World Economic Outlook

The outlook for world growth 10 years after : Unsynchronized, peaking, and vulnerable

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Ten years after: An appraisal of the post-financial-crisis world

- Ten years ago, a garden-variety recession (which began in December 2007) morphed into the worst financial crisis and economic downturn since the Great Depression.
- Trouble had been brewing for many years, and much like past financial crises, debt and banks played the starring roles.
- A major difference between the Great Recession and the Great Depression was the aggressive response of central banks.
- The economic and political fallout from this unfortunate meltdown has been long and painful.
- It is still too early to take full measure of the costs of this ill-fated set of events.
- What we know is that the aftershocks of the global financial crisis will be felt for many years to come.

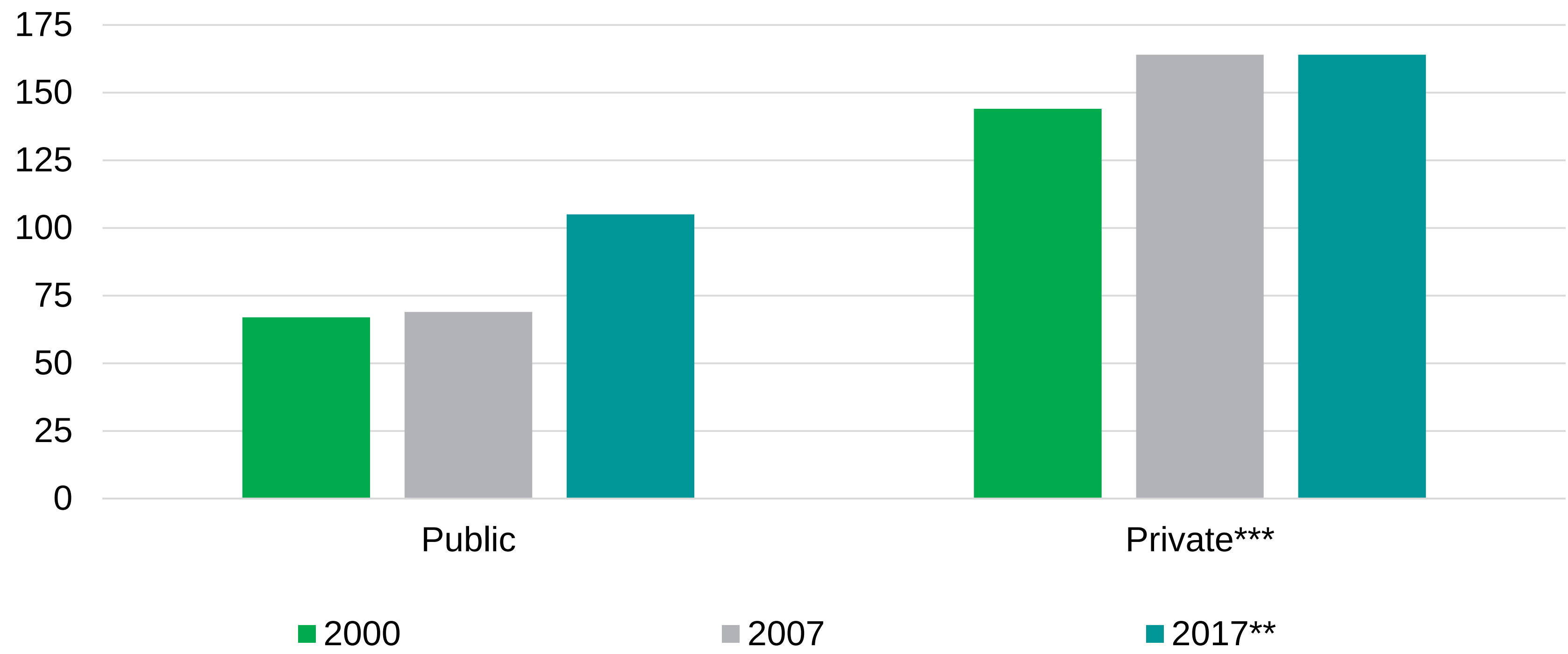
Ten years after: An appraisal of the post-financial-crisis world (continued)

Debt

- Rapidly rising private-sector debt levels in the developed world, elevated (and sometimes hidden) levels of bank leverage, and housing bubbles were among the most important causes of the financial crisis.
- Did the decades-long success of central banks in reducing inflation and interest rates (sometimes called the Great Moderation) help to encourage greater risk-taking?
- In the aftermath of the collapse, private-sector debt was curtailed, especially household debt in the United States and the United Kingdom.
- But, public-sector debt soared—the average ratio of government gross debt to GDP in the Organization for Economic Co-operation and Development (OECD) countries surged from below 80% in 2007 to above 110% in 2017. This was the result of both stimulus in a few countries and recessions followed by weak economic growth in most of the developed world.
- A particularly damaging knock-on effect was the Eurozone sovereign-debt crisis, which hit Greece and Ireland hardest, but also affected Italy, Portugal, and Spain.

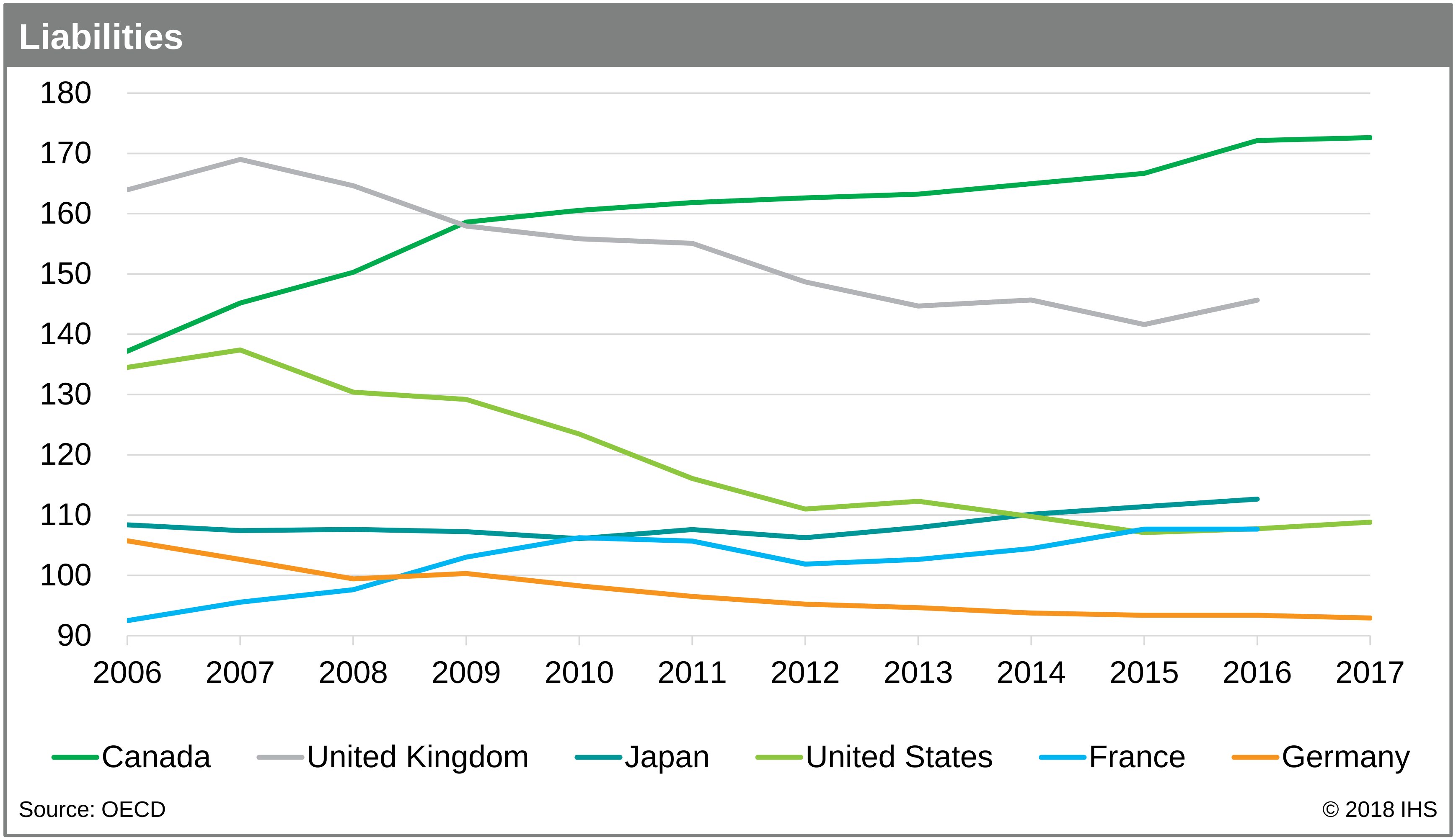
Debt-to-GDP ratio in the advanced economies

