WORLD ECONOMIC OUTLOOK: CHALLENGES TO STEADY GROWTH

October 2018

International Monetary Fund

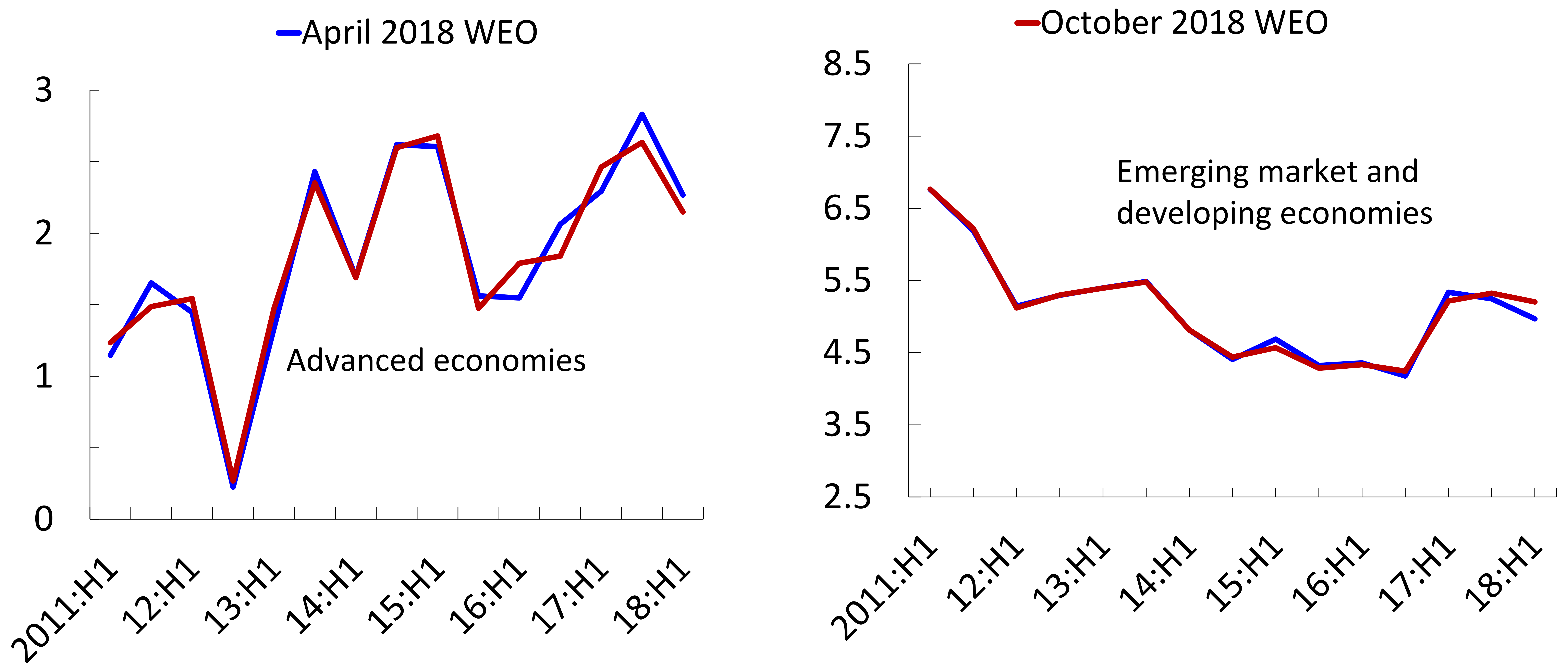
Overview

- Recent Developments
  - Softer, more uneven momentum; global trade slowed in 2018 H1, after rapid growth last year
  - Higher oil prices have lifted headline inflation; core generally remains subdued
  - Financial conditions tightened for some EMs, but remain broadly accommodative
  - Sentiment generally strong; some trade-sensitive indicators have weakened
- Outlook
  - Global growth for 2018-19 projected to remain steady at 2017 level, moderating thereafter
  - Advanced economies: above-trend near-term growth, expected to decline into the medium term
  - Emerging markets and developing economies: stable growth into the medium term for the group, differences in regional prospects
- Balance of Risks
  - tilted to the downside in a context of high policy uncertainty

2018 H1: Growth moderated among AEs, remained broadly stable among EMDEs

GDP Growth

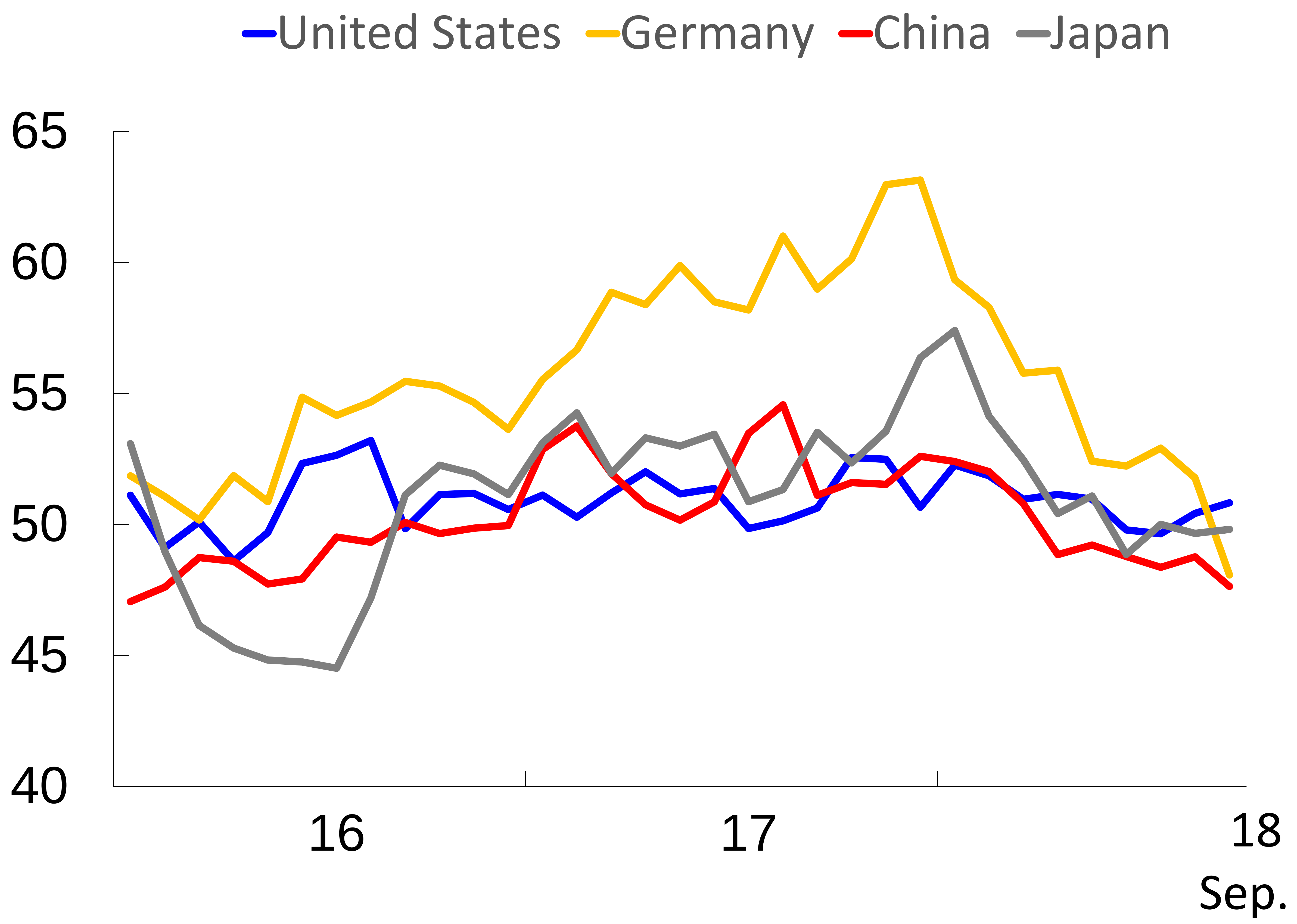
(annualized semiannual percent change)



