THE WORLD ECONOMY
Forecast summary

Global economic growth is forecast to pick up from 3.0 per cent in 2016 to 3.1 per cent in 2017 and 3.5 per cent in 2018 – a slightly weaker acceleration than projected last November.

The unexpected result of the US presidential election has dominated recent financial market developments, with hikes in bond yields, a further appreciation of the US dollar, and rises in stock market prices reflecting expectations of US tax cuts, infrastructure spending, deregulation and trade measures.

Our forecast assumes established policies. Potential policy changes in the US and any response in the rest of the world therefore pose significant risks to our projections.

In line with last November's forecast, world GDP grew by 3.0 per cent in 2016, the slowest annual growth since the 2009 recession. Our projections for 2017 and 2018 have been revised down slightly, to 3.1 and 3.5 per cent, respectively, owing to downgrades for some emerging market economies, including Brazil, India (in 2017) and Russia. Among the advanced economies, upward revisions for the UK (in 2017) and Japan (in 2017–18) are offset by small downward revisions for Canada (in 2017), and the Euro Area and the UK (in 2018).

Inflation has picked up in the advanced economies, mainly reflecting the upturn in global energy prices. The threat of deflation has receded, but inflation remains below targets, markedly so in Japan and the Euro Area, requiring continuing accommodative monetary policies. The recent rise in wage growth in the US adds to evidence that the economy's employment and output gaps have shrunk.

Economic and financial imbalances in the Euro Area continue to pose risks. Recent inflation in Germany above Euro Area averages should promote the correction of external imbalances. If German inflation, recently 1.7 per cent annually, rises above 2 per cent, this alone will not provide cause for the ECB to begin tightening. The Area's continuing institutional shortcomings, including the incomplete banking union, seem unlikely to be addressed in the current political environment. Stage 1 of the Five Presidents' Report seems unlikely to be completed on schedule, by June 2017.

President Trump has set out broad fiscal policy plans for cuts in corporate and personal income taxes, the elimination of estate tax, and increased infrastructure spending, along with plans for an "America–First Trade Policy". The effects will depend on the specifics. The fiscal plans could boost growth in the short term, advance the normalisation of monetary policy, and also bring supply–side benefits. But they could increase the fiscal deficit with little benefit, particularly if the tax and spending measures are regressive. The risks with the trade policies are on the downside. Protectionist trade policies damage economic efficiency and potential growth by weakening competitive forces, raise domestic costs and prices, and thus reduce real incomes. They also risk a downward spiral of economic activity internationally through retaliatory measures. The plans for both fiscal and trade policy point towards further real appreciation of the US dollar, which would conflict with the President's aims of improving the US trade position and boosting US manufacturing output and employment.

Summary of the forecast — Percentage change, year–on–year

	World economy			Real GDP growth in major economies				
	Real GDP(a)	Consumer prices(b)	World trade(c)	US	China	Japan	Euro Area	India
2016	3.0	1.1	2.8	1.7	6.7	1.0	1.7	7.2
2017	3.1	2.0	2.4	2.1	6.4	0.7	1.5	6.0
2018	3.5	2.0	4.3	2.2	5.9	0.8	1.5	7.9

(a) Based on global PPP shares. (b) OECD countries, private consumption deflator. (c) Volume of total world trade.

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