Debt-to-GDP ratio in advanced economies*

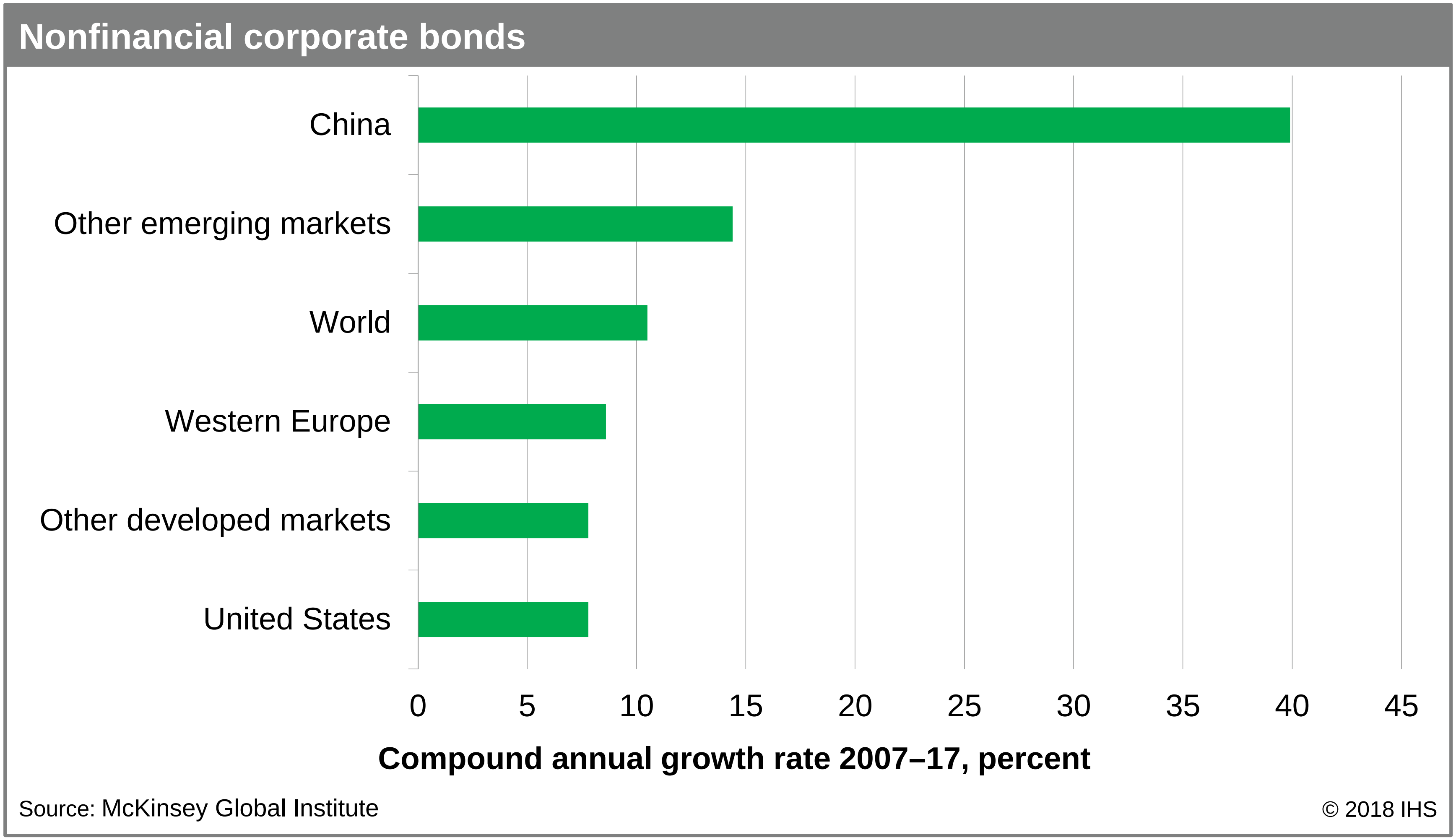


* Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Luxumbourg, Netherlands, New Zealand, Norway, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, United Kingdom, and United States
**First half of 2017
***Includes household and nonfinancial corporate-sector debt
Source: Bank for International Settlements

Household liabilities to disposable income



Nonfinancial corporate bonds outstanding



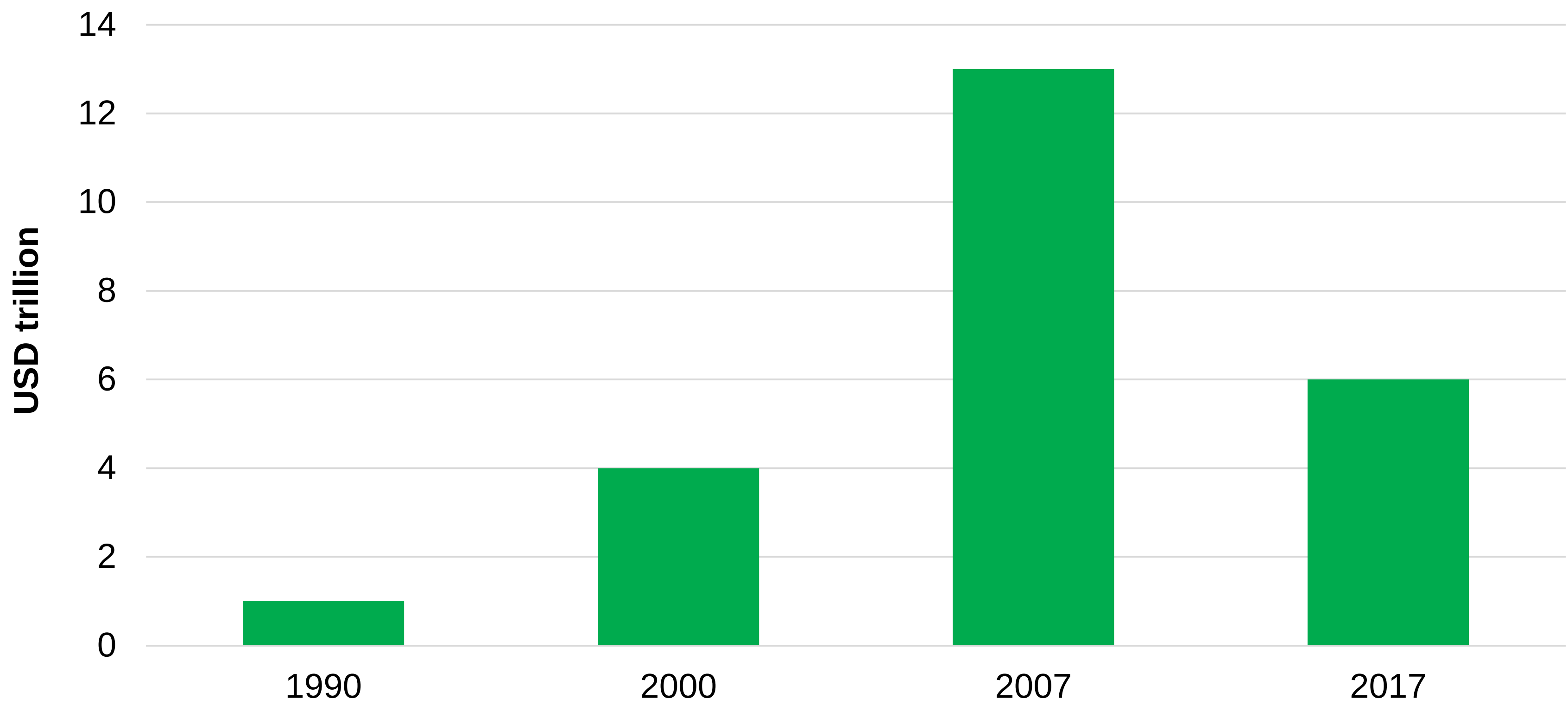
Ten years after: An appraisal of the post-financial-crisis world (continued)

Banking

- Countless times in the past, banks have been at the epicenter of financial conflagrations—the global financial crisis of 2008–09 was no exception.
- In response, governments put in place bailout programs (some more aggressive than others) and tightened banking regulation.
- During the past decade, bank capital positions have become stronger, and bonuses have been more closely tied to long-term performance.
- That said, some of the systemic risks facing the US and European financial sectors—notably the too-big-to-fail challenges—have not been adequately addressed.
- Moreover, banks have lost ground to under-regulated nonbank financial institutions (e.g. private equity and hedge funds).

