The Association of Accountants and Financial Professionals in Business

Think Ahead

Global economic conditions survey report: Q3, 2015

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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 170,000 members and 436,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of 92 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

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The Global Economic Conditions Survey (GECS), carried out jointly by ACCA and IMA, is the largest regular economic survey of accountants in the world, in both the number of respondents and the range of economic variables it monitors.

Its main indices are good predictors of GDP growth in the OECD countries and daily trend deviations correlate well with the VIX or 'fear' index, which measures expected stock price volatility.

Introduction

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Fieldwork for the Q3 2015 GECS took place between 11 September and 22 September, and attracted over 950 responses from ACCA and IMA members around the world, including over 100 CFOs. Nearly half the respondents were from small and medium enterprises, with the rest working for large firms of over 250 employees.

ACCA and IMA would like to thank all members who took the time to respond to the survey. It is their first-hand insights into the fortunes of companies around the world, which make the GECS a trusted barometer for the global economy. We would also like to thank the following for their time and expertise:

- Dr. Howard Archer, Chief European and UK Economist of the Country Analysis and Forecasting Group, IHS Economics
- Andrew Kenningham, Capital Economics
- Dario Perkins, Chief European Economist, Lombard Street Research

Executive summary

The Global Economic Conditions Survey (GECS) Report for the third quarter of 2015 shows business confidence falling sharply, to its lowest point in almost four years.

- The Global Economic Conditions Survey (GECS) Report for the third quarter of 2015 shows business confidence falling sharply, to its lowest point in almost four years. Across the world, 46% of respondents said they were generally less confident than three months earlier, outnumbering those who had become more upbeat by more than two to one.

- Concerns that China might be heading for a 'hard landing' reached a peak, with policymakers devaluing the yuan and the collapse in the Chinese stock market gathering pace. These fears contributed to a drop in confidence across the emerging markets in particular.

- There were also signs that the recovery in the US could be faltering. A string of poor data showing exports and manufacturing performing poorly and employment growth slowing were enough to persuade the Federal Reserve (the Fed) to delay rate hikes. The Survey also showed a dip in confidence and a scaling back of investment plans in Q2. However, underlying economic conditions still look reasonably strong and an improvement looks likely over the coming quarters.

- Even in the euro-zone, where a third bail-out plan for Greece was struck putting to bed the risk of the country exiting the euro-zone – at least for the time being – business confidence still fell in the third quarter.

- Businesses in commodity-producing economies saw some of the biggest falls in confidence last quarter, reflecting the problems in China and the renewed fall in commodity prices. Businesses appeared to be more pessimistic about the ability of governments to fund their spending in these economies. There were particularly sharp drops in government spending expectations in Africa, Russia and Malaysia, where governments are heavily reliant on revenue from the commodities sector.

- The number of firms that were negatively affected by foreign exchange movements increased last quarter. Most emerging market currencies sold off against the US dollar, which will cause problems for businesses with large amounts of US dollar debt. Meanwhile, the strength of the US dollar was undermining the competitiveness of US exporters. That said, the US recently pushed back the start of its tightening cycle, possibly to next year, which has given some respite to emerging market currencies at the start of the fourth quarter.

1. Global level analysis

Across the world, 46% of respondents said they were generally less confident than three months earlier, outnumbering those who had become more upbeat by more than two to one.

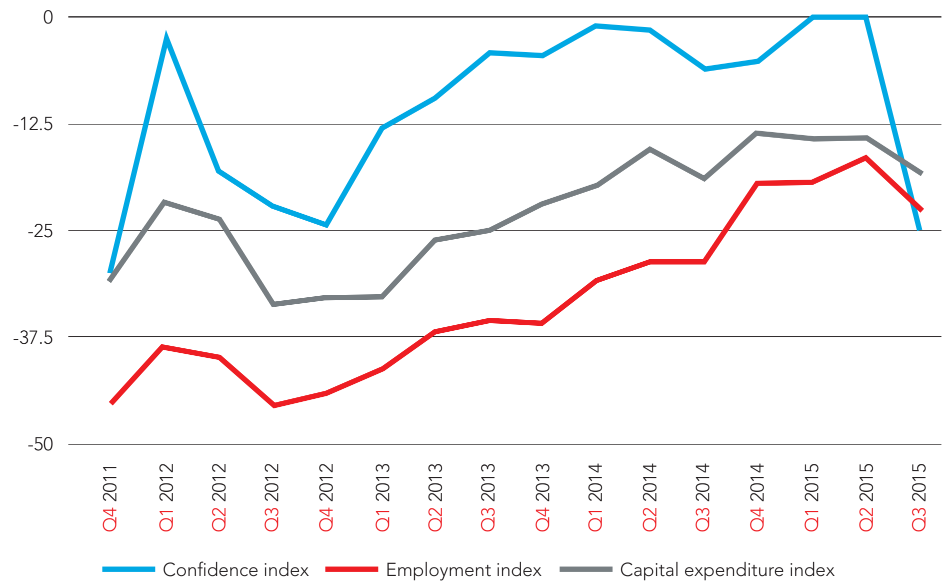
HEADLINE RESULTS

Across the world, 46% of respondents said they were generally less confident than three months earlier, outnumbering those who had become more upbeat by more than two to one. More than half also reported that there were fewer profitable opportunities to invest than there were in the previous quarter.

This dip in confidence affected investment intentions. Almost twice as many firms scaled back their plans for investment last quarter as increased them. The capital expenditure index showed a marked fall in Q3, having been stable over the previous few quarters.

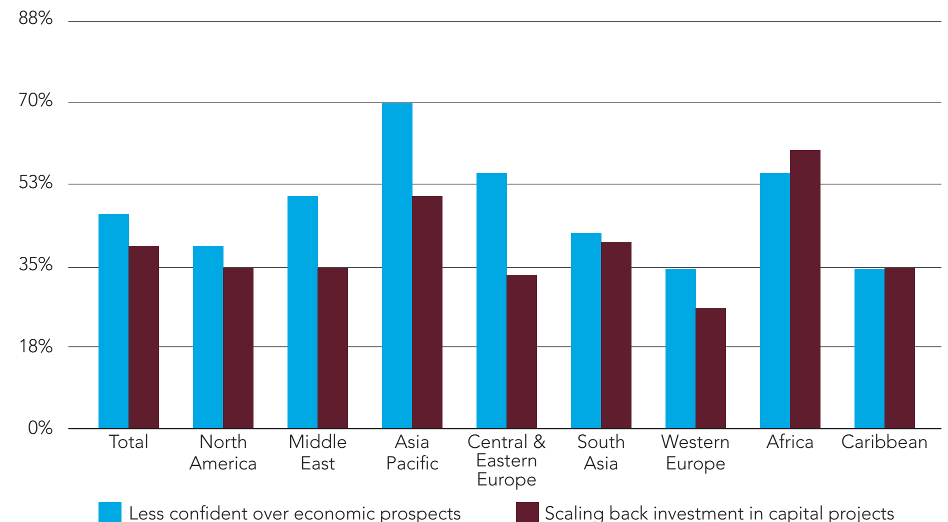
Yet the index is still high by the standards of recent years. Firms have not been as quick to give up on investment plans as the widespread gloom might suggest. Indeed, the only regions where the number of firms scaling back investment matched the number reporting that the outlook had deteriorated were Africa and the Caribbean.

Chart 1: Business confidence plummets



Source: GECS

Chart 2: Investment plans



Source: GECS

> There is little expectation among businesses in most countries that government will increase spending. The government spending index actually fell in Q3, both for OECD and non-OCED economies.

BUSINESSES HAVE NOT SLASHED THEIR EMPLOYMENT PLANS

The employment index also fell last quarter, after six consecutive quarters of improvement. However, as with the capital expenditure index, it held up much better than overall confidence. Across the world, 44% of businesses had a freeze on hiring or were making job cuts, up only slightly from 41% in Q2. In the US, where a slowdown in employment growth had created concerns about the economic recovery, the proportion of firms reporting job cuts or a hiring freeze actually fell. In fact, the employment index improved for the OECD as a whole. It is firms in emerging economies who have been quickest to make cuts.

