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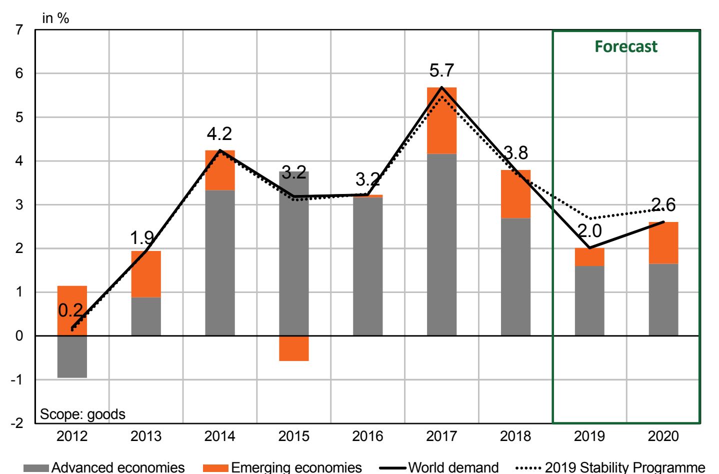
World economic outlook in autumn 2019: slowdown and uncertainty

- After falling to 3.6% in 2018, global growth is projected to decline sharply in 2019 to 3.1%, before posting a slight upturn in 2020 to 3.3%, driven by stronger activity in many emerging countries. In the major advanced countries, growth is expected to weaken, in the wake of the United States reporting slowing momentum.
- In the US, activity is set to remain strong in 2019 on the back of fiscal stimulus, but a slowdown is expected in 2020 as the budgetary impulse fades away and the labour market tightens. Meanwhile, protectionist measures are expected to continue to weigh on activity. In the UK, growth is likely to remain moderate in 2019 and 2020 on account of the uncertainty surrounding Brexit and its repercussions, based on the conventional assumption that the UK will leave the EU with a deal on 31 October 2019. In Japan, growth in 2019 is expected to be buoyed by strong domestic demand, despite trade being undermined by China's slowdown and the downturn in the semiconductor cycle. Growth looks set to decline in 2020, however, due to the forthcoming increase in the consumption tax rate.
- In the euro area, growth is expected to contract sharply over the forecast period against a similar backdrop to 2018 shaped by the international environment and weakening confidence. Domestic demand is expected to be sustained by resilient consumption, however. In the major countries of the euro area, activity is forecast to pick up slightly in 2020 in Germany and Italy, following a very poor year in 2019. Growth is likely to remain robust in Spain but is expected to slow gradually.
- A slowdown in activity is projected to gather pace in China on the back of deleveraging efforts and trade tensions. Growth is expected to remain disappointing in Brazil, India and Russia in 2019, but is likely to improve in 2020 thanks to stimulus measures in 2019. In Turkey, the economy is forecast to contract in 2019, as the after-effects of the 2018 currency crisis are felt. Turkish growth will recover in 2020.
- After experiencing two years of strong growth, global trade is projected to slow notably in 2019 before picking up in 2020 (world trade is forecast to increase by 1.8% in 2019 and 2.8% in 2020 after expanding by 4.5% in 2018 – under a working assumption that protectionist measures will not be escalated further). Global trade is expected to bear the brunt of the global slowdown, protectionism and the downturn in the semiconductor cycle. In 2020, it is projected that global trade will be lifted by the recovery in Asian and Turkish trade. Growth in world demand for French exports is projected to follow the same trend over the forecast period.
- Uncertainty surrounding this scenario has heightened in recent months, due to the rise of protectionist tensions, the threat of a no-deal Brexit and economic policy uncertainty (in Italy and the United States).

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 21 August 2019.

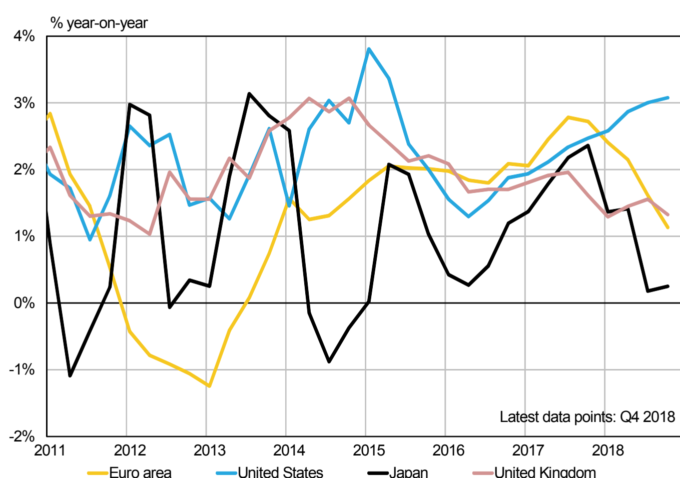
1. Global activity shows signs of a slowdown in the first half of 2019 amid mounting tensions

Growing uncertainty in recent months against a backdrop of heightened trade tensions and political concerns over Brexit and Italy have weighed on global trade and economic activity in advanced and emerging economies.

1.1 Activity was generally buoyant in the first quarter of 2019 before slowing in the major advanced economies and surveys point to a downward trend

