



WORLD FLASH

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The Global Economy in 2007: A Smooth Landing

The global economy is headed for a smooth landing in 2007, with real GDP growth moderating to 3.3% from 3.9% in 2006. Although the world economy is in the midst of a mid-cycle deceleration, 2007 is shaping up to be a good year by most standards. The projected 3.3% expansion is near the world's current potential growth rate and above the 3.0% average of the past 10 years. After above-trend growth from mid-2003 to mid-2006, the slowdown in industrial countries is having some beneficial side-effects. Commodity prices have retreated from lofty peaks, easing inflationary pressures, and global trade imbalances are starting to narrow.

Despite a marked slowdown, the U.S. economy will continue to outpace the Eurozone, Japan, and Canada in economic growth over the next few years. The slowdown in the U.S. economy, which began in spring 2006, is the major driving force behind the global deceleration. Restrained by a housing-market bust and its spillover effects on consumer spending, U.S. real GDP growth is projected to slow from 3.3% in 2006 to 2.3% in 2007. If, as anticipated, housing construction stabilizes in late 2007, U.S. real GDP growth will rebound to 3.2% in 2008. The U.S. acceleration will help to boost world economic growth from 3.3% in 2007 to 3.6% in 2008.

The Asia-Pacific region will continue its strong performance and account for 35-40% of world economic growth. With the United States performing below potential in 2007, Asia-Pacific's importance to the global economy will increase. The region will account for 39% of the world's real GDP growth in 2007, up from 35% in 2006 and 30% between 1995 and 2005. China will contribute 16% of global growth in 2007, pulling three times its weight. Despite a deceleration in fixed investment and exports, China's real GDP is expected to grow 9.7% this year and 8.7% in 2008, when it overtakes Germany as the world's third-largest economy.

Inflation will ease in 2007, thanks to lower commodity prices, strong investment in new capacity, and global competition. Global consumer price inflation is projected to ease from 3.1% in 2006 to 2.6% this year, with most regions showing some deceleration. A notable exception is the Eurozone, where Germany's value-added tax (VAT) increase will push the region's inflation up to 2.1% this year from 2.0% in 2006. Japan is likely to see a slight drop in consumer prices in 2007, reversing last year's 0.3% rise.

The current phase of monetary tightening is nearing an end, but policymakers will remain vigilant. In the first half of 2007, policy interest rates are likely to rise in Europe and Asia, but hold steady in North America. Both the Bank of England and the European Central Bank are expected to raise rates at least one more time. The Bank of Japan will be cautious in the face of weak economic growth, but is likely to lift its policy rate from 0.25% to 1.0% by year-end. In the United States, diminishing core inflation and rising unemployment should enable the U.S. Federal Reserve (Fed) to cut rates by mid-year.

The worst is over for global trade imbalances, with some improvement expected in 2007, facilitated by exchange rate adjustments. The U.S. current-account deficit reached a record annual rate of US\$902 billion in the third quarter of 2006, marking the nadir for global trade imbalances. Now, multiple rebalancing forces are coming into play—slower growth in the U.S. economy and import demand, better growth in domestic demand Western Europe and Asia, currency adjustments, and lower oil prices. Yet, the sheer magnitude of the deficit and the need to continuously attract huge inflows of foreign capital will put further downward pressure on the dollar, especially as U.S.-foreign interest rate differentials decrease.

A Quick Look at the Numbers

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Real GDP Growth (Annual percent change)									
World	2.6	4.1	3.4	3.9	3.3	3.6	3.6	3.4	3.3
United States	2.5	3.9	3.2	3.3	2.3	3.2	3.4	3.2	2.8
Eurozone	0.8	1.8	1.5	2.7	2.0	1.9	2.1	1.9	1.8
Japan	1.5	2.7	1.9	2.0	1.9	2.1	1.7	1.6	1.6
Non-Japan Asia	6.5	7.5	7.1	7.4	6.8	6.7	6.4	6.3	6.1
Exchange Rates (Year-end)									
Dollar/Euro	1.26	1.36	1.18	1.32	1.42	1.47	1.47	1.40	1.37
Yen/Dollar	107.1	104.1	118.0	119.0	105.8	98.4	95.4	93.5	92.6

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