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Article

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Global growth still subdued

By Ferdinand Fichtner, Guido Baldi, Christian Dreger, Hella Engerer, Christoph Große Steffen, Michael Hachula, Malte Rieth and Thore Schlaak

The world economy has yet to regain momentum: after the already weak final quarter of 2015, the pace of expansion slowed down again in the first quarter of 2016. In the emerging countries' economies, growth is expected to remain subdued, especially in China, where the gradual slowdown continues as overcapacities are reduced. Russia and Brazil are likely to remain in recession: apart from the still-low commodity prices, domestic issues are aggravating the situation. Growth is just barely stable in the industrialized countries, which means they cannot compensate for the emerging countries' weaknesses. In the industrialized countries, the primary growth driver is still domestic demand. Strong consumption growth is expected in the US as well as in the euro area, primarily as a result of the improving labor market situation. All in all, the global economic growth rate is expected to be 3.2 percent in 2016, which is lower than previously forecasted. The uncertainty about China's future economic development and the potential impact of a Brexit are the primary risks that are curbing optimism.

Global economic development remains weak: after production experienced a slight increase in the final quarter of 2015, the pace of expansion slowed once again in the first quarter of this year (Figure 1). A slight economic recovery is expected over the course of 2016. This is unlikely to fully compensate for the unexpectedly weak performance in the first quarter, and thus the growth rate should stand at 3.2 for the entire year—again, less than previously predicted (Table). The economy should pick up in the coming year: a growth rate of 3.6 percent is expected.

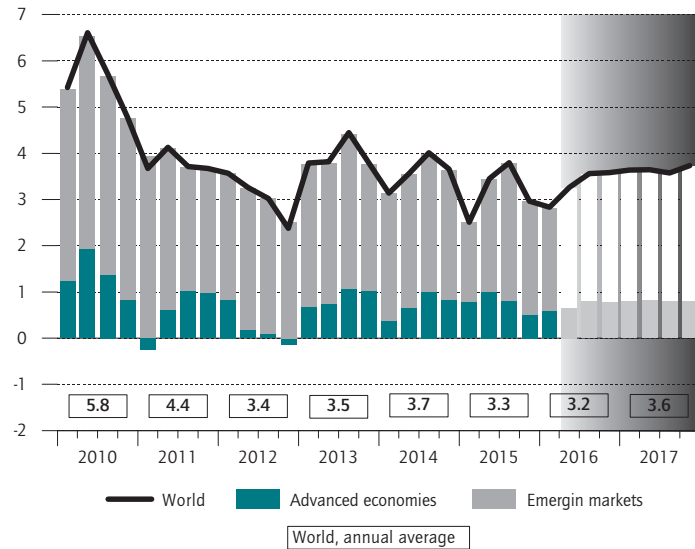
As in previous quarters, it was primarily the emerging countries that were contributing to the slowdown. China recorded the lowest growth since the global financial crisis; however, the major slump in the Chinese economy that was feared among global financial markets this past spring did not materialize. In Russia and Brazil, the economy continued to shrink, albeit at a slower pace. Here, the recent rise in commodity prices is likely to support a return to positive growth rates towards the end of the forecast horizon. In China, government stimulus packages will likely contribute to slightly rising growth rates. The dampening factors will continue, however, with the result that overall, the growth in the emerging countries' economies will remain modest, and will be lower than that of previous years.

In the developed countries, the first quarter was characterized by an upward momentum. While economic output in the US increased less than it did before, the GDPs in Japan and the euro area increased at higher rates. In the next quarters, the stable sideways movement of the economy in the developed economies is expected to continue, with private consumption remaining the primary growth driver due to the improving labor market situation. For the time being, however, neither the development of net exports nor the investment activities are likely to create major impulses, since the emerging countries' economies are not picking up momentum.

Across the globe, monetary policy will be slightly less expansionary. While the central banks in the euro area

Figure 1

World real GDP
In percent



Source: National statistical offices; DIW summer projections 2016.

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Global growth is still subdued.

and Japan continue to implement expansionary measures, the US Federal Reserve is expected to gradually and slightly raise the interest rates, given the generally good situation on the labor market and the early signs of rising inflation rates. Global fiscal policy is expected to be somewhat less restrictive. In Europe, for example, a slower implementation of the deficit reduction is expected.

The risks to the global economy have decreased: uncertainty regarding China's development has lessened among the financial markets, with the result that global financial conditions have seen slight improvements. In Europe, however, uncertainty has been increasing due to the forthcoming referendum on the fate of the UK in the European Union (See box: Brexit).

