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Global Economic Outlook 2016

THE GLOBAL ECONOMY IN A HOLDING PATTERN

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Global Economic Outlook 2016
The Global Economy in a Holding Pattern

RESEARCH REPORT 1595-15

by Bart van Ark, Abdul Azeez Erumban, Gad Levanon, Ataman Ozyildirim, Andrew Polk, Jing Sima-Friedman, and Klaas de Vries

The Global Outlook from 30,000 Feet

In the past few years the global economy has lacked a positive dynamic, exemplified by the uneasy combination of plenty of technological opportunities, slow investment growth—which is exacerbated by lackluster business and consumer confidence—weak productivity, and a range of lingering policy and business challenges. This puts the global economy in a holding pattern in which positive and negative forces offset each other, at least for the immediate future.

This characterization of the global economy is unlikely to change in the next 12 to 24 months. After adjusting our outlook, for the first time, for China's overstated official growth rate, we project a very modest improvement in the growth rate for the global economy to 2.8 percent in 2016, up from 2.5 percent in 2015. There are, however, larger downside than upside risks.[1] Mature economies such as the United States, Europe, and Japan keep flying at low altitude, held back by deflationary pressures and slow investment. Emerging markets will remain on a descending flight path, even if headwinds from low commodity prices and drying up of capital inflows may somewhat ease in 2016.

In the medium term, beyond 2017, the more positive forces of technology and innovation may accelerate, causing some improvement in productivity. However, the continued lack of improvement in investment will constrain the growth contribution that technology and innovation can make. Slower growth of the global labor force provides another headwind both from the supply side (fewer and more expensive workers) and the demand side (less purchasing power from consumers).

It is crucial for companies not to hunker down and miss opportunities as they arise. Major technology booms often take time to play out, in part because businesses are sometimes overwhelmed by the amount of opportunities and uncertainties, which can lead to a "wait it out" attitude. Meanwhile, business could benefit from the current environment, characterized by high liquidity and low interest rates to seek opportunities for growth, which may bring a premium—even in the short term when they may be rare but have potential for a high return.

1 Alternatively, using official China growth figures in calibrating our outlook, global growth comes out to 3.0 percent in 2015.

The Global Economy at a Crossroads

The weak growth performance of the global economy has now been ongoing for more than five years. It is clear that the causes of this slow global growth environment go beyond cyclical developments, even though the recent slowdown in emerging markets does reflect somewhat of a growth recession around the longer term trend. More important than the cyclical forces, structural headwinds in the global economy have increased especially in 2015 as global demand and trade slowed, exacerbated by ongoing oversupply in energy and commodity markets and investment flows beginning to change direction away from emerging markets. A deep recession in Brazil, financial instability in China, and uncertainties around the trajectory of monetary policies in different geographies, especially in the United States, have created heightened uncertainty with regard to growth and investment prospects.

The base scenario in The Conference Board Global Economic Outlook for 2016 predicts that some modest growth gains are possible over 2015, provided that economies can accommodate the low commodity and energy prices (and can benefit where possible) and the reset of monetary policies (especially the anticipated federal funds rate increase by the Federal Reserve); that China avoids a hard landing of its economy; and that the Brazilian and Russian economies significantly limit their contractionary movements. We expect consumer demand, albeit still modestly growing in many economies to lead much of global growth, driven by stronger employment and rising household incomes.

While The Conference Board outlook remains as cautious as it has been in previous years, even the small growth improvements we project for 2016 are certainly not in the bag yet. A more pessimistic scenario, which we have dubbed "continued stagnation," may push the global growth rate in 2016 down to as low as 1.9 percent. In this scenario, we'd see a failure in implementations for the much-needed reforms in labor, product, and capital markets in mature and emerging economies. As a result,

Table 1: **GDP growth rates by major country/region**
Alternative growth scenarios for 2016 suggest a wide variation of possible growth rates.

	2015	2016		
	The Conference Board Global Economic Outlook 2016	Baseline scenario	"Continued stagnation"	"Getting out of the trenches"
United States	2.5	2.4	2.1	2.7
Europe	1.7	1.8	1.5	2.0
of which: Euro Area	1.4	1.6	1.2	1.8
Japan	0.6	1.2	0.5	1.5
China	3.7	3.7	2.0	4.5
China (based on official numbers for China)	7.0	6.3	6.0	7.0
India	6.1	6.2	5.0	6.5
Brazil	-2.2	-0.2	-2.0	1.0
Mexico	2.5	2.8	1.5	3.0
Rest of the world	2.3	3.0	2.0	3.8
World	2.5	2.8	1.9	3.4
World (based on official numbers for China)	3.0	3.3	2.7	3.8

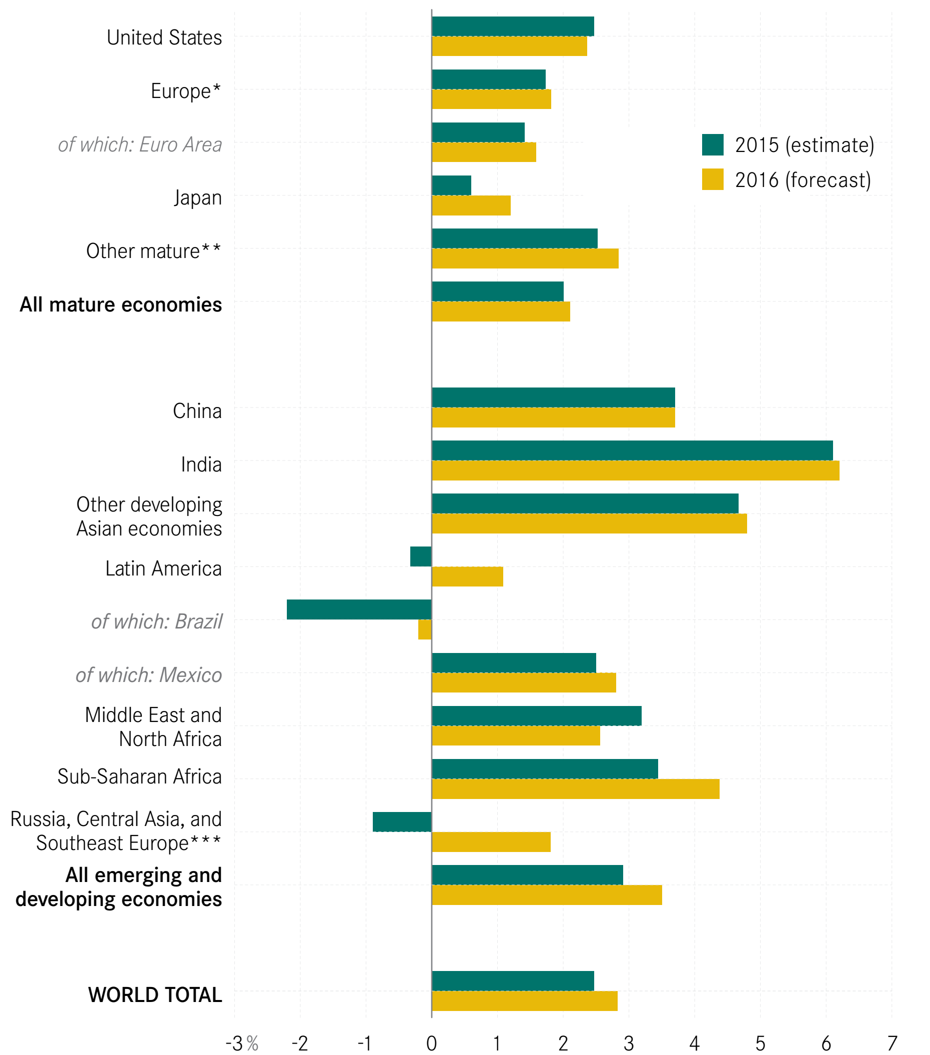
Source: The Conference Board Global Economic Outlook 2016 business may continue to be discouraged in making new investments and raising productivity, offsetting and potentially even reversing the consumption, labor market, and income gains described earlier. While the probability of economic contractions in major economies (except in Brazil and Russia) remains very small, the chances of a significant slowdown in global growth in 2016 could still be in the range of 20 to 25 percent.

We also entertained a slightly more positive growth scenario, in which the global economy will begin to get "out of the trenches," with growth rates being pushed well outside the range of the past five years to 3.4 percent. For this scenario to emerge as early as 2016, we would need to see accelerated (market-friendly) reforms in some of the largest emerging markets, which would incentivize companies to invest and accelerate implementation of new technology and innovation. In addition, it would be

Chart 1

GDP growth (average annual percent change) 2015 and 2016

The outlook is much the same in 2016 as in 2015, except for some improvement in emerging economies.



* Europe includes all 28 members of the European Union as well as Iceland, Switzerland, and Norway.

** Other mature economies are Australia, Canada, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan.

*** Southeast Europe includes Albania, Bosnia and Herzegovina, Belarus, Macedonia, Serbia and Montenegro, and Turkey.

Source: The Conference Board Global Economic Outlook 2016 necessary to see a restoration of a positive feedback between trade and growth and vice-versa, which has receded in recent years, but could be revived through renewed confidence from successful global coordination in trade, environment, and immigration. We expect the probability of such a scenario in 2016 or 2017 to be less than 10 percent, and even if it happens as early as in the next two years, the initial effects are likely to be modest.

In these different projections, China's economy (accounting for around 16.6 percent of global GDP) is the major wild card. While we do not predict a hard landing as the most likely scenario for China, there is a risk that growth may at least temporarily drop off well below our base growth estimate for 2016 of 3.7 percent, with each percentage in China's growth rate accounting for about 0.2 of a percentage point of global growth. On the positive side, while a quick stimulus program is unlikely to have much of a growth effect, a modest recovery is possible especially if financial conditions stabilize and consumer and business confidence improve.

Medium-term Levers of Growth Performance: Technology and innovation driven by investment

Our medium term five-year projections, covering the periods of 2016–2020 and 2021–2025, point at a continued slow growth environment. But the chances for an upside outcome after 2017 are stronger than before. The driving forces of medium-term growth include a key limiting factor that can be predicted with considerable certainty, namely the slowing growth of the global labor force, which is primarily driven by the aging of the large majority of countries' populations around the world. While there is more or less (depending on the country) potential for higher labor force participation, especially from employing more women and older cohorts of the labor force, the major impact on global labor force growth is likely to come from allowing people to migrate to those countries and regions where there is work—a major political and societal challenge with huge positive or negative payoffs depending on how it will be handled.[2]

Two other growth sources are even more uncertain than labor force growth and can make a large difference to growth projections. They are the speed of productive investment in the economy, and the productivity effects that arise from those investments through technology and innovation.

For the period 2016–2020 we foresee growth to be 3.1 percent on average, slightly above the 2016 base projection. While the slowing force of a weakening labor supply is already kicking in in large economies such as the United States, Germany, Japan, and China, several economies are still operating below their growth potential and therefore have some extra room to grow beyond the long-term trend for the next few years. Some of the emerging economies that have been hard hit in 2015 will likely experience more impact from recovery growth in 2017 and beyond.

It is very well possible that the massive amount of technological opportunities that are potentially available for investment will come online once a more positive virtuous cycle takes hold, driven by rising incomes and increased demand. While it is unlikely that we will see such a positive dynamic play out in 2016 given the headwinds described earlier, it is possible that we could see a greater impact of those trends in the last few years of this decade, or perhaps even more strongly into the next decade.

However, the slowing of the growth in the labor force is likely to widen in the 2020s, as several emerging economies will be joining mature economies in seeing a larger aging effect of their populations. The combination of aging and overall slower growth of the population causes fewer people to be available for work, but can to some extent be compensated by more capital-intensive growth (including robotics and digitalization in general) and higher wages of those still in the labor force. However, a potentially more serious consequence of an aging population is that there will be insufficient purchasing power and demand from non-working people to keep the virtuous cycle of investment, innovation, and growth in motion. The ongoing rise of the middle classes coming out of poverty in emerging economies, which can provide a counterforce in terms of purchasing power, could come to a halt if aging effects begin to dominate.

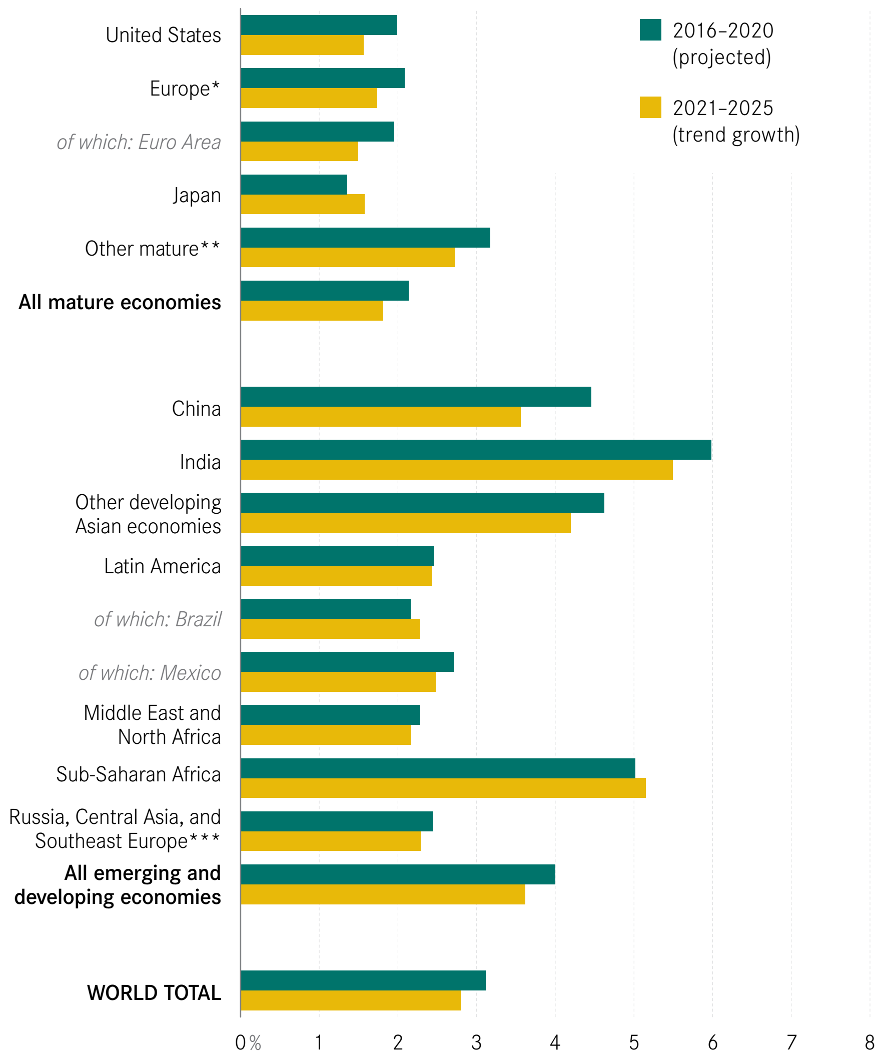
2 See, for example Gad Levanon and Michael Paterra, *The US Labor Supply Problem – Which States Are Most at Risk?* The Conference Board, Executive Action No. 442, September 2015.

As a result of those multiple forces, we estimate global growth to moderately drop off from 3.1 percent in the 2016–2020 period to 2.8 percent in the 2021–2025 period—a slowdown that will take place across the world. There are exceptions to this moderation among the economies of Sub-Saharan Africa and Latin America. Even Brazil's lackluster economy may see a modest improvement, provided investment and productivity growth are unleashed. This type of slow global growth rate, leading to a 2.2 percent increase in per capita income, is historically not unprecedented. However, greater support from investment, innovation, and globalization would not only benefit business opportunities, but also help strengthen the rise in average living standards and avoid the slowing of the declining trend in global poverty of the past two decades.

