Global economic slowdown may run its course while political and policy risks linger

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With 2019 drawing to close, the global economic growth remains subdued as the manufacturing sector continues to languish. Great uncertainties still linger over political and policy issues including the US-China trade war and UK's planned exit from the European Union.

In 2019, real gross domestic product (GDP) growth is projected to decelerate significantly in certain advanced economies compared with 2018. In the US, the growth rate for this year is forecast at 2.3% year-over-year (YoY) compared with 2.9% YoY in 2018. In Eurozone, the growth rate is forecast to slow to 1.2% YoY from 1.9% YoY in 2018. As for China, the world's biggest emerging economy, growth is expected to slow to 6.1% YoY compared with 6.6% YoY last year. Many other emerging economies, in Asia and Latin America, are also on track to decelerated expansion. Japan's growth rate is projected to remain flat from 2018 at 0.7% YoY (fiscal year based). Yet, specific economic gauges such as exports, orders and production activity point to a clear slowdown this year. Country-specific outlook sections will delve into more details about each of these economies.

The current slowdown in the global economy is chiefly understood to be a result of multiple factors affecting mainly the manufacturing sector. These factors include: 1) cyclical downtrend of the global manufacturing sector in a drop-off from uptrends in late 2016 and 2017; 2) political and policy uncertainties related to issues such as the US-China conflict, Brexit, Middle East conditions, as well as their potential impact to supply chains; 3) deceleration of investment-driven economic growth in China due in part to the government-led deleveraging campaign, as well as its ripple effect to the rest of the world through trade activity; 4) global decline in automobile sales due to stricter emission regulations – an example of a macroeconomic impact resulting from environmental regulations targeting a specific industry sector. Meanwhile, other aspects of the current global economic slowdown include: 5) the sluggishness in the manufacturing sector has not spread to the non-manufacturing sector or threatened a recession of the overall economy; 6) slowdowns in manufacturing employment in various economies have had limited effect on non-manufacturing employment, and household income growth has been resilient as a result; 7) domestic demand (especially consumer spending) has been resilient in many economies despite a continued economic slowdown, thereby preventing a serious economic downturn. These supporting factors help explain why

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real GDP growth for 2019 is forecast to be positive in virtually all economies around the world, except in certain locations facing special circumstances such as Hong Kong and Argentina.

As for the outlook for 2020, factors 1) through 4) above will likely continue to play key roles in determining the global economic performance next year. Thus, the following paragraphs will examine related issues such as the US-China relation, US trade policy, Chinese investments and automobile emission regulations, as well as their implications for the global manufacturing industry.

First, on the US-China relation, a partial trade agreement appears highly possible as both countries work to address domestic concerns stemming from the trade friction. Yet, such an agreement could end up lacking in in substance. The prospects of the agreement providing substantial, fundamental solutions to the conflict are increasingly dim, especially with unrest in Hong Kong surfacing as a fresh point of contention (in addition to such longstanding issues as the trade imbalances, rivalry for technological dominance, and national security). In response to Hong Kong authorities' treatment of protesters, the US Congress has passed the Hong Kong Human Rights and Democracy Act of 2019. As is typically the case, Congress is increasingly taking a bipartisan, hard-line approach to China. Meanwhile, China's Communist Party leadership is asserting greater control and cannot afford to show a soft spot to the US. Therefore, the conflict is expected to continue and become the norm next year, with underlying issues like the rivalry for technological dominance and national security still unresolved. This does not mean, however, that the conflict will escalate and lead to greater consequences, either quantitatively or qualitatively. One reason is that the impact of additional tariffs imposed from July 2018 onward may run its course next year. The other reason is that both businesses and consumers will likely adjust their behavior on assumption that the US-China conflict continues.

Second, on the general trade policy of the US, the Donald Trump administration's actions remain difficult to predict, and it is still uncertain whether the US will ratify the United States-Mexico-Canada Agreement (USMCA), a replacement of the NAFTA. One assuring development, however, is that large-scale sanctions like higher automobile tariffs against major trading partners are said to be increasingly unlikely.

