The global economy and the euro area: expansion continues but is losing momentum

By Ferdinand Fichtner, Guido Baldi, Geraldine Dany-Knedlik, Hella Engerer, Stefan Gebauer, and Malte Rieth

ABSTRACT

The global economy is likely to grow by over four percent this year and somewhat less next year. DIW Berlin has slightly raised its forecast for both years. Developed economies as well as emerging markets are experiencing an upturn; however, growth rates are likely to be slightly lower in the future. One reason for the sound global economy is the fact that the labor market situation is steadily improving, leading to an increase in private consumption. Along with fiscal stimuli in the form of tax cuts and government spending programs, more private consumption is also likely to trigger corporate investment activities. Monetary policy remains expansionary, but gradual increases in interest rates in major economies as well as the European Central Bank's (ECB) phasing-out of government bond purchases may somewhat curb growth in the U.S. and the euro area. This would also weaken the expansion in emerging economies. Risks to global growth stem from protectionist activities in the United States as well as political uncertainty in Europe.

Global economic growth weakened slightly at the end of the 2017. Overall, however, global output in 2017 recorded the highest growth rate in seven years. The economy picked up significantly, especially at the middle of the year, in both developed and emerging market economies. These high growth rates will likely not continue over the course of the forecast period, although the upturn will remain (Figure), supported by the strong and continually improving labor market situation.

Employment is rising in most developed economies while the unemployment rate is dropping. Together with continually moderate price increases, the purchasing power of households is improving, which boosts private consumption in particular. With that in mind, corporate investment activity is likely to continue. Fiscal stimuli are mainly being added in the U.S., although they also contribute to the expansion in the euro area. However, over time, the effects of interest rate increases in important economies and the ECB's reduction of the asset purchase program should make themselves felt and slightly curb growth.

High demand in developed economies stimulates international trade, benefiting emerging markets as well. In addition, domestic demand is robust in most emerging market economies, such as in central and eastern European countries. In Russia and Brazil, however, there are no signs of a strong recovery following steady, weak growth in recent years. In China, the structural change over the course of the forecast period should lead to a decline in growth rates.

All in all, the global economy should grow by 4.2 percent this year; next year, growth will likely be somewhat weaker. Compared to the Economic Outlook published in winter 2017, DIW Berlin is raising its forecast slightly for both years (Table).

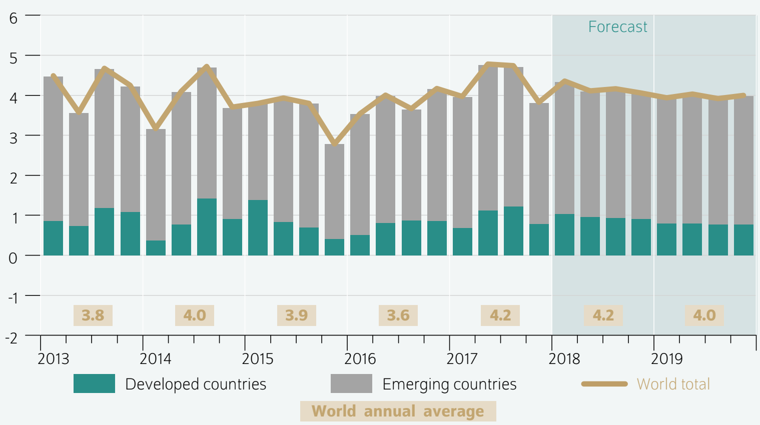
Globally, monetary policy remains expansive. There were recently concerns in the U.S. about a stronger-than-expected price increase and thus a faster tightening of monetary conditions. However, a strong overshooting of prices seems unlikely, also because it is assumed that oil prices are declining during the forecast period. The U.S. Federal Reserve is therefore likely to stick to its announced gradual increase in interest rates. The ECB will probably reduce net purchases under the asset purchase program to zero this year. We do not assume an initial interest rate increase, however, until 2019. The Bank of Japan is likely to maintain its expansionary stance due to the appreciation of the yen since the beginning of the year.