Chart 2

GDP growth, average annual percent change, 2016-2020 and 2021-2025

The growth slowdown in 2020s is worldwide, except in Sub-Saharan Africa and Brazil.



* Europe includes all 28 members of the European Union as well as Iceland, Switzerland, and Norway.

** Other mature economies are Australia, Canada, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan.

*** Southeast Europe includes Albania, Bosnia and Herzegovina, Belarus, Macedonia, Serbia and Montenegro, and Turkey.

Source: The Conference Board Global Economic Outlook 2016

What is the "real" growth rate for China?

The recent turmoil in China's financial markets has exposed the fragility of the Chinese economy, while once again raising serious concerns about its true growth performance. China's recent growth performance based on the official government numbers has been challenged, both internally and externally. Even the so-called Li Keqiang index, named after China's current premier, has shown much weaker growth in recent months as it is based on electricity consumption, bank lending, and rail cargo volume—actually suggesting a rather sudden collapse (or even a hard landing) of China's economy.

We disagree with the view of a sudden collapse, because our own estimates—which do not blindly adopt government statistics nor rely on selective ad-hoc measures but systematically rebuild China's real output (GDP) growth from the bottom up—suggest that the economy has in fact experienced a slowdown over the past five years, beginning in 2011. Our assessment is that the current episode of turmoil is one of much greater volatility around a gradually slowing growth trend, which we dub the "long soft fall," lasting for another decade or so.[1]

The accuracy of any country's GDP estimate is of critical importance to the business and policy community, both in-country and globally. For many arguable reasons, the quality of the Chinese official GDP estimates has long been questioned. This has motivated researchers to provide alternative estimates of Chinese growth, most recently at The Conference Board, following earlier studies by the late Professor Angus Maddison (University of Groningen) and Professor Harry Wu (Hitotsubashi University). We have systematically revised and updated the Maddison-Wu alternative estimates of China's GDP growth by resolving some earlier empirical and data problems. For more than a year we have highlighted the alternative estimates; for example, in our seminal report on China's long soft fall in October 2014, and in several publications from Professor Wu in which he describes his carefully reconstructed data series back to 1952.[2] The final step in the transition to these alternative estimates is to fully integrate them into our annual global economic outlook.

The spirit of the Maddison-Wu adjustment is by no means to treat official data as totally devoid of credibility. Rather, it aims to systematically dig out the most useful, least-biased information from all available official sources. We estimate that the upward bias in the official growth estimates over the past decades is attributable to two sources. The first is a "misreport effect," including data fabrications at any level of the data-generating process from localities to the central authorities (often to meet official high targets, at any cost), which accounts for about two-thirds of the over-reporting. The second is a "price effect," i.e., an underestimation of price changes (or inflation, which accounts for the remaining third).

The principle of our approach is to completely avoid using anecdotal adjustment. Our biggest adjustment is for the industrial sector, where we avoided the misreporting of annual output values and price series. Rather we based our estimates on consistently built production series, with multi-level and multi-year pricing and weighting using input-output table weights.

1 David Hoffman and Andrew Polk, *The Long Soft Fall in Chinese Growth: Business Realities, Risks, and Opportunities*, The Conference Board, October, 2014; Harry X. Wu, *Re-Estimating Chinese Growth: How fast has China's economy really grown?* Special Briefing Paper, The Conference Board China Center for Economics and Business, June 2014; and Harry X. Wu, *China's Growth and Productivity Performance Debate Revisited: Accounting for China's Sources of Growth with a New Data Set*, The Conference Board Economics Working Paper The Conference Board Working Paper Series, EPWP #14, February 2014.

2 Hoffman and Polk, *The Long Soft Fall in Chinese* Growth, October 2014; Wu, *Re-Estimating Chinese* Growth, June 2014; and Wu, *China's Growth and Productivity Performance Debate Revisited*, February 2014.

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What is the “real” growth rate for China?

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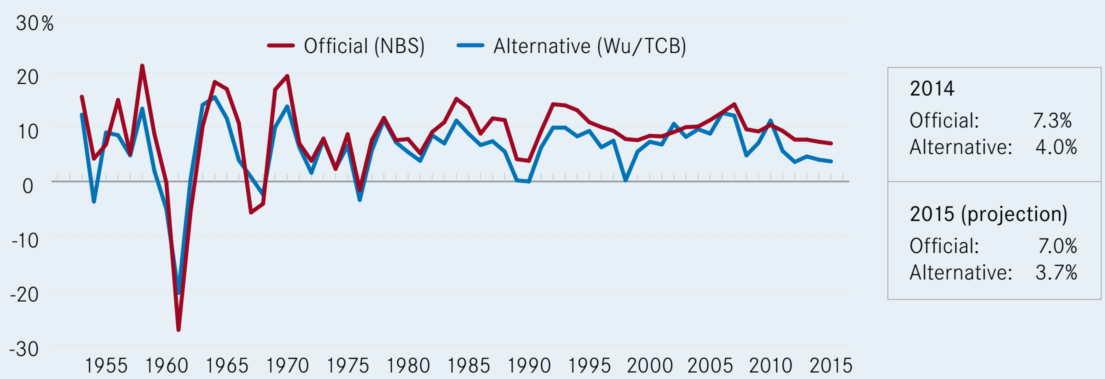
The estimates for the so-called “non-material services” (services excluding transportation, telecommunication and post, trade, and hotel and catering) are based on changes in the number of people employed, but allow for labor productivity improvement of 1 percent per year from 1982 to 1991 and 2 percent from 1992 onward. These percentages are arbitrary but more in line with international experiences in other emerging and mature markets, and also avoid the systematic overstatement of price increases in those sectors. There is, of course, room for further improvement of our series, such as a better measurement of quality improvements and a more solid measurement of productivity in services. There may also be scope for improving the estimates of agriculture and construction, for which we have adopted the official estimates so far. However, various tests suggest those adjustments cause relatively small revisions in the aggregate, and often in opposite directions between sectors.

On average, our new estimate of China’s GDP growth for the period 2005–2015 is 7.0 percent per year, which is 2.6 percentage points lower than the official estimate of 9.6 percent per year (the former includes our 2015 projection of 3.7 percent and the latter includes the official growth target of 7 percent by China’s government for 2015). Examining changes over time, our new results show greater volatility and slower growth than the official estimates, which appear, in particular, to understate slowdowns. For example, since 2011 our alternative growth estimate was 3.5 percentage points lower than the official estimate of 7.8 percent—showing that the economy has grown less than half as fast as the official numbers indicate over that time period.

This recent period of growth overstatement aligns with past episodes of economic stress that were clearly not accounted for in the official statistics. For example, our estimates also show that shocks to the economy, such as the Tiananmen Square crisis, the Asian financial crisis, and the 2008/2009 global economic and financial crisis have had a much more pronounced impact on our estimates than on the official numbers.

GDP growth rates, China, official and alternative estimates, annual growth rate

Our new re-estimation of Chinese GDP growth suggests that China may have already entered a slower stage of growth, at 4 percent per year.



Sources: National Bureau of Statistics, The Conference Board

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What is the “real” growth rate for China?

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On this basis we project significantly more weakness than the Chinese official numbers for 2015 and 2016. Beyond 2016 the economy may receive a modest cyclical boost from the rollout of large-scale Chinese economic stimulus and some stronger demand from mature economies, but we still expect the medium-term trend of the long soft fall to continue at least into the next decade.

Finally, the slower historical growth performance of China’s economy following our adjustments also changes our assessment of how quickly China’s economy has emerged as a leading economic power in the world: it has proceeded more slowly than previously estimated. When using the latest estimates of comparative price levels by the World Bank, which takes account of the relatively strong purchasing power of an equivalent dollar amount for consumers in emerging markets versus mature economies, China’s economy was the second largest economy in the world in 2015 after the United States, producing 16.6 percent of total global GDP—well below the previous estimate, which was closer to 20 percent.[3] In 2005, the size of China’s economy was already at around 12 percent of global output, but in the next 10 years its share in the global economy will advance more slowly and reach 18.4 percent of global GDP in 2025, by which time China’s economy will be larger than that of the United States or Europe.

3 On an exchange rate basis, China’s economy was only slightly smaller in 2015 at 15.5 percent instead of 16.6 percent on the basis of purchasing power parity. In comparison, the size of India’s economy was much larger at 7 percent of global output on the basis of purchasing power parity, versus 2.9 percent in 2015 on an exchange rate basis.

Globalization and Economic Growth Can Feed on Each Other

To get out of the holding pattern of slow growth, weak investment, lagging innovation, and poor productivity, economies and businesses can benefit from greater globalization of the world economy. This is defined as the ability for companies and people to interact; to exchange goods, services, and financial means; and to freely move people and capital around the world. Globalization is therefore multifaceted. While the causality between globalization and output growth can go in both directions, the interaction is a key factor in driving productivity and efficiency. Generally, globalization means closer integration of markets for goods and services, capital, and labor. When it recedes, growth of these flows lessens or in some cases it can even reverse.

In the current era, the globalization process is driven by international trade and foreign direct investment, while aided by technology transfers through a variety of channels. Less globalization hinders the flow of goods in the supply chain and increases the cost of doing business across borders, which can hamper the productivity and efficiency of global business. There could be significant repercussions on profitability if businesses don’t adjust to this new environment.

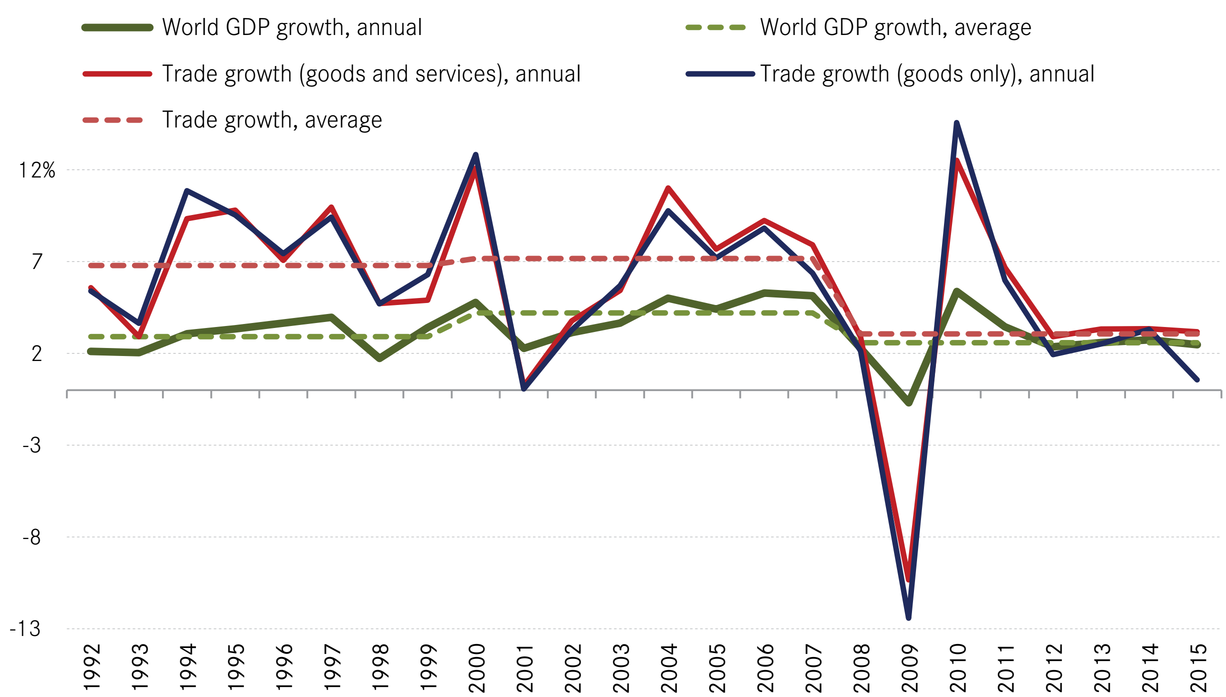
Until major economies started contracting with the Great Recession of 2008/2009, world trade volume was growing much faster than world GDP growth. That period of high globalization before the Great Recession was largely influenced by the emergence of the World Trade Organization (WTO) and China’s accession to the WTO in 2000. Another factor was related to the launch of the European single currency zone. With the Great Recession came an unusually sudden and sharp contraction in global trade volume. Global trade growth has since recovered but has not exceeded the pace of global economic growth as in the 2000s. Whereas trade volume growth has been faster than GDP growth for decades, it has now dropped well below the global GDP growth rate. There may be different explanations for the weakening trade trend relative to GDP, some of it even reflecting positive trends. For example, as emerging economies advance in producing for the global value chain they may have to rely less on imports of materials or exports for further processing elsewhere, and therefore see a greater amount of domestic production relative to intermediate trade. However, weakening demand and barriers to trade can be among the more concerning explanations for the slow growth trend in trade, and they are probably more dominant.

Globalization is not just about trade, it is also about the ease of movement of people and capital, and cultural interactions across borders. Although these broader interactions have not halted altogether, they have been slowing down.[3] The index of globalization published by the KOF Swiss Economic Institute suggests a slowdown in recent years. Economic globalization—which measures on one hand cross-border trade, investment, and income flows in relation to GDP and, on the other, the impact of restrictions on trade and capital movement—seems to have suffered more than other forms of globalization. Indeed economic globalization measures are more likely to directly suffer from slower economic growth, and it is encouraging that the other globalization measures haven't weakened as much. At least in the medium term, the economic aspects of globalization are important to revive growth opportunities.

Chart 3

Trade volume and GDP growth

While trade volume and economic growth feed on each other, trade has dropped off more especially in recent years.



Note: Total trade (goods and services) data is based on annual data including IMF forecasts for 2015, and goods trade is based on averages of monthly data. GDP and trade growth averages (dotted lines) denote averages over the 1992–2000, 2001–2007, and 2008–2015 periods.

Sources: The Conference Board Global Economic Outlook 2016; International Monetary Fund; and CPB Netherlands Bureau for Economic Policy Analysis.

3 The KOF Globalization Index is a composite measure of various indicators of integration with the rest of the world, including economic, political, and social indicators. A higher index suggests a larger integration with the global economy. See Axel Dreher, "Does Globalization Affect Growth? Evidence from a New Index of Globalization," *Applied Economics* 38, Vol. 10 (2006), pages 1091-1110.

