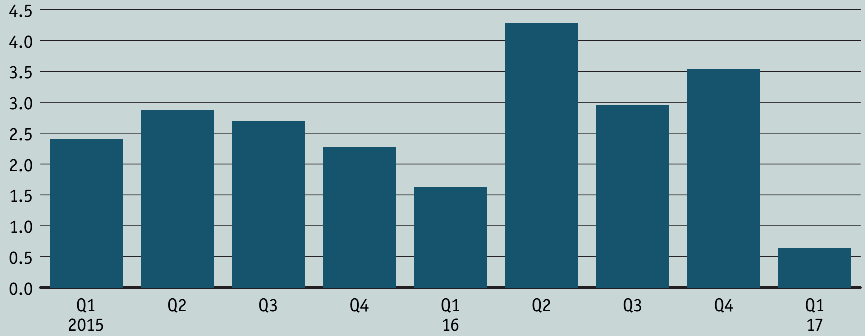
The US government is pursuing a renegotiation of the North American Free-Trade Agreement (NAFTA), which was signed with Canada and Mexico in 1994. Mr Trump has blamed NAFTA for the loss of US jobs and manufacturing competititiveness. The extent to which the US wants to shift the agreement is unclear: government officials have proposed both significant changes to rules-of-origin requirements and labour standards, and more moderate moves on digital trade, intellectual property rights and the environment. We forecast that the negotiations will be complete in 2018, with Mexico and Canada likely to comply rather than call Mr Trump's bluff on the US withdrawing from the deal.

Conditions remain encouraging for consumers, despite a weak first quarter

The economy lost momentum in the first quarter of the year, when it grew by just 1.2% on an annualised basis, owing to a big slowdown in consumer spending growth. We believe that this is more likely to be a blip than the start of a trend. Accelerating wage growth, falling unemployment and low interest rates still represent an encouraging environment for households to spend. We expect a stronger performance in the rest of the year, especially in April-June, resulting in average growth of 2%.

It is hard to conceive of likely scenarios that would generate significantly faster growth than this. Seven years into the recovery from the global financial crisis it is clear that, without a significant boost to productivity or a broad improvement to the global economy, economic growth of around 2% is the new normal for the US. Even if Mr Trump were able to increase public spending on infrastructure or if consumer spending came roaring back, we would expect a faster pace of monetary tightening from the Fed that would offset these effects. We forecast average real GDP growth of 2.1% in 2017-18. Private consumption growth will slow relative to the pace set in 2014-16, but this will be more than offset by faster growth in investment.

North America: US private consumption
(% change, quarter on quarter; seasonally adjusted at an annual rate)



Source: Bureau of Economic Analysis.

When is the next recession?

The Democrats' best hope for 2020 may lie in the medium-term economic outlook. We forecast a mild recession in 2019 as the economy contracts for two consecutive quarters, with average growth for the year at around 1%. We expect this downturn to be triggered by a combination of factors: slower economic growth in China, which will damage global sentiment (causing falls in US equity markets and reducing US consumer and business confidence), and higher borrowing costs resulting from a modest tightening cycle by the Federal Reserve (Fed, the US central bank). We expect the Fed to lift interest rates twice more in 2017 and twice again in 2018. Domestic and external demand will therefore soften in 2019 and cause the US's first technical recession for ten years. Nevertheless, we expect the economy to recover relatively swiftly and annual real GDP growth to rebound to an average of 2% in 2020-21.

The Canadian economy is showing signs of recovery

In Canada, the Liberal Party, led by Justin Trudeau, has shifted politics to the left since it won a majority at the parliamentary election in October 2015, ending a decade of Conservative rule. Its majority, combined with the subdued state of the opposition, has so far made the passage of legislation straightforward. However, conditions are becoming more difficult. Its poll ratings have slipped sharply following several gaffes, and the Conservative opposition is likely to become more focused following the appointment of a youthful new leader in Andrew Scheer. The New Democrats, too, are likely to be invigorated by the appointment a new leader before the end of the year. Nonetheless, we believe that the Liberals have done a good enough job of implementing their policy agenda to win a second term in 2019.

The government is also likely to be boosted by a significant improvement in the economy. We expect growth to accelerate from 1.4% in 2016 to 2.4% in 2017. The data for the early months of the year were very positive, with consistent job growth, stronger exports and further spending from consumers. (Leading indicators suggest that growth is likely to moderate in the second quarter, but only after an exceptional first three months when growth reached 3.7% at an annualised rate) The final piece required in the jigsaw is consistent business investment growth. Surveys suggest that this is coming. Firms will be required to take some of the pressure off consumers: households are financially stretched and the debt/disposable income ratio is at a record high. The bulk of debt is mortgages, and bubble-like conditions have formed in some housing markets. These two connected risks represent the biggest threats to the financial system.

Europe growth and inflation
(% change)

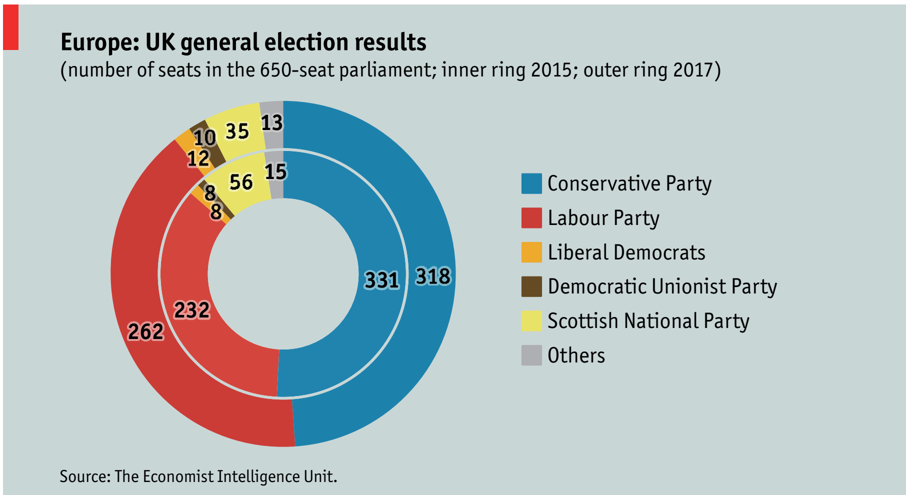
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth										
Europe	0.2	0.8	1.8	1.9	1.8	1.9	1.7	1.6	1.8	1.8
EU28	-0.4	0.3	1.7	2.1	1.8	1.9	1.6	1.5	1.6	1.7
Euro area	-0.8	-0.2	1.3	1.9	1.7	1.8	1.6	1.5	1.5	1.5
Russia	3.6	1.2	0.8	-2.8	-0.2	1.6	1.4	1.7	1.6	1.7
Inflation										
Europe	3.1	2.4	2.0	3.0	1.9	2.8	2.5	2.5	2.4	2.5
EU28	2.6	1.5	0.5	0.0	0.3	1.9	1.7	1.7	1.8	1.9
Euro area	2.5	1.4	0.4	0.0	0.2	1.7	1.4	1.6	1.7	1.8
Russia	5.1	6.8	7.8	15.5	7.0	4.0	4.2	4.9	4.3	4.6

Source: The Economist Intelligence Unit.

UK election result will mean political upheaval ahead of Brexit talks

In the UK's general election held on June 8th, none of the political parties secured a parliamentary majority, resulting in a hung parliament. The Conservative Party secured the most seats in the 650-seat House of Commons, at 318, a loss of 13, while the Labour Party performed much better than expected, gaining 30 seats to 262. The shock result is a spectacular failure for the political strategy of the prime minister, Theresa May, in calling an early election. Rather than increasing her parliamentary majority, giving her a freer hand to pursue Brexit negotiations and implement her domestic policy agenda, Mrs May lost the majority after a disastrous campaign. As predicted, support for the UK Independence Party (UKIP) collapsed, and the Scottish National Party (SNP) incurred a 21-seat loss, dashing hopes of another independence referendum. The Liberal Democrats gained only four seats.

The Labour Party capitalised on its recent improvement in the polls, the result of a good campaign performance by its left-wing leader, Jeremy Corbyn, a popular manifesto, and Mr Corbyn's successful appeal to the youth vote. Labour also benefited more from UKIP's collapse than had been expected. The Democratic Unionist Party (DUP) took two seats from the Ulster Unionist Party (UUP) to increase its share to ten. Combined with Sinn Fein's no-show policy, this should be sufficient to give the Conservatives a fragile, six-seat working majority in the 650-seat parliament.



The election outcome increases the risk of prolonged political instability and compounds uncertainty about negotiations over the terms of the UK's withdrawal from the EU, which begin in June. Mrs May's position is greatly weakened. A Conservative government supported by the DUP will be committed to Brexit. However, it will come under pressure from both Brexiteers and Remainers, and this could make for a messy negotiation. We think it more likely now that the Brexit talks could break down, as a government with a fragile working majority could easily collapse and will be under pressure from both sides of the Brexit divide.

There is a growing populist challenge to mainstream parties that is evident across Europe. Political systems are becoming more fragmented, with national elections resulting in gridlock, making the formation of stable governments challenging. The populists have shown themselves to be more willing than the mainstream parties to debate sensitive political issues, such as the impact of globalisation on income equality and national identity. They successfully mobilise otherwise largely politically disenfranchised people to become engaged and vote. The response of traditional parties has been ambivalent, balancing between dismissing the insurgent parties and their voters as deluded, manipulated or simply irresponsible, and bringing into the fold their populist ideas. Important parliamentary elections are scheduled to take place in France in June and Germany in September. In both of these contests anti-establishment movements and parties will challenge mainstream political forces, albeit to differing degrees. We do not expect populist parties to gain power, but stronger support will grant them greater influence on the topics of domestic political debate. We also anticipate growing difficulties with coalition-building as increasingly disparate mainstream parties try to find common ground on which to work together in order to keep the populists out.

In France, the far-right fell short of taking the presidency

In France, the centrist Emmanuel Macron won a decisive victory over his far-right opponent, Marine Le Pen, in the second round of the presidential election on May 7th. Centre-right and left-wing voters united to block Ms Le Pen, who had pitched herself as the champion of "forgotten France" and had worked to "detoxify" her Eurosceptic, anti-immigrant and anti-Islam party, Front national

(FN). Mr Macron intends to liberalise the labour market, narrow the fiscal deficit and boost growth and productivity. He will also aim to re-energise the Franco-German partnership while pushing for a more integrated euro zone.

