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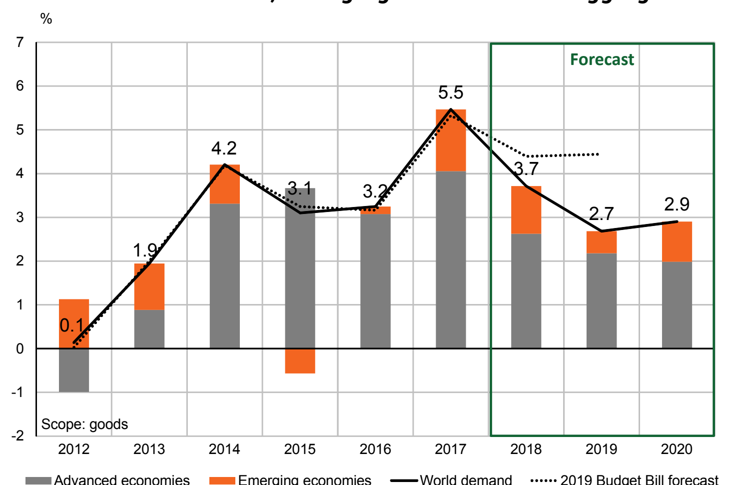
World economic outlook in spring 2019: Diverging performances in the global slowdown

- The global economy showed strong growth again in 2018, with world GDP up 3.7%. However, a slowdown is expected in 2019 and 2020 (world GDP growth seen at 3.4% p.a.), especially in advanced economies.
- The euro area's growth rate is set to decline further in 2019. Apart from temporary factors, this is attributable to a slowdow in world demand, considerable uncertainty weighing on investment and consumption, and the end of the post-crisis catch-up effect. In 2019, growth is expected to be particularly lacklustre in Italy (0.2%) and in Germany (0.8%), which are both more affected by these factors than Spain (2.3%) or France. Euro area GDP is seen up 1.3% in 2019, following growth of 2.5% and 1.8%, respectively, in 2017 and 2018. Thereafter, euro area growth is expected to rebound slightly in 2020 (to 1.4 %), as the economies of its major trading partners return to normal and uncertainty levels off.
- US economic activity is expected to decelerate slightly in 2019, given pressures on the labour market and the roll-out of protectionist measures, before slowing more substantially in 2020 as fiscal stimulus tapers off. In the United Kingdom, growth is likely to be sluggish, dampened by Brexit-related uncertainty. In Japan, growth is set to be moderate in 2019 due to slowing Chinese demand, followed by even weaker growth in 2020 as VAT is increased.
- In the main emerging economies, activity is generally expected to remain upbeat. Growth should be strong in India, but China is set for a soft landing as deleveraging measures and the trade dispute with the United States begin to take a toll. Turkey, which is already in recession, is expected to see its GDP decline in 2019, followed by a recovery in 2020. Both Brazil and Russia should post modest economic recoveries.
- Combined with the build-up of protectionist measures, this weaker economic momentum is likely to put a clear damper on world trade, growth of which is forecast at around 3% p.a. in 2019 and 2020 (after 4.5% in 2018). World demand for French exports is set to follow a similar trend over the forecast period.
- This scenario is subject to major uncertainties: the magnitude of the euro area slowdown, the implementation of protectionist measures in the United States, the terms for Brexit, whether China experiences a soft or hard landing, the economic policy stance both in advanced countries (the United States, Spain, Germany and Italy) and in emerging countries (Brazil), and financial uncertainty in the United States and emerging countries.

Growth in world demand for French exports: advanced economies, emerging economies and aggregate*



Source: DG Trésor.

* The forecasts and data in this document were finalised on 1 March 2019.

MINISTÈRE DE L'ÉCONOMIE ET DES FINANCES

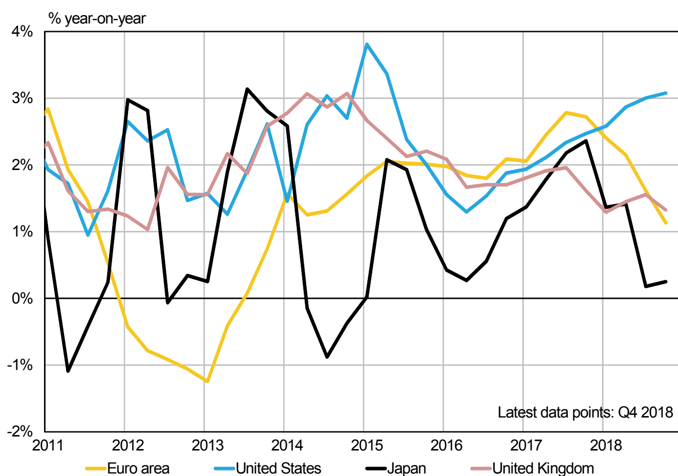
1. The world economy was less dynamic in the second half of 2018 and the start of 2019

1.1 In the second half of 2018, growth declined in the euro area, but remained strong in the United States

The US economy continued to perform well in the second half of 2018, with growth accelerating to 2.9% in 2018 (vs. 2.2% in 2017), buoyed by fiscal stimulus. Conversely, activity slowed in the other advanced economies in the second half (see Chart 1). In the euro area, lacklustre world demand, the knock-on effects of the euro's past appreciation, and the automobile industry's difficulties adapting to new environmental standards (see Box 1) all weighed on the growth trend. The euro area was also adversely affected by weaker investment and consumption in the face of strong political and trade-related uncertainties. The Italian and German economies are more exposed to these factors; growth in both countries stalled in the second half. Overall, euro area growth slowed to 1.8% in 2018 (after 2.5% in 2017). Similarly, UK economic growth slowed to 1.4% in 2018 (vs. 1.8% in 2017), due to Brexit-related uncertainties, and the Japanese economy was adversely affected by weather catastrophes in summer 2018 (growth of 0.7% in 2018 after 1.9% in 2017).

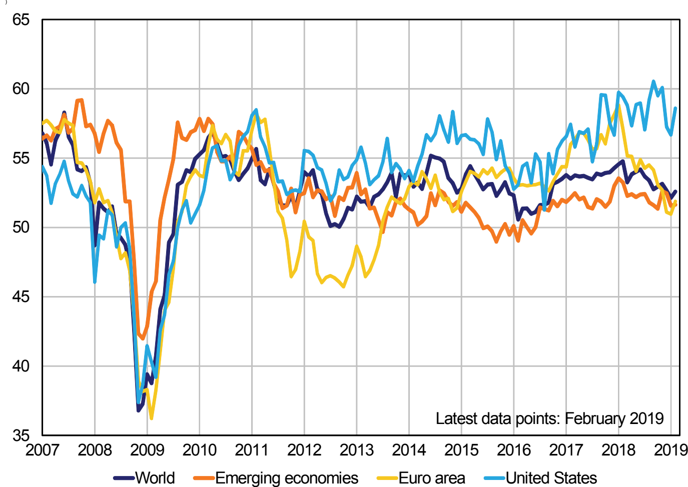
At the start of 2019, economic indicators remained upbeat in the United States despite several months of volatility (see Chart 2). Over the past few months, euro area business confidence has levelled off just above the "expansion" threshold, after posting a significant decline in 2018. Indicators for the United Kingdom and Japan also declined sharply in 2018 to levels close to the "expansion" threshold.

