European Parliament

Autumn 2018 IMF and World Bank Meetings

IMF World Economic Outlook[1] reflects consensus views

A delegation of members of the European Parliament's Committee on Economic and Monetary Affairs (ECON) participated in the Annual Meetings of the Boards of Governors of the International Monetary Fund (IMF) and the World Bank (WB) Group in Indonesia, 8-14 October 2018. The Annual Meetings bring together central bankers, ministers of finance and development, parliamentarians, private sector executives, representatives from civil society organizations and academics to discuss issues of global concern, including the global economic outlook, the world's financial system and international development. There was a broad consensus on major trends presented in the IMF forecasts.

According to the Fund, global GDP growth will remain virtually constant in 2017-2019 at 3.7%. At the same time, economic activity will begin to slow in the United States (US) and will continue to do so in the euro area. Japan's growth will remain close to 1%. Fiscal easing will support China's growth performance, which is, however, unlikely to reach the official government target of 6.5% in 2019. US monetary tightening and a strong dollar may continue to hammer fragile emerging markets. Trade tensions are set to persist as a backdrop of uncertainty. Even a mild additional shock could provoke a more pronounced slowdown. However, the likelihood of a global recession on the same scale remains low.

Lower Economic Growth in the Euro Area, United States and Asia

The IMF blames “country-specific factors, tighter financial conditions, geopolitical tensions, and higher oil import bills” for lowering its growth forecasts on the US, Europe and Asia in 2019. It also cautions that “the trade war between the US and China will drag on growth”. Activity is set to slow across the US, Europe and Asia in 2019. The US and China go into the year with momentum and will thus slow gradually rather than dramatically. However, growth is already weaker in the euro area. The IMF expects developing economies to expand by 4.7% this year and in 2019, down from 4.9% and 5.1% previously. In the longer term, the shift in the world economy’s center of gravity towards Asia is likely to continue[2].

Euro-area: Economic growth is expected to fall marginally to 1.9% in 2019 from 2% in 2018, but the slowdown could prove sharper. Within the EU, individual governments will head in different economic policy directions. For some, it may be tough to meet deficit and debt reduction targets in combination with slow growth. IMF views broadly correspond with the views of the European Commission[3]. At the same time, the Commission believes that risks are far more likely to materialize in 2020 than in 2019[4].

United States: GDP growth will ease to 2.5% in 2019. The US economy will continue growing robustly on the back of fiscal stimulus in 2018 and 2019, outperforming most other developed countries. With a strong

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economy having the lowest unemployment level in half a century and booming consumer confidence, the Federal Reserve (Fed) is expected to continue adjusting its monetary policy gradually by increasing interest rates. Nevertheless, the resilience of the US economy has not been negatively affected so far by higher interest rates. The prospect of another growth-juicing tax cut in 2019 has diminished following the Republican party's loss of control of the House of Representatives. Any stimulus to the economy ahead of the 2020 presidential election will need to come from infrastructure spending. That will be politically fraught and attracting the necessary large-scale private sector financing will be challenging.

Table 1: Overview of the World Economic Outlook Projections (% change)

		Projections		Difference from July 2018 WEO Update		Difference from April 2018 WEO	
	2017	2018	2019	2018	2019	2018	2019
World Output	3.7	3.7	3.7	-0.2	-0.2	-0.2	-0.2
Advanced economies	2.3	2.4	2.1	0.0	-0.1	-0.1	-0.1
US	2.2	2.9	2.5	0.0	-0.2	0.0	-0.2
Euro Area	2.4	2.0	1.9	-0.2	0.0	-0.4	-0.1
Germany	2.5	1.9	1.9	-0.3	-0.2	-0.6	-0.1
France	2.3	1.6	1.6	-0.2	-0.1	-0.5	-0.4
Italy	1.5	1.2	1.0	0.0	0.0	-0.3	-0.1
Spain	3.0	2.7	2.2	-0.1	0.0	-0.1	0.0
Japan	1.7	1.1	0.9	0.1	0.0	-0.1	0.0
UK	1.7	1.4	1.5	0.0	0.0	-0.2	0.0
Emerging market and developing economies	4.7	4.7	4.7	-0.2	-0.4	-0.2	-0.4
China	6.9	6.6	6.2	0.0	-0.2	0.0	-0.2
EU	2.7	2.2	2.0	-0.2	-0.1	-0.3	-0.1

