

World Economy: Prospects and Risks

**Masahiro Kawai
Graduate School of Public Policy
Univ. of Tokyo**

Seoul 13 June 2017

Prospects of the World Economy

- The world economy is growing in 2017
- The US Fed continues its monetary policy normalization, reflecting the sound recovery of the economy. But there is uncertainty as to the policy direction (uncertain prospects of tax cuts, infrastructure investment, and trade policy) under the Trump Administration
- Europe is also recovering, although uncertainty about Brexit has been added by the recent election results in the UK
- The Japanese economy has been growing relatively strongly under Abenomics
- Emerging economies remain an important growth engine for the world economy

World economy outlook by the IMF

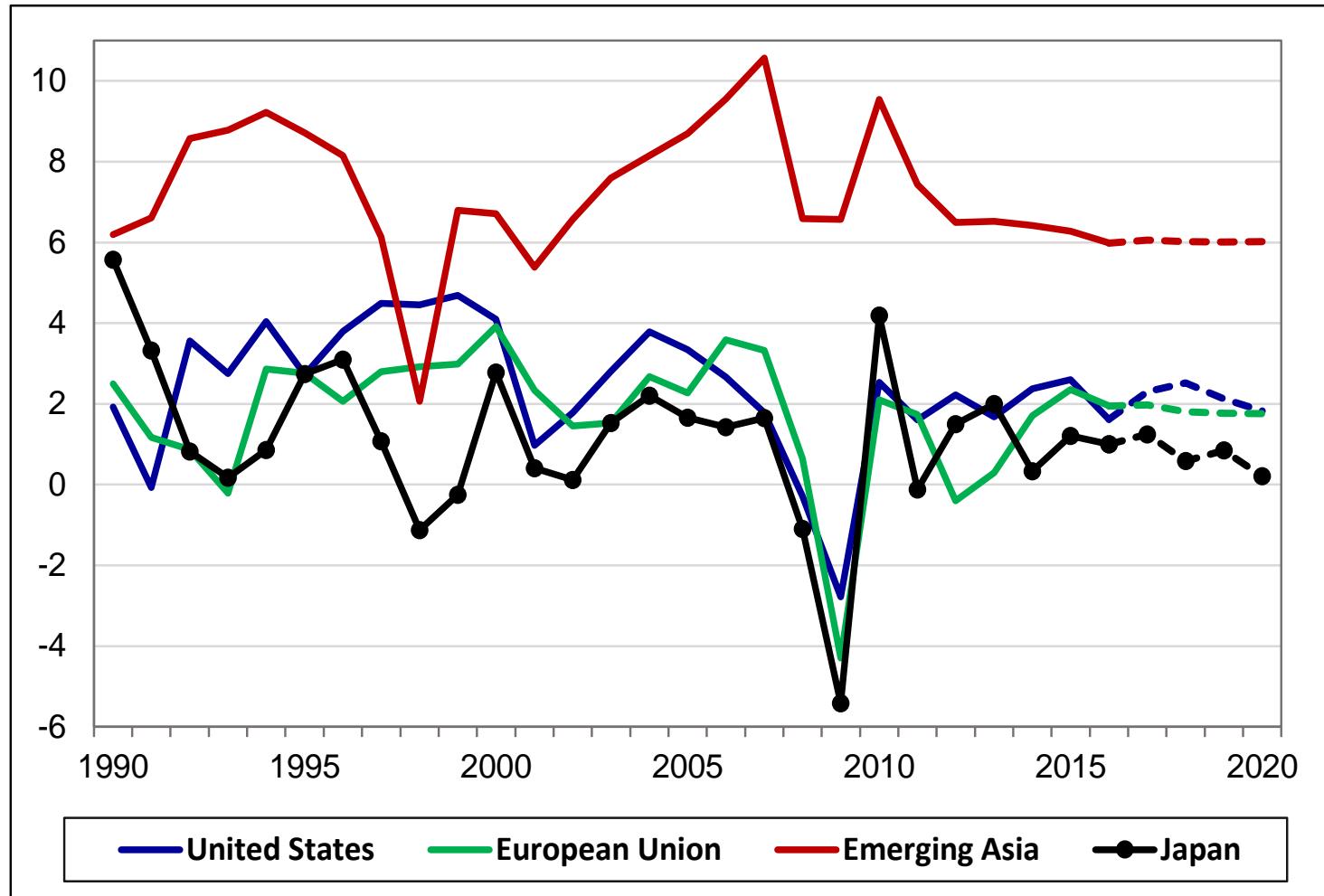
Real GDP growth (%)