Chart 1: GDP growth in the main advanced economies



Sources: National statistical institutes.

Chart 2: Business confidence indices[a]



Sources: PMI (Markit), ISM.

a. The PMI (Purchasing Managers' Index – Markit) for the euro area, emerging economies and the world, and the ISM (Institute for Supply Management) index for the United States.

Box 1: Euro area industrial production loses steam

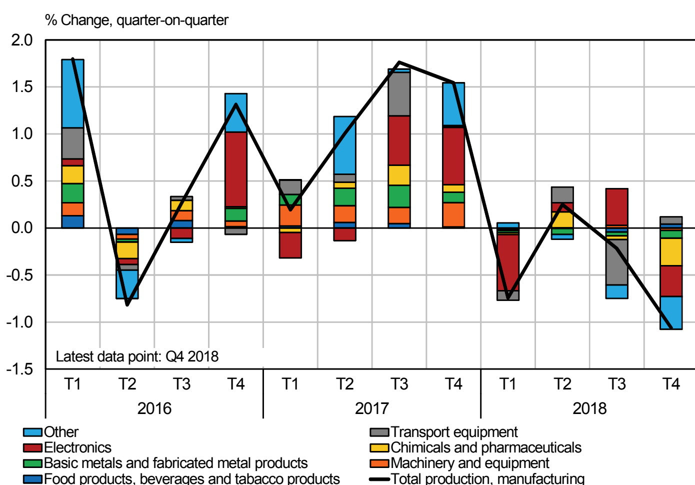
The second half of 2018 saw a decline in euro area industrial production (see Chart 3) across the four main euro area economies. This decline was attributable in part to temporary domestic factors, and in part to a deterioration in the international economic environment.

Euro area exports – especially in the manufacturing sector – were hit by the slowdown in world demand and the knock-on effects of the euro's past appreciation. Exports of the four main euro area economies slowed in late 2018 (year-on-year growth was 1.5% in Q4 2018, vs. 4.0% in Q2), and the manufacturing PMI points to a decline in new export orders in early 2019 (see Chart 4). What's more, investment – and therefore capital goods manufacturers – was impacted by persistent high uncertainty related to the risks of Brexit and its potential impact on value chain restructuring, as well as the Trump Administration's threats to levy tariffs on European automobile exports to the United States. Although tensions between the Trump Administration and the EU eased in summer 2018, a US Commerce Department report on automobile imports, submitted to the Trump Administration in February, rekindled fears of tariffs being imposed on automakers.

In addition to international factors, European industry was affected by domestic factors that are likely to be only temporary. The automobile sector suffered from the introduction, in September, of the Worldwide Harmonised Light Vehicle Test Procedure (WLTP), a new and more stringent emissions test. Automakers' delays in obtaining certificates of compliance with the new standard prevented vehicles from being commercialised, thereby leading to lower automobile sales (declines in both new car registrations and exports), higher inventories and eventual cuts in output. The impact was especially strong for Germany, with automobile manufacturing down 8% in Q3 (compared to declines of 4% in Italy, 3% in Spain and 1% in France). This had a substantial impact on the German economy as a whole given the size of the German automobile sector (around 5% of GDP). In Q4, euro area industrial output was also impacted by reduced output in the German chemicals sector, as low water levels on the river Rhine from mid-August to mid-November affected river freight shipping. The German chemicals sector saw a 10% drop in its output in Q4.

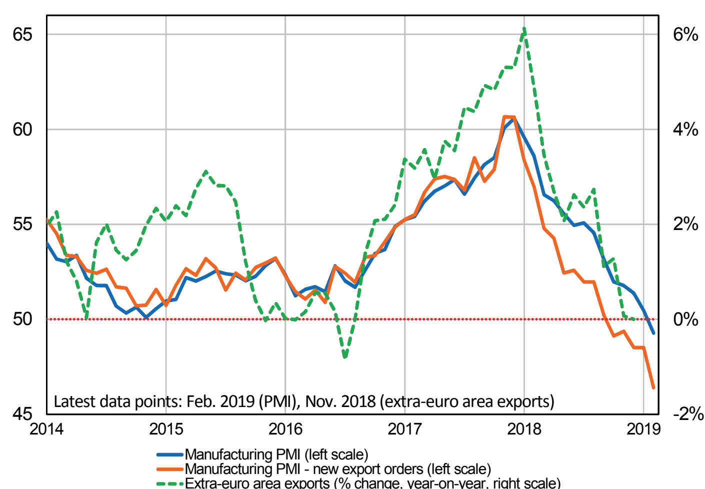
Euro area industrial output is expected to level off in Q1 2019 (at end January, carry-over growth came to 0.1%).

Chart 3: Quarterly trend in euro area industrial production, main component of manufacturing



Source: Eurostat, DG Trésor calculations.

Chart 4: Manufacturing PMI and extra-euro area export growth

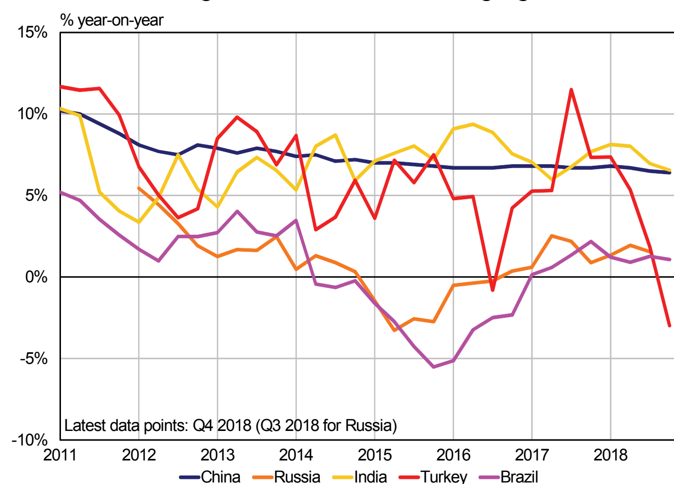


Sources: Markit, ECB.

