Grant Thornton

An instinct for growth™

The global economy in 2016

Grant Thornton International Business Report

Businesses resilient in face of growth challenges

Ed Nusbaum considers the global economic outlook for 2016

At the beginning of a new year, I'm often asked what the number one issue for businesses is over the next 12 months. And while I don't have a crystal ball, this question seems particularly difficult to answer this year.

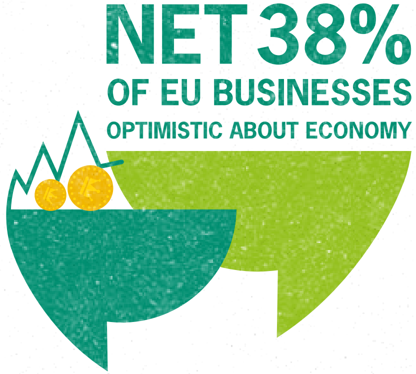
There are numerous economic factors which present both opportunities and risks to businesses. The US has recently increased its interest rate. Oil prices ended 2015 at $37 a barrel compared to $56 12 months ago, and the price of oil is expected to remain low with the lifting of Iranian sanctions. The re-balancing of the Chinese economy presents opportunities, but weaker demand for commodities and raw materials will impact export based economies in 2016. Yet businesses remain resilient in the face of these moving parts; global optimism has held relatively firm and plans to invest for future growth continue.

Despite the numerous challenges facing the EU, net 38% of EU businesses surveyed in our global quarterly survey are optimistic about their national economies over the next 12 months, exactly the same as in Q3 and Q1 of last year. The survey results show broad based confidence across the continent as businesses shrug off the threats of deflation, terrorism and possible British and Greek exits. Furthermore, an increase in expected R&D investment over previous quarters demonstrates that EU business are looking past recent stock market volatility and instead opting to take a long term view.

Also in the US, the Federal Reserve's confidence in the US economy led to the first interest rate hike in nearly a decade in December and it signalled more hikes to come in 2016. However, our research found that US business optimism fell by 24% points heading into 2016, the biggest fall of any of the 36 countries surveyed. Our International Business Report data shows a drop in US export expectations for 2016 as the culprit, fuelled by a strengthening dollar and the shift in the Fed's stance on interest rates. Coming changes in leadership also create some uncertainty with a new president come the end of 2016.

I would argue that the word 'change' also encapsulates what we are seeing in China. Businesses around the world suffered a dent to confidence in 2015 following uncertainty around the speed and the extent of China's economic slowdown. That has subsided somewhat. Optimism across the Asia Pacific region has actually increased to 31% in Q4, compared to 27% recorded twelve months ago.

However, in early January, we saw sharp falls in the Chinese stock market as concerns about the speed of the economic slowdown there remain. They are a reminder that the rebalancing of the Chinese economy, in particular a depressed demand for raw materials compared to recent years, will create challenges. But dynamic businesses will spot new opportunities as the demand for service-led offerings in China grows along with its burgeoning middle class.



Drawing on data and insight from the Grant Thornton International Business Report (IBR), the International Monetary Fund (IMF) and the World Bank, this report considers the outlook for the global economy in 2016.

Does burgeoning also describe the outlook for businesses in Japan? Many are asking if 2016 could be the year when Abenomics starts to bear fruit. Stripped of energy prices, inflation is now at roughly 1%, heading towards its 2% target, and recent figures suggest public debt has stopped rising. While business leaders in Japan are more optimistic about 2016 than they were about 2015, many still remain cautious – perhaps remembering previous upticks in the economy which quickly subsided.

Another region used to economic peaks and troughs is Latin America. My conversations with clients and industry leaders there often involves talk of political and social change and while the economic picture across the continent remains fragile, we see further evidence of business resilience. Optimism reached its highest point in 12 months at the end of 2015, largely driven by the appointment of a new president in Argentina. In Brazil, optimism is weaker but as with the rest of Latin America, there is a feeling that the US will present a healthy market into which they can sell commodities and other goods.

I should also mention the Rio Olympics. Our survey has shown over the years that major sporting events can provide short term boosts to an economy and Brazil's healthy revenue expectations for 2016 further reflect this trend.

The global economy continues to evolve. For business leaders, these shifting landscapes present new challenges but for the most dynamic firms they also offer exciting new opportunities. I think that part of business leaders' instinct for growth is to look beyond the uncertainty and spot emerging pockets of opportunity to build new trade links and ensure your growth plans reap rewards. As businesses look to 2016 and beyond, I'm reassured that the global economy offers great opportunity for those dynamic firms who continue to push boundaries and remain optimistic about the challenges ahead.

Ed Nusbaum

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Global CEO
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Economic growth

The IMF has lowered its 2016 global growth forecast to 3.6% (from 3.8% in July 2015) with managing director, Christine Lagarde, warning that any increase in output this year will be "disappointing and uneven". The fund has also revised down its world trade growth projection for this year from 4.4% in July 2015 to 4.1%.

Looking to 2016, the US Federal Reserve has signalled its confidence in the country's economic recovery with its first interest rate rise in 114 months. Whilst the move was initially welcomed by global markets, the accompanying strength of the US dollar is a concern for the country's exporters. The rate rise will also not be welcome among emerging markets which hold substantial quantities of dollar-denominated debt.

The re -balancing of China's economy to being more service-led continues to shape the global economic outlook. The manufacturing Purchasing Managers' Index (PMI) for China stood at 49.7 in December 2015, after contracting for the fifth consecutive month, while the non-manufacturing PMI rose to 54.4 from 53.6 in November. Growth in China is forecast to be 6.3% this year, 0.5% slower than in 2015, though the impact of changes taking place in the world's second largest economy are having a limited impact on forecasts for the Asia region (5.4%) and ASEAN-5 (4.9%).

