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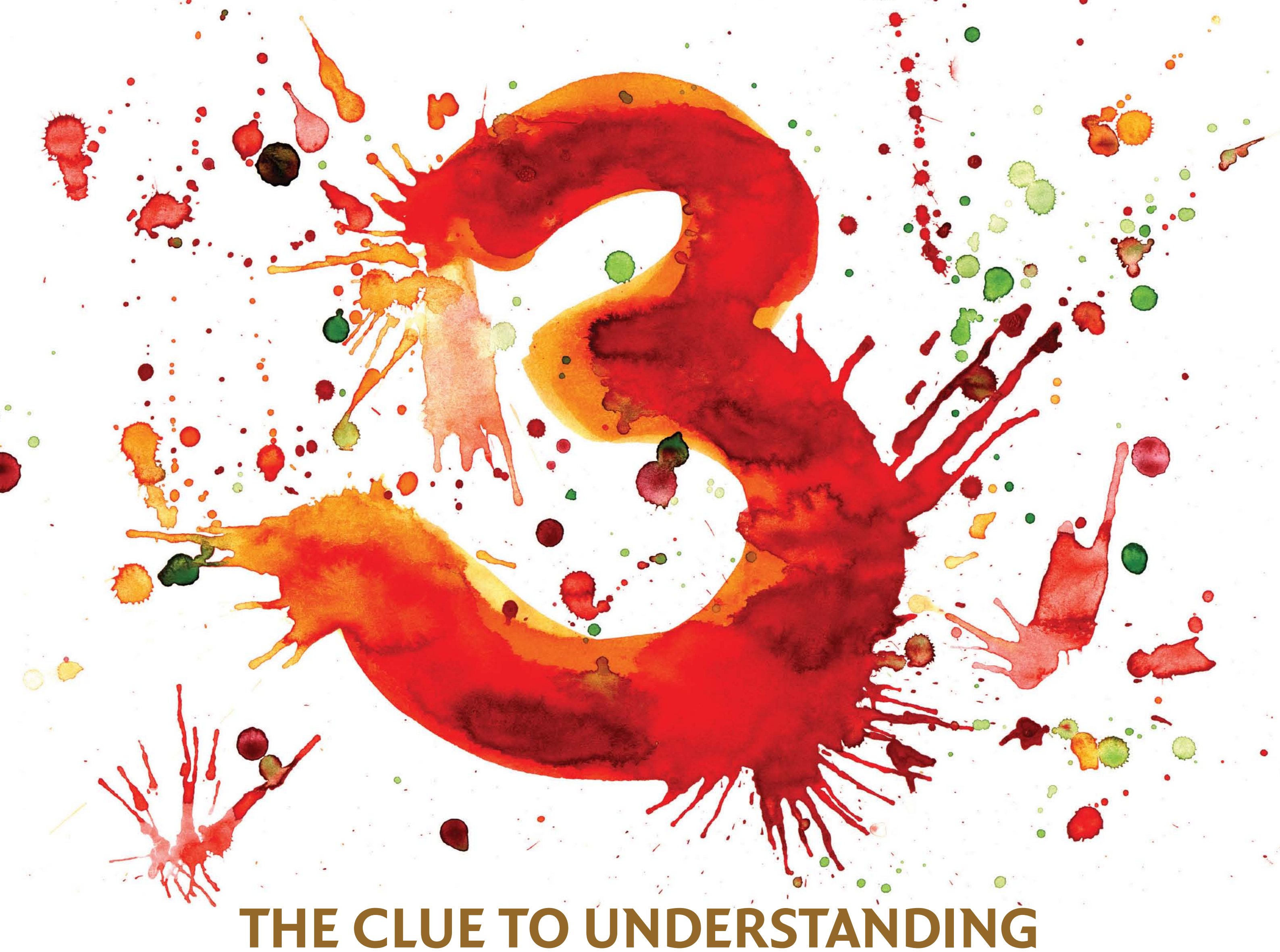