Mr Macron named Edouard Philippe, a deputy from the centre-right party, Les Républicains, as his prime minister. This nomination, as well as the announcement of the new government on May 17th, indicated Mr Macron's intention to end the left-right divide in France. In the first round of legislative elections on June 11th, Mr Macron's la République en marche (LRM) and the centrist Mouvement démocrate (MoDem)—with which the LRM has allied—secured almost one-third of the vote, setting the alliance up to secure a majority in the National Assembly (parliament) in the second-round vote on June 18th. Mr Macron will still face opposition to implementing his reform programme as it stands, both from parliament and on the streets, but the outlook for political effectiveness in France and some progress on structural reforms has improved.

The election in Germany will see the far right make gains

Germany faces federal elections on September 24th. We expect this election to result in another grand coalition of the centre-right Christian Democratic Union (CDU)/Christian Social Union (CSU) and the centre-left Social Democratic Party (SPD) under the continued leadership of the chancellor, Angela Merkel. However, a renewed grand coalition's legislative majority would probably be smaller than at present, as the popularity of both the CDU/CSU and the SPD has fallen since mid-2015. The clearest beneficiary has been the anti-euro, anti-immigration Alternative for Germany (AfD), whose support at the national level has doubled since the last general election, to just below 10% currently, above the 5% threshold needed to enter the Bundestag (the lower house of parliament).

Although entry to parliament will be an important milestone for the AfD, the party's prospects should not be overstated. Its support has slipped from a peak of around 15% in 2016, reflecting a rise in support for the SPD since the replacement of the party's unpopular leader, Sigmar Gabriel, with Martin Schulz, the former president of the European Parliament, who is the SPD's candidate for chancellor. More importantly, for the moment at least, no other party is willing to enter into a coalition with the AfD. Moreover, Germany remains an exception in the EU region owing to voters' unwillingness, for historical reasons, to vote for right-wing populist parties, although it may simply be lagging its regional peers in this respect.

Austria’s early election will install a far-right party in government

Austria’s grand coalition of the centre-right Austrian People’s Party (ÖVP) and the centre-left Social Democratic Party (SPÖ) fell apart in May 2017 following the resignation of the ÖVP, and an early election will be held on October 15th. The popularity of the new leader of the ÖVP, the young minister of foreign affairs, Sebastian Kurz, lifted his party's electoral chances. As a result, we expect the election to be a three-horse race between the ÖVP, the SPÖ and the far-right Freedom Party (FPÖ), with the ÖVP currently best placed to emerge as the largest party in the National Council (Nationalrat, the lower house of parliament). The FPÖ's popularity will continue to define the political scene over the coming years, although Mr Kurz looks to be drawing voters away from it, based in large part on his strong stance on immigration and border control. Nevertheless, the far-right party is likely to form part of the governing coalition after the election, as junior partner to the ÖVP, increasing political instability.

We expect Italy's next general election to be held in early 2018

The resignation of Matteo Renzi as prime minister, following the constitutional reform referendum defeat in December 2016, resulted in the formation of an interim government led by Paolo Gentiloni, a close ally. The government will be vulnerable to political wrangling among the main political parties as leaders seek to harmonise the voting systems in the two houses of parliament before the next general election. The most likely timetable for a general election remains early 2018, either near or at the natural end of the current legislative term. We expect the next election to take place using a highly proportional voting system, which will increase political fragmentation further. We believe that the anti-establishment Movimento 5 Stelle (M5S) will win a plurality of votes at the next election, but that it will not secure a sufficient number of seats to govern alone, and will be shut out of office by a coalition of mainstream parties. However, this will probably only strengthen the anti-politics sentiment among the public.

Cyclical upturn in the euro zone economy will continue

Despite this political uncertainty, the euro zone economy has gathered momentum, and in the first five months of 2017 most economic sentiment indicators for the region paint a positive picture. Strong first-quarter real GDP readings for a number of countries, including Germany, France and Italy, have led to an upward revision to our forecast for the region's economy in 2017, to a healthier 1.8%, from 1.6% previously. Although this reflects a continuation of the current cyclical upturn, the pace of real GDP growth has eased slightly after a relatively strong expansion in 2015 (1.9%). The European jobs market has made steady progress, with the unemployment rate across the 19 euro zone member states reaching an eight-year low of 9.3% in April 2017. Nevertheless, we expect further progress in bringing down the rate of joblessness to remain slow. Some of the pain that the euro zone's weaker economies have endured can be expected to deliver lasting benefits. Structural reforms that have been passed across the euro area, especially in countries such as Spain and Portugal, should support private-sector activity in the medium term. Regulatory reform has improved the business environment, for example by increasing labour-market flexibility, boosting investment incentives and opening closed professions. However, there has been a clear slowdown in the breadth and depth of reforms since the peak of the euro zone crisis.

ECB QE programme will run to end-2017

A sluggish implementation of structural reform, external risks to the economic outlook and the lack of a convincing upward trend in inflation mean that the monetary policy stance in the euro zone will remain extremely accommodative. Major policy interest rates are at or below zero, a series of so-called targeted longer-term refinancing operations (TLTROs) is aimed at pushing banks to lend more money and a quantitative easing (QE) programme of €60bn (US$65bn) per month will run until the end of 2017. Although average inflation across the region is currently close to the 2% target set by the European Central Bank (ECB), this mainly reflects a low base of comparison for energy prices. The recent firming of economic activity reinforces our view that a winding-down, or "tapering", of the QE programme will begin in 2018. However, downside risks to global growth and subdued underlying price pressure (including persistently weak wage growth) suggest that moves to unwind the ECB's extraordinarily loose policy stance are unlikely in the near term. We forecast that the ECB will not tighten policy rates before the end of our five-year forecast period, in 2021.

Greece will struggle to reach a debt deal after Eurogroup impasse

A long-running disagreement between the IMF and some euro zone members on debt relief for Greece continues. After failing to clinch a deal on either the disbursement of the next tranche of funding or debt relief at the meeting of the Eurogroup of euro zone finance ministers on May 22nd, we expect the Eurogroup to agree to sign off the second review of the current bail-out programme on June 15th. This will pave the way for the disbursement of funds to Greece, but we do not expect an agreement on deferred debt-relief measures. Such an outcome could result in the IMF deciding not to participate officially in the programme or in the Greek authorities walking out.

This casts doubt over Greece's ability to meet a July deadline for €7.5bn-worth of bond repayments. Preparing for this deadline had already forced the government to push through an omnibus bill of fiscal and structural reforms on May 19th, despite many of them being politically unpalatable. A compromise whereby the IMF participates in the programme but does not make any payments until it reaches agreement with the euro zone about the sustainability of Greece's debt may not be acceptable to Greece. The government is now having to manage expectations about the timeline for re-entering international capital markets after the end of the bail-out programme in August 2018, and about when it might get some further debt relief (after the German federal election in September, and probably even later). The risk of another stand-off between the Greek authorities and their euro zone creditors in the coming weeks is high, in line with our view that the country's membership of the euro zone remains in question.

Central and east European countries face a tough year

We expect much of central and eastern Europe to face a challenging environment during the 2017-21 forecast period, particularly for countries that have benefited from EU funding. A deadline at the end of 2015 for fund drawdowns from the EU's 2007-13 fiscal period brought an end to a surge in investment spending. Funding inflows for projects under the EU's 2014-20 funding period have not gained the same kind of momentum. Growth in Germany—a key market for these countries—will remain steady, averaging 1.6% in 2017-21, although an economic slowdown in China will dampen external demand. Nonetheless, a shift in the German economy towards greater investment and private consumption will provide a boost to central and east European countries with strong trade links to their larger neighbour.

Within central and eastern Europe there will be significant divergences. The Visegrad states—the Czech Republic, Slovakia, Hungary and Poland—will see solid growth rates in 2017-21, with relatively low oil prices, trade integration with Germany, generally weighty and competitive external sectors, and a lessening fiscal drag all acting to support growth rates.

The Russian economy, which contracted for two consecutive years in 2015-16, is starting to grow again in 2017, owing to a partial rebound in oil prices and low inflation. However, the recovery will be subdued. The weak banking sector and high political risk will depress investment, although external financing conditions for companies that are not subject to sanctions should start to improve as oil prices recover. Structural weaknesses will keep trend GDP growth in Russia below 2% a year in the medium term. The country's economic potential will remain constrained by supply-side factors, including outdated capital stock, low investment, a high dependence on natural resource sectors and manifold institutional weaknesses. A presidential election will take place in Russia in March 2018. We expect Vladimir Putin to run for a fourth term (until 2024) and to win with a large majority in the first round. The main challenge for the regime will be to secure a respectable turnout in the context of a relatively weak recovery in household incomes following two years of recession.

Tight financial conditions in Russia will continue to have a negative effect on the economies of other Commonwealth of Independent States (CIS) countries, with which Russia has strong links through trade, finance and remittances. However, there will be some divergence in 2017-18. In Azerbaijan, high inflation will result in household consumption contracting further, after a heavy decline in 2016, although a return to modest growth will follow from 2018. In Kazakhstan, we expect growth to strengthen in 2017-18 as household spending is buoyed by a 20% increase in pensions, while the recent launch of the Kashagan oilfield boosts industrial production and exports. In Ukraine, we expect modest economic growth to continue, aided by better external conditions, some fiscal loosening and a recovery in credit. However, this forecast assumes that there is slow but steady progress in stabilising the political system, and that there is no return to all-out war in eastern Ukraine.

A change to the system of government in Turkey will have lasting implications

In Turkey, the president, Recep Tayyip Erdogan, has used an attempted coup by parts of the military in July 2016 as a pretext to tighten his grip on power. On April 16th Turkish voters narrowly approved a set of government-proposed amendments to the constitution designed to replace Turkey's parliamentary system of government with an executive presidency. Turkey's government faces a deeply polarised society, a weakened economy held back by protracted domestic political uncertainty, the threat of Islamist terrorism, resurgent violence by Kurdish militants, and increasing military involvement in the Syrian conflict and other regional disputes. The concentration of power in the hands of the president is unlikely to deliver sustainable solutions to these domestic and international challenges.