Forecast growth for the Eurozone (1.6%) is almost unchanged from 2015, with the German (1.6%), French (1.5%) and Italian (1.3%) economies all forecast to grow more quickly this year than last. Elsewhere, the contraction of Greece's economy is set to slow to -1.3% compared with a predicted -2.3% in 2015. Consumer prices across the Eurozone are expected to rise 1% in 2016, still falling short of the region's 2% inflation target, despite record-low base rates and the European Central Bank's expansive quantitative easing programme.

In South America, falling commodity prices and currency depreciation is expected to have a substantial impact on output and inflation, with consumer prices likely to increase 15% this year. Argentina (-0.7%) is expected to contract despite a boost to business confidence following the start of Mauricio Macri's presidency. Brazil's recession is forecast to continue (-1%) as the region's largest economy struggles with the falling value of the Real, down 30% against the dollar in the year to December 2015, and high levels of unemployment, expected to rise to 8.6% in 2016 compared with 6.6% for 2015.

The impact of instability in the MENA, Afghanistan and Pakistan region is forecast to have a limited impact on growth, predicted to be 3.9% in 2016 compared to 2.5% last year. That said, growth is expected to slow in a number of major oil exporting nations, including Saudi Arabia (2.2% down from 3.4% last year) where the current account deficit is set to increase to 4.7% of GDP.

Meanwhile in Sub-Saharan Africa (SSA), major oil exporters appear to be suffering less and are forecast to grow by 4.1% this year compared to 3.5% in 2015. Outlook for the SSA region as a whole is relatively strong (4.3%), though growth is forecast to slow in some low-income countries including Ethiopia (down from 8.7% in 2015 to 8.1%) and the Democratic Republic of Congo (down from 8.4% in 2015 to 7.3%).

Growth is set to return for the Commonwealth of Independent States (0.5%) in 2016 following a fall in output last year. Russia's economy is set to contract by -0.6% as it struggles with falling commodity prices and trade embargoes.

3.6%

FORECAST GLOBAL GROWTH IN 2016

Forecast real GDP growth rates (%)

Source: IMF 2015

* North America is a weighted average of the United States and Canada

Business growth

Looking ahead to 2016, our International Business Report (IBR) finds net global business optimism stands at 36%, a 1pp uplift on this time last year. Surprisingly, EU businesses (38%) are the bedrock of stability. Despite concerns about the migrant crisis, terrorism and potential Brexit, firms across the region have maintained similar levels of confidence for the coming 12 months throughout 2015. Meanwhile in the US, December's interest rate rise has added to concerns among business leaders who reported a sharp 24pp quarterly drop in economic optimism for the year ahead.

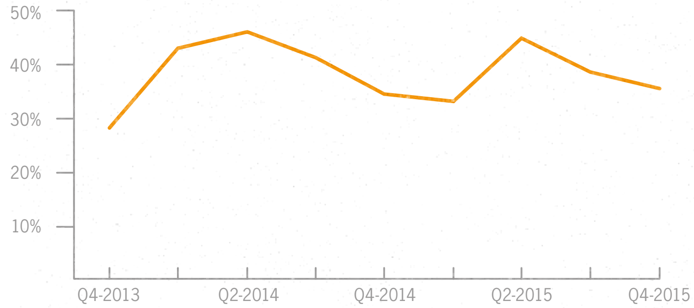
Businesses in developed nations are feeling the most confident about their country's economic prospects, with Ireland (88%), the United Kingdom (73%), Netherlands (68%), the US (50%), Spain (49%) and Australia (46%) all reporting high levels of optimism.

Meanwhile, at the bottom of the table, commodity-intense economies Brazil (-12%), Malaysia (-14%) and South Africa (-24%) have been impacted by falling selling prices for their exports.

In North America, the sharp quarterly fall in business optimism in the US at the end of 2015 to 50% has stemmed from concerns among exporters about the strength of the dollar, which have been compounded by the Federal Reserve's rate rise. Businesses in Canada have also reported a substantial drop in confidence looking ahead to 2016 compared to last year (18% down 35pp), driven by concerns about falling commodity prices.

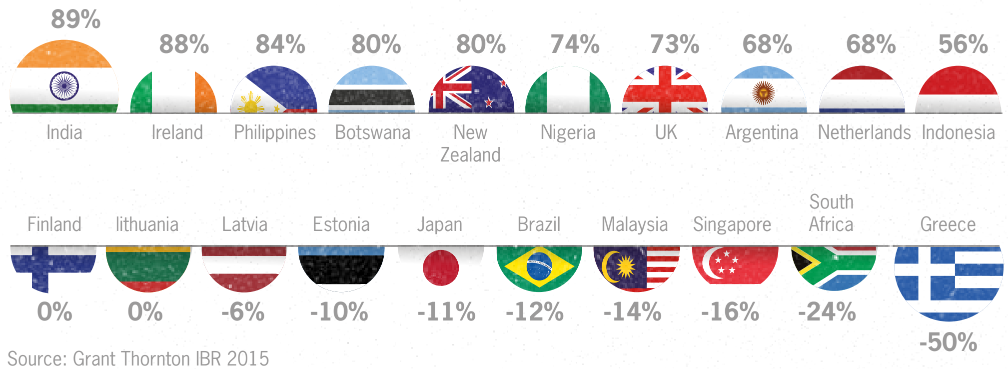
Across Asia Pacific the outlook is remarkably positive considering the economic slowdown in China and resulting market volatility across the nation. Confidence within the region looking ahead to the coming 12 months is up 4pp to 31% compared to this time last year. Some major economies in the region including Australia (46%), China (36%) and Indonesia (56%) have reported substantial quarterly uplifts in optimism. However, in Japan (-11%), Prime Minister Abe's "three arrows" of fiscal stimulus, monetary easing and structural reforms are yet to translate into an uplift in business confidence across the country.