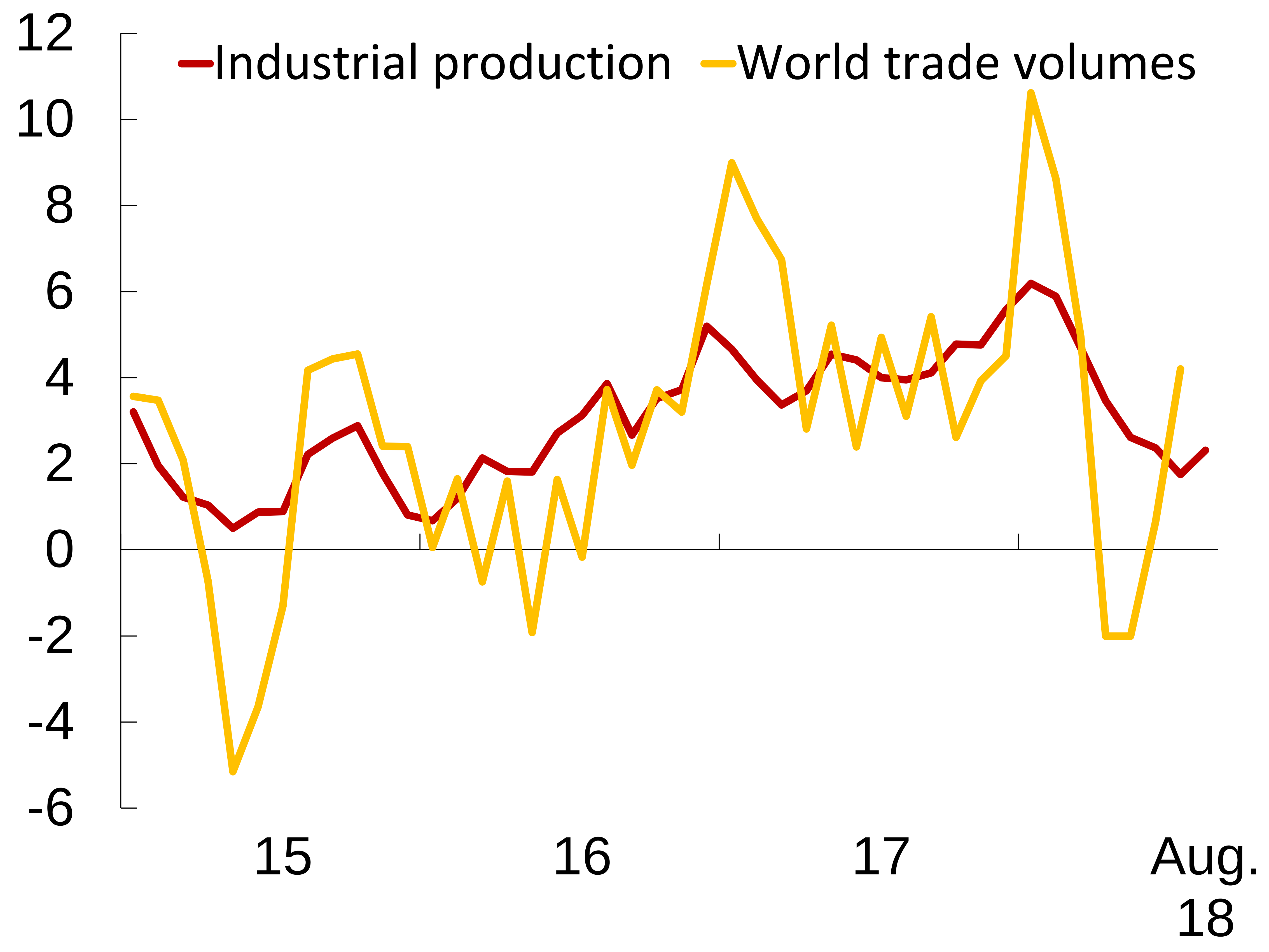
Source: IMF staff calculations.

Consistent with softer growth in export orders, industrial production and world trade slowed in 2018 H1

Market PMI: Manufacturing New Export Orders
(SA, 50+= Expansion)

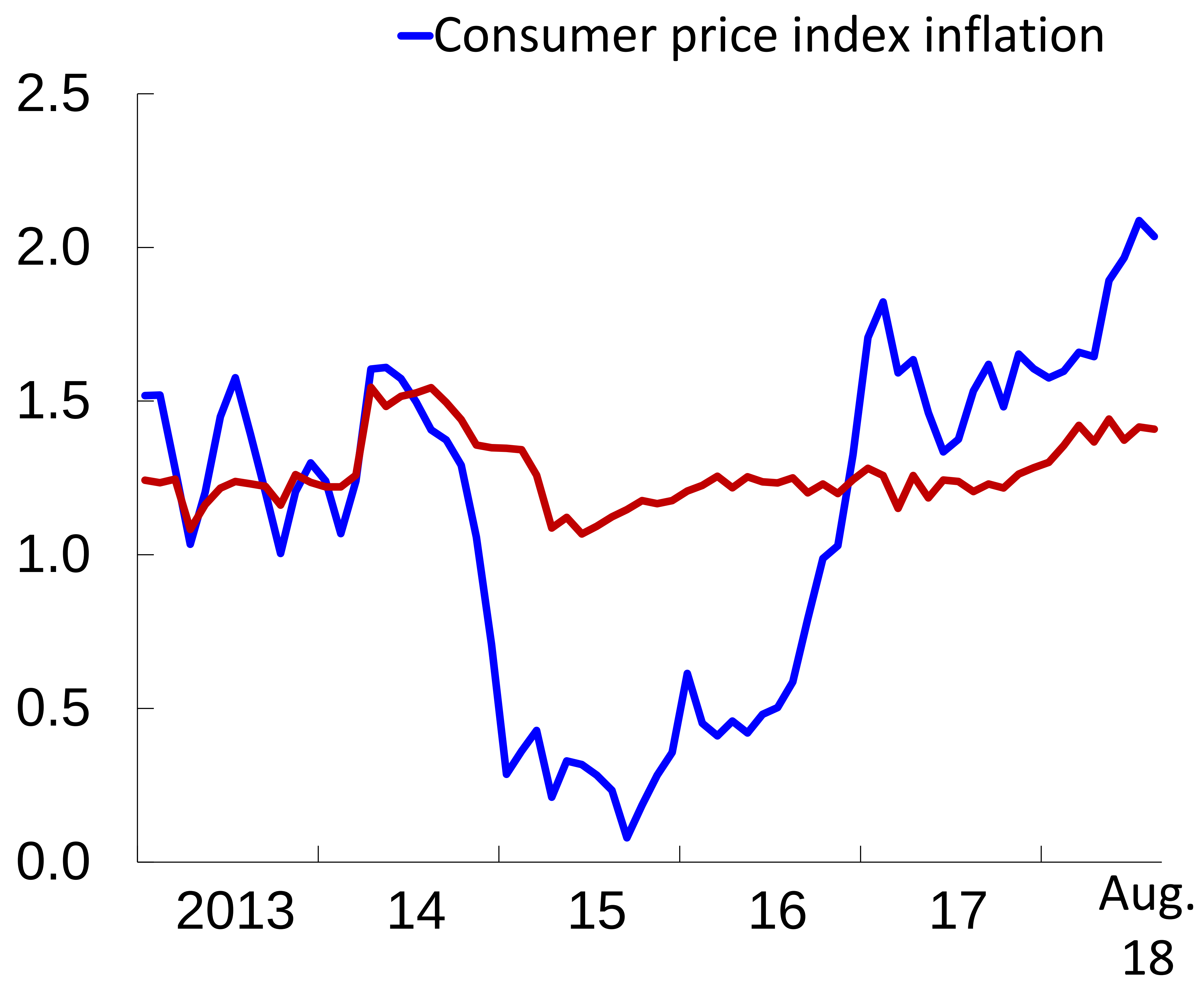


World Trade, Industrial Production
(three-month moving average; annualized percent change)

