Modest Growth Continues

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Not much has changed in the global economic outlook over the last few months and forecast growth rates have hardly budged from those shown in the October note. Modest expansion is expected to continue in the advanced economies as is a gradual deceleration in China. The fears of a 2020 recession have diminished, on the assumption, of course, that tensions in the Middle East do not escalate.

While industrial activity and exports in China are only moving sideways, economic policy remains accommodating and infrastructure investment is growing. More importantly, the recent "Phase one" of the new trade agreement with the U.S., the suspension of the threat of new tariffs in December 2019, and the reduction of some of the tariffs imposed by the U.S. earlier last year, is boosting confidence and should sustain activity. All in all, growth this year and next should settle in the 5.5-6.0% range. The major uncertainty remains in the trade area given that Trump's trade policies have, in the past, been very erratic. A resumption of hostilities can hardly be ruled out (see below) and would, inevitably, affect growth adversely.

Prospects for the United States remain reasonable. Manufacturing and exports show signs of relative weakness and a likely strong dollar (consequent, inter alia, upon interest rate and growth rate differentials favouring the U.S.) will further dampen the external sector. On the other hand, residential construction is picking up speed and consumer confidence remains strong, buoyed by very low unemployment and reasonable wage growth. This being a presidential election year, the Administration will do what it can to further promote growth and employment. The recently signed trade agreement with China has strengthened business confidence and Wall Street. It remains to be seen, however, whether China-bashing (or Europe-bashing, for that matter) may not be an even greater vote catcher. Should Trump feel that that could be the case, expect a renewed shift into protectionism (despite its likely longer-run negative effects on the economy).

Populism appears to have spread from the advanced to the emerging economies. Mass demonstrations seem to be occurring regularly now, and not only in Latin America. Yet, so far at least, this seems to have had little effect on growth trends. Growth remains relatively subdued in South-East Asia, in Africa and, especially in Latin America. Amongst major countries, India seems now to have joined the "slower growth club", while, encouragingly, Russia and Turkey are looking somewhat stronger than they were only a few months ago.

One area of the emerging world which keeps looking resilient is Central-Eastern Europe and this despite its dependence on the very slowly growing Western European market. Growth last year was close to 3.0% and it could still average between 2.25 and 2.5% in 2020-22, driven not so much by exports as by private consumption. Hungary and Slovenia, but also Poland and Romania, continue to surprise on the upside.

Western Europe is more problematic. The bad news is that the manufacturing sector remains very weak and this weakness is beginning to affect the more buoyant service sector, at least in some economies. In addition, employment growth is flattening out. The good news is that the fears of impending recession, widespread until recently, are fading. The overall trend points to a bottoming out of activity rather than to a decline.

The United Kingdom might be expected to recover now that the fog surrounding Brexit has been lifted. This being said, there are still uncertainties linked to the exact terms of Britain's departure from the EU. The government is legislating for a definite break at the end of the year, based upon the terms that have been agreed. Given the very tight timetable, these may not be particularly favourable to the country. The risks of a so-called "hard" Brexit have not gone away, in other words, and prospects for next year remain murky. In a worst case scenario, UK GDP, rather than growing by 2.0% in 2021, might expand by only half that amount.

Turning to the Eurozone, the stabilization of activity at the low rate of expansion witnessed in the recent past should continue. The manufacturing sector will have to wait for an upswing in world trade, which does not look imminent; the construction sector is weak almost everywhere with only services imparting some modest strength to the economy. Germany and Italy were in semi-stagnation over the last few years and risk repeating a similar experience this year. France and Spain did somewhat better (growth of 1.25% and 2.0%, respectively) with forecasts for this year suggesting a not dissimilar outcome for France (unless social unrest were to continue) and a contained deceleration for Spain. Among the smaller countries of the euro area, only Greece and Ireland are expected to record growth rates above 2.0% (and for the latter country that outcome is very uncertain given the possibility of a "hard" Brexit).

As always, negative risks surround these forecasts. The danger of protectionism continues to loom over Europe in view of the frequent threats voiced by Trump and others in the U.S. Administration. Indeed, the recent trade agreement that America has reached with China, should, if it holds, raise the risks for Europe. In an election year, punishing an area with a large trade surplus could be a vote winner. A trade war with the U.S. might not unleash a recession, but it would further reduce an already very modest growth rate of output.

A second global risk relates to the stock market. Share prices have risen very sharply in the recent past despite the relatively subdued growth rate of all the major advanced economies. This could, of course, suggest that forward looking investors are seeing an impending upswing in activity consequent upon a prolonged period of lower interest rates. Yet, the forecasting record of stock markets is, at best, mixed (one is reminded of the quip by the American economist Paul Samuelson that "the stock market has predicted nine of America's past five recessions"). A more worrying interpretation could be that low interest rates have been fueling a bubble which could burst, further adding to the weakness in activity.

A ray of hope for Europe could come from policy. Monetary policy is already expansionary and can hardly be expected to do more. Fiscal policy, for the moment, is in neutral territory, but could turn into a modest expansionary stance given that consensus opinion is moving in the direction of greater fiscal activism. This would seem to be true even in Germany where a respected voice of austerity and rigour (that of Bundesbank president Jens Weidmann) has recently stated that the country's fiscal commitments should not become a fetish.

	GDP GROWTH RATES (%)				
	2018	2019	2020	2021	2022
Eurozone	1.9	1.2	1.0	1.3	1.3
United Kingdom*	1.4	1.3	1.0	1.9	1.7
United States	2.9	2.3	1.7	1.7	1.8
China	6.6	6.1	6.0	5.6	5.5
World	3.2	2.6	2.5	2.8	2.9

*Assumes a "soft" Brexit
Source: Oxford Economics.

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