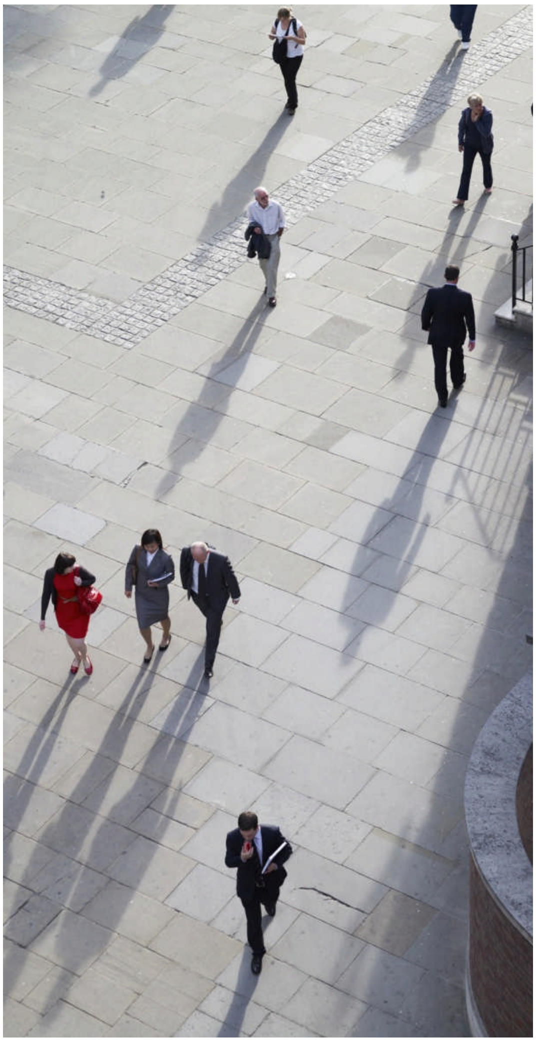
Beyond the numbers: The human cost of the crisis

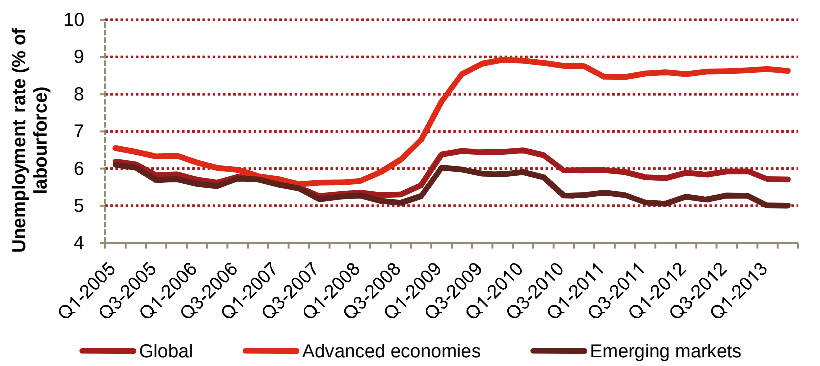


At a glance

In October, policymakers from around the world will gather in Washington DC to take stock of global economic prospects. For the first time since 2010 the prognosis for a sustained recovery in the advanced economies is expected to be positive.

- Specifically, we expect the Eurozone will continue to pick up gradually, posting average growth of just under 1% in 2014. The US is projected to expand by a respectable 2.7% next year.
- But, despite an improving picture among advanced economies, the global economy is still only expect to grow by around 3% next year.
- This is because emerging economies like India, Indonesia, Turkey, South Africa and Brazil have run into trouble as capital has started to flow back to the advanced economies. This complicates the picture for the policymakers meeting in Washington.
- At the same time, downside risks for the advanced economies are also apparent. The Eurozone is still in the early stages of setting up its future banking infrastructure. The US is gearing up for further budget and debt ceiling negotiations. And improved growth in advanced economies is pushing up long-term market interest rates, which is having a knock-on impact on funding costs around the world.
- **Labour markets in advanced economies remain bruised.** In this edition, we have taken a look at the human cost of the crisis. Since the second quarter of 2008, advanced economies have lost around 7 million jobs. Put into context, in the same period, the world economy created 37 million jobs. In other words, for every job lost in the West, the emerging economies have managed to create around six – about 44 million in total.
- **Policymakers and businesses are adjusting to these new realities.** On the plus side, greater spare capacity in advanced economies has meant that the Fed and other central banks have been able to pump large volumes of liquidity into markets while simultaneously keeping inflation under reasonable control. On the flipside, workers, particularly those in the US, who remain unemployed for longer periods are prone to losing some of their skills. US businesses are therefore having to dedicate more resources to training newly hired staff, which could impact their margins, especially in the short-term.