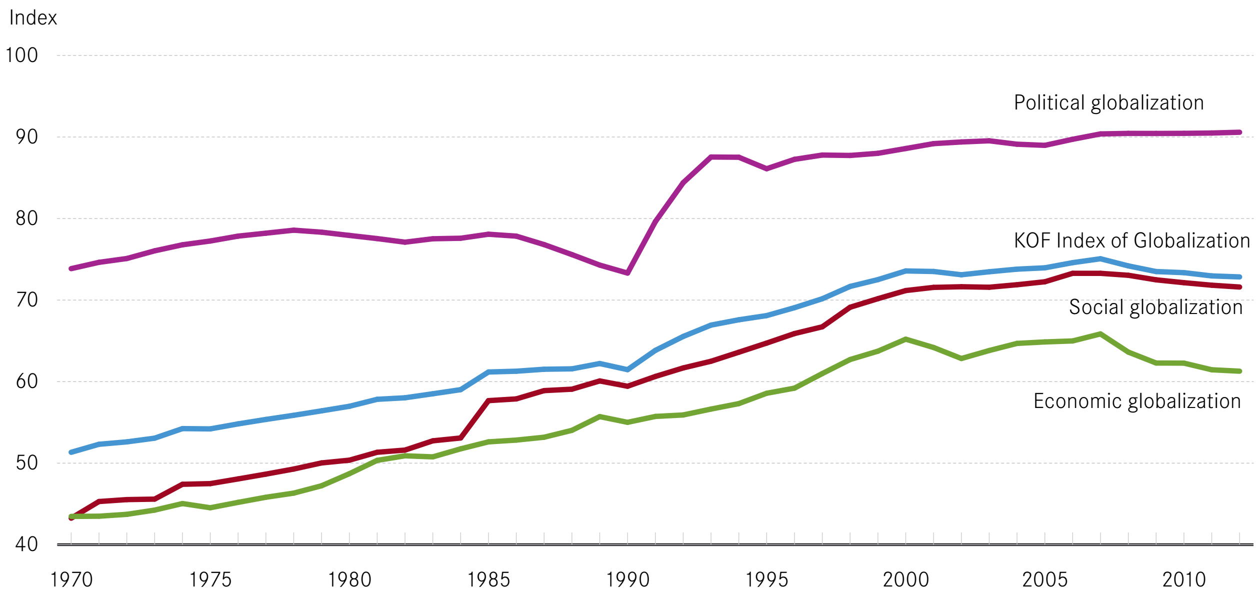
While the reasons for slower globalization are multifold, several opportunities to lower barriers for more trade and global mobility of capital and labor will present themselves over the next year or two. Important coordination initiatives related to trade (TTIP agreements) are on the table for further negotiations beyond the already negotiated TPP deal.[4] These agreements could help create an environment that's more conducive to increasing the productivity of global businesses. A major climate conference in Paris in December 2015 could unlock new incentives for innovation in energy and conservation. And major regional blocs, such as the European Union and ASEAN or country groups like the G-20 and BRICS, can use their own coordination mechanisms to align regulatory frameworks.

Although regional agreements may be sub-optimal compared to a global free trade agreement, by expanding market access and exposing more businesses to increased competition they can force businesses to innovate more in pursuit of market share, ultimately having a positive impact of the global growth trends.

Chart 4

Globalization indexes, 1970-2012

All aspects of globalization have slowed or flattened since 2007.



Note: The World Index of Globalization (blue line) is calculated by TCB as the world aggregate of country globalization indexes provided by the KOF Swiss Economic Institute, weighted using country GDP shares. The World Index of Globalization includes 141 countries in 1970, and the country coverage increases to 191 countries in 2012.

Sources: KOF Swiss Economic Institute; calculations by The Conference Board

4 TPP refers to Trans Pacific Partnership. TTIP refers to Transatlantic Trade and Investment Partnership.

Where Are the Growth Opportunities for Business?

While economies around the world remain mired in slow growth, a perspective on individual sectors and industries still shows a diverse picture, with a rich palette of opportunities across regions and countries. Multinational companies need to reassess their opportunities in the global business environment.

First, mature economies still offer solid volume in major consumer markets, as the consumers in those markets account for more than half of the world's purchasing power. Second, mature economies remain major hubs for technological change and innovation. These economies are more advanced in their ability to create regional innovation systems that bring business, government, and education systems together to develop hubs in specialized areas, and provide a strong environment for cutting-edge investment opportunities.

Emerging markets, despite slowing down, are still growing at about twice the growth rate of mature economies. Underlying the slowdown are often significant shifts toward more consumption (rather than investment), a drive toward higher quality goods, and a larger role for services in general. Emerging markets are also deriving a major benefit from huge numbers of people coming out of poverty into the middle class. This creates a large

The Conference Board Global Economic Outlook, 2010-2025

	Actual growth 2010–2014	Estimated growth 2015	Forecast growth 2016	Projected growth 2016–2020	Trend growth 2021–2025
UNITED STATES	2.1%	2.5%	2.4%	2.0%	1.6%
EUROPE*	1.0	1.7	1.8	2.1	1.7
of which: Euro Area	*0.6*	*1.4*	*1.6*	*1.9*	*1.5*
JAPAN	1.5	0.6	1.2	1.4	1.6
OTHER MATURE**	3.5	2.5	2.8	3.2	2.7
MATURE ECONOMIES	**1.8%**	**2.0%**	**2.1%**	**2.1%**	**1.8%**
CHINA	5.8	3.7	3.7	4.5	3.6
CHINA (based on official numbers)	8.5	7.0	–	–	–
INDIA	7.0	6.1	6.2	6.0	5.5
OTHER DEVELOPING ASIA	5.3	4.7	4.8	4.6	4.2
LATIN AMERICA	3.0	−0.3	1.1	2.5	2.4
of which: Brazil	*2.8*	*−2.2*	*−0.2*	*2.2*	*2.3*
of which: Mexico	*3.3*	*2.5*	*2.8*	*2.7*	*2.5*
MIDDLE EAST AND NORTH AFRICA	3.2	3.2	2.6	2.3	2.2
SUB-SAHARAN AFRICA	5.1	3.4	4.4	5.0	5.2
RUSSIA, CENTRAL ASIA, AND SOUTHEAST EUROPE***	3.9	−0.9	1.8	2.4	2.3
EMERGING AND DEVELOPING ECONOMIES	**4.9%**	**2.9%**	**3.5%**	**4.0%**	**3.6%**
EMERGING (based on official numbers for China)	5.7	4.0	–	–	–
WORLD	**3.3%**	**2.5%**	**2.8%**	**3.1%**	**2.8%**
WORLD (based on official numbers for China)	3.7	3.0	–	–	–

* Europe includes all 28 members of the European Union, as well as Iceland, Switzerland, and Norway.

** Other mature economies are Australia, Canada, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan.

*** Southeast Europe includes Albania, Bosnia and Herzegovina, Belarus, Macedonia, Serbia and Montenegro, and Turkey.

Note: This Global Economic Outlook has used alternative historical growth rates for the Chinese economy as explained on pages 9–11. We also provide historical growth rates for China and regional aggregates that include China, however, we do not use the official GDP figures in our long-term projections. Those are available on request.

Source: The Conference Board Global Economic Outlook 2016 potential for consumer-oriented companies, especially for companies that can serve multiple markets while recognizing the large degree of differentiation across income classes and between regional and metro areas across emerging markets.[5] Businesses that can crack the code in terms of scaling up their production while being able to serve those differentiated markets can still take advantage of the current global growth environment. This requires as much attention paid to the latest production and delivery techniques as to the latest trends in organizational design, management practices, recruitment, training and engagement of the workforce, and marketing and brand research.

If companies take a “wait and see” strategy or focus too much on employing defensive cost-control strategies, they could miss opportunities as they arise. Major technology booms take time to play out, in part because businesses are sometimes overwhelmed by the amount of opportunities, which can lead to a “wait it out” attitude. Instead business can benefit from a high liquidity and low interest rate environment to make the investments needed for future growth. Though they may be in short supply, if found, these opportunities can return an outsized premium on the investment. In emerging economies, local business partners often develop more sustainable business models and new opportunities for M&A may be opening up.

While the recorded pace of investment in the global economy is surprisingly slow, a broader approach to investment is still much needed. Even after making sure that all that is being spent is adequately measured and accounted for in terms of the return, improving growth prospects requires further complementary investment and spending on a firm’s sources of innovation to make everything (products, services, and processes) work.

Finally, business should also keep a close eye on the opportunities that major or bilateral trade deals may offer. Specifically, the Trans-Pacific Partnership (TPP), which if implemented makes it possible to enter new business areas in emerging and developing economies in Asia.

About The Conference Board Global Economic Outlook

The Conference Board Global Economic Outlook 2016 provides projections for the output growth of the world economy, including 11 major regions and individual estimates for 33 mature and 32 emerging market economies for 2016, 2016–2020, and 2021–2025. The projections are based on a growth accounting model that estimates trend growth as the contributions of the use of labor, capital, and productivity to the growth of GDP. Capital and productivity growth are estimated on the basis of a wide range of related variables during past periods. The trend growth rates obtained from this process are adjusted for possible deviations between actual and potential output. A description of the latest methodology, including several adjustments to the estimation model, can be found in Abdul Azeez Erumban and Klaas de Vries, “Global Growth Projections for The Conference Board Global Economic Outlook 2016,” The Conference Board, November 2015. The most important quantitative change is the integration of a new GDP series for China, correcting for the upward bias in the official series. We have also included 10 additional developing countries and enhanced the model estimates to incorporate the impact of globalization on the global outlook. We have also included 10 additional developing countries and enhanced the model estimates to incorporate the impact of globalization on the global outlook. For more information, please visit The Conference Board website page for this publication at (www.conference-board.org/data/globaloutlook.cfm).

5 For a recent study on a segmentation of consumer markets in China, using a detailed model of 200 relevant variables across 286 cities as well as a focus on the demands of so-called connected spenders, see Louise Keeley, Andrew Polk, and Ethan Cramer-Flood, *No More Tiers: Navigating the future of consumer demand across China’s cities*, forthcoming in December 2015.

United States

Will the US Economy Come to the Rescue of the Global Economy?

CURRENT SITUATION

In this current expansion in general, and in the past year in particular, the main feature of the US economy has been a significant drop in unemployment despite only mediocre GDP growth. Since the recession ended in mid-2009, the US economy has been growing at an annual rate of just over 2 percent, well below any previous expansion period in the post-war era. Yet it has been sufficient to lower the unemployment rate from a peak of 10 percent in October 2009 to 5.1 percent in August 2015.

In addition to slow growth, the US economy in the past five years has also experienced an unprecedented slowdown in the growth of the labor force as well as in the growth of output per worker (Chart 5). While overall demand for goods and services has left a lot to be desired, the slowdown in the production capacity of the labor force has been much more extreme. This has resulted in faster growth in the demand for labor than in the supply of labor, hence the rapid labor market tightening despite the lack of a substantial boom in economic activity. This historical slowdown in labor force production capacity is a result of a "perfect storm" of convergence of three major trends:

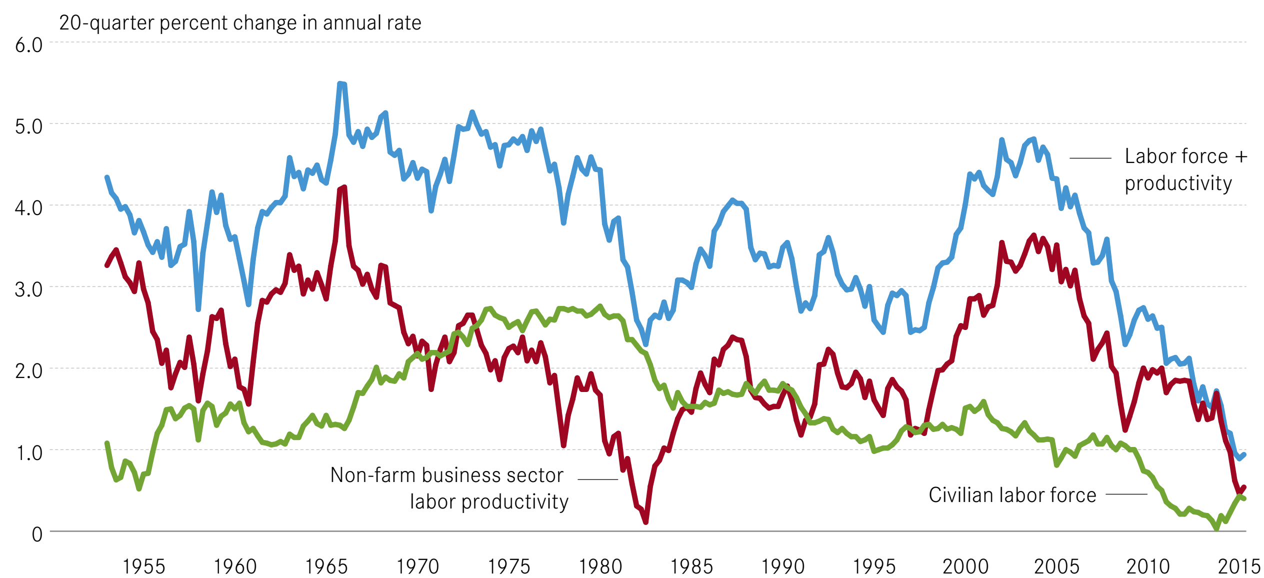
1. The retirement of the baby boom generation
2. Low labor force participation of the working-age population
3. A slowdown in the growth of labor productivity

The sum of labor productivity (red line) and the labor force (blue line) in Chart 5 is shown in the green line, a sum that historically grows a little faster than overall GDP. At 1 percent it is the lowest ever, and suggests that the trend of GDP growth is much lower than ever before.

Chart 5

Growth of civilian labor force and labor productivity, 1953–2015

The US economy has experienced an unprecedented slowdown in the growth of the labor force as well as in the growth of output per worker.



Note: Labor productivity is measured as real output per hour of all persons. The last data point is the second quarter of 2015.

Source: Bureau of Labor Statistics

On the demand side, at present, the US economy is enjoying solid domestic demand. Household spending, in both consumption and housing, has been quite strong in recent quarters compared with earlier parts of this expansion. In addition, government spending, which contracted sharply through most of this expansion, began to grow again in 2014. On the other hand, weak global demand and the strengthening of the dollar are hurting exports. Since the appreciation of the dollar in the summer of 2014, exports have been on a declining trend. In July 2015, exports of goods were 2 percent below their level in the fourth quarter of 2014, whereas imports of goods in July 2015 were 2 percent higher than their level in the fourth quarter of 2014, expanding an already worrisome trade deficit.

Weaker export demand and the drop in oil prices, which reduced the demand for oil-related equipment and structures within the United States, has contributed to weak business investment in recent quarters.

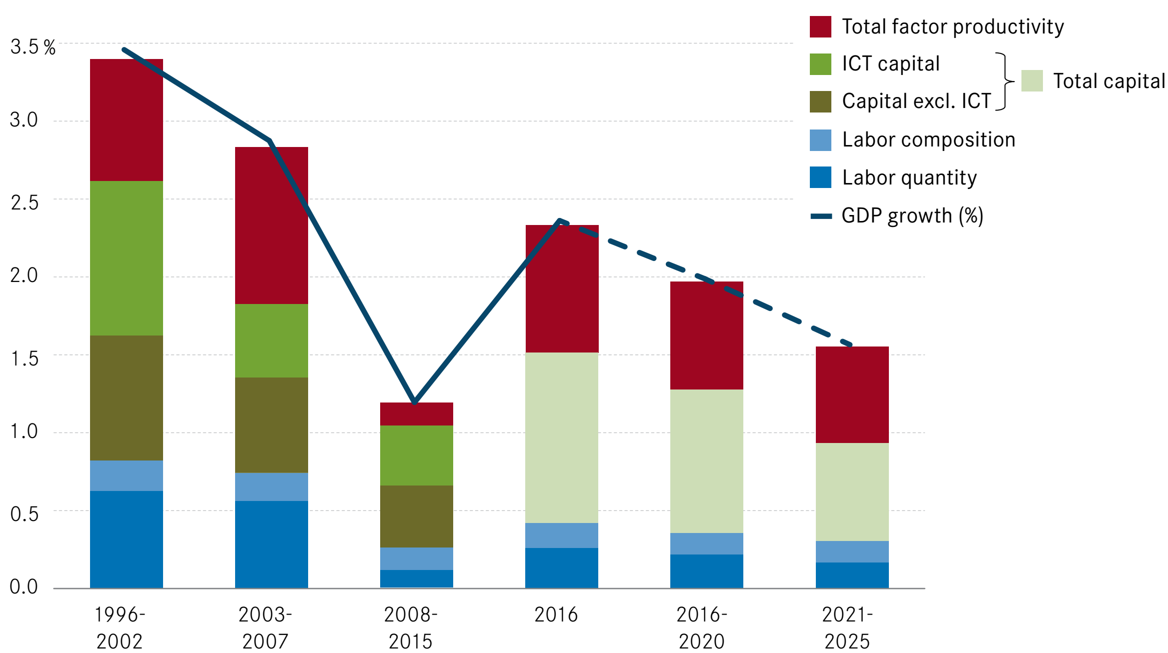
SHORT-TERM OUTLOOK

Some of the main trends from 2015 are likely to continue in 2016. Improving housing and labor markets will continue to boost domestic demand, while weak exports will keep overall GDP growth slightly below 2.5 percent in 2016. Even though this mediocre growth is barely above trend growth, it is strong enough to continue closing the output gap and tighten the labor market. By the end of 2016, the unemployment rate is likely to fall below 4.5 percent.