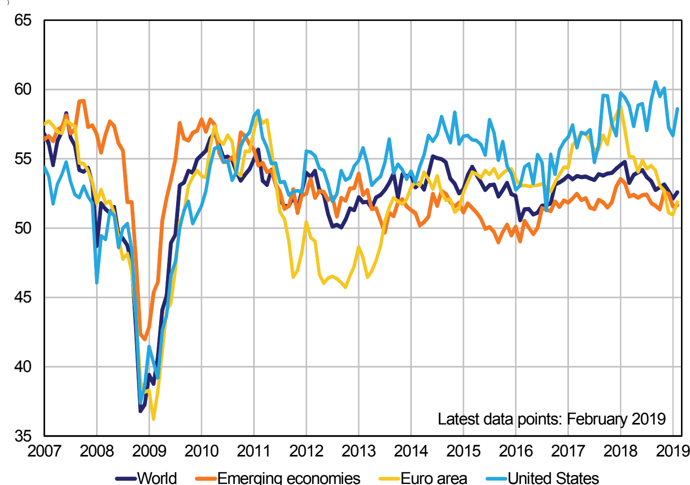
Growth contracted in 2018 in the major advanced economies barring the US before stabilising in the first half of 2019 (see Chart 1). In the US, growth remained strong despite the federal government shutdown from late December 2018 to late January 2019 and the drop in trade with China. Activity in the second quarter was nonetheless affected by the intensification of trade tensions which weighed on foreign trade and a clear downward trend has been noted in US surveys since the start of the year. In the euro area, activity slowed in the second quarter of 2019 amid renewed political and trade uncertainty after temporarily improving at the start of the year. European industrial production contracted again, fuelled by the troubled automotive industry. Following a sharp decline throughout 2018, the business environment stabilised in the first half of 2019 at a level that can still be considered positive growth (see Chart 2) thanks to the resilience of the service sector. In the UK, stronger activity in the first quarter was mainly a reflection of businesses stockpiling as they prepared for a possible no-deal Brexit. The second quarter saw a marked drop, which led to a contraction in activity. In Japan, activity remained upbeat in the first half of 2019 despite weak trade.

Chart 1: GDP growth in the main advanced economies



Sources: National statistical institutes.

Chart 2: Business environment[a]



Sources: PMI (Markit), ISM.

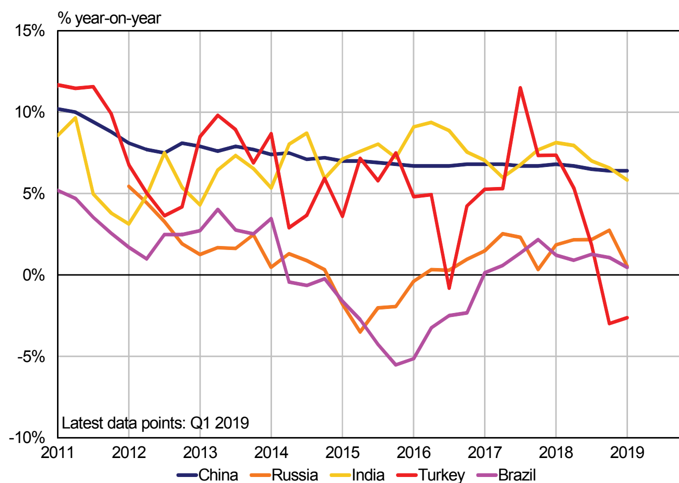
a. The PMI (Purchasing Managers' Index – Markit) for the euro area, emerging economies and the world, and the ISM (Institute for Supply Management) index for the United States.

1.2 Emerging economies are slowing overall and surveys signal a downward trend

Growth has fallen sharply in the major emerging economies since last year (see Chart 3). In China, activity has slowed gradually under the combined effect of measures to rein in structural debt and trade tensions with the US after temporarily stabilising in the first quarter of 2019, sustained by policy stimulus. Turkey went into recession in late 2018 following that summer's currency crisis and returned to growth in the first quarter of 2019 after fiscal support measures were introduced. In India, activity was hit hard early in the year by weakening investment ahead of the elections. Russia also saw a major slowdown in activity driven by lower oil prices in late 2018 and the increase in the VAT rate from 18% to 20% in January 2019. After a weak recovery in 2017 and 2018, activity slowed in Brazil as industry was affected by the Brumadinho dam collapse in January and the recession in Argentina.

Economic surveys point to a downturn. Brazil fell below the mark that separates expansion from contraction in May, as did China in June after a brief recovery from March to May due to stronger fiscal support and a temporary respite from tensions with the US. Despite a slight improvement in the second quarter, the Manufacturing PMI continued to show steep falls in Turkey. The Composite PMI in India declined in the first half but made a strong recovery in July.

Chart 3: GDP growth in the main emerging economies



Sources: National statistical institutes.

1.3 Trade tensions weigh on oil prices and cause market turbulence again as monetary policy eases

Oil prices have been on a downward trajectory since mid-May despite tensions in the Gulf, because of a worsening of the US-China trade conflict in mid-May and early August. OPEC+ extended a deal to reduce oil output until March 2020 in response to uncertainty around the global economic outlook. Oil inventories in OECD countries are higher than their five-year average. The Brent oil price averaged $59 per barrel in early August - higher than the floor price of $56 in December.

The central banks of the major advanced economies have eased monetary policy amid heightened uncertainty. As expected, the US Federal Reserve lowered its key interest rate by 25 basis points in late July 2019, bringing the target range for the Federal Funds Rate to [2% - 2.25%], and ended its balance sheet reduction programme slightly earlier than scheduled. These decisions signal a gradual shift in US monetary policy to a more accommodative stance in a bid to support the US economy. Meanwhile, the European Central Bank (ECB) further reinforced its highly accommodative policy. In early June, the ECB announced the launch of the new series of targeted longer-term refinancing operations (TLTRO III), which aim to encourage lending to the private sector. Further details will be released in September. Faced with persistently low inflation, the Governing Council also adjusted its forward guidance in late July, opening the door to interest rate cuts by mid-2020. In response to the accommodative stance adopted by central banks in developed countries, emerging markets have cut their interest rates in the wake of muted inflation and slower growth. This has been seen in India since January and in Brazil and Russia in July.

A more accommodative monetary policy, coupled with trade and political uncertainty, are the reasons for much lower bond yields in the main advanced economies. Renewed risk aversion in the US, especially over the summer, has driven investors to safe sovereign assets, leading to a drop in 10-year yields. Similarly, the worsening economic situation in the euro area and ECB easing continue to weigh on European bond yields. After rallying in the first half of the year, share markets have declined sharply in response to further trade tensions in August, the unrest in Hong Kong and political uncertainty in Europe. Share prices are still high, however.