Net percentage of businesses optimistic for the economic outlook (global)



Source: Grant Thornton IBR 2015

Net percentage of businesses optimistic for the economic outlook (top and bottom ten)



Source: Grant Thornton IBR 2015

Sales and profits

Global revenue expectations (44%) for 2016 are slightly up compared to this time last year. Whilst the worldwide outlook is promising, optimism is not evenly shared.

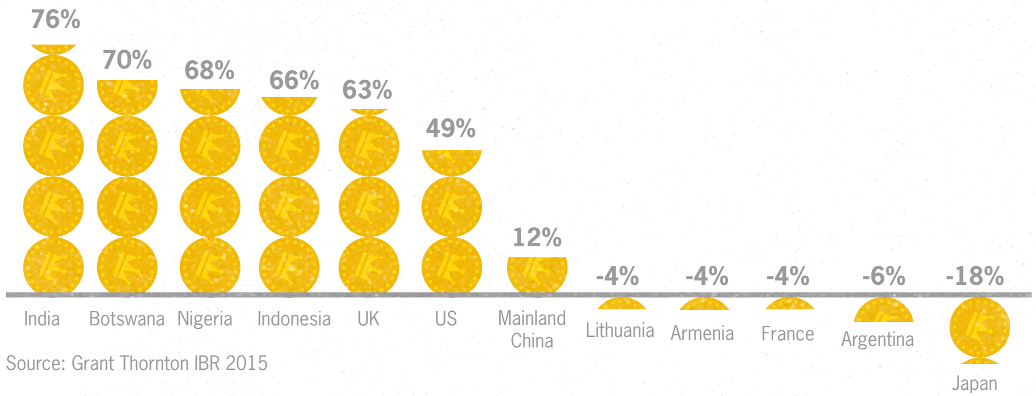
Companies in India (92%), Nigeria (86%), Ireland (74%), Mexico (74%), Argentina (72%) and Turkey (72%) are the most confident about increased revenues for the coming year. Mexico is benefitting from a relatively less commodity-intense economy than its Latin American peers, while businesses in Argentina have welcomed Mauricio Macri's presidency and firms in Turkey appear unconcerned about the impact of the migrant crisis and neighbouring instability.

Countries reporting low revenue expectations include France (11%), Russia (8%) and China (21%), with the latter two nations facing poor export prospects and limited domestic demand.

Across emerging markets, revenue expectations for 2016 are divided. The balance of MINT countries expecting an increase stands at 74%, up 17pp compared to this time last year, while BRIC optimism is at 33%, down 14pp.

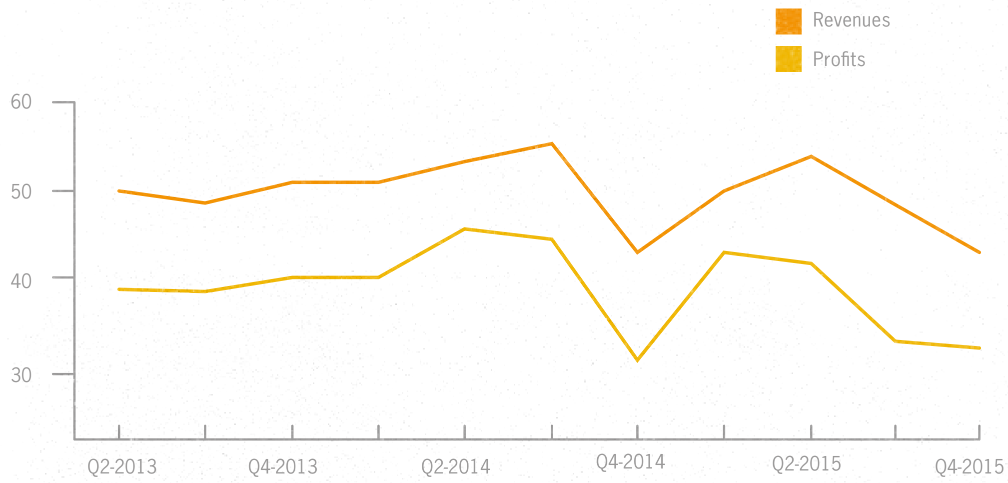
Global profitability expectations (33%) for the coming 12 months are in-line with last year. The UK (63%), Netherlands (62%), Indonesia (66%) and Nigeria (68%) are among the most positive about profitability outlook, while sharp falls in expectations have been reported in Russia (-4%, down 27pp) and Mexico (6%, down 46pp) compared to 2015.

Net percentage of businesses expecting to increase profits (selected economies)



Source: Grant Thornton IBR 2015

Net percentage of businesses expecting to increase revenues/profits (global)