Global cross-border capital flows

Global cross-border capital flows*



* Gross capital inflows, including foreign direct investment, debt securities, equity, lending, and other investment
Source: McKinsey Global Institute

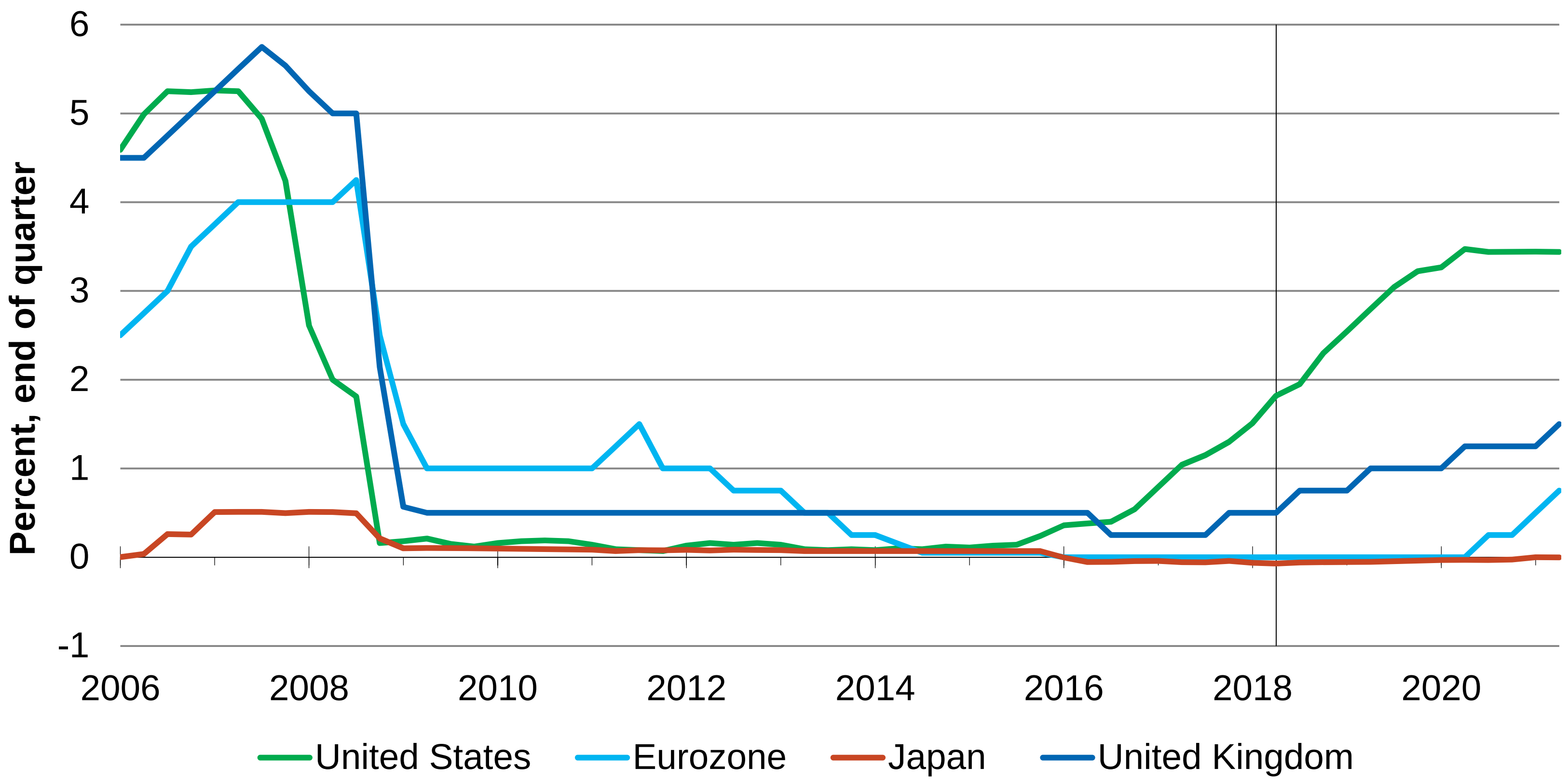
Ten years after: An appraisal of the post-financial-crisis world (continued)

Monetary policy

- Faced with the potential for a catastrophe on the scale of the 1930s, the world's major central banks enacted unorthodox and aggressive policies—including pushing short-term interest rates to zero or below and massive bond-buying programs.
- While these quantitative-easing programs have been controversial, there is a consensus they were necessary and prevented a far worse crisis.
- The Federal Reserve (Fed), Bank of England, and Bank of Canada have begun to "normalize" policy by tapering or selling bonds and raising interest rates; the European Central Bank and the Bank of Japan are much earlier in the process.
- An unintended consequence of the unorthodox monetary policies is the havoc they have created for some emerging markets.
- With the Fed pulling back quantitative easing and raising interest rates, emerging markets with weak economic fundamentals, such as Turkey and Argentina, now face heavy depreciation and debt repayment pressures.

The US Federal Reserve is leading major central banks in raising interest rates

Policy interest rates



Source: IHS Markit

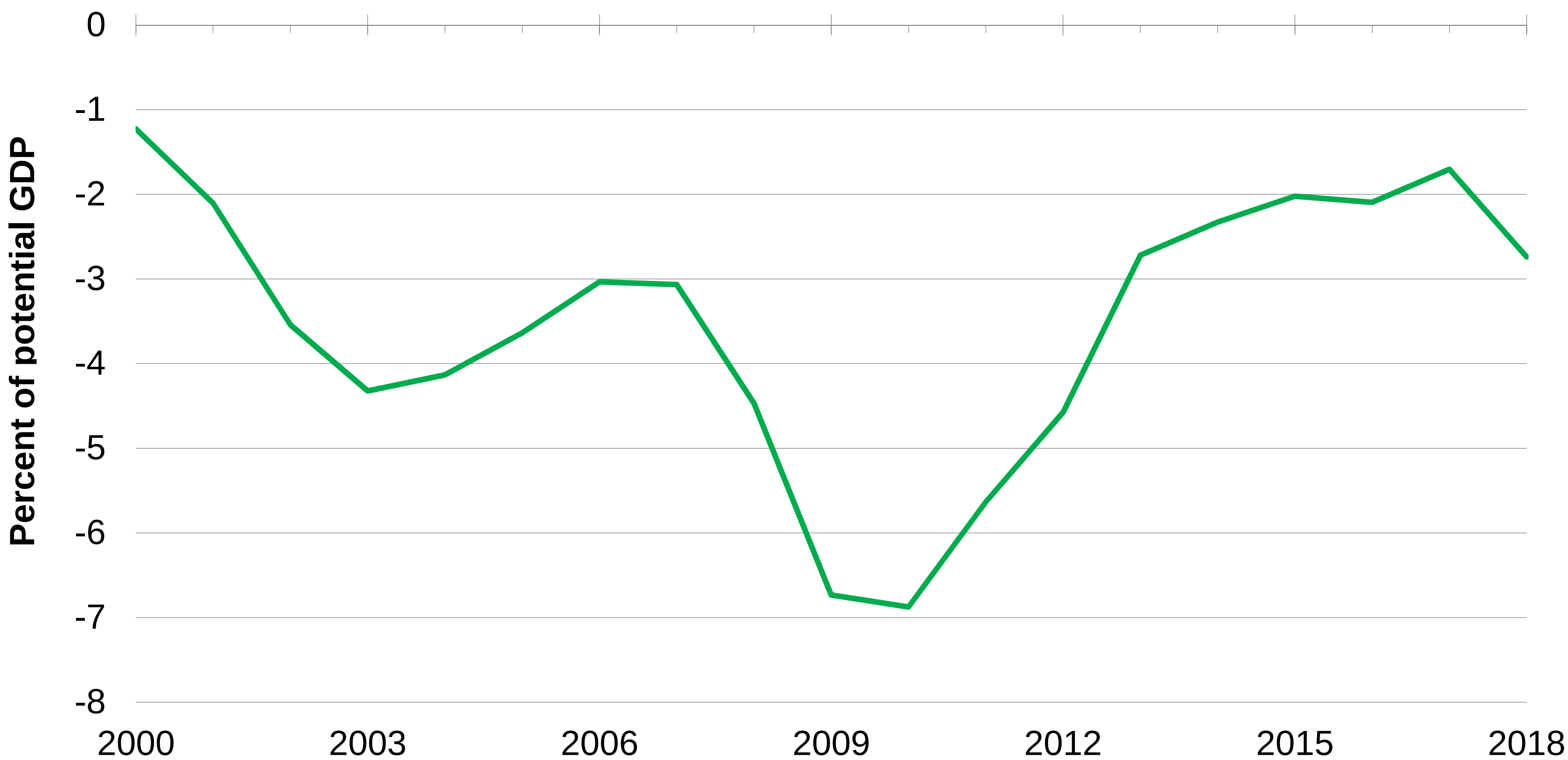
Ten years after: An appraisal of the post-financial-crisis world (continued)

Fiscal policy

- Initially, some governments enacted stimulus to ease the pain.
- However, with the onset of the sovereign debt crisis in 2010, the Eurozone put in place austerity programs aimed at reducing the massive rise in government debt levels.
- In 2011, the United States also curtailed spending with the sequester program.
- These efforts did stabilize public-sector debt ratios, but at the cost of slower growth.
- Earlier this year, the United States enacted large tax cuts and spending increases, which starting next year will result in trillion-dollar deficits and rising debt ratios, as far as the eye can see.

