Institute of Strategic & International Studies
(ISIS) Malaysia

Global Macro Outlook 2019-2020

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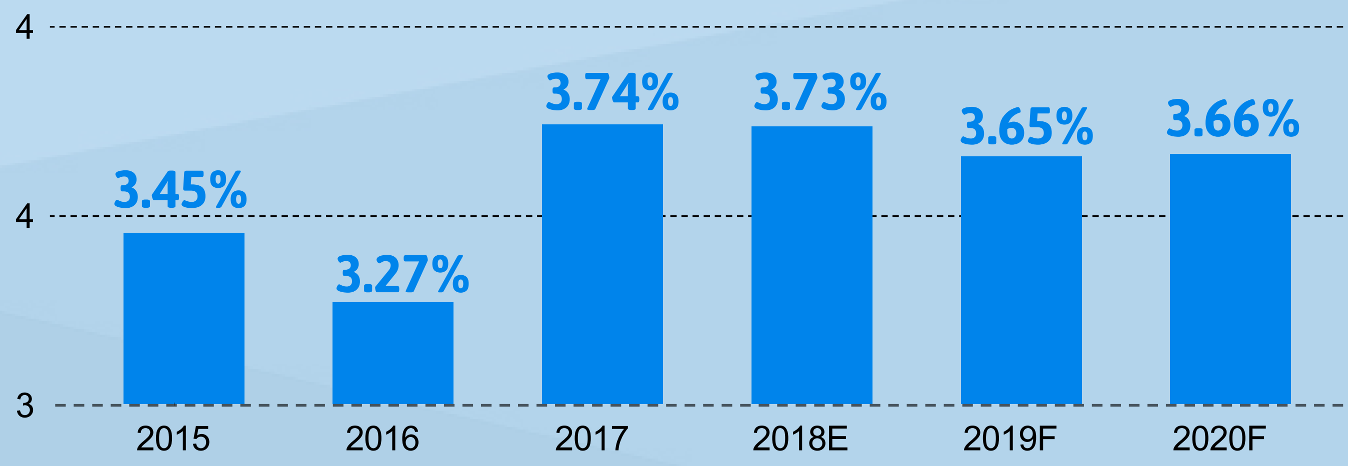
Global Growth

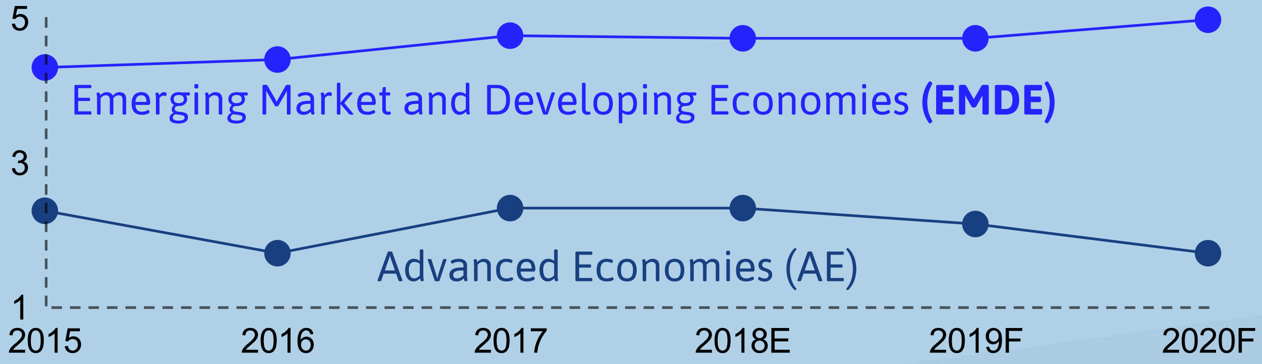
Global GDP growth in 2019-2020 is expected to slow just (very) slightly for now; but there are **large downside risks** to this forecast



This slight slowdown forecast assumes that many current risks do not extend to 2019-2020

Looking increasingly likely that downside risks may drag global GDP growth down further

