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GLOBAL ECONOMIC OUTLOOK 2019

Global Economy

On top of the world... Looking over the edge

THE CONFERENCE BOARD

2018 | V29 N1

Global growth has peaked. What trends are on the horizon?

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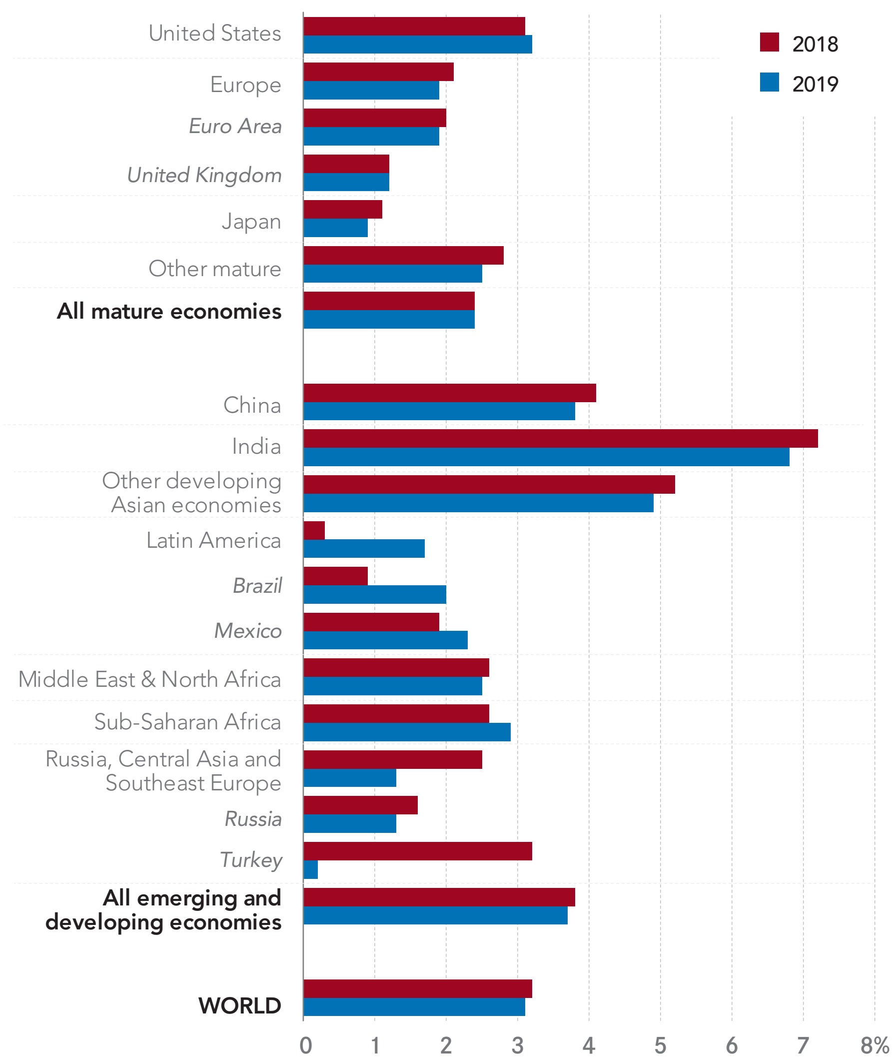
The global economy has plateaued but shows no signs of falling off a cliff in 2019. Assuming no major disruptions, a gradual slowdown seems most likely. On an annual basis, in 2019, aggregate global growth is expected to slow slightly to 3.1 percent, from 3.2 percent in 2018. But underlying shifts in the global economic landscape should not be ignored and will become more visible during 2019 and over the coming decade. Uncertainties about the slowdown are multifold: when, where, and how big? Seven short-term and seven medium-term trends should help businesses identify risks and opportunities and prepare for them.

Strategic Overview

A decade after the global financial crisis of 2008/09, the growth of the global economy seems fairly steady at just over 3 percent but will gradually drop below 3 percent by the beginning of the next decade.

THE MODEST GLOBAL GROWTH SLOWDOWN IN 2019 IS UNDERPINNED BY A MIXED PICTURE AMONG REGIONS

Real GDP growth by major region, 2018 and 2019



Note: GDP growth is revised upward in order to reflect faster declines in alternative ICT prices for countries with significant ICT production and trade, including Japan, the United States, and China; For a detailed list of countries included in each regional aggregate, please refer to the Global Economic Outlook **website**.