Country/region	2008	2009	2010	2011	2012	2013	2014	2015	2016 ^e	2017 ^p	2018 ^p
World	2.8	-0.7	5.1	3.8	3.1	3.3	3.4	3.2	3.1	3.5	3.6
Advanced econ.	0.1	-3.7	3.0	1.6	1.4	1.3	1.8	2.1	1.7	2.0	2.0
US	-0.3	-3.5	3.0	1.8	2.8	2.2	2.4	2.6	1.6	2.3	2.5
Euro Area	0.4	-4.3	2.0	1.4	-0.7	-0.5	0.9	2.0	1.7	1.7	1.6
UK	-0.1	-4.9	1.8	0.8	0.3	1.7	2.9	2.2	1.8	2.0	1.5
Japan	-1.2	-6.3	4.5	-0.8	1.4	1.6	0.0	1.2	1.0	1.2	0.6
Asian NIEs	2.0	-0.4	8.7	4.1	2.3	3.0	3.5	2.0	2.2	2.3	2.5
Developing/EMEs	6.0	2.8	7.4	6.2	4.9	4.7	4.6	4.1	4.1	4.5	4.8
Asian Dev/EMEs	7.7	7.2	9.5	7.8	6.4	6.6	6.8	6.7	6.4	6.4	6.4
China	9.6	9.2	10.4	9.2	7.7	7.8	7.3	6.9	6.7	6.6	6.2
India	6.2	6.8	10.1	6.8	3.2	5.0	7.3	7.6	6.6	7.2	7.7
ASEAN-9	5.0	2.3	7.4	4.8	6.1	5.1	4.6	4.7	4.7	4.8	5.0

Note:: Asian Dev/EMEs do not include Asian NIEs. ASEAN-9 excludes Singapore.

Sources: IMF, *World Economic Outlook (WEO)* and *WEO database*, April 2017

Growth rates of major economies in the world (%)



Note: Dotted plots show growth rates predicted by IMF

Source: Constructed by the author from IMF, *World Economic Outlook database*, April 2017

US economy recovering

- US economy recovering steadily
 - ▣ Declining unemployment rate (full employment level)
 - ▣ Inflation rate approaching the target rate of 2%
- Monetary policy normalization
 - ▣ End of QE3 (Oct. 2014)
 - ▣ Policy rate hikes (Dec. 2015, Dec. 2016, Mar. 2017) and two more hikes expected this year
 - ▣ Fed may start reducing the balance sheet by end-2017
- President Trump wants to cut taxes and increase infrastructure investment
- Combination of monetary policy tightening and the Trump policy is likely to lead to US dollar appreciation
- But this is not consistent with President Trump's desire to reduce its trade deficit

US bilateral trade balances, 2016

(Billion US\$)

US Trade Partner	US Exports			US Imports			US Trade Balance		
	Goods	Services	G&S	Goods	Services	G&S	Goods	Services	G&S
World	1,460	752	2,212	2,210	503	2,713	-750	249	-501
China	116	54	170	463	16	480	-347	37	-310
Euro Area	201	147	348	328	112	440	-127	35	-92
Germany	49	31	80	115	33	148	-64	-2	-68
Mexico	231	31	262	300	23	324	-69	8	-62
Japan	64	45	109	134	31	165	-70	14	-56
Italy	17	9	25	45	11	57	-29	-3	-31
India	22	20	42	46	27	73	-24	-6	-31
Korea	42	22	64	71	11	81	-28	11	-17
Canada	267	54	322	284	30	313	-16	25	8
Other	760	415	1,176	779	250	1,026	-20	166	149

