The world economy and the euro area: global upswing remains intact for the time being

By Ferdinand Fichtner, Guido Baldi, Martin Bruns, Christian Dreger, Hella Engerer, Stefan Gebauer, and Malte Rieth

The global economy is expected to grow by four percent annually over the next two years. This is a slight increase in the German Institute for Economic Research forecast in comparison to that of the fall. The upswing will gain momentum in both developed and emerging economies. Private consumption will play a pivotal supporting role as investment continues to grow rapidly around the globe. Despite the high level of unemployment in some countries, the euro area is experiencing stable growth, though its investment could be more dynamic. In China, cutting back overcapacity in manufacturing should suitably curb expansion. And a somewhat less expansive monetary policy emanating from the USA and euro area could curb worldwide demand to the extent that global economic growth does not continue to accelerate. Political uncertainty in Europe and the USA, as well as potential trade restrictions, pose the primary risks to the world economy.

The strong upswing in the global economy has not abated. In the third quarter, the economic situation developed as positively in developed economies as it did in emerging economies. Consumption was again the main driver of growth. Investment also remained robust, currently resulting in tangible annual growth in world trade. The momentum should be maintained next year, as growth spreads even in emerging economies. In conjunction with the stable domestic economies of developed countries, this should also boost private investment activity. And the situation in the employment market will also continue to improve. In the euro area, unemployment will remain high and the upward trend in wages and prices will be moderate. China has considerable overcapacity in the manufacturing sector, and the sectoral shift there should lead to a slight flattening of world trade in the future. In the USA, on the contrary, shortages in the employment market may be observed by the end of the forecast horizon and inflation will probably increase. Overall, these factors should slow down the global economy's growth (Figure).

And monetary policy is also likely to reduce its level of expansion around the globe somewhat, which will also contribute to the slowdown. In the USA, the Federal Reserve Bank is expected to continue reducing its portfolio of assets and gradually raise the prime rate. Central banks in emerging countries should follow suit, which would slightly increase financing costs for companies and households around the world. The European Central Bank also announced that it planned to reduce the volume of its monthly asset purchases. It will presumably stop net purchases in the second half of 2018 and in the following year, after which the inflation rate will slowly approach its target from below–an initial moderate increase in the interest rate will follow. Global financial policy should take a slightly less restrictive approach. In the USA, tax breaks will set a moderately positive trend.

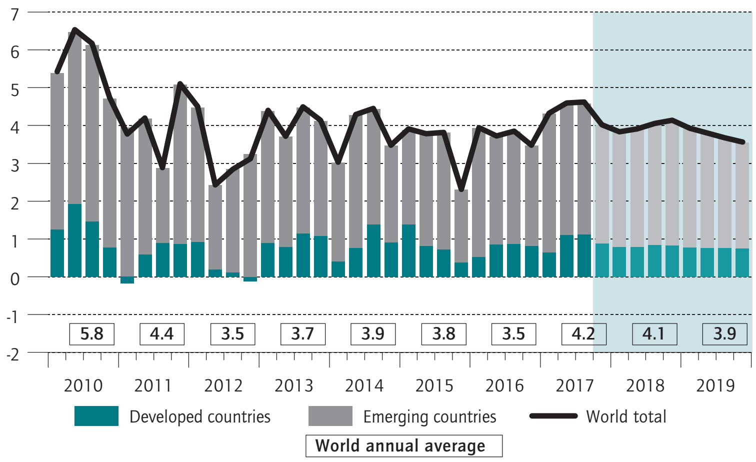
All in all, the world economy should grow by an annual rate of around four percent within the forecast horizon (Table). This slightly improves the forecast in comparison to the September 2017 *Economic Outlook*. The robust expansion will be supported by oil prices, which should rise only mildly.

Risks to the global economy continue to emanate from Europe, where key elections–in Italy, for one–will take place next year. If euroskeptical parties grow stronger or the problems of heavily indebted banks are exacerbated, uncertainty in the euro area could increase and adversely affect investment. The Brexit negotiations could also lead to a higher level of uncertainty and dampen the economic growth of the UK. Trade restrictions imposed by the U.S. are likely to hamper world trade and global investment activity.

Figure

World real GDP

In percent, percentage points



Sources: National statistical offices; DIW Economic Outlook Winter 2017.

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The expansion is losing a bit of steam in 2019.

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	1.7	2.4	2.1	1.7	0.4	1.4	1.6	1.7	10.0	9.0	8.6	8.3
without Germany	1.7	2.3	2.0	1.7	0.3	1.3	1.6	1.7	12.6	11.5	11.0	10.7
France	1.1	1.8	1.8	1.6	0.2	1.1	1.4	1.5	10.1	9.6	9.6	9.4
Italy	1.1	1.6	1.4	1.2	0.0	1.4	1.1	1.4	11.7	11.3	11.0	10.6
Spain	3.3	3.1	2.7	2.3	−0.2	2.0	1.9	2.3	19.7	17.2	15.8	15.3
Netherlands	2.1	3.2	2.6	2.2	0.1	1.3	1.4	1.7	6.0	4.9	4.6	4.4
United Kingdom	1.8	1.5	1.4	1.5	0.7	2.7	2.5	2.2	5.0	4.5	4.6	4.7
USA	1.5	2.3	2.5	2.4	1.3	1.8	1.6	2.1	4.9	4.4	4.1	4.0
Japan	1.0	1.5	1.2	1.2	−0.1	0.3	0.5	1.1	3.1	3.0	3.1	3.0
South Korea	2.8	3.2	3.1	2.6	1.0	2.2	2.5	2.7	3.7	3.6	3.0	3.0
Middle Eastern Europe	3.0	4.6	3.5	3.3	−0.2	1.6	2.4	2.5	5.7	4.6	4.2	3.9
Turkey	3.3	5.4	3.3	3.5	7.8	10.8	8.3	8.2	10.9	11.1	10.7	10.5
Russia	−0.2	1.9	1.6	1.7	7.1	4.2	4.1	4.0	5.5	5.2	5.1	4.8
China	6.7	6.8	6.5	6.5	1.6	1.7	2.5	3.3	4.1	4.1	4.1	4.1
India	7.9	6.7	7.3	6.6	2.9	5.6	6.1	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	2.6	2.2	2.0	2.8	5.7	3.2	3.2	3.9	4.1	4.8	4.8
Developed Economies	1.6	2.2	2.2	2.0	0.8	1.6	1.6	1.9	5.9	5.3	5.1	4.9
Emerging Markets	5.0	5.6	5.4	5.2	3.0	3.4	3.9	4.4	5.3	5.4	5.2	4.9
World	3.5	4.2	4.1	3.9	2.1	2.7	2.9	3.4	5.6	5.4	5.1	4.9

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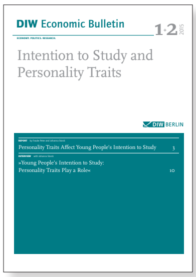

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