Chart 6

Contributions of changes in labor, capital, and total factor productivity to GDP growth, UNITED STATES

Trend GDP growth in the US is the slowest in decades, and projected to reach 1.6 percent by the first half of the 2020s.



Sources: The Conference Board Total Economy Database™, May 2015 and The Conference Board Global Economic Outlook, 2016

It will become harder and more costly to hire qualified workers, employee retention will become a greater challenge, wage growth will likely accelerate, and corporate profits will suffer. Those trends are adding to other headwinds for corporate profits, such as the slowdown in productivity growth and the strong dollar.

MEDIUM-TERM OUTLOOK

As the labor market continues to tighten, through the second half of this decade GDP growth will converge to its long-term trend, which we estimate at just 1.6 percent. This low estimate is partly a result of one prediction that is foolproof: baby boomers are likely to continue to retire in large numbers, however it also depends on another less certain but sobering projection of lackluster productivity growth. While we do not expect labor productivity growth to remain below 1 percent, as has been the case in the past five years, we also do not expect it to get remotely close to the fantastic rates of the 1995–2007 period (Chart 6), which were made possible by the information and communications technology (ICT) boom. Investment in machinery and equipment, including information capital, as well other intangible capital (for example, human and organizational capital) will be crucial to move beyond the long-term trend in the medium term.

Business Takeaways

- While the US economy has been one of the bright spots in a disappointing global economy, it is not immune to the global weakness, nor to the slowing demographic trend of the US population.
- US companies will operate in an environment where raising profits will become increasingly difficult as labor costs accelerate, labor productivity growth is modest, and interest rates are rising.
- Trend GDP growth in the US is the slowest in decades, projected to reach 1.6 percent by the end of the decade and putting a cap on revenue growth potential of domestic business. A search for higher returns would lead to developing countries.
- Becoming more productive is the main action business could take to improve the bottom line in such an environment. This requires more attention to human capital, more investment in innovation, more management capacity to create and sustain conditions that promote productivity at the company level, and more support from competitive markets.

Euro Area

How Far Can the Recovery Proceed?

CURRENT SITUATION

The recovery from back-to-back recessions in the Euro Area (2008–2009 and 2011–2012) finally gained traction in 2015. Positive developments in labor markets, consumer spending, and business and consumer confidence were already getting underway due to cyclical factors, and they received further support from the quantitative easing (QE) program the European Central Bank (ECB) initiated at the beginning of 2015. The crisis around Greece has not significantly impacted the recovery in the rest of Europe. The Conference Board expects an annual growth rate for the Euro Area to end up at 1.4 percent in 2015 and at 1.7 percent for the European Union as a whole.

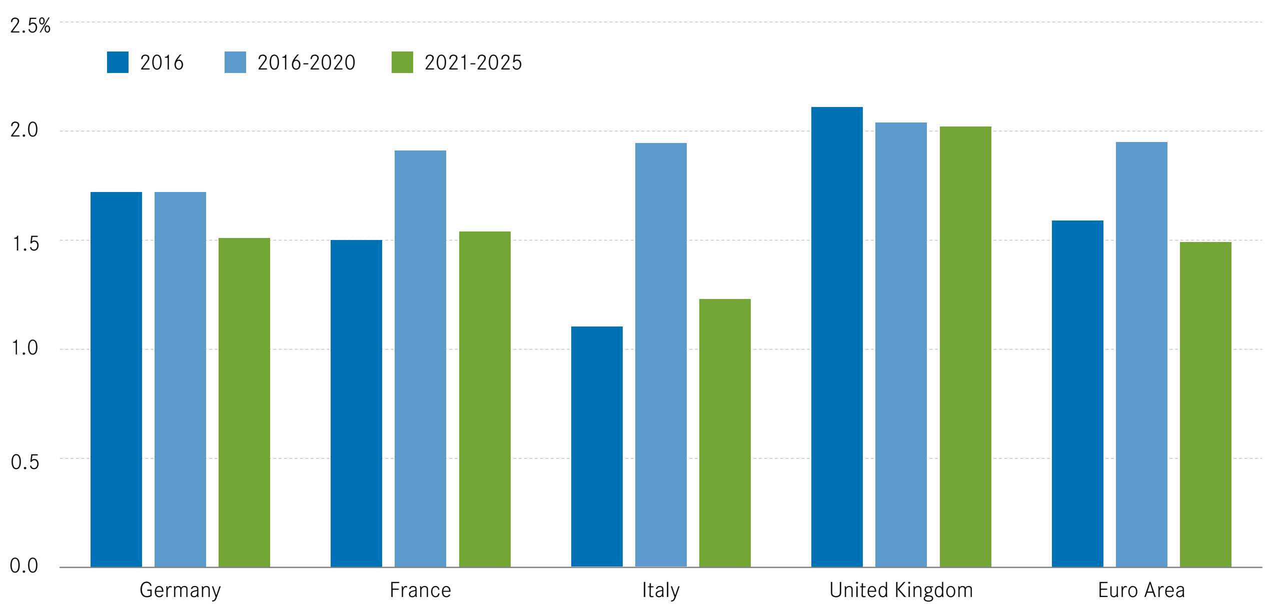
SHORT-TERM OUTLOOK

Despite the cyclical improvement of the Euro Area economy it is susceptible to external shocks, which, if they prove long-lasting, could lead to additional downside risks for the Euro Area outlook in the near term. For example, the sharp decline in the value of the RMB over the summer led to a loss of confidence in the growth prospects of many emerging markets, and the Euro Area has been increasingly reliant on emerging markets as a destination for its exports. The percentage of total exports going to the BRICS nations (Brazil, Russia, India, China, South Africa) more than doubled in less than 15 years, from 3.4 percent in 2000 to 8.1 percent in 2014. But the growth

Chart 7

GDP growth in major European countries, 2016, 2016–2020, and 2021–2025

European economies are expected to continue on a recovery path.



Source: The Conference Board Global Economic Outlook, 2016

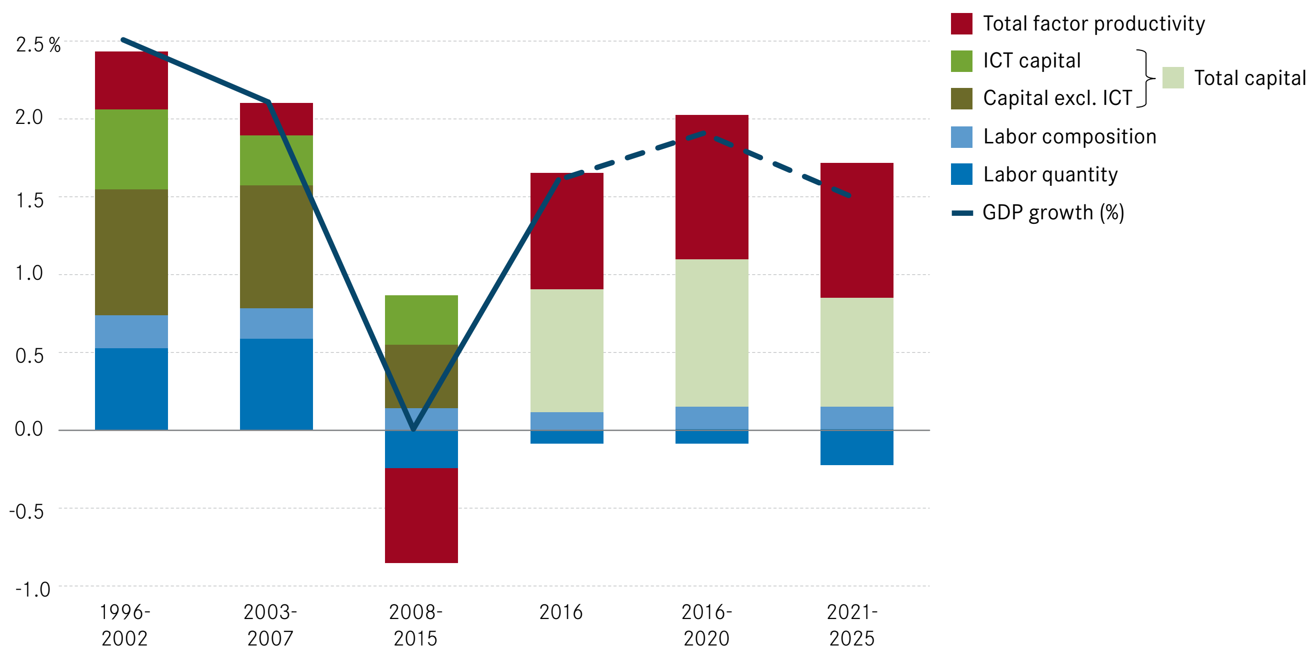
slowdown in these markets is likely to decrease the demand for European products and dampen the current export-dependent recovery. On the other hand, increasing exports to the United States, due to a strengthening economy there, could offset these negative effects.

The emerging market turmoil may further have disinflationary effects on the Euro Area, prolonging the lags required for the QE program to show its effect. It may also require a modification or extension of the program. While the value of the euro has been on a depreciating trend against the Euro Area's major trading partners lately, especially the United States and the United Kingdom, it has appreciated against the BRICS currencies in recent months. The stronger euro compared to emerging markets decreases import prices and helps the exports from BRICS economies, while decreasing costs for European firms and increasing the purchasing power of European consumers. These factors in combination with the current low oil prices dampen the inflation outlook, and threaten the ECB's target to reach an inflation rate of close to 2 percent from the current deflationary period of essentially zero or even negative inflation.

Chart 8

Contributions of changes in labor, capital, and total factor productivity to GDP growth, EURO AREA

Projected pickup in investment growth in Europe and a recovery in productivity can offset the shrinking labor supply.



Sources: The Conference Board Total Economy Database™, May 2015 and The Conference Board Global Economic Outlook, 2016

MEDIUM-TERM OUTLOOK

Average real GDP growth in the Euro Area essentially halted between 2008 and 2014, but the economy has finally gained some momentum in 2015 and is expected to continue its recovery path to an average annual growth of 1.9 percent between 2016 and 2020. As of 2020, it will follow a slower growth path at about 1.5 percent on average from 2021 to 2025. During this period the retirement of the baby boomer generation and aging populations will become so large that labor supply contraction will detract 0.2 percentage point per year off GDP growth. This negative contribution to growth can be offset by a projected pickup in investment growth and by a recovery in productivity, which has been on a long-term declining trend.[6] The Euro Area economy may also benefit from its highly skilled labor force in translating the investments into economic output.

In sum, the decade ahead is likely to see moderate long-term potential growth in Europe of below 2.0 percent compared to the past two decades, when average growth reached as high as 2.4 percent.

Business Takeaways

- Similar to the United States, corporate profits will increasingly come under pressure as overall demand slows down, labor costs accelerate, and productivity trends down.
- Low interest rates and the QE program provide a supportive environment in the short term, buying time for structural reforms in Europe.
- The creation of a banking union, allowing for common EU-wide rules for banks in the Euro Area, helps to further the integration of European financial markets, but also supports other reforms that should help to strengthen the efficiency of production and lead to improved performance.
- But, the process of consensus building for reforms and implementation will remain slow.
- Prioritizing productivity requires more attention to the creation of human capital, more investment in innovation, more management capacity to create and sustain conditions that promote productivity at the company level, and more support from competitive markets.
- As labor markets gradually tighten in the medium term due to slowing population growth and an aging population, upward pressure on labor costs could be mitigated by reevaluating Europe's immigration policies.

6 Bart van Ark, Ataman Ozyildirim, Elizabeth Crofoot, Abdul Azeez Erumban, Prajakta Bhide, and Gad Levanon, *Prioritizing Productivity to Drive Growth, Competitiveness, and Profitability*, The Conference Board, June 2015.

China

From Driving Global Growth to Driving Global Volatility

CURRENT SITUATION

China's equity bubble popped during the summer of 2015 followed, over most of the summer, by large cuts in interest rates and banks' reserve requirements, freezes on trading for over 50 percent of shares on all exchanges and large-scale purchases in the market, and restrictions on certain sales of shares by large shareholders. In addition, the Peoples' Bank of China's (PBoC) surprise 2 percent devaluation that took place on August 11 only added to uncertainty about the country's economic outlook. To defend the currency against further depreciation the PBoC was forced to sell close to $200 billion in US treasuries. The recently released economic data from China's statistical agencies—from PMIs to industrial production to new loans for non-financial companies—are evidence that the financial instability has come alongside renewed deceleration in the real economy in the autumn of 2015.

The current episode of turmoil is one of more volatility around a gradual slowing long-term trend, which we dub the "long soft fall," and which we expect to continue for the next decade or so. In this context, for more than a year we have highlighted alternative estimates for Chinese growth, which we have now incorporated into our global outlook.[7] We currently estimate that growth in China is running at a rate of about 3.7 percent so far in 2015, much lower than the official GDP release, which shows the economy growing at 7 percent throughout the first half of 2015. In our view, it is not that growth in China is now suddenly deteriorating much faster than it had previously, but rather that growth was already much slower than many recognized—with the economy expanding at around for 4 percent per year since 2012 according to our estimates.

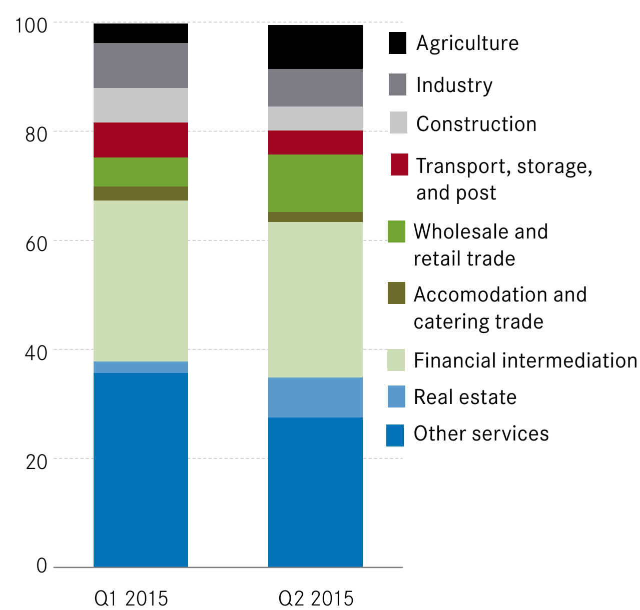
SHORT-TERM OUTLOOK

Traditional support measures through fiscal, quasi-fiscal, and monetary policy levers are increasingly ineffective at impacting the Chinese economy. Moreover, various efforts to support misaligned asset prices are coming at the expense of accomplishing fundamental economic goals: specifically, growth stabilization and marketizing reform. The funneling of financial resources toward unproductive or underproductive uses only exacerbates the structural slowdown.

Chart 9

Percent share of nominal GDP growth, by industry

According to official data, financial services drove about 30 percent of GDP growth in the first half of 2015.



Sources: National Bureau of Statistics of China, CEIC, The Conference Board

7 See box "What is the 'real' growth rate for China?" pages 9–11; and Wu, *China's Growth and Productivity Perfromance Debate Revisited*, February 2014.