Source: Grant Thornton IBR 2015

Exports

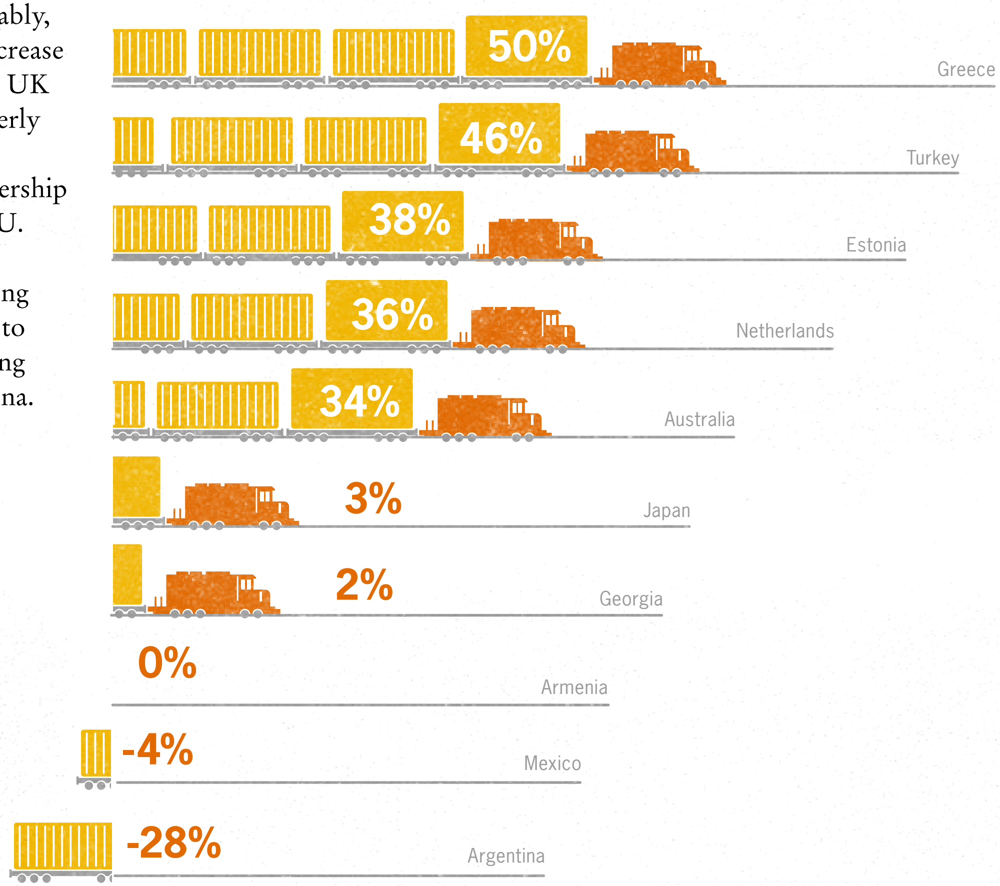
Looking ahead to 2016, businesses worldwide are reporting low export expectations. Net 15% of companies worldwide are looking to increase exports over the coming 12 months, the lowest quarterly figure since 2011.

The Federal Reserve interest rate rise and resulting strengthening of the dollar has hurt export sentiment in the US, where net 11% of companies are expecting to increase exports over the next year. The issue is likely to be compounded by the falling value of currencies across major US export markets such as Mexico, Japan and Brazil.

The EU (26%) has maintained a relatively high level of increased export expectations throughout 2015. Notably, the balance of firms expecting to increase exports over the coming year in the UK (23%) saw a substantial 11pp quarterly uplift at the end of 2015 despite the prospect of a referendum on membership of its primary export market, the EU.

Firms in both Asia Pacific (11%) and Latin America (7%) are reporting low export expectations, likely due to falling commodity prices and slowing demand for raw materials from China.

Net percentage of businesses expecting to increase exports (next 12 months; top ten)



Source: Grant Thornton IBR 2015

Innovation and investment

Worldwide expectation of an increase in infrastructure and R&D investment has fallen this year compared to last, with emerging market sentiment weighing on forecasts.

Looking ahead to 2016, global business expectations for increased investment have fallen from this time last year across the fields of research and development (R&D) (22%, down 8pp), new buildings (17%, down 5pp) and plant & machinery (30%, down 5pp).

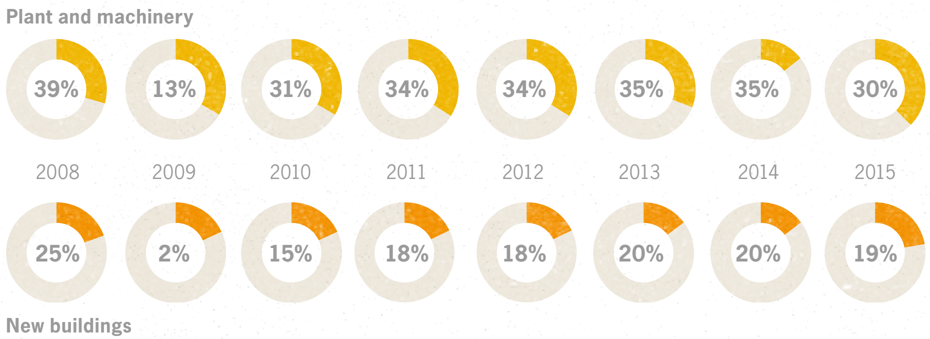
Businesses in Nigeria (68%), Lithuania (62%), Spain (59%), Ireland (57%) and the United Kingdom (53%) are most expectant of an increase in plant and machinery spend for 2016. The global fall over the last year (35% to 30%) is largely due to low expectations across emerging regions. Emerging APAC (20%, down 8pp), Eastern Europe (26%, down 7pp) and Latin America (18%, down 27pp) have all reported falls in expectation for the coming 12 months. The outlook is more promising in Africa, where expectation of an increase is up this year to 59% compared to 39% for the same period last year.

Emerging regions are also weighing on global research and development expectations (R&D), with Emerging APAC (27%, down 7pp), Eastern Europe (16%, down 4pp) and Latin America (25%, down 8pp) all reporting falls in investment plans. Investment intention across the EU is increasing but has fallen sharply in North America (16%, down 19pp). The outlook is better in Africa (58% up 30pp) and the MINT countries (37%, up 7pp).