THE CLUE TO UNDERSTANDING THE GLOBAL ECONOMY

By Mark Spelman

As 2011 fast approaches, concerns remain about the state of the global economy. Some economies (mostly the emerging and Asian markets) are seeing renewed growth, whereas the large western economies are still struggling with the financial and social crises. All of this leads to much uncertainty. In this article, **Mark Spelman**, *Global Head of Strategy at Accenture, explores the short-term outlook for 2011.*

Every day we hear very mixed signals about the global economy. News oscillates from good to bad – global trade is up 13.5 per cent at record levels, unemployment rates remain stuck and not declining, bond yields in countries such as Ireland and Portugal continue to deteriorate with the prospects for a sovereign wealth crisis increase. How do we interpret these conflicting data points?

To avoid excessive optimism or pessimism, we need a structured way of understanding some of these events in a time of significant uncertainty. Many companies and executives continue to plan on the basis of incremental growth and flat line projections despite the uncertainties.

The macro-economic context is important to understand as it provides the framework for changes to industry structure, value, winning strategies and operational excellence. The macro picture sets the context for the day-to-day micro decisions which drive business performance.

EFFICIENT GROWTH

One headline for 2011 will be efficient growth. Why efficient? First, because demand in many countries has been underpinned by government actions and yet we know that many governments around the world are struggling with their debt positions and are looking for more from less.

The second reason why efficiency matters is the link between inputs and outputs. Commodities, from oil to wood to rare metals, are becoming more scarce and difficult to exploit so we need to get more output for less input. Efficient growth will be the name of the game over the next 12 to 24 months.

COMMUNITY COMMENT

Thras Moraitis
Executive General Manager
Group Strategy and
Corporate Affairs, Xstrata plc

In our business – commodities – demand is driven essentially by the developing economies (China, India, Brazil, South Asia, etc) and by the urbanisation and industrialisation that is ongoing in these markets. Last year, China alone accounted for over 100 per cent of the growth in demand for some of our commodities. Therefore, we believe demand will continue to stay strong, supported by a return to growth of the US, which now represents an average of only about 30 per cent of total demand across the suite of commodities we supply and much less in terms of growth in demand.

THE NUMBER THREE

The number three is a good clue to understanding what is happening in the global economy. It is important to remember that there have been three crises, three sets of 'rebalancings' in progress, three different bands for country growth rates and three open questions that will determine how the global economy will evolve as we head into 2011.

The global economy has been hit by three crises:

- **Number 1:** The financial crisis, which stopped credit
- **Number 2:** As credit dried up, we hit the second crisis: an economic one that stopped trade
- **Number 3:** As trade stopped, we hit the third crisis: the social crisis – the one about jobs

To understand why we have uncertainty in the global economy, look at how these crises are playing out. Despite the recent US data pronouncing that the recession finished in June 2009, there are many outstanding issues surrounding the financial and social crisis which are still ongoing.

We have three crises to navigate not one. In addition, there are three sets of rebalancing going on:

- **Number 1:** Government debt
- **Number 2:** Consumer debt
- **Number 3:** Bank recapitalisation

The degree of rebalancing across these three dimensions is determining the capacity of countries to bounce back from the three crises. The reason why a number of Asian economies have been able to recover very quickly is because they have not been handicapped by the need to undertake significant rebalancing actions.

The countries that are trapped with high government debt, high consumer debt, and massive re-capitalisation of their banks are the ones that have struggled most to recover and post positive growth rates in 2010.

We can group countries, not between developed and emerging, but in three groups of high, medium and slow capacity to recover. We have a true multi-speed recovery in process.

As we look at 2011 and beyond, there are three open questions:

- **Number 1:** What is going to happen to the US economy? It accounts for 25 per cent of world GDP. That 25 per cent is not going to go away in the short-term and it has a massive effect on the global economy.
- **Number 2:** How much decoupling will occur? To what extent can growth in Asia, Latin America and the African countries compensate for some of the structural weaknesses that exist in parts of western Europe, Japan and North America?

