World Led by U.S. Poised for Fastest Growth Since 2010

By Rich Miller and Simon Kennedy Dec 12, 2013 5:58 AM GMT+0530

The world economy is primed for its fastest expansion in four years, with the U.S. propelling the improvement in output.

Global growth will accelerate at least 3.4 percent in 2014 from less than 3 percent this year as the euro area recovers from recession and China and other emerging markets stabilize, according to economists at Goldman Sachs Group Inc., Deutsche Bank AG and Morgan Stanley. The U.K. will be a standout, while Japan risks damping the mood by suffering a mid-year slowdown after an April increase in sales taxes.

“So far it’s been a very bumpy, below-par and brittle expansion,” said Joachim Fels, co-chief global economist at Morgan Stanley in London. “Next year could bring a very important transition: a transition to a sounder, safer and more sustainable recovery.”

The upturn should prove bullish for equities and bearish for bonds. If it boosts corporate confidence in the durability of growth, it could further fuel demand, raising the odds that 2014 will break the pattern of recent years and come in better, rather than worse, than projected.

“An improving global-growth picture is widely forecast but, in our view, also still doubted in the investor community,” said Dominic Wilson, chief markets economist at Goldman Sachs in New York. “We therefore see room for markets to price in a better cyclical story.”

Stock Bet

We are telling clients to bet on a gain in the Standard & Poor’s 500 Index to 1,900 by the end of 2014 from 1,782.22 at 4 p.m. yesterday in New York. It predicts the yield on 10-year Treasuries will rise to 3.25 percent from 2.85 percent at 5 p.m. yesterday, according to Bloomberg Bond Trader data.

Key to the improved outlook is the ability of the Federal Reserve and other major central banks to nurture the recovery with easy money while persuading investors not to drive borrowing costs higher prematurely. Chairman Ben S. Bernanke roiled markets worldwide when he hinted in May the Fed might taper its $85 billion in monthly asset purchases this year; policy makers have refrained so far from such a move.

"None of the central banks would actively resist more economic growth if it were fortunate to achieve it," said Neal Soss, chief economist at Credit Suisse Group AG in New York. "The communications challenge is getting financial markets to believe it, too."

Managing expectations will be even more vital if investors react to stronger growth by recalibrating their outlook for monetary policies, said Scott Thiel, head of the global bond team at BlackRock Inc., the world's biggest money manager.

Intensify Stimulus

While Fed officials are seeking to moderate quantitative easing and the Bank of England is ending incentives for mortgage lending, the Bank of Japan and European Central Bank could intensify stimulus. Meanwhile, Morgan Stanley predicts policy makers in 13 emerging markets, including Brazil and India, will raise interest rates.

"We are entering a new environment of monetary-policy dispersion," Thiel said.

The U.S. economy will gain momentum in 2014 after being held back this year by a payroll-tax increase and cuts in federal-government expenditures, said Peter Hooper, co-head of Deutsche Bank's global economics team in New York and a former Fed official.

A continued recovery in the housing market, coupled with stepped-up spending by consumers, will lift growth to more than 3 percent next year from under 2 percent in 2013, he forecast, adding that "the U.S. is a bit of an engine" for expansion worldwide in 2014.

Purchasing Power

Households saw their purchasing power boosted in September by the biggest year-over-year jump in home prices since February 2006, as well as by the rising stock market and continued job growth. Payroll gains have averaged more than 200,000 a month since August, while unemployment fell to 7 percent in November, the lowest in five years, according to data released last week by the Labor Department in Washington.

Automakers are among the companies benefiting from the improvement in consumer finances. Cars and light trucks sold at a 16.4 million seasonally adjusted annual rate last month, the fastest pace since February 2007, according to Autodata Corp.

"We feel very good about the direction of the economy and our own momentum," Kurt McNeil, vice president for U.S. sales and service at General Motors Co., said during a Dec. 3 sales and revenue call. "The economy is creating jobs and household wealth, energy costs are dropping and credit is available and affordable."

More-Sustainable Growth

The return to more-sustainable growth in the U.S. means investors are increasingly focusing on what data say about the economy than what the numbers mean for the Fed, according to HSBC Holdings Plc. strategists. That was certainly the case on Dec. 6, as U.S. share prices shot ahead on the better-than-forecast jobs numbers even as expectations increased that the central bank will rein in its stimulus.

The share of economists predicting the Fed will reduce bond buying in December doubled after the employment report, according to a Bloomberg survey.

What policy makers want to avoid is a repetition of what happened earlier this year, when just the suggestion that they would reduce monthly asset purchases sent long-term interest rates up by 1.37 percentage points. Since then, policy makers have tried to hammer home a double-barreled message: Tapering isn't a tightening of policy or a signal the central bank is anywhere near ready to raise short-term rates.