Expecting R&D investment in North America is down 19pp to 16%

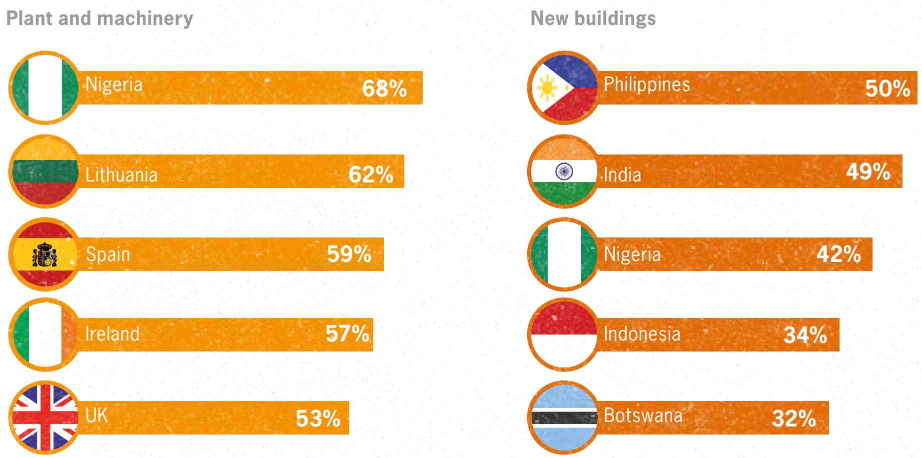
Global expectation of an increase in investment in new buildings for the coming 12 months fell slightly to 19%. Only businesses in the Baltic region (19%) and within the MINT countries (19%) have reported an uplift in expectation from a year ago, up by 9pp and 2pp respectively. Intention to invest is highest among businesses in the Philippines (50%), India (49%) and Nigeria (42%) while in more developed economies such as Germany (3%), France (3%) and Canada (8%) expectations are much lower.

Net percentage of businesses planning to increase investment (next 12 months; global)



Source: Grant Thornton IBR 2015

Net percentage of businesses planning to increase investment (next 12 months; top five)



Source: Grant Thornton IBR 2015

Business growth constraints

Economic uncertainty is set to be the biggest concern for global businesses in 2016, with red tape and a lack of skilled workers also weighing on the minds of business leaders.

Within the context of slowing international trade and rising geopolitical tensions, there has been a 3pp global increase in the balance of companies citing economic uncertainty as a major constraint to growth (38%). Businesses in major emerging and developed economies including Brazil (73%), India (71%), Japan (64%), Russia (57%) and France (54%) are among the countries most concerned about the impact of economic uncertainty could have on their ability to grow.

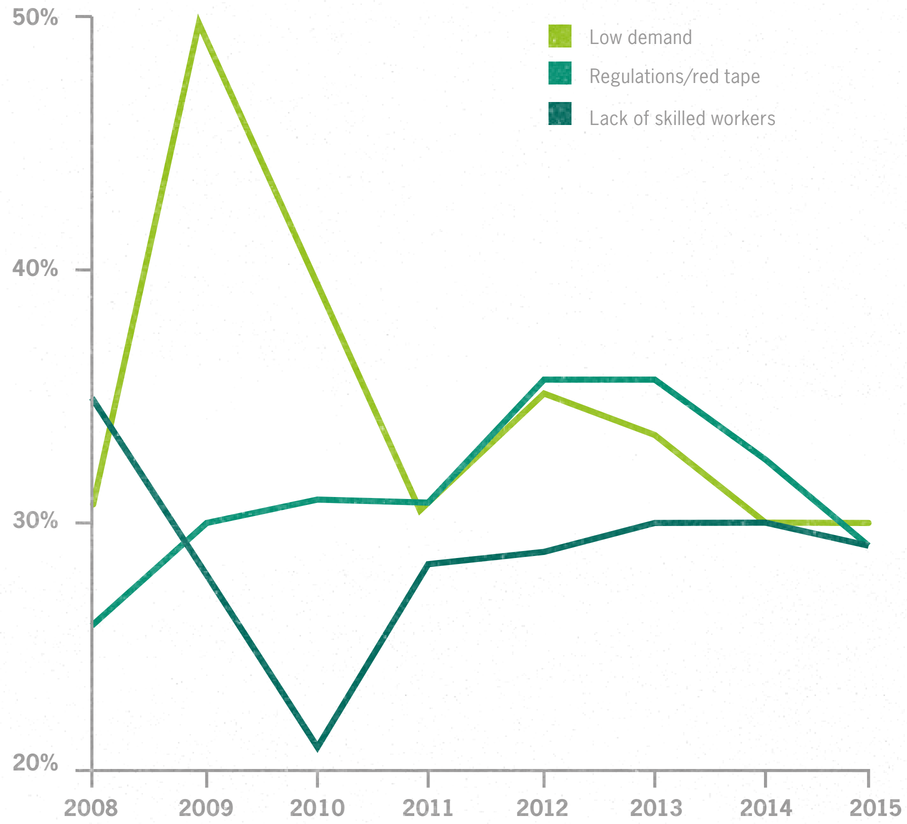
55% of Latin America companies view currency values as a growth constraint.

Despite an oversupply of oil and steel, as well as reduced demand for commodities, the balance of businesses concerned about a shortage of orders remains unchanged at 30%. The balance of companies in the mining and quarrying (28%, up 6pp), manufacturing (38%, up 2pp) and agriculture and forestry (32%, up 5pp) sectors citing a shortage of orders as a major constraint to growth has risen. Latin America (31%, up 8pp) and Emerging Asia Pacific (43%, up 4pp) are among the regions where concern is highest.

Global businesses are slightly less concerned about regulation and red tape down 3pp from last year at 29%. However, these regulatory concerns impacting growth remain high in Greece (66%), Italy (52%), France (51%) and Spain (38%) are among the most concerned about regulation. Following Greece's decision to stay in the Eurozone, the debate about European ties has now shifted to the UK (23%) ahead of its upcoming EU referendum.