Asia and Australasia growth and inflation
(% change)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth	**4.4**	**4.6**	**4.1**	**4.2**	**4.2**	**4.4**	**3.5**	**3.4**	**3.7**	**3.9**
ASEAN	5.9	5.1	4.5	4.5	4.5	4.8	4.2	4.3	4.7	4.9
China	7.9	7.8	7.3	6.9	6.7	6.6	4.6	4.7	5.2	4.9
India	5.6	6.6	7.2	7.9	7.2	7.2	7.8	7.5	7.5	7.8
Japan	1.5	2.0	0.2	1.1	1.0	1.5	1.0	0.8	0.3	1.1
Inflation	**3.5**	**3.7**	**3.4**	**2.2**	**2.1**	**2.3**	**2.5**	**2.5**	**2.8**	**2.7**
ASEAN	3.8	4.4	4.4	3.2	2.4	3.3	3.7	3.0	3.2	3.7
China	2.6	2.6	2.1	1.5	2.1	1.7	1.8	2.2	2.7	2.5
India	9.4	9.9	6.6	4.9	4.9	4.3	4.9	4.8	4.4	4.3
Japan	-0.1	0.3	2.8	0.8	-0.1	0.7	0.6	0.9	1.2	0.7

Source: The Economist Intelligence Unit.

Volatility is on the horizon for Asian economies

The external environment should remain broadly supportive of growth in Asia this year, despite uncertainty about US policy. Many commodity prices have receded in the past two months but remain well above the bottom of the cycle. This has improved market sentiment regarding commodity exporters like Australia, even as importers such as India continue to enjoy relatively cheap fuel and construction materials. Trade volumes have risen sharply this year, and funding remains cheap by historical standards, with many Asian currencies having risen against the US dollar as financial markets lowered their expectations for aggressive US fiscal stimulus.

However, financial imbalances are rising, and the risk of a sharp adjustment at some point in the next five years is growing. This is of particular concern in China, which has seen a spectacular build-up of debt since the global financial crisis of 2008-09. According to the Bank for International Settlements, total credit to the non-financial sector in China rose from 176% of GDP at the end of 2009 to 257% of GDP in December 2016, a period when real GDP grew by an average of more than 8% a year. This is unsustainable. Our forecasts assume a correction in 2018, resulting in a sharp slowdown in Chinese growth. As the effects of a Chinese downturn ripple through Asia, it will become clearer which Asian corporates have been prudent at a time of cheap credit. There are likely to be some casualties.

An external threat?

Next to China's unsustainable debt accumulation, a deterioration in trade ties with the US poses the biggest threat to economic growth and stability in Asia. For now, we believe that Mr Trump will pursue trade policies with a high symbolic impact but limited effects on the real economy, renegotiating rather than cancelling existing trade agreements, launching anti-dumping cases at the World Trade Organisation (as previous US governments have done) or imposing selective tariffs on Chinese goods. We expect China's response to be similarly limited. Nonetheless, the hardening of protectionist rhetoric under Mr Trump could still escalate into more serious trade disputes. If Mr Trump were to upset the global trading system, it would be in Asia that many of the worst effects would be felt.

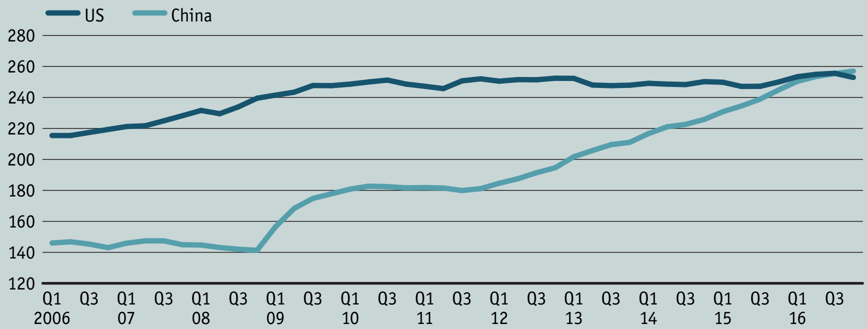
China's slowdown will dominate Asia's outlook for years

The Chinese government has set itself ambitious, and conflicting, economic policy goals for 2017. On the one hand, it intends to press ahead with efforts to rebalance the economy, by reducing excess capacity in heavy industry and real estate, and curbing the financial risks associated with real-estate bubbles, rising corporate debt and a ballooning shadow banking sector. On the other hand, its target for economic growth is "close to 6.5%", a similar pace to last year's 6.7%.

These efforts have had some success. A campaign to impose stricter limits on house purchases is finally having an effect, with the pace of house-price rises slowing in top-tier cities such as Shanghai and Shenzhen. In the steel and coal industries, the government beat its targets for capacity cuts in 2016, and production has begun rising again, supported by the pick-up in global prices. This, in turn, helped to lift economic growth to 6.9% year on year in January-March. Although this pace is likely to slow as the housing market continues to cool, public infrastructure projects will provide some offset. We expect growth to average 6.6% in 2017.

On closer inspection, significant vulnerabilities remain. Much of the burden of adjustment has fallen on the relatively efficient private sector rather than on oversized and overleveraged state-owned enterprises. More broadly, much remains to be done to reduce risks in the financial sector and discourage the accumulation of corporate debt. Corporate debt was equivalent to 166.3% of GDP at end-2016, according to the Bank for International Settlements—worryingly high for an emerging-market economy, and up from less than 100% at end-2008. We expect monetary policy tightening to continue throughout 2017. Some impact is already visible with the softening of credit growth. Targeting shadow banking will also prove complex, given its size and role as a major source of capital for firms, many of them private small and medium-sized enterprises. After the regulatory whirlwind of early 2017, we expect the authorities to adopt a dovish approach on that issue in the coming months.

Asia: credit to the non-financial sector
(market value, end-period, % of GDP)



Source: Bank for International Settlements.

We therefore continue to believe that at some point the government will need to make much harder choices between addressing imbalances and promoting economic growth. Our forecasts assume that the reckoning will come in 2018 as changing political dynamics allow the government to acknowledge the need to tighten monetary conditions. The Chinese Communist Party is due to conduct a reshuffle of its top decision-making body, the seven-member politburo standing committee, at the party congress in late 2017. It will do everything in its power to ensure that the run-up to the congress is smooth, including maintaining rapid economic growth in order to shore up social stability. We expect that the reshuffle will allow the president, Xi Jinping, to strengthen his hand by appointing favoured allies, opening the door to a bolder recalibration of economic policy.

As a result, we expect economic growth to slow sharply, to just 4.6% in 2018 and 4.7% in 2019. Importantly, we expect this to be a managed adjustment, which will not affect all parts of the economy equally. The slowdown will be concentrated in the industrial sector: investment growth will average just 2.7% a year in 2018-21 (compared with 6.5% a year in 2013-17) and industrial production growth will be 4% (compared with 7.1% in 2013-17). Household consumption and government spending will hold up better. This means that the Chinese slowdown will be felt most by economies servicing Chinese manufacturing, such as Australia for raw materials and South Korea for industrial inputs.

There is a risk that the Chinese slowdown will be sharper and less orderly than we expect. The state's deep integration with the banking system should give it the ability to resolve financial strains relatively smoothly, but the bursting of credit bubbles elsewhere has usually been associated with steeper decelerations in growth. A recession in China is not inconceivable, and will become more likely if a managed slowdown is delayed. Given China's central role in global supply chains, this scenario represents the most serious risk to the global economy. However, even our relatively benign central forecast will cause growth in Asia and Australasia as a whole to slow to 3.5% in 2018, from an average of 4.3% in 2016-17.

India has a bright future if it can get through painful reforms

With China losing momentum, India will be Asia's fastest-growing economy over the next five years, expanding at an average annual rate of 7.6%. However, the Indian economy is also going through a period of adjustment. A lending spree earlier this decade has saddled state-owned banks with bad loans. The authorities have pushed the banks to recognise their non-performing assets and taken steps to reform bankruptcy procedures to make it easier for them to do so. However, the government has been less willing to provide funds for the banks' recapitalisation, and has yet to make arrangements to take the problem loans off their balance sheets. Combined with excess capacity in the steel industry, we expect this to depress corporate lending and investment for some time yet. We expect GDP growth in fiscal years 2016/17-2017/18 (April-March) to average 7.2%, compared with 7.9% in 2015/16.

The ambitious reform programme led by the pro-business prime minister, Narendra Modi, is likely to show greater benefits in subsequent years. Although a demonetisation scheme introduced in November 2016 was highly disruptive, over time it will help to expand the formal economy and widen the tax net, while a nationwide goods and services tax, set to come into effect in July, will move India closer to being a genuine single market. There will be major upgrades to physical infrastructure. Perhaps most impressively, there has already been genuine progress on macroeconomic reform. The monetary policy framework has improved and the government has shown a commitment to reducing the fiscal deficit. Inflation and fiscal targets will help to hold policymakers to account and support macroeconomic stability.

Improvements to the regulatory and business environment will be slower and more piecemeal, at least until after the 2019 parliamentary election. Mr Modi's Bharatiya Janata Party (BJP) performed unexpectedly well in state elections held in February-March and is highly likely to secure a second term in office. However, owing to procedural lags, the BJP and its allies are not expected to hold a majority in the upper house until 2019 at the earliest. This will limit the government's ability to push through contentious supply-side reforms.

Growth will remain buoyant in emerging South-east Asian economies, averaging at least 6% a year in Vietnam, Cambodia, Laos and Myanmar. These economies will benefit from relatively low wage costs, advantageous geographic locations and comparatively stable governments. They will also continue to benefit from Chinese investment under the "Belt and Road Initiative" (previously known as "One Belt, One Road"), which we do not expect to be derailed by China's economic slowdown.

Demographic trends will weigh on growth in Japan and South Korea

Asia's struggling industrial powerhouses, Japan and South Korea, have started to see some benefits from recovering global inflation and trade, but remain particularly vulnerable to a renewed weakening in external demand and domestic confidence. After ten years of conservative rule, ending in scandal and impeachment, South Koreans handed power to a liberal candidate, Moon Jae-in, at the presidential election on May 9th. The new president has an ambitious agenda, including job creation, corporate governance reform and re-engagement with North Korea (which we expect to have very limited results, as the North will continue to pursue its nuclear programme). However, his party lacks a strong majority in the legislature, and he will face an uphill battle to deliver on most of his pledges before the next legislative election, in 2020.

The Japanese economy is still struggling to escape deflation. The Bank of Japan (BOJ, the central bank) has been pursuing a policy of "quantitative and qualitative easing with yield curve control"—a flexible programme of asset purchases to keep ten-year government bond yields at zero for long enough for inflation to "overshoot" the 2% target. The central bank hopes that this will be sufficient to bring inflation back up to 2% by 2018. We are dubious, and forecast inflation to average just 1% in 2017-21.