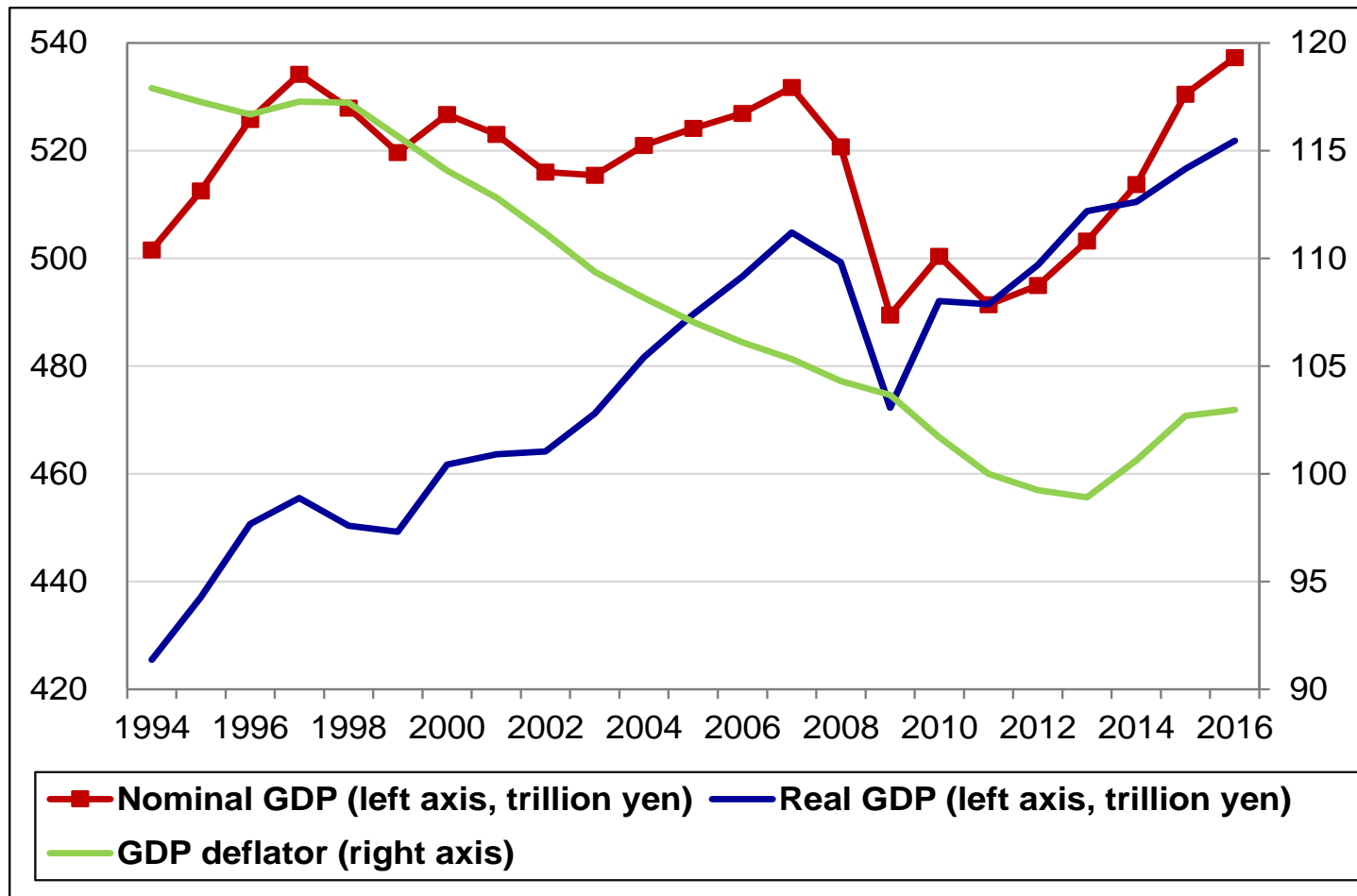
Source: Compiled by the author from trade data of the Bureau of Economic Analysis, US Department of Commerce.