Currency values are less of a concern to global businesses (27%), although the balance citing fluctuating exchange rates as a major constraint to growth has risen 3pp compared to this time last year. Businesses in Africa (69%), Eastern Europe (57%) and Latin America (55%) are the most concerned. Regions using strong currencies like the Eurozone (14%) and North America (13%) are far less concerned, though the US (11%)

Proportion of businesses citing shortage of orders/reduced demand as a constraint on growth (global)

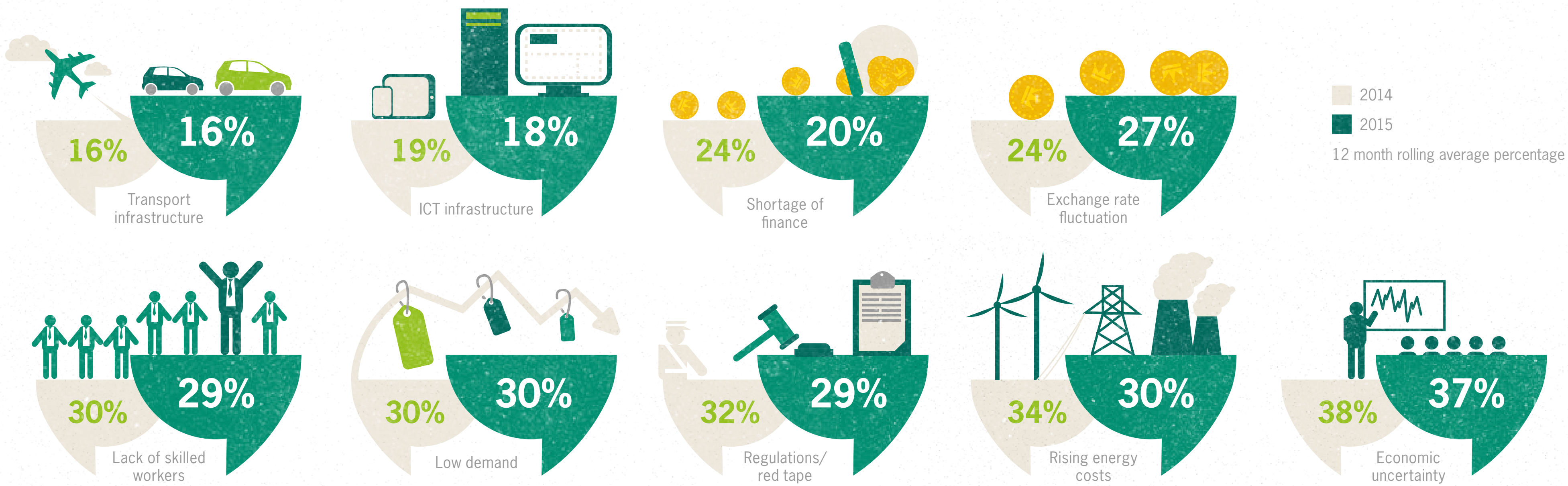


Source: Grant Thornton IBR 2015

has reported a 5pp rise in the balance of business citing exchange rate fluctuations as a concern.

As low interest rates and quantitative easing programmes keep levels of funding high across most regions, fears that a lack of finance will stunt growth are muted. Concern about finance is highest in Greece (64%), where the national administration is working to control the country's spiralling debt-to-GDP ratio which now stands at almost 200%, its highest level since joining the Eurozone. The balance of firms citing finance as a restraint to growth is also notably high in parts of Sub-Saharan Africa, such as Nigeria (48%) and Botswana (30%) as well among some Southern European nations like Italy (32%) and Spain (32%).

Proportion of businesses citing constraint on growth (global)



Source: Grant Thornton IBR 2015

Employment

As technology continues to dominate discussions around employability and skills, global employment expectation for the coming 12 months has remained broadly stable over the past year. With major emerging economies steadily shifting towards service-led growth, a lack of skilled workers is a pressing concern across the APAC and Baltic regions.

Globally, the balance of businesses expecting to hire more staff in 2016 stands at 31%, with both developed regions such as North America (44% up 6pp) and the EU (28% up 6pp), as well as regions dominated by emerging markets such as Africa (53% up 19pp) and ASEAN (37% up 23pp), reporting substantial uplifts in expectation compared to last year.