Third, on China's investment, excessive investments and over-borrowing by the corporate and real estate sectors of China suggest that China's investment is unlikely to drive the global economic growth as it once did. Due to the US-China trade friction that arose last year, foreign-demand related production activity in coastal areas and by foreign companies slowed drastically. It would not be necessarily appropriate, however, to assume that this trend applies to the broader Chinese economy. As the YoY negative impact of the trade war fades, Chinese authorities will likely take measures to mitigate the slowdown in economic growth. Therefore, the impact of China's economic slowdown on the global economy will likely diminish.

And fourth, on auto emission regulations, it is possible that the regulations become even stricter in places like Europe, depending on public opinions about global warming and specific interests of local authorities. Yet, the YoY impact of tighter environmental regulations for 2019

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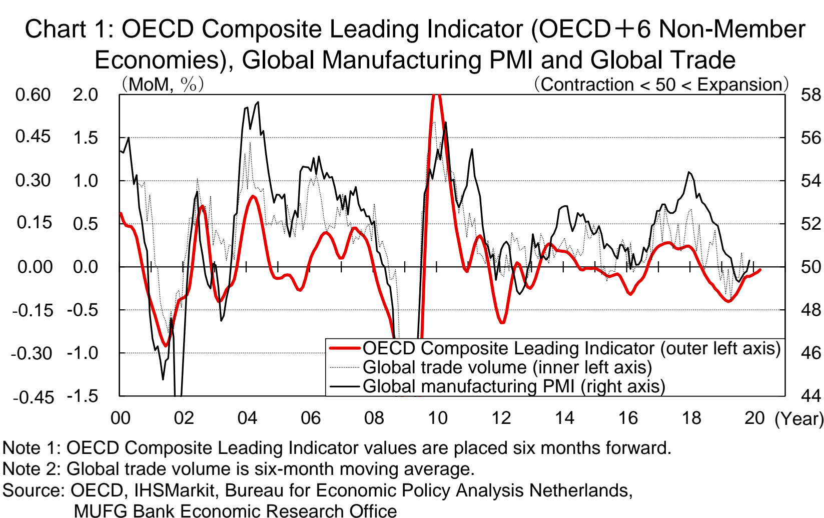
appears to have been historically substantial, and the impact for 2020 is projected to be milder in comparison.

Based on these considerations, the downside pressure that has weighed down the manufacturing sector over the past two to three years could ease as the basis for YoY comparison falls and demand hits rock bottom, leaving no room for further decline. Examples of manufacturing activities severely affected by the downtrend include semiconductors shipments, which decreased sharply after an uptrend in 2016 and 2017. Another is machine tool orders in Japan, which took a hit from sluggish investment demand in China. Still another example is Germany's automobile production, which has been hampered by environmental regulations. All of these gauges, in fact, appear to have fallen to historic lows already, and signs of recovery are beginning to emerge. Separately, global macroeconomic indicators like the OECD Composite Leading Indicators (CLI) suggest that the manufacturing cycle may soon turn upward after a contraction of roughly two years. If this becomes a reality, then global trade (a measure of goods movements in manufacturing) is expected to pick up mildly as well (Chart 1).

Chart 1: OECD Composite Leading Indicator (OECD＋6 Non-Member Economies), Global Manufacturing PMI and Global Trade



Note 1: OECD Composite Leading Indicator values are placed six months forward.
Note 2: Global trade volume is six-month moving average.
Source: OECD, IHSMarkit, Bureau for Economic Policy Analysis Netherlands, MUFG Bank Economic Research Office

Thus, global manufacturing activity may bottom out, and clouds hanging over the economy may gradually clear even as political, policy and geopolitical uncertainties linger in the absence of notable positive factors. The overall economic trend around the world may begin to show signs of resilience by mid-2020, also supported by solid activity in the non-manufacturing sector. Economic performance in 2020 would vary from country to country, partly due to the base-line effect from the growth rate in the October-December 2019 quarter. Major advanced economies US (1.9% YoY), Eurozone (1.2% YoY) and Japan (0.7% YoY) are expected to maintain growth rates comparable to 2019 levels. As for Japan's October 2019 consumption tax hike, the negative impact will likely be limited thanks to various mitigating measures such as free early-childhood education and lower tax rates for select goods. In emerging economies, growth rate in 2020 is expected to accelerate in newly industrialized economies (NIEs) to 1.9% YoY, in ASEAN to 4.8% YoY, and in India to 7.0% YoY (fiscal year based). China's growth rate is projected to decline to 5.8% YoY (below the 6.0% mark) amid a slowdown in investment demand. As for major Latin American economies, growth rate is projected at 1.5% YoY for Brazil and Mexico, and -2.0% YoY for Argentina as they continue facing country-specific risks.

