Global economy and the euro area: protectionism weighing on trade and investment

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ABSTRACT

The global economy is holding steady amidst uncertainty, although subdued export and investment growth in some places is already proving the extent to which protectionism and the unresolved trade conflicts are negatively affecting the economy. Contributing to the uncertainty is the continued unclear outcome of Brexit. In many countries, the domestic economy is fighting against a downturn. However, the situation on the labor market remains good overall and employment and wages are rising, leading many private households to spend some of the extra money. Although DIW Berlin expects the global economy to slow in 2019 and 2020, with growth of 3.7 percent for each year, its forecast remains largely stable compared to the spring of this year.

The global economy expanded somewhat more strongly in the first quarter of 2019 compared to the end of 2018. The expansion accelerated mildly in both developed and emerging market economies (Figure). The economy gained momentum in the US and the euro area in particular, mostly due to domestic demand. The labor markets are continuing to develop strongly and consumers remain mostly confident about the future. In contrast, foreign trade and corporate investment activity have been largely sluggish recently, mainly due to the uncertainties caused by the ongoing trade conflicts.

These conflicts will likely continue. In May, the US once again increased tariffs on imports from China. In addition, they threatened action against European and Japanese car and car part imports. Protectionism is likely to weigh on economic activity in both the US and the countries affected by the tariffs. Consumer prices are likely to continue to rise, but companies' uncertainty is increasing. Some investment decisions are likely to be postponed, and the slowdown in foreign trade momentum will likely weigh on the economy, particularly in Asian countries.

In most countries, robust consumer demand is counteracting these strains so that growth rates are declining only gradually overall. The labor market situation is even improving further in many places, although the pace of employment growth is slowing down. Wages are increasing more strongly than in the previous years, but core inflation rates remain mostly low. However, headline inflation is expected to pick up somewhat over the forecast period, as energy prices have risen due to political tensions in and around the Middle East.

There is hardly any need for action on the part of the central banks. Therefore, monetary policy will remain expansionary globally. In the US, previous interest rate hikes are currently having a slightly dampening effect. Towards the end of the forecast horizon, however, key US interest rates are likely to be lower, especially if the trade conflicts cause the economic situation to become gloomier than expected. In the euro area, longer-term refinancing operations will likely support the economy, especially in the southern countries. Here, too, key interest rate hikes are not to be expected until the end of 2020.

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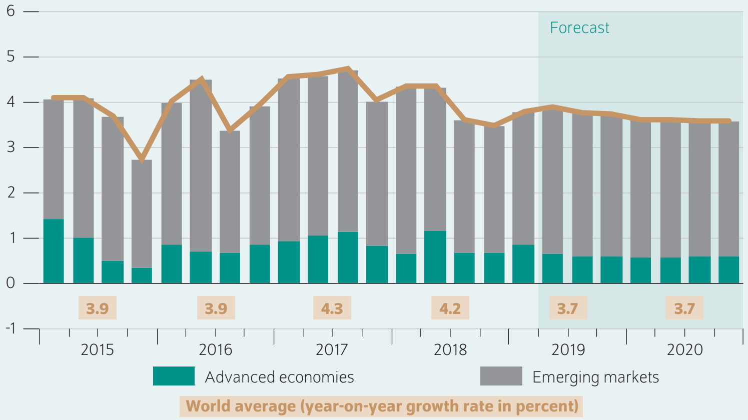
Fiscal policy is likely to become more expansionary globally than it has been recently. In the US, the stimulating effects of tax cuts and expenditure increases are slowly ending. In contrast, governments in China and large euro area countries are likely to launch fiscal stimuli in the near future.

As a result, the global expansion is likely to slow to 3.7 percent in 2019 and in 2020 (Table). Thus, DIW Berlin's prognosis remains largely stable.

The largest risk for the economy are the trade conflicts originating from the US. Should the dispute with China escalate and Europe and Japan become even more involved in the tariff dispute, this will have a greater negative impact on corporate sentiment, foreign trade, and investment in Europe than in the past. Unclear plans for Brexit post a further risk: If a no-deal Brexit occurs, this is likely to affect not only the economy in Great Britain, but also those of its closest trade partners, primarily Germany, negatively. Moreover, due to the renewed budget dispute between the EU Commission and the Italian government, overall economic development in the euro area could be weaker than expected.

Figure

World real GDP growth
In percent



Source: National statistical offices; DIW summer projections 2019.

The global economy is holding steady amidst uncertainty.

Table

Real GDP, 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											
	2017	2018	2019	2020	2017	2018	2019	2020	2017	2018	2019	2020
Euro area	2.5	1.7	1.2	1.4	1.4	1.8	1.4	1.7	9.0	8.2	7.7	7.6
without Germany	2.5	1.8	1.3	1.4	1.4	1.8	1.3	1.5	11.4	10.4	9.9	9.8
France	2.3	1.6	1.3	1.4	1.1	1.8	1.3	1.6	9.4	9.1	8.6	8.3
Italy	1.8	0.7	0.3	0.7	1.3	1.2	0.9	1.1	11.3	10.6	10.4	10.5
Spain	3.0	2.6	2.4	1.8	2.0	1.7	1.2	1.7	17.2	15.3	14.2	14.1
Netherlands	3.0	2.6	1.8	1.7	1.3	1.6	2.4	1.8	4.8	3.9	3.5	3.6
United Kingdom	1.8	1.4	1.3	1.3	2.7	2.4	2.0	2.0	4.5	4.2	4.1	4.2
USA	2.2	2.9	2.5	1.8	2.1	2.4	1.8	2.0	4.4	3.9	3.7	3.5
Japan	1.9	0.8	1.0	0.8	0.6	0.8	1.0	1.2	2.8	2.5	2.4	2.4
South Korea	3.1	2.7	1.7	2.4	1.9	1.5	1.1	2.7	3.7	3.8	3.3	3.0
East-central Europe	5.1	4.5	3.8	3.4	1.7	2.2	2.4	2.8	4.6	3.7	3.4	3.3
Turkey	7.4	2.7	−2.5	2.8	11.1	16.4	17.1	16.2	10.9	11.0	14.0	13.5
Russia	1.8	2.0	1.5	1.9	3.5	3.1	4.7	4.1	5.1	4.7	4.4	4.3
China	6.8	6.5	6.2	6.0	1.4	1.7	2.2	2.2	4.0	3.9	3.7	3.7
India	6.9	7.4	6.6	6.3	4.0	3.9	5.5	6.1				
Brazil	1.1	1.1	0.8	1.0	3.4	3.7	4.7	6.5	12.8	12.3	10.2	9.2
Mexico	2.3	2.0	1.6	1.4	6.0	4.9	4.2	3.2	3.4	3.3	4.8	4.8
Developed economies	2.3	2.2	1.9	1.5	1.8	2.0	1.6	1.9	5.3	4.8	4.6	4.4
Emerging markets	5.7	5.6	4.9	5.0	2.9	3.3	4.1	4.4	5.2	5.0	4.8	4.5
World	4.3	4.2	3.7	3.7	2.5	2.8	3.1	3.4	5.3	4.9	4.7	4.5

Source: National statistical offices; DIW summer projections 2019.

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