Total OECD government balances

General government cyclically adjusted balances



Source: OECD

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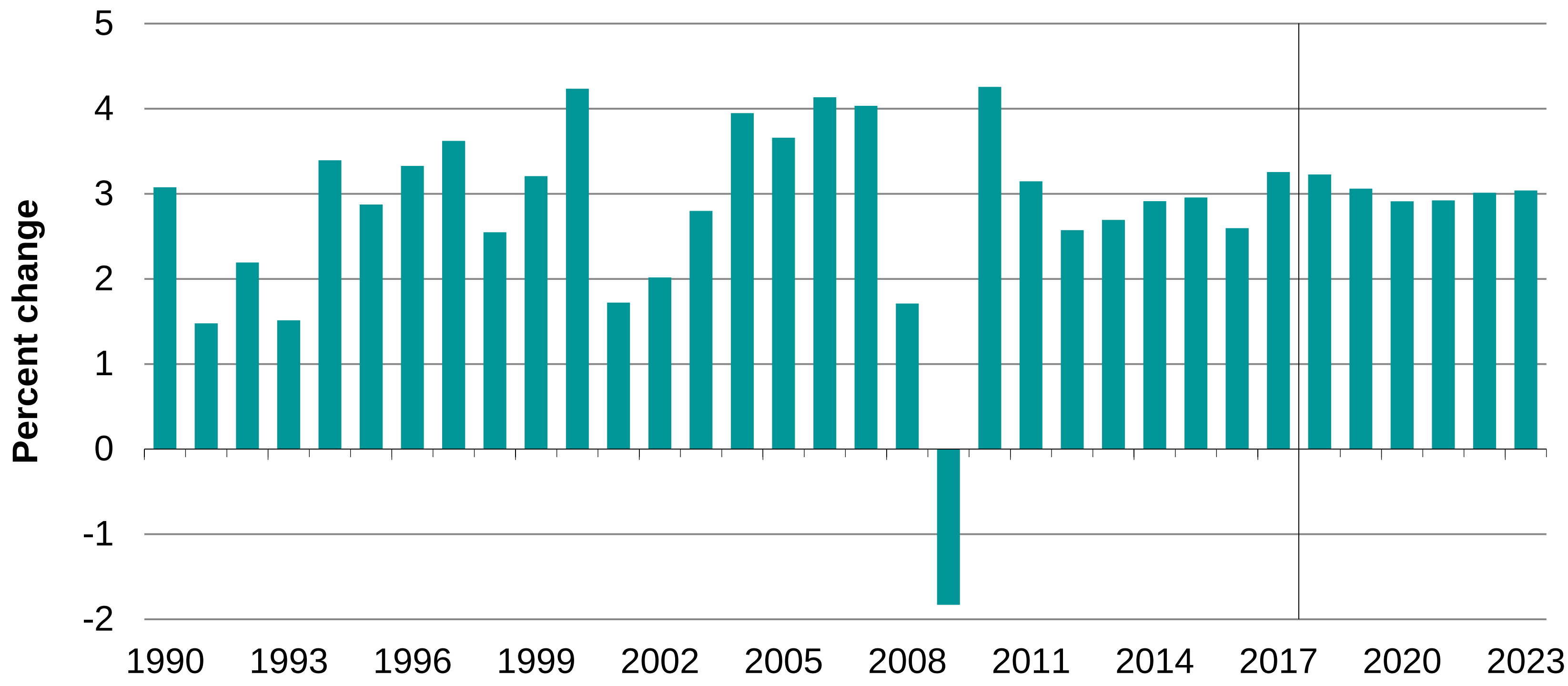
Growth and employment

- Recoveries from financial crises usually take much longer than downturns triggered by other events, such as oil shocks or monetary tightening—the last 10 years have followed this pattern, with the recoveries in most developed economies being much weaker than the postwar average.
- Output gaps (the difference between potential and actual GDP) rose sharply during the Great Recession, have fallen slowly and steadily since then, and are close to zero for most developed economies.
- Similarly, unemployment rates have fallen, and for some countries (e.g., the United States, the United Kingdom, and Germany) are at multidecade lows.
- Even in those economies where the improvement has been the greatest, some measures suggest there is still slack in labor markets—in particular, the sluggish response of wages to low unemployment rates is puzzling and troubling.

Global real GDP: Unusually weak growth in the 2010s

Real GDP



Source: IHS Markit

Ten years after: An appraisal of the post-financial-crisis world (continued)

Stock markets

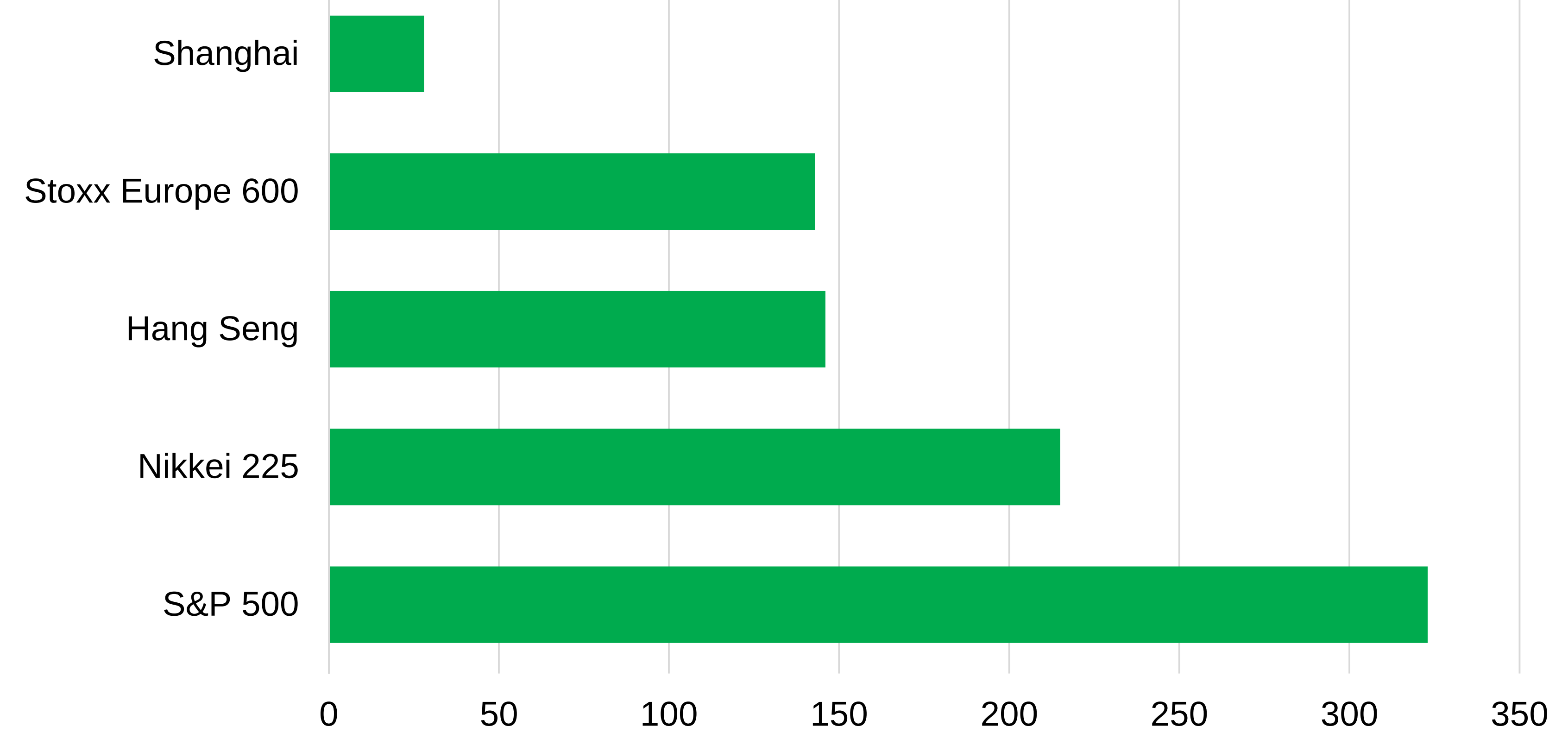
- One of the biggest surprises of the past decade has been the stunning performance of stock markets around the world—most markets are well above their pre-crisis highs.
- While this performance has generated a heated discussion about whether equities are overvalued and in bubble territory, earnings growth has been strong and there is little evidence of speculative activity (other than in some cryptocurrencies).

Inequality

- The global financial crisis and ensuing deep recession hit middle- and lower-income families hardest.
- This has exacerbated already-rising income inequality, driven by the twin forces of technology and globalization that reward high-skilled over low-skilled workers.
- Because of the surge in stock markets, the distribution of wealth became even more skewed in favor of the rich.

The performance of key global stock indexes since March 2009

Stock indexes



Source: Bloomberg

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Ten years after: An appraisal of the post-financial-crisis world (continued)

Populism

- The backlash against the rise in inequality has been one of the most powerful aftershocks of the meltdown 10 years ago.
- Dramatic manifestations have included the vote by the British public to leave the European Union, the result of 2016 presidential elections in the United States, and the recent rise of populist parties in Italy.
- Voters hurt by the economic developments of the last decade have vented their fury on the political establishment.
- The repercussions from these political earthquakes and resulting populist policies are likely to be felt for years to come.

