

Schroders

Global Economic Outlook

Gloom and doom as we enter 2009



In summary:

- **Global economic downturn has spread to industry activity**
- **The credit crunch is forcing companies to cut output as well as employment**
- **We expect a modest recovery in 2010, assuming that the credit crunch does not continue to hamper the efforts of policymakers**

By Keith Wade, Chief Economist

The outlook for the global economy remains poor as we enter 2009. Indeed, there are now signs that the economic downturn has continued to spread and is now affecting industry as well as individuals. We expect OECD¹ activity to contract by 1% this year – its worst performance since World War II – as the ongoing credit crunch forces companies to cut both output and employment. Whilst we anticipate overall global growth to be positive (largely thanks to the contribution of emerging market economies), the size of any rise will be negligible.

Indeed, companies already appear to be preparing themselves for a difficult year ahead. With credit lines still effectively frozen, funding will be a major concern and it seems that many businesses are looking for ways to ensure their survival whilst by-passing the banks. As such, firms are cutting both expenditure and employment. There has also been a tidal wave of bond issuance with recent figures showing that European non-financial companies have sold more than \$50 billion of bonds since November. We can expect a lot more new issuance in 2009 and while this may be seen as a threat to corporate bond prices, those companies that obtain funding will be far more secure than those who leave it too late to raise capital.

Nonetheless, despite the gloom, we are expecting a modest recovery in 2010 as the efforts of the world's governments and central banks start to breathe life into the ailing global economy. All the evidence so far has shown that the actions of monetary authorities, which have included significant interest rate cuts and huge injections of capital, have had little material effect on conditions. However, we believe that these efforts should start to pay dividends and that, with inflation kept under control by lower commodity prices, real incomes will receive a much-needed boost. Tax cuts will also provide additional income for households. While much of this is likely to be saved, some should find its way back into the economy through consumer spending.

It is also worth noting that, whilst the outlook for the economy appears bleak, this may not necessarily be true for financial markets. Concerns about the ability of policymakers to lift activity

¹ OECD: Organisation for Economic Co-operation and Development. An international organization of thirty countries that accept the principles of representative democracy and a free market economy. Most members are high income economies and are regarded as developed countries.



have, so far, hampered a stabilisation of the markets. This should begin to change for equity and credit markets in 2009 for three clear reasons.

Firstly, the markets are already extremely depressed and should, therefore, be more resilient in the face of bad news. With prices also looking extremely cheap there is also a significant opportunity for bargain hunters.

Secondly, it is important not to discount the power of policy. President Barack Obama is set to announce a major fiscal package to stimulate the US economy – there are rumours that this could amount to more than \$500 billion. This, combined with the ongoing efforts of other central banks around the world to boost growth, could lead to a significant improvement in confidence.

Thirdly, we expect investors to begin to return to risk assets (equities and company bonds) in search of higher yields. One consequence of central bank action has been to drive down yields on safe assets to generational lows. With interest rates at such low levels, many investors could be forced to venture back into the market to improve their income.

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