Global economy and the euro area: uncertainty weighs on trade and investment

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ABSTRACT

The global expansion weakened somewhat in the third quarter while the downside risks have increased. DIW Berlin's forecast—almost unchanged—indicates an expansion in global economic production of 4.3 percent for 2018 and 3.9 percent for 2019. In 2020, momentum will slow down further to 3.6 percent. In some countries, temporary factors contributed to the economic slowdown. In major advanced economies, private consumption remains the mainstay of the economy due to the good labor market situation. However, corporate investment and foreign trade are increasingly suffering from the current major political uncertainties. Brexit and the Italian crisis pose risks to investment and consumption and if the trade dispute escalates, there is also a risk of a global recession. Monetary policy should remain expansionary for the time being. No more significant fiscal policy stimuli are to be expected, especially since government measures in the US will expire in the forecast period.

The global economy weakened further in the third quarter of this year (Figure 1). The expansion slowed mildly in both developed and emerging market economies. However, temporary factors contributed to this. In the euro area, especially Germany, production was weak due to registration difficulties in the automotive sector, and in Japan, natural catastrophes caused the economy to shrink. In the US, the pace of growth began to return to normal after a very strong second quarter.

In some countries, there are likely to be temporary catch-up effects in the winter half-year. However, the gradual slowdown in the global economy is likely to continue in the further forecast period. Expansion rates continue to decline in the US. The effects of expiring fiscal policy impulses and tighter monetary policy will weigh on growth. In the US, as in many other major developed economies, private consumption is the mainstay of the economy. Private consumption is benefiting from the continued good situation on the labor market and significant income growth among the population.

In contrast, corporate investments and foreign trade are increasingly suffering from the current major political uncertainties. The trade conflict between the US and China is already affecting foreign trade in Asia, and large international US corporations are increasingly reacting with a wait-and-see approach. Political tensions in Italy and the United Kingdom are putting pressure on private sector sentiment. This seems to influence consumers and businesses in other parts of Europe as well (Figure 2). All in all, global production will decelerate from 4.3 percent this year to 3.9 percent in the coming year and is likely to further lose momentum in 2020 to 3.7 percent (Table 1). DIW Berlin has thus largely left its growth forecast for the global economy unchanged, although the downside risks have increased.

DOI: https://doi.org/10.18723/diw_dwr:2018-50-2

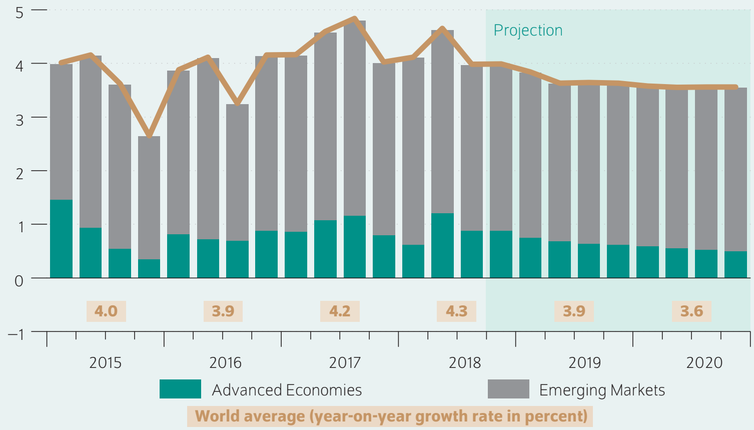
The doves have recently been dominating the direction of monetary policy: in the US, the monetary authorities signaled a somewhat slower tightening of key interest rates. In the euro area, the recent weakening of the economy has also made it more likely that interest rates will not be raised until after late summer 2019. In contrast, fiscal policy is likely to be broadly neutral globally. Additional government measures in China and Europe, for example, are likely to slightly boost growth. In the US, however, the economic effects of tax reforms and expenditure increases are more and more coming to an end.

The risks for global expansion have increased. The standstill agreement in the trade dispute between the US and China is likely to provide an initial respite. This only postpones the risks to world trade, however, and by no means eliminates them. If the current level of tariffs is maintained, the economic effects will remain moderate. However, a global escalation of the trade dispute could lead to a global recession.[1] In addition, Europe is still experiencing politically turbulent times. Both Brexit and Italy's budget dispute with the EU Commission pose considerable risks to private investment and consumer confidence. In contrast, the currency turbulence and thus the risks for emerging markets, which still existed in the summer, have been reduced. In Turkey, the drastic increase in key interest rates stabilized the currency.