Promote Recovery

"I consider it imperative that we do what we can to promote a very strong recovery," Fed Vice Chairman Janet Yellen, nominated to replace Bernanke, told the Senate Banking Committee on Nov. 14.

The U.K. shows how the Fed shouldn't assume its message will be heard, says Guillermo Felices, head of Europe cross-asset allocation at Barclays Plc., which predicts Britain will grow 2.3 percent next year, compared with 1.4 percent this year.

As the nation's consumer-led economic recovery gathered strength, short-term bond yields and sterling rose even as Bank of England Governor Mark Carney said the benchmark rate will stay at0.5 percent until unemployment falls to 7 percent from 7.6 percent. The bank doesn't see this happening before the third quarter of 2015, later than some private economists.

The Fed does have an advantage: a better track record containing inflation, Felices said. Its preferred gauge has undershot its 2 percent target since May 2012; inflation in the U.K. has stayed above the BOE's 2 percent target since 2009.

Low-Rate Guidance

Carney and European Central Bank President Mario Draghi probably will continue to stress their low-rate guidance as they try to avoid their markets' borrowing costs being dragged higher by rates in the U.S.

Next year may be the first in three when the euro area expands -- albeit at about a third the pace of the U.S. Even Greece, the epicenter of the region's debt crisis, is slated to grow, according to the International Monetary Fund, and Ireland is preparing to exit its bailout program.

Having cut the ECB's key interest rate to a record 0.25 percent and pledged to keep it low for an "extended period," Draghi is indicating the central bank may be willing to do more, given that inflation is less than half its target. Possible steps include charging banks to park money overnight or lending them long-term cash if they pass it on.

As in the U.S., fiscal policy also is becoming less of a drag, with Citigroup Inc. economist Giada Giani predicting 2014 will be the first year since 2009 when Europe largely will lack restrictive tax and spending measures. She forecasts expansion of 0.9 percent after a 0.4 percent slump this year.

Quicker Pace

Ericsson AB, the world's biggest supplier of wireless-network equipment, "now sees growth in several European markets," Chief Executive Officer Hans Vestberg said Oct. 24 in the company's third-quarter report.

Fiscal policy may work in the other direction in Japan after a year in which Prime Minister Shinzo Abepursued greater stimulus to defeat deflation. A gauge of Japan's prices rose the most in 15 years in October, and Bank of Japan Governor Haruhiko Kuroda said last month he expects to meet a 2 percent inflation target late in the fiscal year that starts in April or early in fiscal 2015.

Needing to tackle debt surpassing 200 percent of gross domestic product, Abe still will raise the sales tax in April to 8 percent from 5 percent -- a move that Tomo Kinoshita, chief economist at Nomura Holdings Inc. in Tokyo, says "is going to hurt growth."

Stimulus Program

To offset the drag, the Bank of Japan probably will beef up its stimulus program, said David Hensley, director of global economic coordination at JPMorgan Chase & Co. in New York. He predicts expansion will slow next year to 1.5 percent from 1.8 percent this year.

A recovery in the developed world will benefit smaller countries such as Singapore, Taiwan and South Korea that rely on exports or manufacturing for strength, according to an analysis by Standard Chartered Plc.

China also stands to profit, said Louis Kuijs, chief China economist at Royal Bank of Scotland Group Plc in Hong Kong. He sees the world's second-largest economy growing 8.2 percent next year after expanding 7.7 percent in 2013.

Other economists aren't as optimistic, with Tim Condon, chief Asia economist at ING Financial Markets in Singapore, saying programs the Communist Party unveiled recently are "going to be a headwind." These include relaxing the residence-registration system in mid-sized cities, accelerating convertibility of the yuan and reducing price controls on water, oil, gas and power.

Restraints Ahead

Slowdowns in China and Japan will hold back global growth next year even as the U.S. and euro area improve, according to Mohamed El-Erian, chief executive officer of Pacific Investment Management Co. The Newport Beach, California-based firm, which oversees $1.97 trillion in assets, expects expansion of 2.5 percent to 3 percent, up from 2.3 percent this year.

Allen Sinai, chief executive officer of Decision Economics Inc. in New York, anticipates a more positive "sweet spot" for the world economy as it enjoys faster growth without much in the way of higher inflation. That will allow the Fed and other major central banks to keep short-term rates near zero, fueling the expansion.

"The odds are that we get an upside surprise to growth next year rather than a downside one," he said. "That will be a big change from what we've seen over the past few years."