The Telegraph

What lies ahead for the global economy in 2016?

There may be trouble ahead... but there are reasons to be optimistic about the coming year

Take a look into the crystal ball for 2016 Photo: GETTY IMAGES

By Roger Bootle

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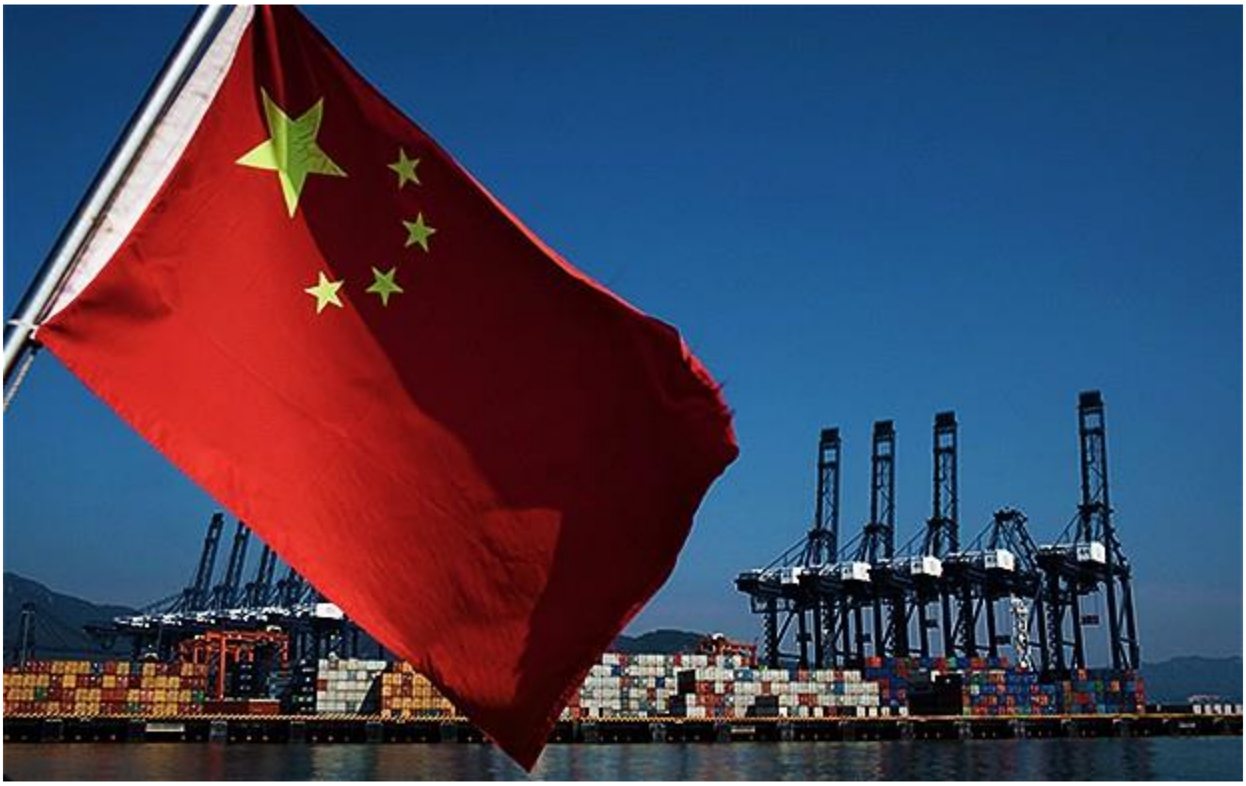
Crystal balls at the ready! This is the time of year when we economists like to give the benefit of our supposed wisdom and you, the readers, indulge us by appearing to believe that we know what is going to happen. Since economists are normally a pretty gloomy bunch, this represents the triumph of fear over experience. By contrast, I find myself fairly optimistic about the year ahead – albeit tempered by the usual dose of worries.

On the global front, the most important influence on our economy will probably continue to be **the price of energy**. I reckon that it is likely to stay roughly at the current level, although it may trend up a bit.

Two consequences follow from continued low energy costs. First, across pretty much all of the developed world the rate of inflation is set to rise from the near-zero rates that have prevailed recently.