USA

In the first quarter of this year, the US GDP increased by an annualized rate of only 0.8 percent. While private consumption has increased markedly, corporate investment has declined. Given the robust consumer demand and a rebound in investment activity, US economic growth should pick up considerably. Private consumption will be supported by the continued recovery in the labor market: the unemployment rate decreased within one year by

Tabelle

Real gross domestic product, consumer price inflation, and unemployment rate in the world economy
In percent

	Gross Domestic Product				Consumer Prices				Unemployment Rate			
	Change over previous year											
	2014	2015	2016	2017	2014	2015	2016	2017	2014	2015	2016	2017
Euro area	0.9	1.6	1.6	1.7	0.4	0.0	0.4	1.3	11.6	10.9	10.1	9.6
without Germany	0.6	1.6	1.6	1.7	0.2	0.0	0.2	1.2	13.8	13.0	12.1	11.5
France	0.7	1.2	1.2	1.4	0.5	0.1	0.3	1.2	10.3	10.4	10.1	10.0
Italy	1.4	3.2	2.7	2.4	-0.2	-0.5	-0.3	1.3	24.5	22.1	19.8	18.5
Spain	-0.3	0.6	1.0	1.4	0.2	0.1	0.3	1.0	12.7	11.9	11.0	10.4
Netherlands	1.0	2.0	1.9	2.2	0.3	0.2	0.6	1.0	7.4	6.9	6.3	6.1
United Kingdom	2.9	2.3	1.8	2.1	1.5	0.0	0.4	1.8	6.1	5.3	5.0	4.9
USA	2.4	2.4	1.8	2.3	1.6	0.2	1.6	1.7	6.2	5.3	4.8	4.7
Japan	-0.1	0.6	0.6	0.5	2.7	0.8	0.1	1.0	3.6	3.4	3.7	3.8
South Korea	3.3	2.6	2.6	2.8	1.3	0.7	1.2	2.2	3.5	3.6	3.2	3.0
Middle Eastern Europe	3.0	3.6	3.2	3.4	0.3	-0.4	-0.3	1.4	8.4	7.3	6.6	6.3
Turkey	3.0	4.0	3.3	3.6	8.9	7.8	7.8	7.4	10.0	10.3	10.4	10.1
Russia	0.7	-3.6	-1.1	0.5	7.9	15.5	6.7	4.4	5.2	5.6	5.7	5.6
China	7.3	6.9	6.1	6.0	-0.6	-0.6	0.9	2.9	3.8	3.8	3.8	3.8
India	7.1	7.4	7.3	6.7	4.4	1.1	3.3	6.1				
Brazil	0.1	-3.9	-3.0	0.2	6.3	9.0	7.0	5.5	4.8	6.8	5.1	5.1
Mexico	2.2	2.5	2.6	2.6	4.0	2.7	2.9	3.2	4.8	4.4	4.8	4.8
Advanced Economies	1.8	2.0	1.6	1.9	1.4	0.2	1.0	1.5	7.0	6.3	5.9	5.7
Emerging Markets	5.2	4.4	4.4	4.8	2.5	2.9	3.0	4.1	4.8	5.0	4.8	4.7
World	3.7	3.3	3.2	3.6	2.0	1.8	2.2	3.0	5.8	5.6	5.3	5.2

Source: National statistical offices; DIW summer projections 2016.

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almost one percentage point and in May, it amounted to 4.7 percent. However, the labor force participation rate is still at historically low levels. All in all, the slight increase in disposable income will also pick up during the forecast period, supporting private consumption as well as residential construction. Against the backdrop of strong consumer demand, businesses will expand their investment activity somewhat over the course of this year. Due to the increasing capacity utilization, investment will see even more significant increases in the coming year. Given the steady improvement of the state of the economy, the US Federal Reserve is expected to raise its key interest rates again by autumn; the following quarters should also see slight and gradual increases in interest rates. In contrast to previous years, fiscal policy is no longer restrictive, and it is assumed that the fiscal policy will not be changed after the presidential elections at the end of 2016. All in all, the US economy is expected to grow by 1.8 percent in 2016, and by 2.3 percent in 2017.

China

In China, production increased by only 1.1 percent in the first quarter of the year. While private consumption experienced above-average growth, investment growth was less pronounced. Negative impulses also came from net exports. The overall annual development, however, was distorted by the long holiday period due to the Chinese New Year. The annual increase in production stood at 6.7 percent.

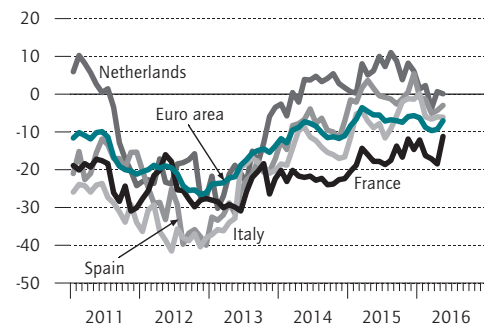
Although the service sector is showing strong growth, the business cycle in the industrial sector is weaker. This is reflected in the PMIs—among others—which are well above the expansion threshold in the service sector, but slightly under the expansion threshold in the industrial sector. State-owned enterprises in particular are dealing with significant overcapacities that are dampening investment. Moreover, the weak demand from the global economy is an impediment for stronger exports. To sustain growth, China will invest roughly 630 billion euros to improve the infrastructure over the next three years. All in all, China's GDP is likely to increase by 6.1 percent this year, and by 6.0 percent next year.