<https://www.bea.gov/iTable/iTable.cfm?reqid=62&step=1&isuri=1#reqid=62&step=2&isuri=1&6210=1>

European economy also recovering

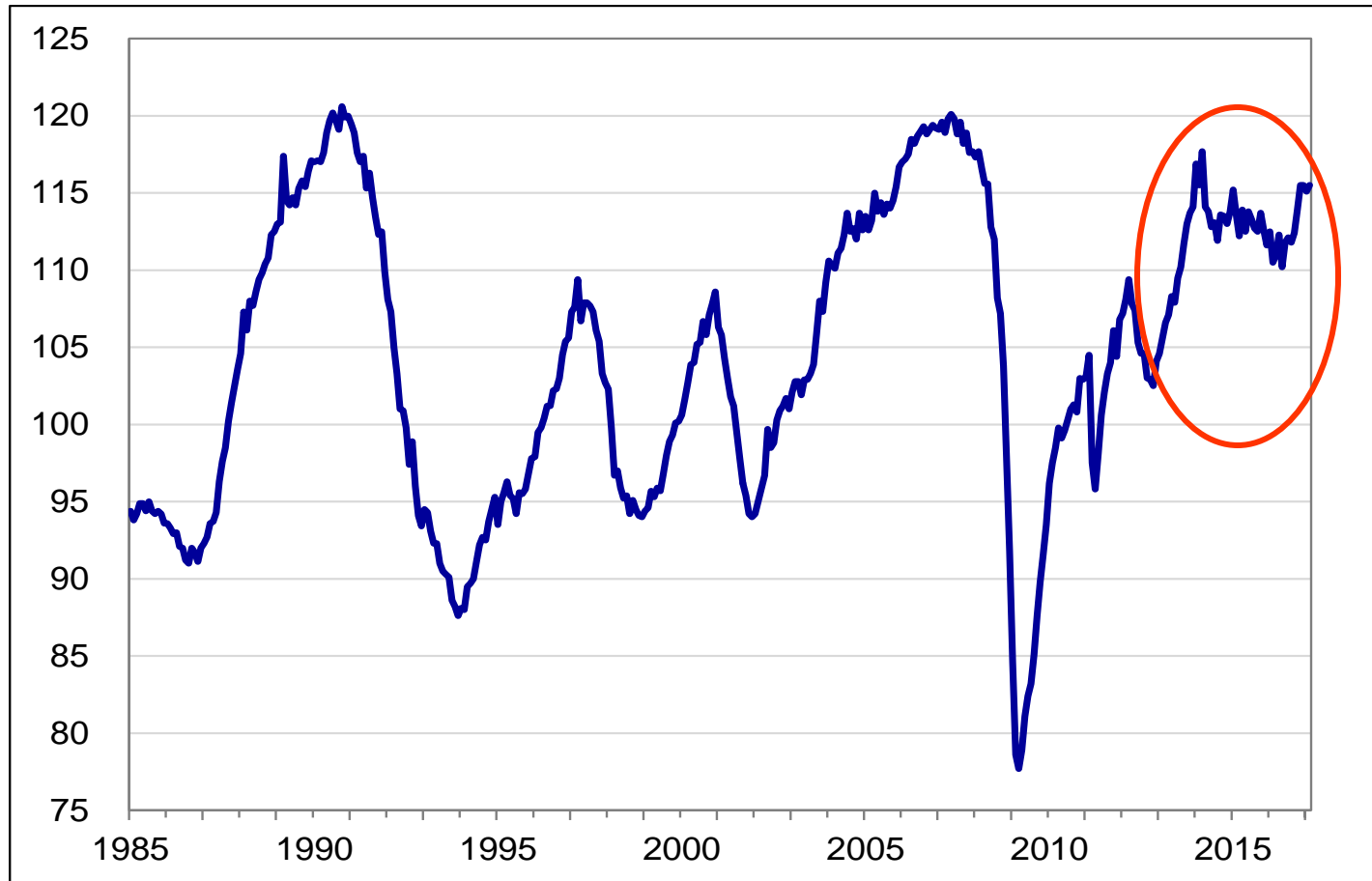
- Europe also recovering
 - ▣ Greece responding to the debt crisis through structural reforms
 - ▣ Italian bank issues being addressed
- Uncertain prospects of UK-EU Brexit negotiations
 - ▣ For orderly Brexit from the single market
 - ▣ For establishing a new comprehensive FTA
 - ▣ For setting up a transition arrangement
- In addition, the UK will have to negotiate new FTAs with its EU partners
- But the UK election results make the UK negotiation stance uncertain