Fig 1: Unemployment remains stubbornly high in advanced economies



Source: OECD, ILO, National statistical authorities

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Economic update

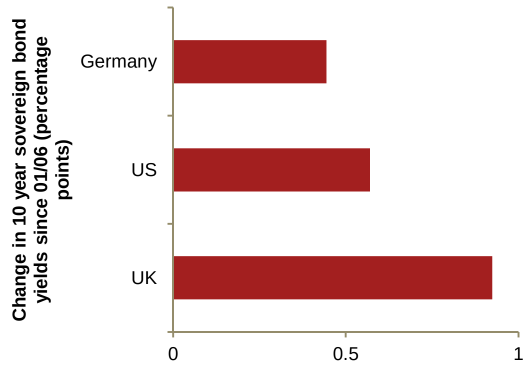
The Fed keeps the taps on for a little longer

In September, the Federal Reserve announced it will wait for more evidence on the progress of the recovery before adjusting the pace of its asset purchases.

Inflation aside, here are a few issues that help explain the Fed's decision:

- **Market interest rates:** Positive economic news from the major economies in the world have pushed up market interest rates, counteracting the effects of monetary easing (see Figure 2). For business, this has translated into higher funding costs and lower margins, which at worst could choke off the recovery.
- **Unemployment rate:** The US economy continues to have an unemployment rate above the 6.5% target set by the Fed, indicating that spare capacity exists. As our analysis on the next page shows, most advanced economies' labour markets still bear the scars from the crisis and have not yet recovered
- **Fiscal squeeze:** In October, US lawmakers will need to approve an extension of the debt ceiling and the US budget. The impact of past inaction has meant that sequestration — automatic cuts to the Federal Budget — have reduced one percentage point off US growth this year.
- Throughout October, we will also be monitoring how emerging market policymakers react to the Fed decision.
- We expect the currencies of the vulnerable emerging economies to come under less pressure in the coming weeks. This however will be short-lived, as good economic news in the US will increase the likelihood of a gradual monetary tightening.

Fig 2: On the back of good economic news, long-term market rates were on the rise….



Source: Datastream (as at 20th September, 2013)

A focus on housing

House construction picking up is good news for major economies

Construction activity in the housing market is typically regarded as a leading indicator of economic growth. Depending on the size and scale of the industry, housing construction can also have a significant impact on GDP growth. For example, our analysis of historic numbers shows that in 2004, household construction boosted US GDP by 50 basis points.

Our reading of the data

Figure 3 highlights the above points. Housing activity started plummeting four quarters ahead of the 2008 downturn. Specifically US housing starts dropped by almost 80% during the financial crisis. The UK recorded a 55% dip. The Eurozone however recorded only a modest drop. This was partly because the excess housing stock was concentrated in a few peripheral economies like Spain and Ireland, rather than the larger economies of Germany and France.

Government spending acting as a cushion

Figure 4 shows that in the aftermath of the financial crisis in 2010, housing activity started growing again at a moderate pace. Meanwhile, GDP bounced back much more aggressively than our leading indicator would suggest.

This was because of the change in the underlying sources of growth in the economy from one fuelled by household construction (and consumption) to one supported by government consumption.

In the UK for example, government spending increased from around 40% of GDP in 2005 to 47% in 2009.

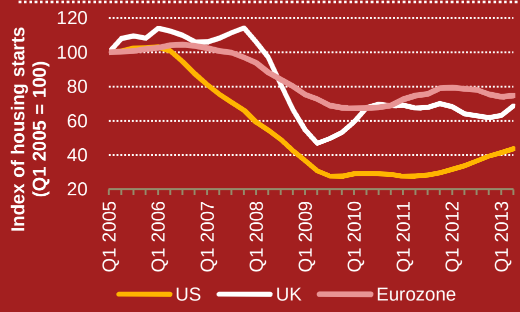
Back to normality?