Box 1: The effect of wage growth on prices in the euro area and the US

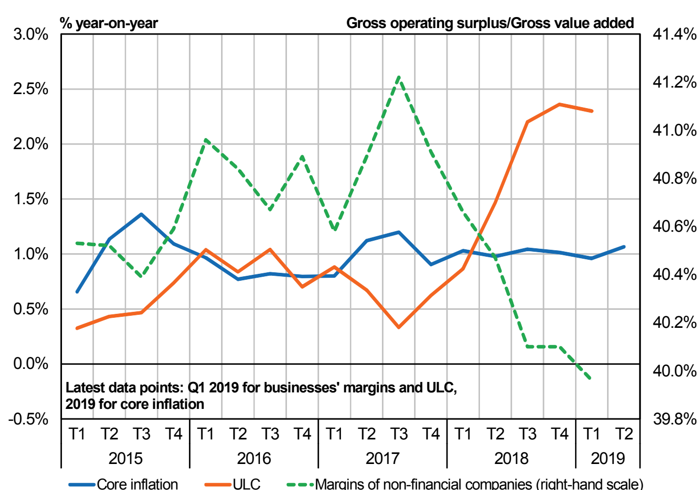
Wages growth has gained momentum in the euro area since mid-2017, increasing by a record 2.5% year-on-year in the third quarter of 2018 – the highest increase since the 2008 financial crisis. Wage growth has been coupled with a tighter labour market: the unemployment rate is still falling (to 7.9% at end-2018, compared with a high of 12.1% in the summer of 2013) and, according to European Commission surveys, it is becoming increasingly difficult to hire new workers, particularly in Germany. As productivity slows, unit labour costs (ULC) have also risen, increasing by 2.4% at end-2018. In spite of this, core inflation has been surprisingly flat[a], averaging 1.0% in 2018, and rising unit labour costs do not appear to have led to higher inflation. In the first quarter of 2019, core inflation remained low (1.0%) and unit labour costs were still growing fast (by 2.3%).

a. In June 2017, the ECB projected core inflation of 1.4% for 2018. This less than expected core inflation is puzzling because the unit labour costs grew more than anticipated: the ECB projected 1.3% growth in unit labour costs for 2018, but they actually rose by 1.8%. Meanwhile, headline inflation growth, which includes energy prices, was relatively vigorous in 2017 and 2018. The rise in oil prices was almost uninterrupted between end-2016 and end-2018.

Several factors may explain this trend: *(i)* the stronger euro in 2017 could have had lower imported inflation in 2018, because of lags in pass-through of exchange rate into euro area inflation; *(ii)* European businesses appear to have largely absorbed higher unit labour costs by significantly reducing their margins, which dropped from a record high of 41.2% in the third quarter of 2017 to 40.0% in the first quarter of 2019, in line with the increase in unit labour costs (see Chart 4). It is projected that wages will continue to grow at the same rate (rising by 2.4% in 2019 and 2.5% in 2020, as in 2018) and businesses will end up gradually passing on the cost of wage hikes to prices, with margins currently staying below their long-term level. As the effects of a strong euro subside, in a scenario of stabilised trade tensions, core inflation is projected to pick up gradually and reach 1.3% on average in 2020, ultimately driven by wage growth.

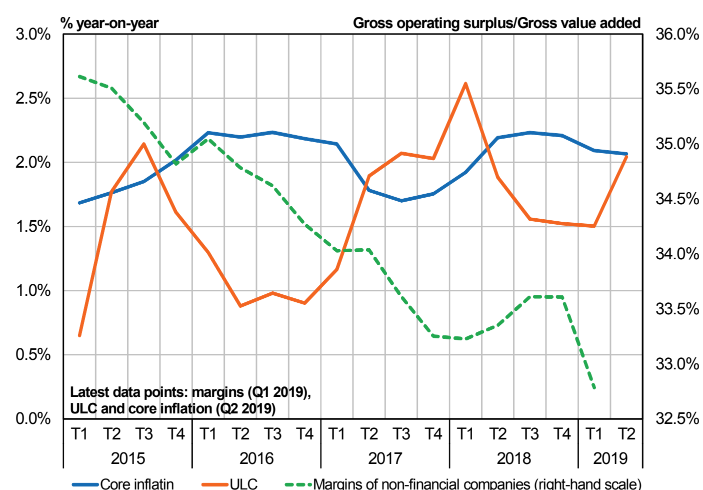
In the US, the average wage per capita[b] has grown at a relatively high rate since 2017. This trend appears to be broadly consistent with the tightening of the labour market: the standard unemployment rate was 3.7% in July 2019, which was below its equilibrium rate (estimated by the Federal Reserve at 4.2%), and the "broader" unemployment rate[c] was 7.0% in July - lower than its long-term average. Meanwhile, surveys[d] show that it is extremely difficult to hire workers. Margins have been on a downward path for several years in the US. This is consistent with the recent trend of higher unit labour costs. US inflation was close to the Federal Reserve's target rate for 2018 (headline inflation, measured by the Personal Consumption Expenditures (PCE) price index, averaged 2.0% in 2018), but was lower between January and June 2019 (1.4% on average). This trend may have prompted the Federal Reserve's switch to an accommodative stance in recent months (see above) and has fuelled the debate on a possible flattening of the Phillips Curve[e], which could be attributable to structural changes (businesses' bargaining power over employees, composition of the labour force, etc.). Core inflation, measured by the Consumer Price Index (CPI) excluding food and energy, was nonetheless above 2% in early 2019 (see Chart 5). It is projected that US wages will continue to rise at a moderate rate and real wage growth will move in step with productivity growth over the forecast period. Core inflation (CPI) is expected to be driven by a tight labour market and the Trump administration's protectionist measures and is likely to reach 2.5% in 2019 and 2.7% in 2020, up from 2.1% in 2018.

Chart 4: Euro area: Core inflation, wage costs and margins



Source: Eurostat, DG Trésor calculations.

Chart 5: US: Core inflation (CPI), wage costs and margins



Sources: Markit, ECB.

b. Measured as the ratio of total wages and salaries (estimated by the BEA) to payroll employment (estimated by the BLS).
c. This includes people in the standard unemployment rate plus people employed part-time for economic reasons (who want full-time work), discouraged workers and other "marginally attached workers".
d. See surveys conducted by the National Federation of Independent Business and the Federal Reserve's Beige Books.
e. The Phillips Curve suggests there is an inverse macroeconomic relationship between the level of unemployment and the rate of price inflation or wage inflation. The concept was developed by A.W. Phillips in 1958. The flattening of the Phillips Curve means that the relationship between unemployment and inflation has weakened.