One obstacle is the government's avowed intention to stabilise its debt, which is above 200% of GDP and rising. Indeed, at this stage it still seems likely that the consumption tax increase planned for October 2019 will go ahead. Without a greater willingness on the part of the government to issue more debt, the ability of the BOJ to deliver monetary stimulus by buying up government debt will become increasingly limited.

Japan's shrinking workforce is a more fundamental barrier to growth and investment. The government hopes to boost real GDP growth to 2%, but we have serious doubts about whether this is possible without faster population growth. Abenomics, the economic strategy of the prime minister, Shinzo Abe, has delivered some benefits in terms of boosting output per head, and Mr Abe's popularity may make it easier for him to deliver future reforms. However, achieving 2% growth would require an overhaul of social policies such as immigration, which neither the government nor the electorate is willing to consider.

Latin America growth and inflation
(% change)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth	**3.0**	**2.8**	**1.3**	**0.2**	**-0.8**	**1.0**	**2.1**	**1.8**	**2.6**	**3.0**
Brazil	1.9	3.0	0.5	-3.8	-3.6	0.0	2.0	2.1	2.3	2.3
Inflation	**7.0**	**7.9**	**10.0**	**11.9**	**18.3**	**17.8**	**13.3**	**10.6**	**5.6**	**4.6**
Brazil	5.4	6.2	6.3	9.0	8.7	4.0	4.2	4.3	4.3	4.1

Source: The Economist Intelligence Unit.

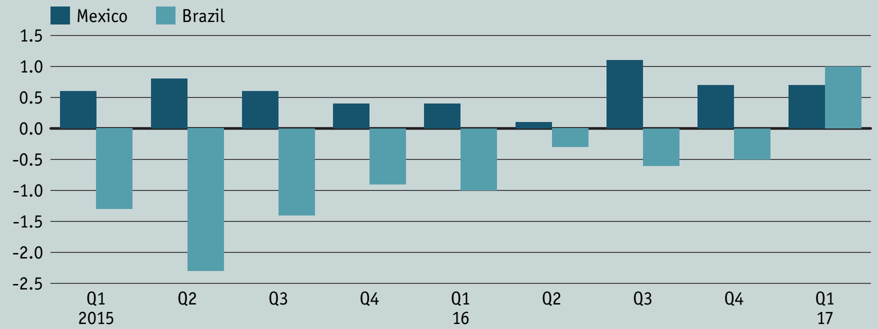
A new crisis in Brazil clouds the recovery outlook

In Latin America, a political shock in Brazil is now threatening to derail the country's emergence from a difficult two-year recession that would help to lift regional growth back into positive territory in 2017, and to more than 2% in 2018. But even if Brazil's recovery avoids derailment, we expected the pace of expansion to be disappointing. Mexico, too, is expected to perform poorly. Thus, the region's two largest economies will struggle to reach their potential, while the likes of Chile, Colombia and Peru will also perform more weakly than during the commodities boom. A particularly busy election period is approaching, as many of Latin America's key economies, including Brazil, Mexico and Colombia, will hold presidential elections in 2018 that will determine the medium-term policy course. Before then, presidential elections are due in November in Chile and Honduras, and partial legislative elections are due in October in Argentina. Depending on how well the ruling Pro party and its partners in the Cambiemos coalition do, the elections in Argentina will determine how much political capital the reformist president, Mauricio Macri, will have in the remainder of his term, ahead of a likely re-election bid in October 2019.

Brazil's president, Michel Temer, has come under intense pressure to resign amid allegations of corruption and obstruction of justice. An investigation by the Superior Electoral Tribunal (TSE) into the funding of Mr Temer's October 2014 campaign has been decided in his favour, but he continues to face a separate Supreme Court investigation into claims that he condoned the payment of hush money by JBS, a Brazilian meat-packing company, as part of a corruption cover-up. Although the TSE ruling will buy Mr Temer time, we continue to see a high likelihood that he will leave office and that Congress will elect a caretaker president. If he does cling on for the remaining 18 months of his term in office, this will undermine governability and cloud prospects for pensions and tax reforms needed to bolster the public finances and support a recovery from Brazil's deep recession of 2015-16. In the short term, the shock from the political crisis is likely to undermine private consumption and business investment. We have therefore revised down our forecast for GDP growth in Brazil from 0.5% in 2017 to 0%, and reversed our decision made in last month's global outlook to raise 2018 GDP growth from 2% to 2.5%. However, the risks remain skewed to an even weaker performance in both years.

In Mexico, revised first-quarter data showed GDP growing by 0.7% quarter on quarter, a better than expected performance given initial fears about the impact of a Trump presidency on Mexico. However, we are keeping last month's growth forecasts unchanged (1.6% and 2% respectively in 2017 and 2018). Risks are still weighted to the downside, related to the renegotiation of NAFTA, which will get under way shortly, following notice given to the US Congress to this effect on May 18th by the US trade representative.

Latin America: real GDP
(% change, quarter on quarter; seasonally adjusted)



Sources: national statistics agencies.

Sovereign bond issuance has been notable so far this year

The region's terms of trade stabilised in 2016 as the bear market in commodities abated and prices rallied, in many cases finishing the year well off their lows. In addition, capital flows into the region picked up as accommodative monetary policy and record low bond yields in the G3 led investors to search for yield in emerging markets and other risky asset classes. The recovery in Latin American currencies since December suggests that concerns about damage from the US election were overplayed and that the region will again attract capital inflows. Indeed, bond issuance by several of the region's sovereigns has been heavy so far this year, reflecting investors' appetite for high-yield paper. Countries with recent sovereign issues include Argentina, Colombia, Honduras and Ecuador in January; El Salvador in February; Brazil and Paraguay in March; and Panama in May. By presidential decree, in mid-May the Argentinian government authorised the issuance of up to US$20bn in external debt in the remainder of 2017, aiming to take advantage of benign global financial conditions in order to undertake liability management operations that will improve the structure and debt-service cost of the public debt.

Latin American export data have shown signs of recovery following the collapse in Chinese import demand in 2015, and this has been reflected in a narrowing of the region's current-account deficit, which we estimate at US$107bn (2% of GDP) in 2016, down from US$176bn (3.2% of GDP) in 2015. We expect the region's deficit to narrow slightly in 2017, to US$102bn (1.8% of GDP). Moderate gains in commodity prices in 2017 will support the region's terms of trade, ahead of a softening in prices in 2018, linked to our forecast of a sharp slowdown in China.

A change in risk appetite was an important factor in the 2016 rally in several of the region's currencies (the Mexican peso being an exception), which recouped part of the losses sustained during the sell-off of 2014-15. In addition to renewed inflows of portfolio capital, increased foreign direct investment inflows have supported many of the region's currencies. After a sell-off in several markets following Mr Trump’s election victory, notably of the Mexican peso, regional currencies have mostly recovered ground in 2017. Nonetheless, Brazil's currency has taken a knock following the political crisis. We forecast that US bond yields will not rise much further, and that, following a 25-basis-point increase in March, the Fed will raise rates twice more in 2017 and twice again in 2018. On these assumptions we expect the currencies of the larger countries in the region to depreciate slightly against the dollar in nominal terms from current levels but to appreciate moderately in real effective terms on an annual average basis. They are likely to come under renewed pressure in 2018 owing to the ramifications of an expected economic slowdown in China.

A mixed outlook for monetary policy in the region

After raising the monetary policy rate by 250 basis points during 2016, Banco de México (Banxico, the central bank) increased its policy rate by 100 basis points in February-May, to 6.75%. These steps were taken to alleviate inflationary pressure stemming from a rise in petrol prices in January that pushed consumer price inflation to close to 6% year on year in April. We now expect only one more 25-basis-point rate rise in the current tightening cycle.

Elsewhere in the region, we mostly expect interest rates to be cut in 2017, although this will be contingent on currencies not weakening excessively in response to higher US interest rates. A moderation in inflation, to 3.8% in May, has paved the way for monetary easing by the Banco Central do Brasil (BCB, the central bank). But, as the political crisis sets back the reform process, we expect policymakers to take a cautious approach and to cut the Selic policy rate to 9% by end-2017, from 10.25% currently.

Meanwhile, recent adverse trends in inflation are creating a monetary policy dilemma for the Banco Central de la República Argentina (BCRA, the central bank). In the first year of a new inflation-targeting regime, the end-2017 inflation target of 12-17% already appears to be out of reach (it would require average monthly inflation of less than 1% in the rest of the year, compared with a month-on-month average of 2.2% in January-April). But the policy rate is already high, at 26.25%, and the BCRA kept rates unchanged at its fortnightly meeting on May 23rd. We expect the BCRA to remain on hold until the real rate turns positive again, before it gradually starts to cut rates in the fourth quarter. Colombia's central bank will maintain its easing cycle, having made 150 basis points of cuts since December 2016, taking its policy rate down to 6.25%. Amid soft economic growth and easing inflation, we now expect the policy rate to bottom out at 5.5%. The Banco Central de Chile (the central bank) cut its policy rate in May by 25 basis points to 2.75% and signalled an end to the current easing cycle.

The medium-term growth outlook is underwhelming

Fiscal, monetary and exchange-rate adjustments (and, to a lesser extent, structural reforms to boost productivity) undertaken in the past two years will support growth beyond 2017 and prevent the region from falling back into recession in the face of weakness in China and the US in 2018-19 (assuming that commodity prices do not weaken beyond our expectations). But amid this more difficult external backdrop, GDP will slow again in those years, before gradually gathering pace and reaching 3% by 2021. This is a disappointing rate compared with the commodity boom era, and suggests limited scope for catching up with developed country incomes.

Middle East & Africa growth and inflation
(% change)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth										
Middle East & North Africa	4.1	2.1	2.6	2.3	2.8	2.1	3.6	3.0	3.7	3.8
Sub-Saharan Africa[a]	4.2	4.7	4.5	3.0	0.9	2.3	3.0	2.8	2.8	3.6
Inflation										
Middle East & North Africa	9.2	11.3	7.3	6.7	6.4	8.7	8.8	7.4	6.9	6.5
Sub-Saharan Africa[a]	9.0	6.8	6.7	6.8	10.5	10.8	8.7	8.0	7.3	7.5

[a] Angola, Botswana, Cameroon, Côte D'Ivoire, Equatorial Guinea, Ethiopia, Gabon, Ghana, Kenya, Malawi, Mauritius, Mozambique, Namibia, Nigeria, Senegal, South Africa, Tanzania, Uganda, Zambia and Zimbabwe.