Worsening real capital expenditure rates, rather than financial volatility, are the factors truly dragging down China's short-term growth. Although this could mark a healthy and long overdue long-term adjustment for China away from investment-dependent growth, it also means that headline growth rates will remain subdued in the near term. The Conference Board projects that growth in China will stand at 3.7 percent in 2016—the same rate as in 2015—as capital expenditure continues to decrease from the previous heavy growth years. Recent initiatives to raise investment and growth prospects such as Manufactured in China 2025, the Four Megacities, and others could be slow to take off due to execution difficulties, if not funding difficulties as well.

MEDIUM-TERM OUTLOOK

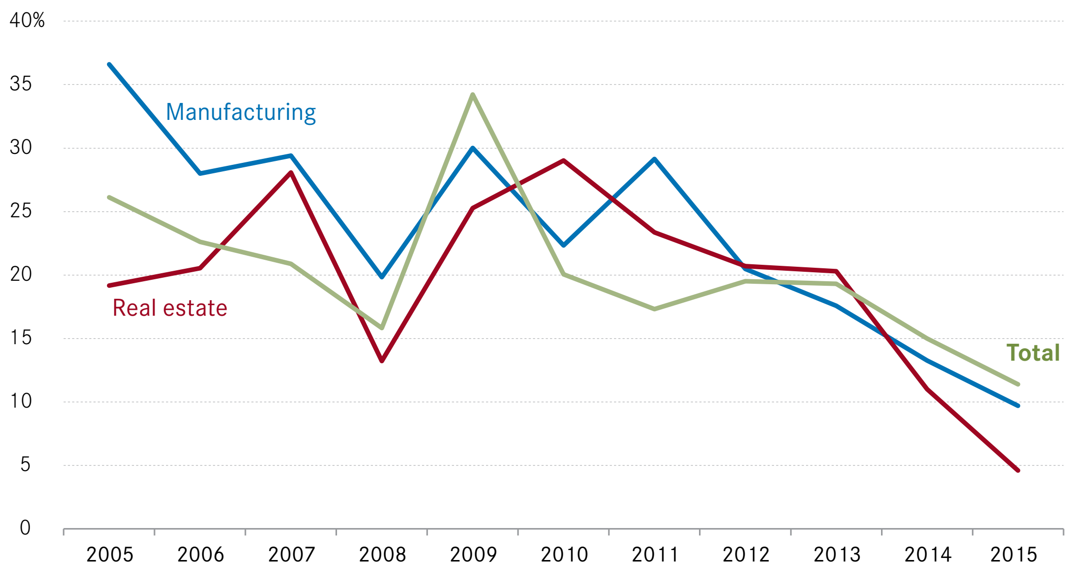
The Conference Board expects China's growth to average 4.5 percent in the 2016–2020 period before easing to 3.6 percent in the period 2021–2025. Much of the continued weakness will stem from the same structural factors that China has been facing for some time—namely, the need to shift away from an investment-driven growth model, a heavier reliance on services, a weaker demographic profile, and institutional constraints on productivity growth.

The outlook holds both positive and negative implications for the economy. The first is that much of the downward adjustment to growth has already taken place. In fact, given our expectation of a slow 3.7 percent growth for

Chart 10

Annual growth rates of investment

Weaker investment rates are driving China's short-term slowdown — a needed adjustment.



Note: 2015 growth rates are the year-on-year rates for the first half of 2015.

Sources: CEIC and The Conference Board

2016, the economy should see some acceleration toward the end of the 2016–2020 period. That improvement, however, is unlikely to be linear. As China's growth slows, average growth may improve through this medium-term period, but forecasting how the economy will perform in any given quarter or year will become much more difficult. Moreover, once China begins to roll out some of its high-level policy programs related to industrial upgrading and continued infrastructure investment in western China (i.e., China Manufacturing 2025 and the One Belt One Road projects, respectively), these programs will likely make capital expenditure rates increase briefly. The intractable institutional challenges that China faces are likely to be a drag on productivity improvements for the foreseeable future.

Trend growth is set to ease again in the 2021–2025 timeframe to 3.6 percent, driven by weak labor supply and continued slow productivity growth as the economic reform program delivers only modest growth effects. On the upside, however, the medium-term slowdown could also result in more pragmatic reform policies and more market access for foreign investors who can contribute tangibly to restoring Chinese growth and productivity.

Business Takeaways

- Recent developments in China's foreign exchange and equity markets suggest that greater financial volatility comes hand-in-hand with China's economic transition.
- Many of the current concerns "in the market" about a hard landing primarily reflect an awakening of international investors to the reality in China.
- Evaluating and understanding financial risks, especially with regard to local counterparts who are exposed to a further downturn in the credit cycle, will become increasingly important for MNC contingency planning.
- Policy mistakes and domestic economic turbulence can easily cause China's integration into the global financial system to reverse, at least temporarily, as we are seeing with RMB internationalization.
- Even at much lower growth rates, the Chinese market remains opportune—especially in higher value product and service categories.

India

Will India Remain a Rising Star?

CURRENT SITUATION

Although India's economy will remain one of the fastest growing emerging economies in the world, its growth has been moderating. On average, the Indian economy has been growing at an annual rate of 6.4 percent during the last five years, which is 2.3 percent lower than its growth rate during the 2006–2010 period. The Conference Board Economic Outlook forecasts a 6.1 percent growth in India's GDP in 2015, compared to 6.9 percent growth in 2014, making it still one of the fastest growing emerging economies; far ahead of China, which is experiencing a continued slowdown.[8] Despite high expectations for the pro-growth and pro-business policies of the government of Prime Minister Narendra Modi, the slow pace of government reform has been a disappointment and is likely having an impact on business sentiment and investment activity. Domestic consumption continues to contribute to growth, as inflation has fallen significantly from 7.1 percent last year to 3.7 percent this year (year-over-year rate, as of August), partly due to the decline in oil prices. Yet the disappointing monsoon season in 2015 has had an adverse effect on agricultural growth and rural consumption, adding to the country's economic challenges.

SHORT-TERM OUTLOOK

While India's macroeconomic fundamentals are solid, delays in several pro-business reforms and a sluggish global economy will continue to hamper its short-term prospects. Being a net importer of oil, India is likely to continue to benefit from low oil prices in 2016. The Conference Board forecasts an annual growth rate of 6.2 percent for India in 2016, which is slightly above 6.1 percent estimated for 2015.

MEDIUM-TERM OUTLOOK

India's growth is likely to hover around 6 percent during the next five years, 1.5 percentage points higher than the rate at which China is expected to grow during the same period. Nearly 70 percent of this 6 percent growth is likely to come from increased investment, which is lower than the contribution from investment during the past five years. The main source of long-term sustainable growth, total factor productivity (TFP) growth, is likely to be about 1 percent—half as strong as the 2 percent TFP growth China achieved during its fast-growth years. Employment contribution to India's GDP growth is likely to improve in the next five years to about 0.7 percent from 0.3 percent during the 2008–2015 period, primarily because of India's large youth population, i.e., its "demographic dividend." But translating this demographic dividend into sustainable growth depends upon investment in human capital, particularly training and education.

Even though the expectations of an improved policy environment will still provide some boost to the Indian economy, India's growth beyond 2016 depends upon the willingness and ability of the government to make substantial economic reforms. A more efficient allocation of resources, in particular public spending, toward infrastructure development and changes in labor market policy, land acquisition, and tax regimes are among the priorities to stimulate investment.

8 India's Central Statistical Organization has recently revised India's GDP growth rates substantially upward. The largest difference in the data is argued to have been from the wider coverage of the private corporate sector. The new approach results in an increase in estimated GDP growth and an increase in the share of manufacturing in GDP. In our forecasts we use the new revised series in years since 2012, along with old series for earlier years, as no data in the new series is available for years prior to 2012. The credibility of these estimates has been questioned by many (see for instance R. Nagaraj, "Seeds of Doubt on New GDP Numbers – Private Corporate Sector Overestimated?" *Economic & Political Weekly* 50, No. 13, pages 14-17, March 28, 2015). However, in the absence of any alternate credible estimate, we rely on official statistics.

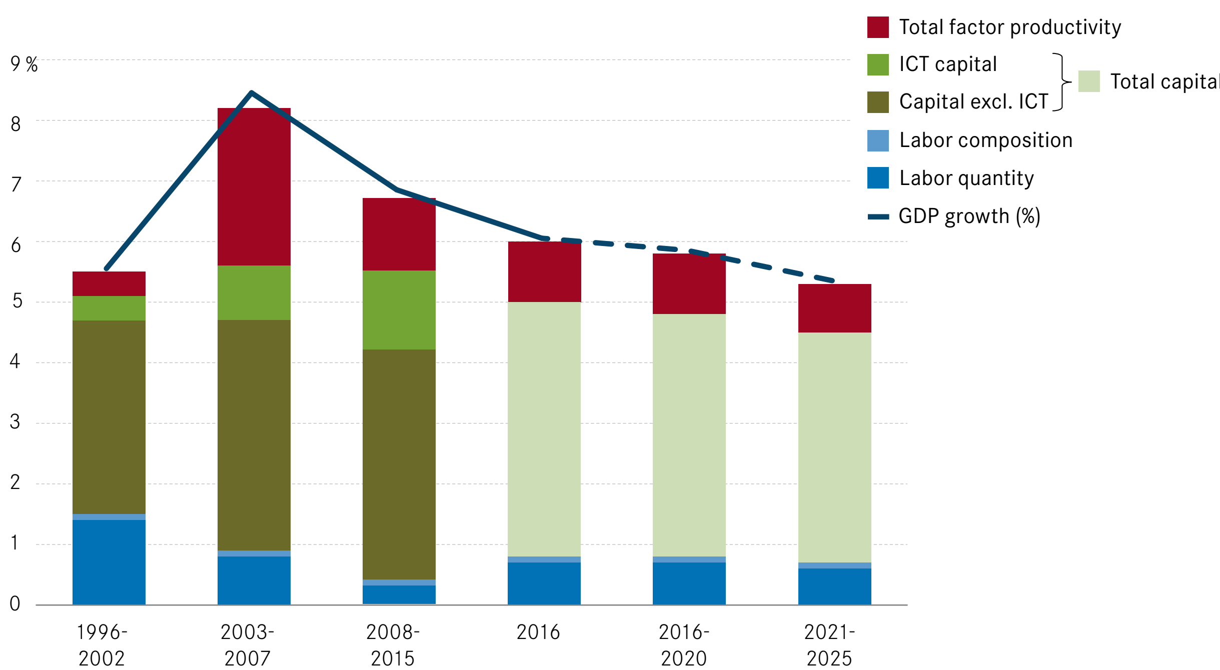
Business Takeaways

- India's economic growth is likely to improve but only moderately in 2016 to 6.2 percent, compared to 6.1 percent in 2015.
- Slow progress in the policy sphere would pose serious threats to upside potential.
- India will bypass China's growth rates in the coming years and continue to grow faster than China, and remain one of the fastest growing economies in the world.
- To achieve continuous progress on its growth path, India would need to focus on developing its manufacturing sector further. However, Chinese-style low-cost manufacturing is less viable, because there are already upward wage pressures in manufacturing in India.

Chart 11

Contributions of changes in labor, capital, and total factor productivity to GDP growth, INDIA

One of the fastest growing emerging economies in the world will see its growth moderating in the long term.

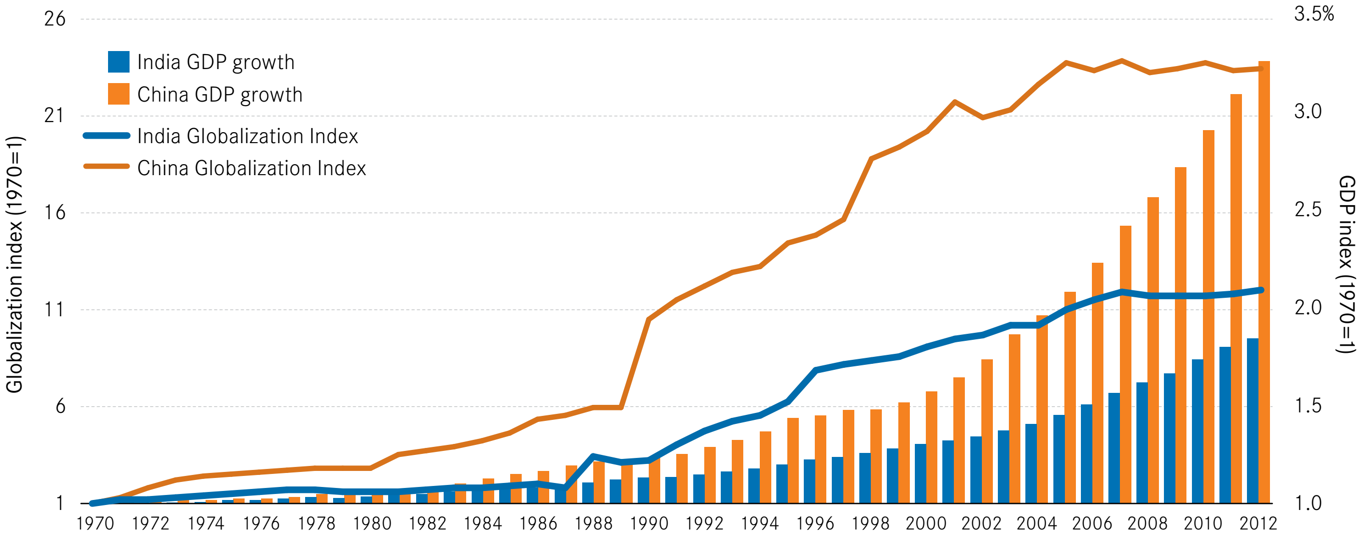


Sources: The Conference Board Total Economy Database™, May 2015 and The Conference Board Global Economic Outlook, 2016

Chart 12

Globalization and economic growth in India and China, 1970–2012

India still has potential to tap the economic benefits of globalization.



Note: Globalization is based on the KOF overall globalization index.

Sources: The Conference Board Total Economy Database™, May 2015; KOF Swiss Economic Institute, http://globalization.kof.ethz.ch/

Latin America

Is Latin America Losing the Race?

CURRENT SITUATION

Growth for the Latin American region is likely to end up at −0.3 percent in 2015, its first contraction since 2009 and following a meager 0.5 percent growth in 2014. Brazil and Venezuela remain in deep recession while Argentina barely escaped one. The other four large regional economies—Chile, Colombia, Mexico, and Peru—are expanding yet at well below trend growth rate. Rapidly falling commodity prices played a key role in this year's dismal performance by reducing export and government revenues, dampening investment returns, and depreciating currency values. Currency values in the region's major oil and metal producers such as Brazil, Chile, Colombia, Mexico, and Peru experienced massive depreciation and hit multi-year lows in the first eight months of 2015. The deterioration in trade balance and government revenues has limited Latin American countries' ability to use countercyclical monetary and fiscal measures to mitigate the impact of falling commodity prices. As economic conditions deteriorate and growth prospects worsen, political dissatisfaction and instability also deepen.

