LPL RESEARCH
WEEKLY ECONOMIC COMMENTARY

KEY TAKEAWAYS

The pace of growth in the global economy is a key driver of global earnings growth, and ultimately, the performance of global equity markets.

The IMF raised its estimate for growth in 2015 for developed economies and sharply lowered its estimate for emerging markets.

On balance, the market continues to expect that global GDP growth will accelerate in both 2015 and 2016, aided by lower oil prices and stimulus from two of the three leading central banks in the world.

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GAUGING GLOBAL GROWTH

AN UPDATE FOR 2015 & 2016

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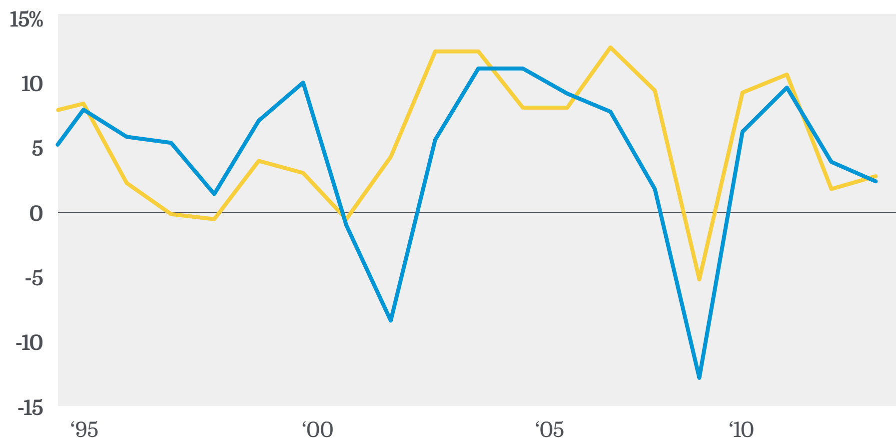
The outlook for global growth is important to investors, since it defines the ultimate pace of activity that creates value for countries, companies, and consumers. As investors digest the S&P 500 earnings reports for the fourth quarter of 2014, we provide an update on how consensus estimates for economic growth for 2015 and 2016—in the United States and worldwide—have evolved over the past few years, and in particular, since oil prices peaked in mid-2014.

The International Monetary Fund (IMF) cut its global growth forecasts for both 2015 and 2016 last week (January 19–23, 2015). While the IMF raised its estimate for growth in 2015 for developed economies, all of the increase to that estimate came in the United States; the IMF lowered its estimates for all other developed economies, except the United Kingdom where 2015 growth estimates were unchanged. The IMF sharply lowered its 2015 growth estimate for emerging markets (EM), with oil-producing, EM nations like Russia, Saudi Arabia, Mexico, Brazil, Venezuela, and Nigeria seeing the largest markdowns in growth.

Typically, when the IMF releases a forecast, the majority of financial market participants take little notice of the report, and that was generally the case last week, as markets focused more on the price of oil and the European Central Bank (ECB), than on the IMF.

1 GLOBAL GDP GROWTH HAS BEEN A GOOD PROXY FOR CORPORATE REVENUE GROWTH

- **S&P 500 Composite Index: Net Sales,** % Change, per Share, Year to Year
- **World GDP at Current Prices and Exchange Rates,** % Change, Year to Year, U.S. $ Billions



Source: LPL Financial Research, Haver Analytics, Standard and Poor's 01/23/15

Past performance is no guarantee of future results.

The S&P 500 Composite Index is an unmanaged index of 500 widely held common stocks that measures the general performance of the market. One cannot invest in an index.

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Why? Because consensus forecasts for global gross domestic product (GDP) growth are available monthly from sources like Bloomberg News, and because markets constantly react to changes in projected paths of economic growth amid the daily, weekly, and monthly drumbeat of economic data and global events.

WHY GLOBAL GDP GROWTH MATTERS

In the past, prospects for U.S. economic growth garnered the most attention from market participants, but in recent years markets have focused more on the prospects for global GDP growth. Why does global GDP growth matter? As we have noted in prior *Weekly Economic Commentaries*, financial markets—especially equity markets—focus intently on earnings. Broadly speaking, earnings growth is driven by "top-line" growth, or revenue growth, less the costs incurred earning that revenue, with labor accounting for more than two-thirds of total costs. A good proxy for global revenue growth is global GDP growth plus inflation. Thus, the pace of growth in the global economy is a key driver of global earnings growth, and ultimately, the performance of global equity markets [Figure 1]. Analysts expect S&P 500 companies to see more than 2–3% revenue growth and 4–5% earnings growth in the fourth quarter of 2014.