Japan's nominal GDP, real GDP and GDP deflator



Source: Produced by the author from data released by Cabinet Office, Government of Japan

Improving composite index (2010=100)

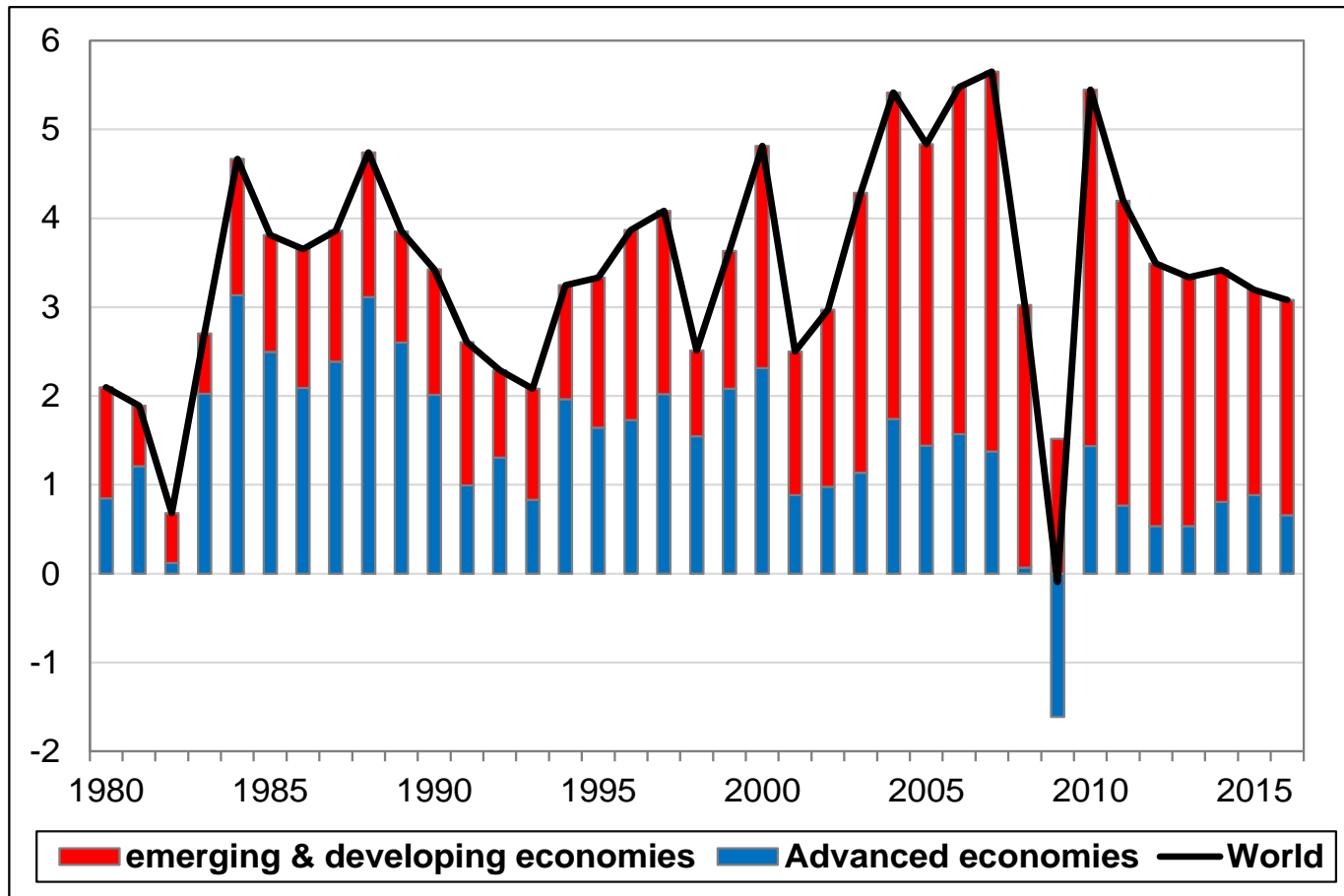


Source: Constructed by the author from data released by Cabinet Office,
Government of Japan

Prospects of emerging economies

- Emerging economies remain the growth engine of the world economy; but there are variations across countries
- China's growth rate is declining as a trend
- India sees growth acceleration since 2013
- ASEAN also sees steady growth
- Brazil and Russia saw negative growth in 2015-16, but are expected to have positive growth (IMF's projection: 0.2%, 1.4%)
- Oil and resource producing countries are also recovering due to the recovery of commodity prices

World economic growth (%): Contributions by advanced and EMEs



Source: Constructed by the author from IMF, *World Economic Outlook* database, January 2017.

Risks to the World Economy

- Risks of protectionism by the Trump Administration under its “America First” policy
- US interest rate increases (due to monetary policy normalization and US fiscal expansion) may induce capital outflows from EMEs and destabilize their financial conditions
- Risk of hard Brexit without completion of Brexit negotiations
- China’s financial instability due to its high corporate debt
- Rise of geopolitical risks, particularly in the Middle East, Ukraine and the Korean Peninsula

US policy directions

- US macroeconomic policy has mixed implications:
 - ▣ Fiscal stimulus will expand US aggregate demand, imports, and trade deficits
 - ▣ This will be a plus for the rest of the world, including Japan, China, ROK
 - ▣ But a rise in US trade deficits is against President Trump's policy goal and will likely invite protectionist measures
 - ▣ At the same time, a higher US interest rate may induce capital outflows from vulnerable emerging economies, leading to currency depreciation and stock price declines
- Two possible directions for US trade policy
 - ▣ Benign case: Pursuit of bilateral trade negotiations without using the threat of trade sanctions under Section 301 of the Trade Act of 1974, or Super 301
 - ▣ High risk case: Adoption of the border adjustment tax, or high tariffs against China, Mexico and a few others