Source: The Economist Intelligence Unit.

Saudi and Iranian rivalry will dominate geopolitics in MENA

Prospects for rapid economic growth in the Middle East and North Africa (MENA) remain stifled by social unrest, war and terrorism. As these difficulties have intensified, the region's problems have spilled over its borders, illustrated by the flood of refugees into continental Europe and the ongoing global threat posed by a jihadi group, Islamic State (IS), despite its recent territorial losses in Syria and Iraq. Moreover, the region is also the crucible for conflicts stoked by the conflicting geopolitical interests of regional heavyweights and global powers. Indeed, with the US's policy on Syria hard to parse—exemplified by the administration's airstrikes on Syrian government strongholds since April—the current civil war is set to continue, albeit at a higher pitch, with Iran and Russia likely to step up their military backing for the government of Bashar al-Assad. However, the risk of a major international escalation in Syria could be diluted by the creation of safe zones in Syria—owing to negotiations (between regime and rebel forces) brokered by Russia, Iran and Turkey.

Nevertheless, uncertainty continues to surround the extent to which Mr Trump is willing to maintain the traditional role assumed by the US as the guarantor of Gulf Arab security. Saudi Arabia quietly welcomed the imposition of fresh US sanctions on Iran in February after the latter conducted a ballistic missile test. However, even with this expression of US hostility, Mr Trump's presidency may eventually prove to be positive for Iran, especially if he steps back from involvement in the region in line with his “America First” policy. Such a development could leave the way more open for Iran to expand its regional influence—an outcome that could prove to be a major concern for all Gulf Arab states and, particularly, Saudi Arabia. In any case, notwithstanding a potential escalation in intra-regional rivalries, Iran's continued adherence to the Joint Comprehensive Plan of Action, combined with the country's obvious economic appeal, should keep EU, Russian, Indian and Chinese firms engaged (even though most US firms will be deterred).

Equally, government policy towards Islamist groups will prove largely divisive across the Middle East, with some, such as Qatar, continuing to back the Muslim Brotherhood and others actively opposing it. In early June Saudi Arabia, the UAE, Bahrain and Egypt—among others—cut transport and diplomatic ties with Qatar, accusing it of funding and supporting regional terrorism. The move is likely to be welcomed by Mr Trump, who is seeking to galvanise regional allies into action against Islamists, particularly jihadi groups. We expect mediation efforts by Kuwait to help to resolve the dispute in time, although Qatar is unlikely to fully abandon its Islamist allies, through which the tiny emirate wields considerable political influence in places such as Palestine, Turkey and Sudan. As a result, even if mediation efforts succeed, there is no guarantee that cordial relations will last between Qatar and its fellow Gulf neighbours.

MENA growth will be hindered by fiscal restraint

More positively, we expect an improvement in the MENA economic outlook in 2018-21. This reflects our forecast for a sharp rise in growth in Iran (the second-biggest economy in the region) to over 5% a year. Coupled with the positive impact of a concerted drive to improve the business environments across much of the region in the forecast period, this will enable faster growth. However, our assumption is that oil prices in the next five years will not be sufficient to enable oil exporters to restore the expansionary fiscal policies that were in place in 2011-14. (Several countries had fiscal break-even oil prices above US$100/barrel prior to the oil price collapse.) Ongoing fiscal restraint and subdued public investment will weigh on the non-oil economy's performance, which means that overall economic growth will remain modest by historical comparison.

More positively, the pace of structural and fiscal adjustment is set to pick up in several countries (the majority of which are oil importers) that have recently adopted reform programmes mutually agreed with the IMF. Some have already taken radical measures to correct market distortions, such as Egypt, which fully floated its currency in November 2016. However, trade- and investment-related inflows from the region's oil producers into these countries will remain subdued, but they will benefit from a small improvement in global economic conditions. Furthermore, as supply bottlenecks ease and non-oil commodity prices remain tepid, inflation will slow in most cases, helping to support real incomes and in turn non-energy and food-related consumption. On balance, we forecast that MENA economic growth will accelerate from 2.1% in 2017 to 3.5% a year on average in 2018-21. Despite the improvement on 2016-17, this will be well below the levels witnessed in the decade prior to the Arab Spring, when the region's annual real GDP growth averaged 5.1%.

Governments are intensifying reform efforts in response to low oil prices

Similarly, economic policy in oil- and gas-exporting countries will continue to be dominated by governments' efforts to diversify economic activity and revenue away from hydrocarbons. In an indication of the scale of the challenge, we estimate that every country in the region posted a fiscal deficit in 2016, with oil exporters returning an average shortfall of 8.5% of GDP. Some major oil and gas producers are beginning to make this strategic shift—for example, Saudi Arabia has announced plans to launch a US$30-50bn renewable energy programme in 2017. However, the process of transforming the structure of these heavily oil-reliant economies will remain slow (for example, the Saudi Arabian economy is forecast to shrink by 0.5% in 2017 as the ongoing domestic structural reform process will take time to bear fruit). Resistance from vested interests, an opaque business environment and reluctance to reform rigid and discriminatory labour laws (to protect the local workforce) will continue to be obstacles. As a result, the fortunes of most Gulf Co-operation Council (GCC) countries and other MENA oil producers will continue to be driven primarily by the oil market in 2017-21.

Another major obstacle to progress in the Gulf states is the slow improvement in increasing tax revenue (although a GCC-wide value-added tax is scheduled to come into force in 2018). This partly reflects policymakers' wariness about inciting unrest, and means that governments will favour privatisation programmes to replenish state coffers. We do not, therefore, expect current policies to trigger any major social upheaval in the GCC, but there may be a rise in labour militancy.

Growth in Sub-Saharan Africa will recover from 2017, but not significantly

Following a dismal performance in 2016—when we estimate that Sub-Saharan Africa's rate of economic growth fell to just 0.9%, the slowest pace of expansion for more than 20 years—economic growth is forecast to pick up slightly in 2017. This reflects our expectation that average prices for most of the region's export commodities—including oil—will be higher than in 2016, as well as the likelihood of more favourable weather conditions in southern Africa following the El Niño-related weather shock in 2015-16. Coupled with some public investment in developing infrastructure and a modest recovery in foreign investment inflows as global confidence strengthens, we expect this to lift regional growth in 2017 to 2.3%.

However, policymakers' lacklustre adjustment to the slowdown in growth will prevent a more robust economic recovery. Across much of the region the policy agenda will continue to be destabilised by political friction between reformists pushing for liberalisation and protectionists that favour a more traditional, state-led approach to development. In Nigeria, some efforts have been made to implement market-oriented reforms (notably, axing domestic fuel subsidies and adopting a somewhat more flexible foreign-exchange policy), but the weakened administration is reluctant to take bold steps to lessen its interference in the economy and boost private-sector investment. The policy outlook for South Africa is uncertain, with the ruling African National Congress (ANC) locked in a fierce internal battle that saw the president, Jacob Zuma, ousted from his position as ANC chairman (he will step down in December but will remain national president). Political tensions will distract from much-needed attempts to reverse the country's sinking growth trend. Economic mismanagement will continue to weigh heavily on the two largest economies in Sub-Saharan Africa in 2017, and policy shocks in these markets pose significant downside risks to the aggregate growth forecast. Nevertheless, our baseline forecast is a modest improvement in both countries' economic performances in 2017 as Nigeria's oil production returns to normal levels—after a series of militant attacks constrained exports in 2016—and South Africa's agricultural production recovers from drought.

Weak external demand will weigh on Sub-Saharan Africa in 2018-19

Regional growth is forecast to accelerate further in 2018, to 3%, although this remains below historical averages. Infrastructure investment, deeper regional integration and expansionary fiscal policies are expected to drive growth in East Africa (the fastest-growing subregion), while agricultural commodity exporters will benefit from a second consecutive of year of slightly higher prices across a basket of staple goods. Among Sub-Saharan Africa's oil exporters, financing pressures will persist, but—with oil prices expected to hover at just over US$50/barrel—a subdued economic recovery will continue. There will, however, be exceptions to this among the more mature exporters in the region (particularly in Central Africa) as production declines and investment into the exploration and/or development of new oilfields disappoints. Anticipating a sharp slowdown in Chinese growth in 2018, economic expansion in Sub-Saharan Africa will be constrained by depressed demand for industrial base metals and weak global confidence. The sharp slowdown in Chinese growth is also likely to translate into a further drop in trade, investment and credit flows between China and Africa from 2018. Coupled with the mild US recession that we expect in 2019, this is forecast to lead to a renewed slump in growth that year. Against the backdrop of a less supportive external environment, the structural flaws that plague most African economies will once again be exposed.

Economic diversification is the key for long-term growth

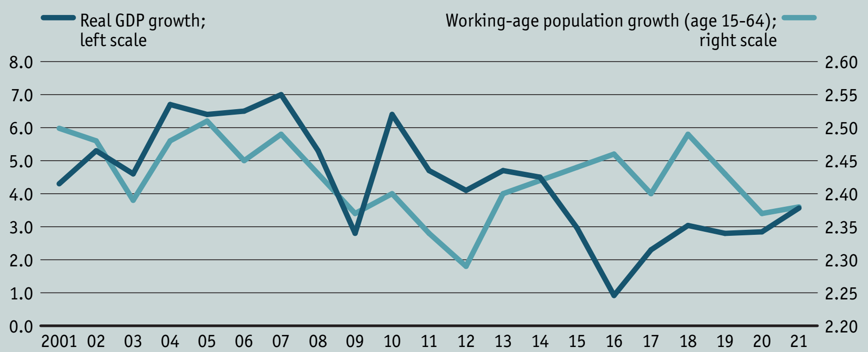
Medium- to long-term prospects vary across the region. Policy mismanagement will continue to weigh heavily on the outlook in some countries, including the regional heavyweights, South Africa and Nigeria, as well as smaller and previously fast-growing economies such as Mozambique and Zambia. Elsewhere, steadily rising domestic demand will spur fairly brisk growth in the countries that have more diversified economies and policy agendas that are more open to foreign trade and investment, such as Kenya, Senegal and

Côte d'Ivoire. Even in these fast-growing countries, however, growth will be held back by tighter fiscal policies over the medium term; a significant amount of capital investment in Sub-Saharan Africa is dependent on foreign financial support, and a normalisation of monetary policy in the developed world will lift international financing costs for the region over the medium term.

