1. Global economic outlook

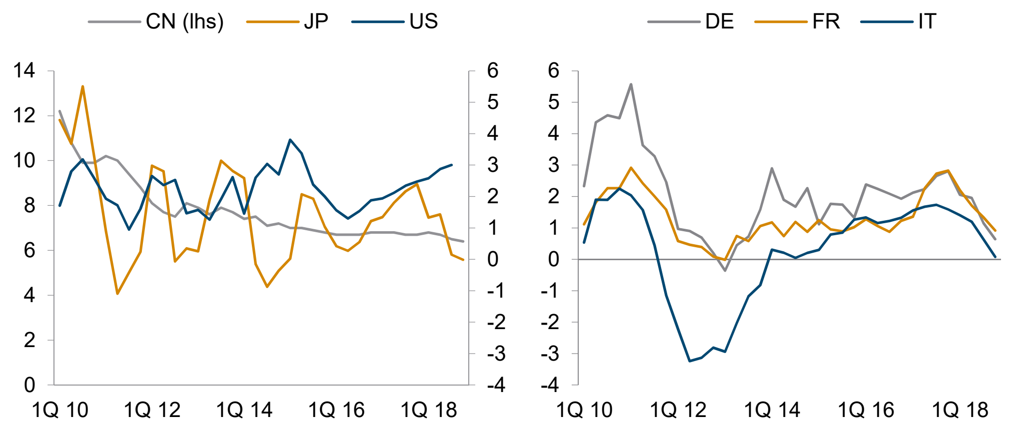
1.1. INTERNATIONAL ECONOMIC ENVIRONMENT

by Mario Holzner

Economic growth in the G20 and the eurozone peaked in the 3rd quarter of 2017 and has been decelerating ever since. In the last quarter of 2018, real GDP growth rates stood at around 3.5% in the G20 and slightly above 1% in the eurozone, up from 4% and 3% at the peak, respectively. The trends are quite similar in the largest economies that go to make up those two economic groups (Figure 1.1). Growth peaked toward the end of 2017 and has been decelerating since then. In the 4th quarter of 2018, real GDP growth rates in both France and Germany were below 1%. Italy's economy had started to stagnate. And Japan even went negative. The dynamics of the Chinese economy have been on a downward path for quite some time, albeit at a high level – the most recent growth figures are well above 6%. The major exception to all of this is the USA. There, growth accelerated from mid-2016 and likely peaked in the 3rd quarter of 2018, with a robust growth rate of 3%. But there, too, a deceleration of the economic dynamics is expected to set in. Clearly, the broad-ranged boom of the past couple of years has come to an end. The question is whether it will be followed by a bust, or whether a soft landing can be expected.

Figure 1.1 / Quarterly real GDP growth, 1Q 2010 – 4Q 2018

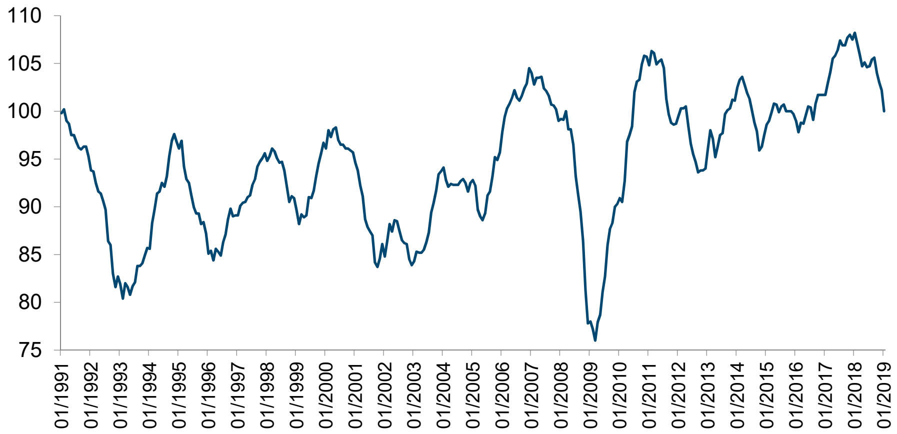
change in % against preceding year



Source: OECD.