Policy implications for China, Japan, ROK

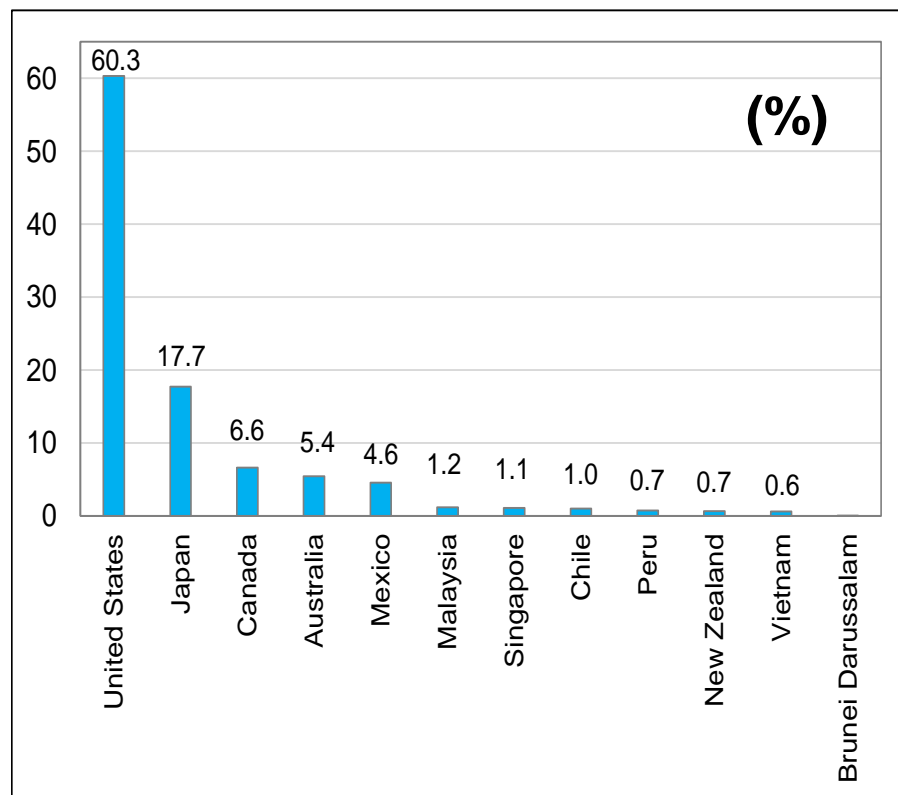
- Trade protectionism can have negative impact on economies in Asia
 - ▣ A possible trade war with China is highly counterproductive to the world, particularly Asian countries
 - ▣ Possible withdrawal from NAFTA is costly for Japanese firms operating in Mexico
- Possible policy responses by China, Japan, ROK
 - ▣ China: Greater opening of the market for goods and services to achieve economic rebalancing from investment to consumption and from manufacturing to services
 - ▣ Japan: Pursuit of Abenomics, completion of a Japan-EU EPA
 - ▣ ROK: Focus on demand management, structural reform
- Joint action by CJK
 - ▣ China, Japan and ROK need to work on a CJK FTA and RCEP (with ASEAN members) more aggressively
 - ▣ Need to support any Asian developing economies adversely affected by higher interest rates in the US (CMIM, liquidity)

What should be done with TPP?

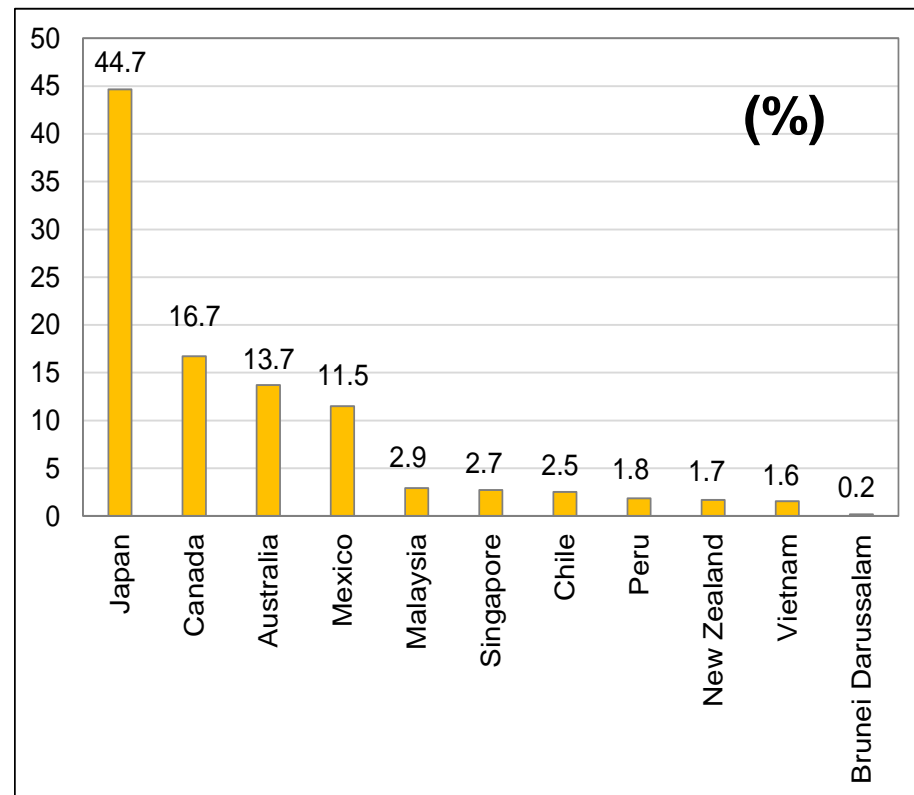
- The Japanese parliament (and then NZ) approved TPP
- US President Donald Trump signed the Presidential Executive Order to withdraw from TPP
- Reasonable options for TPP members:
 - The presence of the US is vital, but in the event of implementing TPP without the US there should be no change to TPP in framework or membership and no re-negotiation
 - Implement TPP among the 11 members without the US, by keeping the same text, annexes, and other documents, except a certain part of Chapter 30 (at least six of the original signatories, which together account for at least 85 per cent of the combined GDP, must approve)
 - If Canada and a few others cannot join soon, implement TPP among countries that are ready to do so
 - At the same time, continue negotiating RCEP
- Reasons for the launch of TPP without the US:
 - TPP can be a model for the 21st century trade and investment rules in the Asia-Pacific region
 - The US (& others) can always come back to the TPP without new negotiations
 - TPP member countries may acquire a certain degree of negotiating power against the US (if the US proposes bilateral FTAs)

