




Opinions

2018 Global Economic Outlook and Implications for Korea



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The world economy is yet to make a complete recovery from the 2008 global economic crisis. It is still suffering from a long period of weak economic activity. However beginning from this year, a somewhat different economic landscape is unfolding.

The U.S. economy seems to have entered a cyclically new phase. The U.S. Fed is expected to raise its policy rate once again within the year. It has already announced that it will begin to contract its balance sheet from October this year. The U.S. economy is projected to grow by 2.1% in 2018 driven by strong pickup in private consumption and investment based on the improving labor market and weak dollar. However there are some downside risks such as policy uncertainty under the Trump administration and negative effects stemming from the normalization of monetary policy.

The Eurozone is also picking up this year, showing a growth rate of 0.6% in the second quarter. Recently the inflation rate has moved to around 1.5%, rising closer to the 2% target, while the unemployment rate still remains high at 9.1%, a record low for the last eight years. The increase in growth in 2017 reflects an acceleration in exports supported by a pickup in

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global trade and continued strength in domestic demand based on accommodative financial conditions. We project the European economy to grow at 1.8% in 2018, which is a bit lower than its 2.0% growth in 2017. We are concerned by two downside risks for the EU: the Brexit negotiations and weak growth in real wage.

For Japan, we see a very similar economic recovery process. We expect Japan to expand at 0.9% in 2018, lower than its 1.3% growth in 2017. This poses an actual and very serious economic problem, where real wage growth is weak even when the corporate sector is gaining a large amount of profit. This is the main reason why we cannot anticipate longer term economic recovery in Japan. We can say the same thing for the EU.

For China, we expect 6.7% economic growth in 2018, lower than the 6.8% growth seen in 2017. The high growth rate in China comes from the following expectations: continued strength in private consumption over 7% and sustained growth in infrastructure investment exceeding 20%. The strong Chinese economy will contribute to boosting emerging economies heavily dependent on China through sustaining commodity prices. The problem is that China is a debt-fueled economy. This issue should be addressed if a high level of economic growth is to be maintained for a longer term in the future.

We expect further economic recovery in some large emerging economies, especially in Russia and Brazil. These economies have suffered from recession for the last three years due to the drastic fall in oil, gas and other commodity prices in 2014. These economies are, however, showing an upturn recently and this trend is expected to continue in the next year. The main sources of economic upturn in these economies seem to originate from China.

We also have to take a closer look at some cross-cutting potential negative factors for the global economy. The proliferation of inward-looking protectionism in advanced economies is the first among these factors. We also need to take a careful look at movements in wage, consumption and investment in major economies after the end of expansionary economic policy to see whether the economic recovery is sustainable or not. We are strongly concerned that the current recovery may come from cyclical but not structural sources. That would indicate that the current recovery might last for a relatively shorter period.

Lower inflation rates in many advanced economies are one of the concerns we should deal with. A lower inflation rate tends to lead to weaker consumer and business confidence. The world economy has not succeeded yet in completely ending the deflation mindset prevalent in many advanced economies.

We are worried about changes in financial conditions. The US Fed has already begun to raise its policy rate and there is a mood of tapering in the ECB. There are many emerging economies propelled by capital inflow from advanced economies. Debt-fueled emerging economies should normalize their balance sheets before accommodative financial conditions are ended. Advanced economies should carefully handle their steering wheel of monetary policy and admit the necessity of emerging economies to possess control over cross-border capital flow.

A pickup in the global economy would have multiple implications for the Korean economy. First is the effect on domestic interest rates. We are concerned about the soundness of the household sector burdened with a large amount of debt. Second is the effect on the stability of the FX market. Cross-border capital outflow could occur even though Korea has shown strong external sector indicators. Geopolitical risks from North Korea's nuclear tests could make the conditions much worse.

Even with all the above downside risks for the Korean economy, the 2018 global economic environment will be tilted to upside opportunities. Our export is expected to recover from three consecutive years of contraction. The fiscal soundness of the Korean government is better than in other advanced economies. We still have the chance to take advantage of fiscal space to boost the economy in order to promote fundamental structural reform such as addressing a dual labor market, improving productivity and establishing a more business-friendly environment to encourage more innovative start-ups. **KIEP**