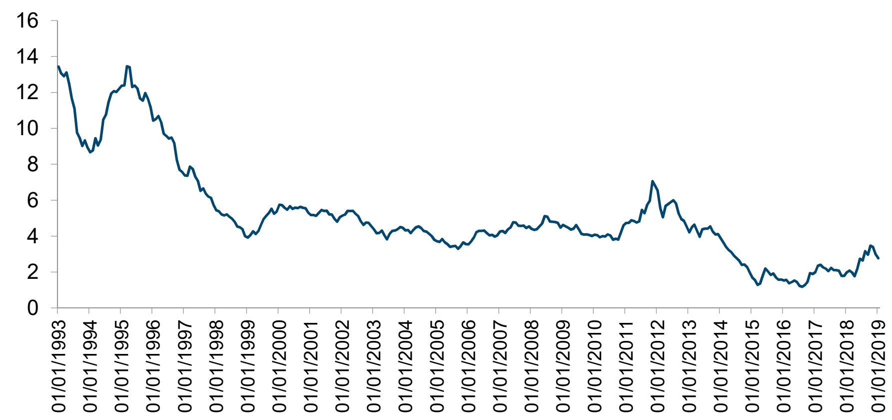
Despite a negative trend, the business climate in the eurozone's main economy – Germany – is still at a very high level. Since German reunification, there have been only very few times when economic agents in manufacturing, trade and construction had a better opinion of the business situation and business expectations than today (Figure 1.2). Particularly in the construction sector, the business climate is good; and it even improved in recent months, compared to the same months the year previously. That raises hopes of more public and private investment in Germany's ailing infrastructure, which would stimulate demand in the rest of Europe – including Central, Eastern and Southeast Europe (CESEE). In this respect, it is reassuring that in its Annual Growth Survey 2019[1] 'For a stronger Europe in the face of global uncertainty', the European Commission identified 'a frontloading of investment in the modernisation and decarbonisation of Europe's industry, transport and energy systems' as one of the key priority areas. Also, the latest Franco-German manifesto for a European industrial policy is reassuring.

Figure 1.2 / German manufacturing, trade and construction business climate index, 2015=100



Source: ifo.

Figure 1.3 / Italian long-term interest rate, in %, 10 years maturity, 28/02/1993 - 31/01/2019



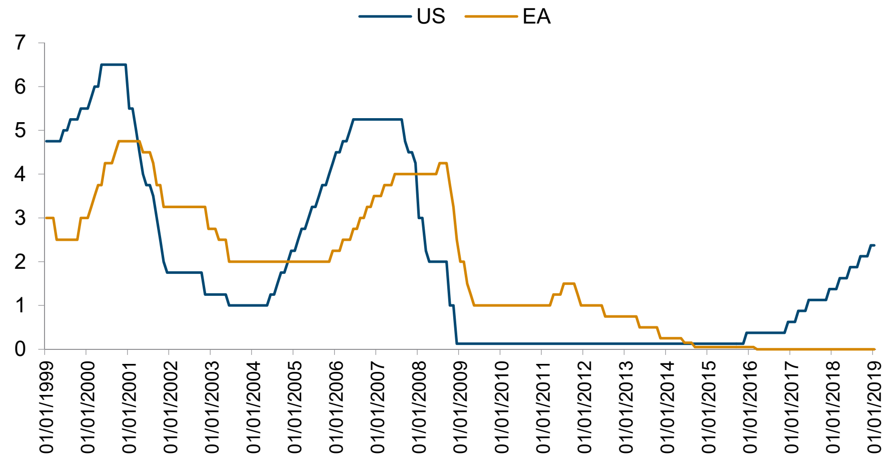
Source: ECB.

1 http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-770-F1-EN-MAIN-PART-1.PDF

Even the economic situation in Italy – the sick man of Europe[2] – although worrying, is not hopeless. Despite some recent increases in the Italian long-term interest rates (Figure 1.3) related to the new populist government's confrontational stance vis-à-vis the European Commission, 10-year interest rates in Italy are at a historically low level. At the end of January 2019, the nominal rate was 2.77%. According to the Italian National Institute of Statistics (ISTAT), inflation stood at 0.9% that month, which leaves the real interest rate at 1.87%. This certainly represents a fiscal burden for Italy at a time of economic stagnation, but it should be manageable in the medium run, and it should be possible to finance key public investment programmes[3] and to produce counter-cyclical effects on the economy.

While global monetary policy was tightening with the US Federal Reserve's policy rate hikes, this trend might have come to an end, with a marked increase in economic policy risks and the fading of the economic boom. By the end of November 2015, US and eurozone central bank policy rates were close to zero (Figure 1.4). Since then, the Fed has gradually hiked the rate up – to a level of 2.375% at the end of January 2019. By contrast, and following different paths of growth dynamics, the ECB reduced its policy rate to zero. However, more recently, the ECB has also phased out its quantitative easing programmes. Nevertheless, with the strong rise in economic policy uncertainty (Figure 1.5) – including US trade disputes and Brexit, as well as weakening Chinese growth prospects – policy rate rises do appear, for the time being, to be off the agenda.[4]

