World Bank warns of “storm clouds” over global economy

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The World Bank has added its voice to those warning of a worsening outlook for the global economy this year, amid signs that some major economies could experience a recession.

In its *Global Economic Prospects* report issued last week, entitled “Darkening Skies,” it stated that “storm clouds are brewing for the global economy” and contrasted the situation with that of a year ago.

“At the beginning of 2018 the global economy was firing on all cylinders, but it lost speed during the year and the ride could get even bumpier ahead,” the World Bank chief executive Kristalina Georgieva said.

Pointing to the main reasons for the slowdown, the bank said international trade and investment had softened, trade tensions remain elevated and several large emerging markets experienced “substantial financial pressures last year.” Growth in emerging markets and developing economies is expected to remain flat, the pickup in economies that rely heavily on commodity exports is likely to be much slower than hoped for and “growth in many other economies is anticipated to be decelerate.”

The bank cut its June forecast for global growth of 3 percent this year to 2.9 percent and warned that “the risks are growing that growth could be even weaker than anticipated.” It predicted that growth in world trade will slow to 3.6 percent this year, down from 3.8 percent in 2018 and 5.7 percent in 2017.

After downgrading its forecasts for global growth last November, saying “global expansion has peaked,” the Organisation for Economic Cooperation and Development (OECD) issued a series of leading indicators yesterday pointing in the same direction.

“In the United States and Germany, the tentative signs of easing growth momentum, that were flagged in last month’s assessment, have been confirmed,” it stated. For the third consecutive month, the OECD’s index for the US was below the 100 mark, which points to steady growth, and the index for Germany was below 100 for the fourth straight month.

One of the clearest indications of economic weakening comes from Europe. Data published last week showing that eurozone labour productivity had stopped growing for the first time in almost a decade. Since the financial crisis of 2008, eurozone productivity growth has been around half its previous levels. But in the third quarter of last year it dropped to zero compared to the same period in 2017. In Germany, Europe’s leading economy, it contracted at an annual rate of 0.3 percent, the first decline since 2009.

Industrial production is falling in the main eurozone economies, bringing warnings that Germany and Italy could record a technical recession with a second consecutive contraction in gross domestic production in the final quarter of last year.

In an editorial comment on Saturday, the *Financial Times* warned that after a “staggered” economic expansion, “a bout of nerves is now gripping the major economies in an unhelpfully synchronised wave” with “signs of trouble” in China and the US, “accompanied by an ever-extending period of weakness in the eurozone.”

Having “chugged along” for the past five years, the eurozone economy seemed to hit some turbulence in the summer months but “more recently, data seem to suggest the blip is at risk of turning into a sustained downturn” and “eurozone growth ended the year very weakly.”

The slowdown is centred in Germany. Economic problems that started to emerge six months ago were initially attributed to the effect of new emissions regulations in the car industry.

“The longer the weakness has continued, however, the more the slowdown has appeared more fundamental,” the editorial noted, with the most recent data showing German industrial production falling sharply, and imports and exports contracting in November.

Another key area of concern is China. The stock market

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fell by 25 percent last year and there are indications that growth rate of 6.5 percent could move down to 6 percent over the next year.

The China slowdown made a major impact earlier this month. For the first time in 16 years, Apple was forced to cut its sales forecasts for the coming year, citing the contracting Chinese market and rising trade tensions with the US. It led a 660-point fall in Wall Street's Dow index.

The fall in the sales of iPhones is only one indicator of the slowdown in Chinese consumption spending which is impacting on all global brands. When the final data for last year are issued they are expected to show that car sales in China fell in 2018 for the first time in 28 years.

The car sector represents about 5 percent of the country's GDP and around 30 percent of the global car market but the significance of China extends far beyond the auto market.

China accounted for around 16 percent of global GDP last year and over the decade since the global financial crisis has contributed around 30 percent of global growth. This has been largely the result of the vast stimulus package initiated by the Chinese government and financial authorities in the wake of the 2008-09 global financial crisis. But now the government is seeking to rein in credit expansion in order to lower debt levels in the economy.

At the same time, the economic problems to which this gives rise are being compounded by the trade war measures of the US. Anti-China hawks in the Trump administration are actively seeking to weaken the Chinese economy in order to extract greater concessions in negotiations.

Evidence of the impact of the US trade war measures emerged yesterday when government data revealed that exports had fallen 4.4 percent in December, far below the predictions of a 3 percent increase from a poll of economists. Imports also shrank 7.6 percent against expectations of a 5 percent rise.

In the US, the turbulence in financial markets is giving rise to concerns that a recession is in the making as the prospect of a yield inversion in bond markets draws closer. An inversion, which occurs when the yield on long-term bonds fall below that on shorter term bonds, is regarded as an indicator of recession as investors seek a safe haven. Inversion has not yet occurred but the gap between the yield on two-year Treasury bonds and of ten-year bonds has been narrowing.

While growth in the rest of the world slowed in 2018, the US continued to advance largely because of the stimulus effect of the corporate tax cuts enacted by the Trump administration at the end of the 2017. While Trump promised this would boost investment and jobs, most of the money went towards share buybacks in an effort to boost equity values and its effect will now start to wear off.

At least one major investor has countered claims by Trump that he is presiding over a strong economy. According to Jeffrey Gundlach, the head of DoubleLine Capital LP, the US economy is floating on an "ocean of debt."

"I'm not looking for a terrible economy, but an artificially strong one, due to stimulus spending," he told a forum organised by the investment and financial news service Barron's. "We have floated incremental debt when we should be doing the opposite if the economy is so strong."

Short-term economic data are not the only cause for concern. A major issue is whether the long-term increase in debt, which has continued since the global financial crisis, and rising geo-political tensions, will exacerbate the impact of any significant global slowdown.

In a comment published last week, *Financial Times* economics correspondent Martin Wolf wrote that the economy appeared to be heading into what he called a "mild cyclical downturn." However, this was taking place amid profound structural changes, characterised by the growth of debt and major political shifts. These included the rise of nationalism, Brexit, the election of Trump as well as "a trade war between the world's two most important economies and an erosion of the liberal global economic order."

The "worry" was not over the short-term cycle, he wrote, but rather "the context in which such a slowdown might occur."

"It is the political and policy instability, combined with the exhaustion of safe options for credit expansion, that would make handling even a limited and natural short-term slowdown potentially so tricky."

But, he concluded, there were "no simple mechanisms" for reducing these "deeply ingrained" developments which were more likely to get worse than better.

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