Fiscal policy should provide stimuli in the forecast period. Spending programs and planned tax cuts will probably noticeably increase growth in the short run, especially in the U.S. Fiscal policy in the euro area is also more expansionary than it has been recently.

The global economy is facing a series of risks. In the U.S., the additional demand created by fiscal policy measures could be reflected in higher prices due to the already well-performing economy. This could lead to a faster-than-expected tightening of monetary policy and end the already protracted upswing in the U.S. earlier than expected. Global financial conditions would also worsen as a result of restrictive monetary policy in the U.S., which would jeopardize emerging market economies in particular. Moreover, if the U.S. implements its announced protectionist measures, it could trigger reactions from other countries and impact international trade. There is the risk in the euro area that Italy will take a long time to form a government and thus cause a political stalemate, which could negatively affect corporate and household sentiment alike and dampen private demand.

Figure

World real GDP
In percent, percentage points



Sources: National statistical offices; DIW Economic Outlook Spring 2018.

The upturn will remain.

Table

Real Gross Domestic Product, Consumer Price Inflation, and Unemployment Rate in the World Economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Change over previous year in percent											
	2016	2017	2018	2019	2016	2017	2018	2019	2016	2017	2018	2019
Euro area	1.8	2.5	2.3	1.8	0.4	1.4	1.8	1.7	10.0	9.0	8.4	8.1
without Germany	1.8	2.5	2.2	1.7	0.3	1.3	1.7	1.7	12.6	11.4	10.7	10.4
France	1.1	1.9	2.0	1.7	0.2	1.1	1.4	1.5	10.1	9.5	9.4	9.2
Italy	1.1	1.5	1.4	1.2	0.0	1.4	1.2	1.4	11.7	11.3	10.9	10.5
Spain	3.3	3.1	2.7	2.2	−0.2	2.0	1.8	2.3	19.7	17.2	15.8	15.4
Netherlands	2.1	3.2	2.8	2.4	0.1	1.3	1.5	1.9	6.0	4.8	4.4	4.2
United Kingdom	1.9	1.7	1.4	1.5	0.7	2.7	2.6	2.1	5.0	4.5	4.6	4.6
USA	1.5	2.3	3.0	2.7	1.3	2.1	2.5	2.1	4.9	4.4	3.9	3.6
Japan	0.9	1.6	1.2	1.0	−0.1	0.5	0.8	1.1	3.1	2.9	2.8	2.7
South Korea	2.8	3.1	3.2	2.6	1.0	2.0	1.8	2.7	3.7	3.7	3.0	3.0
Middle Eastern Europe	3.2	4.9	3.9	3.4	−0.2	1.7	2.7	2.9	5.7	4.6	4.2	3.9
Turkey	3.2	6.6	3.9	3.5	7.8	11.1	9.3	8.2	10.9	10.9	10.7	10.5
Russia	−0.3	1.6	1.8	1.9	6.6	3.5	3.5	4.1	5.5	5.1	5.0	4.8
China	6.7	6.9	6.5	6.3	1.6	1.7	2.1	2.4	4.1	4.0	4.0	4.0
India	7.9	6.2	7.1	6.6	2.9	4.2	5.5	6.1				
Brazil	−3.5	1.0	0.9	1.1	8.7	3.6	4.9	6.0	11.3	12.8	10.6	8.4
Mexico	2.7	2.3	2.1	2.0	2.8	5.7	3.3	3.2	3.9	3.8	4.8	4.8
Developed Economies	1.6	2.2	2.5	2.2	0.8	1.8	2.1	1.9	5.9	5.3	4.9	4.7
Emerging Markets	5.0	5.6	5.4	5.2	3.0	3.1	3.5	4.0	5.3	5.3	5.0	4.8
World	3.6	4.2	4.2	4.0	2.1	2.6	2.9	3.1	5.5	5.3	5.0	4.7

Sources: National statistical offices; DIW Economic Outlook Spring 2018.

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