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. Financial conditions remain buoyant across the world, and financial markets seem to be expecting little turbulence going forward, even as the Federal Reserve continues its monetary normalization process and the European Central Bank inches up to its own.

These positive developments give good cause for greater confidence, but neither policymakers nor markets should be lulled into complacency. A closer look suggests that the global recovery may not be sustainable—not all countries are participating, inflation often remains below target with weak wage growth, and the medium-term outlook still disappoints in many parts of the world. The recovery is also vulnerable to serious risks. Financial markets that ignore these risks are susceptible to disruptive repricing, and are sending a misleading message to policymakers. Policymakers, in turn, need to maintain a longer-term vision and seize the current opportunity to implement the structural and fiscal reforms needed for greater resilience, productivity, and investment. The possibility that they don’t—governments far too often wait for crises to push them into decisive action—is itself a source of risks to the outlook, as well as a barrier to more inclusive and sustainable growth. Recent economic progress provides a global environment of opportunity, and policymakers should not let their chance go to waste.

The current recovery is incomplete in some important ways: within countries, across countries, and over time.

Within countries. Even as negative output gaps close across the advanced economies, growth in nominal and real wages remains weak compared with past recoveries. Weak wage growth is one source of the surprisingly weak inflation that itself is a source of concern, as it leaves nominal interest rates low and makes encounters with the effective lower bound, the point at which central banks can no longer lower interest rates, more likely. Chapter 2 of this World Economic Outlook report studies the recent surprisingly slow growth of nominal wages, which reinforces a longer trend of stagnant median wages, rising income inequality, and job polarization such that middle-skill but well-paying jobs have become increasingly scarce. Those developments have stoked considerable popular anti-globalization backlash—one significant threat to the world economy—although technological developments and government policies together have played larger roles in increasing income inequality, and fears of faster automation are a current cause of anxiety. Emerging markets have faced similar pressures in the face of trade liberalization and technological change, but growth has in many cases lifted all deciles of their income distributions and attitudes toward trade’s effects on labor markets remain largely optimistic.

Across countries. The current upswing reaches more broadly than any in a decade—roughly 75 percent of the world economy, measured by GDP at purchasing power parity—is sharing in the acceleration. But that means the glass is 25 percent empty, implying a drag on world growth and a potential source of destabilizing political shocks. Emerging and low-income commodity exporters, especially energy exporters, continue to struggle, as do several countries experiencing civil or political unrest, mostly in the Middle East, North and sub-Saharan Africa, and Latin America. And many of these same countries are the ones that are also most exposed to the negative impacts of climate change—already being felt via more frequent extreme weather events in some regions, such as heat waves and heavy precipitation. Chapter 3 focuses on the economic costs of climate change and the need for adaptation investments in low-income countries. Advanced economies will not be immune to future climate developments, however—through either direct impacts in some advanced regions, such as the coastal United States, or the spillovers from mass migrations and geopolitical instability emanating from poorer countries.

Over time. Behind recent positive growth developments, longer-term trend per capita growth rates in
many economies will be lower than trend growth rates of the past. In particular, most advanced economies face medium-term growth rates significantly lower than in the decade before the global financial crisis of 2007–09. The reasons behind these slowdowns differ across countries. For some economies, notably China’s, declining long-term growth is a natural result of rebalancing and convergence. For emerging commodity exporters, which benefited from China’s own rapid manufacturing growth in years past, permanently lower export prices call for new growth models. For advanced economies, expected slow productivity growth and aging workforces play major roles. Lower trend per capita growth rates can be problematic for several reasons: they make it harder for the poor to raise their living standards; they raise the pain of reallocating resources in the face of economic changes; they deter productivity-enhancing investment; they harm the sustainability of publicly funded social safety nets; and they feed political resentment by undermining hopes for the future and beliefs about the fairness of economic outcomes. In turn, these forces could derail the baseline forecast.

The preceding gaps in the recovery challenge policymakers to action—action that should take place now, while times are good. Needed structural reforms differ across countries, but all countries have ample room for measures that would raise economic resilience along with potential output. For some countries where output gaps have closed, the time has come to think about gradual fiscal consolidation, to reduce swollen public debt levels and create buffers to be used in the next recession. Such actions could entail adverse spillovers abroad, as discussed in Chapter 4. Countries with more fiscal space can, however, offset the reduction in global demand—for example, through much-needed productive infrastructure investment or through fiscal spending that supports structural reforms. This global fiscal package can also help reduce excess global imbalances.

Critically important to inclusive and sustainable growth is investment in people at all life-cycle stages, but especially the young. Better education, training, and retraining can both ease labor market adjustment to secular economic transformation—coming from all sources, not only trade—and raise productivity. In the short term, the excessive youth unemployment that afflicts many countries urgently deserves attention. Investing in human capital should help to push labor’s income share upward, contrary to the broad trend of recent decades—but governments should also consider correcting distortions that may have reduced workers’ bargaining power excessively. In sum, policy should promote an environment conducive to sustainable real wage growth.

Numerous global problems require multilateral action. Priorities for mutually beneficial cooperation include strengthening the global trading system, further improving financial regulation, enhancing the global financial safety net, reducing international tax avoidance, fighting famine and infectious diseases, mitigating greenhouse gas emissions before they create more irreversible damage, and helping poorer countries, which are not themselves substantial emitters, adapt to climate change. If the strength of the current upswing makes the moment ideal for domestic reforms, its breadth makes multilateral cooperation opportune. Policymakers should act while the window of opportunity is open.

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