1.2 Economic growth in emerging countries was stable overall in 2018, with strong differences in trends across countries

The Fed's interest rate hikes in 2018 were announced in advance and well anticipated, with a limited impact on emerging countries. Financial markets were more concerned about countries with poor fundamentals (e.g. Turkey and Argentina). In China, activity slowed as a result of the structural deleveraging policy designed to rebalance the country's growth model. Trade tensions with the United States compounded this slowdown. Chinese demand fell off markedly in the second half, following a significant decline in business and consumer confidence. This dampened China's demand for imports (see Box 2). In Russia, rising oil prices had a positive economic effect until Q3. The Russian government implemented structural reforms and achieved a budget surplus despite US sanctions being scaled up in spring 2018. Turkey was also hit by US sanctions in mid-August, along with a wave of investor mistrust that precipitated the lira's depreciation and worsened the country's external vulnerabilities. The Turkish economy dipped into recession at the end of 2018 (see Chart 5).

Chart 5: GDP growth in the main emerging economies



Sources: National statistical institutes.

In Brazil, the economic recovery was sluggish in 2018 due to cyclical factors: a haulier strike in May, and investors adopting a wait-and-see attitude prior to the presidential elections. In India, growth increased more rapidly; not only did two negative effects from 2017 subside (the banknote demonetisation and the roll-out of a single country-wide VAT rate), but also consumption was very dynamic and the industrial cycle robust. At the start of 2019, PMIs were upbeat in India, Russia and Brazil, but very poor for Turkey. China's manufacturing PMI just dipped below the "expansion" threshold.

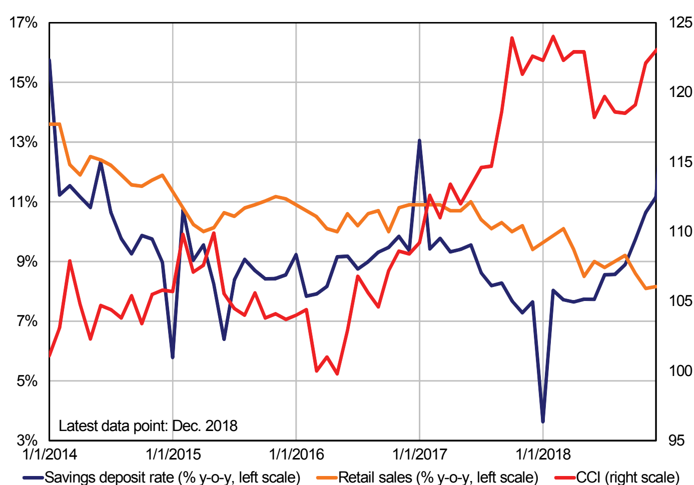
Box 2: Economic indicators point to a substantial slowdown in the Chinese economy at end 2018

Whereas the Chinese economy continues to grow at a strong pace, it has been gradually slowing down since 2010, with a substantial deterioration in 2018. The growth rate steadily declined over the course of 2018, with full-year GDP up 6.6% (vs. 6.9% in 2017). Domestic demand was impacted by policies implemented in early 2017 to curb the financial sector's imbalances in the wake of the 2015 stock market crash. Moreover, trade tensions with the United States have been tangible since the start of 2018, weighing on China's exports and dampening the confidence of businesses and consumers alike.

Business activity slowed throughout 2018. The PMI reported by China's National Bureau of Statistics (NBS) fell sharply, dipping below 50 (the "expansion threshold") in December. The manufacturing sector – especially small and mid-sized firms – was hit hard as output slowed substantially and profits declined. New export orders in the manufacturing sector have slumped since April; this may be a consequence of the trade tensions with the United States. The slowdown in China's manufacturing sector has had a knock-on effect on global supply chains as a whole, especially for China's major trading partners in Asia (Japan, South Korea, Taiwan, etc.). However, China's services sector is still fairly dynamic. It is protected by its low international exposure (it is not dependent on international trade and is not very open to foreign investment) and high proportion of state-owned companies that enjoy an implicit government guarantee and easier access to bank loans.

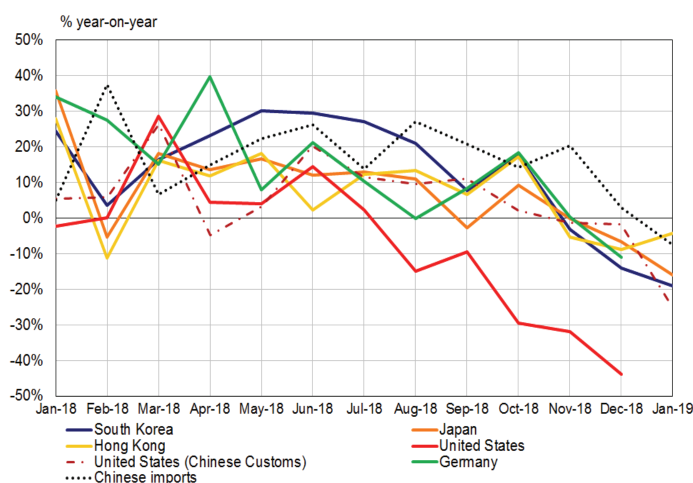
Consumption suffered as households reacted to greater economic uncertainties by increasing their precautionary saving rate. Trade tensions caused Chinese stock markets to drop and its currency to weaken, resulting in a similar decline in the consumer confidence index (CCI) in the second half. At the end of the year, the CCI began to recover as tensions with the United States eased somewhat. Retail sales growth slumped to a 20-year low in November, whereas the household saving rate rose considerably (see Chart 6). Automobile sales began to decline in July and deteriorated further in Q4 2018. These trends cast doubt on the Chinese authorities' efforts to shift to a consumption-driven growth model. In all, this sluggish demand in China had a substantial negative effect on China's imports from its trading partners in late 2018 (see Chart 7).

Chart 6: Trends in Chinese household savings, retail sales and consumer confidence index



Source: NBS.

Chart 7: Exports to China by main trading partner (in nominal terms)



Sources: Customs data, DataInsight.