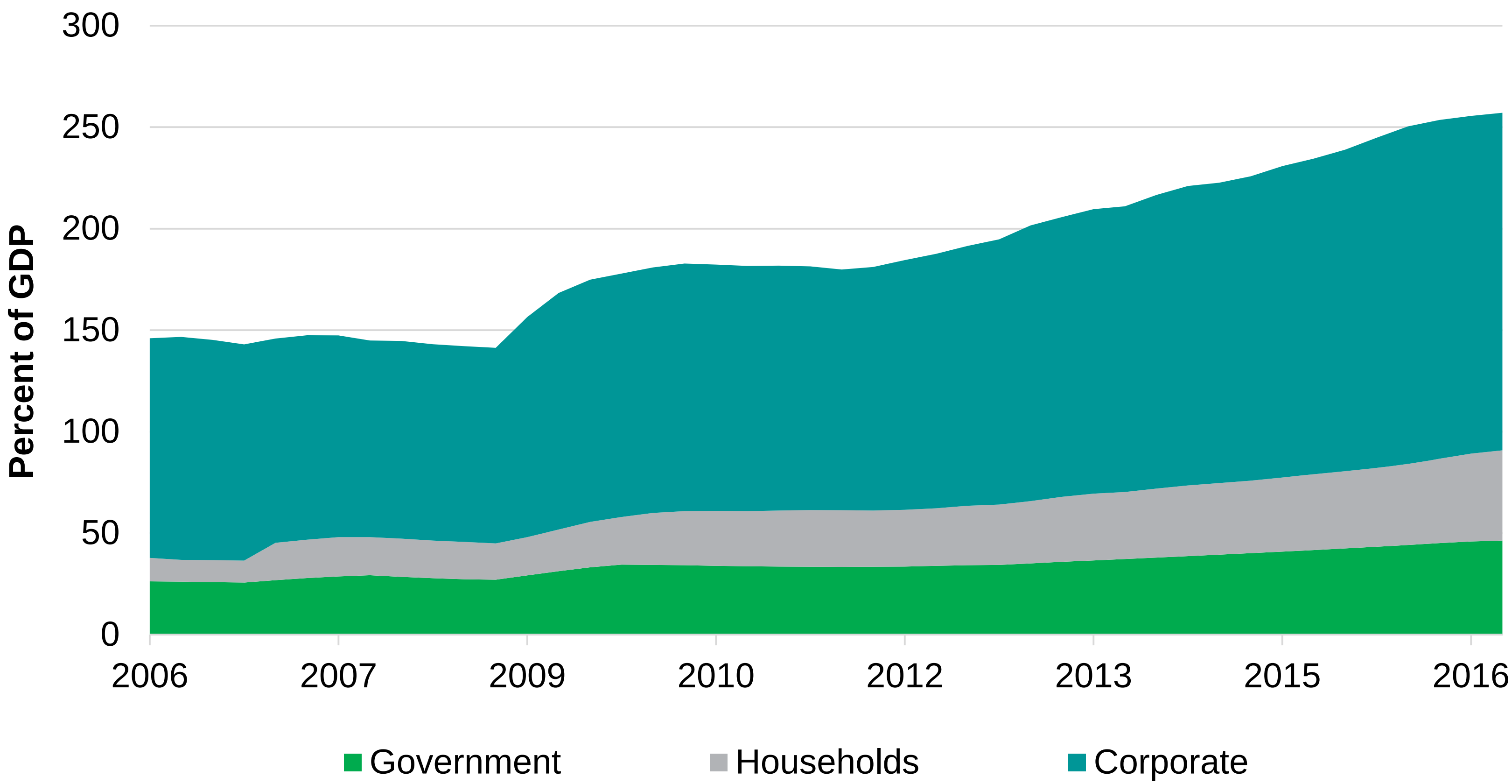
Ten years after: An appraisal of the post-financial-crisis world (continued)

China

- China responded to the events of a decade ago by opening the fiscal and monetary spigots.
- This move cushioned the Chinese economy against the global downturn and helped a few other countries, such as Australia, that are dependent on China.
- Unfortunately, the legacy of this large-scale stimulus has been a massive rise in China’s debt and delay in structural reforms.
- Efforts by the Chinese government to curtail leverage are already undermining growth and will likely continue to drag down growth in the future.

China’s massive debt will constrain future monetary policy, credit growth, and investment

Debt stock by sector



Source: Bank for International Settlements (BIS)

Global economic outlook: Unsynchronized, peaking, and vulnerable growth

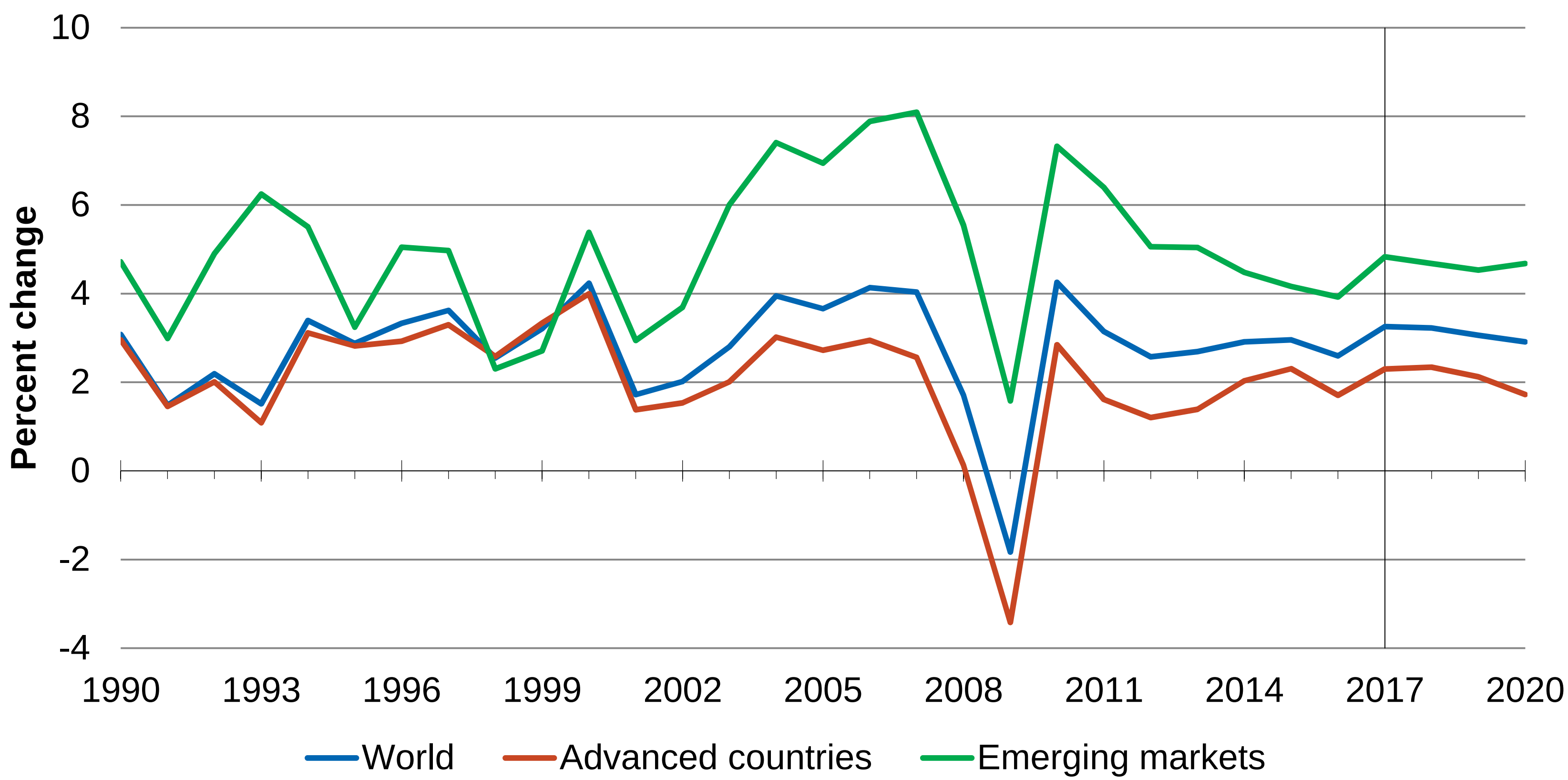
- Global economic growth is expected to hold near 3.2% this year before easing to 3.0% in 2019 and 2.9% in 2020.
- The United States is getting a boost from fiscal stimulus and strengthening business investment in 2018–19, but inflationary pressures and policy tightening will restrain growth in 2020–21.
- Europe’s growth is slowing but remains above trend; risks include higher oil prices, continuing political challenges, and the financial crisis in Turkey.
- China’s growth is slowing as a result of excesses in industrial capacity, debt, shadow banking, as well as rising US-China trade friction …
- … But, the Chinese government will not let the economy slow too much.
- Asia’s other emerging markets are expected to sustain solid growth.
- Emerging markets that depend on external finance (such as Turkey, Argentina, and South Africa) have come under intense pressure and some are headed for recessions.

