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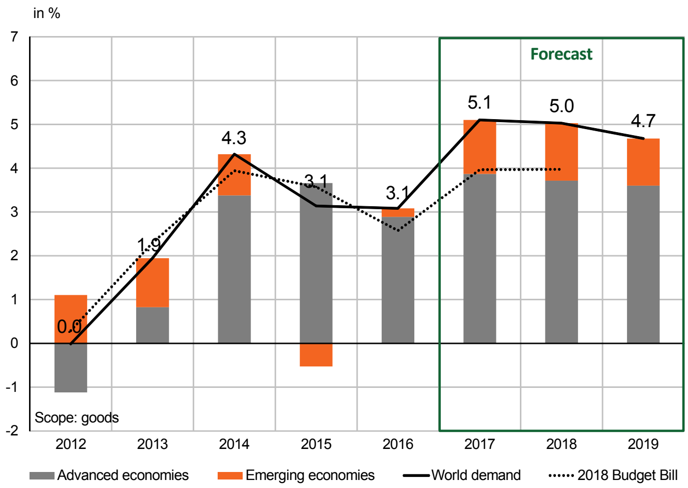
World economic outlook in spring 2018: growth still strong

- After a sharp acceleration to 3.7% in 2017, world GDP growth is set to maintain a similar pace in 2018 and 2019 (3.8% p.a.), driven by both advanced and emerging countries.
- In the United States, growth is expected to gather pace thanks to expansionary fiscal measures (tax reform and budget agreement in Congress leading to higher public spending). Conversely, growth is likely to slow in Japan (albeit remaining strong thanks to rising exports and higher domestic demand) and in the United Kingdom (due to the negative effects of Brexit uncertainty).
- The euro area's recovery is on track to continue at a strong pace. Growth is expected to be driven by dynamic domestic demand against a background of renewed consumer and business confidence, along with robust global demand. Among the major euro area countries, growth is likely to remain dynamic in Spain despite a slight slowdown, stable in Germany thanks to a somewhat expansionary fiscal policy, and also stable in Italy.
- In the main emerging economies, growth is expected to strengthen significantly in Brazil, to accelerate to a lesser extent in India, to remain stable overall in Russia and to slow considerably in Turkey. China should experience a gradual slowdown over the forecast period, as monetary and fiscal stimulus measures taper off.
- World growth is expected again to get a strong contribution from trade. World trade grew by 5.3% in 2017, a much stronger pace than the more modest growth of around 2.0% p.a. over the previous two years. This trend should remain almost as strong in 2018 and 2019 (world trade growth of 5.1% and 4.7%, respectively). World demand for French exports should display a similar profile over the forecasting horizon.
- This scenario is subject to large uncertainties: the implementation of protectionist measures, notably in the United States, which could dampen world trade; political risk in the euro area; the effects of Brexit; the pace of the Fed's interest rate hikes; and financial risks, especially due to the high stock market valuations in the United States and to the elevated debt levels in China.

Growth in world demand for French exports, by area*



Source: DG Trésor.

** The forecasts and data in this document were finalised on 5 March 2018.*

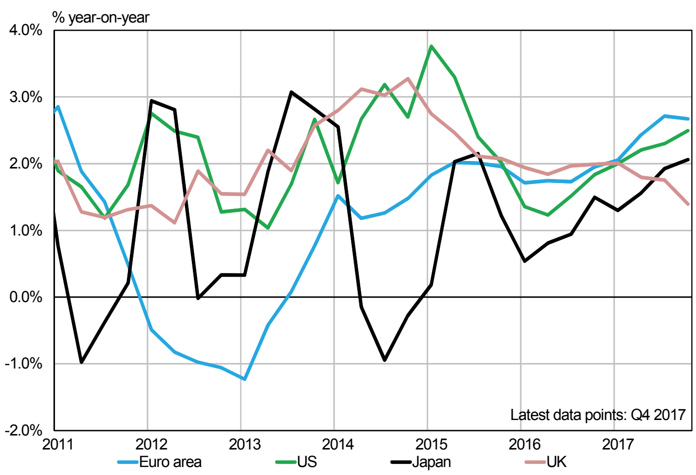
1. The global economy was dynamic in the second half of 2017 and early 2018

1.1 Economic growth kept its momentum in late 2017 in the main advanced economies, with economic indicators still at high levels in early 2018

In the advanced economies, the acceleration in economic activity that began in early 2017 was further confirmed in the second half of the year (see Chart 1). In the United States, economic growth strengthened sharply in 2017 (with GDP up by 2.3% after a 1.5% increase in 2016), fuelled by dynamic private consumption and a rebound in business investment, especially in the hydrocarbon sector in the wake of higher oil prices. In the euro area, growth also remained strong in the second half of 2017. Euro area GDP rose significantly for the full year 2017, by 2.5% (after 1.8% in 2016), on the back of both domestic demand and recovering global trade. In Japan, growth rose to 1.6% in 2017 (after 0.9% in 2016), underpinned by domestic demand. The trend remained relatively dynamic in the second half, with support from exports. Conversely, in the United Kingdom, growth remained upbeat in 2017 (1.7% after 1.9% in 2016). However, the quarterly growth rate has been decreasing since the start of 2017 due to the first negative effects of Brexit.

