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Article

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The global economy and the euro area: uncertainty weighing on world trade and industry

By Claus Michelsen, Guido Baldi, Geraldine Dany-Knedlik, Hella Engerer, Stefan Gebauer, Malte Rieth, and Thore Schlaak

ABSTRACT

The ongoing trade conflicts initiated by the US and the uncertainty surrounding Brexit are negatively affecting the global economy. Global trade and investment activity, and thus in many places industrial output, are the areas most impacted. Consumption, however, is continuing to support the economy in many countries. DIW Berlin is expecting global GDP to grow to 3.7 percent this year and to slightly less in the following two years. Serious risks are weighing on the outlook, as the trade conflicts could continue to escalate and spread to the EU and the likelihood of a no-deal Brexit has increased.

The global economy maintained its rate of expansion in the second quarter of 2019 (Figure). Production expanded significantly in many Asian countries while the economy in western countries is losing momentum; economic output even decreased in the United Kingdom and Germany. In contrast, consumption expanded dynamically in the US and in the euro area, but investment activity was weak.

The overall outlook has dampened. The global trade conflicts, mainly initiated by the US but also between some Asian countries, and the political uncertainties in Europe are negatively affecting foreign trade and investment. Industrial output is sluggish in many places or has already declined. In addition, leading indicators suggest a further lull during the second half of the year. In the services sector, sentiment is dampened but remains good. Labor demand is mostly high and wage developments reflect this. Together with the recent drop in energy prices and generally stable financial conditions, consumers will likely remain in a buying mood.

In addition, various stimulating policy measures are coming into play: the federal funds rate was lowered in the US by a quarter of a percentage point in July and will likely be lowered again this year. In response to the continuing low inflation, the European Central Bank has signaled its willingness to support the economy. No interest rate hike is expected in the euro area before the end of 2021. Fiscal policy remains expansionary globally. Additional public expenditure is imminent in China as well as in several European countries such as France and Spain.

Therefore, the slowdown in the global economy is likely to be only gradual. Demand for capital goods in particular is sluggish while consumption continues to support the economy. The global economy is in a very advanced phase of the economic cycle. World production is expected to grow by 3.7 percent this year after increasing by 4.2 percent in 2018. Growth will be somewhat lower in 2020 and 2021 (Table). Compared to the Economic Outlook published in summer 2019, DIW Berlin is lowering its forecast slightly.

Risks are higher than usually, primarily due to the current high likelihood of a no-deal Brexit. In this forecast, it

is assumed a no-deal Brexit will not occur. However, if it does, growth is likely to be significantly lower than forecast, especially in Europe. In the euro area, a hard Brexit would trim 0.2 percentage point off GDP growth in 2020 and 2021, according to estimates from an econometric model by DIW Berlin. The global trade conflicts are not expected to ease, and the risk that Europe will be directly subject to US tariffs remains. Escalating trade conflicts and a no-deal Brexit would weigh on already weak global trade and subdued corporate investment activity. The political uncertainties in Italy have diminished for now, but the conflict between the US and Iran could lead to a blockade of important transport routes and make energy prices noticeably more expensive. This would weaken households' purchasing power and shake one of the last remaining pillars of the global economy.

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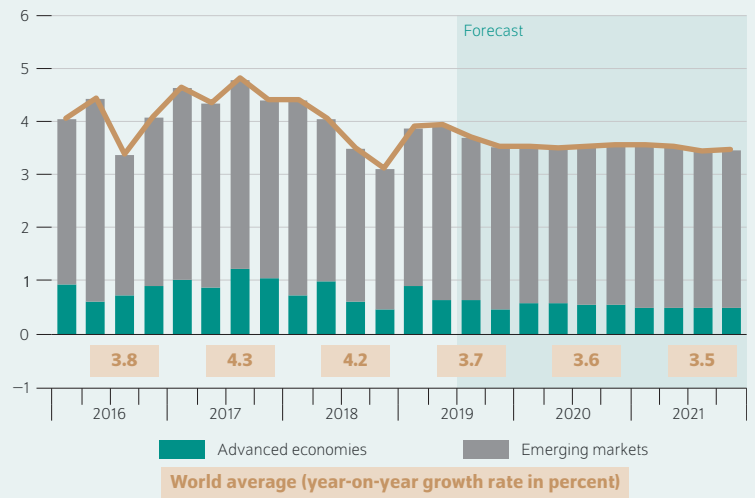
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Figure

World real GDP growth
Quarter-on-quarter, in percent



Sources: National statistical offices; DIW autumn projections 2019.

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Global growth is slowing down.

JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook

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											
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
Euro area	1.7	1.0	1.2	1.4	1.8	1.3	1.5	1.5	8.2	7.7	7.5	7.5
without Germany	1.7	1.2	1.3	1.4	1.8	1.3	1.4	1.4	10.4	9.8	9.7	9.7
France	1.7	1.3	1.4	1.4	1.8	1.3	1.5	1.4	9.1	8.5	8.2	8.1
Italy	0.7	0.1	0.5	0.9	1.2	0.9	1.1	1.3	10.6	10.5	10.5	10.6
Spain	2.6	2.2	1.8	1.8	1.7	1.1	1.5	1.6	15.3	14.1	13.9	13.8
Netherlands	2.5	1.8	1.6	1.7	1.6	2.4	1.5	1.6	3.9	3.4	3.6	3.7
United Kingdom	1.4	1.2	1.2	1.7	2.4	1.9	2.0	2.1	4.2	4.0	4.1	4.2
USA	2.9	2.3	1.8	1.5	2.4	1.8	2.1	1.9	3.9	3.7	3.5	3.5
Japan	0.8	1.1	0.5	0.8	0.8	0.8	1.1	0.9	2.5	2.4	2.3	2.3
South Korea	2.7	2.0	2.4	2.0	1.5	0.9	2.6	2.7	3.8	3.5	3.0	3.0
East-central Europe	4.5	4.0	3.4	3.5	2.2	2.9	3.0	3.0	3.7	3.5	3.5	3.5
Turkey	2.7	0.0	2.5	2.6	16.4	17.8	17.3	15.6	11.0	13.7	13.5	13.5
Russia	2.0	1.4	1.9	1.8	2.7	4.7	4.0	4.1	4.8	4.5	4.3	4.3
China	6.5	6.2	5.8	5.7	1.6	2.2	2.1	2.2	3.9	3.7	3.8	3.8
India	7.4	6.6	6.4	6.1	3.9	5.5	6.1	6.1				
Brazil	1.1	0.4	0.9	1.3	3.7	4.7	6.5	7.0	12.3	9.2	6.2	4.0
Mexico	2.0	0.8	1.4	1.1	4.9	4.2	3.2	3.2	3.3	4.5	4.8	4.8
Developed economies	2.2	1.7	1.5	1.4	2.0	1.6	1.9	1.7	4.8	4.5	4.4	4.4
Emerging markets	5.5	4.9	4.9	4.8	3.2	4.1	4.4	4.5	5.0	4.8	4.6	4.4
World	4.2	3.7	3.6	3.5	2.7	3.1	3.4	3.4	4.9	4.7	4.5	4.4

Sources: National statistical offices; DIW autumn projections 2019.

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