1.3 Since summer 2018, rising uncertainties and a less predictable monetary policy environment have led to market turbulence

Central banks in the major advanced economies followed through on their plans to normalise monetary policy in 2018. However, as the world economic cycle has deteriorated, the trend for 2019 looks less certain and will depend heavily on the economic context. In the United States, the Fed raised its key rates by 25 basis points in mid-December, its fourth rate hike in 2018.[1] The Fed's published "dot plots" point to monetary policy tightening at a slower pace, with two rate hikes in 2019 (vs. three announced previously), then one in 2020. However, these announcements diverged from the scenario priced in by the markets, which no longer forecast any rate hikes in 2019. The Fed's difficulty anchoring its interest rate path, combined with the effects of quantitative easing and the growing appeal of safe haven assets, may have caused the partial inversion of the US yield curve observed since December (see Box 3). Eventually, in late January, the Fed further softened its stance and suggested that the next rate hike was not yet on the horizon. It emphasised that it was prepared to adjust its monetary policy according to economic conditions. In parallel, the European Central Bank (ECB) – as expected – ended its asset purchase programme in early January. Then in March, the ECB stated that it expected interest rates to remain at current levels until end 2019 (previously, it forecast stable rates until summer 2019), and announced the launch of a new series of targeted longer-term refinancing operations (TLTRO) to support bank lending.

In the past few months, the financial markets have been buffeted by high stock market volatility. Stock indices dropped in early October, then posted further declines in mid-December due to a less favourable economic outlook and trade-related uncertainty. Markets rallied in January, especially thanks to an easing of trade tensions between the United States and China and the Fed's more dovish stance. On the bond markets, a "flight to quality" drove sharp reductions in sovereign spreads for the major advanced economies. At the same time, the agreement reached by the Italian government and the European Commission in December helped ease pressure on Italian spreads. Going forward, market expectations for the Fed's funds rate suggest a slight increase in long-term US rates, leaving financing conditions fairly accommodative in the United States.

Following a peak in early October at $86 per barrel, the Brent oil price declined significantly due to fears of weaker oil demand in a less upbeat global economy, in a context of abundant supply after the United States softened its stance on Iranian oil exports by granting six-month waivers on sanctions. As a result, OECD oil stocks broke above their five-year average in October. At the start of 2019, Brent oil rebounded to $65/bbl on average over the last three weeks of February. This rebound was driven both by OPEC production cuts decided by OPEC+ in early December (production cut by an additional 1.2 mbbl/day from January to June 2019), and by reduced production in Iran and Venezuela due to US sanctions.

Box 3: Stock market corrections and a partial inversion of the US yield curve at the end of 2018

Higher volatility roiled the markets at the end of 2018, with stock markets suffering setbacks in October and December. Rising uncertainties over 2018 initially precipitated a sharp correction on the US stock market, with a knock-on effect on European markets as investors became more risk-averse. The S&P 500 lost more than 20% in three months. This was the sharpest correction on the US stock market since the 2008 crisis.

This market correction occurred in a period of high equity valuations underpinned by good overall fundamentals, the US tax reform and share buybacks.[a] In addition to these factors, equity valuations were boosted by low bond yields (due to the still very accommodative monetary policy) and high market liquidity (markets awash with savings, plus direct liquidity injections by central banks). In particular, the Fed's quantitative easing policy,[b] by depressing bond yields, encouraged investors to turn to higher-risk investments with better prospective returns.

In late 2018, the rise in political and trade-related risks and the deterioration in the global economic outlook may have prompted investors to downgrade their profit expectations and triggered a "flight to quality". This movement caused an equity sell-off in an uncertain interest rate environment.

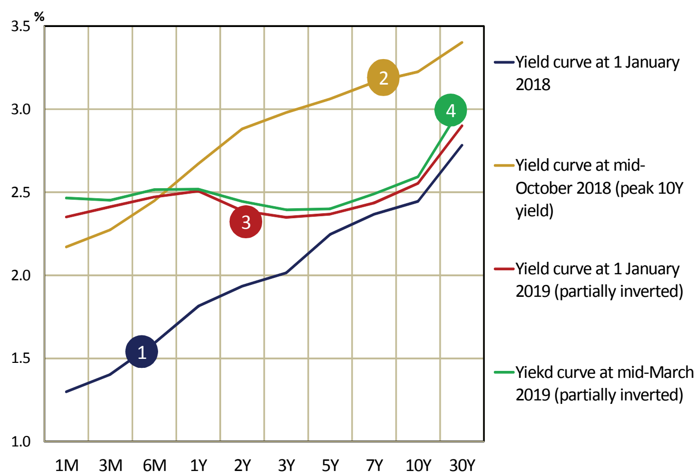
a. $800bn in the first three quarters of 2018.
b. At the end of 2018, the Fed held securities worth roughly 20 GDP points with an average maturity of just under eight years.

(1) The target range now stands at 2.25-2.5%.

In December 2018, the US Treasury yield curve[c] inverted partially for the first time since the 2008 crisis (see Chart 8). This partial inversion sparked concern amongst many market participants. Indeed, since 1950, nine fully-inverted US Treasury yield curves out of ten have preceded a recession of the US economy (see Chart 9).

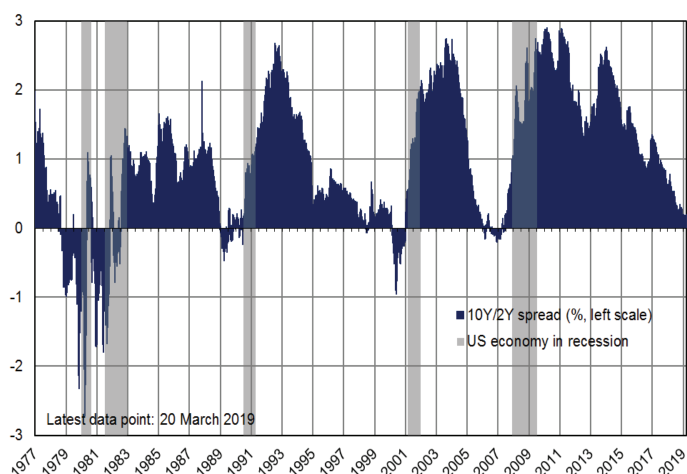
In December 2018, the five-year Treasury rate dipped below the two-year Treasury rate, before this inversion spread to all maturities between one and seven years. Several potential explanations can be given for the flattening yield curve, but none of these is completely satisfactory: 1) The normalisation of US monetary policy, with short-term rates gradually trending towards the Fed's long-term target, may have a greater effect on short-term rates than on long-term ones (at a given term premium). 2) Due to the still very low yields on European and Japanese government bonds, the "flight to quality" may have favoured long-dated US Treasuries, thus lowering long-term US rates more than short-term ones. 3) Lastly, the weak term premiums since 2016, possibly attributable to the Fed's quantitative easing, may have flattened the yield curve.

Chart 8: US yield curve



Sources: Reuters, DG Trésor calculations.

Chart 9: US yield curve slope and recessions



Sources: Reuters, DG Trésor calculations.

