

Has the global economy peaked?

By [Keith Wade](#)

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The world economy continues to expand, but there are signs that growth has peaked as the US, European and Asian economies slow. Trade tensions between the US and China are expected to persist well into next year with higher tariffs creating a more stagflationary environment of lower growth and higher inflation.



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Global GDP growth to slow

Our forecast is for global economic growth to slow to 2.9% in 2019 from an estimated 3.3% in 2018. This is below consensus (3.1%) and largely reflects our more pessimistic view on the US. We see US GDP growth at 2.4% in 2019, as the boost from tax cuts fades while interest rates move higher and the effects of a prolonged trade war with China are felt. While the recent 90-day truce is welcome, we remain sceptical on the prospects for a longer-term agreement on issues such as intellectual property rights. We see a further slowdown in global growth to 2.5% for 2020.

In the Eurozone, we forecast growth to slow further in the first half of 2019 due to the effects of the trade war between the US and China. GDP growth slowing from 1.9% in 2018 to 1.6% in 2019. Assuming Brexit goes smoothly, the UK should see an improvement in growth in 2019; we forecast GDP growth of 1.4%.

For Japan, we forecast GDP growth of 1% in 2019, little changed from 2018. The start of the year looks set to be robust,

helped by reconstruction spending after the damaging earthquakes, floods and typhoons of 2018.

However, VAT is due to rise to 10% from 8% in October and previous VAT hikes have had a significant impact on economic activity.

The picture in emerging markets is mixed. China and the wider Asian economies are under pressure from trade tensions and lower demand in the technology sector. We forecast Chinese growth to slow to 6.2% in 2019 from 6.6% in 2018. Latin America may be a bright spot within the emerging markets as Brazil's economy looks set to strengthen now that the elections are over.

Inflation on the up, driven by emerging markets

Despite cooler economic growth and lower oil prices, the global inflation forecast has increased to 2.9% for 2019. This is a result of higher inflation in the emerging markets, where currency weakness is pushing up import prices.

In the advanced economies, we've trimmed our inflation forecast as a result of downgrades to Japan and the UK. For Japan, the lower forecast includes special factors such as a 20% cut in mobile phone charges. For the UK, we forecast inflation to fall from 2.5% in 2018 to 1.8% in 2019. This is due to softer oil prices as well as expectations that sterling will strengthen against most currencies in the event of an orderly Brexit.

For the US, we see inflation remaining elevated in 2019 at 2.7%. Our projection reflects the tighter capacity typical of this late stage in the economic cycle as well as higher import tariffs as the trade war continues.

US rates to peak in mid-2019

We anticipate three more interest rate increases from the US Federal Reserve (Fed), taking the Fed funds policy rate to a peak of 3% in June 2019. We assume that the Fed will 'look through' above-target inflation in 2019 and will pause to take account of the effects of slower growth on future price rises. We then expect rate cuts in 2020 as the US economy cools further.

For the Bank of England, we look for two rate rises next year, although this is dependent on a smooth exit from the EU with a transition period for the economy.

Meanwhile, the European Central Bank (ECB) is expected to end its asset purchase programme in January 2019 and to raise interest rates in September. This would be the first increase during ECB President Draghi's tenure and would also be his last given he steps down from the post in October. Although Eurozone growth is expected to be weaker next year, it will still be above trend and sufficient for a central bank keen to start raising interest rates from ultra-low levels.

Weaker dollar could be silver lining for emerging markets

A combination of a peak in US rates and the start of tighter monetary policy elsewhere will result in a weaker US dollar in 2019. Although the difference between US interest rates and those elsewhere will remain in favour of the US, that currency markets are likely to have priced this in already. We think currency markets will increasingly focus on the growing budget and current account deficits in the US, which will drag the currency lower. The current account is a nation's transactions with the rest of the world, including net trade.

For the emerging markets, a weaker dollar could be the silver lining in the outlook. Although an escalation of the trade wars and the prospect of slower global growth does not bode well, a weaker dollar would help ease pressure on the region. In 2018, rising US interest rates and a stronger dollar squeezed dollar borrowers outside the US, put pressure on emerging market currencies and forced local central banks to tighten monetary policy. Dollar strength also weakened commodity prices and hurt world trade. In 2019, there is scope for some of these factors to unwind, thereby easing financial conditions and supporting emerging market assets.

For the Eurozone, this scenario is less favourable as a stronger euro will tighten financial conditions, while the slowdown in the US is dragging on global growth. Both factors make it harder for the ECB to keep raising interest rates. There is a strong possibility that the ECB has left it too late to normalise interest rates and will look back on the past year as a missed opportunity. The region could become stuck with low rates and with little monetary firepower to fight the next downturn.

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