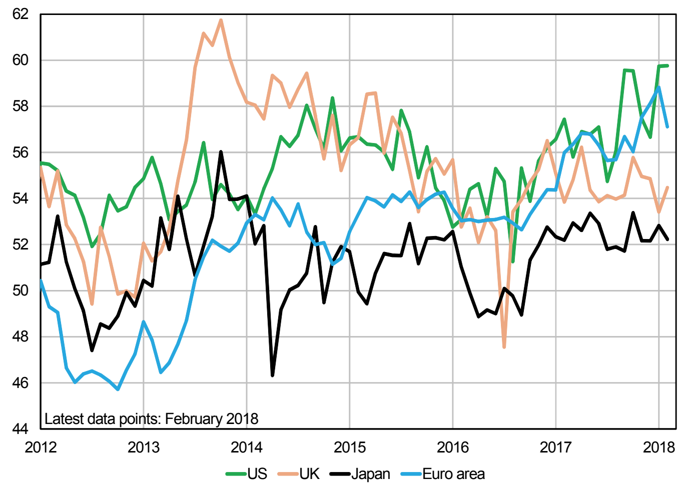
Economic indicators available in early 2018 indicate strong growth in advanced economies (see Chart 2). Since summer 2017, surveys[1] have continued to rise in the United States. The same holds true for the euro area, albeit with a slight slowdown in early 2018. Japanese and United Kingdom surveys have also remained at high levels.

Chart 1: GDP growth in the main advanced economies



Sources: National statistical institutes.

Chart 2: Manufacturing and services PMI surveys in advanced economies



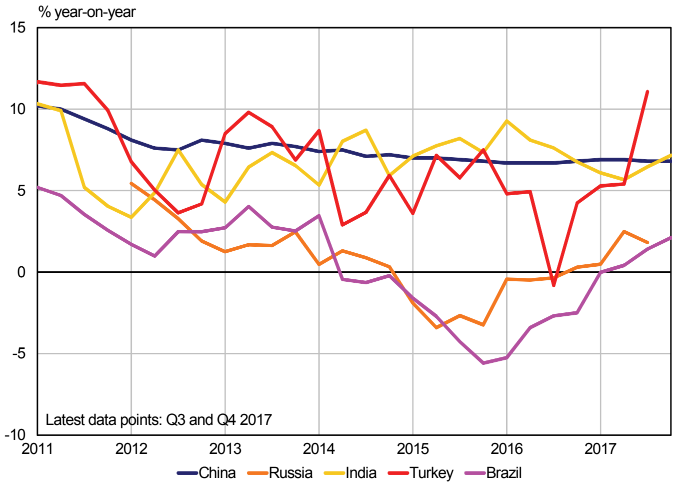
Sources: ISM, Markit.

1.2 Overall, the economic situation of emerging economies improved in 2017, as global financial conditions remained favourable and commodity prices rose

The rebound in oil prices benefited export countries and helped bring Brazil and Russia out of recession (see Chart 3). Turkey's expansionary fiscal policy drove a sharp acceleration in economic activity after the negative impact of terrorist attacks and the failed coup d'état in 2016. In China, for the first time since the economy began to slow in 2011, growth rose in 2017 thanks to stimulus measures and despite slowing somewhat in the second half. However, India experienced a dip in growth partly because of the surprise banknote demonetisation in late 2016 and the roll-out of a single country-wide VAT rate, which is likely to have positive effects in the medium term. In 2017, emerging economies enjoyed net capital inflows for the first time since 2014, thanks notably to their improved economic situation and generally favourable global financial conditions. At the start of 2018, PMI surveys were broadly upbeat in the main emerging economies.

(1) The PMI (Purchasing Manager's Index - Markit) for the euro area, Japan and the United Kingdom, and the ISM index (Institute for Supply Management) for the US.

Chart 3: GDP growth in the main emerging economies



Source: National statistical institutes.

1.3 The past few months have seen a sharp rebound in oil prices, bullish equity markets and the first signs of monetary policy normalisation

After briefly dipping below $50 per barrel in early June, the Brent oil price began a clear recovery in July 2017, breaking the $70/barrel threshold in mid-January – the highest since the end of 2014. Since then, oil prices have ebbed due to higher US production of unconventional oil products and were fluctuating at around $65/barrel in early March. The oil price recovery since summer 2017 is mainly due to better prospects for a rebalancing of supply and global demand for oil. On the one hand, economic growth has strengthened, driving demand for oil. On the other hand, political tensions in the Middle East (especially in Saudi Arabia and Iran) and uncertainties about the situation in Iraq and Libya have dampened the outlook for production. In parallel, coordinated efforts to cut production under the OPEC/non-OPEC agreement[2] have led to an actual decline in daily production and inventories. Declining US oil inventories, in particular, support higher oil prices because they point to demand outstripping supply and rebalancing. However, inventories remain above their five-year average.

In 2017, financial markets saw a steady rise in equity prices that fuelled not only a wave of optimism, but also fears of the stock market overvaluation, especially in the United States.[3] At the same time, market volatility remained very low until the end of 2017, suggesting that underlying risks might be underestimated. Thus, one of the reasons behind the slight market correction in early February 2018 may have been that market participants were becoming aware of a gap between current valuations and fundamentals. On the currency market, the euro has appreciated over the past year, thanks to improved economic outlook and reduced uncertainties about national elections in euro area countries. Conversely, the dollar has weakened in a context of doubts about US economic policy and, since the start of 2018, owing to comments by US officials favouring a softer dollar.

Central banks continued to normalise their monetary policy in 2017, albeit at varying paces. The US Federal Reserve raised its key interest rates by 25 basis points three times (in March, June and December). In early March 2018, the Fed's target range stood at 1.25-1.5%. In 2018, between two and four similar hikes are expected. The Fed is likely to keep raising its key rates in 2019, in addition to the ongoing reduction in its balance sheet.[4] The Bank of England also tightened its monetary policy, notably in reaction to inflationary pressures. In January 2018, with the economy recovering robustly but inflation still weak, the European Central Bank (ECB) initiated its process of very gradually ending unconventional monetary policy by scaling back its asset purchase programme to €30bn per month. This process will continue in the coming months if growth and inflation remain favourable.

2. After a surge in 2017, world growth is set to remain strong in 2018 and 2019

After two years of slowing growth, the world economy accelerated markedly in 2017, with global GDP up 3.7%, driven by both advanced and emerging economies. The world economy is expected to continue to grow at a very similar pace in 2018 and 2019 (see Table 1).

