

## EXECUTIVE SUMMARY

*The upswing in global investment and trade continued in the second half of 2017. At 3.8 percent, global growth in 2017 was the fastest since 2011. With financial conditions still supportive, global growth is expected to tick up to a 3.9 percent rate in both 2018 and 2019. Advanced economies will grow faster than potential this year and next; euro area economies are set to narrow excess capacity with support from accommodative monetary policy, and expansionary fiscal policy will drive the US economy above full employment. Aggregate growth in emerging market and developing economies is projected to firm further, with continued strong growth in emerging Asia and Europe and a modest upswing in commodity exporters after three years of weak performance.*

*Global growth is projected to soften beyond the next couple of years. Once their output gaps close, most advanced economies are poised to return to potential growth rates well below precrisis averages, held back by aging populations and lackluster productivity. US growth will slow below potential as the expansionary impact of recent fiscal policy changes goes into reverse. Growth is projected to remain subpar in several emerging market and developing economies, including in some commodity exporters that continue to face substantial fiscal consolidation needs.*

*While upside and downside risks to the short-term outlook are broadly balanced, risks beyond the next several quarters clearly lean to the downside. Downside concerns include a possibly sharp tightening of financial conditions, waning popular support for global economic integration, growing trade tensions and risks of a shift toward protectionist policies, and geopolitical strains.*

*The current recovery offers a window of opportunity to advance policies and reforms that secure the current upswing and raise medium-term growth to the benefit of all. Such policies should focus on strengthening the potential for higher and more inclusive growth, building buffers to deal more effectively with the next downturn, improving financial resilience to contain market risks and stability concerns, and fostering international cooperation.*

Economic activity in 2017 ended on a high note—growth in the second half of the year was

above 4 percent, the strongest since the second half of 2010, supported by a recovery in investment. Outcomes exceeded the October 2017 *World Economic Outlook* forecasts in the euro area, Japan, the United States, and China, and continued to improve gradually in commodity exporters. Financial conditions remain supportive, despite the recent volatility in equity markets and increases in bond yields following signs of firming inflation in advanced economies. With broad-based momentum and expectations of a sizable fiscal expansion in the United States over this year and the next, global growth is now projected at 3.9 percent for 2018–19, a 0.2 percentage point upgrade for both years relative to the October 2017 forecast.

This positive momentum will eventually slow, however, leaving many countries with a challenging medium-term outlook. Some cyclical forces will wane: financial conditions are expected to tighten naturally with the closing of output gaps and monetary policy normalization; US tax reform will subtract momentum starting in 2020, and then more strongly as full investment expensing is phased out starting in 2023; and China's transition to lower growth is expected to resume as credit growth and fiscal stimulus diminish. At the same time, while the expected recovery in investment will help raise potential output, weak productivity trends and reduced labor force growth due to population aging constrain medium-term prospects in advanced economies. (Chapter 2 examines the drivers of labor force participation in advanced economies.) The outlook is mixed across emerging market and developing economies. Prospects remain favorable in emerging Asia and Europe, but are challenging in Latin America, the Middle East and sub-Saharan Africa, where—despite some recovery—the medium-term outlook for commodity exporters remains generally subdued, with a need for further economic diversification and adjustment to lower commodity prices. More than one-quarter of emerging market and developing economies are projected to grow by less than advanced economies in per capita terms over

the next five years, and hence fall further behind in terms of living standards.