Translated by Chie Okada-Wighe

Table of Global Economic Forecasts

			Nominal GDP (2018)		Real GDP (YoY, %)			CPI (YoY, %)		
			Trillion USD	Japan=100	2018	2019	2020	2018	2019	2020
World (41 economies) (GDP weighted average)			71.14	1,434	3.3	2.7	2.6	2.5	2.4	2.4
	Advanced economies		46.48	937	2.3	1.7	1.5	2.0	1.4	1.6
	Emerging economies		24.67	497	5.2	4.6	4.8	3.5	4.1	4.0
Asia & Oceania	Japan (FY)		4.96	100	0.7	0.7	0.7	0.8	0.7	0.6
	Asian 11 economies		21.58	435	6.0	5.3	5.3	2.3	2.6	2.7
		China	13.37	269	6.6	6.1	5.8	2.1	2.8	2.7
		India (FY)	2.72	55	6.8	6.1	7.0	3.4	3.6	4.1
		NIEs 4 economies	3.04	61	2.8	1.4	1.9	1.4	0.8	1.3
		Korea	1.72	35	2.7	1.9	2.2	1.5	0.5	1.2
		Taiwan	0.59	12	2.7	2.2	2.0	1.4	0.7	1.0
		Hong Kong	0.36	7	3.0	- 1.3	0.5	2.4	2.3	2.4
		Singapore	0.36	7	3.1	0.8	1.9	0.4	0.6	1.0
		ASEAN5	2.46	50	5.2	4.7	4.8	2.8	2.3	2.8
		Indonesia	1.02	21	5.2	5.0	5.1	3.2	3.1	3.6
		Thailand	0.50	10	4.1	2.7	3.0	1.1	0.7	1.1
		Malaysia	0.36	7	4.7	4.4	4.5	1.0	0.7	1.9
		Philippines	0.33	7	6.2	5.8	5.9	5.2	3.3	3.1
		Vietnam	0.24	5	7.1	6.8	6.6	3.5	2.6	3.2
	Australia		1.42	29	2.7	1.8	2.4	1.9	1.5	1.8
America	U.S.A		20.58	415	2.9	2.3	1.9	2.4	1.8	2.0
	Latin America (6)		4.46	90	1.4	0.7	1.4	7.5	9.5	8.8
		Brazil	1.87	38	1.1	0.9	1.5	3.7	3.8	3.6
		Mexico	1.22	25	2.0	0.1	1.5	4.9	3.7	3.5
		Argentina	0.52	10	- 2.5	- 3.0	- 2.0	34.3	55.0	50.0
Europe	Eurozone (19)		13.64	275	1.9	1.2	1.2	1.8	1.2	1.4
		Germany	3.95	80	1.5	0.5	1.0	1.9	1.4	1.4
		France	2.78	56	1.7	1.3	1.3	2.1	1.2	1.4
		Italy	2.08	42	0.9	0.2	0.6	1.2	0.7	1.0
	U.K.		2.83	57	1.4	1.3	1.4	2.5	1.8	1.8
	Russia		1.66	33	2.3	1.1	1.6	2.9	4.5	3.5

Reference

			2018	2019	2020	2018	2019	2020
Weighted mean of 41 economies' GDP based on purchasing power parity			4.0	3.3	3.4	2.6	2.6	2.7

Note 1: CPI for Japan is on a general basis excluding perishable items, in the Eurozone and UK are based on the EU Harmonised Indices of Consumer Prices (HICP).

Note 2: Published figures for Japan, India are on a fiscal-year basis (April-March the following year); "41 economies", "advanced economies" and "emerging economies" are based on the calendar year.

Note 3: According to IMF classification, "Advanced Economies" are Japan, NIEs economies, United States, the 19 Eurozone countries, UK. "Emerging Economies" are China, India, ASEAN5, Latin America and Russia.

Note 4: "Latin America (6) " includes Brazil, Mexixo, Argentina, Colombia, Chile and Peru.

Source: Statistics from each country, MUFG Bank Economic Research Office

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