74% of businesses plan to raise wages

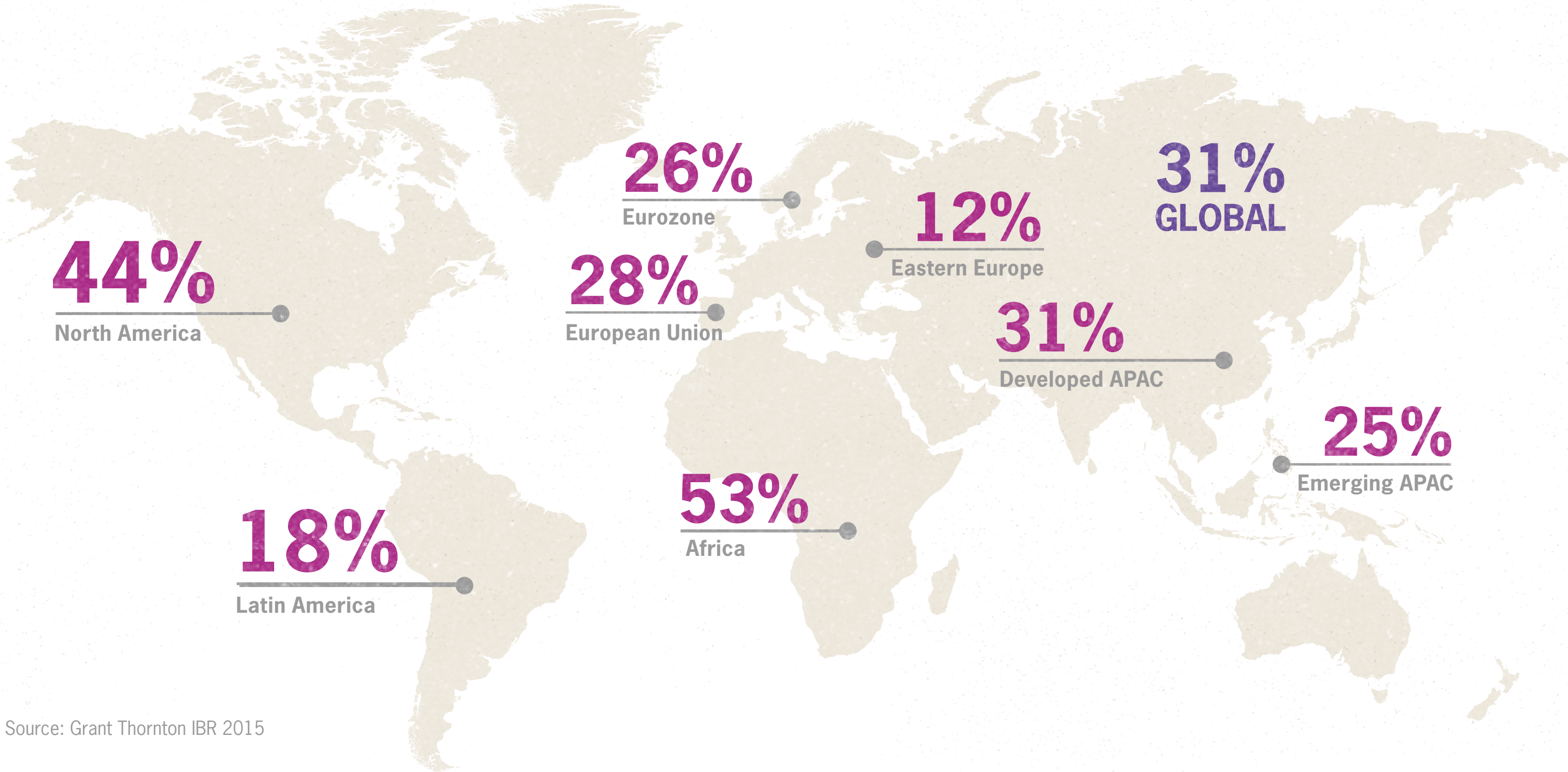
Worldwide concern about a lack of skilled workers has risen over the fourth quater of 2015 up 5pp year over year to 31%. Businesses in Japan are the most concerned about a lack of skilled workers (62%), and the issue is on the minds of leaders across Asia Pacific, with a high balance of firms in Singapore (46%) and China (36%) citing the shortage as a major constraint.

From an employee perspective, the outlook is positive. The quarterly balance of companies worldwide expecting to offer workers a pay rise over the coming 12 months (74%) is at its highest since 2011. Just one in five countries surveyed report a balance not exceeding 40%, including Japan (40%), Russia (26%) and Greece (4%).

Net percentage of businesses planning to add jobs (global)

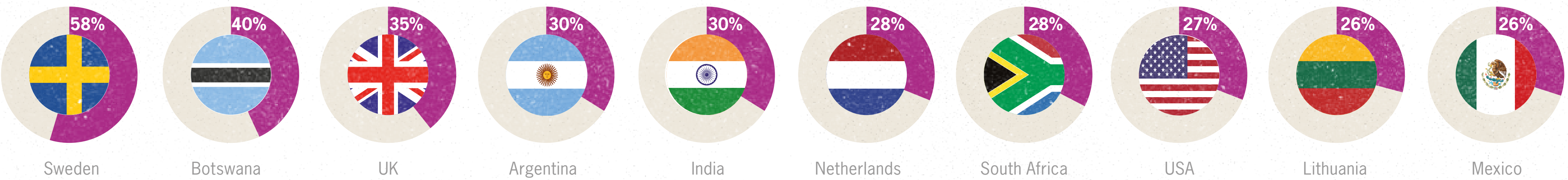
Source: Grant Thornton IBR 2015

Net percentage of businesses planning to add jobs (2015 average)



Source: Grant Thornton IBR 2015

Net percentage of businesses planning to increase worker salaries above inflation (next 12 months; top ten)



Source: Grant Thornton IBR 2015

Inflation

As a number of central banks worldwide aim for the ever-elusive 2% inflation rate, a backdrop of slow consumer price growth and falling commodity prices means global prospects for stable inflation in 2016 are shaky.

The IMF is forecasting a 1.2% increase in advanced economy consumer prices in 2016 and a further 2.4% fall in the price of oil – the price per barrel dropped almost $20 in the year to December 2015.

Just a fifth of businesses globally expect to increase selling prices over the next 12 months. This, combined with the fact that net 74% of businesses globally intend to offer employees a pay rise over the next 12 months, and 18% expect the rise to be above inflation, appears to be better news for consumer spending.

The US Federal Reserve has signalled its belief that the nation has overcome the deflationary pressure that troubled it at the start of 2015, with its first interest rate rise for almost 10 years. The rise comes as net 28% of US companies expect to increase selling prices in 2016 and net 27% expect to offer an above inflation pay rise, up 17pp. This increase in consumer purchasing power should help ensure prices keep rising at a desirable rate.

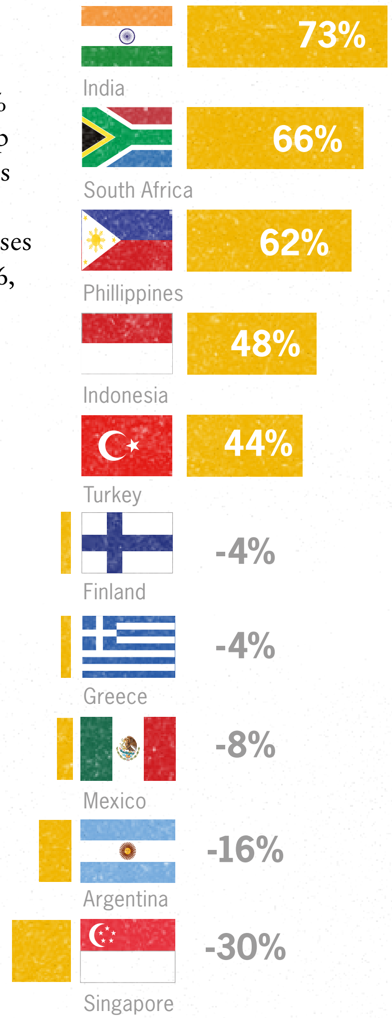
Across the EU, the European Central Bank's extensive quantitative easing programme is yet to put a decisive halt to deflation. The region posted just 0.2% inflation in December, having been -0.1% three months earlier. Net 17% of EU businesses expect to increase selling prices over the coming 12 months compared to 13% a year ago.