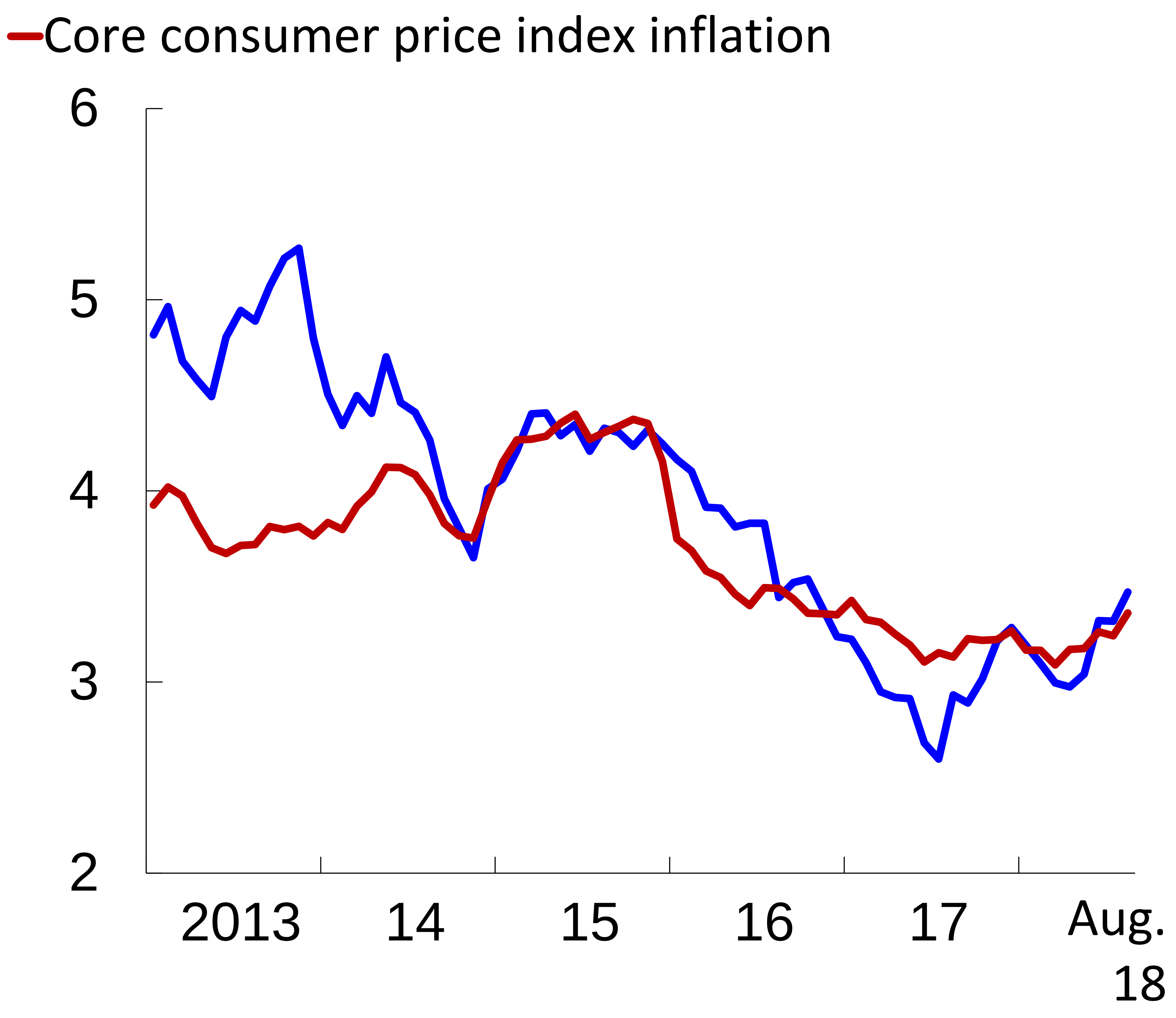


Headline inflation has increased on higher oil prices… Core subdued in AEs, still below past averages in EMDEs

Advanced Economies
(year-over-year growth)



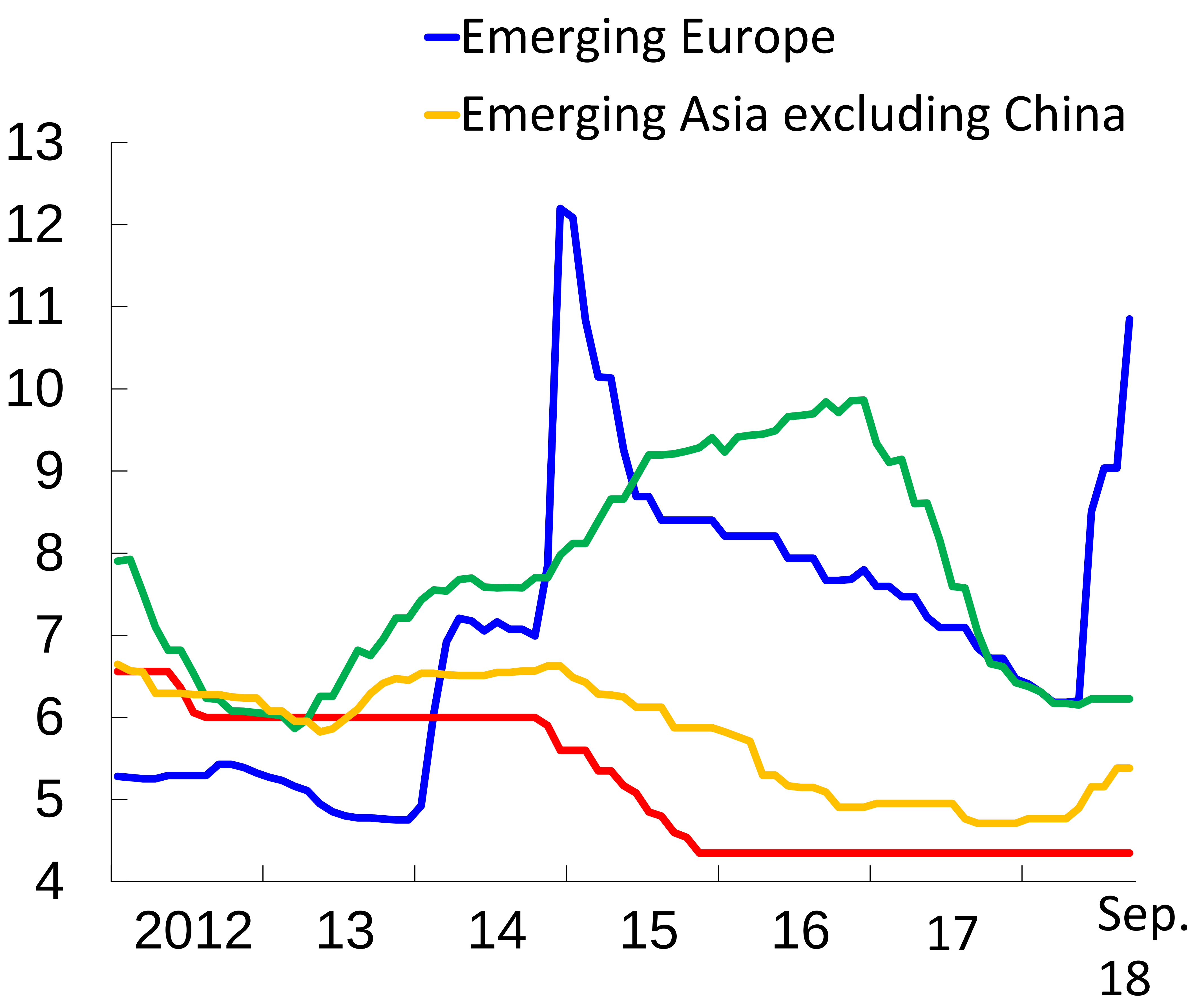
Emerging Market and Developing Economies
(year-over-year growth)



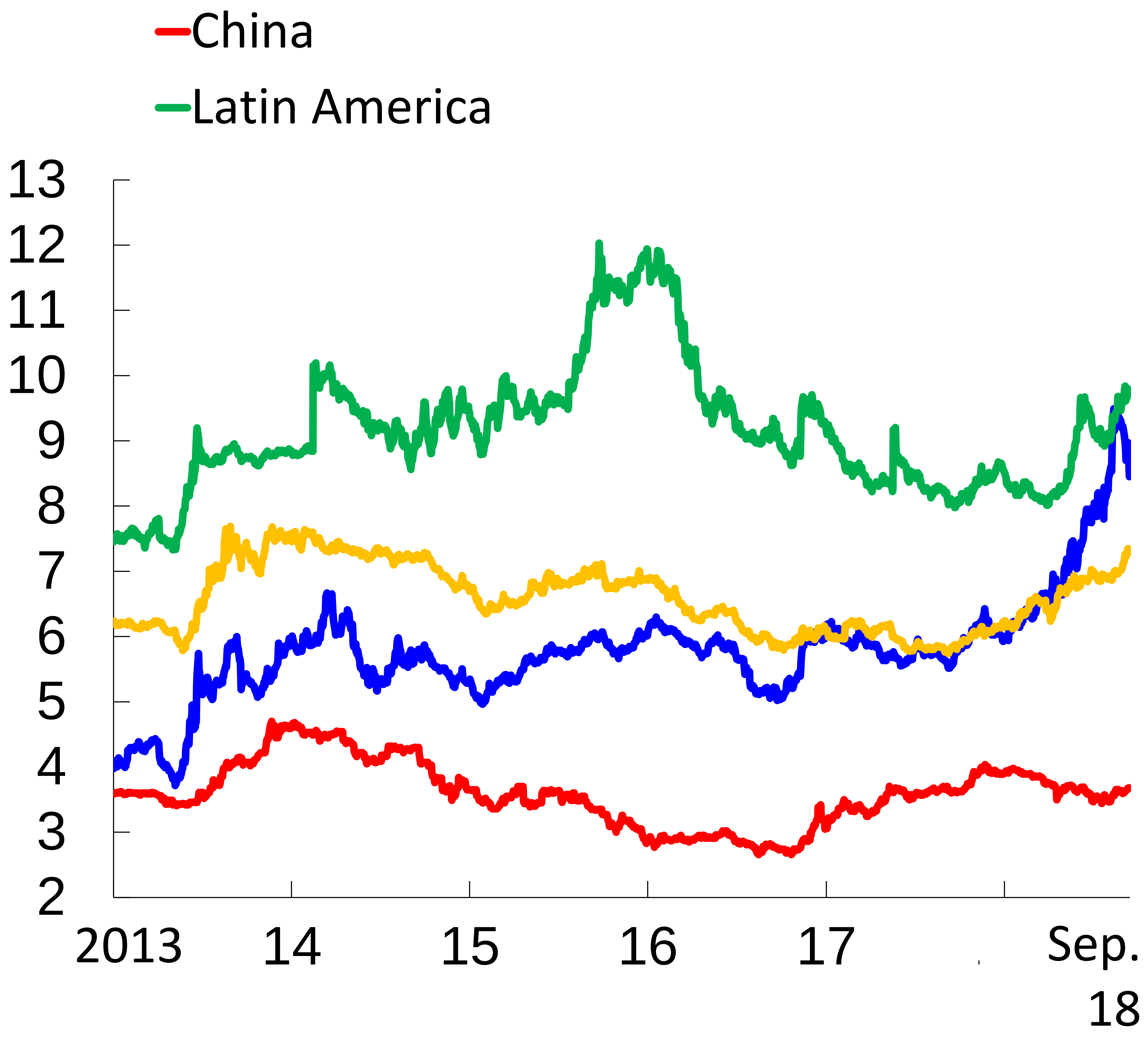
Source: IMF staff calculations.