However, recent data suggests that government spending as a proportion of total spending in the economy is reverting back to historic level . The IMF for example estimates US government spending will gradually revert back to its pre-crisis level of 40% of GDP by 2017.

At the same time, housing construction continues to grow at a modest rate and is expected to do so as prices recover.

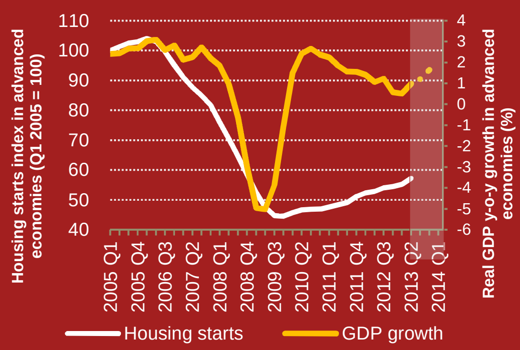
Both of these facts signal that we are seeing a resumption of consumption led growth, which is expected to lend support to the recovery in the future. Our Global Consumer Index (summarised on page 4) also supports this view. It has been growing at its fastest rate since its inception a year ago.

Fig 3: Housing starts[2] in US, UK and Eurozone[3]



Source: Datastream, PwC analysis

Fig 4: Housing starts and GDP growth for selected economies



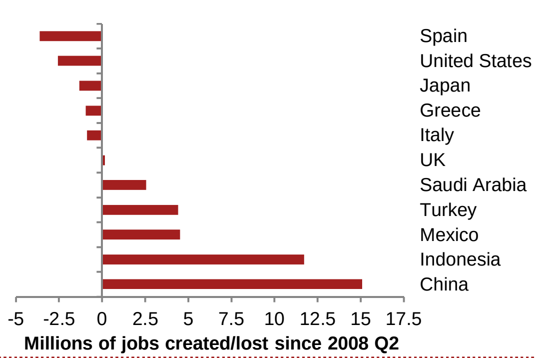
Source: Datastream, PwC analysis

2 Housing start is defined at the point where the foundation of a house is laid.

3 Eurozone economies comprise Germany, France, Italy and Spain.

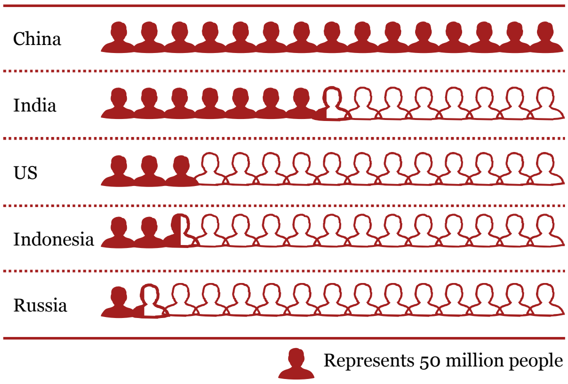
Advanced economies back to modest growth with visible scars on show

Fig 5: Where have all the jobs gone?



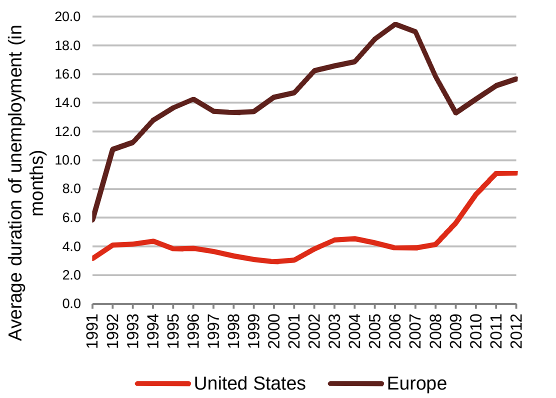
Source: OECD, ILO, National statistical agencies

Fig 6: Which countries are the largest employers of the world?