Figure 1.4 / Central bank policy rates, in % p.a., 31/01/1999 – 31/01/2019



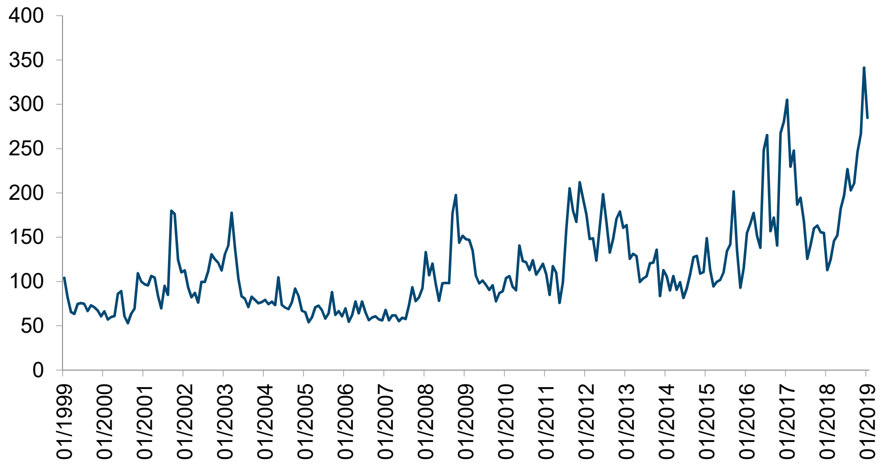
Source: BIS.

2 https://www.bloomberg.com/opinion/articles/2019-01-23/the-case-for-a-european-bounce-depends-on-the-ecb

3 https://www.ft.com/content/6bd24218-248f-11e9-8ce6-5db4543da632

4 https://www.ft.com/content/24508f0e-2b91-11e9-88a4-c32129756dd8

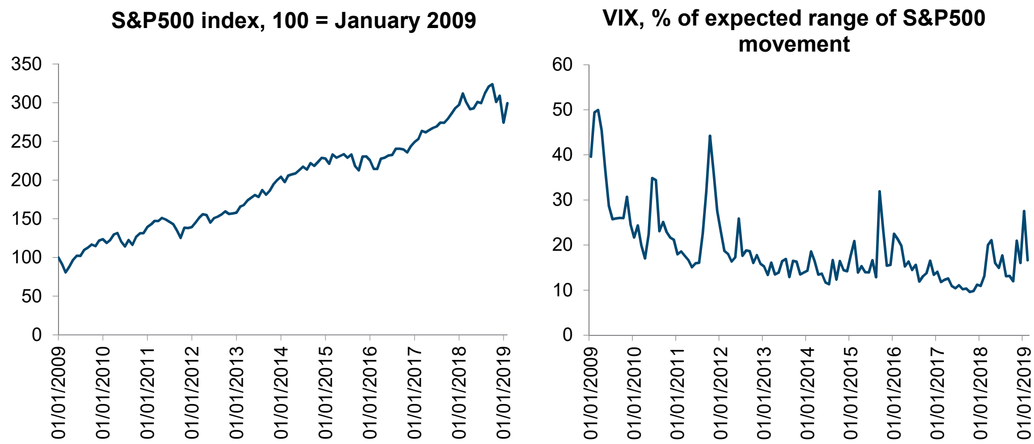
Figure 1.5 / Global Economic Policy Uncertainty, 100 = mean value 1997-2016, 01/1999-01/2019



Source: Economic Policy Uncertainty.

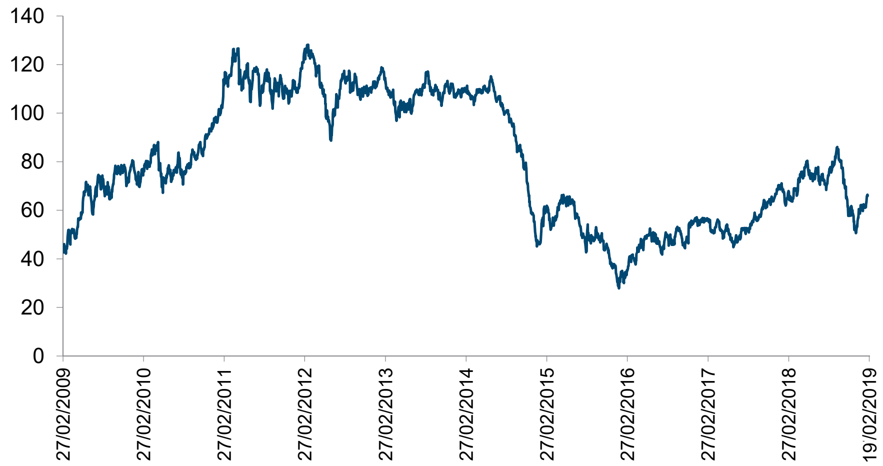
Increased uncertainty about global economic prospects and monetary policy responses are also driving asset markets, causing a downward correction in the oil price and many stock markets at the end of 2018, as well as raising volatility in the markets. This is reflected in the recent ups and downs in, for example, the S&P500 index and the related CBOE VIX volatility index (Figure 1.6). Oil prices, too, have slid to historically low levels (Figure 1.7). However, most recently the asset markets have started to stabilise again, which is related to the expected end of global monetary tightening.