2. Global growth looks set to slow in 2019 and 2020

After growing solidly in 2018, the global economy is projected to face a sharp slowdown in 2019 in both advanced and emerging economies. Activity is expected to edge up slightly in 2020 on the strength of emerging economies (see Table 1).

2.1 In advanced economies outside the euro area, the US economy is projected to slow considerably while growth in the UK is set to remain moderate

In the US (see Box 2), activity is set to remain strong in 2019 (rising by 2.4%, compared with 2.9% in 2018), supported by the fiscal stimulus[1], which will boost consumption and business investment, but is likely to be weakened by trade tensions. Economic growth is projected to decline sharply in 2020 to 1.5%, due to the end of the fiscal stimulus[2], the protectionist measures announced in August (see Box 2)[3] – under the assumption that there will be no further escalation – and the tight labour market.

In the UK, after holding up well following the shock of the Brexit referendum, activity slowed in 2018 (the economy grew by 1.4%, compared with 1.8% in 2017) because of the uncertainty surrounding the Brexit negotiations. The slowdown is expected to continue in 2019 (with projected economic growth of 1.2%) and activity is forecast to only pick up very slightly in 2020 (up 1.3%), based on the assumption that the UK will leave the EU with a deal on 31 October 2019 and the transition period will last until end-December 2020[4]. Consumption is projected to drop marginally in 2020 despite higher real wage growth due to slower employment growth in a tight labour market. Investment and trade will likely continue to suffer until a clear outline is provided of the future relationship between the UK and the EU. The impact of Brexit on economic activity in the euro area is expected to be minimal over the forecast period[5].

In Japan, activity is projected to remain buoyant in 2019 (growing by 1.2%), driven by strong domestic demand and the fading impact of the 2018 natural disasters. Exports are expected to contract amid slowing Asian demand[6] and the downturn in the semiconductor cycle[7], before picking up slightly in 2020. Activity is projected to slow in 2020, rising by 0.6%, because of the projected increase in the consumption tax rate in October 2019 weighing on household consumption. Wages are expected to increase during the forecast period against a backdrop of a tight labour market and measures to support wage growth[8].

Box 2: The US is heading for a sharp slowdown amid heightened uncertainty

US economic activity is projected to slow in 2019 and 2020. While growth was strong in the first half of 2019, industrial production fell in the second quarter of 2019 and the business environment deteriorated considerably. The US economy's current momentum masks a large number of risks. Protectionism, concerns about the direction of monetary policy and financial risks could have a bigger impact than expected on growth.

US protectionism has started to weigh on foreign trade and could have a worsening effect if there is any further escalation. There has been a decline in bilateral trade of goods subject to higher tariffs since they were imposed and Chinese imports of US soybeans have practically been halted[a]. In May 2019, the US administration raised tariffs from 10% to 25% on $200bn of Chinese imports before announcing that a 10% tariff would be imposed on the remaining $300bn of goods on 1 September. It was then announced that another tariff hike from 25% to 30% on $250bn of imports would come into effect

a. See *Trésor-Economics*, "Premiers effets économiques des tensions commerciales sino-américaines", September 2019 (forthcoming).

(1) See Box 1, "US tax reform and the 2018 Bipartisan Budget Act" in *Trésor-Economics* no. 218 "World economic outlook in spring 2018: growth still strong", March 2018.
(2) A budget deal was reached with Congress for 2020-2021 which is expected to lead to the adoption of a fiscal policy that would be neutral for growth in 2020.
(3) Our scenario, finalised on 21 August 2019, includes the protectionist measures in place at the time and the new 10% tariff announced by the US in early August. The Trump administration said in early August it would impose a 10% tariff on the remaining Chinese imports not already taxed on 1 September (the tariff has since been raised to 15%). The tariffs would be imposed in two stages on 1 September (on $110bn of imports according to the Peterson Institute for International Economics) and mid-December ($160bn).
(4) This is a working assumption that does not make any predictions as to the outcome of ongoing talks between the UK and the EU.
(5) However, the IMF estimates that the trade disruptions of a no-deal Brexit would cause a decline in UK GDP of 1.4% in the first year and 0.8% in the second year (WEO, April 2019).
(6) Asia has seen the emergence of new trade disputes, such as the escalating friction between Japan and South Korea in July.
(7) Global demand for semiconductors goes through cycles that are linked to technological innovation (new smartphones, 4G, etc.). The semiconductor market has been affected by the short- to medium-term downturn in the cycle since mid-2018. Asian countries have been the hardest hit as they hold the largest share of the market.
(8) See Ben Yaala M. (2018), "Is higher wage growth on the horizon in Japan?", *Trésor-Economics* no. 220, April.

on 1 October and the tariff would be raised from 10% to 15% on the remaining $300bn on 1 September. China has retaliated with tariffs on US soybeans, oil and cars, on top of the tariffs already imposed. The protectionist measures in place at end-June could reduce US GDP by 0.4 percentage point by 2021-2022 (of which 0.2 percentage point would be due to uncertainty), based on the OECD's Economic Outlook released in May 2019. The supportive fiscal policy up until now could have masked this impact.

Fiscal policy in the US is highly expansionary at the moment and the government deficit stands at around 6½ percentage points of GDP for 2018-2020 according to the OECD. We estimate that the fiscal stimulus (tax reform and the Bipartisan Budget Act) will raise growth by 0.6 percentage point in 2019, mainly by increasing public and private consumption. According to the IMF, tax reform has had a relatively muted impact on investment[b], supporting share buybacks and dividend payouts rather than new investments. The end of the fiscal stimulus is expected to weigh on growth in 2020.

