

## Global Economic Outlook 2015–2020



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### Executive Summary

- The global economy is finally stabilizing following the global financial crisis and Great Recession. Our base-case outlook for average annual real growth between 2015 and 2020 is between 3 and 4 percent.
- Lower global commodity prices are an important factor supporting stronger economic growth. Although economies that are dependent on commodity exports may suffer, lower input prices for industry as well as lower fuel prices for households will provide a boost to aggregate demand and global growth.
- We expect emerging economies to continue to grow by more than 4 percent (contributing \$16.2 trillion to global growth through 2020 at market exchange rates), while the growth rate of advanced economies is forecast to exceed 2 percent (contributing \$13.5 trillion through 2020) for the first time since 2010. The United States is leading the recovery among advanced markets, and we expect the country to be a significant contributor to global growth through 2020.
- However, we anticipate economic performance to continue to diverge within both the emerging and developed market groupings based on key policy choices, as governments grapple with structural reforms in the context of reduced fiscal and monetary stimulus. In this regard, strong leadership and bold government actions will determine whether national economies can escape from the new mediocre of stable but low growth.
- We expect the next wave of global growth to come from seven emerging markets, which we call the 2020–Seven: China, Malaysia, Chile, Poland, Peru, Mexico, and the Philippines. In addition, a variety of strong-performing and high-potential Sub-Saharan Africa markets will begin to contribute more to the global economy.
- Despite this benign base-case medium-term global outlook, several significant risks—economic, political, and environmental—could derail sustained global economic growth. Among them are deflation in developed markets, a hard landing in China, extreme weather, and geopolitical flare-ups. There are also a couple of positive wildcards that could boost growth prospects: an unanticipated economic recovery in Europe and increased agricultural production leading to lower global food prices.

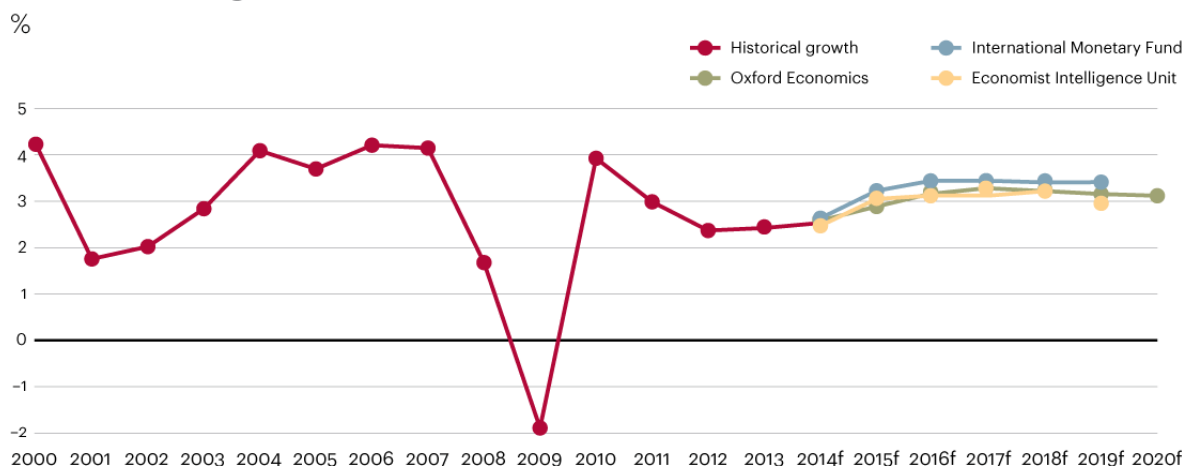
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### Growth with Divergence in the "New Mediocre"

The global economy is finally transitioning from the Great Recession to a period of more stable growth, but there are still pockets of weakness, as well as new risks. As International Monetary Fund (IMF) Managing Director Christine Lagarde described it in October 2014, the global economy is in a "new mediocre" phase in which economies are muddling through with sub-par growth rates. Between 2015 and 2020, we anticipate a return to annual global growth of about 3 to 4 percent (see figure 1).<sup>1</sup> Although this is a higher sustained growth rate than the global economy has enjoyed in many years, it still does not represent a robust recovery from the lost output during the 2008–2013 period. This outlook also includes both bright spots and stagnant markets. Importantly, the United States is returning

to sustainable growth. However, Europe has yet to fully address the core sources of its ongoing financial and economic fragility, and Japan's economic recovery will be determined by whether the government undertakes structural reforms in 2015, a highly uncertain prospect given domestic political constraints. Emerging markets are experiencing a slowdown driven by near-term cyclical and long-term structural factors, but many of them are still growing relatively quickly. There is a shift in the drivers of emerging market growth away from most of the BRICS—Brazil, Russia, India, China, and South Africa—and toward the next wave of emerging growth economies.

Figure 1

**Global growth is expected to stabilize****Real annual GDP growth rate**

Note: Historical growth is an unweighted average of the three sources' GDP data at constant prices and market exchange rates.

Sources: Oxford Economics, International Monetary Fund World Economic Outlook (October 2014), Economist Intelligence Unit; A.T. Kearney analysis

An important global economic development is the apparent reversal of the resource super-cycle that dominated commodity markets in the 2000s. Most notably, the price for a barrel of oil fell from its peak of \$133 in July 2008 to just \$86 in October 2014 and continued to fall through the end of the year.<sup>2</sup> The IMF predicts that global oil prices will remain below \$100 per barrel until at least 2020. This fall in global oil and other commodity prices should provide a boost to global growth as consumers will have more spending power, and thus aggregate demand should increase. In addition, lower commodity input prices for a variety of manufacturing and agricultural producers will also boost growth in those industries. While such trends are largely positive for commodity importers—including the eurozone, Japan, and many emerging markets—they have negative fiscal and growth implications for key commodity exporters—including Russia, Venezuela, Iran, several South American economies, and some Sub-Saharan African economies.

This divergence in the effects of the commodity price drop indicates that although the global economy is returning to a period of stronger growth, identifying specific opportunities will be more difficult than in the previous decade. Through 2020, neither subset of economies—advanced nor emerging—will be as monolithic as in the recent past. As macro-level fiscal and monetary supports recede, growth will be differentiated by the substance of national-level structural reforms and the quality of policy decisions. As such, the quality of government leadership in key markets around the world will be crucial to determining which economies will escape the new mediocre.

Further complicating the global economic outlook is the fact that the drivers of global economic growth are shifting again as the world enters a new era after a decade of instability (see figure 2). In the Great Bubble from 2003 to 2007, advanced economies powered global growth while the emerging economies