Source: The Conference Board Global Economic Outlook 2019.

CHART 1

The medium-term risk environment is particularly challenging because of trends such as aging, uncertainty about the economic impacts from new technologies, and uncertainties stemming from an unequal distribution of the benefits of growth and possible deglobalization. Companies should assess their exposures to such risks and prepare responses to withstand disruptions ahead.

While the global growth slowdown seems gradual from a medium-term perspective, in the short-term business should reckon with greater price and cost pressures, especially from materials, warehousing, transportation, energy, and labor. These pressures will trigger monetary tightening. However, recession risks remain low for now, bar any major geopolitical shock that may kick any of those projections off course.

The Short-Term View (2019): Closer to the Edge or Holding Off?

The modest global growth slowdown in 2019 relative to 2018 is underpinned by a mixed picture among major regions (see Chart 1). Europe, China, and several emerging markets are already slowing. The United States continues to do well but will see stronger headwinds during 2019. Some other regions, such as Sub-Saharan Africa and the Middle East, show recovery from previous rates of slower growth.

SEVEN TRENDS KEEP THE ECONOMY AFLOAT BUT RAISE THE RISK OF A SLOWDOWN

1 The **global economy** stays strong for the next half year, and the outlook shows no signs of a downturn—assuming no major policy disruptions such as an escalation and broadening of the US-China trade war. However, even without such shocks to the economy, leading economic indicators show signs of moderating (Chart 2). This typically implies that business cycles in various countries are peaking, inflationary pressures are rising, and central banks are tightening monetary policy. The bottom line is that while revenue growth can stay strong for a while, cost pressures will rise, and generating a profit will become more challenging.

Takeaways:

- Cost pressures will make profits harder to come by in 2019.
- Watch out for pockets of slower growth, especially in Europe and several emerging markets.
- Look for upstream supply chain challenges as early signs of elevated recession risks.

2 The expansion of the **US economy** will peak soon, dropping from 4 percent GDP growth in mid-2018 to 3 percent by early 2019, and then gradually slow further during the year. Investment will lose the 2018 tailwind from fiscal stimulus (tax cuts and increased federal spending). This also raises concerns about whether the recent modest productivity recovery in the US can be sustained. Consumer confidence has remained very strong, and even though the pace of job creation is slowing, and inflation is gradually rising, the consumer remains quite resilient. However, in this mature phase of the business cycle, the economy is also becoming more vulnerable to an economic or external shock which could pull the risk of recession forward to 2019.[1]

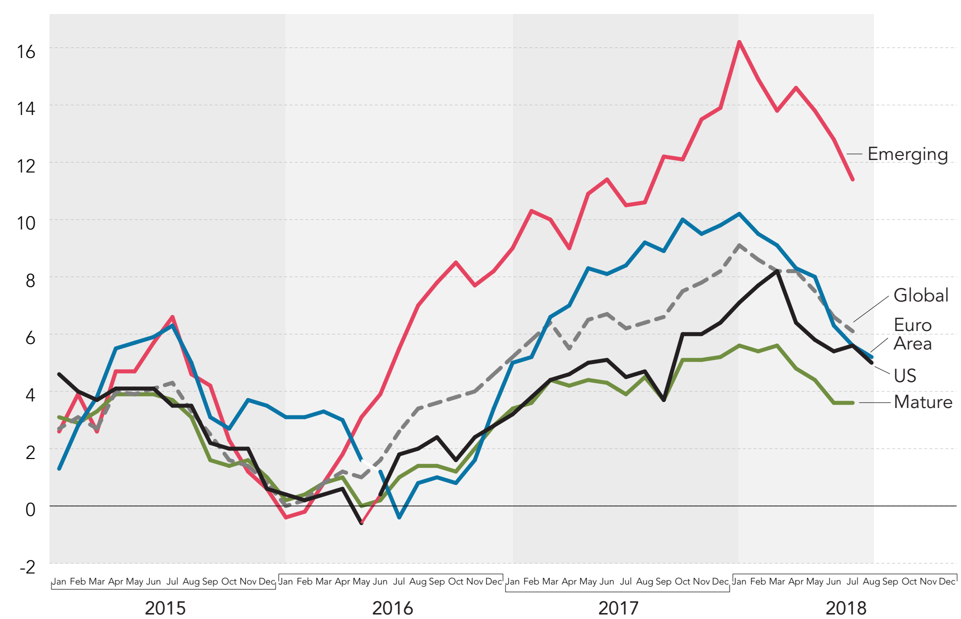
Takeaway:

- In 2019 US businesses need to balance the impact of rising wages and other business costs with leveraging the effects of new technology and innovations for productivity growth and efficiency gains.