Share of GDP in all members' GDPs

Including the US



Excluding the US



Note: Data are for 2013 GDP

Source: Computed from IMF, *World Economic Outlook* database, October 2016

Obstacles to a CJK FTA

- The largest obstacles have been unfavorable political relationships for Japan-China and Japan-ROK
- Another obstacle is uncertain effects of a CJK FTA on industries in China and ROK
- Major issues of a CJK FTA for each of CJK
 - ▣ Japan has concerns over agriculture and fisheries vis-à-vis China and ROK
 - ▣ China has concerns over manufacturing (chemical, automobiles, machinery) vis-à-vis ROK and Japan, particularly competitive pressure on local automakers who account for 25% of the market share
 - ▣ ROK has concerns over manufacturing (general machinery, electronics, automobiles) vis-à-vis Japan because of lower competitiveness and rising and larger trade deficits and over limited gains because of Japan's already low tariff rates; ROK also has concerns over agriculture and fisheries against China

Obstacles to the RCEP

- What is RCEP?
 - ▣ An ASEAN-centered FTA by the ASEAN+6 countries
 - ▣ Not as ambitious as the TPP in liberalization and rule-setting, but includes both developed and less developed countries, allowing special and differential treatment for the latter
 - ▣ Focus on goods trade, services trade, investment, economic technical cooperation, intellectual property, competition policy and dispute settlement
- Major differences among major economies:
 - ▣ Japan wants to achieve a high degree of liberalization and include a wide range of trade and investment rules (e-commerce, IPR, competition, government procurement, etc); Japan may also wish to implement TPP earlier than RCEP
 - ▣ China wants to achieve a moderate degree of trade liberalization in a way that most ASEAN countries support it
 - ▣ India is reluctant to accept a high degree of trade liberalization due to fear of being exposed to highly competitive Chinese products

Conclusion

- The world economy is growing, but there are several risks to a healthy world economy, including Mr. Trump's protectionist policy
- Asia is a region still embracing globalization, including Japan, China, ROK, ASEAN, and many other economies
- President Trump wants to make America great and see US trade deficits reduced
- But his policy directions (tax cuts and infrastructure investment), combined with the Fed's monetary policy tightening, are likely to lead to higher US interest rates, a stronger US dollar, and larger US trade deficits

Conclusion (cont'd)

- As a result, President Trump may choose protectionist policies to limit US imports and reduce US trade deficits
- The CJK countries must strengthen domestic economic fundamentals to increase resilience to possible negative shocks due to US trade protectionism
- At the same time, the CJK need to work on a CJK FTA and RCEP in a more aggressive manner
- Japan is now actively negotiating with the EU on a Japan-EU EPA
- The 11 TPP members need to find ways to implement the TPP without the US

Thank you
For more information:

Masahiro Kawai, PhD
Professor
Graduate School of Public Policy
University of Tokyo

mkawai@pp.u-Tokyo.ac.jp
+81 3 5841 7641