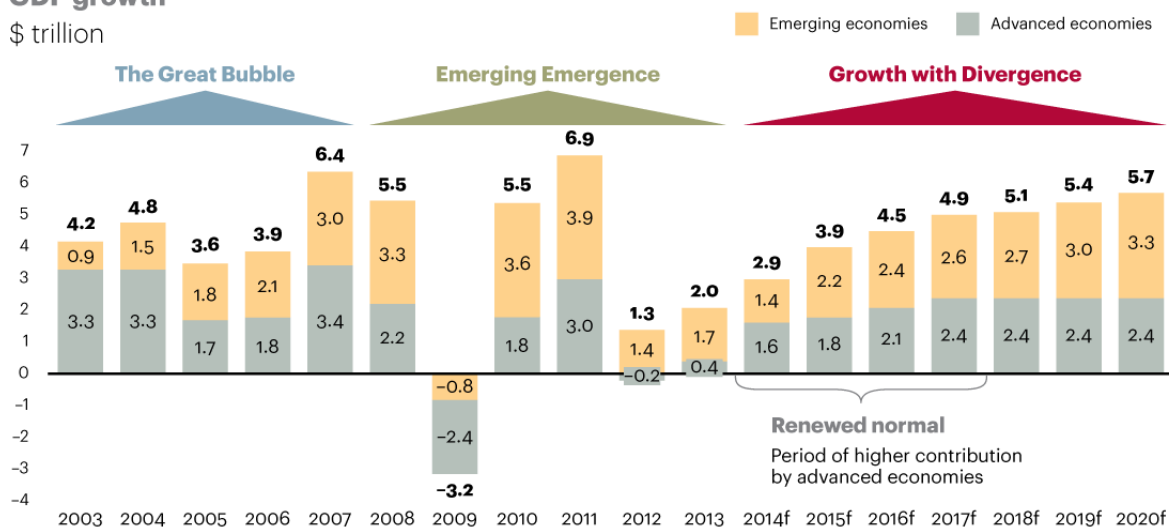
also grew strongly. This growth was fueled partly by a massive asset bubble in the United States and parts of Europe, and as a result, global imbalances between creditor and indebted nations grew to unsustainable levels. The excesses and imbalances of the Great Bubble led to the global financial crisis of 2008–2009 and a new global growth model, Emerging Emergence, which lasted until 2013. During this period, emerging markets decoupled and continued to grow without support from advanced economies. Emerging markets drove the global economy as the advanced economies shrank or stagnated. Global growth was supported in part by unsustainable fiscal stimulus in China and elsewhere and by the U.S. Federal Reserve's unprecedented monetary easing. As of 2014, we entered a new phase: Growth with Divergence. Across many advanced economies, growth rates are stabilizing in positive territory, while emerging market growth rates are slowing to lower levels than those they enjoyed in the previous decades. Advanced economies—led by the United States—will begin to match emerging markets in absolute contribution to global GDP. But in all economies, success will be more tied to structural reforms that unlock underlying growth potential. This marks a return to reality in which country-level fundamentals and policy choices will increasingly trump macro-level trends.

Figure 2

### Advanced economies will contribute more to world economic growth

#### GDP growth

\$ trillion



Notes: GDP is based on current U.S. dollars at market exchange rates. Numbers may not resolve because of rounding.

Sources: International Monetary Fund World Economic Outlook October 2014; A.T. Kearney analysis

### The future of globalization

As a result of higher global economic growth, international flows of goods and capital will likely surpass their pre-Great Recession levels by 2020. But while globalization—the international movement of goods, capital, people, and ideas—continues to advance, its composition may be entering a new phase.

People continue to move across borders at a faster rate. The share of the global population living outside of their native country has risen from 2.8 percent in 2000 to 3.2 percent in 2013—an increase of 57 million migrants.<sup>3</sup> In addition, international tourism has climbed from only 12.8 percent of the global population in 2000 to 16.2 percent in 2012.<sup>4</sup> At the same time, information flows have become more global as a result of advances in communications technology and more widespread access to that technology. Global Internet use has increased from just 6.8 per 100 people in 2000 to 38.1 people in 2013, while mobile cellular subscriptions have similarly increased from only 12.1 to 92.6 per 100 people over the same period.

However, international trade and capital flows suffered as a result of the global economic crisis and have yet to return to their precrisis trends, which may indicate a new normal in terms of the economic factors of globalization. Global FDI flows still remain below the \$2.5 trillion peak they reached in 2007, according to EIU estimates, but are forecast to grow from about \$2.1 trillion in 2014 to about \$2.6 trillion in 2018.<sup>5</sup> This aligns with the findings of the 2014 A.T. Kearney Foreign Direct Investment Confidence Index® that global business executives are more optimistic about the global economy than they were in 2013. As a share of the global economy, though, annual FDI flows have steadily fallen from their peak of 4.4 percent of GDP in 2007 to just 2.7 percent in 2014—a level that is forecast to hold fairly steady in the coming years.

International trade flows, on the other hand, surpassed their precrisis peak in 2011, but are now growing more slowly than many economists had predicted. The World Trade Organization (WTO) recently reduced its 2014 global trade growth forecast from 4.7 percent to 3.1 percent because of weaker-than-expected GDP growth and rising geopolitical risks and expects 4 percent growth in 2015—far below the 20-year average of 5.2 percent annual growth.<sup>6</sup> Some economists are even arguing that international trade will not be as significant of a contributor to global growth as it has been in the past.

Short-term reasons for slower economic globalization include lower-than-expected global economic growth, geopolitical tensions, and the lack of progress in multilateral trade liberalization. In the case of the latter, the two large regional trade agreements currently under negotiation—the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP)—could be crucial to unlocking further growth in global trade. However, there may also be structural reasons for reduced trade and FDI flows, such as the moderation of the decades-long trend in expanding global value chains and the geographic fragmentation of production processes. For instance, a recent report released by the IMF and the World Bank argues that global trade growth may have reached its peak because of structural shifts in the international production system.<sup>7</sup> Such a shift may be the result of additive manufacturing technologies, including 3D printing, which make it cheaper to produce goods closer to end markets. In addition, as large emerging markets such as China develop greater domestic production capabilities, their role in the global supply chain may decrease. While these structural changes do not represent a deliberate retreat from globalization, they may nevertheless change the nature of the global economy in profound ways.

### Key country trajectories

In the **United States**, the economic outlook is stronger than it has been in years, bolstered by financial sector stability, private sector growth, and rising demand. Despite some lingering signs of weakness, U.S. economic stability has increased thanks to stronger financial markets increasing the provision of credit, the wealth effect from greater stability in the housing market, and improved worker mobility. Private sector activity is also much stronger as companies increase their level of fixed investment and begin to employ more workers. Private sector employment surpassed its precrisis peak of about 116 million for the first time in March 2014 and continues to grow steadily, reaching almost 118 million jobs in October 2014.<sup>8</sup> Aggregate demand is rising as a result of both these stronger employment numbers and the steady repair of household balance sheets as debts accumulated before the global financial crisis have been paid off. The reduced level of federal government fiscal consolidation and greater fiscal policy stability is also giving U.S. economic growth a boost. Finally, the shale energy revolution has played a central role in jump-starting the economic recovery. Domestic oil production leapt 44 percent between 2008 and 2013.<sup>9</sup> This increased U.S. oil and gas production has positive ramifications throughout the economy by reducing the cost of domestic energy (and thus improving the

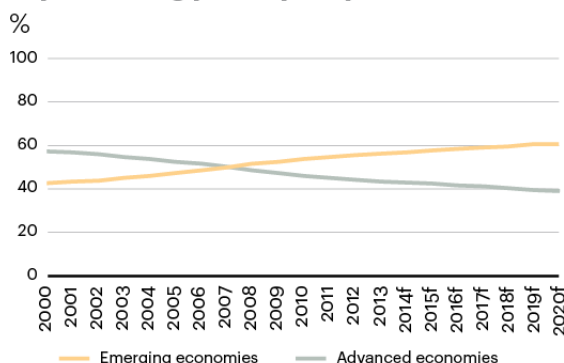
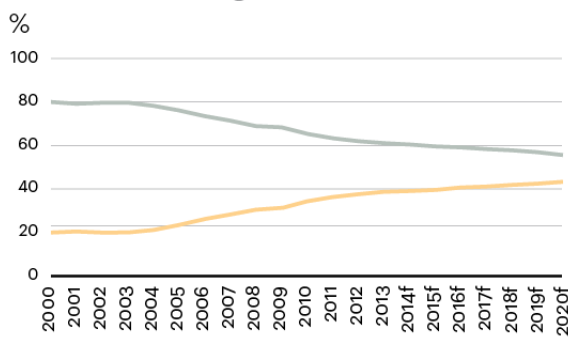
competitiveness of U.S. firms) and by generating new opportunities and employment in petrochemical processing industries. Firms around the world are taking notice of this renewed U.S. economic vitality, with the United States earning the top spot in the 2014 A.T. Kearney Foreign Direct Investment Confidence Index® for the second year in a row.