Euro area

Production in the euro area grew by 0.6 percent in the first quarter of 2016, thus picking up momentum. In the second quarter, however, there was a slight counter-movement—which is partly due to industrial production which, after a significant increase in January, began declining again in the following two months. A key growth driver in the first quarter was private consumption, which should continue supporting growth in the long run. Many consumer indicators, such as the number of motor ve-

Figure 2

Consumer confidence Net Balance



Quelle: European Commission.

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Consumer confidence is above its long-run average, but has stopped increasing in recent months.

hicle registrations, are currently pointing to an upward trend. The moderate increase in employment in many countries continues, and the gradually improving situation on the labor market is manifesting itself through an increase in real disposable income. Over time, however, the development of private consumption is unlikely to gain further momentum. One indication of this is that consumer confidence is still above the long-run average, but has stopped increasing in recent months (Figure 2). Secondly, slightly increasing inflation rates are expected to curb the growth of real disposable income.

Investment is expected to gradually pick up momentum over the forecast period, not least due to improving financial conditions. The current *Bank Lending Survey* of the European Central Bank (ECB) indicates further easing of credit conditions for businesses as well as a slightly stronger demand for loans. Total lending to businesses has increased in recent months, and production capacity underutilization has been declining compared to previous years. A rapid increase in momentum during the forecast period is unlikely. The high level of uncertainty due to the possible Brexit and the overall slowdown of global economic growth, among other things, are still having a dampening effect. Moreover, although various PMIs are above the expansion threshold, they have not increased noticeably so far this year.

Exports developed only modestly in the first quarter, and due to the gloomy growth prospects in key markets, only a minor improvement is expected this year. Given the somewhat more favorable outlook for global growth in 2017 and the euro's weak external value (despite a slight

improvement in the first quarter of 2016), exports are likely to regain momentum next year. Since imports are also developing robustly as a result of domestic demand, foreign trade is not expected to make any positive growth contributions to many member states' economies over the course of the forecast period.

In recent months, the euro area's inflation rate has repeatedly fallen below 0 percent. With a slight increase in oil prices and a slowly closing output gap, inflation is expected to rise again over the forecast period. The ECB is unlikely to reach its inflation target even by the end of 2017, with the result that monetary policy is expected to continue to be extremely expansive over the forecast period. In contrast, fiscal policy will be more neutrally oriented in this year and next. Given the still-low interest rates on government bonds, a slight decrease of the debt-to-GDP ratio is expected.

Overall, output is expected to increase by 1.6 percent this year and by 1.7 percent next year.

United Kingdom

UK economic growth slowed down slightly at the beginning of the year, down to 0.4 percent. Indicators such as the business climate index and manager surveys point to a further slowdown in the second quarter. However, there are signs that economic growth will be gaining momentum again in the second half of the year. For example, employment is still on the rise, which along with the increase in real wages will boost private consumption. Investment activity is likely to regain some momentum given the rising demand. Investment is also likely to benefit from industrial production growth in the first quarter and a constant level of new orders. Overall, output growth

should amount to 1.8 percent this year and 2.1 percent next year—but if a Brexit materializes, growth is likely to be significantly lower in 2017 (Box: Brexit).

Russia

In the first four months of 2016, the Russian economy shrank by 1.1 percent compared to the previous period last year. The decline has now slowed. Compared to the same period last year, construction activity further declined, and industrial production stagnated. The lower retail sales suggest that individuals are further restricting their consumption as a result of a decline in real income. In the first quarter of 2016, investment declined once again compared to the previous year. In May, the PMI for the manufacturing sector improved over the previous month, but it still remains slightly below the expansion threshold. Overall, domestic demand is expected to create only minor impulses. In foreign trade, Russian merchandise imports experienced declines, especially in January. They picked up again in the following months, but remain below the level of the previous year. In the first months of 2016, the development of exports in terms of value was influenced by the low price of oil. Since oil prices are now rising once again, Russian export revenues will also increase. Moreover, the exchange rate of the ruble has been stabilizing with the oil-price development. This has contributed to a further decline in domestic inflation, which stood at 7.3 percent in April and remains above the inflation target to be reached by the end of 2017 (4 percent). The Russian central bank has not ruled out the possibility of lowering the interest rate if there is a further slowdown of the price increase. Given the slightly increasing oil prices, GDP is expected to contract less severely than it did last year, and increase slightly in 2017.

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