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# The Global Economic Outlook

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On 19 September, in his final address to the General Assembly, Secretary-General Annan spoke of three great global challenges facing humanity which had been of particular concern to him since the beginning of his term: world disorder, unbalanced economic development, and human rights violations. He noted the progress made against each by the United Nations over the last decade, but admitted also that recent events served to present other equally difficult problems. "All must play their part in a true multilateral world order (toward solving these problems)," he said, "with a renewed, dynamic United Nations at its centre."

In a speech following the remarks of the Secretary-General, President Bush acknowledged the promising, if gradual, progress and acceptance of democracy in regions of the world beset by strife. "People are making the choice for freedom," he said. He warned, however, against the national sponsorship of terror or extremism and cautioned such activity would only be an obstacle to peace and prosperity. To be sure, peace and uniform access to economic development are central to the establishment of viable societies and are necessary, certainly, for achieving the other great goals of humanity.

Turning more specifically to macroeconomics, in September, the IMF (International Monetary Fund) increased by 0.2% its forecast for global economic output for both the current year (5.1%) and 2007 (4.9%) from its April report. Collectively, the world's economies, according to the IMF, are likely to expand at the fastest rate in more than thirty years. The predictions, of course, remain subject to a variety of difficult-to-quantify risks such as: the possible resurgence of energy prices, a deep contraction in housing activity in the United States, an over-tightening of credit by the world's central banks, a rapid withdrawal of excess Asian investment, increased protectionism, or an over-valued European currency that restrains exports. Or else, as happens more often than appreciated, there might arise an entirely unforeseen event or shock that inhibits growth or dampens confidence in markets. In September alone, world markets have alternately absorbed or been adversely affected by: a military intervention in Thailand, political discord in Hungary, the near-collapse of a large U.S. hedge fund, intimations of default out of Ecuador, and the threat of another high-level political scandal in Brazil. In general, it appears that globalization itself has become an additional source of volatility that markets and economies must learn to interpret and accommodate.

In the United States in September, the Federal Reserve, for the second time in more than two years, decided by a 10-1 vote to hold its main policy instrument unchanged at 5.25%. The Fed's current view, given the recent evolution of the data, is that high energy prices together with the cumulation of all previous rate increases, are now exerting restraint on economic activity, and thereby also inflationary pressures. The Fed did not yet abandon, however, its bias toward tightening credit further as it cited lingering inflation risks related to high resource use rates and factory input prices. It should be noted also that while employment costs have predictably risen with the labor market expansion, both productivity growth and global competitive forces have largely contained goods price inflation.

Interestingly, the debt and equity markets themselves seem to have adopted broadly dissimilar views regarding the intermediate term economic outcome. The U.S. Treasury market has already essentially factored a string of 2007 Fed rate cuts (on expectations of sharply diminishing growth and inflation) into bond prices. In contrast, the equity market, not far removed from its five-year peak in prices, seems to favor a still-robust economy yielding a continuum of above-consensus corporate profitability reports, cash-heavy balance sheets, low default rates, and shareholder friendly actions (i.e. share buy-backs and mergers). The economy's true future path may likely be somewhere in-between. With U.S. potential growth slowing, or converging toward that of Japan and Europe, U.S. equities are likely to produce mid-to-single digit returns, on average, but with increasing volatility, while bonds return moderately less.

Although a slowing U.S. economy generally impacts all other nations around the globe, particularly those countries sharing U.S. borders, Canada may prove remarkably resilient. In fact, the IMF expects Canada to outperform the other G-7 industrialized nations in 2007 with output growth of 3%. With fully 85% of its exports directed to the United States, Canada is unquestionably exposed to weaker external demand, especially for its non-petroleum products. However, record consumer spending, low unemployment, low mortgage rates, double-digit home price appreciation and sub-target inflation (i.e. 1.5% CPI in August), may adequately shield Canada from the U.S. effect. In Mexico, the outlook appears less clear, but the economy is now expanding at its best rate in six years with record low inflation. In April, the Bank of Mexico discontinued its easy monetary policy stance, but the near-term policy direction is especially uncertain.

In Japan, the risk of a U.S. slow-down and reduced capital equipment spending should pressure the economy somewhat. Monetary policy will remain skewed toward modest restraint, but the frequency of rate adjustments will depend largely on overall business conditions, consumer prices and real asset prices. Shinzo Abe, newly elected leader of the Liberal Democratic Party, is expected to continue the reforms begun by Prime Minister Koizumi in 2001 and extend also, perhaps, the nation's longest economic expansion since World War II. With regard to China, whose goods exports eclipsed those of the United States for the first time ever in July, incremental progress on Yuan re-valuation seems now increasingly likely in coming quarters.