The **eurozone**, on the other hand, still has a weak growth outlook. According to Economist Intelligence Unit (EIU) forecasts, the eurozone grew only 0.8 percent in 2014, after two years of mild contraction, and will rise to 1.1 percent growth in 2015.<sup>10</sup> Recent currency depreciation could help counteract competitiveness problems, but persistently low inflation and mild deflation are problematic for the bloc's economic recovery. Additional expansionary monetary policies undertaken by the European Central Bank (ECB), such as the plan to re-expand the ECB's balance sheet to €1 trillion through additional purchases of covered bonds, will only be able to help price stability and stimulate economic activity if they are aggressive enough to counteract expectations about falling prices. Eurozone periphery countries such as Spain and Greece have implemented a variety of structural reforms since the crisis and falling wage levels have improved their intra-eurozone competitiveness, but a significant degree of popular dissatisfaction remains with how governments have responded to the crisis, and the risk of a renewed challenge to the eurozone persists. In addition, key pan-European and national reforms still need to be enacted for the bloc to achieve long-term economic resiliency. Fiscal stimulus measures could also provide a boost to growth throughout the continent—particularly infrastructure investment and other measures that would enhance long-term growth prospects. If European political leaders have the willingness and ability to undertake these reforms and stimulus measures, then there is substantial potential upside in the eurozone growth outlook. If not, weak growth or stagnation is likely to continue.

In **Japan**, the Abenomics economic reform agenda had shown signs of traction, but the economy unexpectedly fell into a recession in the third quarter of 2014, shrinking 1.9 percent at an annualized rate, driven primarily by the April sales tax hike.<sup>11</sup> After years of very low inflation and deflation, Japanese inflation was forecast to remain above the 2 percent target for 2014, but it is estimated to fall short of it in 2015 at 1.8 percent.<sup>12</sup> While the first two arrows of Abenomics—expansionary monetary and fiscal policies—initially showed signs of success, these recent setbacks have left economists wary of the ambitious economic plan. The third arrow of structural reforms is still necessary to boost Japan's economic prospects. Prime Minister Shinzo Abe has proposed a set of such reforms—including corporate governance, the promotion of entrepreneurship, and deregulation in National Strategic Special Zones—but political resistance to them must still be overcome. Abe sought to boost his political capital by holding a snap election in mid-December, which gave his coalition an even greater legislative majority and the popular mandate to pursue reforms. Whether he can convince his political allies to undertake these difficult structural reforms remains to be seen.

Across **emerging markets**, growth through 2020 will be lower and more divergent than in the Emerging Emergence period. In the Growth with Divergence period, GDP growth in emerging economies is projected to drop slightly, but to still remain above 4 percent per year through 2020. This slowdown is primarily driven by China, where the EIU forecasts that growth will moderate from an average of 9 percent annually in 2008–2013 to somewhat more than 6 percent through 2020. Even with the slowdown in China, the highest regional growth rates through 2020 will be in East and South Asia, followed by Sub-Saharan Africa. Although growth will slow in emerging markets, it is important to note that their growth outlook still outpaces that of advanced economies, so emerging markets will continue to increase as a share of the global economy (see figure 3). As more emerging markets achieve middle-income status, their global economic and political clout will rise accordingly.

Figure 3

**Emerging markets are more prominent in the global economy****Share of global GDP  
at purchasing power parity****Share of global GDP  
at market exchange rates**

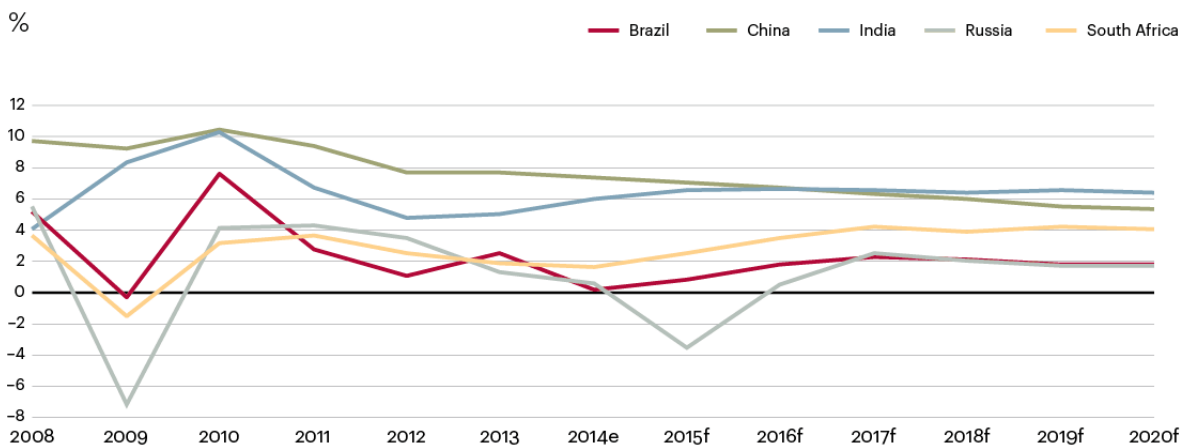
Note: Numbers may not resolve because of rounding.

Sources: International Monetary Fund World Economic Outlook October 2014; A.T. Kearney analysis

China will continue to lead the BRICS in economic growth rates through 2016, but India could pull ahead of the pack closer to 2020 (see figure 4). However, all of the BRICS economies will increasingly face significant cyclical and structural constraints to growth. China's constraints are primarily structural because of an economy that is imbalanced both domestically and internationally. A crucial medium-term uncertainty is China's ability to reduce its reliance on investment for growth and achieve the soft landing it seeks by rebalancing its economy toward consumer-driven growth. India faces both cyclical and structural constraints. Its economy was hit hard by the U.S. Federal Reserve's tapering talk in 2013, as growth slowed, inflation rose, and the currency depreciated. At the same time, India's economy has structural inefficiencies because of protectionist policies and poor infrastructure. However, India's economic growth could be unleashed by Prime Minister Narendra Modi's proposed reform agenda. Cyclical forces associated with lower oil prices and geopolitical tensions are damaging Russia's economic prospects in the near term. Russia also has several structural weaknesses, including an aging population, politicized enforcement of business regulations, and an overreliance on the oil and gas sector. Brazil has similarly been hurt by the cyclical factor of falling commodity prices. Its decline in economic growth—from an average of 3.1 percent in 2008–2013 to just 2.0 percent expected in 2014–2020—has been exacerbated by structural factors, including poor infrastructure and burdensome business and taxation regulations. The cyclical factors affecting South Africa are both positive—as a base of operations and investment for the "rising Africa" trend—and negative—as commodity prices fall. In addition, South Africa's burdensome regulatory environment and personal security issues are often pointed to as structural impediments to higher growth.



Figure 4

**China still leads the BRICS in economic growth, but India could pull ahead****Real annual GDP growth rate**

Note: BRICS is Brazil, Russia, India, China, and South Africa.

