Status of World Economy

2017/12/19

The global cyclical upswing that began midway through 2016 continues to gather strength. Only a year and a half ago, the world economy faced stalling growth and financial market turbulence. The picture now is very different, with accelerating growth in Europe, Japan, China, and the United States. Global growth, which in 2016 was the weakest since the global financial crisis at 3.2 percent, is projected to rise to 3.6 percent in 2017 and to 3.7 percent in 2018.

But the recovery is not complete: while the baseline outlook is strengthening, growth remains weak in many countries, and inflation is below target in most advanced economies. Commodity exporters, especially of fuel, are particularly hard hit as their adjustment to a sharp step-down in foreign earnings continues. And while short term risks are broadly balanced, medium-term risks are still tilted to the downside. The welcome cyclical pickup in global activity thus provides an ideal window of opportunity to tackle the key policy challenges—namely to boost potential output while ensuring its benefits are broadly shared, and to build resilience against downside risks. A renewed multilateral effort is also needed to tackle the common challenges of an integrated global economy.

The global pickup in activity that started in the second half of 2016 gained further momentum in the first half of 2017. Growth is projected to rise over this year and next in emerging market and developing economies, supported by improved external factors—a benign global financial environment and a recovery in advanced economies. Growth in China and other parts of emerging Asia remains strong, and the still-difficult conditions faced by several commodity exporters in Latin America, the Commonwealth of Independent States, and sub-Saharan Africa show some signs of improvement.

In advanced economies, the notable 2017 growth pickup is broad based, with stronger activity in the United States and Canada, the euro area, and Japan. Prospects for medium-term growth are more subdued, however, as negative output gaps shrink (leaving less scope for cyclical improvement) and demographic factors and weak productivity weigh on potential growth.

Financial market sentiment has generally been strong, with continued gains in equity markets in both advanced and emerging market economies. Given current expectations of a more gradual pace of monetary policy normalization compared with March, US long-term interest rates have declined by some 25 basis points since then, and the dollar has depreciated by more than 5 percent in real effective terms, with a commensurate real appreciation of the euro. Despite expectations of more robust global demand going forward, commodity prices have remained low, with oil prices reflecting stronger-than-anticipated supply.

Headline consumer price inflation has softened since the spring, as the boost to prices from the oil price recovery of 2016 has faded and the decline in oil prices in recent months has started to exert downward pressure. Despite stronger growth in domestic demand, core inflation has generally remained muted across advanced economies, reflecting still-weak wage growth. Inflation is likely to rise only gradually toward central bank targets. Across emerging and developing economies, the waning of pass-through effects from earlier currency depreciations against the US dollar, and in some cases recent appreciations, have helped moderate core inflation rates.

Short-term risks are broadly balanced. On the positive side, the recovery could strengthen further, supported by strong consumer and business confidence and benign financial conditions. At the same time, in an environment of high policy uncertainty and geopolitical tensions, policy missteps—which the baseline assumes will be avoided—could take a toll on market confidence, resulting in tighter financial conditions and weaker asset prices.

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