EMs with weaker economic fundamentals and higher political risk have experienced tighter financial conditions

EM: Policy Rate
(Percent)



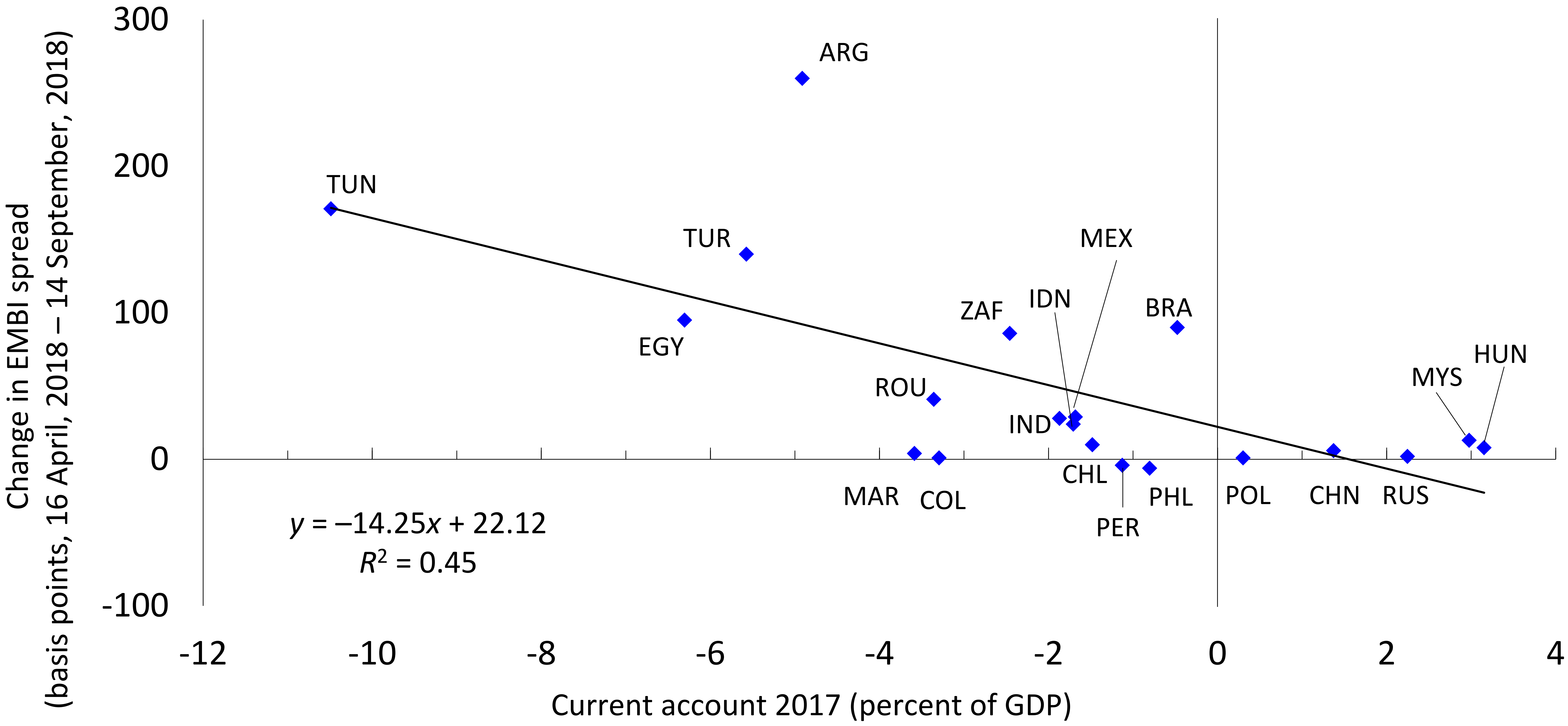
EM: Ten-Year Government Bond Yields
(Percent)



Source: Haver Analytics; Bloomberg Finance L.P.; and IMF staff calculations.

Investors are differentiating across EMs: spreads have widened more in economies with higher external financing needs

EM: Current Account Balance and Change in EMBI Spreads

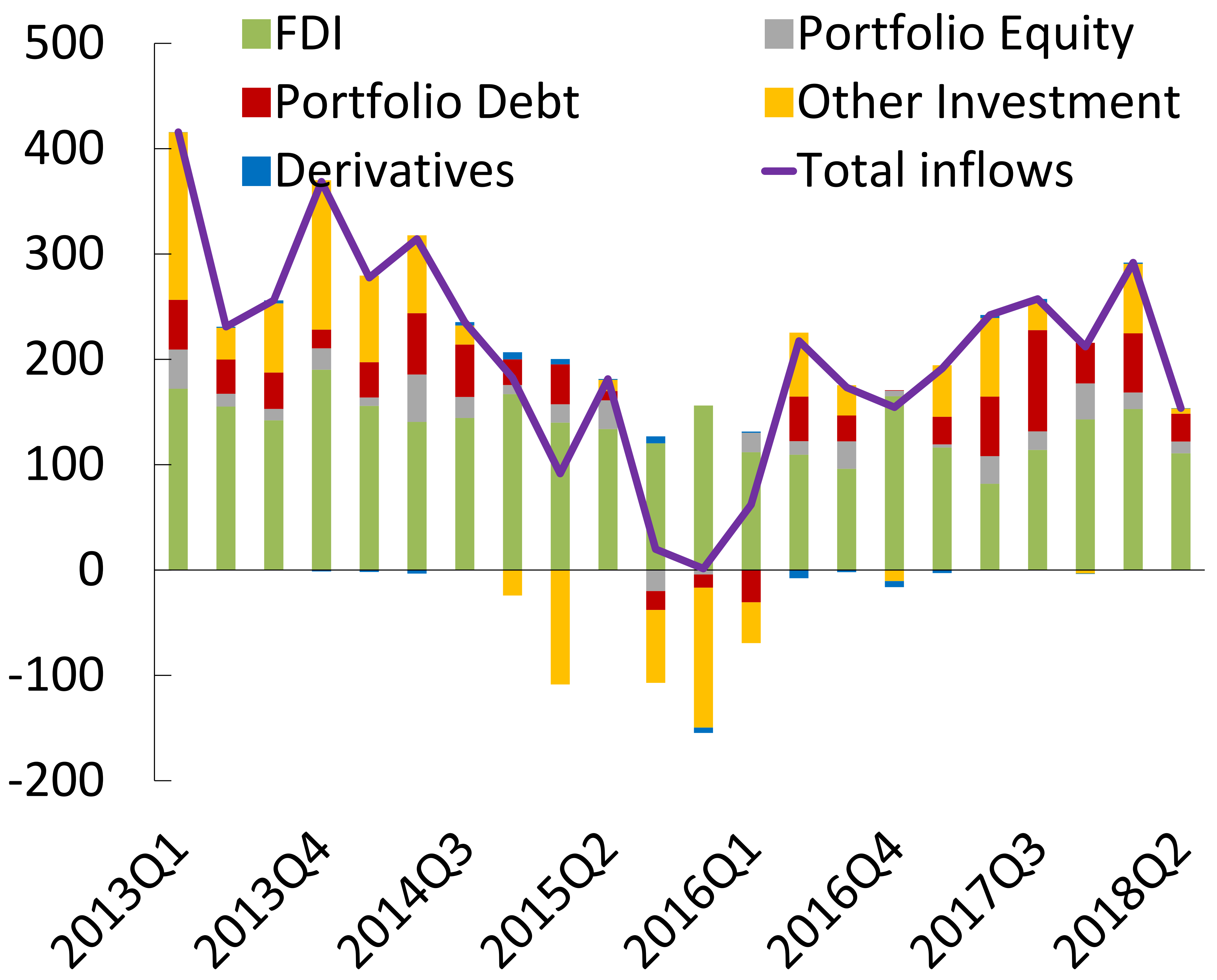


Source: IMF staff calculations.