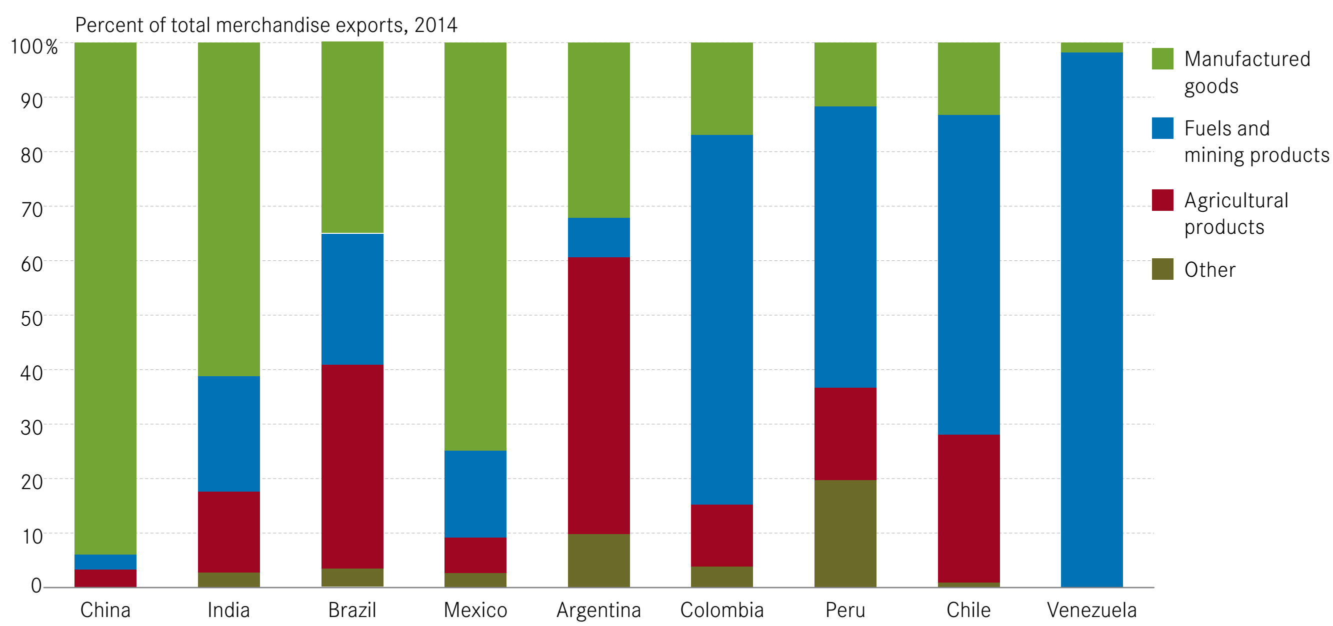
SHORT-TERM OUTLOOK

As low commodity prices are expected to persist beyond 2015, growth prospects for all major Latin American commodity producers are unlikely to improve rapidly in 2016. Uneven growth performance in the region will also continue, with recessions in Brazil and Venezuela weighing on the region's economic outlook while the Pacific Alliance trade bloc countries (Chile, Colombia, Mexico, and Peru) are expected to grow in the range of 2 to 3 percent in 2016. The Conference Board Global Economic Outlook

Chart 13

Percent share of merchandise exports, 2014

The commodity price decline hit Latin American exporters particularly hard.



Source: World Trade Organization, September 2014 projects 1.1 percent growth for the Latin America region for 2016 on the back of some stabilization in the decline in commodity prices and slightly improving conditions in Brazil. Argentina is also expected to see some improvement, if the new administration following the spring election yields a new administration that will implement gradual reforms. However, slowing demand from China, a tightening US monetary policy and stronger dollar, and deterioration of global liquidity conditions are risks that may potentially derail Latin America's recovery next year.

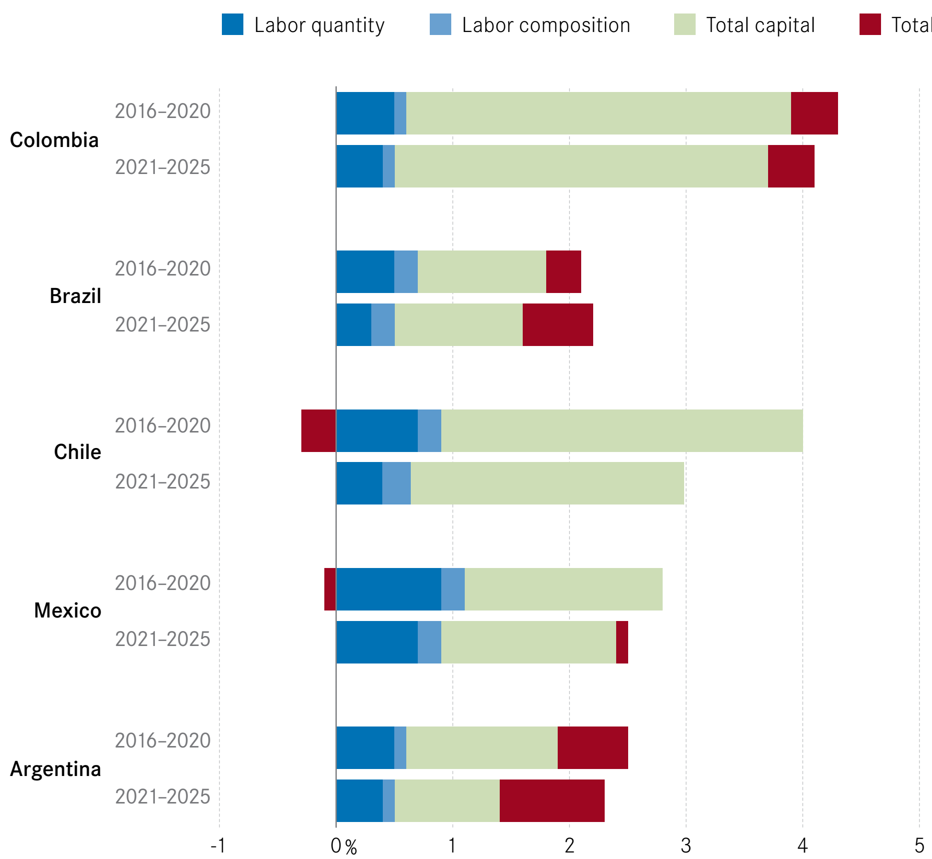
MEDIUM-TERM OUTLOOK

The potential growth for Latin America is projected at only 2.5 percent in the period 2016–2020 and falls slightly to 2.4 percent in the 2021–2025 period, well below the 2.7 to 2.9 percent trend growth rate during the 1990s and 2000s. But realizing such potential from a 0.3 percent contraction in 2015 and projected 1.1 percent growth in 2016 is an uphill battle. Since the 1990s, Brazil's economic growth has increasingly become highly correlated with commodity price fluctuations, a sign that Brazil has been

Chart 14

Contributions of changes in labor, capital, and total factor productivity to GDP growth in selected Latin American economies, 2016–2020 and 2021–2025

Growth divergence within the region will likely continue.



Source: The Conference Board Global Economic Outlook, 2016

unable to reduce its overreliance on natural resource exports, and its deep and prolonged recession is having a negative impact on the regional economy. Moreover, since the 2008/2009 global financial crisis, Brazil's economy has failed to tackle fiscal and consumer indebtedness and its eroding productivity growth. Inconsistent macroeconomic policymaking, poor infrastructure and transport networks, and industry protectionism have curbed private-sector and foreign investment, resulting in lack of innovation and manufacturing competitiveness. Alongside Brazil, the economies of Argentina and Venezuela show considerable weakness as the governments still play a large role in the economy, and the economies are least exposed to global supply chains and were little prepared for the end of the "commodity super cycle."

In contrast to these Atlantic bloc countries, the Pacific Alliance trade bloc countries consisting of Chile, Colombia, Mexico, and Peru seem to be better poised to weather the commodity price slump. Chile and Mexico have made impressive transitions to diversify their exports, trade partners, and industries in recent years despite some ongoing reliance on energy and mining exports. Their economies are also more open and business-friendly to foreign investment and have built up solid foreign exchange reserves, experienced lower inflation, and gained broader access to global consumer markets through actively pursuing intra- and inter-regional free-trade agreements.

The region's productivity growth still lags far behind its emerging Asian peers such as China and India, and remains below emerging markets' average productivity growth on account of the large informal sector share, where workers largely lack systematic education and training. Total factor productivity (TFP)—a key to building a long-term sustainable growth—in Latin America contracted by 2.0 percent in the 2008–2015 period, pointing to large inefficiencies deriving from a poor quality labor pool, inability to take advantage of technology investments, and a lack of innovation capacity. TFP growth is projected to be close to zero in the next five years.

Business Takeaways

- Latin America's economy is likely to recover modestly in 2016, at 1.1 percent as commodity prices stabilize, but the growth is still 1.4 percentage points below its long-term potential growth at 2.5 percent.
- Even this modest outlook presents significant downside risks due to persistently low commodity prices and the region's internal weaknesses.
- Growth divergence within the region will likely continue, and countries that have moved higher in the global value chain with balanced economic structures will see more stable and sustained growth.
- To help lift economic potential and drive productivity growth, more private sector and foreign investment is needed as well as integration of the informal sector into large and modern business practices.

Sub-Saharan Africa

Good Growth Possible, but from a Low Base

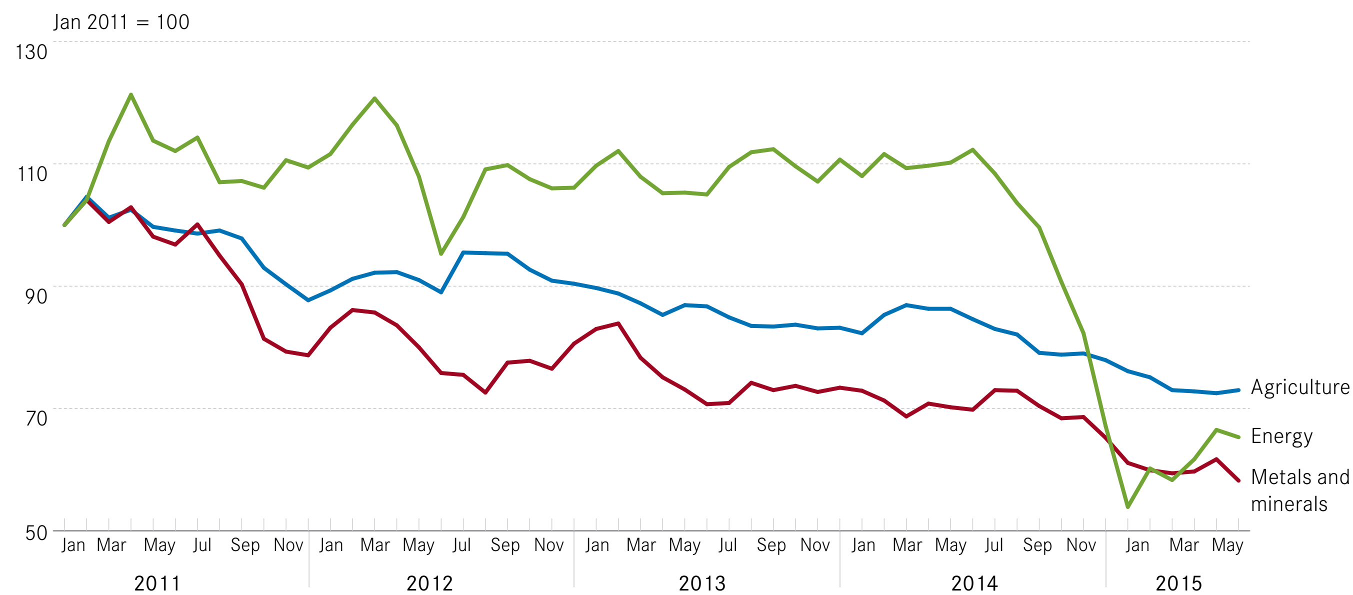
CURRENT SITUATION

As Sub-Saharan Africa is a net exporter of oil and other commodities, the decline in commodity prices since the summer of 2014 has been a severe hit to the region's economic performance. Overall growth in 2014 however held up well at 4.9 percent—mainly thanks to the resilience of other sectors of the region's economies, especially market services. The biggest negative impact has been on government revenues, which in most countries are highly dependent on export revenues. The resulting cuts in government spending and widening of fiscal deficits are among the factors that are causing projected growth to come in much lower in 2015 at 3.4 percent. Growth performance for the two largest economies of the region, Nigeria and South Africa, has been muted. The Nigerian economy failed to rebound from a significant contraction in the first quarter of 2015 caused by heightened political tensions arising from national elections and mounting security threats from the Boko Haram insurgency. South Africa seems to be slowly drifting toward recession, with continued labor unrest and power shortages crippling the industrial sector. However, as most other large economies on the sub-continent such as Ghana, Tanzania, Ethiopia, and Kenya remain on track for solid expansion, Sub-Saharan Africa remains among the fastest growing regions in the world.

Chart 15

Commodity price indices in nominal US dollars

The prolonged fall in commodity prices is causing headwinds for the region.



Notes: Agriculture index includes beverages, food, and agricultural raw materials. Metals and minerals index includes aluminum, copper, iron ore, lead, nickle, tin, and zinc. Energy index is a Laspeyres index with fixed weights based on 2002–2004 average developing countries' export values for coal, crude oil, and natural gas.

Source: Global Economic Monitor (GEM) Commodities, World Bank

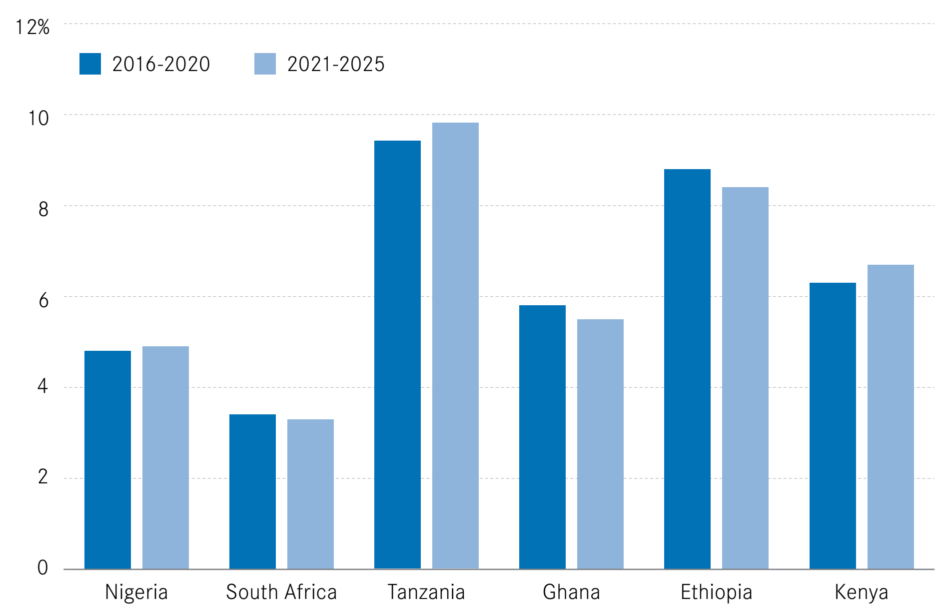
SHORT-TERM OUTLOOK

There is still much potential for sustained economic growth in Sub-Saharan Africa, and we expect the region to grow by approximately 5 percent on average in the coming five years until 2020. However, the downside risks have increased, which make the outlook somewhat more uncertain. A slowing Chinese economy, a further fall in commodity prices, and a possible continued deterioration of global liquidity conditions are among those risks. China has become increasingly more important for Africa as a source of (infrastructure) investments and demand for commodities. The recovery of the European economy, which is the region's largest trading partner by far, and the rise of India in the global economy provide additional global demand for commodities and raw materials and might offset some of these negative risks. Furthermore, regional and ultimately continental free trade agreements that are expected to come into force gradually in the coming years will provide a desperately needed boost to intra-regional trade and investment, which have been weak historically. Not only will further regional integration make the continent less vulnerable to a slowing global environment, increased cooperation and trade-creating exchanges should also increase political stability.