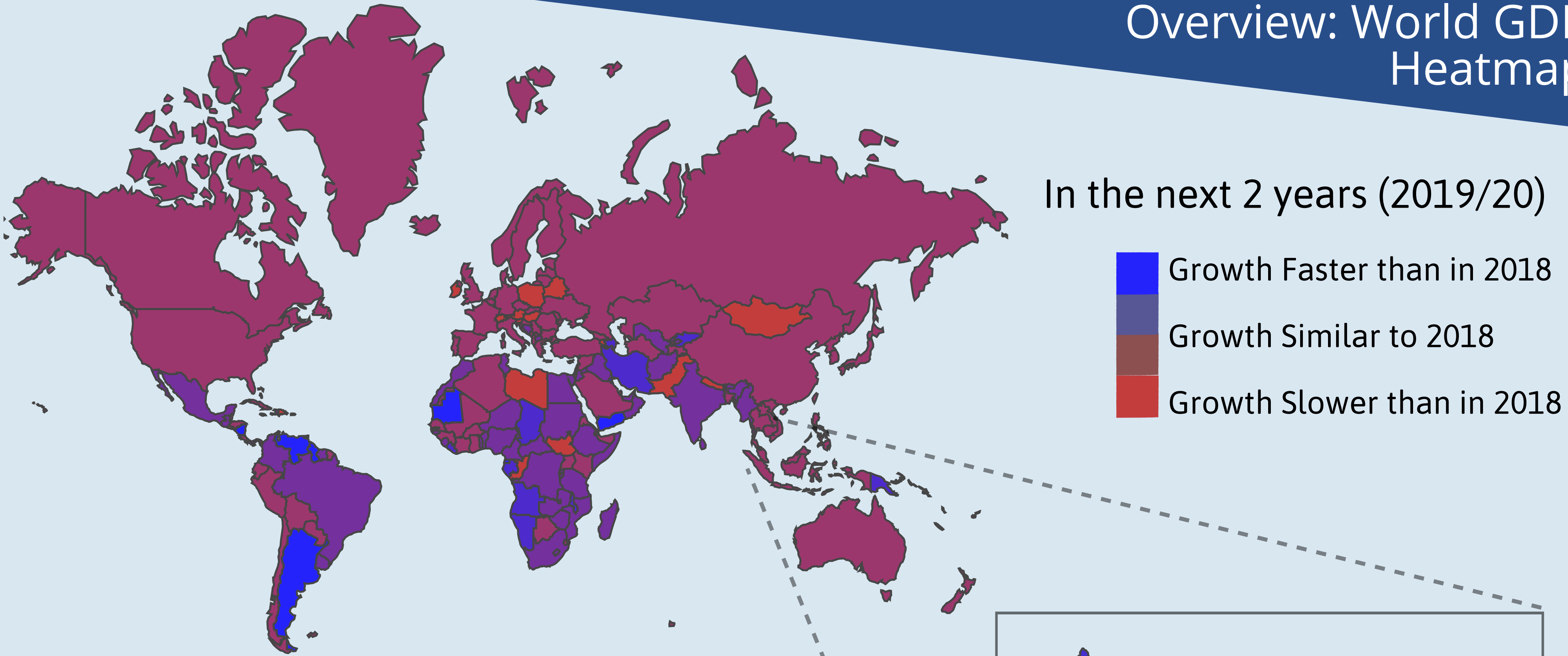
2019-2020 marks a return to **deceleration in advanced economies'** GDP growth after robust growth period in **2016-2017**



Divergence between GDP growth in AE and EMDE increases in 2019-2020 as EMDE growth picks up pace even as AE slows