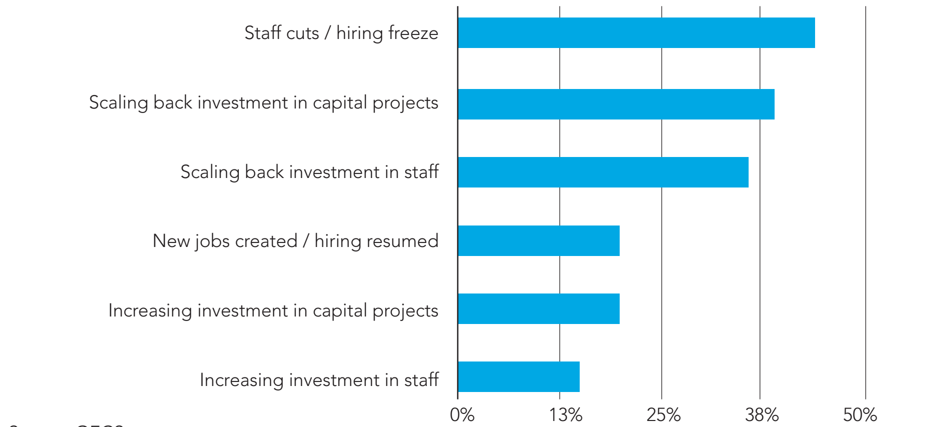
NO HELP FROM THE GOVERNMENT

There is little expectation among businesses in most countries that governments will increase spending. The government spending index actually fell in Q3, both for OECD and non-OCED economies. There were particularly sharp drops in Africa, Russia and Malaysia, where governments are reliant on revenue from the commodities sector to fund their spending. The most notable economy to buck the global trend was China, where businesses expect the government to ramp-up spending to support growth.

44%

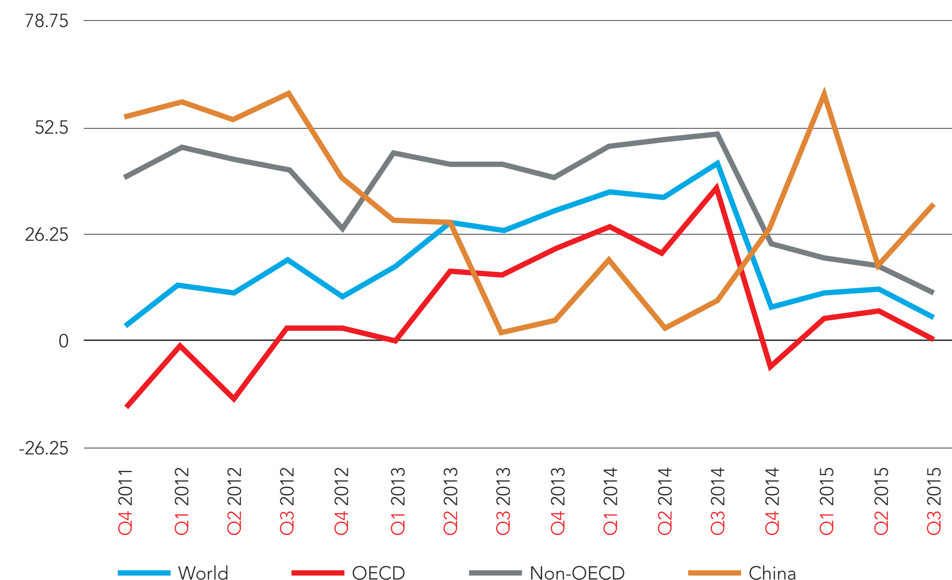
of businesses had a freeze on hiring or were making job cuts

Chart 3: Firms' responses to the global economy, Q2 2015



Source: GECS

Chart 4: Government spending expectations



Source: GECS

Rising costs remained a problem for businesses, despite global commodity prices falling again in the quarter, with 40% of respondents reporting that they had affected their business over the previous three months.

FALLING INCOME: THE BIG PROBLEM

The increased uncertainty over the global economy has affected earnings. Globally, 41% of respondents reported that income had decreased compared with three months earlier. It was the main way in which firms had been negatively affected by developments in Q3. Firms in Asia Pacific were the worst affected, with 53% reporting a drop in earnings. But half of respondents in Central and Eastern Europe also reported a fall in income, compared with 41% in Q2.

Rising costs remained a problem for businesses, despite global commodity prices falling again in the quarter, with 40% of respondents reporting that they had affected their business over the previous three months. This was down from 46% in Q2, but it still meant that 'rising costs' was the second most common problem for businesses in Q3. Africa (53%) and Asia Pacific (47%) have been the worst affected.

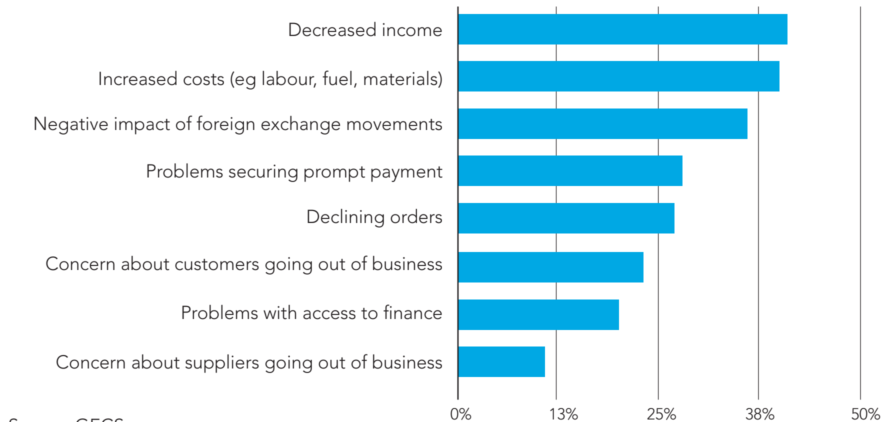
Although businesses in these regions will have benefitted from the drop in global commodity prices, in most economies this will have been at least partly offset by currency depreciation, which raises the cost of imports and servicing debts denominated in foreign currency. These are also two regions where wages have continued to rise, often quite strongly.

Foreign exchange movements hurt 36% of firms, up from 32% in Q2. Most emerging market currencies sold off against the US dollar last quarter, with the Russian ruble, Malaysian ringgit and South African rand among the hardest hit. Indeed, it was businesses in emerging regions such as Central and Eastern Europe (69%) and Africa (68%) that were worst affected by currency movement, with less than a quarter of firms in North America and only 30% in Western Europe reporting any negative effects. That said, there are signs that US dollar strength is starting to hurt US exports.

36%

of firms hurt by foreign exchange movements

Chart 5: Negative impacts



Source: GECS

2. Thematic analysis

Sentiment towards emerging markets became more pessimistic in the third quarter.

ARE EMERGING ECONOMIES HEADING FOR CRISIS?

Sentiment towards emerging markets became more pessimistic in the third quarter. Currencies generally sold off against the US dollar, stock markets performed poorly, and forecasters, such as the IMF, revised down growth expectations. The business confidence index for non-OECD economies fell to a record low in Q3, with investment and employment intentions also weakening.

China's problems have been at the centre of concerns. Its slowdown and shift to a less investment-intensive growth model have led to a reassessment of prospects for other emerging economies, particularly for commodity producers and countries in Asia Pacific with close trade links to China and commodity producers.

For commodity producers, the latest problems in China and the related fall in commodity prices only adds to the pain caused by the collapse in commodity prices since mid-2014. Many emerging markets (EMs), stretching from the Middle East to Russia, much of Latin America and Africa, are reliant on commodities for export revenue and to fund government spending. The currencies of these economies have generally fallen sharply, making imports more expensive. Currency depreciation will have helped to boost the competitiveness of non-commodity exports, but many of these countries have small manufacturing sectors that are unable to make-up for the effects of the fall in commodity revenue.

"The main impact has been on other countries in emerging Asia – even more on the quantity exporters. Particularly those that export enough drill metals. China imports roughly half of the entire global production of copper, nickel, aluminium and zinc," says Andrew Kenningham of Capital Economics.