Note the India figure ignores the large informal sector
Source: OECD, ILO, National statistical agencies

Fig 7: The average duration of unemployment in the US has hit historic highs



Source: OECD

In October, high-ranking policymakers will gather in Washington D.C to assess the prospects for the global economy at the annual World Bank-IMF meeting. At a time when economic optimism is gaining momentum in the advanced economies, it's easy to focus on the economic numbers and ignore the human cost of the crisis. So what does our analysis show on the status of the global job market?

7 million jobs lost in advanced economies

Our analysis of the data shows that advanced economies have borne the brunt of the financial meltdown. Specifically, since the second quarter of 2008, advanced economies have lost 7 million jobs. The US, Japan and the peripheral Eurozone economies together shed more than 9 million jobs. Surprisingly, Spain's job losses topped those of the US, which is the largest economy in the world.

On the bright side, Germany, Australia, Canada and the UK are the only major advanced economies bucking the trend, and have created around 3.5 million jobs since Q2 2008.

As a result, unemployment rates remain stubbornly high; Figure 1 (see page 1) shows that the average across the major advanced economies has been higher than 8% for more than four years.

44 million jobs created in emerging markets

On a global* scale, the picture is much more positive as over the same period the world has created a total of 37 million jobs. A third of these were created in the last 12 months, which is consistent with our view of a pickup in global economic activity increasingly led by the US and other advanced economies (see September Global Economy Watch).

Bringing together the analysis, we can see that, for every job that has been lost in the advanced economies, six new ones have been created in the emerging world - around 44 million net new jobs in total in emerging economies since the second quarter of 2008. China, Indonesia and Mexico lead the job creation scoreboard, reflecting the relative dynamism of these markets. As a result, unemployment in these economies is low, averaging only around 5%.

At the same time, emerging economies are increasingly employing a greater number of people. For example our analysis points out that Turkey hosts more jobs than Italy and now ranks as the 11th largest employer in the world (up from 13th in 2008).

So what are the implications of these trends and changes for businesses and policymakers?

Inflation pressures subdued because of spare capacity

First, let's focus on the good news. High unemployment (or spare capacity) has presented policymakers in most advanced economies with the opportunity to deploy unprecedented stimulus without having to worry too much about inflation (although the UK is a partial exception to this).

For example, the IMF projects that G7 output in 2013 will be around 3% below the level at which inflation pressures build in the economy (the 'potential' level of output). Had the labour market been in a better state, then the scope for keeping monetary policy so loose would be much less in both the US and the Eurozone.

US businesses vulnerable to longer unemployment duration

But it's not all good news. As the economy has taken a longer time to recover in most advanced markets, workers have been unemployed for a longer period of time. Our analysis shows that, in 2012, an average out-of-work person in the OECD took around 10 months to find a job. This is significantly higher than the historic average of around 7 months.

The US seems to be one of the most vulnerable major economies to this change. In 1990, the average duration of US unemployment was 2.8 months. In 2012, it was three times higher. The delay in finding a job is projected to have a detrimental impact on the skills of those looking for jobs, which means that US-based companies will have to spend more resources than usual to train newly hired workers. In the short-term this could have a particularly adverse impact on labour intensive businesses.

* We have analysed the labour market of the countries listed on page 4.These economies cover more than 80% of global GDP.