US monetary policy is surrounded by growing uncertainty. The Federal Reserve is faced with balancing the prospect of an economic slowdown with the tightening of the US labour market, which could push up wages and inflation. It is increasingly moving to keep the economic expansion going, cutting its key interest rate by 25 basis points in late July 2019[c]. Meanwhile, financial markets look like they are expecting several rate cuts in 2019 amid doubts about the US growth outlook, and the inversion of the US yield curve has deepened[d]. Against the monetary policy uncertainty, any revision by market participants of their expectations could trigger violent market corrections. The markets are already worried that shares might be overvalued and corporate debt could be rising for some companies.

b. See the report of the 2019 Article IV Consultation with the US.
c. In December 2018, the Federal Reserve forecast three rate increases by end-2020.
d. See Box 3, "Stock market corrections and a partial inversion of the US yield curve at the end of 2018", *Trésor-Economics* no. 237 "World economic outlook in spring 2019: Diverging performances in the global slowdown, March 2019.

2.2 Euro area growth is expected to stabilise slightly below its potential rate amid ongoing uncertainty

Growth in the euro area is projected to contract sharply over the forecast period (to 1.2% in 2019 and 2020, down from 1.9% in 2018), which is slightly below the European Commission's estimated potential growth rate. Like in 2018, the continued weakening of world demand for exports from the euro area is likely to be partly responsible for the downturn. Persistent uncertainty is likely to continue to weigh on investment, which is projected to slow. Furthermore, the slowdown in employment growth is expected to affect domestic demand. The bottoming out of energy price inflation is set to drive down inflation over the forecast period, despite core inflation gradually picking up (see Box 1). In addition, the partial rebalancing of labour costs across the euro area in recent years is projected to continue, with Germany posting slightly higher inflation and labour costs than the countries of southern Europe.

In Germany, after stalling at the end of 2018, growth is forecast to improve to 0.6% in 2019 and 0.9% in 2020. Household consumption is likely to remain relatively resilient, underpinned by strong purchasing power and the use of precautionary savings, based on the assumption that uncertainty will ease in 2020. However, the worsening of the international environment is expected to continue to affect investment and exports. The lower demand for German capital goods and cars now appears to be having spill-over effects on every sub-sector of industry. Trade is therefore expected to undermine growth in 2019 and, to a lesser extent, in 2020. Employment growth was still resilient in early 2019 but is projected to slow over the forecast period.

In Italy, political and fiscal uncertainty is expected to weigh on growth in 2019 before easing in 2020, based on a public finance scenario where structural adjustment would be virtually neutral. Growth is projected to be zero in 2019 and 0.5% in 2020. Uncertainty will likely take a huge toll on capital investment, which is forecast to contract in 2019 and 2020, but to a lesser extent, and prompt households to save more. Job creation is set to slow as employer exemptions from social security contributions are scaled back (only new hires of young people aged under 35 will still be eligible).

In Spain, activity is projected to continue to slow in 2019 (with projected growth of 2.3%, down from 2.6% in 2018) and 2020 (1.9%), but is forecast to remain robust. Household consumption is expected to be boosted by fiscal measures, including pay rises for civil servants, retirement pension increases and a jump in the minimum wage, but will likely slow in the wake of job creation. Imports are projected to be driven down by the subdued manufacturing sector in the euro area in 2019 and softening investment before recovering in 2020 as exports gather pace.

2.3 Growth is expected to decline broadly across emerging economies

In Brazil, growth is projected to remain weak in 2019 prior to a recovery in 2020. Activity was undermined by circumstantial shocks in early 2019 and continues to suffer from soft investment dragged down by credit market

distortions and poor public finances. The social security reform bill, which includes overhauling the pension system, was announced by the government in February and is about to be voted on in the lower house. The reform would help contain rising public debt, which would have a positive influence on investment decisions in late 2019 and 2020. As a result, investment is expected to recover in Brazil, particularly in the manufacturing sector, restoring the country's production capacity and lifting growth in 2020.

In India, activity slowed in the first quarter of 2019. This came after strong growth was reported in early 2018 as the negative effects of the banknote demonetisation in late 2016 subsided faster than expected and the Goods and Services Tax (a single national VAT) was introduced in mid-2017. Growth is expected to rise in the second half of 2019 as political uncertainty comes to an end after the re-election of Modi as prime minister, monetary policy is eased considerably (with four interest rate cuts since January) and fiscal stimulus is implemented. Growth is projected to pick up in 2020 once the full effects of stimulus measures are felt.

In Russia, GDP growth is predicted to fall in 2019 on the back of the VAT rate increase and the decline in oil prices. After peaking in March (to 5.2% year-on-year), inflation is expected to soften gradually over the year, but household consumption is forecast to remain flat. In 2020, public investment will be ramped up as part of the "National Projects" scheme, which is forecast to place activity on a slightly stronger footing.

In China, the slowdown in activity is expected to continue in 2019 and 2020 due to the trade tensions with the US and the government's structural deleveraging. China's foreign trade looks set to take the hardest hit. Against this backdrop, the government is expected to extend fiscal and monetary support measures to contain the slowdown. These include the support measures announced in late 2018 and ramped up in March 2019, but it is projected that they will not be enough to kick-start the economy.

In Turkey, the economy is expected to contract over 2019. Private consumption and investment continue to bear the brunt of still-high inflation, which is gradually declining, and the tight monetary policy implemented since the currency crisis of summer 2018. Activity is forecast to be bolstered by public spending since the government has room to manoeuvre on fiscal policy (public debt was 30.4% of GDP in 2018). In 2020, it is projected that slower inflation and plans to ease monetary policy will drive domestic demand back up and boost GDP growth to its potential rate (estimated at around 3-4%).

Box 3: Long-term downward trend in inflation in emerging countries

Inflation has fallen significantly in emerging countries in recent decades, declining from 17.3% in 1974 to around 3.5% in 2018, as highlighted in recent World Bank reports[a]. Even by changing the sample countries, the years analysed and the calculation methods, we reached the same conclusion: average inflation was nearly halved between 2000 and 2018. This was the case in BRICS[b], where inflation dropped from around 9% to nearly 5%, and in a sample of 40 emerging countries[c], where inflation declined from 6.0% to 4.4%, by weighting each country's inflation rate by its share of the global economy (see Chart 6). However, inflation in emerging countries has recently become subject to renewed volatility in response to trade and monetary policy changes in developed countries. In 40 emerging countries, average inflation reached a high of 6.25% in October 2018 (see Chart 7) due to the Federal Reserve's monetary tightening (leading to capital outflows and downward pressure on emerging market currencies) and protectionist tensions (currency friction and imported inflation). This was soon followed by a low of 4.1% in January 2019 as monetary tightening eased and there was a reprieve in the trade war between the US and China.