Capital flows to EMs weakened considerably in 2018 Q2

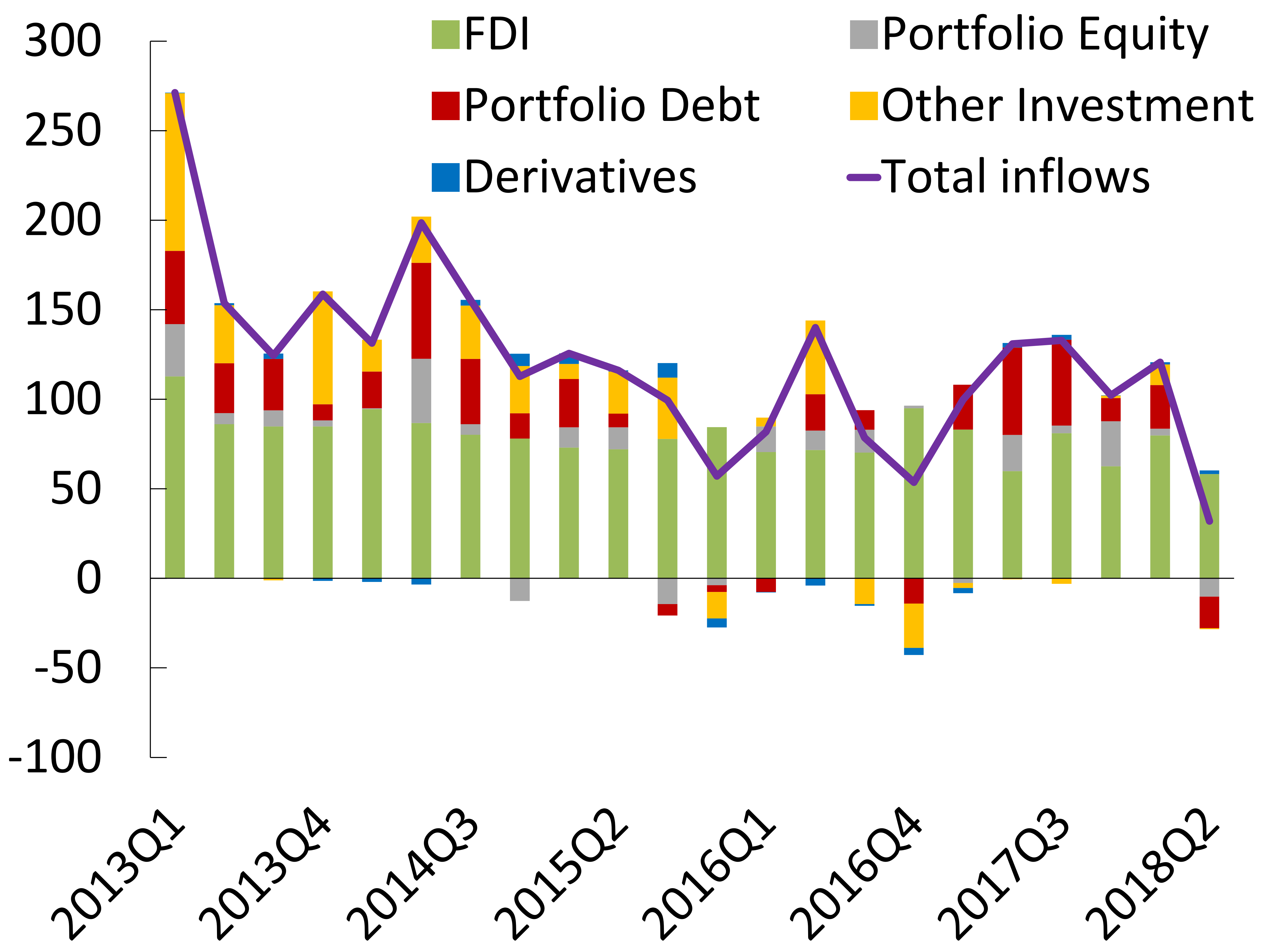
Capital Inflows to EMs

(billions of U.S. dollars)



Capital Inflows to EMs Excluding China

(billions of U.S. dollars)