While revenue growth may stay strong, cost pressures will rise and profits fall.

GLOBAL ECONOMIC GROWTH HAS PEAKED, BUT THE ECONOMY IS STILL EXPANDING

The Conference Board Leading Economic Index® (LEI) (6 months % change, annual rate)



Source: The Conference Board Global Business Cycle Indicators

CHART 2

An escalation of the US-China trade dispute could exacerbate the growth slowdown in China.

3 The economic expansion in **Europe** has moderated to just below 2 percent growth, and a toughening global trade environment could challenge the outlook further for 2019. Growth varies substantially across economies, however. France and Germany are forecasted to grow at 1.6 and 1.9 percent respectively. Italy and the United Kingdom are among the countries with the slowest forecasted growth rates at 1.3 and 1.2 percent respectively. The United Kingdom is particularly vulnerable to high recession risk, as indicated by *The Conference Board Leading Economic Index®* for the UK. High uncertainty about how Brexit will proceed over the coming years increases the risk it might serve as a recession trigger. At the higher end of the growth range, Ireland and several Central and Eastern European economies, including Hungary and Poland, outperform the European average with projected growth rates of up to 3.8 percent in 2019. However, those countries also need to fight rapidly rising wages, especially in manufacturing, as well as slow productivity growth, which is a challenge to their competitiveness.[2]

Takeaways:

- Leverage the scale of Europe's vast market to provide high quality products and services across the region.
- Focus on productivity gains above all else, as this is the only way to generate resources for further growth in this big, but slow-moving and ageing market.

4 **Major emerging markets** are under the greatest strain. Tightening external conditions are raising inflationary pressures because of US interest rate hikes, increases in commodity and energy prices, and a stronger US dollar. However, in various countries (China, India, Brazil, and others with troubled economies such as Argentina, South Africa, and Turkey) domestic challenges add to a sobering growth outlook. Contagion risks are relatively contained, even though Europe is affected by Turkey's malaise through some of its banks and firms that trade intensively with it. The rapid accumulation of debt in many emerging markets could create major difficulties for those that are exposed to rising interest rates or have large sums of debt held in US dollars. One of the biggest uncertainties is China, which is undergoing a further slowdown of growth, dropping to 3.8 percent in 2019 (from 4.1 in 2018), according to our measures of GDP growth in China. This is due to a slowdown in investment, significant weakness in exports, and a modest outlook for consumption growth. An escalation of the current trade dispute between the US and China could significantly worsen the outlook for 2019.[3]

Takeaways:

- Carefully examine future growth opportunities in emerging markets, and do not take past performance as a guarantee for future growth.
- Macroeconomic stability and national policies for trade and foreign direct investment are critical to growth opportunities.

5 **Monetary policy** in the US is likely to continue to tighten, while in Europe and Japan such policies may get less easy, depending on how rapidly inflation pressures emerge. Some argue that the aftermath of a decade of large central bank balance sheets, which have kept interest rates very low, might mute the effects of the current tightening. However, the impact of monetary policy responses is typically not linear but exponential: central banks will accelerate tightening if full capacity and labor utilization become more visible. Also, monetary policy makers will typically interpret financial market turbulence, especially a shift from equities to treasuries, as a signal that the economy is approaching full capacity.

Takeaways:

- As the era of cheap money comes to an end, reassess financing needs, especially reliance on open market borrowing.
- Consider how to better allocate capital to maximize productivity and limit risks from new investments.