2.1 Growth is likely to strengthen in the United States, but to lose momentum in Japan and the United Kingdom

In the United States, growth is expected to increase significantly (2.7% p.a. forecast in 2018 and 2019, after 2.3% in 2017), thanks to the implementation of substantial fiscal stimulus measures (see Box 1). These measures are

(2) In late November 2016, OPEC and 11 non-OPEC countries (including Russia but not the United States) signed an agreement in Vienna to reduce production by 1.8 million barrels a day for six months from 1 January 2017 on. This agreement was later extended.

(3) For example, the P/E ratio - which measures stock prices relative to earnings per share - currently stands above its long-term average for the S&P 500 index, after rising steadily since 2012.

(4) See L. Baquero, M. Ezzaim and S. Sorbe (2018), "The size of central bank balance sheets: a new monetary policy instrument", *Trésor-Economics* no. 213.

likely to fuel private and public domestic demand, including business investment in particular, which is also supported by the oil sector thanks to higher oil prices. Exports should remain dynamic due to global demand and the dollar's depreciation. Similarly, imports are expected to remain strong thanks to robust domestic demand. Moreover, the low unemployment rate is set to drive an increase in wage growth, which will support private consumption and strengthen inflation (with core inflation expected to rise).

In Japan, while economic activity is expected to weaken slightly, it should still be relatively dynamic (1.5% and 1.2% forecast in 2018 and 2019, respectively, after 1.6% in 2017), under the combined effects of rising exports and growing domestic demand. Following the recovery in consumption in 2017, Japanese domestic demand is likely to slow in 2018 but remain robust, notably because of private investment ahead of the 2020 Tokyo Olympics. Wages are expected to grow more rapidly due to an improved economic environment, strong pressures on the labour market and measures to support wage hikes

Table 1: Growth forecasts*

GDP (annual average, %)	Average 2000-2007	2014	2015	2016	2017 (forecasts, working day ajusted)	2018	2019
World growth[a]	**4.5**	**3.5**	**3.4**	**3.3**	**3.7**	**3.8**	**3.8**
Memorandum: world growth forecast in the 2018 Budget Bill (PLF)	*4.5*	*3.5*	*3.4*	*3.2*	*3.6*	*3.6*	
Advanced economies[b]	**2.6**	**2.1**	**2.3**	**1.7**	**2.3**	**2.4**	**2.4**
United States	2.7	2.6	2.9	1.5	2.3	2.7	2.7
Japan	1.5	0.3	1.4	0.9	1.6	1.5	1.2
United Kingdom	2.9	3.1	2.3	1.9	1.7	1.6	1.4
Euro area[c]	**2.2**	**1.3**	**2.1**	**1.8**	**2.5**	**2.5**	**2.3**
Germany	1.6	1.9	1.7	1.9	2.5	2.4	2.4
Italy	1.5	0.1	1.0	0.9	1.5	1.6	1.4
Spain	3.7	1.4	3.4	3.3	3.1	2.8	2.6
Other advanced economies	3.9	3.0	2.0	2.3	2.6	2.5	2.8
Emerging economies[b]	**6.6**	**4.7**	**4.3**	**4.4**	**4.8**	**4.8**	**4.8**
Brazil	3.6	0.5	−3.8	−3.5	1.1	2.5	2.8
China	10.5	7.3	6.9	6.7	6.9	6.3	5.7
India	7.1	7.5	8.0	7.1	6.9	7.3	7.3
Russia	7.2	0.7	−2.8	−0.2	1.5	1.9	1.7
Turkey	5.4	5.2	6.1	3.2	7.0	4.0	3.8
Other emerging economies	4.2	3.4	3.4	3.7	3.4	3.7	3.9
World demand for French exports[d]		*4.3*	*3.1*	*3.1*	*5.1*	*5.0*	*4.7*
Total world trade[e]		*4.2*	*2.0*	*1.9*	*5.3*	*5.1*	*4.7*

a. Data for 2017 is taken from national accounts and supplemented by the DG Trésor's forecasts as needed.
b. Aggregate figures for advanced economies and emerging economies are estimated using 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. Aggregate 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, US, UK, 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 5 March 2018.*
Source: IMF, January 2018 WEO update; European Commission (February 2018). DG Trésor calculations and forecasts.

In the United Kingdom, after an impressive resilience following the shock of the Brexit referendum in June 2016, the economy began to slow in 2017 (GDP up by 1.7% in 2017 after 1.9% in 2016). This slowdown should continue in 2018 and 2019 (GDP growth forecast at 1.6% in 2018 and 1.4% in 2019): high inflation and sluggish wage growth should continue to dampen consumption, with investment hit by uncertainties related to Brexit, which should also impact trade.[5] The effects of Brexit on economic activity in France and the other euro area countries are likely to be modest over the forecast period.[6]

Box 1 : The US tax reform and the 2018 Bipartisan Budget Act

In late December 2017, the US Congress passed a tax reform bill including the following measures:

Overall taxation of households is reduced:

- There will still be seven tax bands, but marginal rates will be lowered. In particular, the top band will go from 39.6% to 37%.
- The standard income tax deduction will be increased.
- However, certain tax shelters will be eliminated (this only partly offsets the effects of the above-mentioned measures).

Corporate income tax is cut substantially and moved to a territorial system:

- The corporate income tax rate will be lowered from 35% to 21%.
- The United States will move to a territorial system for corporate income tax: US companies' profits abroad will no longer be taxed when they are brought back to the United States.
- Immediate full expensing of capital investments.
- A 20% deduction on the income of "pass-through" entities (i.e. sole proprietor businesses), which are then liable to personal income tax.