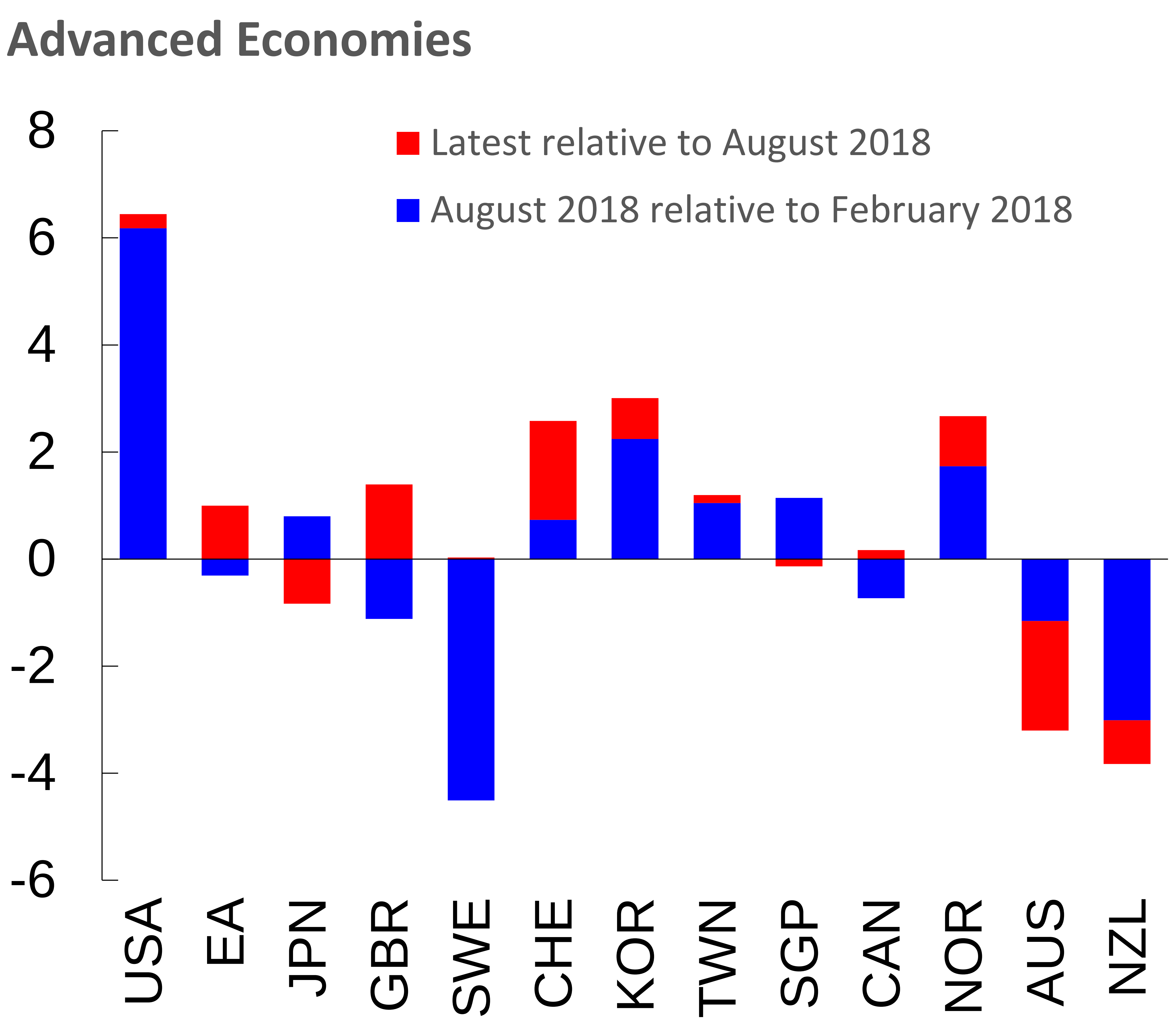


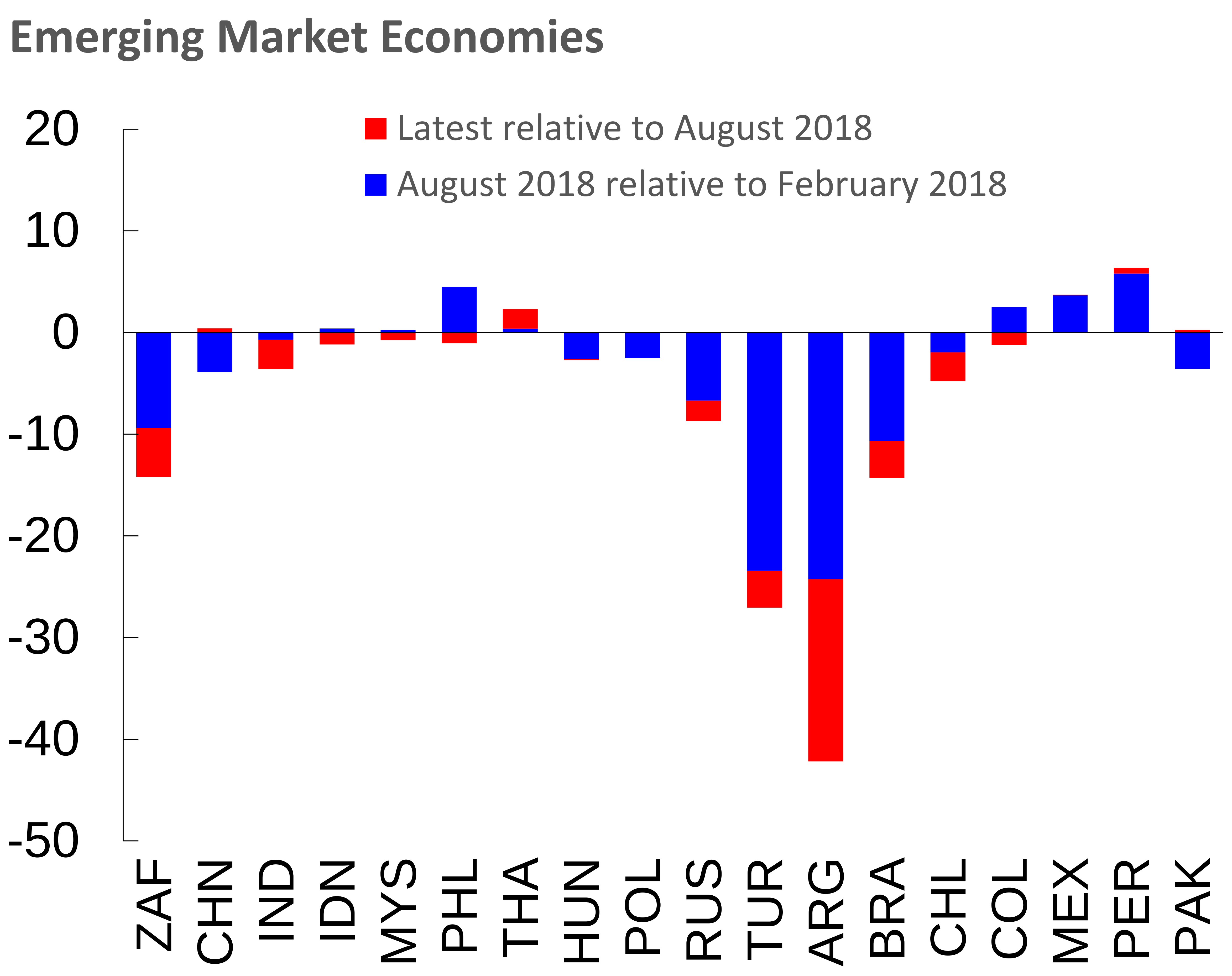
Sources: Haver Analytics, and IMF staff estimates.

Against a backdrop of dollar strengthening, currency movements in EMs have reflected underlying imbalances and growth prospects

Real Effective Exchange Rate Changes, February – September 2018

(Percent)





Source: IMF staff calculations.

Forces shaping the outlook

Advanced economies

Emerging market and developing economies

near-term…

Advanced economies

- Diverging cyclical positions
- Global effects of US fiscal policy changes
- Rising trade barriers, policy uncertainty
- Generally accommodative monetary policy

Emerging market and developing economies

- Higher oil prices: diverging prospects for fuel exporters and importers
- Rising trade barriers, policy uncertainty
- Localized financial market pressures
- Idiosyncratic factors – political uncertainty, conflict

…medium-term

Advanced economies

- Demographic headwinds
- Lackluster productivity growth

Emerging market and developing economies

- Group aggregate: growth stabilization close to current level; offsetting regional prospects
- 45 EMDEs, accounting for 10 percent of global GDP (PPP), falling further behind AE income levels over projection horizon

Growth projections: Advanced economies

(percent change from a year earlier)

	World	Advanced Economies	U.S.	U.K.	Japan	Euro Area	Germany	Canada	Other Advanced Asia
2017	**3.7**	**2.3**	**2.2**	**1.7**	**1.7**	**2.4**	**2.5**	**3.0**	**3.0**
2018	**3.7**	**2.4**	**2.9**	**1.4**	**1.1**	**2.0**	**1.9**	**2.1**	**3.0**
Revision from Apr. 2018	–0.2	–0.1	0.0	–0.2	–0.1	–0.4	–0.6	0.0	0.2
2019	**3.7**	**2.1**	**2.5**	**1.5**	**0.9**	**1.9**	**1.9**	**2.0**	**2.6**
Revision from Apr. 2018	–0.2	–0.1	–0.2	0.0	0.0	–0.1	–0.1	0.0	–0.2

Sources: IMF, *World Economic Outlook* October 2017 Update; and IMF, *World Economic Outlook* April 2018.

Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)

	Emerging Market and Developing Economies	China	India	Brazil	Russia	ASEAN-5	Commodity Exporting Economies	Low Income Developing Countries
2017	**4.7**	**6.9**	**6.7**	**1.0**	**1.5**	**5.3**	**2.2**	**4.7**
2018	**4.7**	**6.6**	**7.3**	**1.4**	**1.7**	**5.3**	**2.1**	**4.7**
Revision from Apr. 2018	–0.2	0.0	–0.1	–0.9	0.0	0.0	–0.8	–0.3
2019	**4.7**	**6.2**	**7.4**	**2.4**	**1.8**	**5.2**	**2.6**	**5.2**
Revision from Apr. 2018	–0.4	–0.2	–0.4	–0.1	0.3	–0.2	–0.6	–0.1

Sources: IMF, *World Economic Outlook* October 2017 Update; and IMF, *World Economic Outlook* April 2018.

Risks: tilted to the downside

- Potential for upside surprises has receded, downside risks have become more pronounced

- Sequence of tariff actions
  - Has set the stage for possible further escalation of tensions to an intensity that carries systemic risks
  - Escalation could severely dent business confidence, harm financial market sentiment and increase volatility, slow investment and trade

- Financial conditions
  - Despite some localized pressures in EMs, financial conditions have generally remained easy
  - Could tighten sharply (for example, sparked by trade actions, higher political and policy uncertainty, or inflation surprise in US)
  - Sudden tightening would expose financial vulnerabilities accumulated over years of ultralow interest rates

- Other factors
  - Geopolitical strains
  - Declining trust in mainstream political parties, regional and national institutions
  - Climate shocks

- Interlinked risks could exacerbate effects: materialization of one could trigger realization of others

Downside risks from trade tensions are significant

Trade tensions scenario

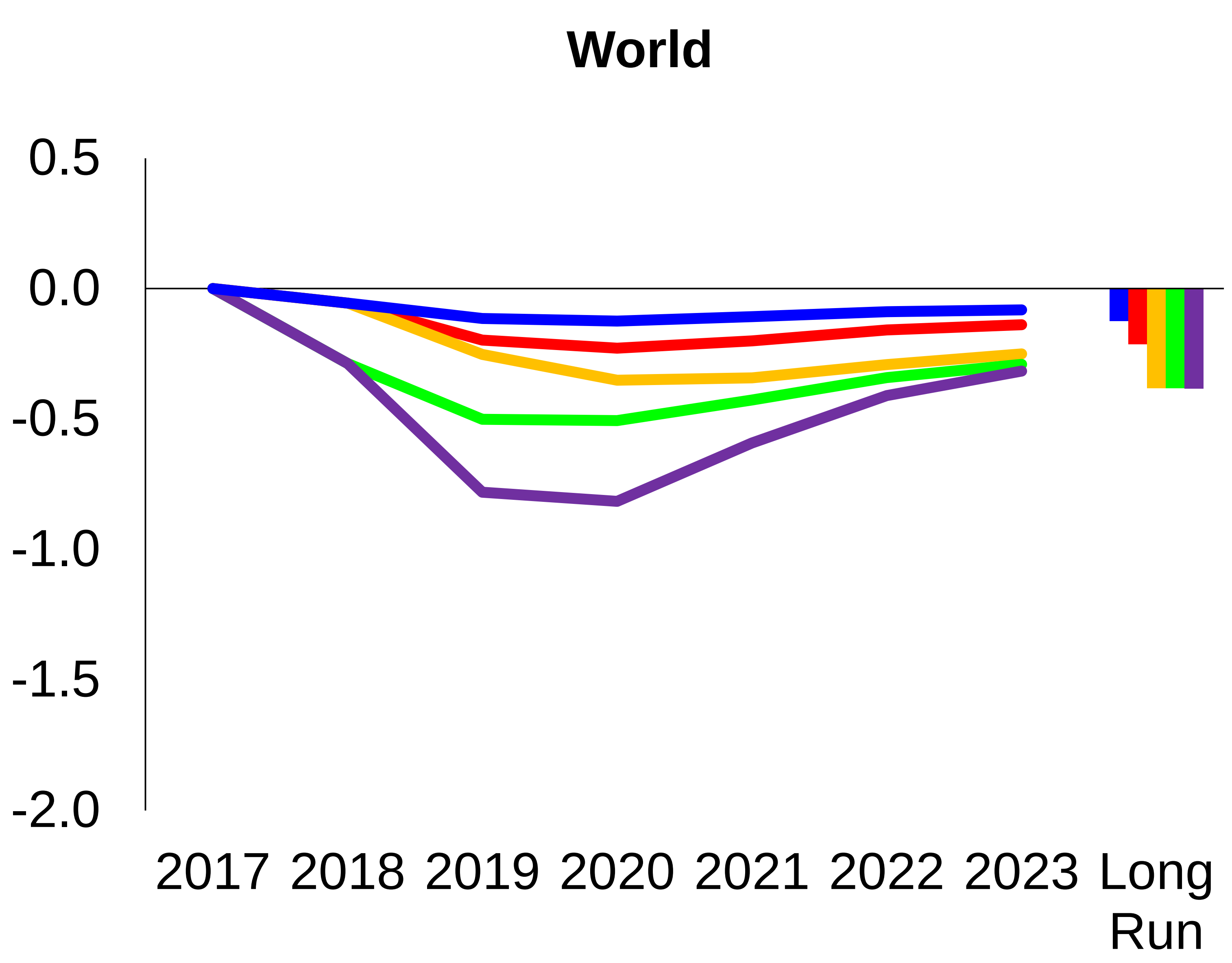
Steel, aluminum, and 25% tariff on 50bn + 200bn of US imports from China, including retaliation