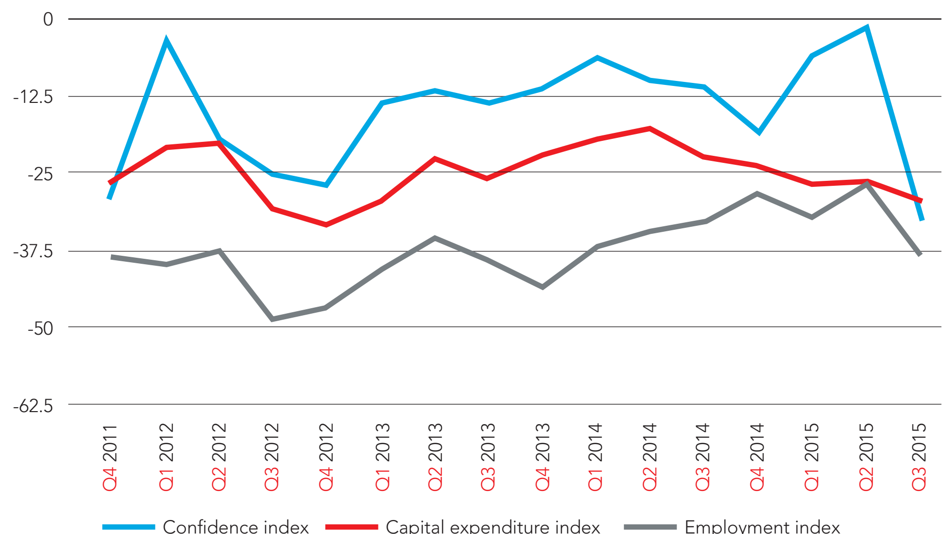
But the emerging world's struggles stretch beyond China and the drop in commodity prices. The Bank of England's Chief Economist, Andy Haldane, has warned that the slowdown in EMs could represent the third leg in the global crisis that began with the financial crisis in the US in 2008, then brought the euro-zone close to break-up, and is now threatening to derail the emerging world.

In particular, the loose monetary policy that has helped revive advanced economies has also fuelled unsustainable credit booms in a number of emerging economies. No one region stands out as vulnerable, with credit bubbles looking most concerning in Brazil, Russia, Korea and Turkey (as well as China itself). With currency depreciation pushing up the cost of servicing foreign-currency denominated debt in most emerging markets, and falling commodity prices weighing on the revenue of many indebted firms in places like Brazil and Russia, there is a risk that credit bubbles will soon start to burst.

The report showed little sign that businesses across the emerging world were finding it more difficult to secure payment from clients, or that they were becoming especially worried about suppliers or customers going out of business. But such fears do appear to be on the rise in pockets, most notably in Russia.

Dario Perkins, Chief European Economist, Lombard Street Research, says: "I don't think it's like the 1990s, where we had this series of very acute crises and very strong rebounds. This seems to be a slow-burning deterioration in growth and an attempt to improve competitiveness by reducing real exchange rates. Devaluation is quite painful and quite protracted, but I don't think it creates a real sense of crisis for the developed economies."

Chart 6: Non-OECD confidence plunges



Source: GECS

A number of business leaders spoke out to allay concerns about a Chinese 'hard landing', most notably Tim Cook at Apple, who pointed to strong sales in China, but respondents were clearly affected by the souring of market sentiment.

CHINA PAST THE WORST?

China's slowdown almost certainly has further to go, with the IMF forecasting growth of just above 6% next year. This hasn't necessarily been cause for concern. After all, even at a growth rate of 6%, China's economy would be adding as much to global growth as it did in 2010, when it expanded by 10% – such has been the increase in its share of world GDP.

The fear is that the slowdown could become a 'hard landing'. If China's growth fell to 2%, for example, that would knock almost a full percentage point off global growth, even before any knock-on effects for other economies are considered. The consequences for commodity-producing economies of a slump in Chinese investment – the most likely cause of a 'hard landing' – would be especially severe.

In the third quarter, these fears came to the fore, as a 43% collapse in the Shanghai composite between June and August, as well as a botched policy response from the Chinese authorities, sent global markets and many policymakers, into a panic. Central banks in Vietnam and Kazakhstan, for example, responded by devaluing their currencies, Taiwan's central bank cut interest rates and Singapore also loosened monetary policy.

A number of business leaders spoke out to allay concerns about a Chinese 'hard landing', most notably Tim Cook at Apple, who pointed to strong sales in China, but respondents were clearly affected by the souring of market sentiment. Business confidence dropped to close to its lowest since the survey began. The capital expenditure and employment indices tumbled particularly sharply.

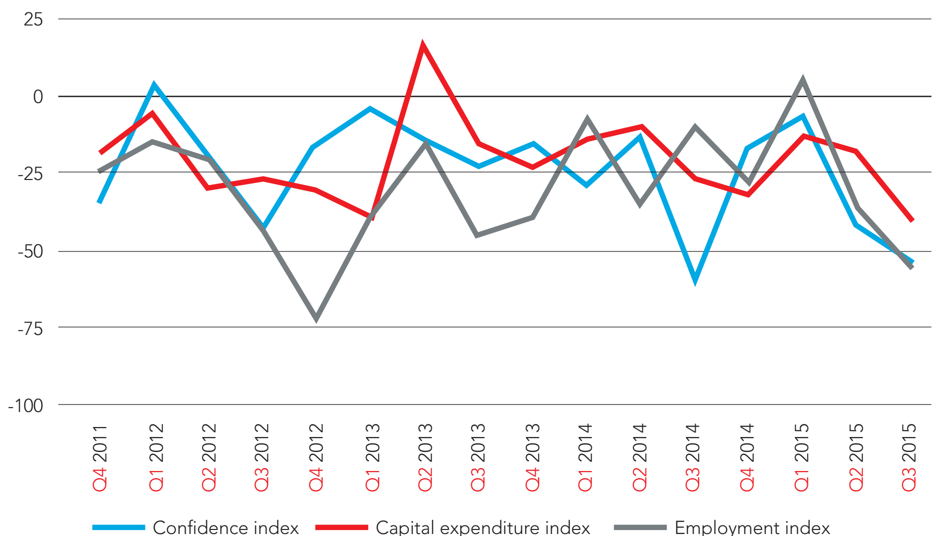
The good news is that sentiment did start to improve from late September and there appears to be a growing sense that the panic went too far. After all, the stock market is not a good guide to trends in China's real economy.

"It's relatively easy to prop up an economy if you've got the right kind of investment strategies," says Dario Perkins, Chief European Economist, Lombard Street Research. "Propping up a stock market is obviously more difficult – I think they've learnt there are maybe some parts of capitalism that they can't intervene directly in."

Indeed, the government has been rolling out measures to support growth, loosening monetary conditions and ramping up infrastructure spending. The government spending expectations index for China reached its highest since 2012 in Q3. The latest data has also helped to allay the worst fears. Official GDP data for the third quarter showed growth slowing from 7.0% year-over-year to 6.9% rather than collapsing.

"We've seen a bit of a pick up recently in credit growth," says Andrew Kenningham of Capital Economics. "Property prices have risen in some areas. In fact, although we're not certain yet, we think that the economy may have already gone past the worst. It may grow faster in the last quarter than in the first three quarters of this year."

Chart 7: China sentiment sours



Source: GECS

> "The issue is that wage growth hasn't begun to pick up. It's about 2%. And it hasn't started to rise as much as one would expect historically given the level of unemployment..."

IS THE US RECOVERY FALTERING?

The slowdown in emerging economies and weak growth in the euro-zone has left the US economy as the main driver of the global economy in recent years. But there have been signs recently that this one bright spot is starting to fade. The slowdown at the start of the year could be put down to temporary factors, such as the cold winter. But after a brief turnaround in Q2, a string of poor data showing exports and manufacturing struggling, as well as a sharp drop in employment growth, has created concerns that the US recovery is under more serious threat. Less than 150,000 jobs were added per month on average in the third quarter. That's the lowest since mid-2012 when QE3 was launched.