The private sector will continue to be held back by difficult operating environments, with government bureaucracy and corruption likely to remain tough challenges. Domestic supply constraints, such as tight labour markets, illiquid capital markets and infrastructure shortcomings, also reduce potential growth while adding to inflationary pressures and exacerbating current-account imbalances. In addition, the weaker outlook for oil prices—we now expect the price of Brent crude to remain below US$55/b until at least 2020, owing to persistent oversupply—to worsen the current-account imbalances in commodity-reliant countries. In the light of these constraints, the growth rate in Sub-Saharan Africa is forecast to average less than 3.4% per year in 2018-21. We doubt that this level of economic growth will be sufficient to generate enough jobs to absorb the ballooning labour force, and this therefore raises major doubts about Sub-Saharan Africa's progress towards poverty-reduction over the medium term. Moreover, in a slow growth environment, there is a risk that the borrowing spree of recent years, which has lifted the median level of gross public debt in Sub-Saharan to 50.4% of GDP, from 32.4% of GDP at end-2012, will expose debt pressures in some countries over the medium term.

A slight slowdown in inflation will go some way towards reducing the pressure on living standards, with the aggregate inflation forecast to fall from 10.8% in 2017 to an average of 7.9% in 2018-21. Assuming more favourable weather conditions than in 2016, when much of the region was hit by a severe El Niño-related drought, we expect agricultural output to improve over the medium term. This, as well as more stable currencies vis-à-vis the US dollar, will help to temper inflationary pressures. However, with a high dependency on subsistence farming and rain-fed agriculture, Sub-Saharan Africa will remain heavily exposed to weather-related shocks. Indeed, even a modest shift in rainfall patterns has the potential to radically alter most countries' trade balances and consumption levels. After the late onset of rains in late 2016, East Africa is particularly vulnerable to near-term food shortages (and, by extension, higher inflation, weaker consumption and wider trade deficits).

Sub-Saharan Africa: real GDP growth and working-age population growth



Sources: World Bank; UN; Economist Intelligence Unit forecasts.

Risk of social unrest and terrorist attacks will remain high

The political fortunes of Sub-Saharan Africa remain mixed. Elections have become more common, and are due in 2017 in Angola, Kenya and Senegal, among others. However, incumbents often use their time in office to stifle the opposition, weaken institutions meant to hold the executive to account and skew the election process in their favour. Coups d'état will be rare but conflict, failed governments, crackdowns on political freedoms and human rights violations will remain relatively widespread. In addition, the threat from radical Islamist factions—which include Boko Haram in Nigeria, Niger, Chad and Cameroon, al-Shabab and IS in Somalia, and al-Qaida in the Islamic Maghreb, which operates across the Sahel—will persist. Under the Trump presidency, the US has taken a more active role in anti-terrorism campaigns in Africa, increasing the mandate of the US military to crack down on al-Shabab in Somalia and promising to sell the Nigerian government aircraft to assist their fight against Boko Haram. However, terrorism in Africa thrives on political exclusion, a lack of economic opportunities and weak security infrastructure. With governments (and their international partners) still struggling to address these underlying issues, we doubt that military aggression alone can significantly reduce the terrorist threat levels.

In the context of weak job creation and frequent restrictions on political freedoms; social discontent will continue to increase. This, as well as rising urbanisation, will intensify the risks to social stability, and mass protests are likely to increase in both scale and frequency across much of the region. There is precedent for these to spill over into significant violence. However, we expect anti-government movements in Sub-Saharan Africa to remain fairly unco-ordinated, which limits the prospects of an Arab Spring-style uprising and reduces the risks that protests will be scaled up to a level that could affect governments' hold on power. Moreover, the determination of African consumers to seek higher incomes in a more stable environment—coupled with the fact that stronger, if still fragile, democracies have taken root over the past decade—will further limit the appetite for popular revolt.

Exchange rates

Foreign-exchange markets have become sceptical about the US dollar

The US dollar has lost most of the gains that it had made since Donald Trump's victory in the November 2016 presidential election, as financial markets have become increasingly doubtful that the new administration will reflate the economy and provoke a faster pace of monetary tightening by the Federal Reserve (Fed, the central bank). The Economist Intelligence Unit shares this scepticism. Interest-rate differentials will increasingly favour the dollar—the Fed raised its policy rate by 25 basis points in March, and we expect it to increase by another 100 basis points over the remainder of 2017 and 2018. However, much of this is already priced in, leaving the dollar vulnerable to further disappointment on economic growth, not to mention possible shocks emanating from erratic policymaking under the Trump administration.

There are also risks to the upside: in particular, a Republican proposal for a border adjustment tax that would tax imports but not exports has the potential to push the dollar sharply higher, at least in the short term. But the proposal is complex and, owing to opposition from large importers, appears to be losing favour in Washington. We do not factor it in to our forecasts but see it as one of the main global risks. On balance we continue to expect the dollar to hold fairly steady against the euro and yen over the coming quarters. Over the medium term we expect the dollar to weaken moderately on a trade-weighted basis as a US downturn in 2019 prompts a renewed easing cycle by the Fed.

The euro has strengthened as political risks have waned

The euro fell below US$1.04:€1 in December 2016 following the rejection of proposed constitutional amendments in the Italian referendum and the subsequent resignation of the prime minister, Matteo Renzi. However, it has since rallied, as pro-EU parties performed well in Dutch elections in March and Emmanuel Macron defeated Marine Le Pen of Front national at the French presidential election in May. During May the euro has strengthened further in response to unexpectedly strong economic activity in the euro zone. The common currency's resilience will again be tested by the German parliamentary elections in September, although we expect the ruling centre-right Christian Democratic Union (CDU)/Christian Social Union (CSU) to prevail. We expect the European Central Bank to keep interest rates at the lower bound throughout the forecast period but to start "tapering", or winding down, its quantitative easing programme in 2018. The anticipation of this should lend support to the euro ahead of time. The euro will also derive structural support from a large current-account surplus (4% of GDP in 2016). Accordingly, we expect the euro to trade in a narrow range close to the current level in 2017-18, averaging US$1.08:€1, but to begin strengthening in 2019, approaching US$1.20:€1 by the end of the forecast period in 2021.

The yen was among the best-performing currencies in the first nine months of 2016. It gave up a large part of its gains against the US dollar in the last quarter of the year but strengthened to ¥110:US$1 at the end of April. As the Bank of Japan (the central bank) remains committed to a very loose monetary policy (targeting 0% yields for ten-year government bonds), the yen is a natural funding currency for carry trades, even more so than the euro. As with the euro, loose monetary policy is offset by the structural support of a large current-account surplus and relatively low inflation. We expect the yen to appreciate further against the US dollar in the medium term as its safe-haven appeal again comes to the fore during the slowdown in China in 2018 and the US recession in 2019.

Fears of a renminbi devaluation remain

The renminbi, which is pegged to a basket of currencies, has been under pressure since the middle of 2016, as strong domestic credit growth has created excess liquidity in the financial system and bond yields in the US have risen. It weakened markedly against the dollar in the month following Mr Trump's election victory, reaching Rmb6.95:US$1 at year-end, compared with Rmb6.50:US$1 at the start of the year and Rmb6.78:US$1 before the US election. The People's Bank of China (PBC, the central bank) has attempted to resist this trend, mainly out of a desire to restrain capital outflows. The introduction in May 2017 of a so-called counter-cyclical factor into the mechanism for fixing the daily trading mid-point of the renminbi against the US dollar, designed to prevent excessive fluctuations, was the latest step in this regard.

In the light of these developments, we have strengthened our forecast for the average exchange rate in 2017 to Rmb6.93:US$1, from Rmb7.06:US$1 previously, and also in subsequent years. Nonetheless, we believe that the renminbi will continue to depreciate gradually, reaching a low of Rmb7.3:US$ in 2019, owing to an anticipated tightening in US monetary policy and weaker domestic economic growth. We expect the currency to rebound in 2020-21, which ought to give the authorities confidence to renew liberalisation efforts as they focus again on internationalising the renminbi.

If pressures on the renminbi were to intensify, there is a risk that the authorities would allow another one-off adjustment in the exchange rate, similar to the one in October 2015. However, they would be reluctant to do this, as it would risk encouraging further capital outflows and could be highly destabilising for other emerging-market currencies. It would also complicate relations with the US, as it could lead to fresh accusations from Mr Trump that China was devaluing its currency to "steal jobs" from the US.

Emerging-market currencies have bounced back, for now

Two years of decline gave way to a period of broad emerging-market currency recovery against the majors in the first half of 2016, reflecting investors' search for yield amid highly accommodative monetary policy in the G3 and record low bond yields. The rally faltered in the middle of the year as bond yields in developed countries edged up, and went into reverse in November following Mr Trump's election win. However, as doubts have risen about Mr Trump's ability to implement his campaign promises, capital inflows have recovered and—with some exceptions—emerging-market currencies have recouped most of the losses that they had sustained against the dollar in November. Even the Mexican peso, the currency worst hit by Trump risk, has rebounded in 2017.

In the event of further increases in US bond yields in 2017, emerging-market currencies would again be vulnerable. However, on our assumption that the Fed tightens by only 100 basis points, emerging-market currencies should hold up near current levels, at least for the next few months. Yields on emerging-market local- and hard-currency debt are still relatively attractive, and most emerging-market currencies remain cheap. Some emerging-market currencies are likely to come under renewed downward pressure in 2018, and possibly as early as the second half of 2017, as Chinese growth slows and some commodity prices falter. However, in 2019 the forces affecting emerging-market currencies will once again become more mixed as the Fed cuts US interest rates swiftly to support the economy.

World trade

World trade
(% change; goods)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
World trade	**3.6**	**4.0**	**4.1**	**2.5**	**1.9**	**3.3**	**2.9**	**2.3**	**3.2**	**3.5**
OECD	2.1	2.4	4.2	4.4	2.4	3.2	2.8	2.0	2.8	2.5
Non-OECD	4.8	5.3	3.2	-0.9	1.0	3.8	3.0	3.0	3.9	3.6

Source: The Economist Intelligence Unit.