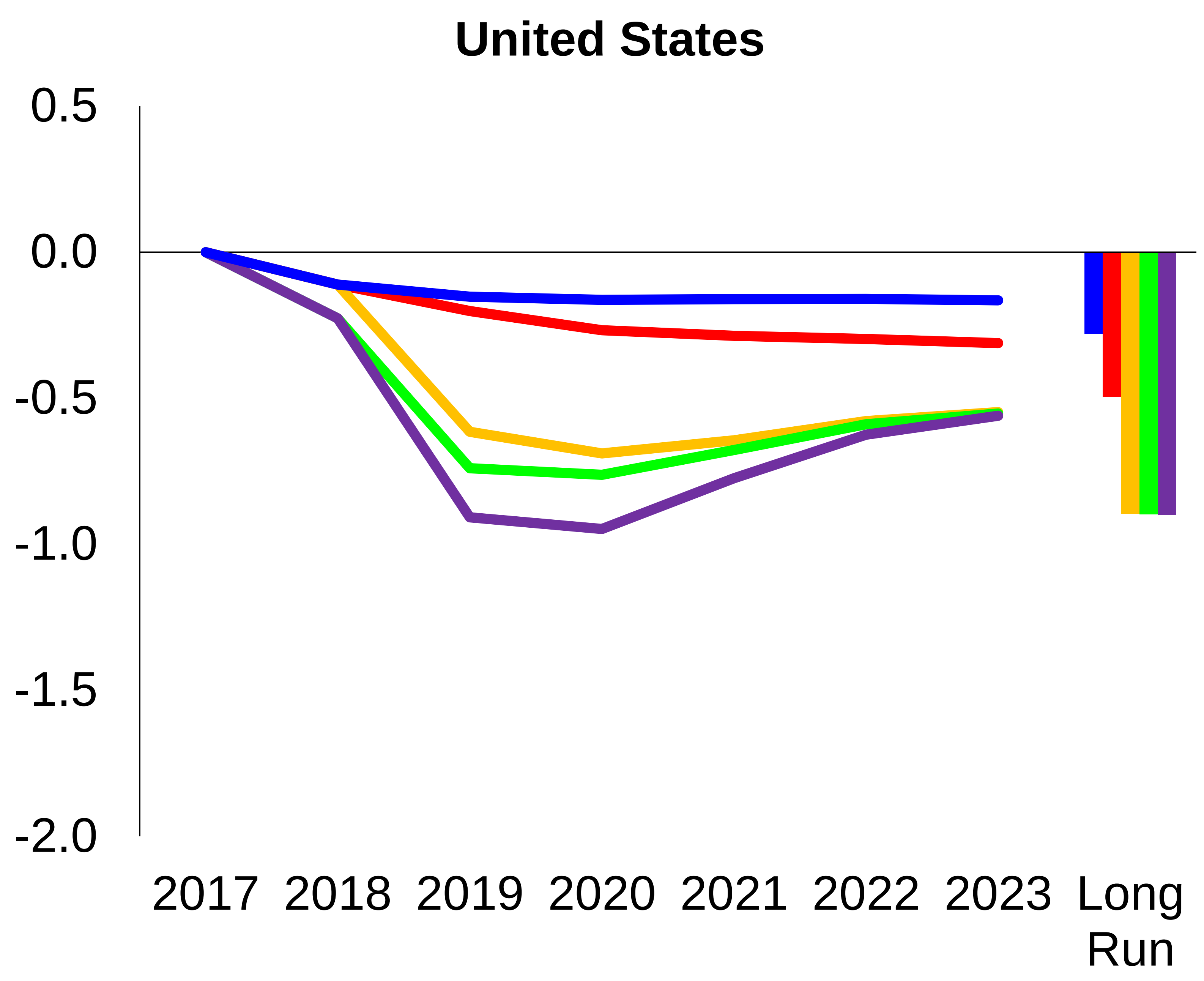
Add 25% tariff on 267bn US imports from China, including China's retaliation

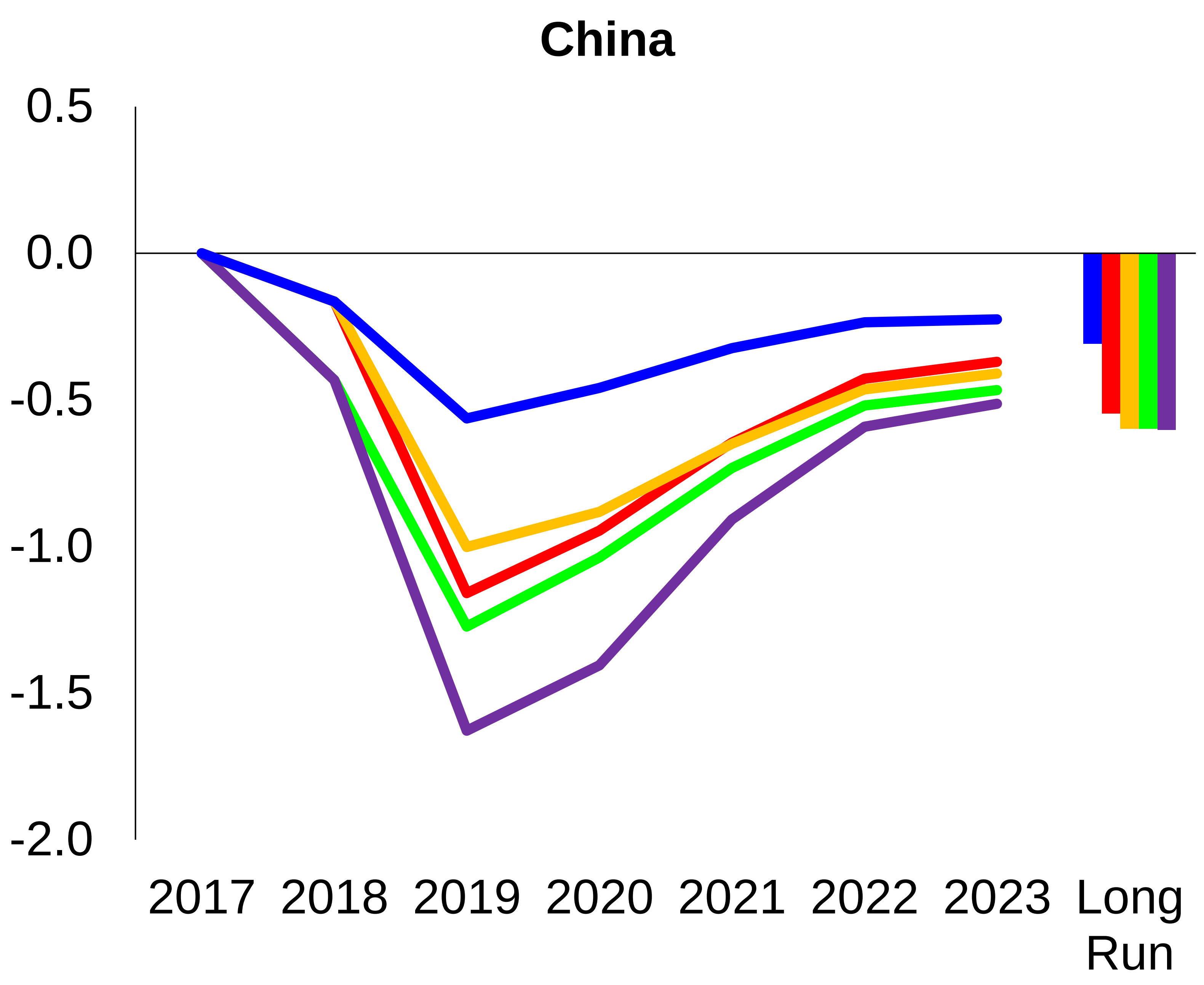
Add cars, trucks, and parts with retaliation

