press release

Global Focus 2015: Rekindling animal spirits

UAE, 09 December 2014 – Standard Chartered Global Research expects global growth to improve in 2015, rising to 3.4% from 2.9% in 2014, but says that confidence is crucial and will require more than just better economic indicators to drive it. We believe that what John Maynard Keynes referred to as "animal spirits" - a spontaneous urge to action rather than inaction, and not the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities - are what the world economy lacks right now.

Although the world economy is improving, momentum is sluggish and animal spirits are fragile, especially in the West. This leads to two problems. First, unanticipated shocks (geopolitical or otherwise) can have bigger effects than in a stronger world economy. Second, policy can improve growth dynamics, but it can also be a significant source of risk. So far, the policy approach to boosting growth has taken the form of monetary easing. This will likely continue in 2015.

Marios Maratheftis, Head of Macro Research, commented: "2015 is likely to bring better growth and low inflation, which should be positive for financial markets. Stronger US growth and the resilience of emerging markets in Asia, Africa and the Middle East should provide support, but the absence of animal spirits is sobering. Confidence is needed for the recovery to gain momentum, and policy support will be essential to establishing this confidence. The risk of a policy mistake will be an important worry regarding 2015."

We expect the European Central Bank (ECB) and the People's Bank of China (PBoC) to ease further, and the Bank of Japan (BoJ) to continue its quantitative easing programme. Although monetary easing can help, it has serious limitations, especially in countries where interest rates are already close to zero.

The Fed is likely to normalise policy in 2015 by hiking interest rates. This normalisation needs to be carefully timed and managed. Although we expect the US economy to grow faster, we think the growth recovery is long overdue. Premature tightening would risk derailing the US recovery, especially as there are currently no signs of inflation.

Growth in the US since mid-2009 has averaged only 2.3% – too low, given that the economy was emerging from a financial crisis and a recession that started at the end of 2007. We expect the US to finally break out in 2015, growing by 2.8%.

While we expect the euro-area economy to improve in 2015 compared with 2014, this needs to be put into context. The 11 largest euro-area economies grew an average of 0.3% during the Great Depression between 1929 and 1936 – better than the 0.2% contraction they averaged between 2007 and 2014. Real GDP per capita in the euro area is now at 2006 levels.

In such situations, fiscal policy needs to play a bigger role. If animal spirits are absent, businesses are not investing, and households are not spending despite low interest rates, the onus should shift to governments to purchase goods and services. We do not expect a dramatic change in the euro area’s fiscal policy, although we anticipate a more neutral fiscal stance after years of austerity.

China faces a structural transformation amid cyclical headwinds. The country is rightly changing its economic model. The old model, which helped China become a middle-income country, was dependent on investment, manufacturing and exports. But if China is to avoid the dreaded middle-income trap, it needs to rely on a new model in which domestic consumption and services become increasingly important. This ongoing transition is likely lead to lower growth, which the authorities seem willing to tolerate. We forecast GDP growth at 7.1% in 2015, but it will probably feel slower.

India is an exception to the weaker animal spirits that prevail elsewhere, and could be a positive surprise in 2015. We expect economic indicators to continue to improve in 2015. More importantly, sentiment is also rising sharply due to changes made by the new government to reduce red tape and promote investment. The increased credibility of the central bank has also helped to rein in inflation. We expect stronger growth and slower inflation in the coming years.

There has been no shortage of animal spirits in the Middle East, particularly in the oil-rich Gulf Co-operation Council (GCC) countries. These economies boomed in 2014 on the back of increased spending on infrastructure projects. Although GCC economies are taking active steps to diversify, government revenues are still highly dependent on hydrocarbon proceeds.

The drop in oil prices in 2014 raises the question of whether GCC governments can keep raising government spending year after year without facing fiscal pressures. The answer is that they probably cannot, and fiscal policy will have to be reassessed. We expect oil prices to rebound in 2015. Additionally, our client surveys in the GCC suggest optimism for 2015. With animal spirits high, we expect moderately slower but still-high rates of growth in the GCC.

Strong animal spirits also prevail in Africa. We expect GDP growth in Sub-Saharan Africa to remain robust in 2015. The strong momentum of recent years is likely to continue. Domestic factors will be important drivers of activity. We expect the region to be able to cope with rising US interest rates, as growth in Africa remains robust. Elections in Nigeria, Côte d'Ivoire, Zambia and Tanzania have the potential to affect confidence and economic activity.

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Note to editors:

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