Second, whereas last year saw the predominance of the negative effects of low energy prices over the positive ones, this year that balance should reverse. The losers from low prices will already have done most of their cutting, while the gainers may still increase their spending.



Has China's economic slowdown come to an end? Photo: 2010 Getty Images

I doubt whether China is again going to provide the main source of anxiety this year. I suspect that **the slowdown has pretty much come to an end**and there may even be scope for economic growth to pick up a bit. In America, I expect the recovery to continue bowling along at its recent solid though unspectacular pace.

In recent years the euro-zone has been a running sore for the world economy. Although it did a bit better last year, I suspect that its growth rate will fall back in 2016. Certainly no one should suppose that its fundamental economic problems are fixed.

In some ways 2016 is going to be a watershed year. Having flirted with deflation, most developed economies will now experience a return to more familiar territory and policymakers – except in the euro-zone and Japan – will return to the once familiar quandary as to how far and how fast to put up interest rates in order to fend off the danger of inflation.

I suspect that investors and commentators will be taken by surprise at the speed of interest rate rises. In America this will be because **job creation will continue at an impressive pace** and there will be clear signs of a pick-up of core inflation, with wages rising alongside.

The Bank of England should raise rates before long Photo: CHRISTOPHER PLEDGER

In the UK, things are rather different and I do not expect the Bank of England to follow the Fed's lead quickly. But I do expect it to follow before very long. As inflation rises over the next few months, with the economy strong, and more attention paid to the distortions caused by excessively loose monetary policy, the pressure will build for higher interest rates.

Admittedly, I don't expect them to reach more than about 1pc by the end of the year, but after these seven long years of rates held steady at the record low of 0.5pc, even this small increase is going to be felt keenly. Over recent months I have become increasingly aware that there are a large number of people, both financial experts and ordinary punters, who have come to believe that the current era of ultra-low interest rates is here to stay for an extended period. These people will be in for a shock.

Despite the prospect of higher interest rates and continued fiscal tightening, the **UK economic outlook looks to be me to be pretty good**. I expect wages to rise as the employment rate increases, thereby allowing the growth of real incomes to continue at a decent pace even as inflation rises to the 2pc target.

Nevertheless, there is a major political worry ahead that could have serious economic consequences. I refer, of course, to the coming **referendum on our membership of the EU**. We still don't know the date of the referendum, although that may become clear pretty soon. It could be spun out to the end of 2017 but I think that is unlikely. More likely is that the vote will occur either just before the summer break this year or in the autumn. Whether the result will have a major impact on the UK economy is a subject that I will turn to several times in the coming months. But the more immediate question is whether, before the referendum, uncertainty about the result could itself inhibit economic activity, causing the economy's growth rate to falter.

The EU referendum will probably happen this year Photo: Reuters

We are always hearing that financial markets, companies and households abhor uncertainty. There is much in this but not as much as we are often encouraged to believe. The result of the next Rugby World Cup – or this year's Grand National – is purely uncertain but I don't suppose that these uncertainties are going to do much to dent the rate of economic growth. For uncertainty to matter, the thing that is uncertain must itself have a major bearing on financial markets and/or economic activity.

To listen to extremists on either side of the debate you might readily conclude that **Armageddon awaits the UK if it chooses the wrong path** – whatever that may be. By contrast, I think that a sober analysis of the economic plusses and minuses suggests that the immediate net impact of our EU decision would not be very large. If that were widely believed, then the fact that the result is uncertain should not cause the UK economy to falter.

If there is one market which might register a significant impact from referendum uncertainty it is probably the foreign exchange market. We may well see some jitters on the exchanges and indeed **the pound could be forced lower** as people worry about the possibility of an "out" vote. But if this were to occur I would not regard it as a problem. Quite the opposite.

Through all the UK's recent economic success, the glaring exception has been our overseas trade. We are running the largest current account deficit in our peacetime history. There are several factors behind this but an over-valued exchange rate is one of the most important.

Wouldn't it be ironic if fears of the adverse economic consequences of an EU exit delivered for the UK a massive boost to its competitiveness, causing both the overall rate and the balance of economic growth to improve?

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