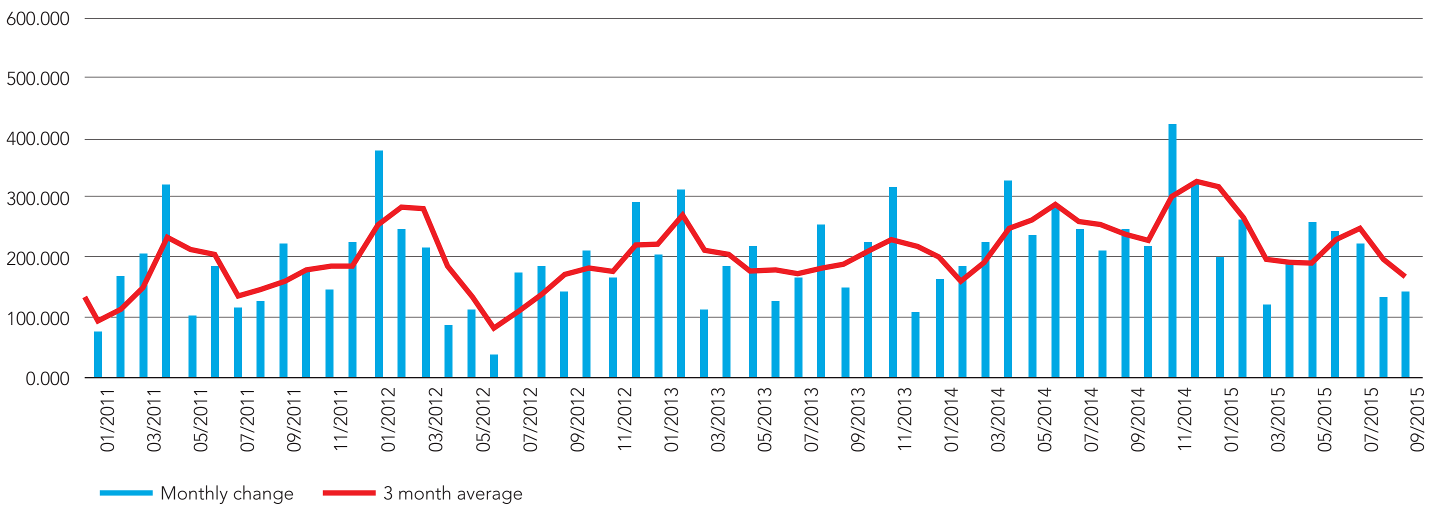
This survey was completed before the disappointing September employment figures were released, but it still clearly shows that the mood had soured even before then. Business confidence fell to its lowest since 2012 in Q3, and the capital expenditure index has dropped. Concerns about recent exchange rate movements are lower than in most other regions, but are still elevated compared with a year earlier, which is likely to reflect the competitiveness problems that have been created by US dollar strength.

Still, there are plenty of reasons not to write off the US recovery just yet. Indeed, Capital Economics stress that away from the export-oriented manufacturing sector, the economy is still doing well. "Overall we think the US economy will grow by about 2.5% this year and a similar amount next year," says Andrew Kenningham. "Unemployment is down to 5% and it will be lower by the end of 2016."

"The issue is that wage growth hasn't begun to pick up. It's about 2%. And it hasn't started to rise as much as one would expect historically given the level of unemployment. That again is a reason for the Fed to be cautious in deciding when to start raising rates."

That delay to the Fed's first rate hike, possibly until next year, has provided a silver lining for businesses around the world. As a result, emerging market currencies have generally rebounded from their disastrous third quarter in October. It may only be a temporary reprieve, but it is nonetheless a welcome one for businesses with US dollar-denominated debt.

Chart 8: US job creation drops



Source: US Bureau of Labor Statistics

But there is another reason why business confidence was not lifted by the Greek bailout deal: a 'Grexit' is no longer seen as a major risk to the wider euro-zone.

GREECE: MOVING ON AT LAST

In August, Greece reached an agreement with its creditors on a third bailout plan, pulling it back from the brink of exiting the euro-zone. Despite this, the business confidence index for Western Europe still dropped in Q3 (see chart below).

A number of factors could be at work. Businesses are likely to have been affected by the dip in global sentiment. After all, confidence held up much better in Europe than in most other regions.

There is still every chance that Greece will leave the euro-zone at some point over the coming years. The bailout plan sets ambitious targets for the country to improve its fiscal position and is based on unrealistic assumptions about the performance of its economy. It might not be long until those targets are missed and creditors again start to think about cutting Greece off.

But there is another reason why business confidence was not lifted by the Greek bailout deal: a 'Grexit' is no longer seen as a major risk to the wider euro-zone. Policymakers are much better prepared with the potential fallout than they were a few years ago. Official creditors now hold most of Greece's debt, with euro-zone banks having slashed their lending to Greek banks and companies, while the European Central Bank's (ECB) bond-buying programme has reduced the risk of contagion to bond markets around the rest of the euro-zone.

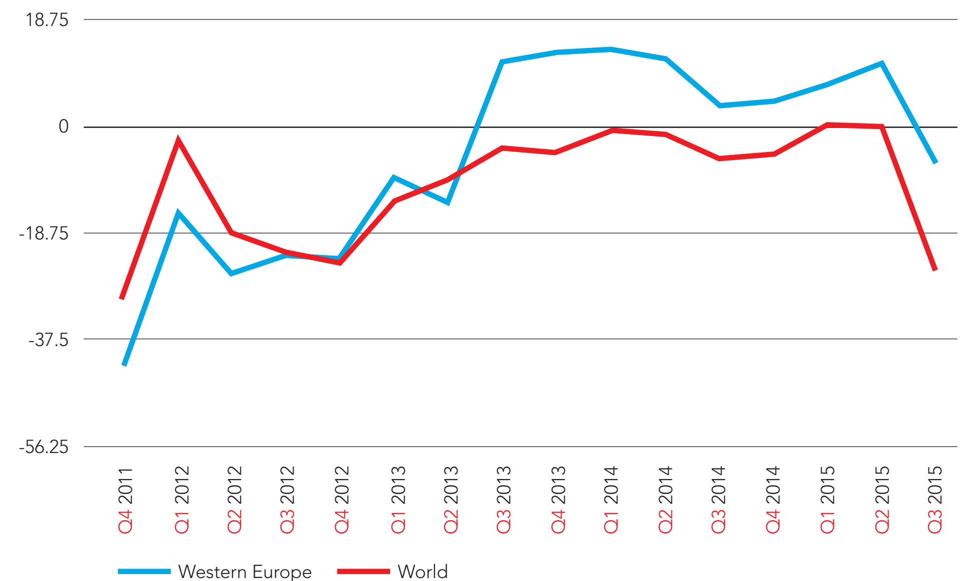
These policy buffers mean that the risk of countries outside the euro-zone being hurt by a 'Grexit' have also fallen dramatically. Global bond markets remained relatively calm at the height of 'Grexit' concerns. And crucially, there was very little sign of Western Europe's banks pulling back from Central and Eastern Europe, which stands in stark contrast to 2012, the last time Greece flirted with default, when Emerging Europe's economies were choked by a credit crunch.

"It's over for the time being," says Dr Howard Archer, Chief European and UK Economist of the Country Analysis and Forecasting Group, IHS Economics. "We've pushed back our risk of an exit to 15% within the next year. We've cut it over a five-year horizon to 40%. There's still a serious risk in the longer term. Obviously if Greece fails to implement the reforms then the situation could quickly deteriorate again."

15%

risk of an exit within the next year

Chart 9: Business confidence: Western Europe vs World



Source: GECS

3. Regional analysis

The downturn in business confidence in the US looks likely to prove temporary, given that underlying economic conditions still look healthy.

NORTH AMERICA: MIXED FORTUNES

The downturn in business confidence in the US looks likely to prove temporary, given that underlying economic conditions still look healthy. But it is hard to be optimistic about prospects for Canada, despite an improvement in confidence last quarter.

Having rebounded in Q2 from the weather-related slowdown that held back the economy at the start of the year, in Q3 the US economy started to feel the effects of weak global demand and a strong dollar, which has appreciated by around 20% in trade-weighted terms over the past year. Exports have performed poorly and manufacturing growth has slowed. The employment recovery also lost momentum in the third quarter.