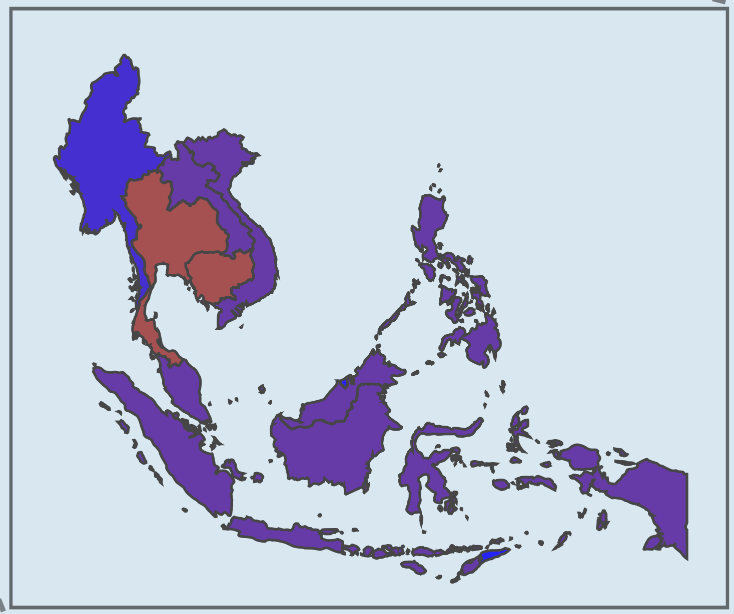
May have important implications for monetary policy in AE and EMDEs going forward

Data source: IMF



Major ASEAN Economies
Average GDP growth in the next 2 years vs **2018**:

Malaysia: +0.05 pp **higher**
Singapore: **-0.10 pp lower**
Indonesia: -0.02 pp **lower**
Thailand: **-0.50 pp lower**
Philippines: +0.04 pp **higher**
Vietnam: -0.05 pp **lower**



ISIS Macro, Data source: IMF

Downside Risks to Global Growth

Bumpy road ahead in 2019… and it may get even worse in 2020 especially for advanced economies

1 Trade Tensions

- Ongoing trade tensions are a negative for world trade and GDP growth, and further affects growth through increased uncertainty dampening consumption and investment; higher inflation; loss of efficiency (esp in short-term) as global value chains shift
- Key question: temporary or structural?

2 Global Tightening

- Global interest rates are now beginning to tighten materially after a decade of ultra-low interest rates after the 2008 Global Financial Crisis
- Tightening global monetary conditions have already contributed to outflows and pressures in emerging markets, including Malaysia

3 Geopolitics

- Brexit remains a crucial uncertainty going into 2019-2020
- Euro-Area related risks: Italy, Germany, France
- Thailand and Indonesia General Elections in 2019
- Volatility in global oil prices

Trade war not just US vs China

The US has been waging a multi-sided trade war with many different countries, though the US' fight with China is much more intense

USA

US has imposed tariffs on about **US$300 bil** of foreign goods →

← **Retaliatory tariffs** on various US goods are about US$145 bil

Canada, European Union, Mexico, Korea, Turkey, etc

Trade wars hurt the world economy in more than one way

Trade war → **Higher Tariffs** / **Increased Uncertainty** →

- Higher prices
- Lower World Trade
- Lower Investment
- Value Chain Disruption
- Market Volatility

→

- Lower World GDP Growth
- Loss of production efficiency
- Lower consumer welfare
- Lower corporate earnings

Selected protected industries in the US and in SE Asia may benefit in the shorter-term from supply chain shifts, but on aggregate, a sustained trade war is a **net negative** for the world economy

Outcome of recent G20 US-China talks was encouraging: US & China agreed that there would be no further escalation for now and both sides would work to resolve the dispute. China has already announced steps to tighten its IP regulations. Arrest of Huawei CFO in Canda clouds near-term outlook

Ultimate question: are these trade disputes temporary or structural (i.e. the new normal?)

Tightening Global Monetary Conditions

Global interest rates are now materially **higher** and monetary conditions **tightening** after a decade of ultra-low rates and easy monetary policy post-2008 Global Financial Crisis.

The US Fed is likely to hike once more this month, and two more times in 2019, and once more in 2020. Meanwhile, the European Central Bank (ECB) has already reduced its asset purchase program and may begin raising interest rates for the first time since the Crisis by 2019.