For Chart 8: We note the following: 1) Between 1 January and mid-October 2018 (i.e. yield curves 1 and 2, respectively), the yield curve shifted upward as the Fed raised its key rates, with long-term yields shifting upward to almost the same extent. 2) Between mid-October and end-December 2018 (i.e. yield curves 2 and 3), the yield curve inverted partially, with long-term rates declining even as short-term interest rates continued to rise. The January 2019 yield curve showed the steepest inversion since the period of partial inversion began.

c. The yield curve depicts the interest rate at which an economic agent can borrow at each maturity. The interest rate at a given maturity depends on: 1) the short-term interest rates expected by the market out to the maturity; and 2) a term premium, which reflects the market's overall preference for short-dated securities and is therefore usually positive. Thus, the yield curve is generally upward sloping, as long-term rates are usually higher than short-term rates.

2. World growth is set to weaken in 2019 and 2020 as the international environment remains uncertain

World growth was resilient in 2018, with global GDP up 3.7% (the same as in 2017). However, growth is set to decline in 2019 and 2020 to 3.4% p.a., especially in the advanced countries whose growth is thought to have peaked (see Table 1).

2.1 The US economy is expected to slow down significantly in 2020

Assuming stable oil prices, US activity is set to be dynamic again in 2019 (GDP expected up 2.6%), boosted by fiscal stimulus, but a slowdown is on the horizon for 2020 (GDP expected up 1.7%), given the end of stimulus measures, the effect of protectionist policies, less favourable financing conditions and a tight labour market. Fiscal policy is set to have a clear expansionary effect in 2009 (+0.6 pt after +0.3 pt in 2018), followed by a neutral effect in 2020. The partial shutdown of the Federal government in late December 2018/early January 2019 is expected to have a very modest impact on 2019 growth.[2] However, the various customs tariffs are likely to shave 0.2 pt off of growth in 2019, then 0.1 pt in 2020 (after a –0.1-pt effect in 2018), assuming all current customs measures are maintained (including retaliation by trading partners) but no new tariff hikes are implemented.[3]

(2) According to the Congressional Budget Office (January 2019), the "unrecoverable costs" of the shutdown are equal to 0.02 pt of GDP in 2019.
(3) Notably after the United States and China agreed to a "truce", which President Trump extended in late February. Estimates by DG Trésor were made using the NiGEM macroeconomic model.

In Japan, after slowing in 2018, growth is set to level off in 2019 (GDP expected up 0.7%) and decline in 2020 (GDP expected up 0.4%). The non-recurrence of weather catastrophes (which impacted 2018 growth) will be offset by the slump in Chinese demand for Japanese goods. Private investment is likely to slow further as the knock-on effect of the Tokyo 2020 Olympics fades, despite the gradual levelling off of residential investment. The VAT hike planned for October 2019 will probably dent domestic demand in 2020 even though the government has pledged to take measures to support consumption. Wages are likely to continue to accelerate given the very tight labour market and pro-wage growth incentives.

In the United Kingdom, after showing impressive resilience following the Brexit referendum in June 2016, the economy showed signs of a slowdown in 2018 (GDP growth was 1.4 % in 2018 after 1.8% in 2017). The medium-term growth outlook is modest, with the main growth driver being private consumption, underpinned by higher purchasing power thanks to a dynamic real wage trend in a context of lower inflation. Meanwhile, Brexit-related uncertainties are expected to weigh on corporate investment and foreign trade. In this scenario,[4] Brexit would have a modest impact on activity in France and the euro area over the forecast period.

2.2 The euro area faces a substantial slowdown

Over the forecast period, euro area activity is expected to slow (GDP expected up 1.3% in 2019 and 1.4% in 2020). Likewise, headline inflation is likely to decline due to lower energy prices and despite a recovery in core inflation (driven by the stronger wage growth). As in 2018, the expected slowdown is partly attributable to a slump in global demand (mainly in China and OPEC countries). This should weigh especially on Germany's export-led growth. However, despite the slump in global demand, euro area exports – after performing poorly in 2018 – are expected to recover in 2019 as the negative effects of the euro's past appreciation and certain one-off factors fade. The export growth is nevertheless likely to be much weaker than in 2017.

Persistent uncertainties (especially Brexit and protectionism) are set to dampen domestic demand again in 2019, especially in Italy, where uncertainties surrounding fiscal policy impacted domestic demand and caused a recession in 2018. However, this situation is expected to return to normal in 2020, with Italian growth enjoying a slight rebound. Similarly, in Germany, the level of uncertainty is expected to stabilise in 2020, resulting in a stable household saving rate and higher consumption growth after a very weak consumer spending trend in 2019. On a more structural level, the post-crisis catch-up effect is fading and companies are facing greater difficulties hiring staff: the tighter labour market is set to affect domestic demand, as in Spain, where growth is set to decline year after year. In addition, corporate investment is expected to be affected by less favourable economic policies in Italy and Spain. Conversely, less restrictive fiscal policy in Germany is expected to support 2019 activity to a slight extent. Furthermore, the gradual rebalancing of labour costs – visible in recent years in the euro area –is likely to continue. Inflation and wage growth are expected to be stronger in Germany than in the countries of southern Europe.

Thus, in Germany, after stalling at the end of 2018, growth is expected to lack momentum at the start of 2019, as inventories built up in 2018 are drawn down and as uncertainty continues to dampen consumption. German economic activity is expected to expand gradually with GDP growth expected at 0.8% in 2019 and 1.3% in 2020. For household, despite the expected slowdown in job creations, purchasing power gains made in 2018 are likely to continue in 2019, thanks to targeted tax cuts and stronger wage growth. However, purchasing power is expected to slow in 2020, as the impact of tax cuts fades and inflation gathers pace. Nevertheless, as households precautionary saving levels off 2020, consumption is expected to accelerate. For business, investment is likely to slow due to a deterioration in the economic outlook and a reduction in corporate profit margins.

(4) Our forecast scenario uses the conventional assumption of a transitional Brexit agreement between the United Kingdom and the European Union taking effect in the first half of 2019. This is a working assumption that does not make any predictions as to the outcome of ongoing talks between the United Kingdom and the European Union.

In Italy, activity is expected to slow in 2019 (GDP growth forecast at 0.2% after 0.8% in 2018) before regaining momentum in 2020 as economic uncertainty stabilises (+0.6%).[5] More specifically, investment is likely to stall in 2019, as the "super-depreciation" scheme expires and financing conditions become more stringent, before recovering somewhat in 2020. Job creations are set to slow in 2019, in line with the economic activity trend and as exonerations on employers' social security contributions are phased out.