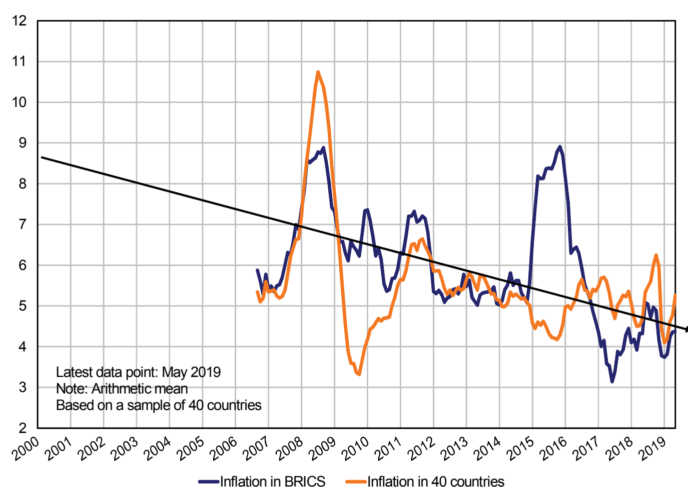
Inflation in emerging countries appears to be increasingly synchronised and guided by global cycles, which currently have a downward tendency. This situation may be explained by two structural trends seen around the world since the 1990s: a stricter monetary policy framework underpinned in particular by inflation targeting (introduced in Brazil in 1999 and South Africa in 2000), which has limited the dispersion of inflation rates, and globalisation, i.e. deepening trade integration (the share of trade in the GDP of emerging countries increased from 50% to 75% between 1970 and 2017) and financial integration. Lower transport and communication costs, coupled with increased foreign competition due to the rapid development of international trade, have translated into downward pressure on prices.

a. Global Economic Prospects of January 2019, Darkening Skies and Ha, Jongrim; Kose, M. Ayhan; Ohnsorge, Franziska. 2019. Inflation in Emerging and Developing Economies: Evolution, Drivers and Policies. Washington DC: World Bank.
b. Brazil, Russia, India, China and South Africa.
c. Including almost all the countries classified as emerging market and developing economies by the IMF.

We cannot rule out a sudden return of high inflation in emerging countries through one of three channels: currencies (imported inflation), trade or governance. First, the recent rise in emerging market currencies, prompted by the easing of monetary policy in developed economies and investors seeking returns, could be quickly reversed if investors started looking for safehaven securities in a climate of uncertainty. Second, imported inflation could increase again as a result of rising protectionism. Third, monetary policy in emerging countries could succumb to the current wave of populism, which has already started to gain ground in some countries as governments interfere with their central banks' monetary policy.

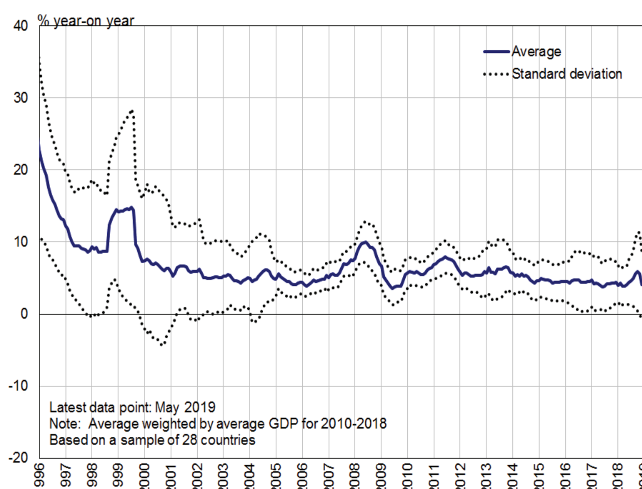
Two countries - Argentina and Turkey – are exceptions to the global trend of lower inflation. In May 2019, the inflation rate was 57.3% in Argentina and 18.7% in Turkey year on year as a result of the currency crises in summer 2018 and worsening political and institutional instability (a general election is due to be held in October 2019 in Argentina and there is a debate surrounding the continuation of the IMF's programme in its current form; president Erdogan lost the local elections in Ankara and Istanbul in late March and the central bank governor was sacked in early July). Based on IMF forecasts, inflation is expected to fall in 2020, but will likely remain at a high rate, at 32.1% in Argentina[d] and 14.1% in Turkey.

Chart 6: Inflation in emerging countries and BRICS



Sources: Reuters, DataInsight, calculations DG Trésor.

Chart 7: Change in the dispersion of inflation in emerging countries



Sources: DataInsight, calculations DG Trésor.

d. According to the Fourth Review of the IMF programme in Argentina (July 2019).

3. World demand for French exports is projected to drop sharply in 2019 before picking up in 2020

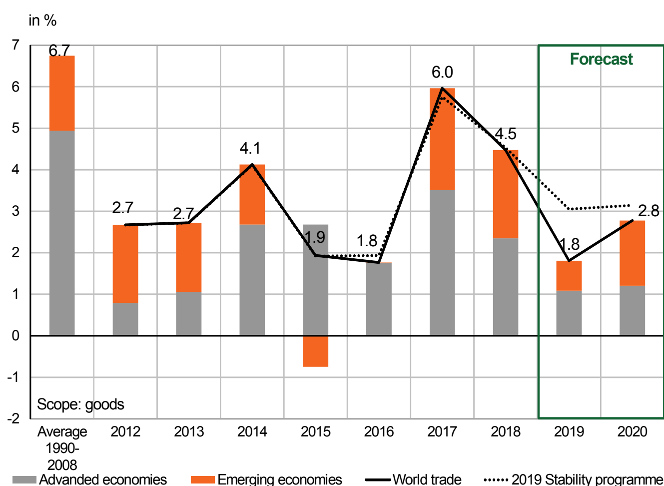
World trade in 2017 reached an all-time high since 2011 before moderating throughout 2018, but still growing at a robust rate (averaging 4.5% in 2018). In the first half of 2018, world trade was buoyed by a sharp increase in Chinese imports on the back of stronger Asian trade since 2017 and in anticipation of higher US tariffs taking effect in mid-2018. Conversely, in the second half, Asian imports fell off substantially against a backdrop of tariffs and lacklustre Chinese domestic demand. Imports from the euro area also softened amid political and trade uncertainty, as well as in the UK ahead of Brexit.