Measures for multinationals are introduced to broaden the tax base and tackle tax base erosion:

- Base Erosion Anti-avoidance Tax (BEAT), a special tax on international intragroup payments above a certain threshold.
- An exception tax on overseas profits, allowing these profits to be repatriated to the United States at a preferential rate of 15.5% for cash and equivalents and 8% for reinvested earnings.
- A "patent box" scheme with a lower tax rate and taxation of foreign-derived intangible income (at an effective rate of 13.125%).

This tax reform should underpin US economic activity in the short term by driving higher consumption and investment. However, it will adversely affect the country's fiscal sustainability. According to forecasts by the Joint Committee on Taxation (JCT), this reform will cost around $1,500bn over the next ten years (see Table 2). Taking into account its macroeconomic impact, this reform would increase public debt by more than $1,000bn over ten years, according to the JCT, i.e. more than five points of GDP.

Table 2: Cost of US tax reform excluding macroeconomic effects (in points of GDP for 2017)

Type of measures	2018*	2019*	2018-2027**
Measures for households	−0.3%	−0.8%	−0.4%
Tax cuts for businesses	−0.8%	−0.8%	−0.5%
Measures for multinationals to broaden the tax base and tackle base erosion	+0.4%	+0.2%	+0.2%
Total	**−0.7%**	**−1.4%**	**−0.8%**

*Sources: Joint Committee on Taxation. DG Trésor calculations. * in level. ** average cost p.a.*

(5) Our forecast scenario uses the conventional assumption of a transitional Brexit agreement between the United Kingdom and the European Union taking effect in March 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.

(6) See Box 2, "What effects will Brexit have, a year after the referendum?" in J.B. Bernard, L. François, T. Gillet, J. Lecumberry, Y. Osman and M. Salomé (2017) "The global economic outlook in September 2017: signals remain upbeat", *Trésor-Economics* no. 205.

In early February 2018, Congress passed the Bipartisan Budget Act to raise public spending limits by nearly $300bn for 2018-2019 (with an appropriations bill to be passed by end March). The Act includes $165bn in defence spending and $131bn in non-defence spending ($20bn for infrastructure, spending for social programmes, etc.), as well as almost $90bn in additional hurricane relief funding following hurricanes in autumn 2017.

The OECD (in its Interim Economic Outlook from March 2018) estimates that these two measures (i.e. tax reform and the Bipartisan Budget Act) are equivalent to fiscal expansion of around one point of GDP in 2018 and 2019. The macroeconomic impact of these measures remains uncertain. In particular, fiscal multipliers are generally lower at the cycle peak.[a] The OECD forecasts a positive growth effect of between 0.5 and 0.75 points of GDP p.a. in 2018 and 2019. Our forecast – which is more consistent with economic literature and with the US economic situation[b] – is lower; we anticipate a positive growth effect of 0.3 points of GDP in 2018 and 0.5 points in 2019.

Furthermore, these expansionary measures come at a time when the United States is close to full employment, and will increase public debt at the cycle peak (raising the public debt ratio by 5-6 points of GDP by the mid-2020s, according to the OECD). They therefore increase the risk of the US economy overheating and prompting the Fed to tighten its monetary policy sooner than expected.

a. See, for example, Batini *et al.* (2014), "Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic Projections", *IMF Technical Notes and Manuals*.
b. See, for example, Coenen *et al.* (2012), "Effects of Fiscal Stimulus in Structural Models?", *IMF Working Paper*.

2.2 The euro area should continue to recover at a strong pace

The euro area economy is expected to maintain a strong momentum in 2018 (growing by 2.5%) and in 2019 (2.3%), bolstered by strong world trade growth and dynamic domestic demand, against a backdrop of renewed consumer and business confidence. Investment should remain upbeat thanks to a continued recovery in lending, supported by the ECB's loose monetary policy and favourable financing conditions, and despite the persistent weaknesses of banks in some euro area countries. Investment is also expected to respond to the high capacity utilisation rates observed in some countries in a context of robust demand. In 2019, with a decline in unemployment and increased pressure on labour markets (see Box 2), wages are set to accelerate and core inflation to increase gradually. Thus, core inflation should drive headline inflation higher despite energy price inflation subsiding.[7] The partial rebalancing of labour costs observed over the past few years in the euro area is likely to continue: we forecast slightly stronger inflation and wage growth in Germany than in southern euro area countries.[8] Nevertheless, this converging trend would be very modest and still incomplete at the end of the forecast period and would not shrink the German current account surplus.[9] Fiscal policy is set to be neutral overall in Italy and Spain, but slightly expansionary in Germany (see below).

In Germany, economic growth should remain strong (2.4% forecast in 2018 and 2019, after 2.5% in 2017). The German workforce should continue to grow at a strong pace as refugees gradually enter the labour market. However, hiring difficulties are likely to cause a slight slowdown in job creations. Domestic demand is set to be buoyed by the new German government's relatively expansionary fiscal policy, which is expected to add 0.2 point of growth in 2019 according to our forecasts, and by an increase in wage growth. Wages should be driven by increasing pressure on the labour market and by wage talks, for example in the metallurgy sector. Exports and business investment are both expected to remain firm thanks to dynamic global demand.

In Italy, growth is forecast to increase again in 2018 (to 1.6% after 1.5% in 2017), then ebbing in 2019 (1.4%). This forecast is attributable notably to the gradual end of tax and social security incentives to boost employment and investment. Exemptions from social contributions, which have supported employment and thus consumption, are slated to taper off gradually, whereas investment is likely to be buoyed by measures allowing for additional depreciation, and then to slow after these measures expire. However, dynamic global demand is expected to drive Italian exports, with the external balance making a positive contribution to growth for the first time in several years.