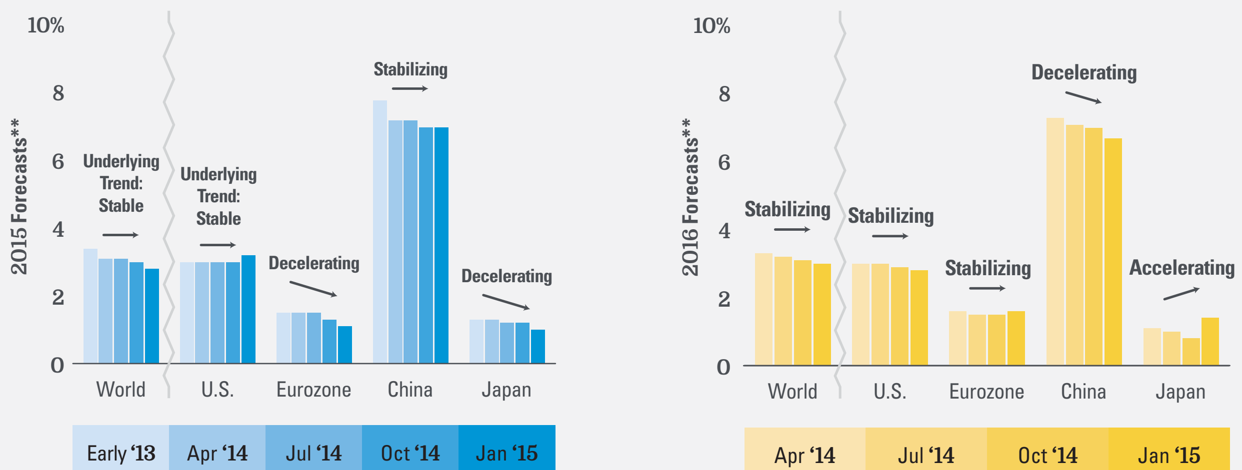
OIL'S EFFECTS ON GLOBAL GROWTH ESTIMATES

Figure 2 details the progression of the consensus GDP forecasts for 2015 and 2016 for the world, the United States, China, the Eurozone, and Japan over the past several years, while Figure 3 presents the change in the Bloomberg consensus GDP growth estimate for 2015 and 2016 for the 15 largest economies in the world, which account for 83% of global GDP.

The latest (mid-January 2015) Bloomberg-tracked economists' consensus forecast for 2015 global GDP growth stands at 2.8%, down from the 3.0% expected three months ago in October 2014. Six months ago, just as oil prices peaked, the consensus expected 3.1% growth in 2015. A year ago, in early 2014, the consensus expected 3.1% growth in 2015, and back in early 2013 when Bloomberg first began tracking consensus estimates for global GDP growth for 2015, the consensus expected 3.4% world GDP growth.

2 OIL IS ONLY ONE FACTOR IN DETERMINING GLOBAL GROWTH TRENDS

Progression of 2015 and 2016 GDP Forecasts for the World, United States, Eurozone, China, and Japan



Source: LPL Financial Research, Bloomberg 01/23/15

**Forecasts for 2015 and 2016 made in 2013, 2014, and 2015.

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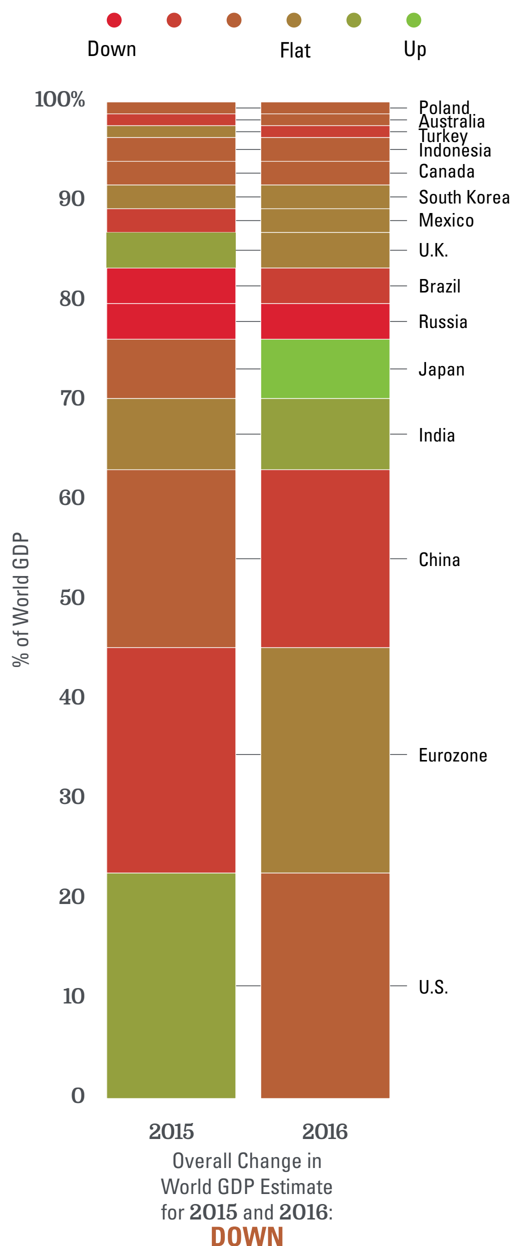
CHANGES TO CONSENSUS GDP FORECASTS SINCE OIL PRICE PEAK IN JUNE 2014