The global outlook (continued)

- Businesses remain relatively upbeat, despite policy and political risks.
- Trade is faltering as an engine of growth.
- Oil prices remain elevated …
- … But, at current levels they will only have a limited negative impact on growth.
- Given closing output gaps, inflation will move up—but probably slowly.
- Most central banks will take their time in reducing stimulus—with the US Federal Reserve at the head of the pack.
- The US dollar is likely to remain strong in the next couple of years, before beginning to weaken again.
- Policy mistakes remain among the biggest threats to the current expansion.

World growth has peaked

Real GDP



Source: IHS Markit

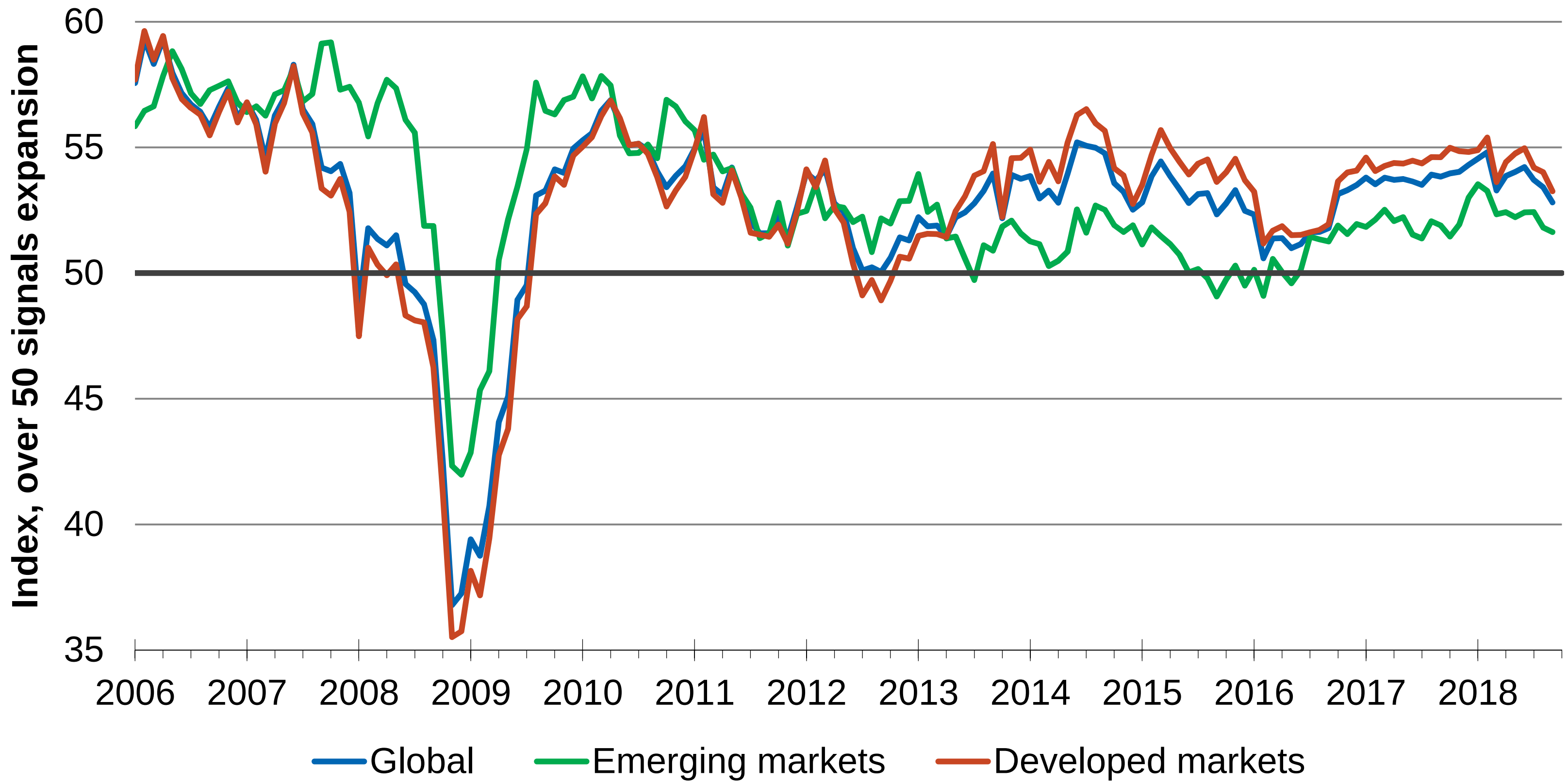
Real GDP growth in major economies

Real GDP					
Percent change	**2016**	**2017**	**2018**	**2019**	**2020**
World	2.6	3.3	3.2	3.0	2.9
United States	1.6	2.2	2.9	2.7	2.1
Canada	1.4	3.0	2.2	2.3	2.2
Eurozone	1.9	2.5	2.0	1.5	1.3
United Kingdom	1.8	1.7	1.2	1.1	1.3
China	6.7	6.9	6.6	6.1	6.0
Japan	1.0	1.7	1.0	0.9	0.5
India*	7.1	6.7	7.2	7.1	7.0
Brazil	-3.4	1.0	1.4	1.9	2.0
Russia	-0.2	1.5	1.6	1.7	1.7

* Fiscal years starting 1 April
Source: IHS Markit

The JPMorgan Global PMI™

Purchasing managers' indexes



Source: IHS Markit

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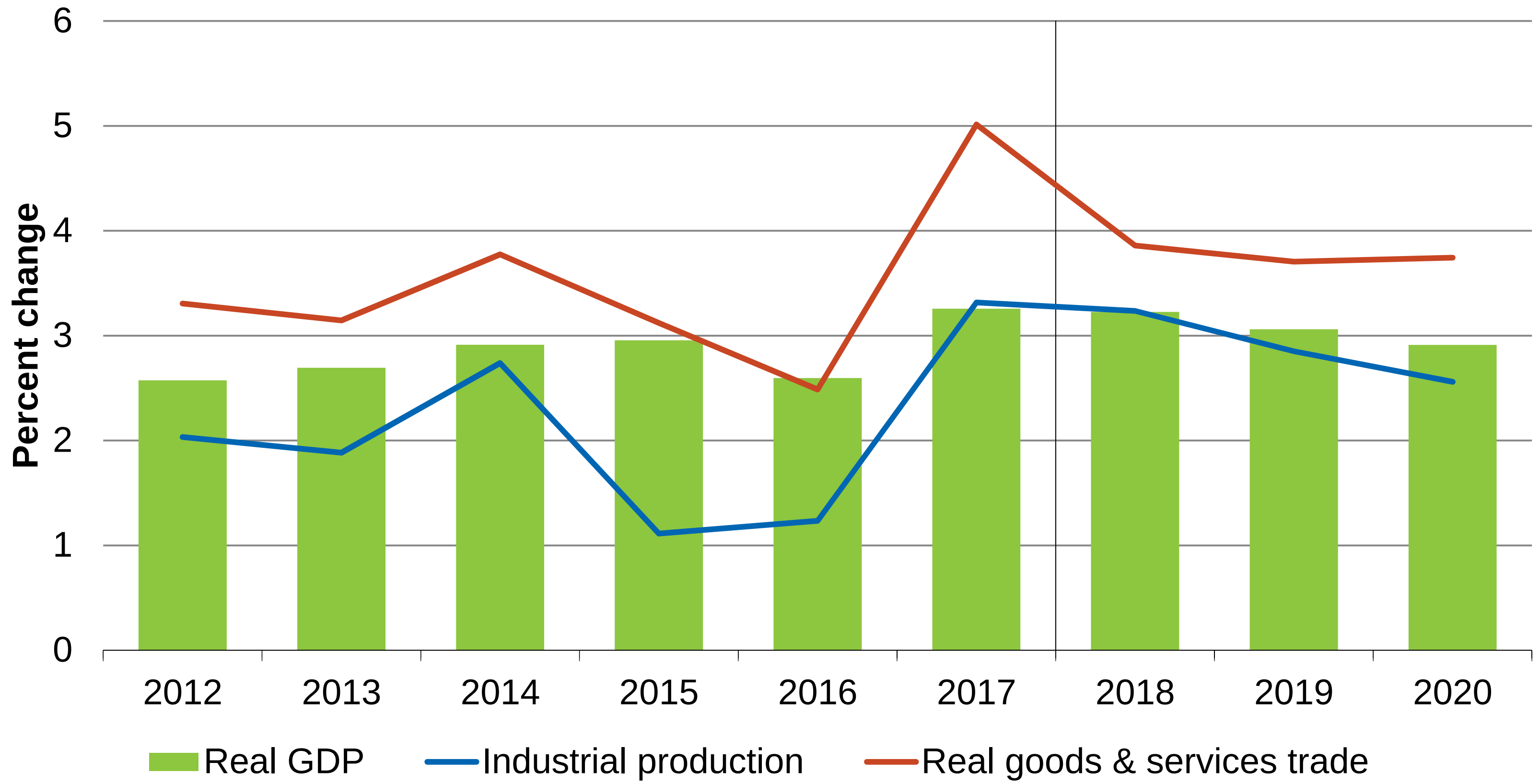
Global trade growth is slowing

Global real GDP, industrial production, and real exports



Source: IHS Markit

Emerging markets face new financial pressures

- High and rising debt levels.
- US monetary policy tightening.
- Capital flight, leading to currency depreciation:
  - Fueling inflation.
  - Forcing central banks to raise interest rates.
- US tariffs and trade protectionism.
- Higher oil prices.
- Political uncertainty around elections.