In Spain, the economy's good momentum is set to slow gradually (growth expected at 2.3% in 2019 and 1.9% in 2020, after 2.5% in 2018). After the Spanish labour market grew tighter in 2018, job creations are expected to be less supportive of household consumption. Nevertheless, the 22.3% hike in the minimum wage will drive consumption in 2019, as will pay rises for civil servants and increases for pensions. Investment is set to slow gradually, due notably to less pro-investment economic policies, partially offset by continued relaxed financing conditions.

2.3 Aggregate growth of the main emerging economies is expected to be stable

In China, economic growth is expected to slow substantially out to 2020. This slowdown is mainly attributable to economic policies aimed at deleveraging the economy and tightening financial regulations. While these macro-prudential measures are intended to rein in the surge in local government off-balance-sheet debt and corporate debt and to reduce the role of shadow banking, they affect the entire private industrial sector and consumption by restricting access to credit. In addition, trade tensions with the United States have magnified the economic slump. The fiscal and monetary stimulus measures launched in late 2018 and bolstered in early 2019 are unlikely to be sufficient to offset the growth slump entirely, they will provide temporary support, with activity slowing more gradually in 2020.

In Turkey, the recession is expected to continue in 2019. Inflation, still running at nearly 20%, will impact household purchasing power. Corporate debt levels are very high, monetary policy is tight and public investment is being cut back. In 2020, a strong recovery is expected, thanks mainly to a reduction in inflation.

In Brazil, accommodative monetary policy and low inflation are set to buoy growth in 2019, with further support from renewed investor confidence after political uncertainty was dispelled by the presidential election. This scenario assumes that the new government successfully reforms the retirement system, which has been responsible for an uncontrollable rise in public debt since 2014, fuelling concerns from investors. Activity is expected to be more dynamic in 2020, driven mainly by a recovery in investment in the manufacturing sector to restore the country's industrial output capacity.

In India, growth is set to peak in 2019 under the combined effect of fiscal stimulus for farmers, high public spending ahead of elections, a continued dynamic investment trend and an improvement in the terms of trade. In addition, the newly appointed governor of the Reserve Bank of India might herald a more accommodative monetary policy. Growth is expected to slow slightly in 2020 due to inflationary pressure and risks in the banking sector, which already has a high non-performing loan ratio.

In Russia, US sanctions enforced in spring 2018 triggered depreciation of the rouble. Combined with the VAT hike (from 18% to 20%) on 1 January 2019, the weaker currency has rekindled inflation. With the decline in oil prices, growth is set to slow in 2019. Next year, these effects should fade but growth is expected to remain hampered by serious structural weaknesses. Nevertheless, the investments announced by the government in several key sectors (including infrastructure, new technologies, education and housing) are expected to boost potential growth.

(5) Our forecasts include all measures in the Italian government's draft budget for 2019, but no policy changes in 2020 (in line with the European Commission's forecasts).

Table 1: Growth forecasts*

GDP (annual average, %)	Average 2000-2007	2015	2016	2017	2018	2019	2020
					(forecasts, working-day adjusted)		
World growth[a]	**4.5**	**3.4**	**3.2**	**3.7**	**3.7**	**3.4**	**3.4**
Memorandum: world growth forecast in the 2019 Budget Bill (PLF)	*4.5*	*3.4*	*3.2*	*3.7*	*3.8*	*3.8*	
Advanced economies[b]	**2.7**	**2.3**	**1.7**	**2.4**	**2.3**	**1.9**	**1.5**
United States	2.7	2.9	1.6	2.2	2.9	2.6	1.7
Japan	1.5	1.3	0.6	1.9	0.7	0.7	0.4
United Kingdom	2.8	2.3	1.8	1.8	1.4	1.2	1.3
Euro area[c]	**2.2**	**2.0**	**1.9**	**2.5**	**1.8**	**1.3**	**1.4**
Germany	1.6	1.7	2.2	2.2	1.5	0.8	1.3
Italy	1.5	0.9	1.1	1.6	0.8	0.2	0.6
Spain	3.7	3.6	3.2	3.0	2.5	2.3	1.9
Other advanced economies	3.9	2.1	2.1	3.2	2.9	2.2	2.2
Emerging economies[b]	**6.6**	**4.3**	**4.4**	**4.7**	**4.6**	**4.5**	**4.7**
Brazil	3.6	−3.5	−3.5	1.1	1.3	2.2	2.5
China	10.5	6.9	6.7	6.9	6.6	6.2	5.9
India	7.1	8.2	7.1	6.2	7.4	7.6	7.3
Russia	7.2	−2.5	−0.2	1.5	2.3	1.3	1.8
Turkey	5.4	6.1	3.2	7.4	2.9	−1.5	3.0
Other emerging economies	4.5	3.4	3.6	3.3	3.2	3.3	3,7
World demande for French exports[d]	*6.9*	*3.1*	*3.2*	*5.5*	*3.7*	*2.7*	*2.9*
World trade[e]	*7.5*	*1.9*	*1.9*	*5.8*	*4.5*	*3.0*	*3.1*

a. Data for 2018 is taken from national accounts and supplemented by the DG Trésor's forecasts as needed.
b. Growth forecasts for advanced economies and emerging economies are based on IMF forecasts, corrected using DG Trésor forecasts covering the countries in the table above and France, with past figures adjusted for revisions to national accounts.
c. Growth forecasts for the euro area are based on DG Trésor forecasts for Germany, France, Italy and Spain and on the European Commission's forecasts for the other countries.
d. World demand covers 39 countries and organisations (Germany, Belgium, Italy, Spain, United States, United Kingdom, OPEC, Netherlands, China, Switzerland, Japan, Russia, Poland, Turkey, Brazil, Sweden, South Korea, Hong Kong, Singapore, Canada, Morocco, Portugal, Austria, Czech Republic, Hungary, Australia, India, Malaysia, Mexico, Thailand, Ireland, Denmark, Greece, Slovakia, Norway, Taiwan, Finland, Philippines and Argentina), which receive 86% of French exports.
e. World trade covers 40 countries (the 39 listed above plus France), which receive 85% of world exports.

** These forecasts were finalised on 1 March 2019, and assume that oil prices and currency exchange rates remain unchanged at recent levels.*
Sources : IMF, January 2019 WEO update; European Commission (February 2019). DG Trésor calculations and forecasts.