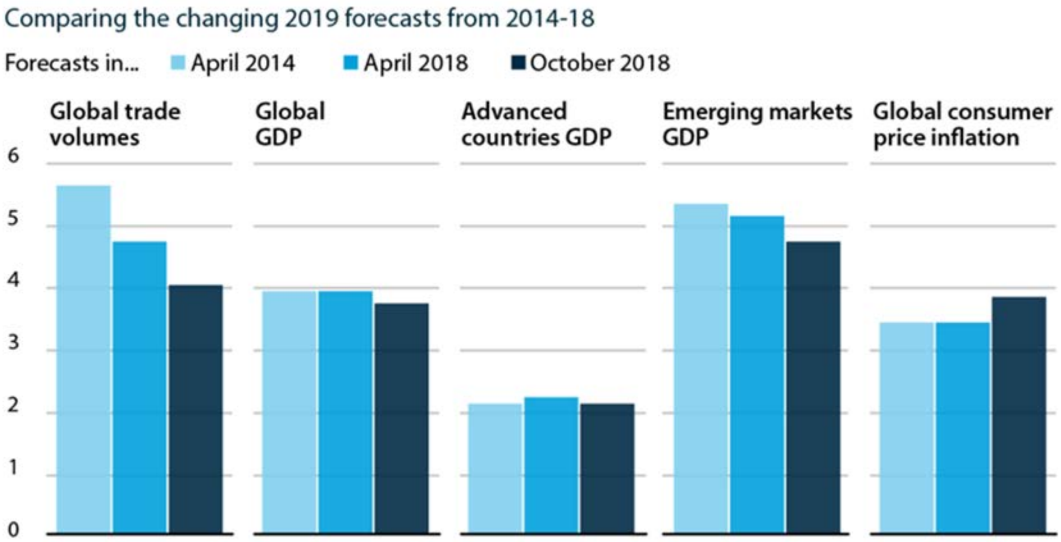
Source: IMF WEO, October 2018.

China goes into 2019 dealing with a US trade policy that is proving far more aggressive than expected a year ago, when it was pursuing goals of deleveraging debt, reducing pollution and cutting overcapacity in specific industries. Consequently, growth is expected to fall from 6.6% in 2018 to 6.2% in 2019. To stimulate the economy, China has selectively relaxed fiscal and monetary policy and put support for trade and investment ahead of the original goals.

Inflation and Monetary conditions

The upward momentum of inflation is expected to persist but not worsen across the world in 2019. Rising fuel prices initiated this trend, but other factors are maintaining upward pressure in spite of the recent drop in oil prices. The IMF forecasts that global consumer price inflation will remain unchanged at 3.8% in 2019, having risen in 2018 from 3.2% in 2017. The Fund expects consumer prices in developing economies to rise by 5.2% in 2019, against an estimated 5% in 2018, but advanced economies' inflation rates will be little changed at around 2%. Specifically for the euro area, the Fund forecasts inflation (HICP) to stand at 1.7% by end 2019 and at 1.9% by end 2020. Real wage growth in most advanced economies remains muted, even as labour markets tighten and output gaps close (and, in some cases, as the gap turns positive with the economy operating above potential).

Figure 1: IMF World Economic Outlook Forecast for 2019 (% growth)



Source: IMF WEO.

Trade developments present major risk

Further disruption in world trade is the most significant risk that could intensify the slowdown of global growth. IMF, WTO and European Commission have all reduced their estimates for growth in world trade volumes. The European Commission being the more pessimistic, expecting 3.5% growth in 2019, compared to 3.9% early in the year.

Box 1: Consequences of US trade policy on EU-US trade relations and the trading system

Global import tariffs have fallen dramatically over previous decades. At the same time, most countries' economies' have greatly benefited from lower tariffs, which in turn stimulated global trade, including in the 1930s and in 2008-09 when economic crises hit hard.

In 2018, however, the US increased import tariffs for reasons of "national security". By these measures, the US started a trade war with a large part of the world, and in particular Canada, Mexico, Japan, the EU and very much with China. At this stage, the US is the biggest loser.[5] Overall, the global impact on economic growth appears limited. However, a further confidence fall risks denting asset prices. Such would inevitably affect central banks' policy stances as it may boost inflation in tandem with falling asset prices and subdued growth, and have a major impact on the world economy.

The scenarios for U.S.-EU trade relations as well as the global trading system are anything but rosy.[6] The EU can stand up to this Administration's "bullying", or it can take advantage of America's need for a "rebalancing" to build its own stature by taking simple steps to improve EU-U.S. trade, forging a way forward in the WTO.

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[1] For all details: https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018.

[2] Realistic projections that include labour capital, energy and technological progress and price adjustment indicate a factor of 16 for China, 21 for India, the US doubling and the European economy increasing by 40 % - source: http://www.cepii.fr/PDF_PUB/wp/2010/wp2010-27.pdf.

[3] https://ec.europa.eu/info/sites/info/files/economy-finance/ecfin_forecast_autumn_081018_overview_en.pdf.

[4] An abrupt end to fiscal stimulus in the US in 2020 could lead to a sharper slowdown in the US with spillovers to its major trade partners (including the EU), while Chinese authorities' attempt to shore up growth could increase debt and heighten the risk of a disorderly adjustment - ECFIN forecast Autumn 2018.

[5] Walmsley T., Minor, P., *Estimated Impacts of US Sections 232 and 301 Trade Actions on the US and Global Economies: A Supply Chain Prospective 2018-2030*, November 2018, p. 25.

[6] http://www.europarl.europa.eu/RegData/etudes/STUD/2018/603882/EXPO_STU(2018)603882_EN.pdf.

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