Global trade growth will accelerate in 2017

Growth in global merchandise trade will accelerate in 2017, reaching 3.3%, after a lacklustre 1.9% in 2016. The improvement is being driven by economic growth in both developing and developed markets. Recent data from China, the bellwether of global trade, painted a positive picture for short-term growth in the world's second-largest economy. The official manufacturing purchasing managers' index (PMI) released by the China Federation of Logistics and Purchasing and the National Bureau of Statistics (NBS) was unchanged from a month earlier, at 51.2 in May. Given this growth, we anticipate non-OECD trade to expand by 3.8% in 2017, up from 1% in 2016. OECD trade growth, meanwhile, will reach 3.2%, following 2.4% growth in 2016. The cyclical upturn in the euro zone will continue, and we have recently upgraded our US trade forecasts for 2017, following strong first-quarter data; we now expect US exports and imports of goods and services to expand by 2% and 3.1% respectively, up from 1.2% and 2.6% previously. The acceleration in global trade will be short-lived, however, owing to the lack of synchronicity in the business cycles of the world's major economies.

Momentum in global trade will be difficult to maintain

Beyond 2017, on the assumption that the president, Donald Trump, makes only modest adjustments to US trade policy, we expect global trade growth to average 3% a year in 2018-21. This forecast is relatively cautious, given that it was not uncommon for world trade to expand at roughly double the pace of global GDP prior to the global financial crisis. First, we assume that a slight rise in protectionism will inhibit trade throughout the forecast period. Governments around the world have introduced a slew of protectionist measures over the past couple of years (largely driven by a desire to support domestic industries in a period of weak economic growth); we expect this pattern to continue. Second, we assume that prospects for any major multilateral trade deal like the Trans-Pacific Partnership (TPP) are unlikely to materialise. Third, we expect a structural slowdown in global trade as the integration of global supply chains abates. Finally, on the demand side, we expect a significant slowdown in the Chinese economy in 2018, followed by a mild recession in the US in 2019, both of which will drag on global trade.

The risk to global trade from the Trump administration is fading

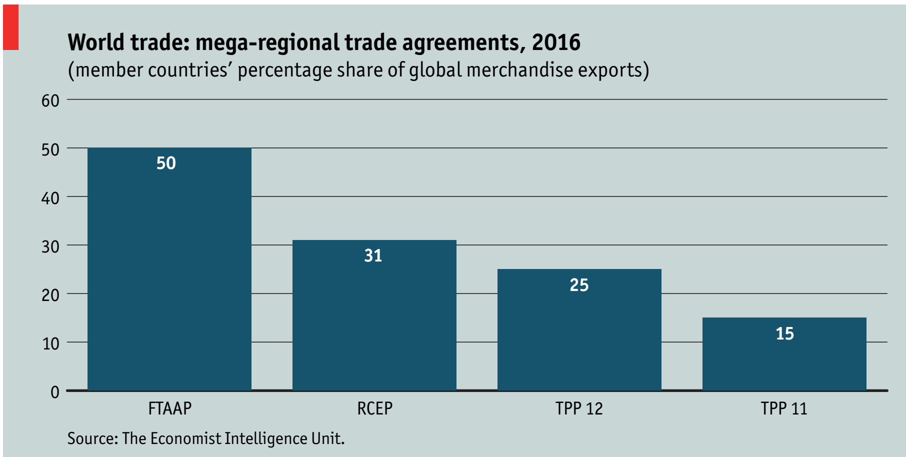
We have become more sanguine about the threat of protectionist policies from the US, after a period of heightened risk for global trade. On May 12th, after stepping back from a threat made by Mr Trump to label China a currency manipulator, the US agreed a series of minor trade concessions with China. It appears that the realities of geopolitics have begun to percolate through the White House, with the US administration keen to keep relations with China positive in order to secure greater co-operation in containing North Korea. Other political expediencies are likely to prevent the US from following through on its most alarming protectionist threats in the coming years.

We expect the North American Free-Trade Agreement (NAFTA) to be renegotiated, with the US securing concessions from Canada and Mexico rather than withdrawing altogether, as Mr Trump had threatened. The new agreement will include tighter labour laws and higher rules-of-origin requirements, but Mexico and Canada will accept these modifications rather than risk a collapse of NAFTA. However, impulsive actions from the White House that threaten global trade cannot be ruled out.

Global trade is also at risk from an overhaul of the US tax code. Among the multiple options under discussion to finance big tax cuts for individuals and business is a border adjustment tax. There is considerable uncertainty over its potential effect on the US dollar, and the measure may serve to reduce trade regardless of how the dollar responds. If the dollar remained range-bound, the tax would push up the cost of imports in the US, increasing the chances of tit-for-tat trade disputes with the US's major partners. Conversely, if the dollar were to rise significantly, it would lead to a big increase in the cost of servicing dollar-denominated debt in emerging markets, thus increasing concerns over debt sustainability. Perhaps more than the specific policy pursued, the most alarming aspect of the Trump administration's apparent enthusiasm for protectionist tax reform is the potential flouting of World Trade Organisation (WTO) rules. Mr Trump's outsider image is partly cultivated through disdain for multilateral regulatory bodies such as the WTO. But if he were to match rhetoric with action and the world's largest economy disregarded the guidelines behind the global trading system, it would lead others to question the wisdom of following the rules. We assume that, similar to the adjustments on his trade policy towards China and Mexico, Mr Trump will backtrack on his most extreme trade positions.

Few major trade deals will come into force in 2017-21

The current backlash against trade liberalisation has wrecked prospects for several mega-regional trade deals that had the potential to boost trade and economic growth. The proposed agreement between the US and the EU, known as the Transatlantic Trade and Investment Partnership, is now dead in the face of public opposition on both sides of the Atlantic. With the US turning away from trade liberalisation, China now has the opportunity to help to set the rules of engagement. However, we are doubtful that China has the capability or willingness to take on the free-trade mantle for now. Although an agreement in 2017 on the Regional Comprehensive Economic Partnership (RCEP) is planned, we believe that completion is a long way off. Part of the reason for the slow pace of negotiation is the size of the RCEP. It would cover more than 3bn people if completed, which would rival the size of the TPP. The proposed agreement includes the ten Association of South-East Asian Nations (ASEAN) member states and six partner countries (Australia, China, India, Japan, New Zealand and South Korea). Even if agreement is reached on the RCEP, the benefits would not be felt until the 2020s at the earliest. It is likely that the only new major trade deal that will come into force in 2017-21 (albeit partially and provisionally) is the EU-Canada Comprehensive Economic and Trade Agreement (CETA), which Canada and the EU signed in October 2016 after seven years of negotiations.



In the short term we expect a proliferation of smaller trade deals in Asia that could eventually lead to a new regionwide agreement. Indeed, there is some chance that an agreement could be reached on the TPP, but that it would exclude the US. On May 21st trade ministers representing 11 of the 12 signatories to the original TPP pact agreed to revive the deal, following the US's withdrawal. Trade ministers have outlined a rough timeline for future meetings, but there have been no details of how a revived TPP might look. The next meeting of the so-called TPP 11 has been set for July, but details of the pact are unlikely to be debated until November, when ministers are scheduled to meet again. What is clear is that there is a desire by all parties to leave the door open for the US to re-engage at a later date—something that the new US trade representative, Robert Lighthizer, has dismissed as unlikely.

Commodity prices

Commodity price forecasts

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Oil prices										
Brent; US$/b	112.0	108.9	98.9	52.4	44.0	54.0	52.3	53.5	57.5	60.1
Non-oil commodities[a]										
Total	**-10.3**	**-7.2**	**-5.2**	**-17.3**	**-3.0**	**6.3**	**0.8**	**-1.8**	**-1.3**	**2.2**
Food, feedstuffs & beverages	-3.5	-7.4	-5.2	-18.7	-3.5	-0.9	2.4	3.2	-1.1	1.7
Beverages	-20.1	-12.2	21.5	-10.3	-1.4	-1.3	0.9	4.7	-1.4	2.5
Grains	0.5	-5.9	-12.0	-20.4	-11.1	1.3	4.3	3.3	-4.2	3.7
Oilseeds	4.8	-5.8	-9.0	-21.9	3.0	-2.9	1.2	0.8	3.0	-1.8
Sugar	-17.1	-17.9	-3.9	-21.0	34.4	-5.8	0.6	10.9	5.3	2.5
Industrial raw materials	-19.4	-6.8	-5.1	-15.2	-2.2	16.9	-1.2	-8.3	-1.7	2.9
Metals	-13.2	-6.6	-1.6	-17.3	-5.5	20.7	0.3	-12.7	-1.6	3.6
Fibres	-31.5	-0.1	-3.5	-5.0	8.1	4.3	-2.4	-1.6	-0.9	0.8
Rubber	-27.9	-15.7	-25.8	-19.2	-1.3	21.0	-9.0	10.0	-3.6	3.2

[a] % change in US dollar prices.

Source: The Economist Intelligence Unit.

Compliance with OPEC production cuts has been strong in early 2017

OPEC members, as well as key non-OPEC partners—most notably Russia—agreed in May to extend their existing oil-production cut until end-March 2018. Thus far, participating countries have shown a record level of compliance with the output quotas outlined in the deal. The latest data from the International

Energy Agency (IEA) show that in the first four months of 2017 OPEC had reduced its output by over 1.1m barrels/day (b/d) from the October 2016 baseline—equivalent to 96% of the bloc's total promised cut—owing in part to particularly deep cuts from Saudi Arabia, which are compensating for weaker compliance elsewhere. This is a major reversal of the "free-for-all" market-share strategy that Saudi Arabia and other Gulf Arab states had adopted in 2014 as they sought to defend their market share against rising US shale production, and confirms real political will on the part of major oil producers to stabilise the oil price. Boosting the impact of the deal, several non-OPEC producers, including Russia, are also sticking to their promised cuts. Russia reduced its output by roughly 140,000 b/d on average in January-April 2017, albeit from a record production level of nearly 11.6m b/d in November 2016.

US production and investment are booming

Restraint on the part of OPEC and non-OPEC producers has not, however, had the desired impact on prices, which have fluctuated considerably since March on news of ample global oil stockpiles and a faster than expected recovery in US oil production. The bloc does not exert the same level of influence over the global oil market as it once did, owing largely to the development of the US shale sector. There is no mechanism for strategic, collective decision-making among US oil producers, as there is in OPEC, meaning that US output is driven solely by market forces. Nimbler, more cost-effective shale oil producers are able to respond to even modest increases in the oil price; this has led to a boom in US energy production in recent months, with total crude output reaching 9.3m b/d in early June, 6.5% higher than at the same point last year. Meanwhile, American oil producers continue to invest; the US oil-rig count, compiled by Baker Hughes, rose to 916 active rigs on June 2nd, a 125% increase on a year-on-year basis. The rapid expansion in US production, together with stubbornly high global oil stocks, has reversed the oil price rally seen in January-February, and will continue to act as a brake on price growth throughout the year.