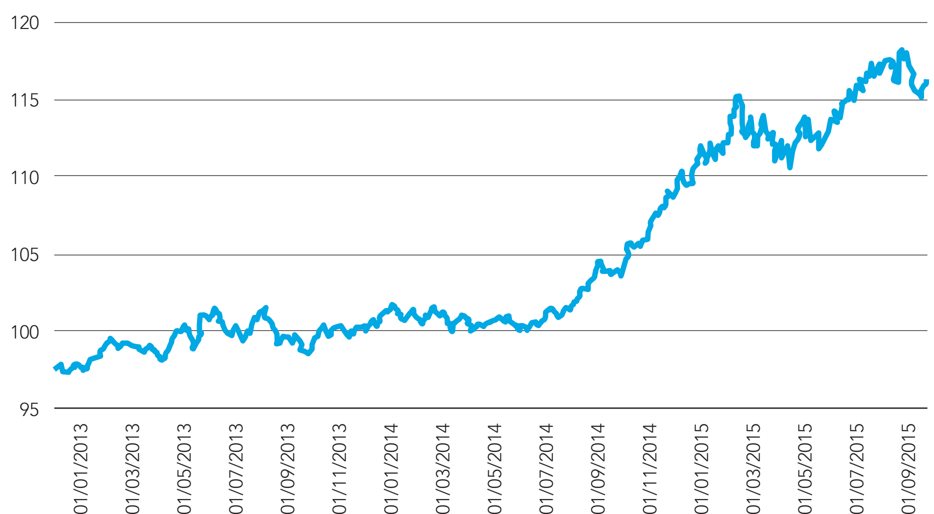
However, underlying conditions in the US economy still look relatively healthy. Despite the slowdown in job creation, the economy is still approaching full employment. Employment sentiment among respondents actually improved in Q3, which suggests that the recent weakness in hiring may not last. Moreover, the problems in the export-oriented manufacturing sector have not yet fed into the services industry.

Retail sales growth has been healthy, with households having benefitted from the drop in oil prices, which has boosted real incomes. The headwinds created by credit constraints and fiscal tightening have also started to fade. There is reason then to think that despite the economy slowing in Q3 (real GDP increased 1.5% compared to 3.9% in Q2) the dip in business confidence in Q3 will prove to be a blip.

"It's mainly a manufacturing and inventory story. And I think it's probably temporary," says Dario Perkins, Chief European Economist, Lombard Street Research. "My worry is that it comes at a time where markets are extremely jittery and looking for any evidence of a global slowdown. The fear is that we get this inventory cycle; some people start to panic about what's happening in the US, and then you get a correction in stock."

Meanwhile, the rise in business confidence in Canada is unlikely to last. The economy has exited the mild recession suffered in the first half of the year, and the survey shows an improvement in new orders last quarter, which could reflect the fall in the Canadian dollar and the boost to competitiveness this gives non-commodities firms. But the weaker exchange rate will not be enough to compensate for the oil-related slump in fixed investment, which is far from over, and there is a risk that the property market will burst.

Chart 10: US nominal exchange rate



Source: JP Morgan

The composite PMI index is pointing to growth of around 0.3-0.4% quarter on quarter in Q3, which would be on a par with the first half of the year.

WESTERN EUROPE: RECOVERY STILL ON TRACK

Business confidence in Western Europe held up much better than in other regions. The bailout agreement reached with Greece to keep it in the euro-zone is likely to have helped, but even in Q2 businesses did not appear overly concerned about the risks posed by a potential 'Grexit'.

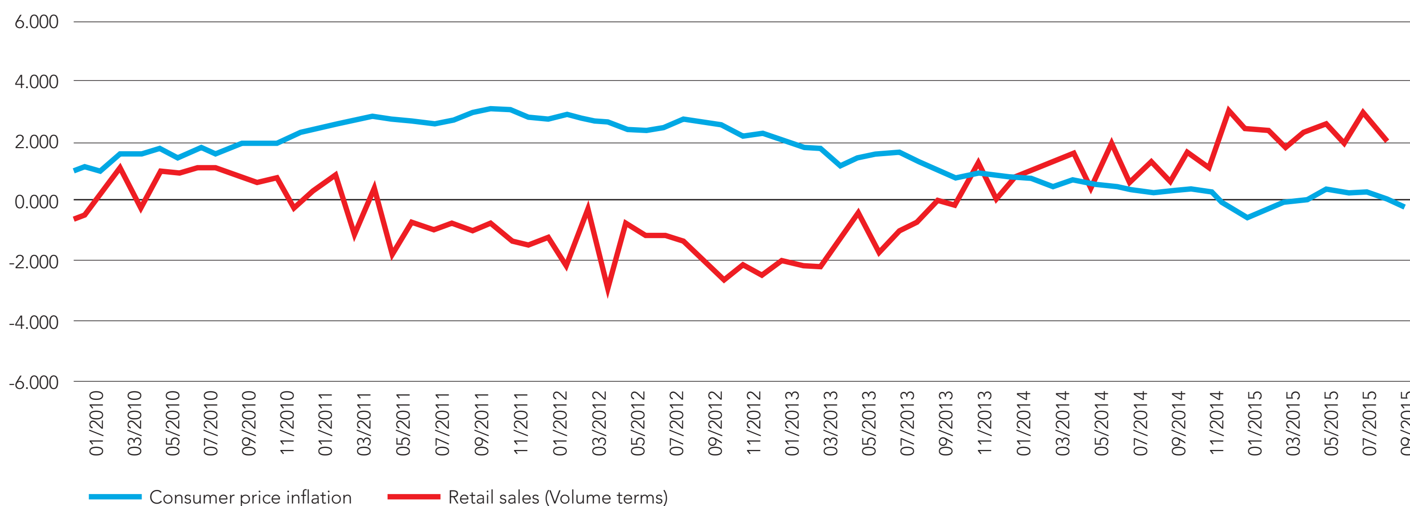
More importantly, the euro-zone economy looks to have performed relatively well in the third quarter. The export sector has been given a boost by the weakness of the euro; household spending has performed well, and the drop in inflation has lifted real wage growth, while the ECB's quantitative easing programme continued to drive a recovery in bank lending. The composite PMI index is pointing to growth of around 0.3-0.4% quarter on quarter in Q3, which would be on a par with the first half of the year.

Dr. Howard Archer, Chief European and UK Economist of the Country Analysis and Forecasting Group, IHS Economics believes the conditions are still in place for an unspectacular but relatively solid Eurozone upturn. "You've still got oil prices around $50 a barrel which is very good news. There's much reduced fiscal headwinds. In fact, more and more countries seem to be actually starting to take stimulative measures," he says.

"If anything the immigration crisis should actually be positive for Eurozone growth. We think it's likely to add maybe 0.2/0.3% to German growth next year, for example, because there's going to be an increase in public spending to deal with the situation."

Hard data, however, is showing some signs of a slowdown. Industrial production shrank by 0.5% in the euro-zone in August. The Volkswagen scandal could further undermine manufacturing activity, particularly given how important the car industry is to the German economy, and in particular exports. In the short-term at least, the damage to confidence is likely to offset any boost to production that might result from the recall. Combined with the renewed slide into deflation, this could prompt the ECB to ramp up its asset purchasing programme at its meeting in December.

Chart 11: Sales confidence



Source: Eurostat

> "We think the Bank of England is likely to very, very gradually raise interest rates over the next two years – much more slowly than the Fed."

UK IN FOCUS

Beyond the euro-zone, the UK's recovery looks to have lost momentum in the third quarter. There are reasons to think it will return – real income growth is picking up and consumer confidence is high – but the survey suggests businesses are concerned, with confidence dipping to its lowest since the last quarter of 2012.

Andrew Kenningham of Capital Economics says: "Employment growth has been very good. Consumption is still growing steadily. The fiscal squeeze is going to re-intensify and will be a headwind for growth. But it shouldn't be sufficient to derail the recovery. We think the Bank of England is likely to very, very gradually raise interest rates over the next two years – much more slowly than the Fed."