Figure 1.6 / S&P500 and CBOE VIX index, 01/2009 – 02/2019



Source: yahoo finance.

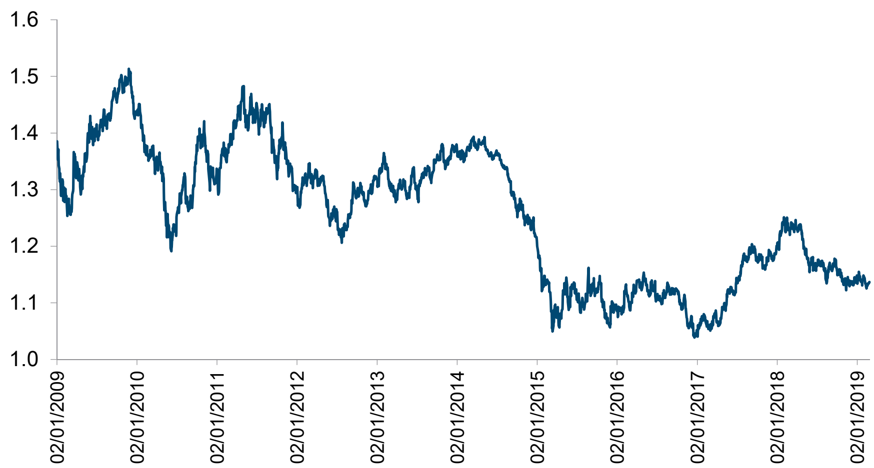
Figure 1.7 / Daily Brent Crude oil price, in USD, 27/02/2009 – 19/02/2019



Source: macrotrends.net.

A potential end of monetary tightening might also put an end to the strengthening of the US dollar against the euro that has been observed over the past year. The USD/EUR exchange rate dropped from levels of 1.25 USD per 1 euro in February 2018 to 1.14 in February 2019 (Figure 1.8). This reflects a nominal euro depreciation against the dollar of almost 9% within a year. Most recently, signs of the Fed becoming dovish have led to a stagnation of the USD/EUR exchange rate over the past few months (which has to be seen in combination with the ECB being dovish too). Thus, our expectation is that over our forecast period (2019-2021), both the oil price and the USD/EUR exchange rate will remain relatively stable, at close to current levels of above 60 USD/barrel and at 1.14 USD/EUR, respectively (Table 1.1).

Figure 1.8 / US dollar euro exchange rate, in USD per 1 EUR, 02/01/2009 – 26/02/2019



Source: macrotrends.net.

Table 1.1 / Technical assumptions for 2018 and the wiiw forecast period 2019-2021

	2018	2019	2020	2021
Eurozone real GDP growth	1.9	1.6	1.5	1.4
USD/EUR exchange rate	1.18	1.14	1.14	1.16
USD per barrel Brent oil	71.5	62	61	60

Source: Own assumptions.

Despite increased global uncertainties – including Brexit, reduced global trade volumes and fears of a renewed euro crisis, this time around Italy – our expectation is that eurozone growth will only decelerate slowly over the forecast period. While the European Commission in its latest Winter Forecast predicts a fairly strong growth correction in 2019 – 1.3%, down from 1.9% in 2018 – our own forecast of 1.6% provides a somewhat smoother picture (Table 1.1). This is based on our stronger valuation of the potential positive risks to the forecast, including a more extensive use of EU funds for investment at the end of the current EU Multiannual Financial Framework and the still favourable labour market conditions that should result in stronger domestic demand. Particularly the latter factor has so far been underestimated in the Commission's GDP growth forecasts. Moreover, recent high frequency indicators related to domestic demand in Germany are pretty strong and might even be a bit stronger at the beginning of this year. Also, a weaker euro exchange rate and lower oil prices should additionally soften the eurozone's business cycle downswing. On the other hand (and unlike the Commission), we do not expect a rebound in 2020, but rather a further gradual deceleration of economic dynamics in the eurozone, which will have associated smoothing effects for the CESEE economies as well.