In Spain, economic growth is set to decrease in 2018 and 2019 owing to a slight slowdown in employment and external demand. The political crisis in Catalonia should also have a slight impact on economic growth this year. Nevertheless, growth is expected to be robust (2.8% in 2018

(7) Under the conventional assumption of stable oil prices going forward.
(8) See D. de Waziers (2017), "Rationale for the new wage momentum in Germany", *Trésor-Economics* no. 202.
(9) See M. Bechetoille, T. Blaize, B. Campagne and D. de Waziers (2017), "How to explain Germany's strong current account surplus?" *Trésor-Economics* no. 209.

and 2.6% in 2019, after 3.1% in 2017) as investment should remain strong and the good momentum on job creations is likely to continue driving consumption. Household purchasing power should rebound (under the combined effect of nominal wages and weaker inflation), with the household saving rate levelling off at a low level. Foreign trade is expected to continue to support growth despite a slightly weaker export trend in the wake of global demand.

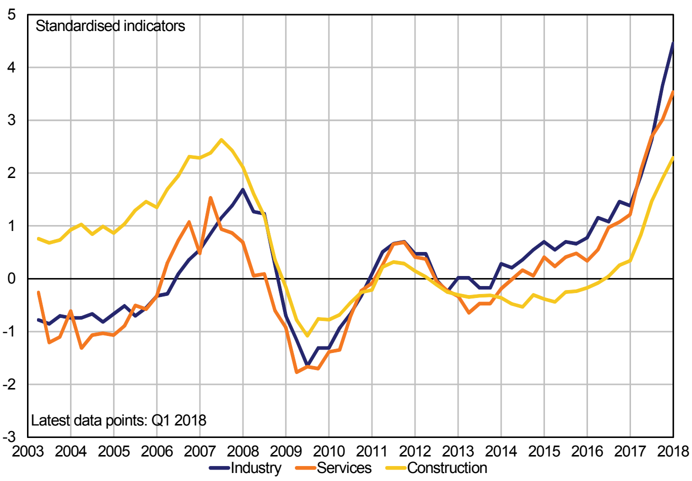
Box 2 : Growing pressure on manufacturing capacity in the euro area

Since mid-2016, euro area businesses have been facing increased supply constraints that curb their capacity to meet growing demand. Surveys by the European Commission point to a substantial rise in the proportion of businesses reporting that supply constraints have limited their production: in Q1 2018, 47% of euro area businesses reported facing supply constraints, vs. 39% in Q1 2016. Since 2014, this figure is higher than the number of businesses reporting that they must contend with insufficient demand (25% in Q1 2018 vs. 33% in Q1 2016). The increase in supply constraints primarily reflects difficulties hiring staff in certain business sectors (industry, services and construction; see Chart 4).

In particular, pressure on manufacturing capacity is increasing substantially in Germany, due to both higher demand and increased hiring difficulties (which now stand well above their historical averages). Conversely, higher pressure does not seem to have a significant impact on companies in Spain, where the reduction in material and financial difficulties offsets the increase in hiring difficulties, and especially not in Italy, where hiring difficulties are unchanged and broadly below their historical average.

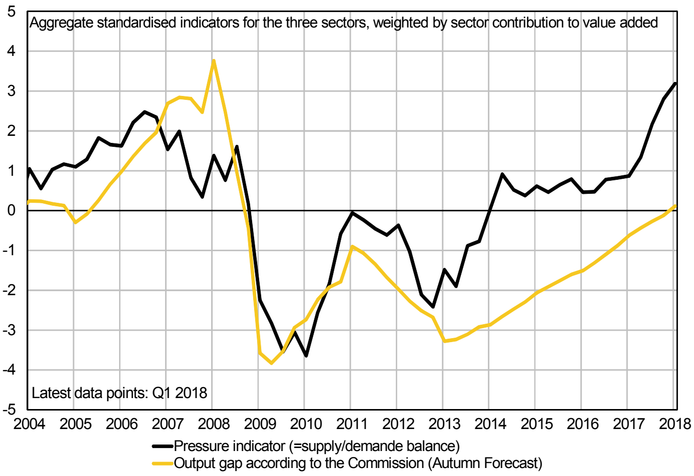
The pressure observed on euro area manufacturing capacity could suggest that we are further along in the cycle than estimated by the European Commission (see Chart 5). Such pressure generally returns at the peak of the economic cycle and suggests that the acceleration in economic activity cannot be sustained to meet rising demand. However, this interpretation contradicts the forecasts of international organisations which consider the euro area's output gap to be virtually nil. Conversely, this pressure may instead reflect temporary difficulties related to stronger-than-expected activity following several years of sluggish growth. After an adjustment period, this scenario would lead to additional hiring and increased investment.

Chart 4: Contribution of labour shortages to production constraints of euro area businesses by sector



Sources: European Commission, DG Trésor calculations.

Chart 5: Indicator of pressure on euro area manufacturing capacity



Sources: European Commission, DG Trésor calculations.

2.3 Growth expected to be flat overall in emerging economies

In China, economic activity is expected to slow in 2018 and 2019 as the Chinese government gradually scales back pro-growth incentives (i.e. fiscal and monetary stimulus measures). The high level of internal imbalances and especially financial ones, due notably to the sharp increase in the debt held by economic agents, and the implementation of regulations (see Box 3) to curb lending, should dent growth in the medium term. These effects are expected to start to materialize this year. Our growth scenario is lower than that of the main international organisations (e.g. in its March 2018 forecasts, the OECD expects growth of 6.4% in 2019, vs. 5.7% in our scenario).

In Brazil, growth is likely to gain strong momentum over the forecast period, with economic activity rebounding following a severe recession in 2015 and 2016. In 2018, growth should be buoyed by low inflation (which stood at 2.9% in January 2018, below the bottom of the Central Bank of Brazil's target inflation range of 4.5% ± 1.5 points) and key interest rates being held at a low level (currently 6.75% after declining by 750 basis points since October 2016), but dented by greater political uncertainties ahead of the presidential elections in October. The economic recovery is set to gather strength in 2019 as uncertainties ease, despite anticipated fiscal tightening.