Another of the world's largest economies also appears to be closer to achieving its target 2% inflation rate. Having struggled with deflation throughout 2012 and into 2013, Japan has seen steady inflation over the last year. Net 5% of businesses in the country expect to increase selling prices in 2016, up from -4% in the final quarter of 2014.

Net 5% of Japanese businesses expect to raise selling prices

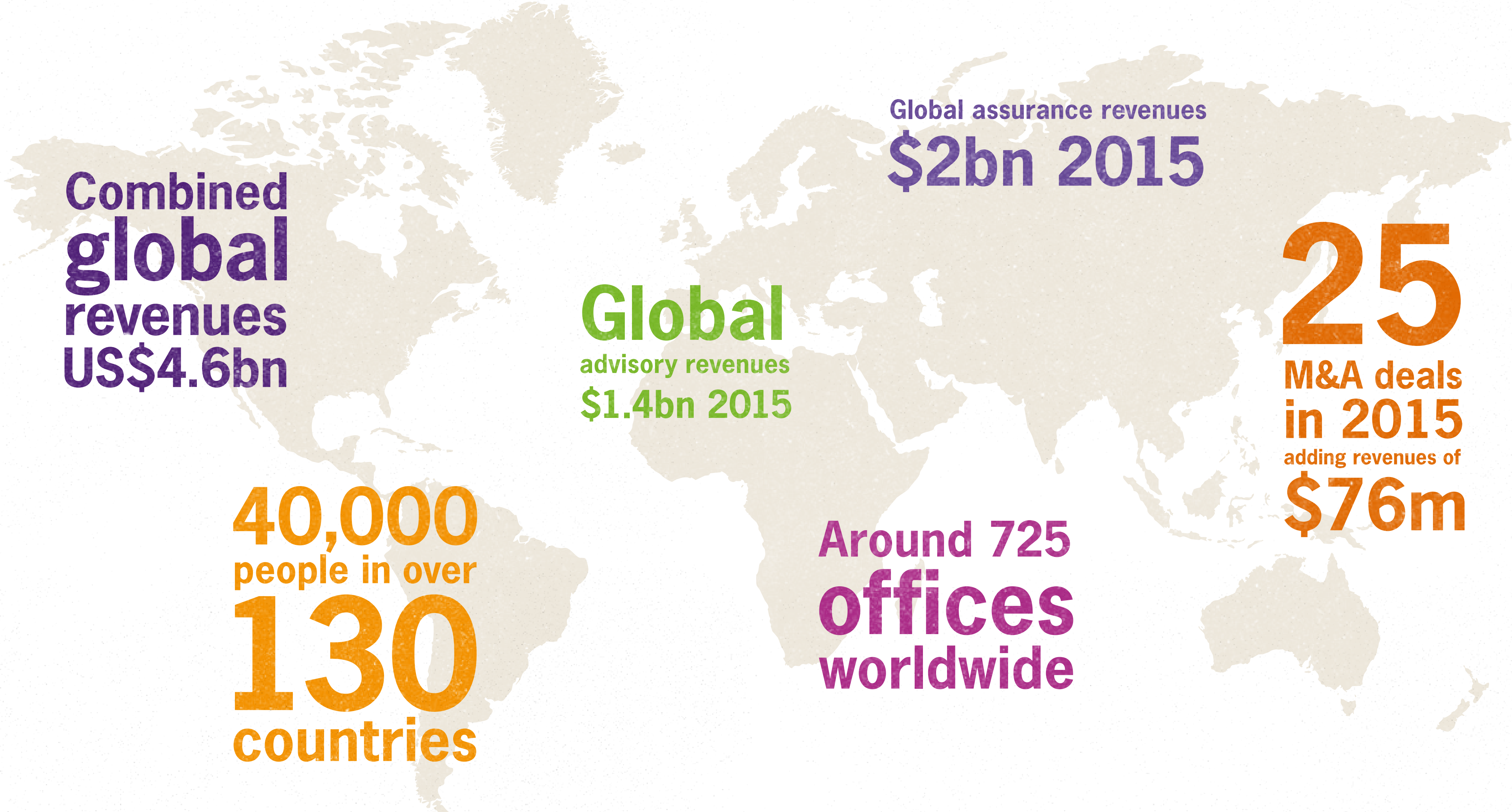
By contrast, major economies across Latin America continue to battle spiralling inflation. The IMF forecasts that consumer prices in Brazil and Argentina will rise by 6.3% and 25.6% respectively in 2016 against a backdrop of weakening currencies. Mexico offers relative stability, with a 3% increase forecast. In Brazil, net 43% of businesses expect to increase selling prices in 2016, while Mexico (-8%) and Argentina (-16%) have seen huge 96pp and 56pp respective negative swings compared with expectation for 2015.

Net percentage of businesses expecting to increase selling prices (top and bottom five)



Source: Grant Thornton IBR 2015

How Grant Thornton can help



IBR 2016 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in over 36 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from more than 10,000 interviews with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 36 economies conducted between February and December 2015. The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1000 employees; in the United States, those with US$20m to US2bn in annual revenues; in Europe, those with 50-499 employees.

More information:

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