Add confidence effect

Add market reaction

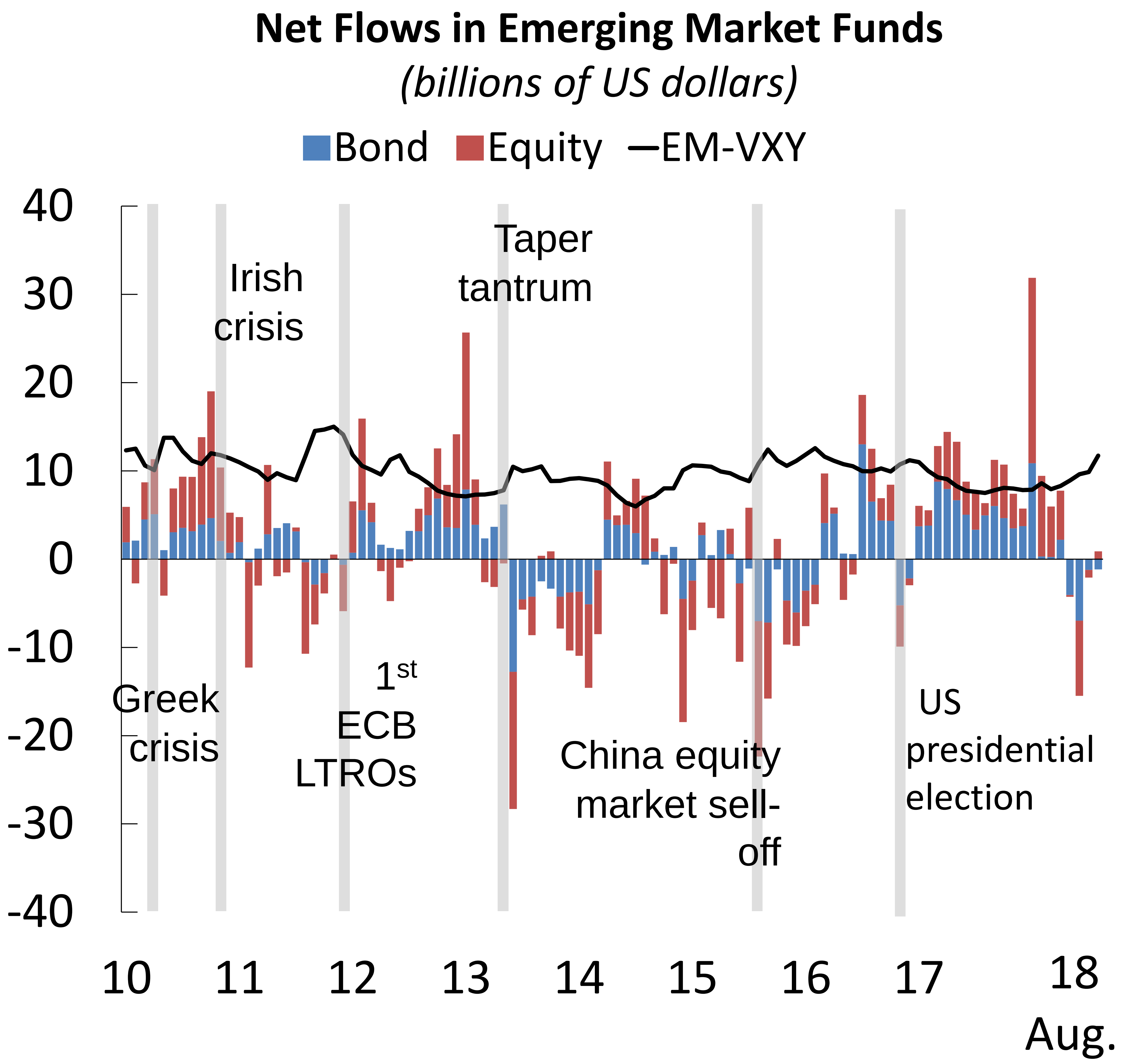


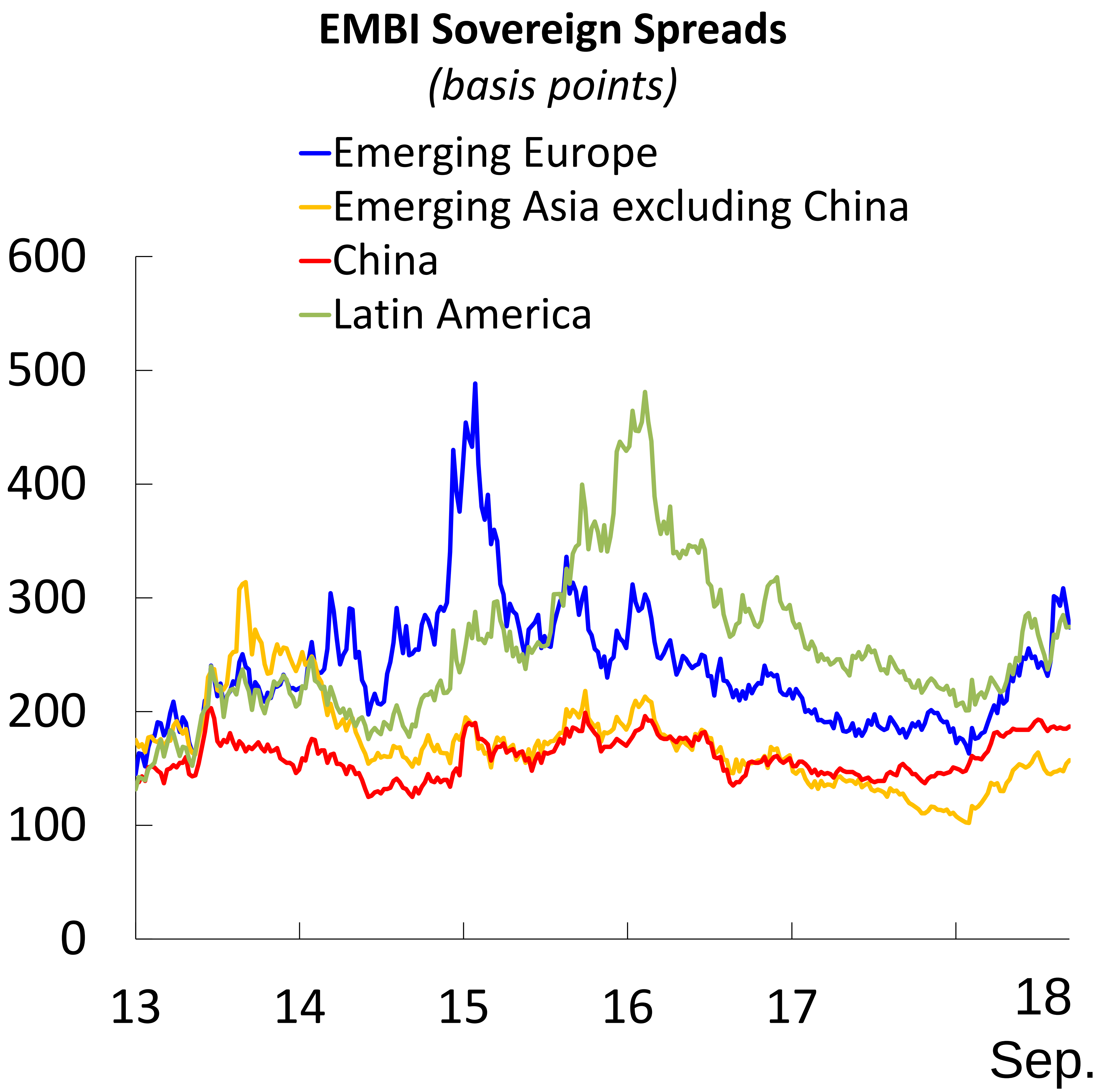




Sources: IMF, *World Economic Outlook,* October 2018, Chapter 1; and IMF staff estimates.

Although markets have discriminated across EMs, likelihood of contagion has increased





Narrowing window of opportunity for implementing reforms to lift potential growth and contain vulnerabilities

Advanced economies

- Monetary policy: support closing of output gaps where needed; gradually normalize where inflation is rising toward target
- Orient fiscal policy more toward medium-term goals
  - Start rebuilding buffers where needed
  - Shift budget composition to lifting potential growth and enhancing inclusiveness (infrastructure, workforce skills, participation rates)
- Structural reform policies to boost potential and ensure benefits shared widely

Emerging market and developing economies

- Priorities differ based on diverse cyclical positions and country-specific vulnerabilities
- Common objectives: bolster financial resilience, boost potential growth, and enhance inclusiveness
- Strengthen fiscal positions where needed (particularly LIDCs, commodity-dependent economies), focusing on revenue mobilization, limiting recurrent expenditure, and curbing poorly-targeted subsidies
- Promote economic diversification (commodity exporters, countries particularly vulnerable to climate events) – judicious macro management, improving access to credit, investing in infrastructure and workforce skills