In India, growth slowed in 2017 following the banknote demonetisation in November 2016 and the roll-out of the Goods and Services Tax (a single national VAT) in mid-2017. As these temporary negative effects subside, growth is expected to increase in 2018 and then level off in 2019. The deteriorating quality of bank assets (on account of the rising proportion of bad loans) raises the risk of credit slowing in the medium term, with a knock-on effect on domestic demand. Given these circumstances, the authorities have announced a bank recapitalisation plan.

In Russia, the recovery in economic activity is set to continue thanks to the recent rebound in oil prices, further easing of monetary policy, low inflation and less fiscal consolidation. Growth is expected to decrease slightly in 2019, constrained by low potential growth due to an ageing and shrinking population, weak investment, a high level of corruption and low level of economic diversification.

In Turkey, economic activity is expected to slow considerably even though fiscal policy is likely to remain expansionary ahead of the 2019 presidential elections. Strong inflation should dampen household purchasing power, whereas private investment is set to be affected by uncertainty and increased tensions on a geopolitical scale. The anticipated tightening of international financing conditions could also slow down activity as Turkey is highly dependent on foreign capital inflows.

Box 3 : China continues its regulatory efforts to curb financial imbalances

After widening substantially in the past few years, China's financial imbalances now stand at high levels. For example, according to the Bank for International Settlements, total debt for all economic agents amounts to nearly 260% of GDP, up by almost 100 points of GDP over the past ten years. In addition, the banking sector is suffering from a significant rise in the percentage of "risky" loans, which currently stands at almost 13% of the total loan stock according to the IMF (this figure is much higher than official statistics), whereas banks' off-balance-sheet commitments are also growing substantially.

In 2011, the Chinese government launched a policy aimed at curbing the rise in financial sector imbalances. This policy was strengthened in the first half of 2017 and has continued in the past few months. This "regulatory storm", which ensued after the two main directors of regulatory authorities were ousted, notably calls for a comprehensive audit of brokers' asset management activities and a ban on selling certain risky life insurance products. More recently, the Chinese authorities announced additional measures to further this trend. More specifically: *(i)* implementation of a unified regulatory framework for asset management activities, notably with requirements such as risk provisioning for holders of financial products, and *(ii)* authorisation from authorities required prior to acquiring a stake above 5% in commercial banks. This is far from an exhaustive list of measures, but these examples show that the Chinese authorities have begun to grasp the magnitude of internal imbalances.

Measures have also been rolled out to curb rising property prices, especially in the largest cities. These measures include longer mandatory ownership periods (to curtail speculative behaviour), tighter restrictions on mortgages and incentives in favour of the rental market (notably by announcing a "forthcoming" China-wide property tax), in a country where 90% of the population owns its own home.

In all, these measures are beginning to yield results. The growth in bank lending and other forms of financing for the economy (equity, bond and shadow banking) has been trending down for the past several months. On the property market, price growth – after showing very strong rates in 2016 – has clearly slowed in the past few months in the large cities. Conversely, prices are recovering in smaller cities as the glut of homes is gradually being absorbed.

3. Growth of world demand for French exports is expected to remain strong in 2018 and 2019 despite a slight loss of momentum

After two years of weak growth, world trade[10] clearly accelerated in 2017, posting its highest growth rate since 2011 (up 5.3% after around 2.0% p.a. in 2015 and 2016). This acceleration is driven partly by stronger global economic growth, notably in the United States (following a sluggish 2016), but mostly by stronger contribution from trade to growth. Several factors contribute to this trend: *(i)* sharply higher growth in the euro area (a region of intense trade due to imports/exports among its member countries); *(ii)* a recovery in investment, which includes high import content; *(iii)* a recovery in Asian imports, owing notably to China's stimulus measures and an upturn in the assembly trade in Asia (mainly electronics); *(iv)* a rebound in Russian imports after three years of decline; and *(v)* sizeable gold purchases in India.

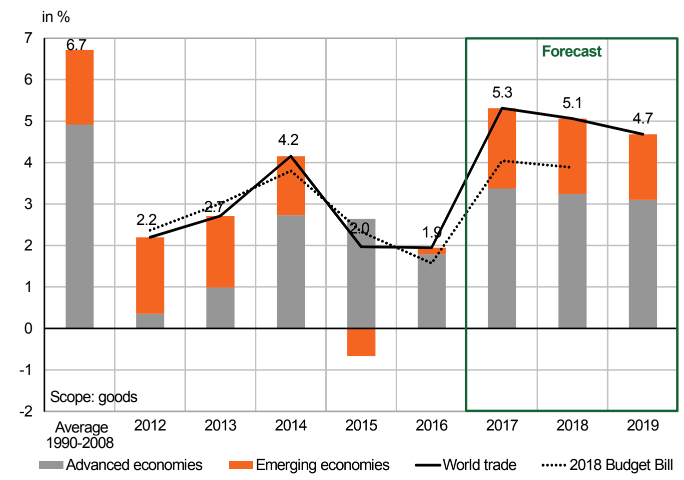
World trade is set to remain robust in 2018[11] and in 2019, despite a slight deceleration: it is expected to grow by 5.1% in 2018 then 4.7% in 2019 (see Chart 6). Following their very substantial recovery in 2017, imports should grow less strongly in Russia, China and India. In advanced economies, trade is set to benefit from a continued dynamic trend in the US, while being adversely affected by the anticipated growth slowdown in Japan, the United Kingdom (as the tangible effects of Brexit would appear) and the euro area in 2019.

