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2024 KIEP World Economic Outlook: Debt Capacity Stretched, Growth Squeezed

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Over the past five years, the global economy has faced a steady stream of challenges, ranging from the U.S.-China conflict and the COVID-19 crisis to global supply chain disruptions, the Russia-Ukraine war, the Silicon Valley banking debacle, and the Israel-Hamas conflict. The global economy is currently facing significant strain, characterized by weakened growth drivers, reduced resilience, and heightened downside risks. Global policy coordination appears fragmented, with countries prioritizing their national interests. There is growing concern that the global economy may be moving toward a worse equilibrium in a non-cooperative game.

In its "World Economic Outlook 2024" released in November, the Korea Institute for International Economic Policy (KIEP) projects global economic growth at 2.8% next year. This forecast represents a 0.2 percentage point decline from this year's growth forecast of 3.0%. Notably, recent global economic forecasts by prominent organizations, including the KIEP, IMF, and OECD, have been revised upward for 2023 and downward for 2024.

The slowdown is underpinned by several negative factors, including uncertainties about the timing of monetary policy adjustments amid high interest rates and the sticky core inflation. Other concerns include geopolitical risks such as prolonged war and escalation, as well as the slowdown in China's medium- to long-term growth and its declining contribution to the global economy. In summary, despite the existing maneuvering room, the global economy is anticipated to face growth constraints in 2024.

The key theme of this Outlook, "Debt Capacity Stretched, Growth Squeezed," captures our concern that major economies, in response to the COVID-19 crisis, have relied on low interest rates and expansionary fiscal spending. This has resulted in substantial increases in government, household, and corporate debt levels. While this response was deemed necessary during a more severe economic crisis than the Global Financial Crisis, the global economy now faces challenges from supply chain shocks, rising inflation, and elevated interest rates before achieving full recovery.

The premise is that the significant borrowing from the future under the guise of low interest rates, coupled with the impact of higher interest rates, will compel adjustments in consumption, investment, and spending, thereby weighing on overall growth. Given that the downside risks to the global growth outlook outweigh the upside potential, we outline three main risks.

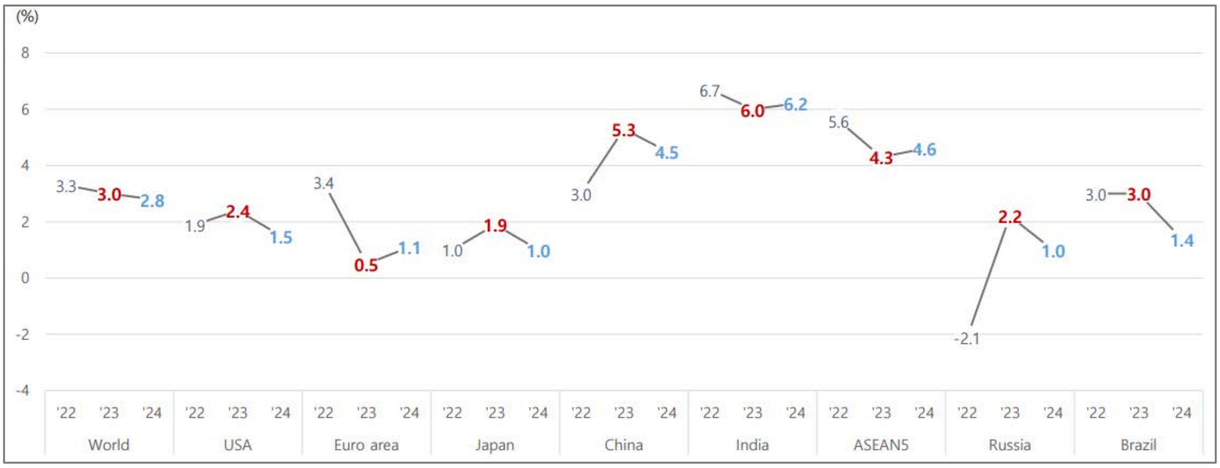
First, there is a concern about the possibility of China's economy entering a medium- to long-term low-growth trajectory. Although China has historically met the government’s growth targets and contributed significantly to the global economy through foreign direct investment (FDI) and a global manufacturing base, there are growing concerns about a potential slowdown. The real estate sector, which is characterized by structural weaknesses, poses a risk to future growth levels, although the central government's assumption of local government financing vehicle (LGFVs) debt has alleviated some concerns. Without structural reforms, medium- to long-term growth is expected to decline, exacerbated by factors such as declining productivity, wealth inequality, an aging population, declining fertility rates, and geopolitical tensions.

Second, the combination of high debt and elevated interest rates could hamper growth. The unexpected era of high interest rates is adding to the existing debt burden. To address this, households, firms, and governments need to deleverage in an orderly manner, which inevitably leads to a contraction in economic activities such as consumption and investment. Countries with rapid debt growth, especially those with debt burdens in two or more sectors (among government, households, and corporations), warrant special attention. It is crucial to monitor the situation of marginal firms and households with low interest coverage ratios or high principal payments relative to income within countries.

Third, there is the potential for additional geopolitical conflicts and subsequent supply shocks. The Israel-Hamas conflict erupted in October, while the Russian-Ukrainian war continues to persist. While the latter remains ongoing, the former, if prolonged or escalated, could be particularly alarming, especially due to its location in the Middle East, a major crude oil producer. Although we consider it unlikely, if the Israeli-Hamas conflict leads to a repeat of the oil price shock experienced in the first half of 2022 during the escalation of the Russian-Ukrainian war, it could once again throw the global economy into turmoil.

The global economy is grappling with complex and multi-faceted challenges that underscores the need for a comprehensive approach to various policy objectives. First and foremost is the need to steer a well-managed deleveraging of debt. Inevitably, economic growth will be constrained as households, firms, and governments seek to reduce their debt burdens. The key challenge is to strike the right balance between achieving price stability and supporting growth through an appropriate monetary policy stance, all the while ensuring that the build-up of debt remains manageable and does not lead to distress or contagion.

Figure 1. 2024 KIEP World Economic Outlook



Notes: 1) Based on PPP, 2) ASEANS refers to Indonesia, Malaysia, The Philippines, Thailand, and Vietnam.
Source: KIEP World Economic Outlook (November, 2023)

Fiscal policy should prioritize medium-term consolidation, although targeted support for vulnerable groups remains crucial, given the uneven impact of the downturn across economic entities. There is a continued need to support investment in both human and physical infrastructure to enhance long-term productivity. In addition, investment in intangible assets, particularly in research and development (R&D) and software, which are becoming increasingly vital, should not be neglected.

Against a backdrop of geopolitical conflicts and supply chain fragmentation, a new imperative for security and stability must be integrated into the economic and policy analysis frameworks. Building policy capacity is essential to address the growing complexity of determining who bears the costs and who reaps the benefits. Reassessing perspectives and approaches to China, particularly given its central role in supply chain fragmentation, is also imperative.

Finally, the potential conflict between maintaining the competitiveness of the current industrial structure and promoting the next generation of industries must be reconciled within the broader framework of sustainability and energy transition. A holistic perspective is required to reconcile these objectives within the overarching context of long-term economic and environmental sustainability. KIEP