Sources: Economist Intelligence Unit; A.T. Kearney analysis

All of these challenges demonstrate the growing extent to which government actions and policy choices will determine the economic trajectories of the BRICS. In fact, structural reforms will be essential in determining the growth outlook for a broader set of both advanced and emerging economies. Advanced economies face the challenge of enacting policies that address underlying competitiveness issues including long-term debt, education, innovation, inequality, aging, and unresolved institutional weakness—particularly in the eurozone. Many emerging markets continue to be under near-term stress from the end of the U.S. Federal Reserve's quantitative easing program, the structural limits of their growth models, or both. Emerging-market governments must begin to implement reforms in labor markets, rules governing foreign direct investment (FDI), education, infrastructure, and other areas to attract both domestic and foreign investment and drive more balanced consumption-driven growth.

## The Next Wave of Growth

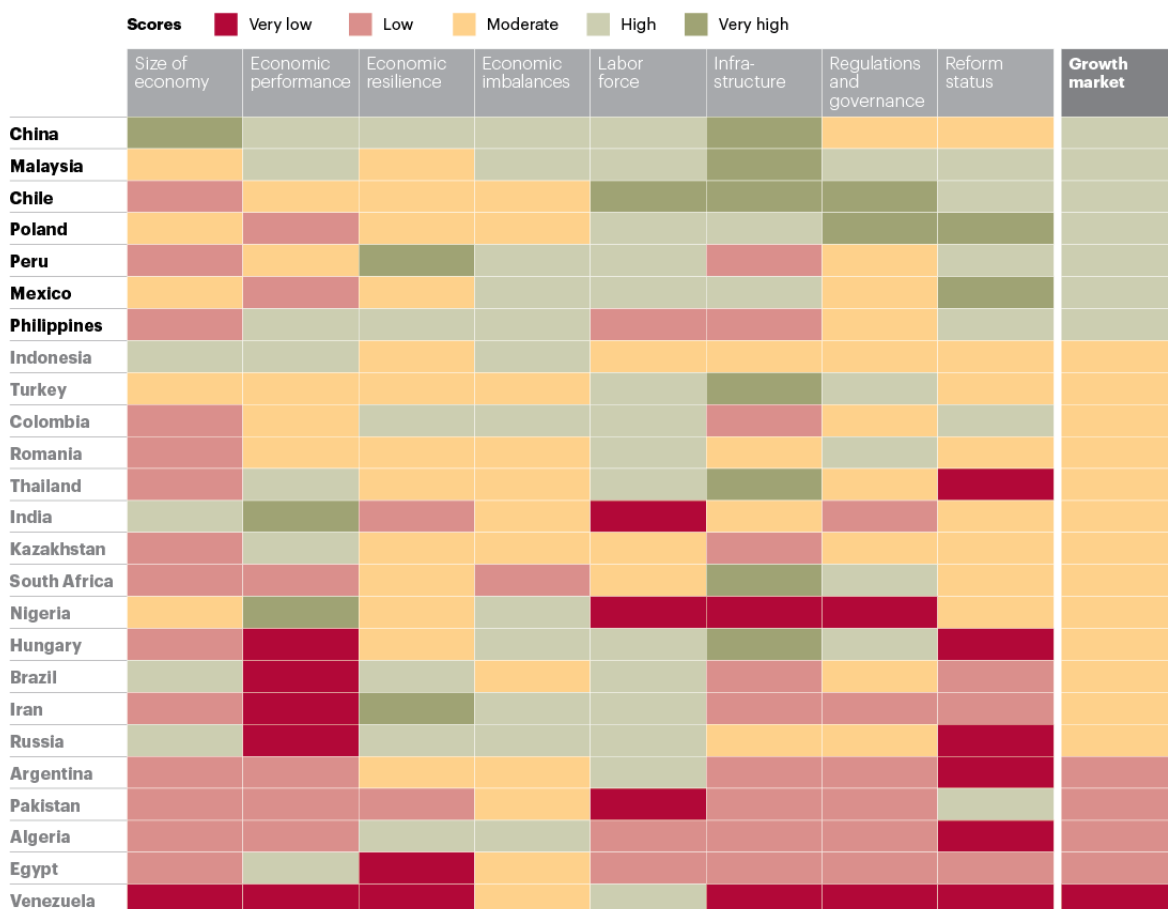
In the new Growth with Divergence phase of global economic performance, it will be important to analyze country-specific economic and policy factors to determine which markets will provide the best growth opportunities for businesses. Recovery in the United States, given its vast size and importance in the global economy, will be a significant source of growth in the coming years. In addition, some emerging markets are poised to outperform their peers and play a greater role in the world economy through 2020. As a result, the next wave of growth will come not only from the U.S. recovery, but also from seven key emerging markets—the 2020–Seven.

### The 2020–Seven

To determine which emerging markets are likely to drive investment opportunities and growth between 2015 and 2020, the A.T. Kearney Global Business Policy Council (GBPC) analyzed the 25 largest emerging markets—as measured by the size of the economy, population, and per capita GDP at purchasing power parity—across eight key factors (see figure 5). This analysis goes beyond simply comparing GDP and related economic forecasts, which have a tendency to be volatile, to include structural factors that position markets to withstand unforeseen economic shocks and foster longer-term economic growth and stability. Half of the factors are economic, including the size of the economy, expected economic performance, economic resilience (arising from the availability of financial

resources), and the risk of economic or financial imbalances. The GBPC also analyzed two policy factors: how regulations and governance affect economic activity and the status of needed structural economic reforms. Finally, the Council analyzed two more factors that are important facilitators of economic growth and business opportunity: the size and quality of the labor force and the quality of the country's infrastructure. From this comprehensive analysis, seven markets emerge as the likely drivers of growth in the next five years. These are the 2020–Seven growth markets.

Figure 5

**The 2020–Seven growth markets**

Sources: Economist Intelligence Unit, International Monetary Fund, World Bank, World Economic Forum, United Nations; A.T. Kearney analysis

Despite the risks associated with rebalancing, **China** remains an important growth market. With 1.4 billion people, China is the most populous country in the world—providing both a large labor force and a huge consumer market. The IMF estimates that China overtook the United States in 2014 as the largest economy in the world in purchasing power parity (PPP) terms.<sup>13</sup> Adding to its consumer market gravitas, China's GDP per capita in PPP terms has risen rapidly in recent years, from \$5,040 in 2005 to \$13,260 in 2014—and the EIU projects that it will rise to \$21,240 in 2020.<sup>14</sup> In addition to its sheer size, China's large infrastructure investments have improved logistics in the country—a competitive advantage over many other emerging markets.

**Malaysia's** business-friendly regulatory environment and relatively high per capita income provide growth opportunities. The economy has recently begun to transition toward being driven by domestic demand, helped along by government policies such as the strengthening of the social safety net. In addition, the population's education level continues to improve, with about 80 percent of the labor force having secondary or tertiary degrees.<sup>15</sup> As a key member of the Association of Southeast Asian Nations



(ASEAN) and the TPP negotiations, Malaysia is a very open economy with trade volumes amounting to 154 percent of GDP in 2013. The country is also well-placed to withstand any global capital markets turmoil thanks to its strong regulatory institutions, flexible exchange rate, and high international reserves level.

