

A Weakening Expansion

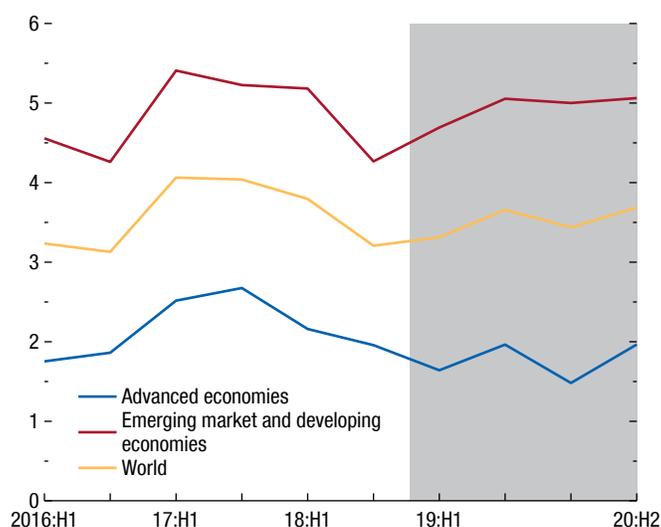
After strong growth in 2017 and early 2018, global economic activity slowed notably in the second half of last year, reflecting a confluence of factors affecting major economies. China's growth declined following a combination of needed regulatory tightening to rein in shadow banking and an increase in trade tensions with the United States. The euro area economy lost more momentum than expected as consumer and business confidence weakened and car production in Germany was disrupted by the introduction of new emission standards; investment dropped in Italy as sovereign spreads widened; and external demand, especially from emerging Asia, softened. Elsewhere, natural disasters hurt activity in Japan. Trade tensions increasingly took a toll on business confidence and, so, financial market sentiment worsened, with financial conditions tightening for vulnerable emerging markets in the spring of 2018 and then in advanced economies later in the year, weighing on global demand. Conditions have eased in 2019 as the US Federal Reserve signaled a more accommodative monetary policy stance and markets became more optimistic about a US–China trade deal, but they remain slightly more restrictive than in the fall.

Global Growth Is Set to Moderate in the Near Term, Then Pick Up Modestly

As a result of these developments, global growth is now projected to slow from 3.6 percent in 2018 to 3.3 percent in 2019, before returning to 3.6 percent in 2020. Growth for 2018 was revised down by 0.1 percentage point relative to the October 2018 *World Economic Outlook* (WEO), reflecting weakness in the second half of the year, and the forecasts for 2019 and 2020 are now marked down by 0.4 percentage point and 0.1 percentage point, respectively. The current forecast envisages that global growth will level off in the first half of 2019 and firm up after that (Figure 1). The projected pickup in the second half of 2019 is predicated on an ongoing buildup of policy stimulus in China, recent improvements in global financial mar-

Figure 1. Half-Yearly Growth Rates
(Annualized semiannual percent change)

Global growth is expected to level off in the first half of 2019 and firm up after that.



Source: IMF staff estimates.

ket sentiment, the waning of some temporary drags on growth in the euro area, and a gradual stabilization of conditions in stressed emerging market economies, including Argentina and Turkey. Improved momentum for emerging market and developing economies is projected to continue into 2020, primarily reflecting developments in economies currently experiencing macroeconomic distress—a forecast subject to notable uncertainty. By contrast, activity in advanced economies is projected to continue to slow gradually as the impact of US fiscal stimulus fades and growth tends toward the modest potential for the group.

Beyond 2020, global growth is set to plateau at about 3.6 percent over the medium term, sustained by the increase in the relative size of economies, such as those of China and India, which are projected to have robust growth by comparison to slower-growing advanced and emerging market economies (even though Chinese growth will eventually moderate). As noted in previous WEO reports, tepid labor produc-

tivity growth and slowing expansion of the labor force amid population aging will drag advanced economy growth lower over the projection horizon.

Growth across emerging market and developing economies is projected to stabilize slightly below 5 percent, though with variations by region and country. The baseline outlook for emerging Asia remains favorable, with China's growth projected to slow gradually toward sustainable levels and convergence in frontier economies toward higher income levels. For other regions, the outlook is complicated by a combination of structural bottlenecks, slower advanced economy growth and, in some cases, high debt and tighter financial conditions. These factors, alongside subdued commodity prices and civil strife or conflict in some cases, contribute to subdued medium-term prospects for Latin America; the Middle East, North Africa, and Pakistan region; and parts of sub-Saharan Africa. In particular, convergence prospects are bleak for some 41 emerging market and developing economies, accounting for close to 10 percent of global GDP in purchasing-power-parity terms and with total population close to 1 billion, where per capita incomes are projected to fall further behind those in advanced economies over the next five years.

Risks Are Tilted to the Downside

While global growth could surprise favorably if trade differences are resolved quickly so that business confidence rebounds and investor sentiment strengthens further, the balance of risks to the outlook remains on the downside. A further escalation of trade tensions and the associated increases in policy uncertainty could further weaken growth. The potential remains for sharp deterioration in market sentiment, which would imply portfolio reallocations away from risk assets, wider spreads over safe haven securities, and generally tighter financial conditions, especially for vulnerable economies. Possible triggers for such an episode include a no-deal Brexit withdrawal of the United Kingdom from the European Union; persistently weak economic data pointing to a protracted

global growth slowdown; and prolonged fiscal uncertainty and elevated yields in Italy—particularly if coupled with a deeper recession—with possible adverse spillovers for other euro area economies. A rapid reassessment by markets of the monetary policy stance in the United States could also tighten global financial conditions. Over the medium term, climate change and political discord in the context of rising inequality are key risks that could lower global potential output, with particularly severe implications for some vulnerable countries.

Policy Priorities

Amid waning global growth momentum and limited policy space to combat downturns, avoiding policy missteps that could harm economic activity needs to be the main priority. Macroeconomic and financial policy should aim to prevent further deceleration where output could fall below potential and facilitate a soft landing where policy support needs to be withdrawn. At the national level, this requires monetary policy to ensure that inflation remains on track toward the central bank's target (or if it is close to target, that it stabilizes there) and that inflation expectations remain anchored. It requires fiscal policy to manage trade-offs between supporting demand and making sure that public debt stays on a sustainable path. Where fiscal consolidation is needed and monetary policy is constrained, its pace should be calibrated to secure stability while avoiding harming near-term growth and depleting programs that protect the vulnerable. If the current slowdown turns out to be more severe and protracted than expected in the baseline, macroeconomic policies should become more accommodative, particularly where output remains below potential and financial stability is not at risk. Across all economies, the imperative is to take actions that boost potential output growth, improve inclusiveness, and strengthen resilience. At the multilateral level, the main priority is for countries to resolve trade disagreements cooperatively, without raising distortionary barriers that would further destabilize a slowing global economy.