Global trade is expected to record a severe slowdown in 2019, growing by 1.8%, before regaining some ground in 2020 to climb by 2.8% (see Chart 8). It is likely to be undermined in 2019 by soft imports: *(i)* in China amid stronger protectionism and slower activity, *(ii)* in the rest of Asia, which is exposed to Chinese demand due to the region's trade integration and the mid-year downturn in the global semiconductor cycle (the semiconductor market is a trade-exposed sector), *(iii)* in the US, reflecting increased protectionism and the projected slowdown in domestic demand, and *(iv)* in the euro area against a backdrop of weakening growth. In 2020, imports are expected to rebound dramatically in Turkey, as a correction to the sharp contraction experienced at present, and gain momentum in Asia, driven by the end of the downturn in the semiconductor cycle, policy stimulus in China and the easing of the confidence shock in connection to trade tensions (based on the assumption that there will be no further escalation in the trade war). The elasticity of world

trade to growth is expected to decline to less than 1, a trend consistent with weaker global growth and increased protectionism.

Growth in world demand for French exports is expected to fall to 2.0% in 2019 from 3.7% in 2018 before improving to 2.6% in 2020. The French export sector is expected to be hit harder by the slump in the euro area than global trade as a whole in 2019, which is consistent with average trends in French exports, but is likely to be less exposed to the slowdown in trade in Asia in 2019 and the recovery in 2020. World demand for French exports is forecast to be sustained by stronger Turkish demand in 2020.

Chart 8: World trade and contributions by area



Source: DG Trésor.

Table 1: Growth forecasts*

GDP (annual average, %)	Average 2000-2007	2015	2016	2017	2018	2019 (forecasts, working-day adjusted)	2020 (forecasts, working-day adjusted)
World growth[a]	**4.5**	**3.4**	**3.4**	**3.8**	**3.6**	**3.1**	**3.3**
Memorandum: world growth forecast in the 2019 Stability Programme	*4.5*	*3.4*	*3.2*	*3.7*	*3.7*	*3.4*	*3.4*
Advanced economies[b]	**2.7**	**2.3**	**1.7**	**2.5**	**2.2**	**1.8**	**1.5**
United States	2.7	2.9	1.6	2.4	2.9	2.4	1.5
Japan	1.5	1.3	0.6	1.9	0.8	1.2	0.6
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**	**2.6**	**1.9**	**1.2**	**1.2**
Germany	1.6	1.7	2.2	2.2	1.4	0.6	0.9
Italy	1.5	0.9	1.1	1.7	0.9	0.0	0.5
Spain	3.7	3.6	3.2	3.0	2.6	2.3	1.9
Other advanced economies	3.9	2.1	2.2	3.1	2.5	2.1	2.5
Emerging economies[b]	**6.6**	**4.3**	**4.6**	**4.8**	**4.5**	**4.1**	**4.6**
Brazil	3.6	−3.5	−3.3	1.1	1.1	1.0	1.9
China	10.5	6.9	6.7	6.8	6.6	6.0	5.7
India**	7.1	8.0	8.2	7.2	6.8	7.0	7.2
Russia	7.2	−2.5	−0.3	1.6	2.2	1.3	1.8
Turkey	5.4	6.1	3.2	7.4	2.6	−1.7	3.0
Other emerging economies	4.5	3.4	3.7	3.4	3.1	2.7	3,6
World demande for French exports[d]	*6.9*	*3.2*	*3.2*	*5.7*	*3.8*	*2.0*	*2.6*
World trade[e]	*7.5*	*1.9*	*1.8*	*6.0*	*4.5*	*1.8*	*2.8*

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 calculated using quarterly accounts adjusted for working days. They are based on DG Trésor forecasts for Germany, France, Italy and Spain and 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 21 August 2019.*
*** These forecasts are presented for the fiscal year, from April to March of the next year.*
Sources: IMF, July 2019 WEO update; European Commission (July 2019). DG Trésor calculations and forecasts.

4. Uncertainty surrounding the baseline scenario has increased notably in recent months

The baseline scenario is subject to uncertainty on many fronts:

- Global trade is expected to suffer from an intensification of protectionist tensions between the US and China, or with the European Union. Global trade is also likely to be affected by weakening Asian trade as a result of these growing trade disputes.
- The extent of the impact of Brexit is particularly uncertain. This is because there might not be a deal at end-October. And even if the UK exits the EU with a deal, uncertainty surrounds the outcome of talks on their future relationship. The market reaction and the chosen policy mix will be key.
- Germany's industry has been suffering from soft global trade and a troubled automotive sector since last year and could post a stronger-than-expected recovery amid a pick-up in global trade.
- The political and fiscal situation in Italy remains a source of uncertainty. A severe economic downturn could affect its partners through trade or financial channels, or uncertainty could be the cause. Conversely, clarity from the government over its policies and a smoother relationship with the European Commission over the 2020 budget would help ease uncertainty.
- Imbalances in China and a breakdown in trade talks with the US could lead to a more brutal slowdown of its economy. Nevertheless, growth could be bolstered by the government increasing monetary and fiscal stimulus.
- Emerging countries remain vulnerable to the outcome of trade tensions, as highlighted by the volatility of emerging market currencies since May 2019. However, a more dovish monetary stance is expected to reduce the pressure on capital outflows, including in the hardest-hit countries (i.e. Turkey and Argentina).
- Oil prices could fall again if fears over global growth gain momentum or if non-OPEC oil production remains at a high level. Oil prices could also go up if OPEC and its partners decide to cut crude oil exports further or in the event of geopolitical tensions.
- Uncertainty remains high in financial markets, in particular over the Federal Reserve's policy direction amid high share prices.