**Chile's** strong institutions and liberal economic policies provide a stable macroeconomic environment. Its reforms in the 1980s put the country on a more sustainable economic growth path than many of its peers, and it continues to be very open to foreign investment and trade. Chile is also known for having the most transparent governance and the best rule of law in the region. As the world's largest copper producer, Chile's economy benefited from the commodity boom cycle of the 2000s, and the government has used the windfall revenues to create a rainy-day fund that increases the economy's resilience to the current commodity price downswing—although economic growth is expected to slow somewhat. In addition, President Michelle Bachelet's government reformed taxes to fund a proposed education reform, which aims to improve the quality of the labor force and enhance social stability.

**Poland's** diversified economy, business-friendly regulations, and educated labor force make it a strong growth market. Its proximity to Germany—the economic powerhouse of Europe—and its access to the Baltic Sea provide the country with structural geographic advantages. But policy choices are also an important factor in Poland's economic strength. The government embraced economic liberalization in the early 1990s and has implemented other policies, such as investments in infrastructure and education, which have fostered sustained economic growth. In fact, Poland was the only European Union member to maintain positive economic growth throughout the Great Recession and eurozone crisis, giving it the highest average annual growth rate in the European Union between 2008 and 2013.<sup>16</sup> Poland also ranks highest among its large Central and Eastern European peers on the World Bank's Doing Business indicators.<sup>17</sup>

The economic fortunes of **Peru** appear to be rising following recent structural reforms and continued economic liberalization. Economic growth of late has been driven in part by Peru's endowment of minerals and natural gas, but natural resource rents only account for about 12 percent of the country's output.<sup>18</sup> After decades of populist or authoritarian politics, Peru's government has become part of Latin America's new, more pragmatic left, combining liberalization with social spending. As a result of this orthodox policy mix, the EIU predicts that Peru's productivity growth will average 1.4 percent annually between 2015 and 2020.<sup>19</sup> Peru's membership in the Pacific Alliance and its involvement in TPP negotiations highlight the country's outward-looking policies as well as its higher growth potential once TPP is enacted.

**Mexico** also scored high in our growth markets analysis. The government's ambitious structural reform agenda is unlocking growth and providing new opportunities for investment. Mexico's economy has benefited over the long term from its close proximity to the United States and its oil wealth, but it had lost some of its dynamism in the first decade of this century. President Enrique Peña Nieto's structural reforms—including partial liberalization of the vital oil sector—are reinvigorating Mexico's economy and boosting growth. Partly as a result of these reforms, the EIU predicts that FDI into Mexico will rise from \$26 billion in 2014 to \$50 billion in 2019.<sup>20</sup> Another benefit of Mexico's economic performance is the strengthening of the country's middle class. Mexico's national statistical institute estimates that the middle class grew by about 4 percent from 2000 to 2010, reaching almost 40 percent of the total population, and it continues to expand.<sup>21</sup> However, many middle class Mexicans are growing impatient with the promised payoffs from the structural reforms and instead are demanding that the government focus on security and corruption issues. Peña Nieto will need to address these concerns if his reforms

are to realize their full economic potential.

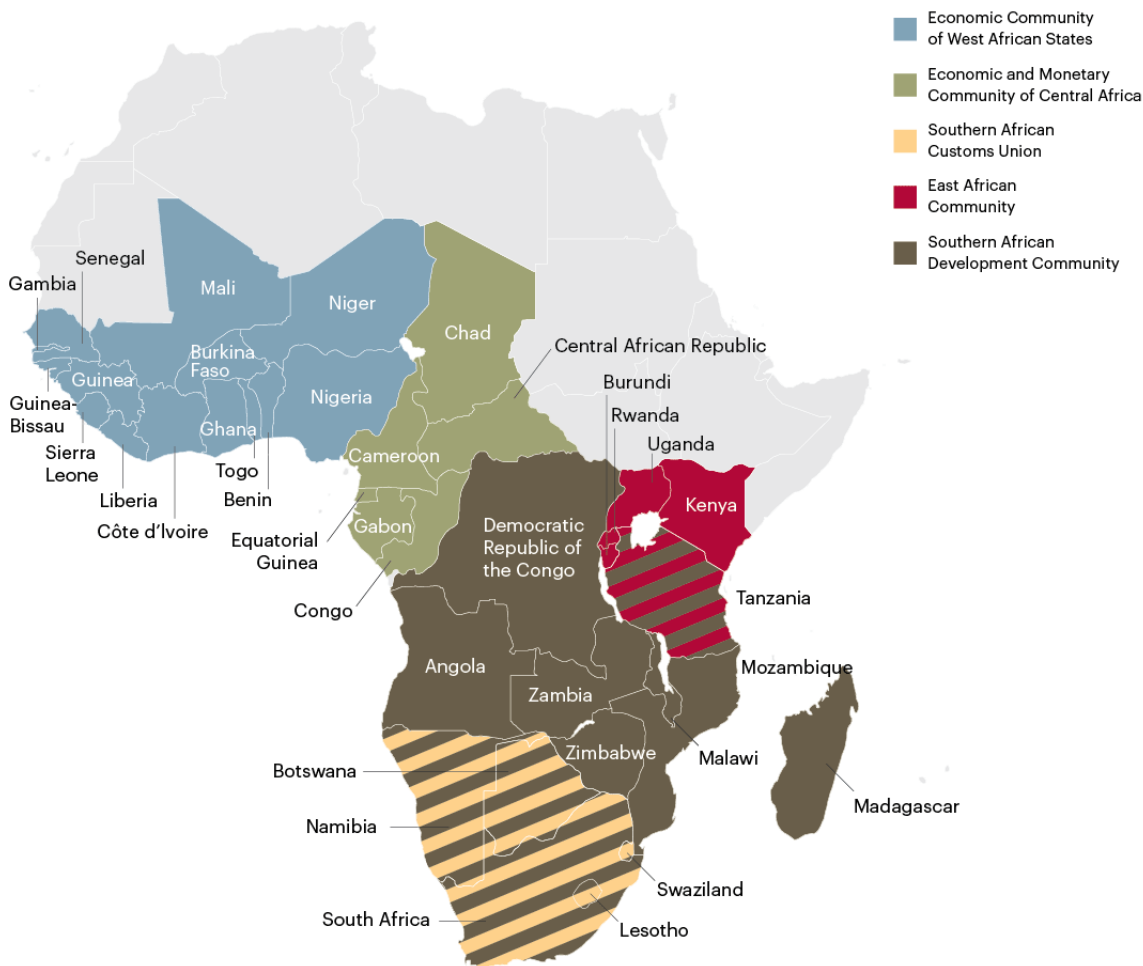
Finally, after years of being branded as the sick man of Asia, recent reforms and more stable politics have enabled the **Philippines** to grow faster than the ASEAN average in recent years. In fact, the Philippines' economy grew by an impressive 6.4 percent in 2014 and is forecast to expand by 6.3 percent this year.<sup>22</sup> President Benigno Aquino's government has implemented a variety of structural, administrative, institutional, and governance reforms that have unlocked the country's growth potential. As a result of these sound economic policies and high economic growth, all three major credit ratings agencies upgraded the Philippines to investment grade in 2013. One driver of this growth is the country's competitive business process outsourcing sector. The Philippines ranks seventh on A.T. Kearney's **2014 Global Services Location Index™**, highlighting this strategic advantage.<sup>23</sup> In addition, the Philippines has favorable demographics that will enable the economy to continue to grow, with the working-age share of the total population projected to rise from 61 percent in 2010 to 64 percent in 2020.<sup>24</sup>