Which emerging markets are most vulnerable?

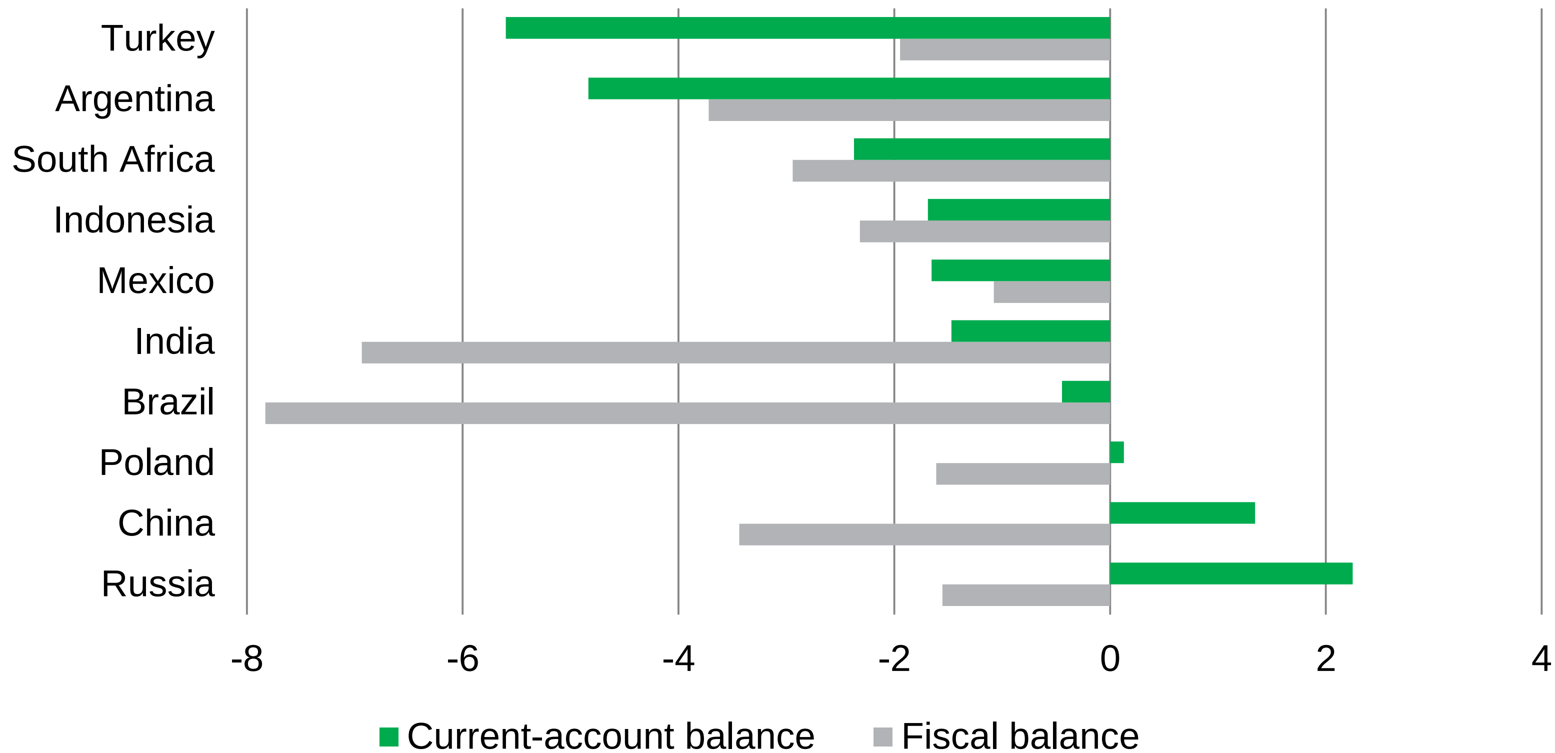
	Vulnerability rank	Current account incl. FDI (% of GDP, 2018)	External debt % of forex earnings (2018)	Import cover (months, 2018)	CPI (Average, 2018)	Political instability*
Ukraine	**8**	-0.5	189.3	3.0	11.4	6.5
Turkey	**10**	-6.4	276.7	2.8	15.9	4.3
Argentina	**25**	-0.7	287.1	6.7	27.7	5.0
South Africa	**30**	-2.9	134.0	4.9	4.7	5.7
Egypt	**39**	0.5	211.9	7.0	13.7	5.6
Romania	**51**	-1.2	102.9	3.4	5.0	4.5
Mexico	**56**	0.6	94.4	3.9	4.4	5.9
Colombia	**65**	-0.2	181.1	9.4	5.4	5.0
India	**80**	0.2	119.0	9.5	4.9	5.6
Indonesia	**91**	0.5	156.7	7.4	3.3	4.7
Brazil	**105**	1.6	113.6	19.0	3.8	6.0
Philippines	**106**	0.9	56.0	6.2	4.9	5.2
Russia	**138**	5.7	96.1	23.4	5.4	4.7
China	**168**	2.8	65.0	14.9	2.2	4.2

*Sum of CRAFT political + operational risk
Source: IHS Markit

Vulnerable countries depend on external financing: Current-account and fiscal balances