Risks around the short-term outlook are broadly balanced, but risks beyond the next several quarters are clearly to the downside. On the upside, the growth spurt in advanced economies may turn out to be stronger and more durable than in the baseline, as slack in labor markets can be larger than currently assessed (Chapter 2 of the October 2017 WEO). Furthermore, the ongoing recovery in investment could foster a rebound in productivity, implying higher potential growth going forward. On the downside, financial conditions—which remain easy despite the onset of monetary policy normalization—could tighten sharply and expose vulnerabilities that have accumulated over the years, with adverse repercussions for growth. Indeed, as discussed in the April 2018 *Global Financial Stability Report*, Growth-at-Risk analysis suggests that risks to medium-term growth, stemming from easy financial conditions, remain well above historical norms. In the United States, financial conditions could tighten faster than expected, triggered, for example, by an adjustment in market pricing of the future path of monetary policy, higher realized or expected wage and price inflation, and/or a sudden decompression of term premiums. Tighter financial conditions in the United States would have spillovers to other economies, including through a reduction in capital flows to emerging markets. Very expansionary fiscal policy in the United States, at a time when the current account deficit is already larger than justified by fundamentals, combined with persistent excess current account surpluses in other countries, is projected to widen global imbalances. Anxiety about technological change and globalization is on the rise and, when combined with wider trade imbalances, could foster a shift toward inward-looking policies, disrupting trade and investment. Recent import restrictions announced by the United States, announced retaliatory actions by China, and potential retaliation by other countries raise concerns in this regard and threaten to damage global and domestic activity and sentiment. Similarly, changes in US tax policies are expected to exacerbate income polarization, which could affect the political climate for policy choices in the future. Climate change, geopolitical tensions, and cybersecurity breaches pose additional threats to the subdued medium-term global outlook.

The current juncture offers a window of opportunity to advance policies and reforms that safeguard the upswing and raise medium-term growth to the benefit of all.

- *Strengthen the potential for higher and more inclusive growth.* All countries have room for structural reforms and fiscal policies that raise productivity and enhance inclusiveness—for instance, by encouraging experimentation and diffusion of new technologies, increasing labor force participation, supporting those displaced by structural change, and investing in the young to enhance their job opportunities. The analysis, in Chapter 3, of one aspect of structural change—the decline in the share of manufacturing jobs in overall employment and its implications for productivity growth and inequality—highlights the importance of facilitating the reallocation of labor to the most dynamic sectors through workforce skills development, lowering job search costs, and reducing barriers to entry and trade in services.
- *Complete the recovery and build buffers.* Monetary accommodation needs to continue where inflation is weak, but a well-communicated, data-dependent normalization should follow in countries where inflation looks set to return to the central bank's target. Fiscal policies should start rebuilding buffers where needed, incorporate supply-side measures to bolster potential output, and promote inclusiveness. In countries at or close to full employment, with an excess current account deficit and an unsustainable fiscal position (notably the United States), there is a need to stabilize and eventually reduce the debt and reverse the procyclical stimulus that is already in place. This will require ensuring higher future revenues and gradually containing the growth of public spending, while changing its composition toward improving infrastructure, boosting labor force participation, and reducing poverty. Countries with both excess current account surpluses and fiscal space (for example, Germany) should increase public investment that boosts potential growth and demand.
- *Improve financial resilience.* Macro- and microprudential policies can curb rising leverage and contain financial market risks. In some advanced economies, balance sheet repair needs to continue. Emerging market economies should keep monitoring exposures

to foreign currency debt. Building on recent efforts, China should continue to rein in credit growth and address financial risks.

- *Improve convergence prospects for low-income developing countries.* Continued progress toward the 2030 United Nations Sustainable Development Goals will require low-income developing countries to implement policies that strengthen their fiscal positions, boost financial resilience, reduce poverty, and make growth more inclusive. Investment in workforce skills, improving access to credit, and reducing infrastructure gaps can promote economic

diversification and improve the capacity to cope with climate shocks where needed.

- *Foster cooperation.* Maintaining financial and regulatory reform momentum and preserving an open, multilateral trade system should take priority. As Chapter 4 documents, global integration has helped increase cross-border knowledge flows, the diffusion of innovation, and productivity growth across countries—a key driver of improvements in living standards and welfare over time. It is also crucial that countries collaborate to address shared problems, such as excess external imbalances, cybersecurity, and climate change.