### **Sub-Saharan Africa growth markets**

In addition to the 2020–Seven emerging markets, Sub-Saharan Africa will become more of an engine for the global economy. Despite the Ebola crisis in several West African countries, Sub-Saharan Africa's economy grew at an average annual rate of 5.3 percent between 2008 and 2014—higher than any other region except Emerging and Developing Asia.<sup>25</sup> The regional economy is not only growing larger, it is also becoming more globalized. For instance, exports to the non-African BRICS increased from 9 percent of total Sub-Saharan African exports in 2000 to 34 percent a decade later.<sup>26</sup> In addition, international tourism has boosted many African economies, growing 5.3 percent in 2013 and reaching a record of 36 million tourists.<sup>27</sup>

Sub-Saharan Africa has a variety of strengths that position it for continued economic growth and rising prosperity. Although most domestic African markets remain small, regional trade agreements and other economic unions provide greater scale for investments (see figure 6). Another growth driver is urbanization. About 38 percent of the Sub-Saharan African population lives in cities, and the urban population is expected to grow 3.8 percent annually between 2015 and 2020.<sup>28</sup> In particular, the Sub-Saharan African cities in A.T. Kearney's **2014 Emerging Cities Outlook** will continue to spur growth in their respective countries and will play more of a role on the global stage. These include Addis Ababa, Nairobi, Johannesburg, Cape Town, and Lagos.<sup>29</sup>

Figure 6

**Economic unions create larger markets****Regional economic unions in Sub-Saharan Africa**

Notes: Cape Verde, not pictured, is a member of the Economic Community of West African States. Mauritius and Seychelles are members of the Southern African Development Community.

Sources: World Trade Organization; A.T. Kearney analysis

Of course, Sub-Saharan Africa is an incredibly diverse region, and not all markets will contribute as much to global growth as others. An analysis of several measures of economic size and performance points to 17 dynamic Sub-Saharan Africa markets that have the potential to help drive global growth through 2020 (see figure 7). Economic opportunities in these markets will be highest in three areas: retail, natural resources, and manufacturing.

Figure 7

**Sub-Saharan Africa growth markets**

■ Top-five data point

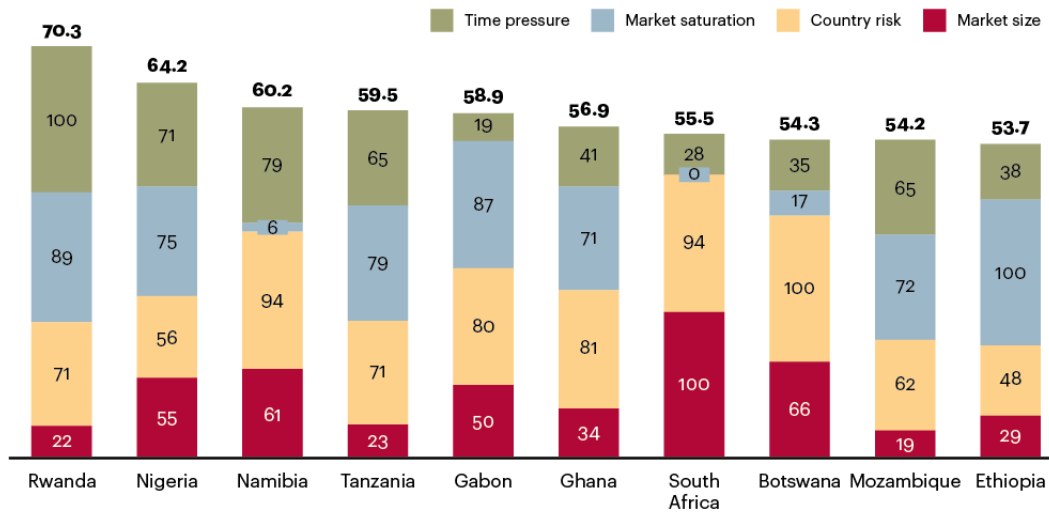
	Real GDP (\$ billion)	GDP at PPP (\$ billion)	GDP (at PPP) per capita (\$)	Population (million)	Average real GDP growth, 2008-2013 (%)	Average annual inflation, 2008-2013 (%)
Angola	63.2	154.2	8,870	22.8	5.4	11.5
Botswana	15.6	30.1	17,600	2.1	3.7	7.7
Cameroon	24.4	57.5	2,960	23.4	4.0	2.8
Côte d'Ivoire	24.0	61.5	3,480	21.3	4.3	2.3
Democratic Republic of the Congo	13.8	30.9	564	71.2	6.7	19.0
Ethiopia	31.0	125.6	1,520	98.9	9.9	19.0
Gabon	12.9	30.8	23,110	1.7	4.0	2.9
Ghana	35.7	87.0	3,890	27.0	8.1	12.7
Kenya	35.7	115.2	3,110	46.8	4.8	10.8
Mozambique	13.0	27.5	1,260	27.1	7.0	6.6
Namibia	11.6	17.2	8,690	2.4	4.4	6.6
Nigeria	329.0	1,517.0	6,180	183.7	6.3	11.0
Rwanda	5.2	16.7	1,610	12.4	7.0	6.7
South Africa	327.9	597.5	13,440	53.5	2.1	6.3
Sudan	36.0	81.4	3,130	31.3	1.0	25.1
Tanzania	27.6	84.1	1,930	52.3	6.8	10.2
Zambia	17.3	57.7	4,390	15.5	7.7	8.9

Notes: Real GDP is at constant 2005 prices and market exchange rates. PPP is purchasing power parity.

Sources: Economist Intelligence Unit; A.T. Kearney analysis

Many **retailers and consumer packaged goods firms (CPGs)** consider Sub-Saharan Africa the next big thing thanks to its rapidly urbanizing population of nearly 950 million people and the proliferation of Internet and mobile phones. In addition, the region's fast economic growth in recent years has promoted both increased investment and improved living standards. A middle class is now emerging, providing opportunities for retailers and CPGs. A.T. Kearney's **2014 African Retail Development Index™** highlights 10 Sub-Saharan African markets that provide particularly strong opportunities for the retail sector as growing consumer markets (see figure 8).<sup>30</sup> The index ranks Sub-Saharan Africa countries on a scale from zero to 100, with higher scores meaning there is greater urgency to enter the country.