World trade growth is likely to outpace economic growth. After decreasing sharply in 2015 and 2016, the elasticity of world trade to GDP growth rebounded significantly in 2017 to more than 1 (see Chart 7). Apart from the aforementioned factors that are likely to fade to a certain extent, this increase in world trade may be due to the global growth recovery. Some research[12] indicate that the elasticity of trade is actually cyclical: it could be higher than 1 (i.e. its equilibrium) for cyclical reasons and not due to structural changes such as those that contributed to high elasticity in the 1990s and 2000s.[13] Several factors may explain this trend: *(i)* trade is largely comprised of manufactured goods, for which demand is more cyclical than demand for services and farm products; *(ii)* investment has a high import content and is more volatile than the other demand components; *(iii)* exports incorporate a growing proportion of imported intermediate inputs, which accentuates the cyclicality of trade; and *(iv)* during crisis periods, world trade is limited by the reining in of commercial lending and the deterioration in collateral. In the central scenario of a continued global economic recovery, the elasticity of trade to economic growth would stay above 1 over the forecasting period.

World demand for French exports is expected to follow a similar trend to global trade: virtually stable growth in 2018 (5.0% vs. 5.1% in 2017), followed by 4.7% in 2019 (see the chart on page 1).

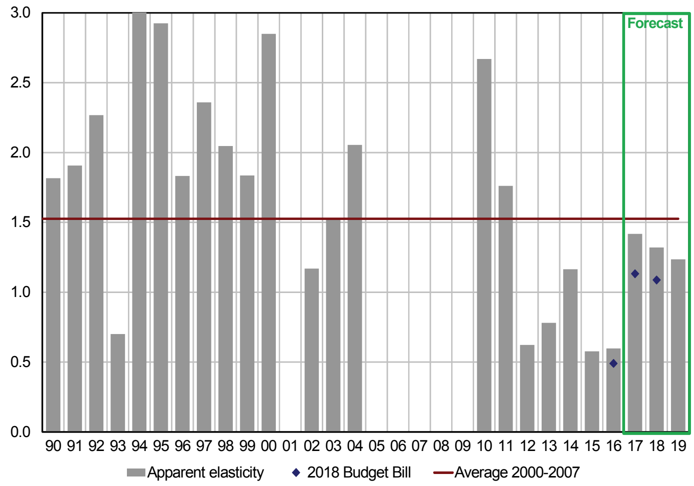
(10) World trade in goods, in real terms.
(11) As at the end of Q4 2017, carry-over growth in global trade for 2018 stood at 2.0%. This is higher than the previous-year figure (i.e. as at the end of 2016, carry-over growth for world trade for 2017 stood at 1.5%), which suggests that trade momentum has strengthened.
(12) See Alessandro Borin *et al.* (2017), "The cyclicality of the income elasticity of trade", Bank of Italy's Temi di discussione (working papers).
(13) See L. François, J. Lecumberry and L. Shimi (2016), "Why is world trade so weak?" *Trésor-Economics* no. 166.

Chart 6: World trade and contributions by area



Source: DG Trésor.

Chart 7: Elasticity of trade to GDP growth



Source: DG Trésor.

4. This baseline scenario is subject to several uncertainties

- Protectionist measures could have a considerable negative effect on trade. Notably, if the United States applies import duties of 25% on steel and 10% on aluminium, as announced by President Trump in early March, this could set off a chain reaction by trade partners with a high risk of escalation; the EU has already stated that it is prepared to respond. However, world trade growth could be stronger than anticipated if the global economic recovery gathers momentum.
- The outcome of Italian elections. A Eurosceptic government in Italy could have destabilising effects on the euro area in a context in which countries are having difficulty agreeing on a common path towards greater euro area integration.
- It is uncertain which direction some economic policies will take: in the United States (the public finance trajectory, debt sustainability, the pace of the Fed's interest rate hikes if the economy were to show signs of overheating); in Italy (the outcome of March elections); in Germany (the speed at which the coalition will implement its coalition agreement); in China (the size of government incentive measures); and in the euro area (a drop in core inflation could force the ECB to postpone the end of its unconventional monetary policies).
- The magnitude of Brexit effects (progress on Brexit talks, final agreement with the EU, length of the period of uncertainty, market reaction and impact on the policy mix).
- Emerging economies are still exposed to major contingencies. Financial and fiscal imbalances in China could feed into a sharper slowdown than currently expected. Emerging countries are also vulnerable to a faster-than-expected rise in the Fed's interest rates, which could trigger substantial capital outflows, while political and geopolitical uncertainties are another potentially negative factor.
- Financial risks remain high in light of current P/E ratios. Equities look overpriced in the United States. This may also be the case in Europe – albeit to a lesser extent – despite the stock market correction in early February. Moreover, after a period of historically low interest rates that has spurred greater risk taking, a faster-than-anticipated rebound in interest rates could trigger substantial pressure on financial markets.

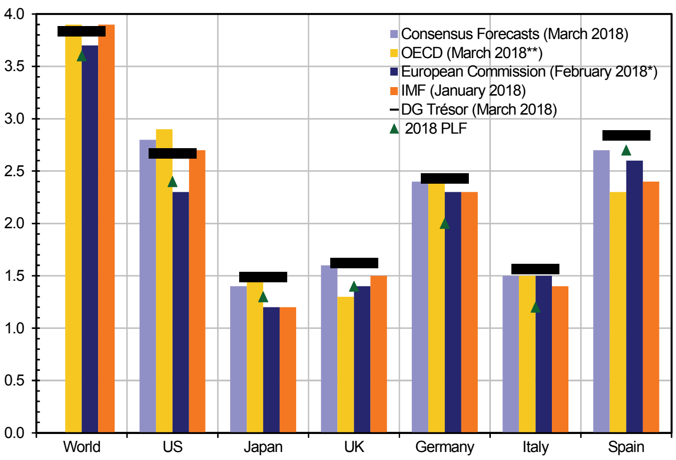
Box 4 : Main revisions since the French 2018 Budget Bill (*Projet de loi de finances, PLF*) and comparison with forecasts by international institutions