Chart 16

GDP growth in major Sub-Saharan African countries, 2016–2020 and 2021–2025

Sub-Saharan Africa is perhaps the global region with the highest long-term potential growth rates.



Source: The Conference Board Global Economic Outlook, 2016

MEDIUM-TERM OUTLOOK

Sub-Saharan Africa is perhaps the global region with the highest long-term potential growth rates, with projected trend growth of 5.2 percent on average in the period 2021–2025—slightly faster than the trend growth of 5 percent in the period 2016–2020. This is mainly for two reasons: Africa has an abundant supply of labor, sometimes referred to as a "demographic dividend"; and there is enormous potential for catch-up, since GDP levels of most of the region's economies are among the lowest in the world. It is however not yet evident that the region will live up to this potential. One of the features of its growth spurt of the last two decades has been the failure to create enough formal private sector jobs—those with output per worker high enough to offer decent wages and a path out of poverty. Instead, most workers end up in the informal services sector, such as household enterprises and small-scale street vendors. This presents a real challenge in the region's pursuit for poverty reduction and sustained economic growth. Nevertheless, most of the fundamentals for a continuation of Africa's current path of economic expansion such as better economic policies, political stability, and a productivity surge in the agricultural sector are still in place—despite slowing demand and falling prices for commodities.

Business Takeaways

- The fall in commodity prices will cause headwinds for most of Sub-Saharan Africa's economies, as they will need to adjust to a paradigm of lower prices and lower demand.
- Nigeria and South Africa, the region's two major economies, both had a difficult year in 2015 mainly due to internal problems not all of which were economic or business related. Overall growth in 2015 came in positive but below expectations with growth rates dropping to 3.0 percent and 1.5 percent for Nigeria and South Africa respectively, down from growth of 5.7 percent and 2.9 percent in the decade leading up to 2015.
- Downside risks to the outlook for Sub-Saharan Africa, such as a slowing Chinese economy and deteriorating global liquidity conditions, are increasing but so are opportunities such as a recovering European economy, the rise of India in the global economy, and the prospects of regional and continental integration through trade and investment agreements.
- The region still has a lot of potential for strong economic expansion in the medium to long run, mainly based on its demographic dividend, and there is ample room for catch-up.

Southeast Asia

Could the Region Surprise on the Upside?

CURRENT SITUATION

Overall, with projected 4.6 percent growth in 2015, the region of Southeast Asia performed only slightly below its long-term trend growth—and in fact slightly improved compared to 4.4 percent in 2014 with a boost from a good recovery in Thailand. But for much of 2015, the region's economies (including among others Malaysia, Indonesia, Thailand, and Singapore) that are mostly small and open and sensitive to the global environment have been challenged by weakening world trade and slowdowns in their domestic manufacturing sectors.[9] The challenges have been exacerbated by China's financial and exchange rate market volatility. Falling energy and commodity prices have also affected some players in the region, although at the same time created space for energy importers in the region to cut costly public fuel subsidies.

SHORT-TERM OUTLOOK

Southeast Asia's regional growth in 2016 is projected to improve marginally to 4.7 percent, on the back of low but more stabilized energy prices and government stimulus programs. However, downside risks remain high. Many economies are highly exposed to slowing global demand for manufacturing products and natural resources. Their direct and indirect dependence on China's economic performance through trade, investment, and tourism has also put the region in a tough position to sustain growth. As well the recent broad-based currency depreciation in the region's large economies has not yet helped its export sector.

Despite concerns that the region may be at risk of repeating the 1997–1998 Asian financial crisis, another full-blown crisis in the near term is unlikely since major regional economies such as Indonesia, Thailand, and Singapore have lower external debt and much larger foreign exchange reserves than in 1997. Malaysia is in a weaker financial position, but the risks still appear manageable. In the short term, Southeast Asia is likely to remain on a moderate growth path. Volatility in equity, capital, and currency markets in the region will likely remain high, and uncertainties concerning the Fed's monetary polies could create greater turmoil in Southeast Asian financial markets.

MEDIUM-TERM OUTLOOK

The regional growth rate is expected to be 4.7 percent on average in the 2016–2020 period, and to slow to 4.2 percent in the 2021–2025 period. The larger and more open regional economies such as Indonesia, Thailand, Malaysia, and Singapore have increasingly become strong forces in the global economy. The smaller and less-developed Southeast Asian nations such as Myanmar, Laos, and Cambodia have been growing in the 7 to 9 percent range, relying on their catch-up potential and driven by greater integration into the global supply chain, increased flow of foreign investment in manufacturing and natural resources (as well as renewable energy projects), and tourism.

Despite relatively resilient economic growth in Southeast Asia, non-transparent governance and vested interests; underinvestment in infrastructure, human capital, and education; and the slow pace of labor market reforms keep the regions' economies from living up to their full growth potential. Workforce skills and investment in R&D and innovation are critical to sustain growth for the most advanced markets in the region, while others still require a focus on infrastructure improvement.

The creation of the ASEAN Economic Community (AEC), which is due by the end of 2015, will support intra-regional free trade in goods and services and greater mobility of capital and labor, even though the effects are expected to only be visible in the longer term. The China-led Asia Infrastructure Investment Bank (AIIB)—which includes all the ASEAN countries—may provide the much-needed infrastructural financing for Southeast Asian economies, particularly for those with lower income.

9 Singapore has the highest trade-to-GDP ratio in the world, and 70 percent of its exports is manufacturing goods—mostly intermediary goods in electronics and chemicals.

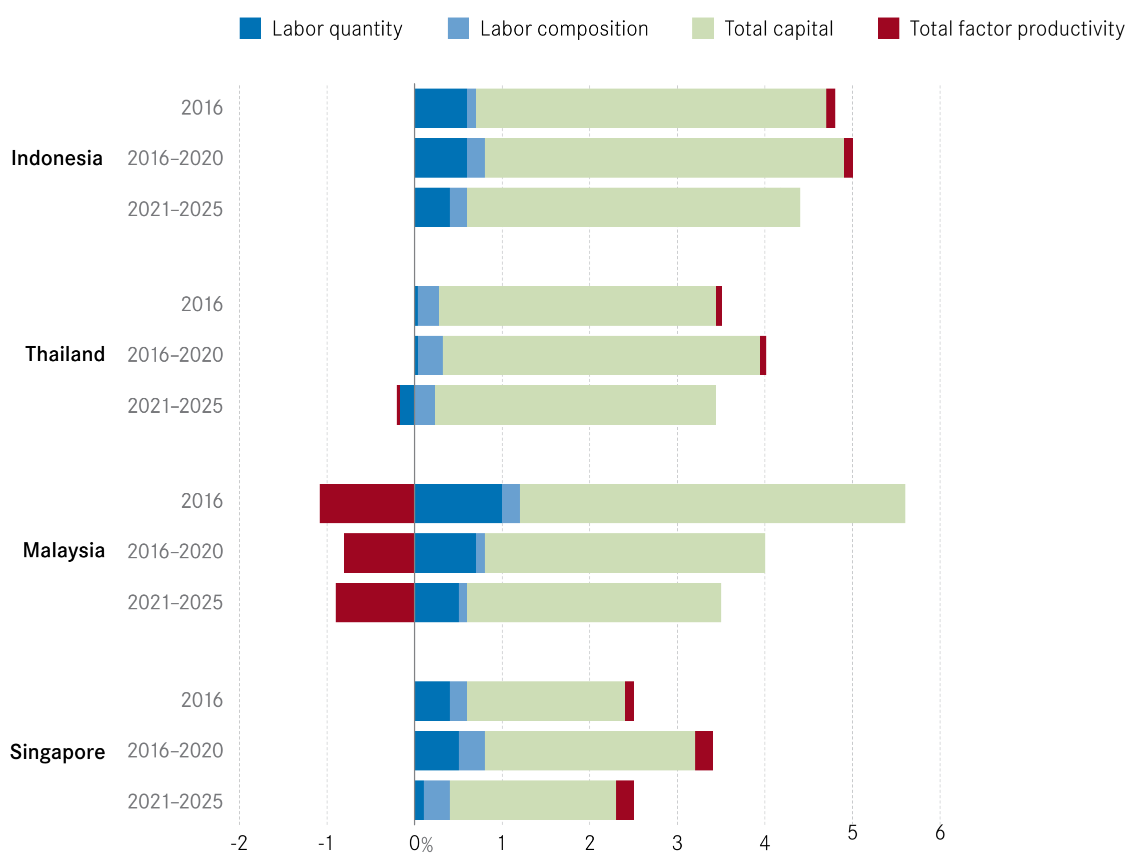
Business Takeaways

- Despite external headwinds and moderating growth, Southeast Asian economies remain strongly competitive and a base for production for the Asian region and beyond.
- At average growth of over 4 percent for the next decade, Southeast Asia will likely see high growth in investment to satisfy infrastructure needs.
- A stronger buildup of a consumer base, supported by the integration of product markets across ASEAN economies, can release substantially larger consumer purchasing power than in the past.

Chart 17

GDP growth in major East Asian countries, 2016, 2016–2020, and 2021–2025

The regions' economies are not living up to their full growth potential.



Source: The Conference Board Global Economic Outlook, 2016

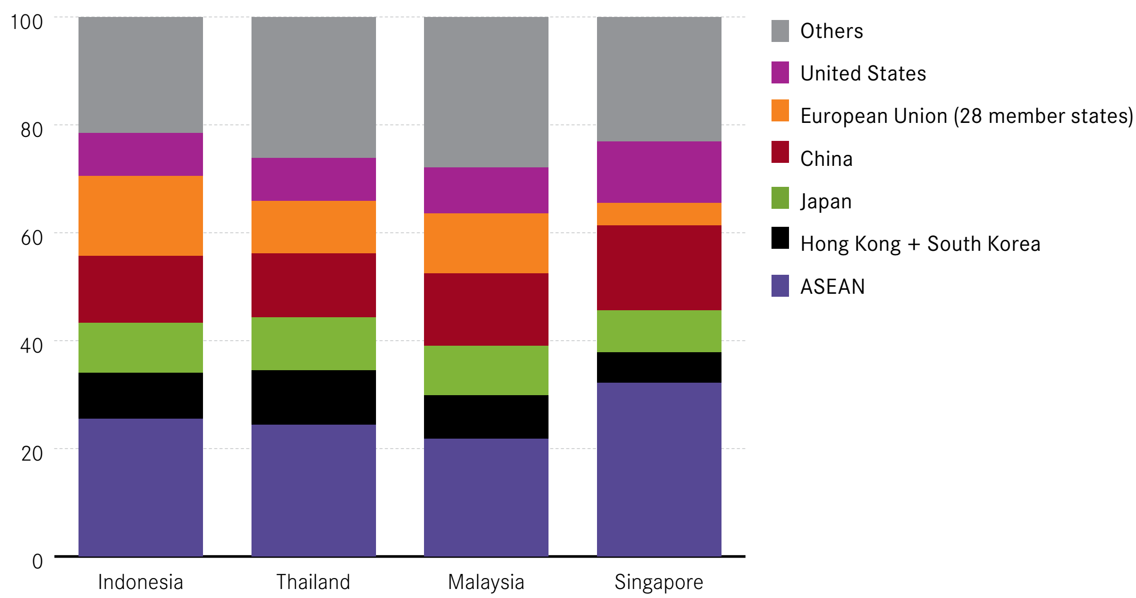
- The establishment and execution of the ASEAN Economic Community (AEC) could further facilitate regional product, consumer, and human capital integration and will likely also improve the region's global manufacturing and export competitiveness.

- To continue advancing in the global value chain, a stronger drive toward more innovation, more deep-seated reforms in the labor market, and investment in upskilling of the labor force will be key for the Southeast Asian economies to sustain growth into the 2020s.

Chart 18

Percent share of total merchandise exports, by country, 2014

Many economies are highly exposed to slowing global demand for manufacturing products and natural resources.



Note: The European Union comprises 28 member states, a list of which can be found here: http://europa.eu/about-eu/countries/member-countries/

Sources: World Trade Organization, September 2014; Haver Analytics

Gulf Cooperation Council

GDP Growth Will Slow amid Negative Productivity Growth

CURRENT SITUATION

Gulf Cooperation Council (GCC) economies as a whole are expected to see GDP growth slow to 3.9 percent in 2015 from an average annual growth rate of 4.6 percent in the 2008–2015 period (Chart 20).[10] The GDP growth rate of the largest GCC economy, Saudi Arabia, is expected to be around 4.1 percent in 2015 after average annual growth of 5.4 percent in the 2008–2015 period. Rising economic diversification and global integration of these economies could have raised their resiliency, but slowing globalization trends and the recent drop in oil prices are introducing additional volatility and complexity into the outlook.

SHORT-TERM OUTLOOK

In the near term the slowdown in GCC economies is expected to continue with the potential for large swings in economic activity around a slowing trend as a result of volatility in oil prices and slowing growth in emerging markets. GCC is projected to grow 3 to 4 percent in 2016, albeit with increasing downside risks.

Because the GCC economies (led by Saudi Arabia) have maintained oil production at roughly pre-price-decline levels, low oil prices put growth in government revenues and spending at risk. In most GCC economies, the private sector is dependent on public sector spending. A reduced public spending budget will have implications on the private sector and its leverage to increase the diversification of the region's economies as well as to drive productivity growth.

Some GCC countries are also increasing military spending because of involvement in regional conflicts, which could divert resources away from other public and private sector endeavors and put more pressure on public finances. Debt downgrades are a real possibility for the region's economies—such as Kuwait, Oman, and Bahrain—as even Saudi Arabia has started borrowing in global markets for the first time in almost a decade.[11]

MEDIUM-TERM OUTLOOK

Economic growth is projected to be 1.7 percent in the 2016–2020 period and fall to 1.5 percent in the period 2021–2025. Globally, oversupply in oil production, combined with a slower rate of growth in energy demand, is likely to continue in the medium term—and the longer term impact remains uncertain. The emergence of US self-sufficiency in shale oil and gas and the return of Iran to supplying oil globally compounds the difficulties of the region's economies. Competition by Middle East exporters for Asian markets will intensify even while emerging markets, especially China, are slowing.

Iran's economic reemergence on the regional and global stage could mean that investment flows will be diverted away from the region to upgrade Iran's oil infrastructure in the near term. On the other hand, this could create potential for the regional economies, especially in the consumer sectors, if the region becomes a conduit for trade and investment. Although geopolitical or cultural factors could create obstacles, GCC companies could invest in Iran indirectly via other global companies or they could merge or acquire companies outside of the region that invest in Iran.

10 The Gulf Cooperation Council is made up of Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Bahrain, and Oman.

11 Clifford Krauss and Rick Gladstone, "From Venezuela to Iraq to Russia, Oil Price Drops Raise Fears of Unrest," *The New York Times*, August 24, 2015.

Growth continues to be largely investment driven, with low or negative productivity growth and a shrinking labor supply. Without a big push in education to raise the skill level of the workforce, there is little potential for labor productivity to offset this slowdown. A potential increase in women's labor force participation and participation in civic life could have far-reaching effects and impact economic growth and development positively. While there have been positive signs of increased female participation in labor markets, overcoming societal and religious traditions is a highly difficult challenge, one that will likely take decades.