Figure 8

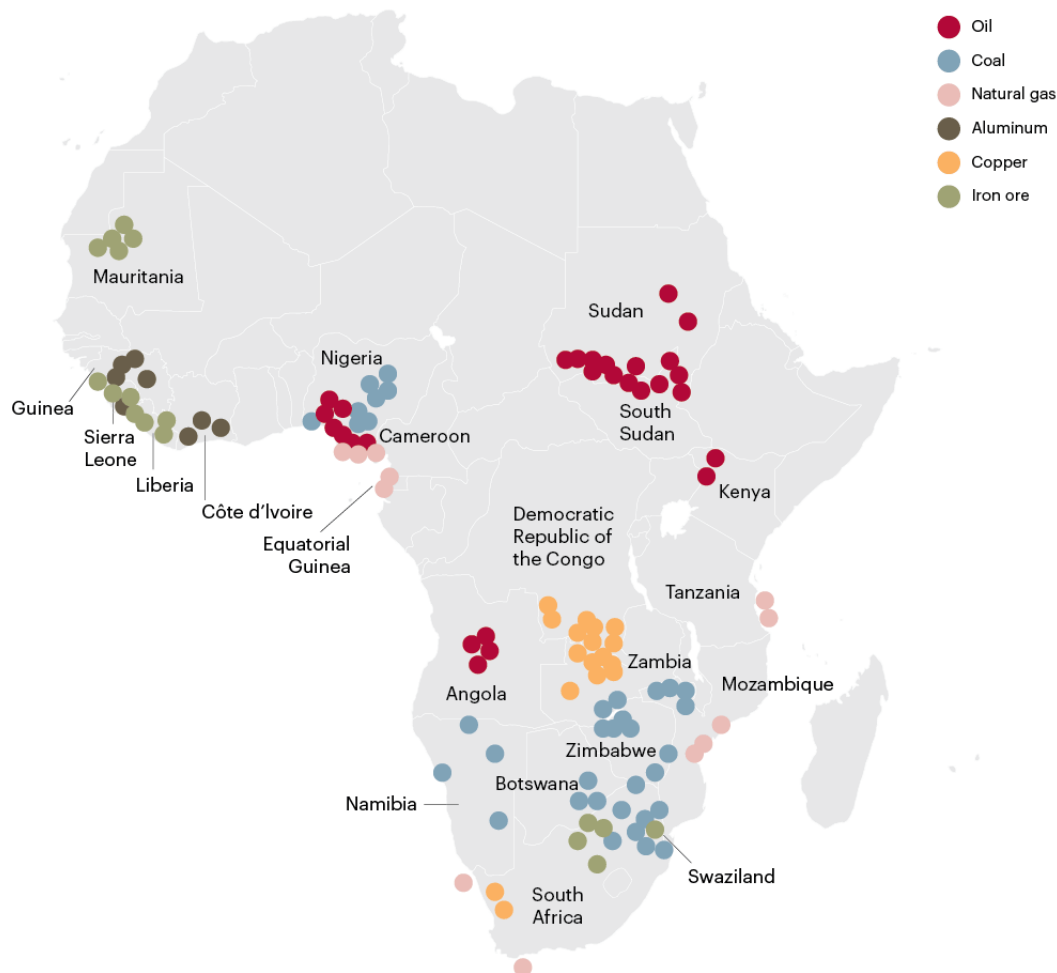
**A.T. Kearney's 2014 African Retail Development Index™****ARDI score**

Notes: Rankings are based on 2012 data. Each of the four factors (time pressure, market saturation, country risk, market size) is worth 25 percent. Maximum value for each factor is 100. ARDI is African Retail Development Index.

Sources: Euromoney, Population Reference Bureau, World Bank, EIU; A.T. Kearney analysis

Sub-Saharan Africa also has vast **natural resources**—many of which remain untapped and provide future investment opportunities (see figure 9). The region has 63.2 billion barrels of proven crude oil reserves and 6.3 trillion cubic feet of proven natural gas reserves.<sup>31</sup> In addition, 32 percent of the world's bauxite, the main source of aluminum, is in Sub-Saharan Africa.<sup>32</sup> The region also produced about 85 million tons of iron ore in 2012.<sup>33</sup> Particularly mineral-rich markets include the Democratic Republic of the Congo and Zambia, which are the largest producers of copper in Sub-Saharan Africa, each with about 20 million tons of proven copper reserves.<sup>34</sup>

Figure 9

**Resource wealth in Sub-Saharan Africa**

Sources: African Development Bank, U.S. Geological Survey, U.S. Energy Information Administration; A.T. Kearney analysis

Finally, while **manufacturing** has historically been underdeveloped in Sub-Saharan Africa, it is starting to expand in some markets. Sub-Saharan Africa has lower average unit wage costs than many other emerging market regions, which could lead some manufacturers to shift production there—particularly as wages in China, which has been the manufacturer to the world in recent decades, become less competitive. There are still hurdles to manufacturing in Africa—including poor infrastructure and security issues in some areas—but certain markets are poised for growth. These include Uganda, Nigeria, and Angola, where manufacturing has significantly grown as a share of GDP since 2005 and could continue to do so.<sup>35</sup>

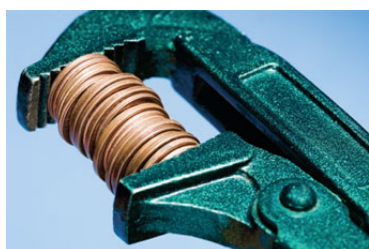
Despite all of these advantages and opportunities, Sub-Saharan Africa is still grappling with development challenges that could put this promising economic outlook in jeopardy. First among these is poverty. Living standards have improved in recent years—for instance, regional GDP per capita grew 47 percent in the 20 years to 2013, to \$3,223 on a PPP basis—but 70 percent of the region's population still lives on less than \$2 per day.<sup>36</sup> The second challenge is poor infrastructure. According to the World Bank, the region needs \$60 billion in annual new infrastructure investments in order to provide adequate electricity, transportation, and other services.<sup>37</sup> Another impediment to faster growth is low productivity levels. The large Sub-Saharan markets averaged labor productivity growth of only 2.8 percent in the decade to 2014, compared with 3.9 percent in the non-African BRICS economies.<sup>38</sup> Finally, weak governance continues to pose a challenge in many African countries. Corruption is prevalent in many markets, and the rule of law is often weak, creating an uncertain and



often costly business environment.<sup>39</sup> For Sub-Saharan African markets to live up to their promise, governments will need to address these four crucial issues.

## Wildcards

Despite the positive force of lower global commodity prices and all of these growth-driving economies, the projected global economic growth of 3 to 4 percent annually through 2020 is subject to downside disruption from a remarkably wide range of contingencies. In particular, six significant risks could produce negative economic shocks and derail the nascent economic recovery. However, two more wildcards could provide a positive shock to the global economy.



The first wildcard is the risk of disinflation—or even deflation—in developed markets. The United States appears to have relatively strong monetary fundamentals, with the Fed ending its quantitative easing program and the IMF estimating that annual inflation was about 2.0 percent in 2014 and will rise to 2.1 percent in 2015. The United Kingdom, Australia, and Canada are also in solidly positive inflation territory, with IMF forecasts ranging from 2.0 to 2.5 percent for 2015. Fundamentals are weak in Europe, however, and there is concern that an external shock, such as dramatically reduced oil prices, could spark a prolonged period of deflation. Even without such a shock, the ECB forecast in early December 2014 that eurozone inflation would be only 0.5 percent in 2014 and rise to just 0.7 percent in 2015—far below the ECB's target of "below, but close to, 2 percent."<sup>40</sup> The risk of another slide into deflation in Japan had receded as a result of fiscal and monetary stimulus measures in early 2014, but core inflation fell to just 0.9 percent in October 2014—a 13-month low. As a result, concerns remain that disinflation could return if the Abenomics economic reform agenda stalls. Disinflation or deflation would undercut aggregate demand and make it more difficult for public and private borrowers to pay down their outstanding debts. In addition, it would likely result in borrowers and businesses delaying purchases and investments, reducing aggregate demand and thus economic growth.



Another wildcard is whether the Chinese transition from an investment- to a consumption-driven economy will be successful while avoiding an economic crisis, as highlighted in the GBPC's 2014 report, *The Dragon at the Precipice: China's Challenging Path to a Balanced Economy*.<sup>41</sup> Consensus forecasts put Chinese economic growth at between 6 and 7 percent for the coming years, but an unanticipated hard landing would have major consequences domestically and in the rest of the world. Markets that would be particularly hard-hit by a dramatic slowdown in the Chinese economy include South Korea and Taiwan, as well as the global markets for oil and base metals. There are already some warning signs. The growth in non-financial private sector debt as a share of GDP has set off early-warning indicators at the Bank for International Settlements, which notes in its latest annual report that China's credit-to-GDP ratio is 23.6 percentage points above its long-term trend; it also notes that its debt service ratio is 9.4—above the 6.0 critical threshold.<sup>42</sup> Non-performing loans have risen to their highest levels since the 2008 crisis.<sup>43</sup> As a result, banks have begun to tighten credit and Chinese authorities have also begun cracking down on loan standards and shadow banking. The longer China delays reforms to balance its economy, the greater the risks for Beijing and the global economy of a hard landing. In 2015 and beyond, Beijing must strengthen market discipline in the financial sector, ensure that that housing market avoids a disorderly adjustment from oversupply, successfully implement and expand the reform of its *hukou* household registration system, enforce revisions to new local government budget laws, and

liberalize its land use policies at the local level.