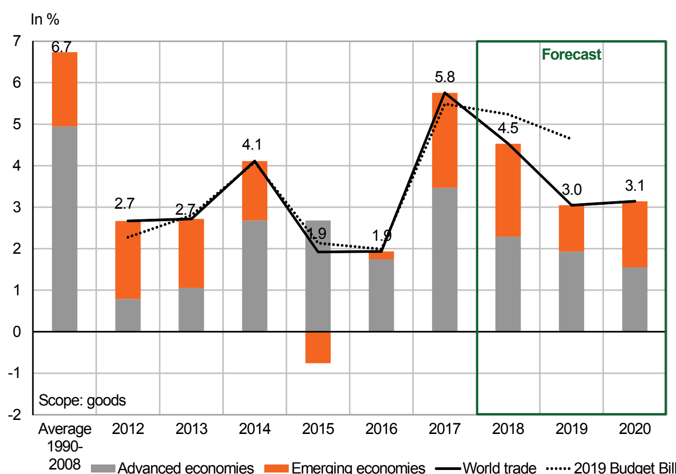
3. World demand for French exports is likely to lose momentum

World trade accelerated in 2017, growing by 5.8% – the best performance since 2011. Despite slowing significantly in 2018, growth was still a sound 4.5%. In the first half of 2018, world trade was buoyed by a sharp increase in Chinese imports in anticipation of higher US tariffs taking effect mid-year. Conversely, in the second half, Chinese imports fell off substantially against a backdrop of protectionist measures and lacklustre Chinese domestic demand. Moreover, world trade was affected by a slump in imports to several regions: 1) the euro area, due to weaker domestic demand and weaker demand in the rest of the world; 2) the United Kingdom, ahead of Brexit; 3) Turkey and Argentina, given the deterioration in those two countries' economies; and 4) non-China Asian countries (namely South Korea, Malaysia and Taiwan), due to a high base effect after the Asian assembly trade recovered in 2017.

World trade is set to lose further momentum in 2019. It is projected to grow by 3.0% in 2019 and at a similar pace in 2020 (see Chart 10). In 2019, Chinese imports are expected to slow sharply on account of US-China trade tensions and the economic slowdown. Imports to oil producing countries are also likely to slow due to lower oil prices than in 2018. Amongst advanced economies, the United States is likely to be the most affected by the slowdown in imports, due to the combined effect of weaker growth and greater protectionism. In 2020, US and Japanese imports are set to weaken, while imports are likely to rebound in Turkey (as the Turkish economy recovers from recession) and in China (after the import shock of late 2018 is absorbed, and assuming a softer landing for the Chinese economy).

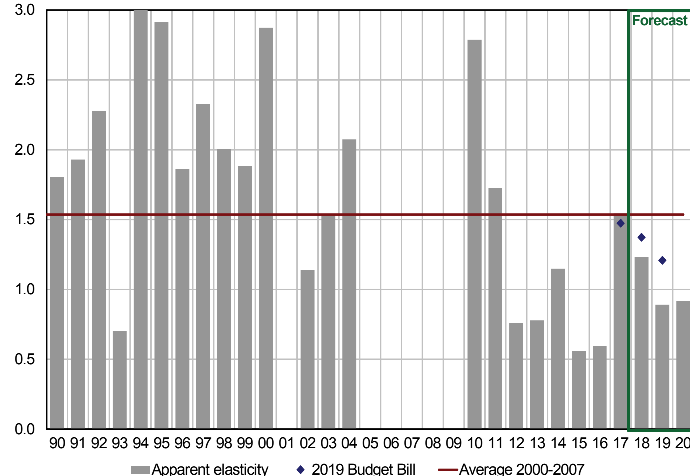
Elasticity of trade to GDP growth rose sharply in 2017, in parallel with stronger world growth. However, this metric is expected to decline to less than 1 over the forecast period (see Chart 11), a trend consistent with both less dynamic world growth and research suggesting that elasticity of trade to growth is cyclical.[6] It declined in 2018, notably due to sluggish European imports. Forecasts point to Asian and US trade contributing less to the world growth trend, as international free trade agreements come under threat and investment is scaled back due to heightened uncertainty.

Chart 10: World trade and contributions by area



Source : DG Trésor.

Chart 11: Elasticity of trade to GDP growth



Source: DG Trésor.

World demand for French exports is expected to slow to +2.7% in 2019 (after +3.7% in 2018), followed by a slight recovery to +2.9% in 2020 (see chart on page 1). The French export sector underperformed world trade in 2018 as it was more exposed to the slump in Europe. However, in 2019 and 2020, French exports should be less exposed to the slowdown in trade in the United States and Asia.

4. This baseline scenario is subject to several uncertainties

- Domestic demand in the euro area has surprised on the downside in the past few months. A faster-than-expected recovery in business and consumer confidence could boost domestic demand.
- The actual effects of Brexit will depend on several factors: 1) the outcome of talks on the future relationship between the United Kingdom and the European Union; 2) the market's reaction to any deal; and 3) a potential "no deal", which would raise tariffs and non-tariff barriers to trade and could lead to disruptions of a logistical or regulatory nature.
- Emerging economies continue to face considerable uncertainty. In China, a breakdown in trade talks with the United States could fuel a harder landing. However, Chinese authorities have a good track record of taking forceful measures to support economic activity. Turkey could enjoy a stronger recovery if it opts for fiscal stimulus, but this would also raise a risk of worsening imbalances. In Brazil, the government's ability to pass a far-reaching pension reform is still uncertain. While political and geopolitical uncertainties continue to hang over emerging countries, the risk of massive capital outflows appears to be fading as the Fed has placed its monetary policy tightening on hold.
- Although the risk of the Fed adopting a more hawkish monetary policy now looks less likely, given the absence of inflationary pressures at this stage, there is major uncertainty about US fiscal policy. If Congress is unable to reach a budget agreement for 2020, tighter fiscal policy could result.
- In the euro area, a narrowing of Italian sovereign spreads over the forecast period would support economic growth, and elections in the first half of 2019 (for the European Parliament and in Spain) will give a clearer idea of future economic policy.
- It is hard to forecast the oil price trend, which depends on the reduction of OPEC+ inventories, the enforcement of US sanctions against Iran and Venezuela, the growth rate of the US oil supply and the strength of the global economy.

(6) See L. Boisset *et al.* (2018), "World economic outlook in spring 2018: growth still strong", *Trésor-Economics* no. 218.