3 OIL AND COMMODITY PRICE DROP A PLUS FOR SOME, A MINUS FOR OTHERS



Source: LPL Financial Research, Bloomberg 01/23/15

Although other factors are at play (inflation, war, sanctions, weather, fiscal and monetary policy, longer-term secular trends like demographics, etc.), the drop in oil and other commodity prices over the past year or so has played a key part in the progression of GDP forecasts across the globe. The United States, the United Kingdom, and India were the only countries to see the consensus expectations for 2015 growth prospects revised higher over the past year. The consensus for South Korea's 2015 growth rate was unchanged over the past year. The United States, India, and South Korea are all in the top five of net oil-importing countries and are benefiting from the drop in oil. Although China is also on the list of top oil-importing nations (it is number two), economic growth prospects have moved down sharply over the past 12 months.

All else being equal, the drop in oil and commodity prices should have been a net positive for China's growth prospects, but several of the factors noted above swamped the positive impact of oil, and forecasters have continued to mark down their estimates for China's growth. A year ago, in early 2014, the consensus was looking for the Chinese economy to grow at 7.2% in 2015. Today, the consensus is looking for 7.0%. In recent months, China's leaders have set the stage for a downshift in growth expectations in China and want markets to focus on a set of broader economic and social indicators as the best measures of China's economy, and they have hinted that economic growth in 2015 may be in the 6.5 to 7.0% range.

Not surprisingly, Russia, one of the globe's top oil producers, has seen its 2015 growth estimates cut sharply over the past year, but oil wasn't the only reason forecasters took down their view of Russia's economic activity. Russia's undeclared war with Ukraine—and the sanctions imposed on it because of the war—along with an increase in uncertainty around Russian President Putin's activities, have taken a severe toll on Russia's economy.

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Since oil prices peaked in June 2015, only five nations have seen their 2015 growth estimates remain the same or move higher: the United States, United Kingdom, Turkey, South Korea, and India. Six nations have seen their 2016 growth estimates hold steady or move higher over the same period, including the Eurozone and Japan. The central banks of both areas (the Bank of Japan [BOJ] and the ECB) have both embarked on massive bond buying (quantitative easing, or QE) programs in an effort to reinvigorate their respective economies. Both the Eurozone and Japanese economies should be net beneficiaries of the drop in oil and commodity prices, but demographics lean heavily in the other direction.

At this point in the year, 2015 economic growth matters much more than 2016, but by the middle of this year, market participants' focus will be firmly on 2016. When Bloomberg first tallied up 2016 global growth estimates in early 2014, the consensus was for 3.2% growth [Figure 2]. Today, the forecast stands at just 3.0%, which is an acceleration from 2015's forecast of 2.8%, but still relatively sluggish by historical standards. Since oil peaked in mid-2014, the consensus forecast for GDP growth in 2016 has moved from 3.2% (July 2014) to 3.0% (today), dragged lower by the same factors that have dragged 2015's forecast lower.

On balance, the market continues to expect that global GDP growth will accelerate in both 2015 and 2016, aided by lower oil prices and stimulus from two of the three leading central banks in the world. The prospect for another year of decelerating growth in emerging markets remains at the forefront for some investors, who may still be waiting (in vain) for China to post 10–12% growth rates as it consistently did during the early to mid-2000s. The likelihood of rate hikes in both the United States and United Kingdom in 2015 is also a potential growth headwind. Still, much stimulus remains in the system, and more is likely from the BOJ and the ECB, which may help to bolster growth prospects in two key areas of the globe. Although China is very unlikely to embark on QE, in recent months, Chinese authorities have enacted a series of targeted fiscal, monetary, and administrative actions aimed at stabilizing China's economy in 2015 and beyond. Stabilizing oil prices in 2015 would help to further solidify the global growth picture in 2015 and 2016. ■

IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted.

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Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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