6 Recent **trade disputes** have created significant uncertainties over which countries, sectors, and companies are most exposed. So far, the global macroeconomic effects of the disputes have been small, as sectors and companies at the losing end are outweighed by those not affected or even benefitting, for example, from changes in supply chain sourcing. On the positive side, the resolution of NAFTA 2.0, the USMCA, suggests no major departure from the overall framework of regional trade agreements but largely reflects extensions and updates. However, the agreement includes tariffs on steel and aluminium that add to the cost pressures that many companies, especially those in the auto industry that rely heavily on those materials, are facing already. The largest business challenge, however, is the US-China dispute, which in essence is more about securing intellectual property and determining technological leadership than about the reduction of the US trade deficit with China. While a negotiated solution between the two countries remains a possible outcome during the course of 2019, there is a high risk of escalation which would create significant economic damage for both, though the impact would be greater in China (where estimates go up to a loss of 1.5 percent of GDP in 2019) than in the US (where GDP loss would be in the lower tenths of one percentage point).

Takeaway:

- Continuously assess exposure to trade disputes, and especially to a possible escalation of US-China trade tariffs or other retaliatory measures by either administration, and prepare for the outcomes of different scenarios.
- In particular, examine how strategic agreements for technology partnerships and other types of collaboration between Western firms and Chinese partners will be viewed by authorities in both the US and China.

Central banks will accelerate tightening if full capacity and labor utilization become more visible.

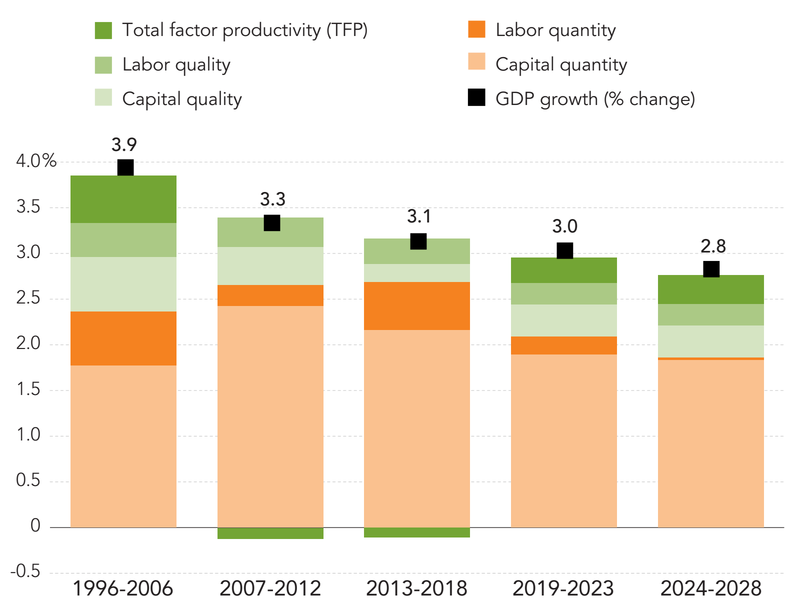
7 **Labor markets** around the world are tightening, while wages and productivity have only shown modest signs of a comeback so far. This is about to change for a variety of reasons. Some occupations, especially blue-collar ones, such as those in manufacturing and transportation, are already seeing broad shortages and rapid wage increases. The silver lining is that those labor cost increases will incentivize businesses to raise productivity. Increased productivity is already becoming somewhat more visible in the latest US quarterly estimates.[4] While faster productivity growth may take some pressure off the demand for labor in general, more productivity will raise demand on the skills and competencies of workers which are already hard to come by, especially in the digital space.

Takeaway:

- Prepare for increased wage pressures by identifying supply and demand dynamics for skills and competencies for specific occupations and across geographies.
- Respond to labor shortages by building on productivity gains from the past and accelerating current technology and innovation efforts.

LABOR SUPPLY VANISHES AS A SOURCE OF GROWTH—FUTURE GROWTH WILL NEED INVESTMENT SUPPORTED BY LABOR QUALITY, DIGITAL TRANSFORMATION, AND INCREASED PRODUCTIVITY

The contribution of factor inputs, input quality, and efficiency changes to global GDP growth, selected time periods



Notes: Labor quantity refers to the change in the number of workers; labor quality refers to differences in educational attainment of the labor force; capital quantity is growth in aggregate stocks of capital goods; capital quality is the increase in the quality of capital goods because of a shift from nondigital to digital assets. TFP refers to total factor productivity which represents the increase in efficiency through the combined use of labor and capital. The components that make up GDP growth are presented as log changes, which means they will not add up to GDP growth which is shown as percentage change.