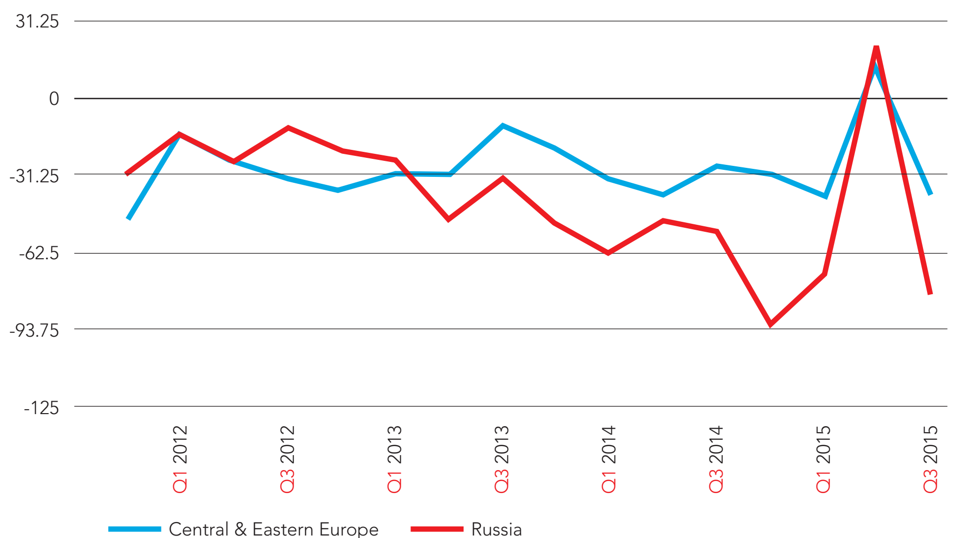
CENTRAL AND EASTERN EUROPE: FALSE DAWN

The recent sharp recovery in business confidence in Central and Eastern Europe proved to be a false dawn. In Q3, the confidence index slumped back to where it has been for most of the last year. Although any fears that a 'Grexit' might curtail lending by Western Europe's banks into the region have been allayed for now, Russia's problems escalated last quarter.

The renewed fall in the oil price has hurt export revenue. Another collapse in the ruble has added to inflation concerns, and will create problems for firms with debt denominated foreign currency. Russian businesses reported a sharp rise in concern about the negative effects of recent currency volatility. They are also more worried about the government being forced to cut spending than at any point in the past four years.

The rest of the region is, for the most part, far less dependent on commodities. In fact, most economies should benefit from lower commodity prices. Some commentators have voiced fears that the Volkswagen scandal will hurt the region's large manufacturing sector, but any negative effects should prove short-lived if the experience of previous vehicle recalls is anything to go by.

Chart 12: Business confidence: Central & Eastern Europe and Russia



Source: GECS

Without a further wave of reform, Prime Minister Modi is unlikely to achieve his aim of turning India into a manufacturing powerhouse – and the economy will continue to disappoint.

SOUTH ASIA: BACK DOWN TO EARTH

The third quarter saw a sharp drop in business confidence in South Asia, reversing the buoyant mood that swept across the region just months earlier. There were no obvious domestic problems that might have worried businesses. In fact, in the region's major economy, India, all signs point to an economy that is slowly building momentum.

Industrial production growth has settled at rates of around 4-5% year-over-year in recent months, having been almost flat for much of the previous three years. Spending on new capital projects has also picked up, albeit from extremely low levels. Meanwhile, low inflation has given the Reserve Bank of India scope to cut its policy rate by a cumulative 125 basis points (bp) in 2015, most recently by 25bp in late September. The central bank is now putting pressure on commercial banks to pass these rate cuts on to customers.

The jump in confidence in the second quarter never really looked sustainable. Although official data is showing that GDP grew by 7.0% year-over-year in Q2, it is being treated with a degree of skepticism. Most analysts think growth is much slower, and well below the rates being racked up during the boom years of 2004-2011.

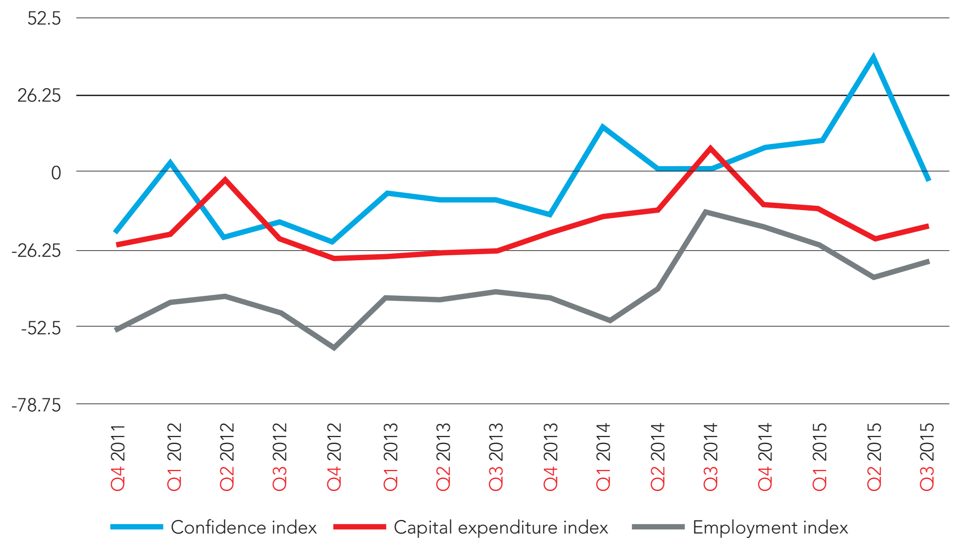
There are also signs that the reform drive of Prime Minister Narendra Modi is running into problems.

Proposed changes to domestic tax policy and land acquisition laws, for example, have recently been rebuffed by parliament. The current land acquisition laws are seen as a big obstacle to reviving investment. The survey certainly shows businesses have little enthusiasm for investment. In fact, 40% of businesses in South Asia reported that they have recently cut their investment plans, more than in any other region except Africa and Asia Pacific. Without a further wave of reform, Prime Minister Modi is unlikely to achieve his aim of turning India into a manufacturing powerhouse – and the economy will continue to disappoint.

40%

of businesses in South Asia reported that they have recently cut their investment plans

Chart 13: Business confidence: South Asia



Source: GECS

In China itself, business confidence dipped from already low levels, but it was elsewhere in the region that the biggest swings were seen.

ASIA-PACIFIC: CHINA CASTS A SHADOW

China's problems clearly cast a shadow over Asia-Pacific last quarter. Confidence plummeted to its lowest since the GECS began. Investment and employment intentions also weakened sharply. The number of firms increasing capital expenditure fell from 22% in Q2 to just 12% last quarter. In China itself, business confidence dipped from already low levels, but it was elsewhere in the region that the biggest swings were seen.

Australia, Indonesia and Malaysia saw especially sharp falls. These economies benefitted over the last decade from China's investment boom, both in the form of direct Chinese demand for their exports and, perhaps more importantly, from the sky-high commodity prices that it helped to create. As the commodity cycle has turned, investment in mining in all three countries has suffered and the effects of a sharp drop in export revenue is gradually feeding through.

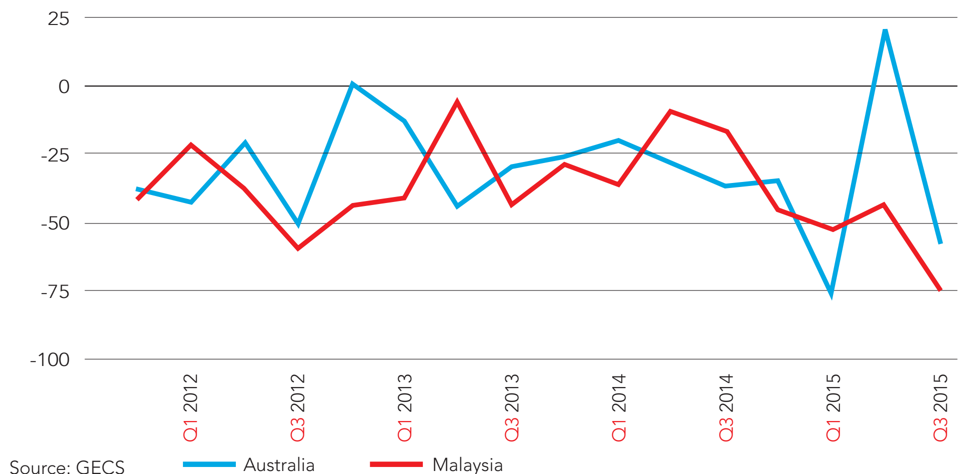
But it could be much worse. Compared with commodity-producing economies such as Russia, Brazil and Venezuela, all three are coping relatively well. Australia has been helped by a series of rate cuts by the Reserve Bank of Australia, along with a sharp depreciation of the Australia dollar, which has helped to revive its non-mining economy. Malaysia and Indonesia are less dependent on commodity exports than is often assumed. Around 70% of Malaysian exports are manufactured goods, while Indonesia's is relatively closed. Malaysia has been rocked by a political scandal in recent months, which is unlikely to have helped business confidence.