Global oil prices will at most stabilise in 2017-18, amid a persistent supply glut

OPEC's attempts to rebalance the global oil market in the first half of 2017 have undeniably failed. Instead, OPEC producers appear to be shifting to a more pragmatic approach, in which they will continue to exercise restraint in order to bring about a modest, and very gradual, market rebalancing. The bloc's decision to extend the production cuts into early 2018, and probably longer, is an attempt to prevent another oil price crash. If participants were to abandon the agreement in 2017, before global stocks begin to show a noticeable decline, this would bring around 1.8bn b/d in currently frozen production back on line quickly. This would cause prices to plummet again, potentially back down to the low of US$30/barrel seen in 2016. The Economist Intelligence Unit remains of the view that OPEC producers would not be willing to accept this outcome, particularly as Saudi Arabia seeks to bolster oil prices and, by extension, the valuation of the state-owned oil firm, Saudi Aramco, ahead of the sale of up to a 5% stake in the firm in 2018. As a result, we expect OPEC and its key partners, including Russia, to unwind the deal only gradually (with the deepest cuts still coming from Saudi Arabia) and only once global stocks have begun to decline, probably in the third quarter of 2018. This will allow for a more orderly end to the OPEC production agreement, avoiding a disruptive market crash. Important downside risks remain; most notably, if some participants chose to abandon the deal abruptly, seeing it as a failure, this could push other members to do the same, which would send prices plummeting.

Global oil prices look set to hover around the US$54/b mark in 2017-18

Beyond rising output from the US, the other main obstacle to market rebalancing has been modest global consumption. We expect global oil demand to expand steadily, at an average of 1.4% per year, in 2017-18 but this will be too slow to run down global stocks in the near term. As a result, we expect the global oil market to register a small deficit, of roughly 90,000 b/d, in 2017, but to return to surplus in 2018 as countries gradually seek to regain lost market share. Overall, the global oil story has shifted to one of stagnation rather than recovery. We expect the price of dated Brent blend, the international benchmark, to rise to an average of US$54/b in 2017 as the market registers a small deficit, before inching back down to US$52.3/b in 2018 as the OPEC deal slowly unwinds and as demand slumps in the second half of the year—particularly from China. We expect Chinese consumption to soften in line with an abrupt slowdown in industrial production and investment growth there, which will have negative knock-on effects on other economies in the region and weigh on sentiment globally.

Geopolitical risk remains a factor throughout the forecast period

We expect prices to rise marginally in 2019, to US$53.5/b, as rising production costs weigh on output in the US and global stocks begin to tighten. We then forecast prices to firm slightly, reaching US$60.1/b by 2021, supported by an improvement in global economic growth and slower increases in OPEC production. The lack of policy clarity under the US president, Donald Trump, remains a risk factor within our price forecast. On the one hand, energy policies in the US that favour domestic oil producers may, by boosting supply, exacerbate downward pressure on prices. On the other hand, Mr Trump's decision to take the US out of the 2015 Paris agreement on climate change is likely to generate stronger demand for fossil fuels, which will be supportive of prices. Deteriorating relations with Iran—potentially as a result of erratic US foreign policy in the Middle East—could also put upward pressure on prices.

Non-oil commodity prices will fail to recover significantly in 2017-21

After years of oversupply and falling prices, tightening supply-demand balances have triggered rapid increases in the prices of several commodities. However, the rebalancing process is far from complete, reflecting a sluggish supply response to low prices (mostly related to producers cutting costs), and, for some industrial commodities, insufficient demand from China. We believe that in 2017-21 the prices of many industrial and agricultural commodities are unlikely to break away from recent lows. For those that do see substantial growth in 2017—particularly base metals—this is unlikely to be sustained in 2018 as China's economic slowdown takes hold. Many agricultural prices remain under downward pressure from record stocks accumulated through successive bumper harvests.

Hard commodities: Industrial raw materials (IRM) prices remain volatile, but we expect the prices of all six base metals that we track on the London Metal Exchange (LME) to rise in 2017, the first such co-ordinated increase since 2011. The rise will be driven by recovering demand across emerging markets—including in China but also from India—and further supported by a partial recovery in global oil prices compared with 2016. However, the tide will turn again in 2018, especially for metals that are most vulnerable to China's investment and industrial cycles and for which China's relative weight in global consumption is greatest, such as copper and aluminium. On balance, we expect industrial commodity prices to rise by nearly 17% in 2017, driven largely by the sharp rise in the price of base metals as markets tighten and stocks are gradually worked through. Prices will drop in 2018, by 1.2%.

Soft commodities: We expect food and beverage prices to remain relatively flat over the forecast period, reflecting subdued demand (in historical terms), record-high inventories following several bumper harvests and several large grains outturns in the 2016/17 season. Despite concerns that another potentially disruptive El Niño weather event could be gathering on the horizon, we do not expect this to be serious enough to provoke an agricultural price shock in 2017-18. We forecast the food, feedstuffs and beverages (FFB) price index to contract slightly, by 0.9%, in 2017 (0.4% previously) as higher than expected production of several goods, primarily sugar and cocoa, further inflates large global stocks. Unlike IRM prices, agricultural commodity prices will return to growth of 2.4% in 2018, despite the economic problems in China, underpinned by rising populations and incomes, as well as rapid urbanisation and changing diets. However, price growth will be limited by ample stock availability.

Global assumptions

(Forecast closing date: June 12th 2017)

Global forecast

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real GDP growth (%)										
World (market exchange rates)	**2.3**	**2.4**	**2.7**	**2.6**	**2.3**	**2.7**	**2.5**	**2.1**	**2.6**	**2.7**
US	2.2	1.7	2.4	2.6	1.6	2.0	2.1	1.0	2.0	2.0
OECD	1.3	1.4	2.0	2.2	1.7	2.0	1.8	1.3	1.7	1.9
Japan	1.5	2.0	0.2	1.1	1.0	1.5	1.0	0.8	0.3	1.1
Euro area	-0.8	-0.2	1.3	1.9	1.7	1.8	1.6	1.5	1.5	1.5
China	7.9	7.8	7.3	6.9	6.7	6.6	4.6	4.7	5.2	4.9
World (PPP exchange rates)[a]	**3.4**	**3.4**	**3.5**	**3.3**	**3.1**	**3.5**	**3.3**	**3.0**	**3.5**	**3.6**
OECD	1.4	1.5	2.1	2.3	1.8	2.0	1.9	1.3	1.8	2.0
Non-OECD	5.3	5.1	4.7	4.1	4.1	4.6	4.3	4.3	4.7	4.8
World trade growth (%)										
Goods	3.6	4.0	4.1	2.5	1.9	3.3	2.9	2.3	3.2	3.5
Consumer price inflation (%; av)										
World	**4.0**	**3.8**	**3.6**	**3.2**	**3.8**	**4.5**	**3.9**	**3.4**	**3.1**	**3.0**
US	2.1	1.5	1.6	0.1	1.3	2.3	2.0	1.3	1.7	1.9
OECD	2.2	1.5	1.6	0.5	1.0	2.2	1.9	1.6	1.9	1.9
Japan	-0.1	0.3	2.8	0.8	-0.1	0.7	0.6	0.9	1.2	0.7
Euro area	2.5	1.4	0.4	0.0	0.2	1.7	1.4	1.6	1.7	1.8
China	2.6	2.6	2.1	1.5	2.1	1.7	1.8	2.2	2.7	2.5
Export price inflation (%)										
Manufactures (US$)	-0.9	-0.3	-0.1	-4.6	-1.8	1.5	2.3	5.8	4.1	4.7
Commodity prices										
Oil (US$/barrel; Brent)	112.0	108.9	98.9	52.4	44.0	54.0	52.3	53.5	57.5	60.1
% change	0.9	-2.8	-9.1	-47.1	-15.9	22.7	-3.3	2.4	7.5	4.6
World non-oil commodity prices (US$, % change)	**-10.3**	**-7.2**	**-5.2**	**-17.3**	**-3.0**	**6.3**	**0.8**	**-1.8**	**-1.3**	**2.2**
Food, feedstuffs & beverages	-3.5	-7.4	-5.2	-18.7	-3.5	-0.9	2.4	3.2	-1.1	1.7
Industrial raw materials	-19.4	-6.8	-5.1	-15.2	-2.2	16.9	-1.2	-8.3	-1.7	2.9
Main policy interest rates (%, end-period)										
Federal Reserve	0.13	0.13	0.13	0.38	0.63	1.38	1.88	0.38	0.38	0.63
Bank of Japan	0.08	0.07	0.06	0.07	0.07	0.07	0.07	0.07	0.07	0.07
European Central Bank	0.75	0.25	0.05	0.05	0.00	0.00	0.00	0.00	0.00	0.00
Bank of England	0.50	0.50	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25
Exchange rates (av)										
US$ effective (2010=100)	98.0	99.1	101.2	113.8	117.5	123.0	124.9	123.4	120.6	117.4
¥:US$	79.8	97.6	105.9	121.0	108.8	112.6	111.2	103.3	100.2	100.0
US$:€	1.29	1.33	1.33	1.11	1.11	1.08	1.08	1.11	1.13	1.15
Rmb:US$	6.31	6.20	6.14	6.23	6.64	6.93	7.16	7.34	7.10	6.95
US$:£	1.59	1.56	1.65	1.53	1.35	1.25	1.21	1.21	1.23	1.26
¥:€	102.6	129.6	140.7	134.3	120.4	122.0	120.4	114.6	112.9	115.0
£:€	0.81	0.85	0.81	0.73	0.82	0.87	0.90	0.92	0.92	0.92
Exchange rates (end-period)										
¥:US$	86.6	105.3	119.9	120.3	116.8	111.8	109.0	100.1	100.1	99.9
Rmb:US$	6.29	6.10	6.12	6.49	6.95	7.02	7.27	7.34	6.91	7.07
US$:€	1.32	1.38	1.21	1.09	1.05	1.08	1.10	1.12	1.14	1.17

[a] The 122 countries for which The Economist Intelligence Unit publishes five-year forecasts.

Source: The Economist Intelligence Unit.