Projections: October 2013

	Share of world GDP		Real GDP growth				Inflation			
	PPP*	MER*	2012	2013p	2014p	2015-9p	2012	2013p	2014p	2015-9p
Global (market exchange rates)			2.6	2.2	3.0	3.1	4.7	4.7	5.1	4.6
Global (PPP rates)			3.2	2.8	3.5	3.7				
United States	19.1%	21.7%	2.8	1.6	2.7	2.4	2.1	1.5	1.9	1.9
China	14.3%	10.5%	7.7	7.5	7.5	7.0	2.7	2.9	3.2	3.4
Japan	5.6%	8.4%	2.0	1.8	1.5	1.2	-0.0	0.3	1.6	1.5
United Kingdom	2.9%	3.5%	0.1	1.3	2.3	2.4	2.8	2.7	2.4	2.0
Eurozone	14.2%	18.8%	-0.7	-0.5	0.9	1.5	2.4	1.4	1.6	1.9
France	2.8%	4.0%	0.0	0.1	0.8	1.6	2.2	1.1	1.6	2.0
Germany	3.9%	5.1%	0.9	0.5	1.5	1.5	2.1	1.6	1.8	2.0
Greece	0.4%	0.4%	-6.4	-3.8	0.2	2.5	1.0	-0.3	0.0	1.0
Ireland	0.2%	0.3%	0.1	-0.5	2..1	2.7	1.9	1.9	1.5	1.7
Italy	2.3%	3.2%	-2.4	-1.8	0.3	0.8	3.3	1.2	1.5	1.7
Netherlands	0.9%	1.2%	-1.3	-1.3	0.4	1.6	2.8	2.9	2.2	2.1
Portugal	0.3%	0.3%	-3.2	-1.7	1.0	1.8	2.8	0.8	1.2	1.5
Spain	1.8%	2.1%	-1.4	-1.4	0.5	1.7	2.4	0.0	0.0	1.7
Poland	1.0%	0.7%	2.0	1.1	2.3	3.9	3.7	1.3	2.2	2.5
Russia	3.0%	2.7%	3.7	2.6	3.3	3.8	5.1	6.4	5.6	5.6
Turkey	1.4%	1.1%	2.2	3.4	4.5	5.3	8.9	7.2	6.2	4.8
Australia	1.2%	2.1%	3.7	2.5	2.7	3.1	2.4	2.1	2.5	2.7
India	5.7%	2.4%	5.1	4.5	5.5	7.0	7.5	5.7	6.3	6.0
Indonesia	1.4%	1.2%	6.2	5.8	6.0	6.3	4.3	7.4	7.0	5.1
South Korea	2.0%	1.6%	2.0	2.6	3.2	3.8	2.2	1.7	2.5	2.9
Argentina	0.9%	0.6%	2.0	2.6	2.3	3.3	10.0	10.7	11.4	9.7
Brazil	2.9%	3.6%	0.9	2.2	2.7	4.0	5.4	6.1	5.5	4.8
Canada	1.8%	2.5%	1.7	1.6	2.4	2.2	1.5	1.3	1.9	2.1
Mexico	2.1%	1.7%	3.9	3.0	3.9	3.6	4.1	3.8	3.8	3.6
South Africa	0.7%	0.6%	2.5	2.1	3.5	3.8	5.7	5.7	5.7	4.8
Saudi Arabia	0.9%	0.8%	6.8	4.4	4.2	4.3	2.9	4.0	4.6	4.0

Sources: *PwC analysis, National statistical authorities, Thomson Datastream and IMF. All inflation indicators relate to the CPI, with the exception of the Indian indicator which refers to the WPI. Note that the tables above form our main scenario projections and are therefore subject to considerable uncertainties. We recommend our clients look at a range of alternative scenarios, particularly for the Eurozone. *PPP refers to Purchasing Power Parity and MER refers to market exchange rates.*

Interest rate outlook of major economies

	Current state (Last change)	Expectation	Next meeting
Federal Reserve	0-0.25% (December 2008)	QE tapering expected during 2014	29-30 October
European Central Bank	0.5% (May 2013)	On hold at least until 2014	2 October
Bank of England	0.5% (March 2009)	On hold at least while unemployment is above 7%	10 October

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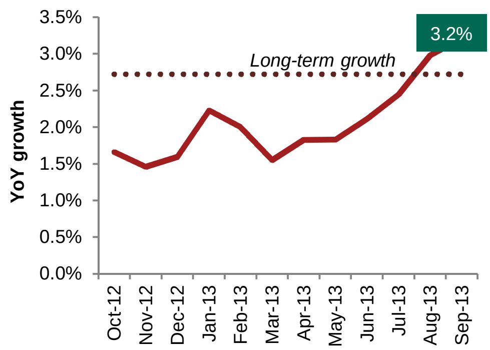
PwC's Global Consumer Index – October 2013

Consumer spending this year continues to power ahead, on the back of renewed confidence in the global economic recovery with growth recovering to pre-recession levels. The GCI gained further momentum after last month's high, hitting 3.2%, marking the highest levels we have seen yet since we started tracking the Index. This is driven by strengthening global equity markets, confidence and industrial production.



The GCI provides an early steer on consumer spending and growth prospects in the world's 20 largest economies. For more information, please visit *www.pwc.co.uk/globalconsumerindex*

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