Asia-Pacific's small trade-dependent economies, Hong Kong and Singapore, also suffered a sharp drop in confidence last quarter. Hong Kong's particularly close links to China help explain its concerns, while Singapore's sensitivity to global demand undoubtedly account for its souring sentiment. But both these economies are also among those most vulnerable to the start of the US Fed's tightening cycle.

12%

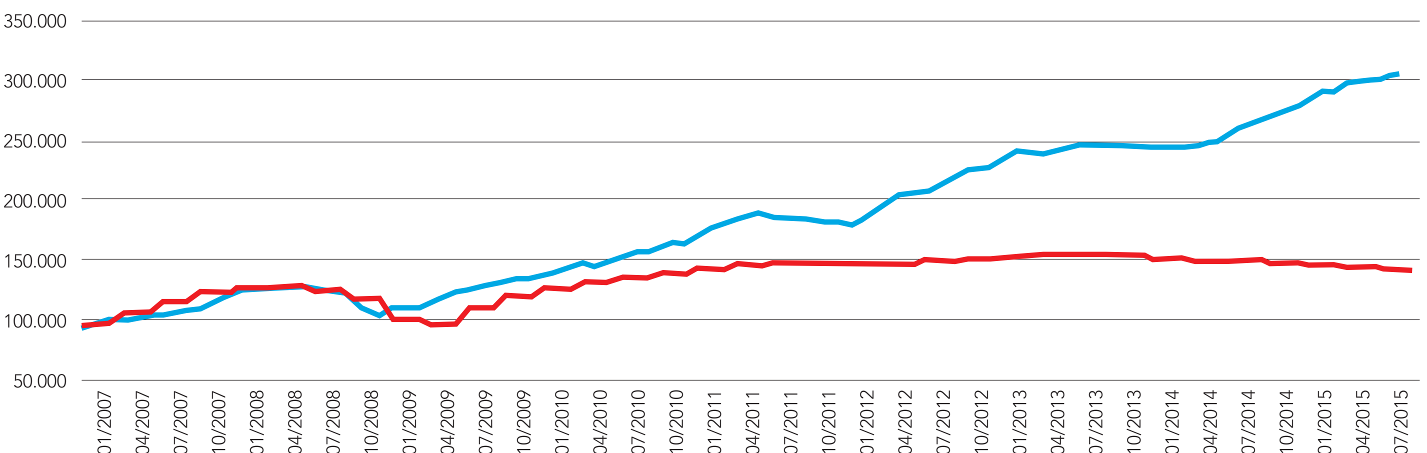
of firms increasing capital expenditure last quarter, falling from 22% in Q2

Chart 14: Business confidence: Australia and Malaysia



Source: GECS

Chart 15: Property crash?



Source: CEIC

> The renewed fall in oil prices is likely to have concerned businesses, given the region's dependence on energy exports. Capital expenditure plans have understandably been pared back.

Because of their exchange rate regimes (a hard peg to the US dollar in Hong Kong's case and a target band for the nominal effective exchange rate in Singapore's), local authorities have no control over local interest rates, which tend to track the US Fed funds rate closely.

What's more, worryingly large credit bubbles have built up in both economies over the years of ultra-loose US monetary policy. These could quickly unwind once the Fed starts to hike. A sharp rise in default cannot be ruled out, with a property crash looking like a serious risk in Hong Kong, where house prices have risen at breakneck speed over the past five years.

A number of countries in the region, most notably Singapore, Taiwan and Thailand, have been through a bout of deflation over the past year. For the most part, this should not be seen as a big concern. The drop in commodity prices has been the main cause, and its effects will start to fade in the fourth quarter. Indeed, consumer price inflation has already turned positive in Taiwan. Importantly, nominal wage growth has remained strong across the region, which means that the fall in consumer prices has boosted real wages. For businesses, costs have generally dropped more sharply than income. Low inflation is also allowing monetary policy to be kept loose across the region.

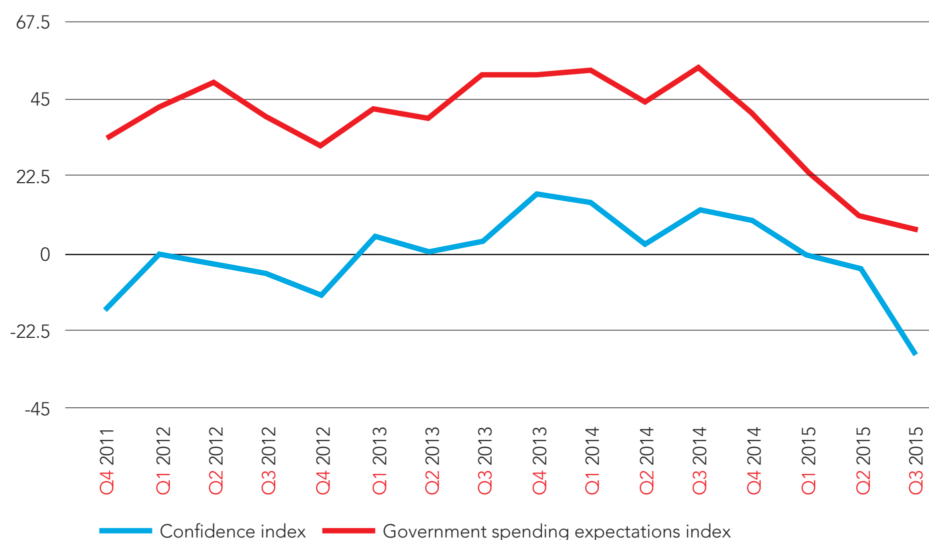
MIDDLE EAST: FEELING THE STRAIN

Business confidence in the Middle East is at its lowest ebb since the GECS began. The renewed fall in oil prices is likely to have concerned businesses, given the region's dependence on energy exports. Capital expenditure plans have understandably been pared back. Businesses have also become much more downbeat about the ability of governments to continue propping up growth with fiscal stimulus.

The government spending expectations index for the region has never been lower. That said, the withdrawal of government support is likely to be gradual. Governments in the Middle East generally have large amounts of fiscal reserves and relatively little debt. It was notable that more respondents still expected government spending to increase over the next five years than expected it to decline.

One country where the outlook could be brightening is Egypt. As a net energy importer it is not as vulnerable to lower oil prices as other economies in the region. It will also receive a boost from the major extension of the Suez Canal and an increase in natural gas output, which will help resolve electricity shortages. Much, of course, will hinge on whether the country can avoid further bouts of social unrest.

Chart 16: Middle East: Confidence and Government Spending



Source: GECS

> It is easier to blame problems in Nigeria on the fall in oil prices. Energy accounts for over 90% of the country's exports, while 70% of the government's revenue comes from the oil sector.

AFRICA: RUNNING INTO TROUBLE

The fresh fall in commodity prices clearly played a role in the sharp drop in confidence last quarter, but plenty of the region's recent problems have been of its own making. In particular, policy mistakes are crippling Africa's two largest economies: South Africa and Nigeria.

South Africa is actually a net importer of energy and should be benefitting from lower oil prices. But consistent power shortages and structural problems have prevented its manufacturing sector from taking advantage of the depreciation of the rand. Its economy contracted in the second quarter and there has been little sign of a pick-up in monthly data.