Rising global interest rates →

- Capital outflows from EMDEs
- Depreciation pressures on EM currencies
- Increase foreign currency debt burden
- Dampens liquidity, investment and affects infrastructure financing*

In **2018**: EMDEs which...
1) Are already facing **crises**: Argentina, Turkey
2) Are **at-risk**: South Africa, Mexico, Indonesia, Philippines, Brazil

Made worse by large amounts of foreign currency debt taken on in EMDEs since 2008

*Braunning & Ivashina (2018)

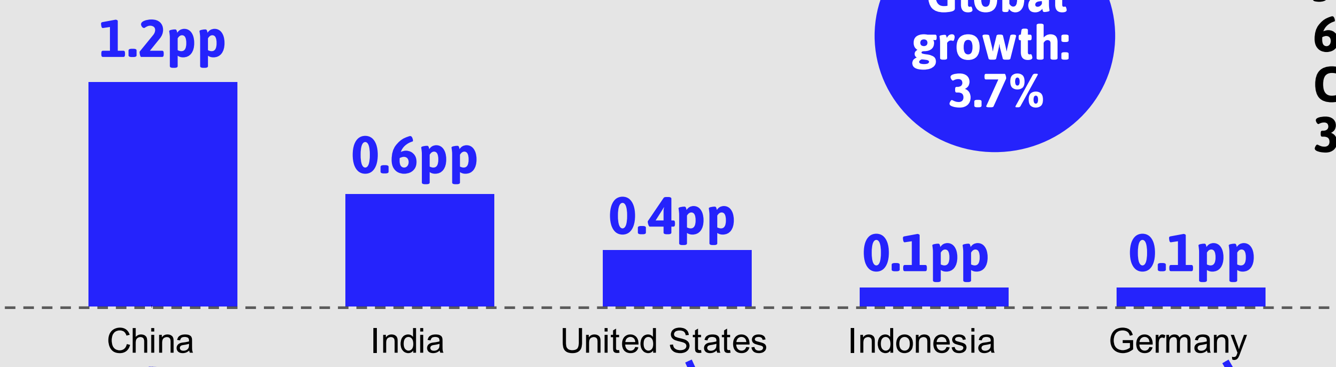
Overall, tightening global financial conditions will dampen world GDP growth as well as global macro-financial stability.

The Fragile Engines of Growth

It may take surpisingly little to derail the global growth train

We depend on just a **few** economies to drive global growth. This means that unexpected slowdowns or events in one or two countries can severely **curtail** global GDP growth as a whole...

Top 5 contributors to global GDP growth



Global growth: 3.7%

Just 5 economies account for **64%** of global GDP growth ... and **China alone accounts for about 33%** of global growth

*country nominal GDP share of world GDP multiplied by real GDP growth, IMF data

...Which will falter first?

- Fighting a trade war
- Undergoing domestic reforms to reduce debt
- Recent slowdown in macro indicators

China

- Fighting a trade war
- Effects of 2018 fiscal stimulus will fade by 2019
- Monetary conditions tightening

US

- Recent signs of a slowdown
- Exposure to Euro Area related geopolitical risks and fiscal risks (Italy)

Germany

And at the same time…

1 The world is more interconnected than before

Over the past decade, globalization has progressed. Cross-border financial claims (debt) has increased, trade linkages have deepened, and supply chains have internationalized drastically

In the past, crises in certain parts of the world could stay isolated without affecting the pace of overall global growth. Today, the world economy has become much more sensitive and fragile, and isolated events can and do spill over to the global economy

2 Lack of crisis response options!

During the **2008 Global Financial Crisis**, a deeper depression was averted by:

1) a **coordinated** response by major economies to increase global trade, and maintain liquidity
2) the **ability** of major central banks and world governments to aggressively use monetary policy and fiscal policy respectively

Today, fractured political alliances, protectionism, already too-low interest rates, and lack of fiscal space in many economies makes prospects of a coordinated crisis response less likely, and limits room for effective **monetary** or **fiscal** policy.

Shorter term

- Revenue troubles without the GST; a return to reliance on oil-related revenue
- Despite a smaller cabinet size, OPEX remains high
- Real wages of civil servants have been increasing steadily over the past decade but **less so** in the private sector

Medium term

- Revision of key labour laws needs to balance **efficiency & equity**
- The prospects of high-impact infrastructure projects to drive future economic growth
- The prospects of future high-quality trade agreements: e.g. CPTPP and RCEP

Longer term

- Malaysia is projected to reach aging nation status by 2035. As such, future growth strategies **must** be explicit.
- There is a need for the government to devise a new long-term economic model in meeting post-2020 challenges.

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Thank you

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