Since the scenario prepared for the 2018 PLF, the international environment has improved in advanced and emerging economies. World growth was a slight 0.1 points higher than forecast in 2017 - a trend that touched most major economies. We have revised up our 2018 world growth forecast by 0.2 points. This upward revision is attributable to:

- In advanced economies, mainly the euro area and the United States. In the euro area, the economic growth forecast has been upgraded substantially. Economic growth should benefit from a substantial improvement in economic confidence and a stronger rebound in international trade. In the United States, private consumption is expected to be more dynamic, and business investment to benefit from good momentum in the hydrocarbon sector due to the recovery in oil prices. Tax reform and the Bipartisan Budget Act do not have a significant impact on our scenario, which forecasts a growth effect similar to the PLF (0.3 points vs. 0.4 points in the PLF).
- Among the emerging economies, Brazil is now expected to enjoy a stronger post-recession recovery despite ongoing political uncertainty, China to see a stronger pro-growth effect from stimulus measures, and Turkey to adopt a more expansionary economic policy with a stronger short-term boost to growth.

This scenario of virtually unchanged growth in 2018 and 2019, underpinned by both advanced and emerging economies, is broadly consensual (see Charts 8 and 9). It is similar to the forecasts published by the OECD in March, the IMF in January and the European Commission in November. It is also consistent with the March Consensus Forecasts.

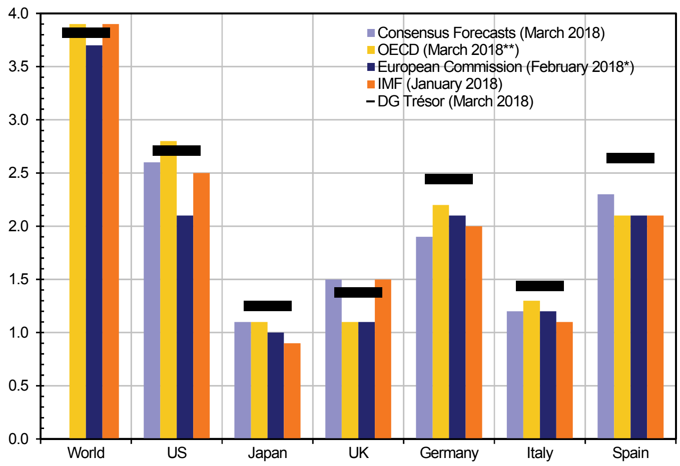
Chart 8: Comparison of world growth forecasts for 2018



* Except world, US and Japan, November 2017 /**Except Spain, November 2017

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

Chart 9: Comparison of world growth forecasts for 2019



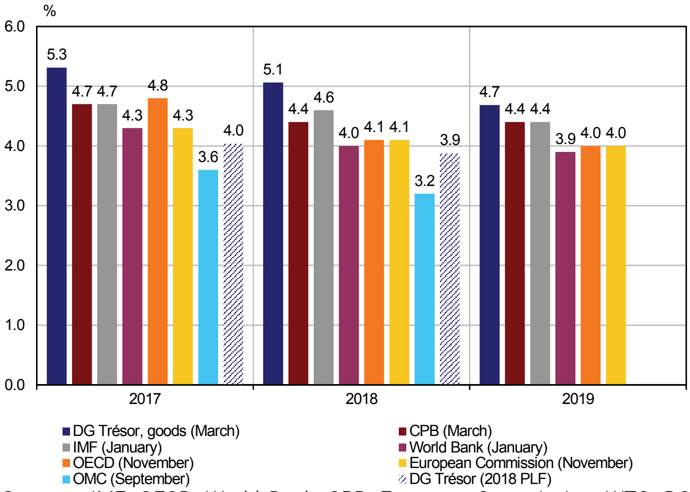
*Except world, US and Japan, November 2017 /**Except Spain, November 2017

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

World trade growth has been revised up significantly compared to the PLF, by 1.3 points in 2017 and 1.2 points in 2018, reflecting more trade in advanced and emerging economies alike. The PLF forecasts for world trade were fairly cautious, but the world trade momentum ultimately remained upbeat in 2017. Likewise, we have revised up our forecast of world demand for French exports: it is expected to grow by around 5% p.a. in 2017 and 2018, vs. 4% p.a. in the PLF.

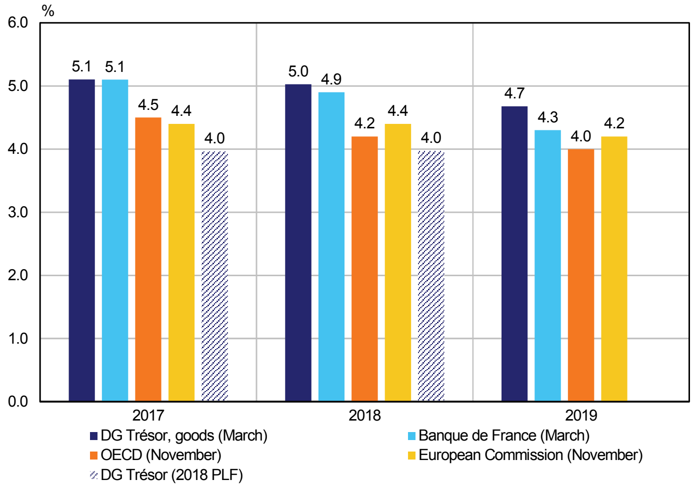
The overall scenario of a continued recovery in world trade despite a slight deceleration is broadly consensual, but the strength of this recovery varies from one institution to the next, especially because some forecasts were established before the strong import growth at the end of 2017 could be factored in (see Charts 10 and 11).

Chart 10: Comparison of world trade forecasts



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

Chart 11: Comparison of world demand forecasts for French exports



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

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