Sources: The Conference Board Total Economy Database™ (adjusted version), November 2018; *The Conference Board Global Economic Outlook 2019.*

CHART 3

The Medium-Term View (2019-2028): Looking over the Edge

With global growth set to slow over the medium to long term, any business strategy should focus as much on key long-term drivers as on short-term ones. The following underlying dynamics of future growth are clear from our model (see Chart 3):

- Growth of global labor supply will vanish at the beginning of the next decade. This will be a unique event in modern economic history, posing large challenges to companies to find other sources of growth.
- Despite shrinking labor supply, high-skilled occupations will remain a critical growth contributor, implying that education and skill creation are key parts of economic success.

- Investment is the main driver of economic growth, but in light of slowing labor growth, capital will play an even greater role in driving growth than usual.
- Ongoing digital transformation (measured as the contribution of capital quality to growth) may create a path for sustained economic growth and a return of productivity growth (which had virtually vanished in recent years).

SEVEN TRENDS SHIFT OVER THE NEXT DECADE, CAUSING THE GLOBAL ECONOMY TO SLOW

1 **A richer but more slowly growing world economy** is emerging. The greatest certainty for our medium-term outlook is that large emerging markets will grow at a more moderate pace than in the past decade as they have become much wealthier. The much larger share of middle classes in emerging markets tends to limit the speed of growth. Rapidly increasing demand for high-quality health care and education is challenging to meet on a large scale and at a reasonable cost. The demand for better housing for middle classes is often difficult to fulfill. And consumer-oriented service industries are characterized by slower productivity compared to their manufacturing and investment driven counterparts. As emerging economies move closer to the innovation frontier, it will be more difficult to grow than in the past catching-up period, when they could rely on technology available from elsewhere. This will slow the contribution of emerging markets to global growth, most notably in China.

Takeaways:

- Focus on innovation through delivering new products and services, especially in the technology and service sectors, such as health care and education, which will see increased demand as the global middle class expands.
- Cost efficiency and productivity measures will help determine which firms stake claim to slower-growing markets.

2 **Shifts in demographic factors**, including increased longevity and declining birth rates will slow GDP growth rates and weaken labor supply growth (or even cause it to contract). The effects of aging populations will be most visible in Europe and Japan, but also in the two largest global economies, China and the United States. As occupations become harder to fill, the pressure to use skill-qualified immigrants who can fill those jobs will intensify. While adding to societal challenges, immigration provides the largest lever for relieving labor shortages, as other forces such as increased retirement age and greater labor force participation are more limited in scope.[5]

Takeaways:

- Take a more global approach to talent acquisition. Carefully assess what types of occupations can be filled in which locations, and what recruitment strategies are most effective to close gaps between supply and demand.
- Review changes in immigration legislation which determine the ease with which skilled immigrant labor can be accessed more strategically.

With slower global growth ahead, business strategy should focus as much on key long-term drivers as on short-term ones.

Current trade disputes are just one chapter in a larger book of challenges to globalization—greater competition for technological and economic leadership, especially between China and the United States is another.

3 **Technological change and innovation** will contribute to productivity growth, especially as (digital) technology evolves and is diffused across sectors during the coming decade. However, digital transformation has turned out to be a challenging task for many organizations, especially for those that must transition from the "old" digital economy, characterized by standalone computer hardware, software, and the rise of the internet, to the "new" digital economy, powered by mobile technology, data analytics, and artificial intelligence. The transition from an installation phase of a given technology characterized by experiment to the deployment phase that translates technology into faster growth is often not smooth.[6] Privacy and security challenges may cause a technology crisis. Or, an economic crisis may spur a sorting out of successes and failures, unleashing macroeconomic productivity growth which has been underwhelming so far.

Takeaway:

- Invest in digital transformation in ways that make the business more productive and more resilient to economic turbulenc.
- Start to demand returns from digital investments and projects on the basis of a more disciplined approach to digital transformation.

4 While **globalization** in terms of free flows of goods and services, capital, and labor has supported economic growth for decades, the current era signals a backlash against this trend. The contribution of foreign trade, foreign direct investment, migration, and capital flows to global growth that we saw during the 1990s and 2000s is likely to slow in the coming decade. Current trade disputes are just one chapter in a larger book of challenges to globalization—greater competition for technological and economic leadership, especially between China and the United States is another. Recently concluded bilateral trade and investment agreements point to a more regulated and unlevel playing field in the global economy. This will make it costlier to do business globally and harder to leverage competitive advantages between different countries.