It is easier to blame problems in Nigeria on the fall in oil prices. Energy accounts for over 90% of the country's exports, while 70% of the government's revenue comes from the oil sector. But the government elected in March has hardly helped matters. President Muhammadu Buhari's long delay in announcing a cabinet or any meaningful policies left it down to the central bank to respond to the slump in oil prices. Its efforts to shore up the Naira with foreign exchange controls have resulted in liquidity shortages and restricted imports. Manufacturers have suffered as a result.

Nigeria is far from the only country in the region where a sliding currency has become a concern. The survey showed that 68% of businesses in Africa had been negatively affected by currency movements in the third quarter – more than in any other region.

There is no denying the potential for rapid growth, especially in the manufacturing sector, which could benefit from rising costs in China and the pressure this creates for firms to find cheaper locations for their factories. But few African nations are taking advantage. Indeed, the IMF expects the region to grow by just 4.3% in 2016, which would be slower than emerging economies as a whole.

THE CARIBBEAN AND SOUTH AMERICA: BLEAK IN BRAZIL

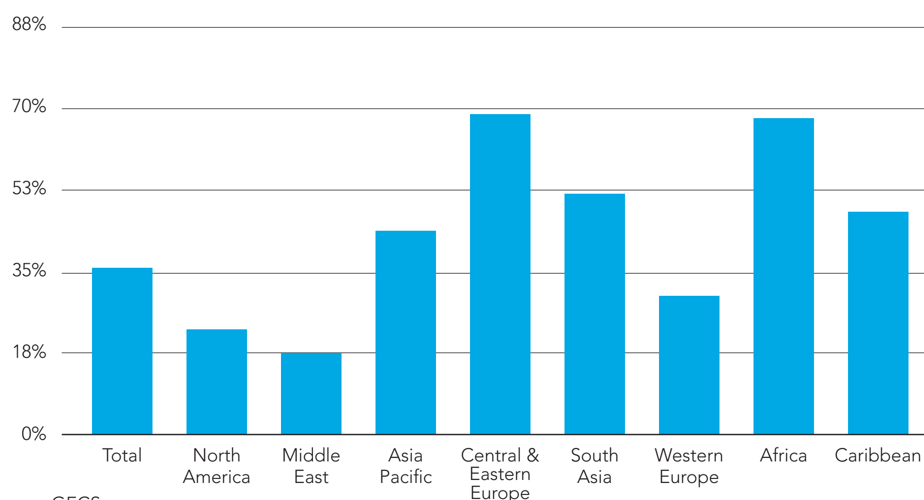
Latin America has not escaped the pain of low commodity prices. Its biggest economy, Brazil, is suffering a particularly bad hangover from the commodity boom years. Unlike in the Middle East, where much of the oil windfall was saved and used to build up fiscal reserves, a big credit bubble has built up. Credit growth has slowed sharply. The government is being forced to cut spending now that commodity revenue has dried up, and has aggressively raised interest rates this year to bring inflation under control.

Other economies in the region are suffering similar problems. Governments in Mexico and Colombia are being forced to tighten fiscal policy in response to lower commodity revenue, while Venezuela is going through a fully blown crisis. Chile and Peru are better placed, given the more prudent fiscal policies of their governments during the crisis. Still, the IMF's forecasts that regional GDP will contract by 0.3% in 2015 and grow by just 0.8% next year underline why businesses are pessimistic.

68%

of businesses in Africa had been negatively affected by currency movements in the third quarter

Chart 17: Negative impact of foreign exchange movements



Source: GECS

Conclusion

The third quarter was marred by a string of poor data, financial turmoil and falling commodity prices. The one piece of good news for the global economy – a deal to keep Greece in the euro-zone – got lost in the avalanche of bad news.

The third quarter was marred by a string of poor data, financial turmoil and falling commodity prices. The one piece of good news for the global economy – a deal to keep Greece in the euro-zone – got lost in the avalanche of bad news. It was no surprise then, that respondents generally reported that the last quarter was a bad one for their businesses and that they were less confident about the outlook than three months earlier.

But there are reasons to think that the panic of the third quarter went too far. Sentiment on China has certainly taken a turn for the better since August. GDP data for the third quarter showed growth slowing rather than collapsing, and while the official figures are increasingly treated with skepticism, a pick-up in credit growth suggests policy support is starting to feed through the economy. Monthly activity data will be watched eagerly, and should show signs of stabilization.

An improvement in China's economy would underpin some recovery in commodity prices, easing pressure on a range of emerging economies. However, there is no chance of commodity prices recovering to their previous highs, which means that governments that rely on commodity revenue to fund their spending will soon need to start tightening their belts.

US data will also be keenly watched. Signs that its economic recovery is getting back on track will not necessarily be welcomed by all businesses. A strong US economy is needed to help drive the global recovery, with export-dependent economies, especially in Asia-Pacific, desperate for an end to the slump in global trade. But an improvement would also bring tightening by the US Fed quickly back onto agenda, pushing down emerging market currencies and potentially creating problems for businesses with high levels of US dollar debt.

Overall, some improvement in business confidence looks likely in the last quarter of the year. And most forecasters are expecting a rise in global growth next year. If those expectations prove right, then business conditions will continue to improve. But as the turbulence of the third quarter illustrated, there is no shortage of potential threats to the global recovery.

Appendix I: Economies covered by Q3 survey responses

North America	Middle East	Asia Pacific	Central & Eastern Europe	South Asia	Western Europe	Africa	Caribbean	Central & South America
Canada	Bahrain	Australia	Bulgaria	Afghanistan	Cyprus	Cameroon	Barbados	Honduras
USA	Egypt	China, People's Rep of	Czech Republic	Bangladesh	Finland	Ethiopia	Bermuda	Mexico
	Iraq	Hong Kong SAR	Hungary	India	Germany	Ghana	Grenada	Suriname
	Israel	Indonesia	Moldova	Kazakhstan	Greece	Ivory Coast	Guyana	
	Jordan	Japan	Poland	Maldives	Ireland, Republic of	Kenya	Jamaica	
	Kuwait	Korea, Republic of	Romania	Nepal	Italy	Liberia	Puerto Rico	
	Lebanon	Malaysia	Russia	Pakistan	Luxembourg	Malawi	St Vincent	
	Oman	New Zealand	Slovakia		Malta	Mauritius	Trinidad & Tobago	
	Palestine	Philippines	Ukraine		Netherlands	Namibia		
	Qatar	Singapore			Spain	Nigeria		
	Saudi Arabia	Vietnam			Switzerland	Sierra Leone		
	United Arab Emirates				Turkey	South Africa		
					UK	Sudan		
						Tanzania		
						Uganda		
						Zambia		
						Zimbabwe		

ACCA, IMA and the global economy

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Global economic conditions continue to dominate business and political life. News and debates on economic issues are almost constantly the focus of media attention. While most national economies are now growing once again, it is far from clear how sustainable this growth is or how long it will be before a sense of normalcy returns to the global economy.

ACCA and IMA have been prominent voices on what the accounting profession can do to help turn the global economy around. Both bodies have published extensively on a range of topics, from the regulation of financial markets or the prevention of fraud and money laundering, to fair value or the role of international accounting standards, to talent management and the development of an ethical business culture.

ACCA and IMA aim to demonstrate how an effective global accountancy profession contributes to sustainable global economic development; to champion the role of accountants as agents of value in business; and to support their members in challenging times. Both professional bodies believe that accountants add considerable value to business, and never more so than in the current environment.

Accountants are particularly instrumental in supporting the small business sector. Small and medium-sized enterprises (SMEs) account for more than half of the world's private sector output and about two-thirds of all employment.

Both ACCA and IMA focus much of their research and advocacy efforts on articulating the benefits to SMEs of solid financial management and reliable financial information.

WHERE NEXT?

As countries around the world continue to consider strategies to promote stability and stimulate growth, the interconnectedness of national economies, and how they are managed and regulated, is now under close scrutiny. The development of the global accountancy profession has benefited from, and in turn contributed greatly to, the development of the interconnected global economy. The fortunes of the two are tied. ACCA and IMA will, therefore, continue to consider the challenges ahead for the global economy, and focus on equipping professional accountants for the uncertain future.

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