A third negative wildcard is geopolitical tension that could damage global economic prospects from Russia's foreign policy in its near-abroad. Russia's involvement in the Ukraine crisis in 2014 sparked the highest level of tensions between the United States and Russia since the end of the Cold War and damaged diplomatic and economic relationships between Russia and the European Union. American and European sanctions on Russian individuals and companies prompted the Kremlin to retaliate with restrictions on Western food imports. These measures—along with the rapid decline in the global oil price—have seriously damaged Russia's economic outlook for the coming years. Domestic economic pain could prompt the Russian government to become more aggressive in its foreign policy in order to direct popular anger over deteriorating living conditions on external sources. If the Kremlin ramps up pressure on other countries in its near-abroad—such as Kazakhstan, Georgia, or Belarus—geopolitical tensions could spread throughout Eastern Europe and Central Asia, damaging those countries' business environments and economic growth prospects.



Another geopolitical wildcard is conflict in the Middle East. The Syrian civil war is a continuing source of instability and geopolitical risk in the region, with more than six million internally displaced persons and more than three million international refugees. Even as the Bashar al-Assad regime remains in power in Damascus, the rise of the Islamic State in Iraq and Syria (ISIS) has gained ground in the north and east of the country. ISIS has also destabilized parts of northwestern Iraq and provoked an internationally coordinated air campaign against their strongholds. Another potential source of instability in the region is Iran. Although the regime continues to engage with the P5+1 (the United States, Russia, China, the United Kingdom, and France plus Germany) on talks to demilitarize its controversial nuclear program, the risk that negotiations abruptly fail remains high. Recent flare-ups in the Israeli-Palestinian conflict also point to the risk of additional violent confrontations there. Finally, fragile states or failed transitions—most notably in Libya, Egypt, and Yemen—contribute to an environment of uncertainty about the region's geopolitical stability. Such security risks and geopolitical tensions damage regional economic prospects and could create wider ripple effects in the global economy if they intensify in the coming years.



A variety of fragile or near-fragile states could crack in 2015 or the coming years—or at least experience periods of significant financial or sociopolitical instability that would disrupt business operations and economic activity. Falling global oil prices, years of heterodox economic policies, and an increasingly unpopular president put Venezuela near the top of this list. A crisis in Venezuela would not only damage its economy and cause further hardship for its citizens, but would also have negative repercussions in countries that rely on subsidized Venezuelan oil or other forms of largess, including Cuba, Nicaragua, and Haiti. Another somewhat fragile South American country is Argentina, where inflation has been in the double-digits for years and where the outcome of the October 2015 general election is highly uncertain. Nigeria is also holding a general election in February 2015 that is expected to be the most contentious electoral contest since the country's return to civilian rule in 1999. A contested electoral result could spark violence between the country's two main parties, religious groups, and regions. In addition, the ongoing Boko Haram insurgency in the northeast could further destabilize the country. Another country that faces a potential crisis in the near to medium term is Thailand, where the king's failing health could

provoke a secession crisis because of the unpopularity of his heir among the elites and the country's current military rulers. Other countries that could experience an economically damaging crisis include Zimbabwe, the Democratic Republic of the Congo, Somalia, and the perennially risky and unpredictable North Korea.



Another wildcard is the risk of extreme weather. Droughts, floods, wildfires, and intensified storms are becoming more frequent in many parts of the world and can have crippling effects on the economy of countries that are directly affected, as well as their key trading and investment partners. Such events disrupt business operations, reduce consumer demand, and inflict costs on businesses in terms of fortifying or rebuilding infrastructure.

The World Bank found that extreme weather has cost \$150 billion each year in the past decade and that economic losses from such events will only continue to rise. For example, the U.S. government has estimated that extreme weather could cause domestic economic losses up to \$1.2 trillion through 2050. The California drought of 2014 alone is predicted to cost the state \$2.2 billion. Typhoon Haiyan slammed into the Philippines in November 2013, leaving an estimated \$12.7 billion in damages and losses—and the country faced a second typhoon in the same area in December 2014. Countries and urban areas that are unprepared to adapt to these more frequent extreme weather events, especially in emerging markets, could experience devastating effects that could not only damage near-term economic growth, but also hinder their long-term economic prospects.



Not all wildcards would be negative for the global economy, though; two wildcards could actually boost global economic growth. The most significant would be an unanticipated and robust economic recovery in Europe. If the economic boost provided by lower global commodity prices, a weaker euro improving export competitiveness, and more robust growth in the United States—one of the European Union's most important trading

and investment partners—is augmented by aggressive monetary easing, fiscal stimulus measures, and structural reforms (such as those improving labor market flexibility) to boost various European economies' competitiveness, then Europe's economy could escape its current malaise much more quickly than anticipated. The prospects for such a growth-boosting alignment of government policy actions may be limited but would be significant for the global economy if they came to pass. Key countries to watch for these types of positive policy shifts include Germany, France, and Italy.



Another positive wildcard that could manifest itself over the next few years is dramatically reduced global food prices, which have already been steadily declining in contrast to the recent historical highs in the past four years. Thanks to abundant supplies, favorable growing conditions, and less market uncertainty, global food prices fell to a five-year low in 2014.<sup>44</sup> The Organisation for Economic Co-operation and Development

(OECD) and the United Nations Food and Agricultural Organization (FAO) forecast that crop prices will continue to drop for the next two years before stabilizing at levels above the pre-2008 crisis but significantly below more recent price spikes.<sup>45</sup> The exception is animal-based products. After hitting an historic high in April 2014, the FAO Meat Price Index has continued to rise because of unanticipated limited supply in 2013 and increasing demand. The OECD and FAO expect meat, dairy, and fish prices to continue to rise over the next few years but decline in the medium term. However, if more efficient agricultural tools, policy reforms, and scientific breakthroughs in extreme weather-resistant crops and increased yields enable agricultural markets around the world to become more resilient to shocks, then



meat prices could fall along with crop prices in the coming years. Such improvements in the efficiency and stability of agricultural production would support global economic growth by improving rural incomes, enabling current low-productivity agricultural workers to seek employment in more productive sectors, and boosting the purchasing power of urban food consumers.

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## Business Opportunities in the "New Mediocre"

With the global economy finally transitioning from the Great Recession to a period of more stable growth, businesses will likely find growth opportunities across both developed and emerging markets. However, identifying specific growth opportunities will be more difficult than in the previous period of Emerging Emergence. The Growth with Divergence phase through 2020 will be characterized by greater variation in economic performance among both advanced and emerging economies. As macro-level fiscal and monetary supports recede, growth will be differentiated by the substance of national-level structural reforms and the quality of policy decisions. The quality of government leadership and policymaking in each market will determine whether national economies can escape the new mediocre. Thus far, there is not an abundance of evidence that government leaders around the world will rise to the challenge. As a result, it will be important for corporate decision makers to closely monitor markets for policy changes that create new challenges or opportunities, while also being aware of the global wildcards that could disrupt the economic growth outlook in both positive and negative ways.

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