Current-account and fiscal balances

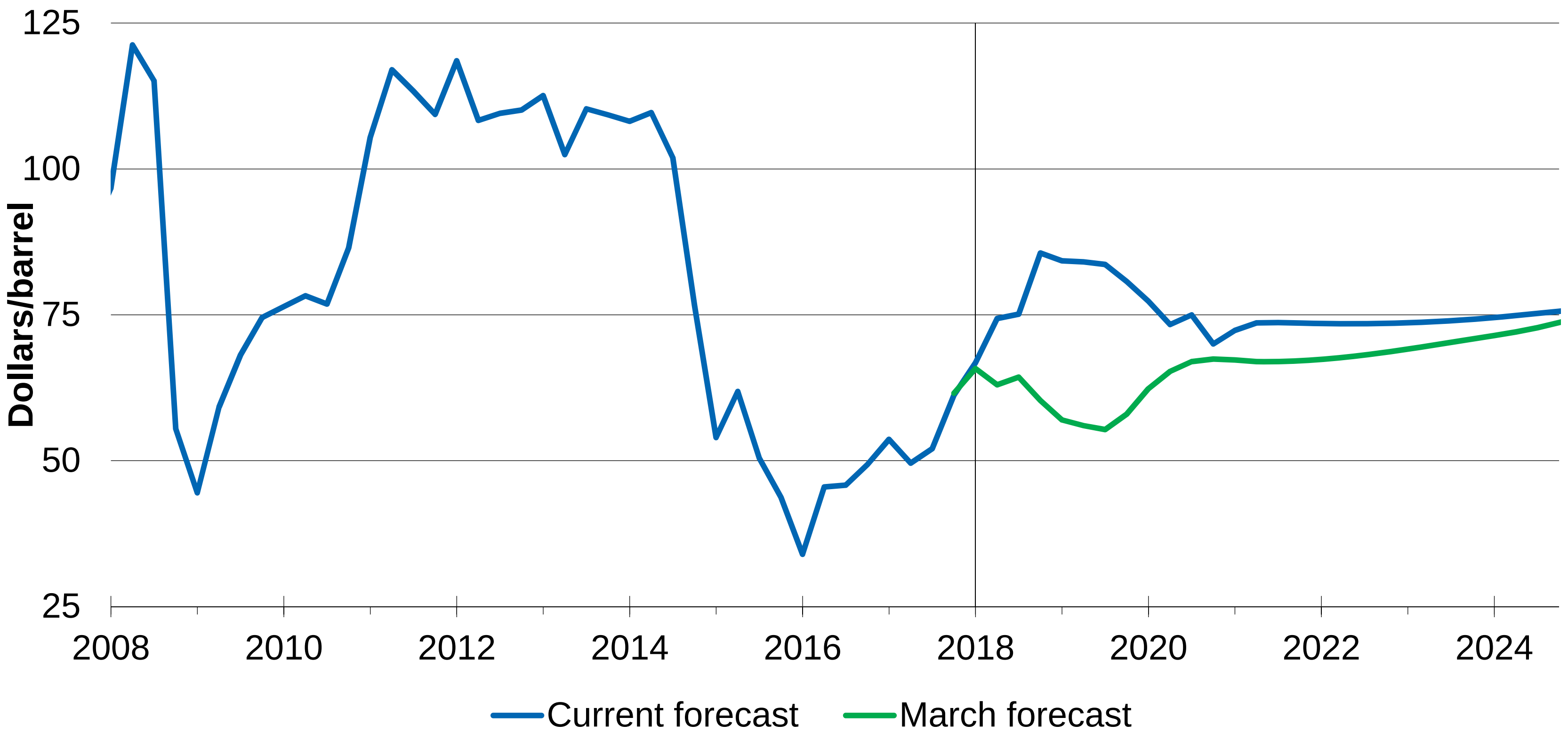
Percent of GDP, 2017



Source: IHS Markit

Crude oil price forecast comparison

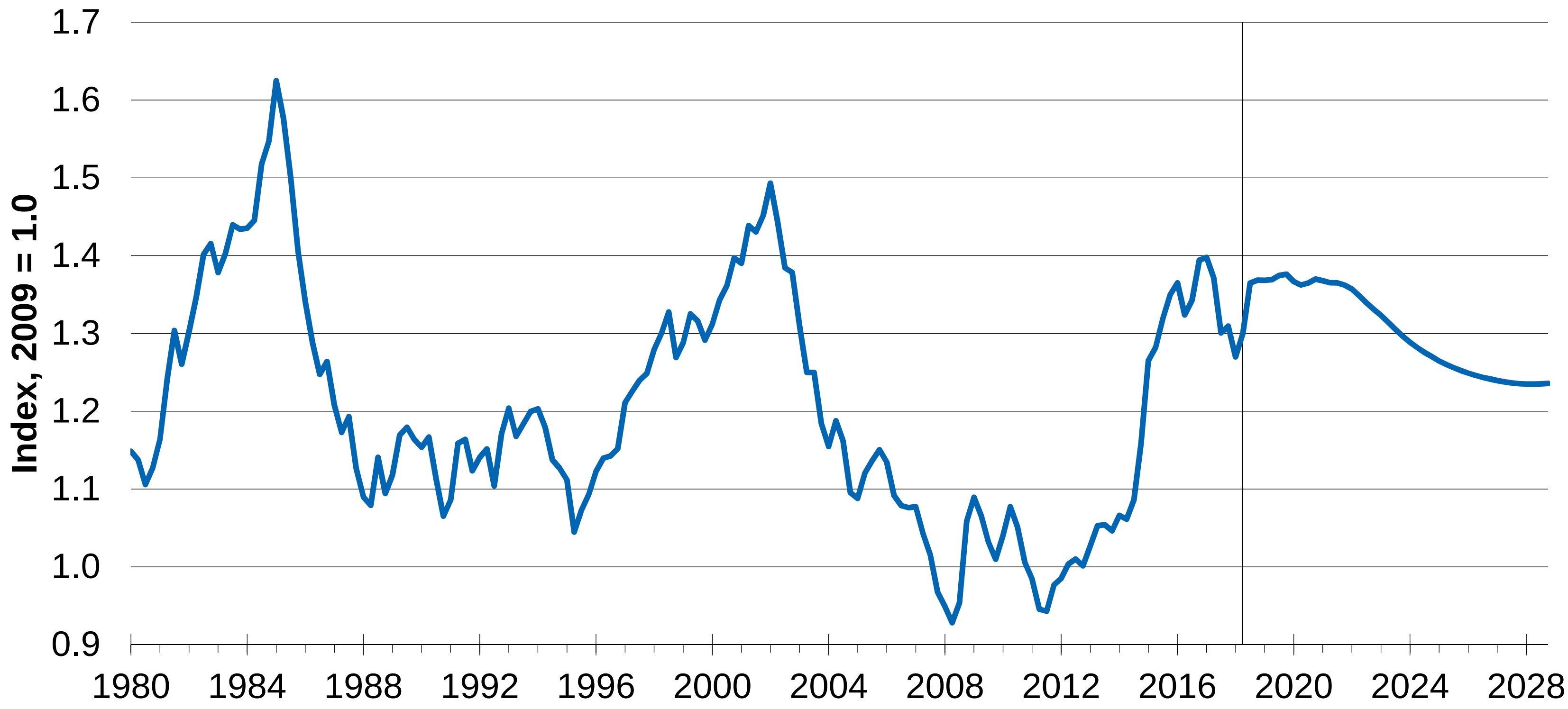
Price of Dated Brent crude oil



Source: IHS Markit

The US dollar’s real trade-weighted exchange value

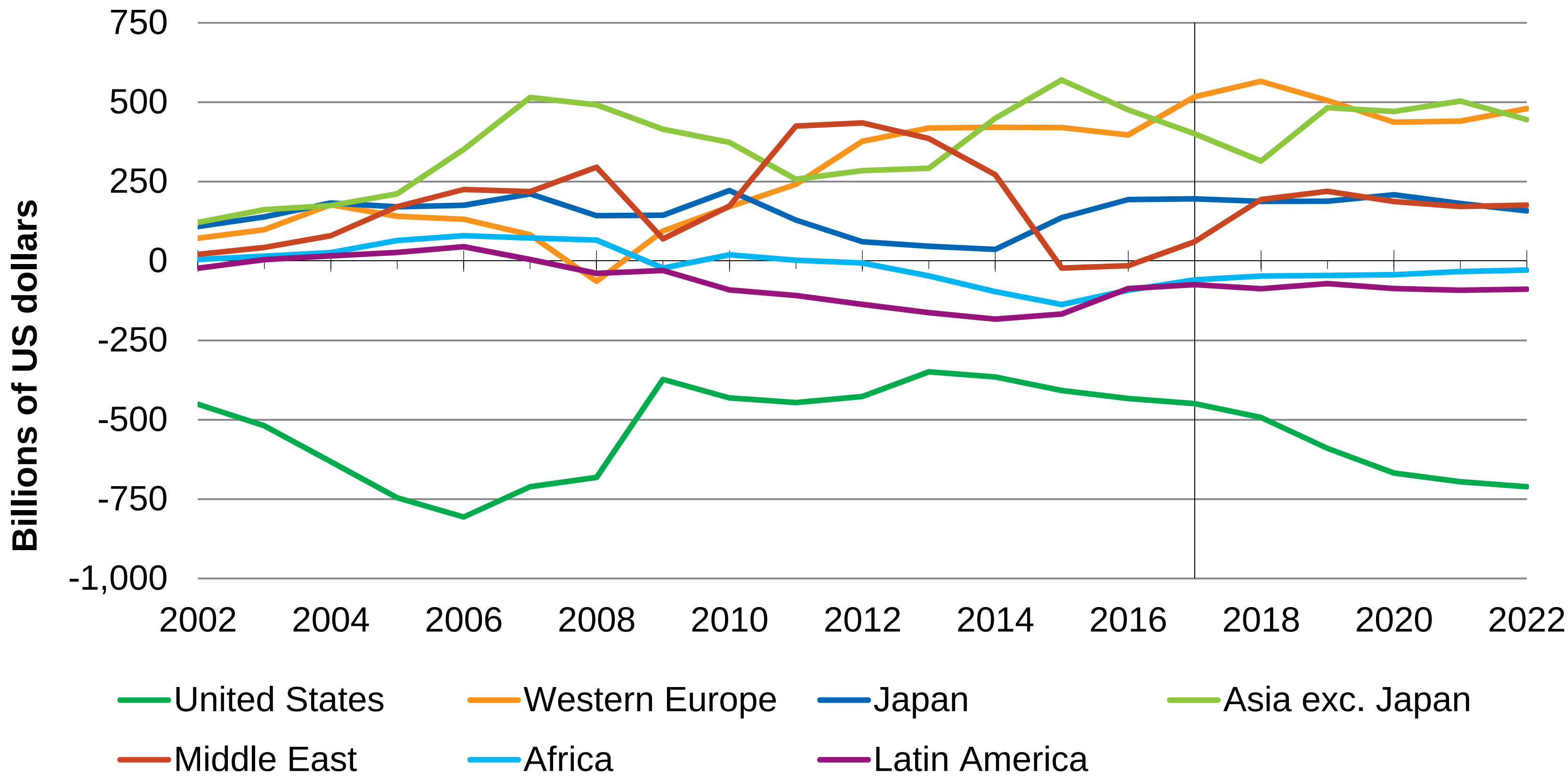
Real trade-weighted dollar index



Source: IHS Markit

Current-account surpluses in Asia and Europe are offset by deficits in the Americas and Africa

Current-account balances



Source: IHS Markit

A trade war could hurt growth

- The tariff increases between the United States and China run the risk of escalating into a broader trade war.
- The tariffs implemented or under review in 2018 will have limited macroeconomic impacts.
- Yet, the effects on specific industries and global supply chains could be significant.
- Trade protectionism has unsettled financial markets and could deter business investment plans.
- Asia and North America would be hit hardest in a trade war.
- If 25% tariffs are applied to USD467 billion worth of Chinese imports (virtually all), the negative effect on US growth, even before retaliation, could be significant—possibly 0.5 percentage point next year.

What could trigger the next crisis?

- A sharp rise in inflation and interest rates.
- Too much corporate debt, which goes bad.
- Increased Chinese financial stress.
- Full-blown emerging-markets crisis.
- Worsening politics in Europe and loss of confidence in the euro .
- Loss of policy flexibility.
- Rising risks associated with under-regulated nonbanks.
- A geopolitically driven oil shock.
- Escalating regional conflicts.

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