Takeaways:

- Reassess how to capture the benefits of globalization and respond to greater challenges through restructuring value chains.
- Prepare for alternative approaches for accessing important consumer and labor markets.

5 The frequent occurrence and intensity of **natural and environmental disasters** not only lead to increased human suffering but create significant obstacles to economic growth in the medium term. Access to key natural sources of production, including fertile land, clean water, and air, which are significant to economic growth and wealth, is another growing concern. Business models that take such environmental considerations into account are more likely to pay off over the next decade by helping to reduce costs and identify new growth opportunities.

Takeaways:

- Create better plans for disaster resilience and recovery that include consideration of relocating activities to areas less vulnerable to environmental catastrophe.
- Take sustainability concerns into account in business strategy to manage the costs of natural and environmental disasters, avoid higher regulatory costs, and create new growth opportunities.
- Move from responding to emergencies to anticipating opportunities that include the environment in business cost and growth equations.

6 The fruits from growth, technological progress, and employment are likely to continue to be **distributed unequally** among the global population. The analogy that a rising tide lifts all boats is only valid if all boats are equally seaworthy, which often is not the case in a world of big disruptions. Inequality has three strongly connected dimensions:

- While the average income gap between poorer economies and richer ones has narrowed, the poorest ones are deprived of the basic preconditions for catching up which include adopting best practices in technology, management, etc., to generate faster growth.
- For the last decade, the share that income from labor contributes to total national income has declined. This trend is unlikely to improve as long as technological progress remains biased in favor of those who have access to financial, physical, and intangible capital, and against those whose most important or only asset is their labor.
- Economies which fail to meet the basic needs of their population such as housing, education, health care, and healthy food will likely see a widening income gap relative to economies that furnish those fundamental needs. Improved access for poorer countries, disadvantaged groups, and individuals to critical sources of growth, including human capital and the benefits of innovation, are most likely to produce lasting results.

The analogy between greater equality and a rising tide that lifts all boats is only valid if all boats are equally seaworthy, which often is not the case in a world of big disruptions.

ABOUT THE CONFERENCE BOARD GLOBAL ECONOMIC OUTLOOK 2019

The Conference Board Global Economic Outlook 2019 provides projections for the output growth of the world economy, including 11 major regions and individual estimates for 33 mature and 36 emerging market economies for 2019–2023 and 2024–2028. The projections are based on a growth accounting model that estimates trend growth as the contributions of the use of labor, capital, and productivity to the growth of GDP. Capital and productivity growth are estimated based on a wide range of related variables during past periods. The trend growth rates obtained from this process are adjusted for possible deviations between actual and potential output. For more information, interactive charts and tables, and details of the model, please visit The Conference Board Global Economic Outlook website www.conference-board.org/data/globaloutlook/.

Have a question about this issue of ***StraightTalk***® or the economics program of The Conference Board? Readers are encouraged to contact the author at straighttalk@conferenceboard.org. Bart van Ark is also available for in-house economics briefings.

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Takeaways:

- Businesses can contribute to a reduction in inequality by supporting education, skill-set development, retraining for displaced workers, and equality of access to productivity resources in the economy.[7] The business case for these activities is especially powerful in times of labor shortages.
- Deploy new technology and innovations to reach out to customer bases with less purchasing power and offer products and services at competitive prices.

7 Consumers, corporations, and governments have accumulated vast amounts of **debt** to finance their needs. Even though there are large differences between countries, the world is flushed with liquidity. Much of that capital is devoted to less productive applications, especially because the period of low interest rates reduced penalties for less productive investments and overspending. Debt will become difficult to service when interest rates go up, markets get tighter, and economies move into a slower growth mode. This is especially true for emerging markets. The silver lining of interest rate increases, however, is that it activates the need for higher returns on investments.

Takeaway:

- Balance holdings between making capital available for productivity purposes and preparing for more difficult times ahead.
- Look for areas where unsustainable pockets of debt are being held and avoid overexposure to risks in such situations.
- Remain conservative in balance sheet management in anticipation of future downturns and crises of any kind.