Box 4: Main revisions since the 2019 Stability Programme and comparisons with forecasts by international organisations

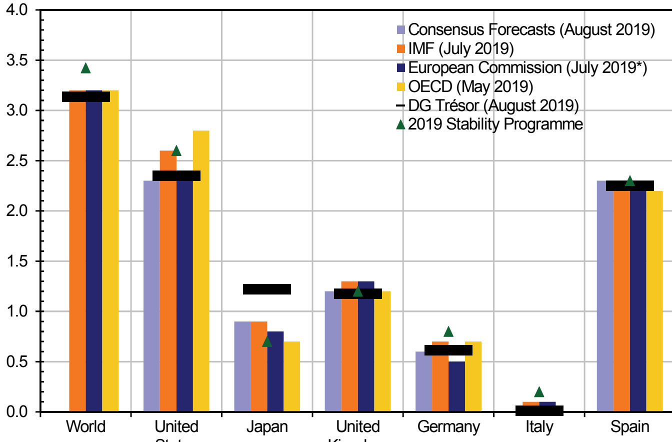
Since the scenario prepared for the Stability Programme, we have downgraded growth forecasts for advanced economies and emerging economies.

In advanced economies, growth forecasts were revised down for the euro area because of disappointing export data, sluggish industrial production in the first half of the year and rising uncertainty. The growth forecast for the US was also downgraded due to worsening trade tensions since the Stability Programme.

In emerging economies, China's growth is projected to slow more sharply than expected amid escalating trade tensions. The forecasts for Brazil and India have also been revised down due to the unexpected contraction in activity in the first half of the year.

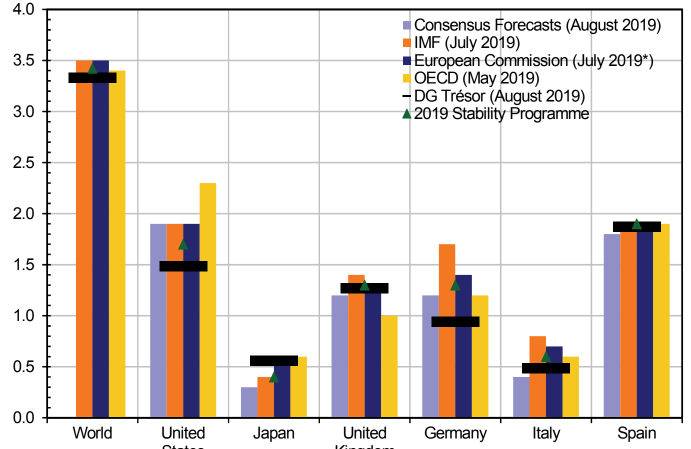
The scenario is for a global slowdown in 2020, compared with 2018, due to heightened uncertainty. It is broadly in line with the consensus (see Charts 9 and 10) and is similar to the scenario presented by the IMF in July (WEO update), the OECD in June and the European Commission in May. It is also in line with the Consensus Forecasts published in August.

Chart 9: Growth forecasts for 2019



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

Chart 10: Growth forecasts for 2020

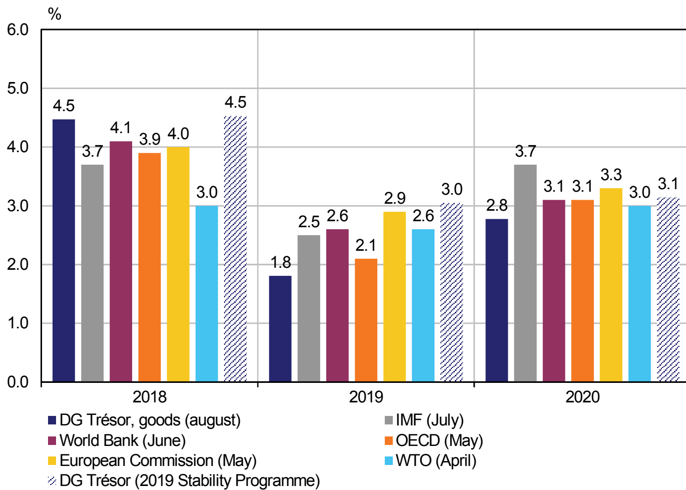


Sources: IMF, OECD, European Commission (forecasts not adjusted for working days), Consensus Forecasts (forecasts not adjusted for working days), DG Trésor.

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

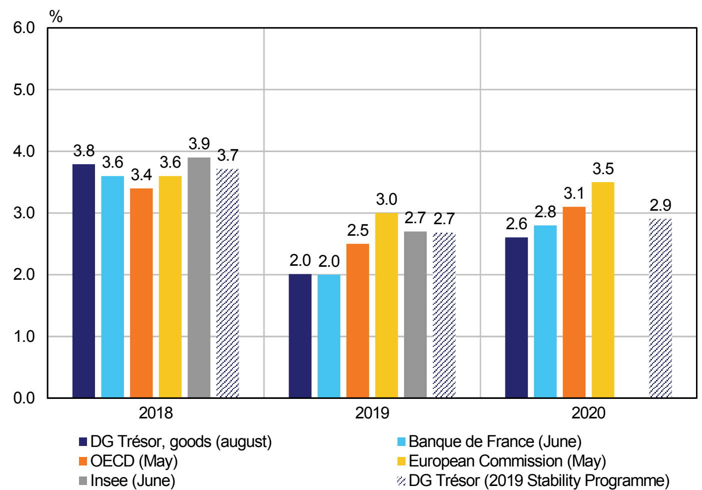
Growth forecasts for world trade have been revised down significantly since the 2019 Stability Programme (down 1.2 percentage points in 2019 and 0.4 percentage point in 2020). Trade contributed less to the world growth trend in all economies, notably in the US and China amid rising protectionist measures, and also in the rest of Asia in the wake of the slowdown in Chinese demand. World demand for French exports has been revised down by 0.7 percentage point in 2019 and 0.3 percentage point in 2020 on the back of weakening European trade. This scenario of less robust world trade is in line with the consensus even though international institutions differ in their forecasts for the magnitude of the slowdown (see Charts 11 and 12).

Chart 11: Comparison of world trade forecasts



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

Chart 12: Comparison of world demand for French exports



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

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