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Emerging economies continue to drive world growth

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We believe that the national economy will slow significantly for the first half of the year and start improving the second half of 2008. Our best guess is that total GDP growth will be around 1.5 to 1.7 percent through the second quarter, picking up a full point in the third and fourth quarters. Thus, we forecast total GDP growth of 1.9 to 2 percent for the year.

Unfortunately, the weaker dollar is not helpful for companies' profits overall. It may help exporters and firms with overseas operations but it means higher costs for those companies with overseas suppliers—costs they will probably be unable to pass on to struggling consumers. The weak dollar will continue to boost exports but at only 12 percent of GDP, exports are too small to make up for a weakening of consumer spending, which accounts for 70 percent of GDP.

The credit crunch is also certainly not helpful to the economy. Optimists argue that corporate profits could stay high because the balance of power has moved in favor of capital and away from labor, thanks to the globalization of the workforce. But we believe profits have been boosted by accommodative monetary policy, a credit boom and the associated surge in asset prices, particularly housing. Clearly, this credit boom made the corporate spending-driven recession of 2001 much shorter and less serious than it could have been. In other words, financial services may have dragged the rest of corporate America up. If the credit crunch has a long-lasting effect, the banks may end up dragging corporate profits back down again. Oil prices are another red flag. More expensive oil is set to squeeze households further. If it climbs above $100 a barrel, we would finally see consumer spending stumble, which in turn would hurt companies' profits and investment.

Globally, we see the emerging economies continuing to drive world growth. Although it remains unclear what effect the U.S.'s slowdown will have on the rest of the world, it will certainly affect it some and therefore we forecast world growth of around 4.8 percent for 2008. Measured at market exchange rates and not purchasing power parity that growth should come in at around 3.3 to 3.5 percent.

The big question we all ask in our business is: will the U.S. economy drag the rest of the world down with it? Europe and Japan look likely to slow down. Although both should be able to keep chugging along, neither is likely to set any great pace. Strengthening currencies will hurt exporters in both places. Europe’s own housing hotspots such as Spain are cooling and some of its banks have been sideswiped by our credit woes.

As discussed, we believe that the best hope that global growth can stay strong lies instead with emerging economies. A decade ago, the thought that so much depended on these crisis-prone places would have been laughed at. Yet thanks largely to economic reforms, their annual growth rate has surged to around 7 percent. This year they will contribute half of the globe’s GDP growth, measured at market exchange rates, over three times as much as the U.S. In the past, emerging economies have often needed bailing out by the developed world. This time they could be the rescuers.

Of course, a recession in the U.S. would reduce emerging economies’ exports, but they are less vulnerable than they used to be. The U.S.’s importance as an engine of global growth has been exaggerated. Since 2000 its share of world imports has dropped from 19 percent to 14 percent. Its vast current-account deficit has started to shrink, meaning that America is no longer pulling along the rest of the world. Yet growth in emerging economies has quickened, partly thanks to demand at home. In the first half of this year, the increase in consumer spending (in actual dollar terms) in China and India added more to global GDP growth than that in the U.S.

Most emerging economies are in healthier shape than ever. They are no longer financially dependent on the rest of the world but have large foreign-exchange reserves and much smaller budget deficits overall. Thus, they can boost spending to offset weaker exports if need be.

This does not mean emerging economies will grow fast enough to make up for the whole of a fall in the U.S.’s output. Most of them will slow a bit next year: for instance, China’s growth rate may dip to “only” 10 percent. So again, global growth will ease—which, after five years at an average of almost 5 percent, close to its fastest pace ever, it needs to do. But thanks to the strength of the new titans, it will stay above its 30-year average of 3.5 percent. Conversely, the rising importance of the world’s new giants will also continue to have a negative upward effect on prices. The rise in prices (inflation) and a lower dollar will be uncomfortable for us in the near to mid term.

Regionally, the DFW economy will slow somewhat, possibly mirroring the overall national economy. But because housing prices didn’t appreciate during the housing boom like they did on the coasts, Las Vegas and Phoenix, the values here are not correcting as much. Although we realize it’s still a very tough Realtor residential market, the commercial market regionally still has some room to peak. 2008 should be good for certain areas in commercial real estate, possibly very good.

Long term, DFW’s economy continues to grow. The combination of plentiful and inexpensive land along with plentiful capital has made the DFW region the nation’s fourth largest metropolitan area. It is now also the nation’s fourth largest in terms of Fortune 500 headquarters. There are no natural barriers such as mountains, oceans, major rivers or hurricanes to slow development down. Global warming prospects simply move more people here and increases business opportunities for HVAC suppliers like Lennox. The economy becomes ever more diverse as companies from across the globe at least feel that they need a presence here. So although transplants rightly complain that there’s nothing to do here except shop and go to restaurants, they keep coming. Why? Economics. Their employers keep coming here.

Bill Billeaud is the managing partner of Lombard Global, a Plano-based global expansion and real estate consultancy. He can be reached at bill@lombardglobal.com or at 214-675-5539. They are business consultants, brokers, international attorneys and real estate and equity investors. Business focus is global expansion.... research, strategies and execution. Lombard serves firms inbound (overseas entity to USA) and outbound (USA and overseas entity abroad).

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