On the horizon, we see a global economy that will slow in relative terms, though the pie will continue to grow in absolute terms. Challenges are plentiful. More debt than ever seems needed to drive growth, while the gains are increasingly unequally distributed, leading to a backlash against globalization. The promise of new technological developments may alleviate some of these pressures but may at the same time worsen others. It is up to individual companies to prepare and meet these common challenges, while taking care not to derail their future potential ■

ENDNOTES

1 Brian Schaitkin, *Global Economic Outlook 2019: United States—The High-Flying Economy of 2018 Will Slow in 2019 and Beyond*, The Conference Board, November 2018.

2 Ilaria Maselli and Klaas de Vries, *Global Economic Outlook 2019: Europe—Thriving in a Slow-growing Europe*, The Conference Board, November 2018.

3 Erik Lundh, Abdul Erumbam, and Yuan Gao, *Global Economic Outlook 2019: Emerging Asia—Slower and Riskier, but Still Ahead of the Pack*, The Conference Board, November 2018.

4 Gad Levanon and Frank Steemers, *Why Are Labor Markets for Blue-Collar Workers Tighter than for White-Collar Ones?*, The Conference Board, October 2018.

5 Gad Levanon, Ilaria Maselli, and Frank Steemers, *Global Labor Market Outlook 2018: Finding Ways to Counteract Worker Shortages*, The Conference Board, 2018.

6 Bart van Ark, Abdul Erumban, Carol Corrado, and Gad Levanon, *Navigating the New Digital Economy: Driving Digital Growth and Productivity from Installation to Deployment*, The Conference Board, May 2016.

7 Steve Odland and Joseph J. Minarik, *Sustaining Capitalism: Bipartisan Solutions to Restore Trust and Prosperity*, The Conference Board Committee for Economic Development, 2017.

THE CONFERENCE BOARD GLOBAL ECONOMIC OUTLOOK, 2013–2028 (AVERAGE) ANNUAL GROWTH IN PERCENT

	2013-2018	2018	2019	2019–2023	2024–2028
	ACTUAL GROWTH	ESTIMATED GROWTH	FORECASTED GROWTH	PROJECTED GROWTH	TREND GROWTH
UNITED STATES	2.5%	3.1%	3.2%	2.2%	2.0%
EUROPE	1.8	2.1	1.9	1.6	1.2
EURO AREA	*1.5*	*2.0*	*1.9*	*1.6*	*1.1*
UNITED KINGDOM	*2.0*	*1.2*	*1.2*	*1.3*	*1.2*
JAPAN	1.4	1.1	0.9	1.4	1.3
OTHER MATURE	2.7	2.8	2.5	2.9	2.5
ALL MATURE ECONOMIES	**2.1**	**2.4**	**2.4**	**2.0**	**1.7**
CHINA	4.9	4.1	3.8	3.8	3.4
INDIA	7.0	7.2	6.8	5.9	5.5
OTHER DEVELOPING ASIAN ECONOMIES	5.0	5.2	4.9	4.9	4.6
LATIN AMERICA	0.4	0.3	1.7	1.9	1.9
BRAZIL	*-0.3*	*0.9*	*2.0*	*1.7*	*1.8*
MEXICO	*2.4*	*1.9*	*2.3*	*2.1*	*1.9*
MIDDLE EAST & NORTH AFRICA	3.0	2.6	2.5	3.1	3.0
SUB-SAHARAN AFRICA	3.1	2.6	2.9	3.8	3.9
RUSSIA, CENTRAL ASIA AND SOUTHEAST EUROPE	2.3	2.5	1.3	2.3	2.2
RUSSIA	*0.5*	*1.6*	*1.3*	*0.6*	*0.5*
TURKEY	*5.6*	*3.2*	*0.2*	*4.4*	*3.9*
ALL EMERGING AND DEVELOPING ECONOMIES	**4.0**	**3.8**	**3.7**	**3.8**	**3.6**
WORLD	**3.1**	**3.2**	**3.1**	**3.0**	**2.8**

Notes: GDP growth is revised upward to reflect faster declines in alternative ICT prices for countries with significant ICT production and trade, including Japan, the United States, and China. For a detailed list of countries included in each regional aggregate, please refer to the Global Economic Outlook website

Sources: The Conference Board Total Economy Database™ (adjusted version) November 2018; *The Conference Board Global Economic Outlook 2019.*

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