

World economic momentum peaks

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At the start of 2018 the global economy is in full swing. On a PPP-basis growth in 2017 was 3.9 percent, the highest rate since 2011. While leading indicators point to still robust growth in early 2018, sentiment has recently been negatively affected by increasing uncertainty about the pace of monetary tightening in the US and concerns about the future of global trade. Financial market turbulence in the course of the coming normalization of monetary policies and an escalation of trade conflicts constitute major risks to our baseline forecast of a gradually moderating but still robust world economy. We expect global output to rise by 4.0 percent and 3.8 percent in 2018 and 2019, respectively. The upward revision from our December forecast by 0.1 resp. 0.2 percentage points to a large extent reflects the incorporation into our baseline of the US tax reform.

- **The world economy has stayed on course towards the end of 2017.** While growth moderated somewhat from the high pace registered in mid-2017, fourth quarter growth remained robust, and the elevated level of sentiment indicators suggest that the expansion is still on track in the first months of 2018. Advanced economies remained in an upswing, whereas growth in the emerging economies did not accelerate further and continued to be relatively moderate.
- **The trade conflict with the US is a risk for global growth especially in the medium term.** After Donald Trump last year had refrained from the introduction of protectionist measures he had advocated in the election campaign, he has now announced first steps into this direction. The short-term impact on global activity should be modest, however, unless retaliation and further measures take the issue to a different level. In the medium term the negative impact of protectionism and economic disintegration on productivity are potentially more significant.
- **Inflation remains subdued for the time being.** In the advanced economies inflation continued to be moderate with little evidence that the increasing level of capacity utilization, which is reflected in falling and in many countries historically low unemployment, is already significantly pushing wages and inflation up. In a number of large emerging economies inflation is historically low, reflecting slack in the economy and exchange rate appreciation.
- **Monetary policy is expected to remain expansive for the time being, despite the rising levels of capacity utilization.** The nervous reaction of financial markets to a temporary inflation scare in the US earlier this year is evidence of the challenge central banks face of finding the right dose of monetary tightening in an environment characterized by still low inflation, but increasing evidence of diminishing slack and financial exuberance. We expect that the Fed Funds Rate will be raised to a still moderate 2.5 percent by the next year. In Japan and in the euro area, policy rates will not be raised before 2019 and tapering of bond purchases in the euro area is assumed to take until autumn this year.
- **The global growth momentum will gradually decelerate in the course of 2018 and 2019.** With more and more countries approaching substantial levels of excess capacity utilization, we expect the momentum of world output growth to gradually diminish. In the short-term, US GDP will accelerate on the back of significant fiscal stimulus, but return to more moderate levels of economic expansion later this year. At the same time, growth in China is bound to slow as policy is concerned with reigning in credit growth. On a PPP-basis global output is forecast to rise by 4.0 percent in 2018 and 3.8 percent in 2019.
- **The euro area economy will continue to recover but momentum of growth should start to slow.** Supported by monetary policy, GDP growth in the euro area will remain robust during this year and next. But growth rates will gradually decline as limits of productive capacities are being approached in an increasing number of countries and stimulus from exports is diminishing due to slower growth in China and currency appreciation. We expect GDP to expand by 2.1 percent next year, following 2.4 percent this year and 2.5 percent in 2017.

- **There are substantial downside risks to the outlook from economic policy and financial developments.** The global upturn could be derailed by a broad-based move of policies against free trade. In Europe the lack of consensus about the future of European institutions has a potential to trigger uncertainty and weigh on growth. At the same time, financial risks associated with the necessary process of normalization of monetary policies in the advanced economies are significant. Financial risks are also prominent in some emerging economies, which in recent years have experienced strong growth in debt of private households or private corporations, notably China.

Real GDP and consumer prices in selected countries and regions, 2017–2019

	Gross domestic product			Consumer prices		
	2017	2018	2019	2017	2018	2019
United States	2.3	2.9	2.3	1.9	2.2	2.2
Japan	1.7	1.4	1.3	0.5	0.8	1.8
Euro Area	2.5	2.4	2.1	1.5	1.5	1.6
United Kingdom	1.7	1.4	0.9	2.6	2.5	2.2
Advanced economies total	2.4	2.5	2.1	1.7	2.0	2.0
China	6.9	6.5	6.1	1.6	2.1	2.3
Latin America	1.4	1.8	2.4	6.8	5.1	4.7
India	6.7	7.4	7.8	3.8	4.9	4.8
East Asia	5.2	5.0	4.8	3.1	3.3	3.4
Russia	1.5	1.8	1.5	3.7	3.2	4.4
World economy total	3.9	4.0	3.8	3.0	3.2	3.4
<i>Addendum:</i> World trade volume	4.5	4.0	3.8	.	.	.
Oil price (Brent in US-\$)	54.1	63.6	64.6	.	.	.
World economy total (weighted according to GDP at market exchange rates)	3.3	3.4	3.2	2.6	2.8	2.9

Weighted according to GDP at PPP rates. — East Asia: Emerging Asia excluding China and India. — Shaded: Ifw forecast.

Source: Forecast of the Kiel Institute for the World Economy.

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