The macro picture sets the context for the day-to-day micro decisions which drive business performance

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COMMUNITY COMMENT

Alison Carnwath
Chairman, Land Securities Group plc & Non-executive Director, Barclays plc

I do not think the global economy will look better until the US shows sustainable recovery and this will require the housing market to sort itself out, which will lead to confidence recovering and, ultimately, to a less invasive monetary policy. This is not assured in 2011 by any means.

- **Number 3:** Sovereign debt: Will a default occur and produce a new crisis? The probable picture is of a global economy growing more slowly in 2011 than in 2010, but there is still a possibility of a shock to the system pushing us back into a new crisis.

The number three is a useful reminder of some of the key issues underpinning the dynamics of the global economy. But the global economy should be looked at through both short-term and long-term lenses.

SHORT-TERM OUTLOOK

It is important to understand why the first half of 2010 was so good in the global economy. There were two factors. First, we had a massive de-stocking owing to economic trade slowing down and the resulting restocking was a significant one-off stimulus to the global economy.

The second driver was the coordinated impact of government led fiscal stimulus packages that focused on infrastructure projects and which compensated for the shortfall in demand in many countries.

This was a short-term win. The problem for the global economy was that restocking was a one-off and government fiscal stimulus packages have begun to run out of steam. What really matters now is what happens to domestic consumption and the confidence of consumers to get money out of their pockets.

COMMUNITY COMMENT

Ruth Cairnie, VP Commercial Fuels, Shell International

We have been seeing recovery in Europe and North America. Looking ahead, growth is expected to be at best weak, although patchy. This requires continued strong focus on the sectors and markets that drive growth, maintaining high discipline on cash and risk. Our sale of fuels to businesses has a good exposure to growing economies in the East and Latin America. These should continue to grow, albeit potentially at a rate reflecting lacklustre growth in their export markets and impacts of exchange rates on competitiveness.

In the West, consumers are hesitant because they are concerned about jobs. Wages are unlikely to grow; debts have to be paid back and, in order to do that, savings have to rise. More savings means less to spend and domestic consumption will remain weak. If domestic consumption is weak, the only way for these economies to grow is through exports; and so we now have a battle for export-led growth.

Emerging economies have exactly the same tensions between domestic consumption and exports. In China and India, it is not so much about consumers saving money in order to pay off debts, but saving for healthcare, education and pensions. The reason why the Chinese government has been trying to help people with healthcare provision is because they know the more they provide in health services, the more people have to spend on domestic consumption. The battleground is around domestic consumption: how robust this remains will be a crucial indicator for global growth rates over the next 12 to 18 months.

The other economic trend issue is around capital and investment, and the resulting impact on jobs. There is considerable attention on banks and strengthening their capital ratios. The crucial issue in most economies is that large companies do not drive job creation, but small companies do.

The danger is that, as we increase regulation around banks and strengthen capital ratios, credit gets tighter and this disproportionately impacts small companies. It is the small companies that historically have been the most flexible but, owing to tight credit, they are now struggling to create jobs, making reducing unemployment harder, particularly in the West. Tight credit limits and governments with reduced spending capacity means the outlook for unemployment remains relatively bleak in the West with the resulting knock-on effects to domestic consumption.

This weak outlook is the basis for my belief that growth in 2011 is likely to be lower than in 2010.

Look for **Agile Growth in Uncertain Times** *on Criticaleye - the second part of Mark's outlook for 2011, where he explores the multi-speed world and the long-term implications for organisations.*

Mark Spelman
Global Head of Strategy, Accenture

Mark leads Accenture's Global Strategy practice and runs Accenture's global macro economic and political think-tank and the Institute for High Performance. He is responsible for the firm's strategic relationship with the World Economic Forum (WEF) and is a regular participant and session leader at Davos and the WEF regional summits. Mark has almost two decades of experience working at board level in senior management and business strategy positions. His client work over the past decade has centred on energy, utilities, natural resources and chemicals companies globally.

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