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Kiel Institute
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Weakness in emerging markets weighs on global growth

By Klaus-Jürgen Gern, Philipp Hauber, Nils Jannsen, Stefan Kooths, Galina Potjagailo and Maik Wolters

The world economy is expanding at a more moderate pace with growth momentum continuing to shift from emerging to advanced economies. World GDP will increase by 3.3 per cent this year – even somewhat less than the already modest growth in the recent past. For 2016 and 2017 we expect growth to pick up, although moderately, with global production expanding by 3.7 per cent. Advanced economies will gradually gain momentum over the forecast horizon. Emerging markets are set to overcome the currently weak and partly even recessionary performance but growth remains will remain low by historical standards.

- The near term outlook for the world economy has darkened somewhat. Doubts about China's growth prospects have led to increased volatility in financial markets.

- The outlook has deteriorated first and foremost in emerging economies. Sluggish Chinese demand is taking its toll on emerging economies via weaker trade and lower commodity prices. But domestic impediments to growth abound as well. Brazil and Russia are in a recession, while the South-East Asian economies have considerably lost momentum.

- Oil prices will only rise towards the end of the forecast horizon owing to abundant supply from OPEC countries and Iran returning to the world market. We expect (Brent) oil prices of around $50 and $63 per barrel in 2016 and 2017, respectively.

- The Fed's rate lift-off will be delayed. We now expect the FOMC to raise rates in December when – according to our forecast – the outlook for the world economy will have stabilized. Simulations from various models suggest that a surprise rate hike in September would have little sustained effect on the US economy.

- After the devaluation of the renminbi in August, fears of a „currency war" arose. But we are already in the middle of it. The Chinese authorities' move was only the most recent element in a sequence of devaluations driven by a succession of expansive monetary policy decisions in the major economies. The international competition for monetary stimulus will result in depressed interest rates across the world and abundant global liquidity – with all the risks involved.

- World GDP – measured at PPP exchange rates - will expand by 3.3 per cent in 2015 and gain pace over the next two years growing by 3.7 per cent.

- Growth in advanced economies will pick up over the forecast horizon. Develeraging has gone a long way in key economies making expansive monetary policies more effective. Cheaper oil will provide additional stimulus.

- The US economy will grow by 2.5 per cent this year and accelerate to 3 per cent in 2016 and 2017. Better funding conditions and rising capacity utilization rates are going stimulate fixed capital formation. In Japan, after a weak 2015 with the economy expanding by a meagre 0.6 per cent, growth should pick up as external headwinds subside. We expect GDP to increase by 1.2 and 1.4 per cent in the next two

years. Growth in the euro area will also gain pace and expand by 1.7 and 2 per cent in 2016 and 2017, respectively.

- Domestic problems and lower commodity prices will weigh on emerging economies. We expect growth for this group of countries to continue to fall below expectations. This year we forecast growth of 4.1 per cent – almost a percentage point lower than the 5 per cent recorded in the previous year. Over the coming years, growth will pick up but stay below its 2014 value.

- A key risk to the world outlook is a more severe downturn in China. According to our analysis, a "hard landing" of the Chinese economy would dampen global growth significantly: a 3 per cent reduction in Chinese growth would lower global GDP by 1 per cent, implying that the world economy would experience a "growth recession" (defined as global growth of less than 3 per cent). Excluding China, world production would shrink by 0.5 per cent with Asian economies affected most strongly.

Real GDP and consumer prices in selected countries and regions, 2015–2017

	Gross Domestic Product			Consumer prices		
	2015	2016	2017	2015	2016	2017
United States	2.5	3.0	3.0	0.1	2.1	2.4
Japan	0.6	1.2	1.4	0.8	0.6	1.4
Euro Area	1.5	1.7	2.0	0.0	0.9	1.8
United Kingdom	2.5	2.5	2.2	0.3	1.1	1.7
Advanced economies total	2.1	2.4	2.5	0.3	1.4	2.0
China	6.6	6.3	6.0	1.5	2.0	2.0
Latin America	-0.1	1.5	2.4	10.6	10.4	8.7
India	7.0	6.7	6.5	5.0	5.5	5.5
East Asia	4.2	4.4	4.7	4.0	4.7	5.1
Russia	-3.6	1.0	2.6	15.0	9.5	7.0
World economy total	3.3	3.7	3.7	3.5	3.8	3.7
Addendum: World trade volume	1.0	3.0	4.0	.	.	.
Oil price (Brent in US-$)	52.8	48.6	63.3	.	.	.
World economy total (weighted according to GDP at market exchange rates)	2.7	3.2	3.2	2.6	3.1	3.2

Weighted according to GDP at PPP rates. East Asia: Emerging Asia excluding China and India. Shaded: IfW forecast.

Source: Forecast of the Kiel Institute for the World Economy.

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