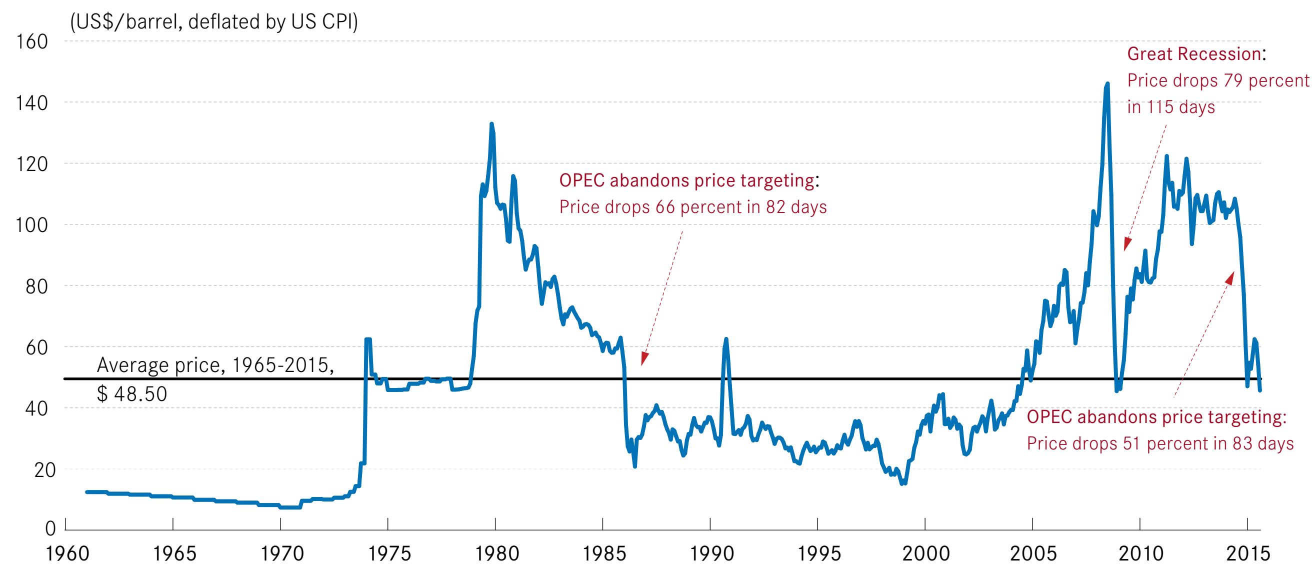
Business Takeaways

- There are significant near-term downside risks in the modest outlook for the region due to persistent volatility and weakness in commodity prices, combined with structural weaknesses.
- Risks from debt downgrades could affect GCC economies that are heavily reliant on government revenues and public sector spending, as well as trigger capital outflows and interest rate hikes.
- Domestically, investment opportunities, including construction and manufacturing, could potentially come from emerging markets foreign direct investment (FDI) inflows (i.e., Chinese investment in the region).
- Challenges including the quality of the workforce, talent shortages, and a reliance on ex-pat labor supply will remain for domestic as well as foreign firms operating in the region.
- Sustainable growth performance in the region also depends on improving productivity through investment in technology and innovation, including attracting foreign investment.
- Despite efforts to diversify these economies, moving industrial activity higher in the global value chain and creating a more balanced economy remain a challenge.

Chart 19

Monthly oil prices in US dollars, 1960–2015

The oil price decline since 2014 has been the third largest in history.



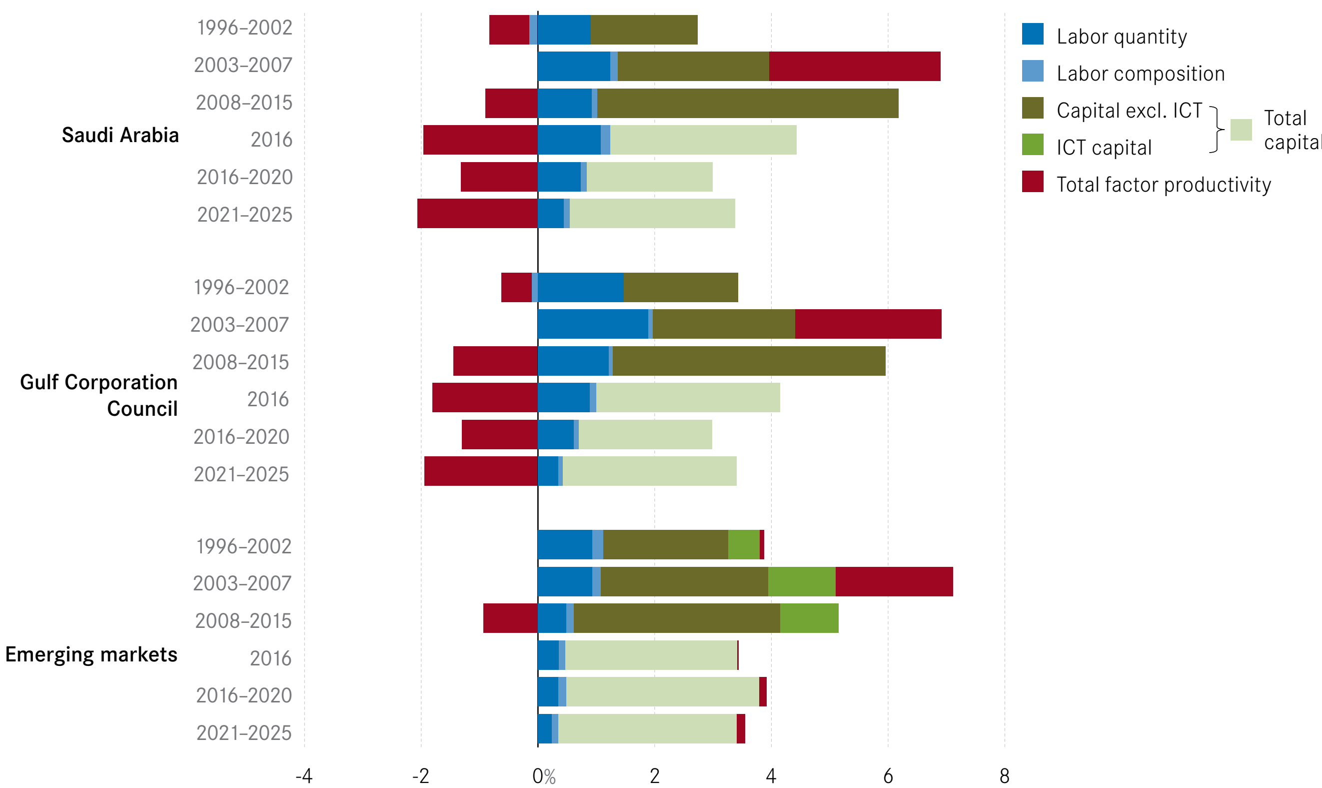
Note: Last observation is August 2015.

Source: World Bank

Chart 20

Contributions of changes in labor, capital, and total factor productivity to GDP growth, 1996–2025

The slow growth outlook for investment leads to a slow economic growth outlook with few upsides in the region amid dismal productivity growth.



Note: There is no ICT capital data available for Saudi Arabia or the GCC. For emerging markets, total capital is the sum of ICT and non-ICT for years up until 2016. For future bars only the total capital value is shown.

Sources: The Conference Board Total Economy Database™, May 2015 and The Conference Board Global Economic Outlook, 2016

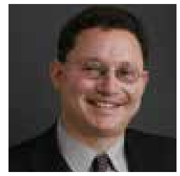
About the Authors

Bart van Ark is executive vice president, chief economist, and chief strategy officer of The Conference Board. He leads a team of almost two dozen economists in New York, Brussels, and Beijing who produce a range of widely watched economic indicators and growth forecasts and in-depth global economic research. A Dutch national, he is the first non-US chief economist in the history of The Conference Board.

Van Ark is also responsible for strategy development and major new initiatives at The Conference Board. Van Ark continues to steward the longstanding research collaboration of The Conference Board with the University of Groningen in the Netherlands, where he has been a professor since 2000 and holds the university's chair in economic development, technological change, and growth.

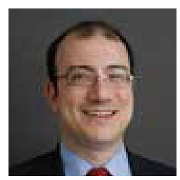
Abdul Azeez Erumban is a senior economist at The Conference Board. He is responsible for developing and managing research projects on productivity and long-term economic projections. His research centers on the fields of productivity, technological change, globalization, international comparisons of economic development, and structural change. He has extensive experience in data construction, analysis, research, and policy analysis. In particular, he has worked extensively on the measurement and analysis of productivity, with a special focus on different aspects of measuring capital for productivity analysis. He has been actively participating in the KLEMS initiatives (EU KLEMS, Asia KLEMS, and World KLEMS), which seeks to understand productivity dynamics in the world's major economies. Erumban received his master's degree in applied economics from Centre for Development Studies, Trivandrum, India, and his PhD in economics from the University of Groningen, the Netherlands.

Before joining The Conference Board, he worked as an assistant professor in economics at the Faculty of Economics and Business of the University of Groningen, where he taught international economics, statistics, and research methods.



Gad Levanon is managing director, economic outlook and labor markets at The Conference Board. His research focuses on trends in US and global labor markets, consumer trends, and forecasting using economic indicators. He also serves on The Demand Institute™ leadership team. Levanon created The Conference Board Employment Trends Index™, a widely used measure that fills the need for a leading index of employment. He is the principal writer of The Conference Board Labor Markets in Review™, a quarterly publication that documents the main trends in labor markets across the globe, and writes a popular blog on labor markets for Human Capital Exchange™. In addition to writing reports for The Conference Board, he has published extensively in academic and professional journals.

Before coming to The Conference Board, Levanon worked at the Israeli Central Bank where he participated in the analysis of financial markets and monetary policy. Levanon received his PhD in economics from Princeton University, and he holds undergraduate and master's degrees from Tel Aviv University in Israel.



Ataman Ozyildirim is an economist and director of business cycles and growth research at The Conference Board. He joined The Conference Board in 1999 as part of the Global Business Cycle Indicators Program that produces The Conference Board Leading Economic Index® (LEI) for the United States, the Euro Area, China, and 10 other countries. In addition to leading The Conference Board research program on business cycles and developing business cycle indexes for emerging economies, he also manages the research program in productivity, innovation, and competitiveness as well as on the annual Global Economic Outlook.

Before coming to The Conference Board, Ozyildirim worked for Management Science Associates, Inc. in Pittsburgh and served as a lecturer at Pennsylvania State University. A native of Istanbul, he received his BA in economics from Ithaca College and his PhD in economics from Pennsylvania State University.

Andrew Polk is the resident economist at The Conference Board China Center for Economics and Business in Beijing. Previously, Polk worked at the Institute of International Finance, where he conducted macroeconomic analysis on emerging markets in the Asia/Pacific region. His research focus has included monetary policy, capital flows, and financial market development throughout East and Southeast Asia, with a particular emphasis on China. He has also conducted growth and inflation forecasting and country risk analysis for the region.

Polk has held research positions at the East Asia Desk of the US Treasury Department, the Woodrow Wilson International Center for Scholars, and Foreign Policy magazine. He earned his BA in American studies and communication at Texas A&M University and holds an MA with distinction in economics and China studies from the Johns Hopkins School of Advanced International Studies.

Jing Sima-Friedman is a senior economist at The Conference Board. She joined The Conference Board in 2000 and has since been working in the US and Global Business Cycle Indicators Program. She leads research projects on macroeconomics in emerging markets, with a focus on structural changes, monetary policy, capital and financial market developments, and trade flows as well as systemic risks. She also produces and regularly appears on The Conference Board Economics Watch® – Emerging Markets View, which focuses on the measurement of emerging economies and helps business leaders understand risks as well as identify opportunities in emerging markets.

In addition, Sima also leads research analysis and produces The Conference Board Leading Economic Index for major emerging economies including China, Brazil, India, and Mexico. Sima received her MBA in finance and investment from Baruch College, CUNY, and her BA in economics from the Capital University of Economics and Business in Beijing.

Klaas de Vries is a research analyst at The Conference Board Europe. He works with the productivity and growth research team and manages various database updates and enhancements. De Vries updates the Total Economy Database, Global Economic Outlook, and the International Labor Comparisons Program. In addition, he co-authors the European Economic Highlights of the Week.

De Vries studied history at the University of Groningen and has published a book on a nineteenth-century Dutch national initiative to reduce poverty through land grants in newly formed villages. He received a second Master's degree when he completed his teaching qualifications. After doing research as a student assistant at the University of Groningen Growth and Development Center, he started working as a full-time research assistant tasked with constructing a long-term dataset on African countries for the purpose of productivity analysis.

Authors' Note:

Quarterly updates of The Conference Board Global Economic Outlook, are forthcoming in 2016, each focusing on unique topics:

The quarterly update in February 2016 will be accompanied by a special report featuring a thorough analysis of corporate profits in an era of slow global growth.

The update in May 2016 will be accompanied by a special report featuring a more thorough analysis of Sub-Saharan Africa's growth prospects.

The update in September 2016 will be accompanied by a special report featuring a thorough analysis of the performance of China's industrial sectors.

About the Total Economy Database™

The Total Economy Database (TED) is a comprehensive database with annual data covering GDP, population, employment, hours, labor quality, capital services, labor productivity, and total factor productivity for about 123 countries.

TED was developed by the Groningen Growth and Development Centre (University of Groningen, The Netherlands) in the early 1990s, and starting in the late 1990s, it was produced in partnership with The Conference Board. As of 2007, the database was transferred from the University of Groningen to The Conference Board, which has maintained and expanded the database since then. In January 2010, the database was extended with a module on sources of growth, including labor quantity and quality, capital services (non-ICT and ICT), and total factor productivity. The module aims to integrate two previous data sets: the world economy productivity data set created by Dale Jorgenson and Khuong Vu of Harvard University and the Total Economy Growth Accounting Database of the Groningen Growth and Development Centre.

TED is published every year in January, providing preliminary estimates for the previous year and projections for the current year. The main results are published in The Conference Board annual Productivity Brief. The series in the database are also used by the International Labor Office for their Key Indicators of the Labor Market (Chapter 17), and by the Department of Commerce in the Statistical Abstract of the United States. TED includes data for 123 countries from 1950 onwards, consisting of the following series:

- Real gross domestic product
- Population
- Employment
- Annual working hours
- GDP per capita
- GDP per person employed
- GDP per hour worked
- Labor compensation share
- Change in labor composition
- Growth in non-ICT capital services
- Growth in ICT capital services
- Growth in total factor productivity

These countries represent about 97 percent of the world population and, as smaller and poorer countries in particular are not yet included in the database, the sample represents an even larger share of world GDP (99 percent).

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BART VAN ARK Executive Vice President, Chief Economist, and Chief Strategy Officer
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ABDUL ERUMBAN Senior Economist, focusing on productivity and long-term economic projections
Twitter: @eabdul75

GAD LEVANON Managing Director, Economic Outlook and Labor Markets
Twitter: @GadLevanon

ATAMAN OZYILDIRIM Director, Business Cycles and Growth Research
Twitter: @aotcb

ANDREW POLK Senior Economist, The Conference Board China Center for Economics and Business
Twitter: @andrewpolk81

JING SIMA-FRIEDMAN Senior Economist, focusing on emerging markets

KLAAS DE VRIES Research Analyst, The Conference Board Europe

JANET HAO Senior Economist, The Conference Board China Center for Economics and Business

ERIC HAYEK Research Analyst, The Conference Board International Labor Comparisons program
Twitter: @ephayek

HARRY WU Senior Advisor to The Conference Board China Center for Economics and Business

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Publications Team

Senior Editor **Megan M. Hard**
Managing Editor, Publishing Service **Marta Rodin**
Director, Publishing Service **Peter Drubin**
Publishing Systems Developer **Kathleen Mercandetti**
Production **Pam Seenaraine**

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THE CONFERENCE BOARD, INC.

AMERICAS
+ 1 212 759 0900
customer.service@conferenceboard.org

ASIA
+ 65 6325 3121
service.ap@conferenceboard.org

EUROPE/AFRICA/MIDDLE EAST
+ 32 2 675 54 05
brussels@conferenceboard.org

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