Figure 1

World real gross domestic product growth

In percent



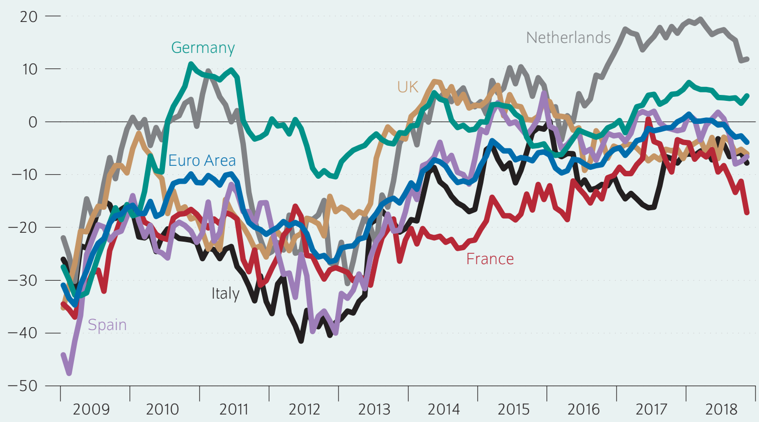
Source: National statistical offices; DIW autumn projections 2018.

The pace of expansion is slowing somewhat worldwide.

Figure 2

Consumer sentiment in Europe

Index, deviation from long term average



Source: Eurostat.

Last observation: November 2018.

Consumer sentiment has softened across Europe.

1 Projektgruppe Gemeinschaftsdiagnose, "Aufschwung verliert an Fahrt – Weltwirtschaftliches Klima wird rauer," *Gemeinschaftsdiagnose Herbst 2018* (2018) (in German; available online; accessed December 7, 2018).

Table

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

	Gross domestic product				Consumer prices				Unemployment rate in percent			
	Change over previous year in percent											
	2017	2018	2019	2020	2017	2018	2019	2020	2017	2018	2019	2020
Euro area	2.5	1.8	1.7	1.5	1.4	1.9	1.8	1.7	9.0	8.3	7.8	7.5
without Germany	2.6	2.0	1.7	1.6	1.3	1.8	1.7	1.6	11.4	10.6	10.1	9.9
France	2.3	1.6	1.7	1.6	1.1	2.0	1.6	1.7	9.4	9.2	8.6	8.3
Italy	1.6	1.1	1.2	1.1	1.3	1.3	1.3	1.4	11.3	10.7	10.4	10.3
Spain	3.0	2.5	2.3	2.0	2.0	1.8	1.8	1.7	17.2	15.3	14.2	13.9
Netherlands	3.0	2.5	2.0	1.9	1.3	1.6	2.2	2.0	4.8	3.9	3.8	3.7
United Kingdom	1.7	1.3	1.3	1.4	2.7	2.5	2.1	2.0	4.5	4.2	4.4	4.4
USA	2.2	2.9	2.4	1.6	2.1	2.5	2.2	2.1	4.4	3.9	3.6	3.5
Japan	1.7	0.9	1.1	0.8	0.5	1.0	1.1	1.2	2.8	2.4	2.4	2.4
South Korea	3.1	2.7	2.6	2.5	2.0	1.7	2.6	2.7	3.7	3.6	3.0	3.0
Middle Eastern Europe	4.9	4.4	3.7	3.3	1.7	2.2	2.7	2.8	4.6	3.7	3.5	3.4
Turkey	7.4	4.9	2.6	3.2	11.1	16.6	15.6	8.2	10.9	10.9	10.6	10.1
Russia	1.6	1.5	1.7	2.0	3.5	3.0	4.3	3.7	5.1	4.7	4.6	4.5
China	6.8	6.6	6.3	6.0	1.4	1.7	2.3	2.4	4.0	4.0	4.0	4.0
India	6.2	7.7	6.0	5.7	3.5	4.1	6.0	6.1				
Brazil	1.0	0.8	0.8	1.2	3.4	3.9	5.9	6.5	12.8	11.3	8.4	6.2
Mexico	2.3	2.0	1.8	1.6	6.0	4.4	3.0	3.2	3.4	4.0	4.8	4.8
Developed economies	2.2	2.3	2.0	1.5	1.8	2.1	2.0	1.9	5.3	4.8	4.5	4.4
Emerging markets	5.6	5.7	5.1	4.9	2.8	3.3	4.2	4.0	5.2	5.0	4.8	4.5
World	4.2	4.3	3.9	3.6	2.4	2.8	3.3	3.2	5.3	4.9	4.7	4.5

Source: National statistical offices; DIW autumn projections 2018.

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JEL: E32, E66, F01

Keywords: Business cycle forecast, ecoomic outlook

LEGAL AND EDITORIAL DETAILS

DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e.V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89 – 0   Fax: – 200
Volume 8   December 17, 2018

Sale and distribution
DIW Berlin Leserservice, Postfach 74, 77649 Offenburg
leserservice@diw.de
Phone: +49 1806 14 00 50 25 (20 cents per phone call)

Layout
Roman Wilhelm, DIW Berlin

Cover design
© imageBROKER / Steffen Diemer

Composition
Satz-Rechen-Zentrum Hartmann + Heenemann GmbH & Co. KG, Berlin

ISSN 2568-7697