SIMPLY SHORT

Only very subdued growth in sight

International economy | 12.11.2019

Global economic growth has slowed substantially in the current year. One cause has been the trade war between the United States and China, which has escalated further since the spring. Now both countries have already imposed additional customs duties on most of their bilateral trade in goods. Meanwhile, Brexit has added further to the uncertainties over the direction of the economy.

The trade war and uncertainty over the future course of the economy have led to both a reduction in exports and a decline in the investment outlook. This has had a negative impact particularly on manufacturing. The trend in services has been somewhat brighter, as these have so far benefited from continued low unemployment and low interest rates. News of developments in the trade negotiations and the weakened outlook for growth have caused turbulence on the financial markets, but to date there have been no significant disruptions.

Economic growth will slow or remain unchanged in the major economic regions next year. The intensification of the trade war and the possibility of a no-deal Brexit also raise expectations of even weaker developments.

The weakened global growth is also visible in the euro area, where growth has slowed to around

1%. Moreover, euro area growth is not expected to accelerate significantly in the immediate years ahead. The euro area is not actually in recession, but the trade war and Brexit increase the risk of recession. At present, euro area growth has slowed most markedly in manufacturing-intensive economies like Germany. The weakness of manufacturing growth in the euro area could begin to be reflected on the labour market and in the services sector; there are already some signs of this. Euro area growth has thus far been sustained by the favourable labour market trend. The unemployment rate has already come down more or less to the level preceding the financial crisis.

In the immediate years ahead, euro area inflation will be slower than the European Central Bank's price stability objective. According to the ECB's latest forecast, inflation will slow to 1% next year, and pick up to 1.5% in 2021. The forecast is, however, attended by some uncertainty. Core inflation, which depicts medium-term price pressures in the economy, has for 6 years already remained in the region of 1%. The decline in the euro area unemployment rate and the strengthening pace of rising wages have not yet led to an acceleration in core inflation. The risk of deflation – i.e. a longer-term downward trend in prices – remains slight, even if it has increased somewhat just recently.

The ECB Governing Council decided at its September meeting to further support the accommodative stance of monetary policy with the help of a package of several measures designed to encourage a sustainable acceleration in the pace of inflation in line with the ECB's inflation aim. Interest rates will remain low for a prolonged period. Banks will receive favourably priced central bank funding, which will bolster their ability to finance e.g. business investment. The era of negative interest rates will continue.

Key words

euro area, inflation, international economy, monetary policy