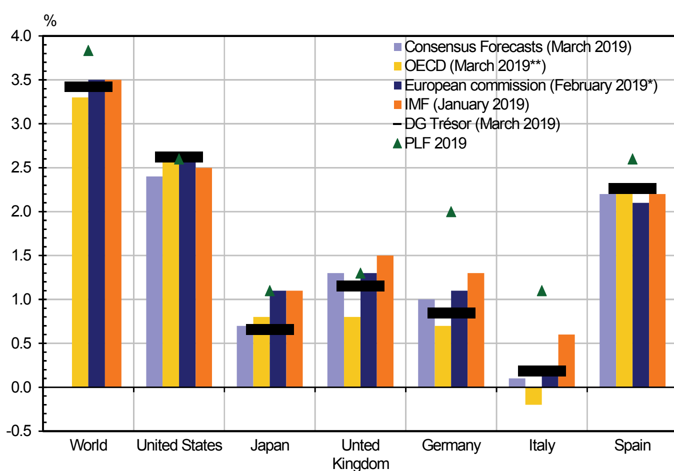
Box 4: Main revisions since the French 2019 Budget Bill (*Projet de loi de finances, PLF*) and comparison with forecasts by international institutions

Since the scenario prepared for the 2019 PLF, uncertainty has remained high and the overall international environment has deteriorated. World growth was not as strong as expected in 2018 (0.1 pt below forecasts), both in the euro area and in emerging economies. The forecast of world growth for 2019 has been revised down by a sharp 0.4 pt:

- This downgrade is mainly attributable to emerging economies: lower oil prices have dampened the economic momentum of oil-producing countries, and the economic downturn has been worse than expected in Argentina and Turkey. Furthermore, the deterioration in China's economic indicators at the end of 2018 has prompted a downward revision to the Chinese growth forecast.
- To a lesser extent, forecasts have been revised down for advanced economies, chiefly in the euro area. In the second half of 2018, growth surprised sharply on the downside, due to a stronger-than-anticipated slump in extra-euro area exports, the automobile sector's difficulties in Q3 2018, and the fact that high uncertainty had a more serious negative impact on confidence and domestic demand than expected. The downward growth forecast revisions are especially substantial for Italy and Germany.

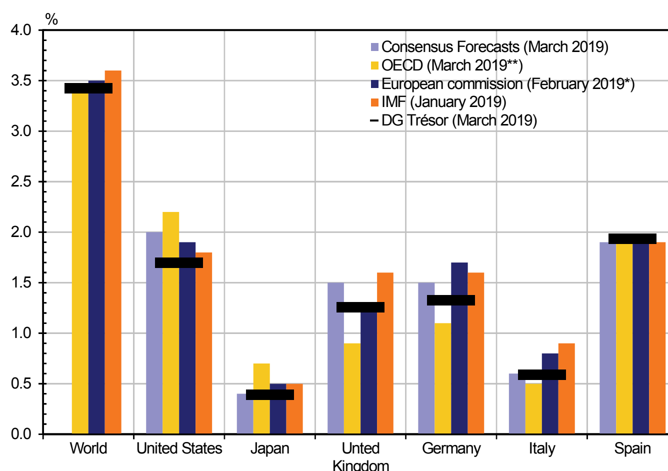
This scenario of weaker world growth in 2019 and 2020 – with an across-the-board slowdown in advanced economies and more mixed growth trends for emerging ones – is broadly in line with the consensus (see Charts 12 and 13). It is consistent with the scenarios presented by the IMF in January, by the OECD in March and by the European Commission in February. It is also in line with the Consensus Forecasts of March.

Chart 12: Growth forecasts for 2019



Sources: IMF, OECD, European Commission, Consensus Forecasts, DG Trésor.

Chart 13: Growth forecasts for 2020



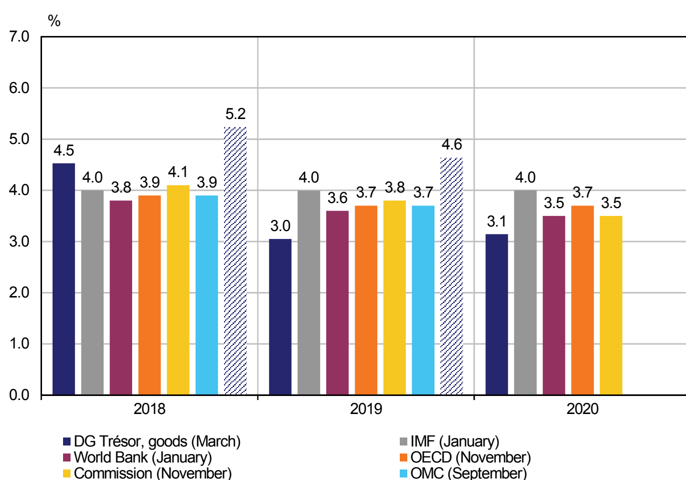
Sources: IMF, OECD, European Commission (forecasts not adjusted for working days), Consensus Forecasts (forecasts not adjusted for working days), DG Trésor.

How to read this chart: Germany will have more working days in 2020, with a positive growth effect of around 0.3-0.4 pt.

Similarly, growth forecasts for world trade have been revised down significantly since the 2019 Budget Bill: –0.7 pt in 2018 and –1.6 pt in 2019. This reflects the stronger-than-expected slowdown in trade in the second half of 2018 in advanced economies, China, Turkey and oil-producing countries. Lastly, world demand for French exports has been revised down substantially, with growth now forecast at 3.7% in 2018 and 2.7% in 2019, compared to 4.4% p.a. in the 2019 Budget Bill.

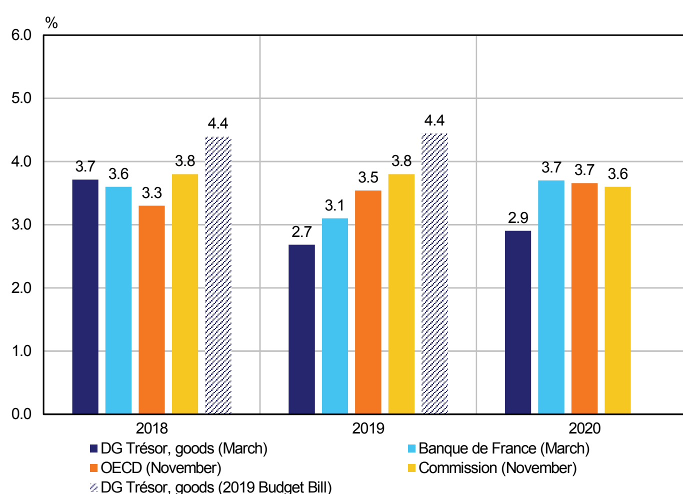
This scenario of less robust world trade is broadly in line with the consensus even though international institutions differ in their forecasts for the magnitude of this slowdown (see Charts 14 and 15).

Chart 14: Comparison of world growth forecasts



Sources: IMF,OECD, World Bank, CPB, European Commission, WTO, DG Trésor.

Chart 15: Comparison of forecasts for world demand for French exports



Sources: OECD, Banque de France, European Commission, DG Trésor.

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