

OUTLOOK 2018

Global prospects: a (minimal) lexicon for an accurate reading of 2018

Using the right adjective was of the utmost importance for the Catalan writer Josep Pla. He believed that any adjective chosen should be intelligible, clear and precise. Albeit in a different sphere, economists face a similar challenge when it comes to characterising the cyclical outlook. The language used should be precise and capture the essence of the moment, as Josep Pla demanded. With this challenge in mind, and hand in hand with the Collins English Dictionary, we propose a brief lexicon of adjectives we believe will be applicable in the approaching 2018 and subsequent years.

Dynamic: *adj.* 3. characterised by force of personality, ambition, energy, new ideas, etc.

The first distinguishing feature of the current phase in the global economic cycle can clearly be associated with the adjective «dynamic». According to CaixaBank Research forecasts, the world economy will grow by 3.8% in 2018, slightly more than the 3.6% estimated growth in 2017. Similar forecasts are given by other organisations, such as the IMF and the World Bank. Historically speaking, these are positive figures that outperform the average annual growth since 1980, namely 3.5%. Moreover, if we broaden our focus and extend the timescale to 2022, these forecasts point to growth continuing at similar rates to those of 2017 and 2018. Consequently, after the global GDP growth observed in 2017, in 2018 the world economy will press down a little harder on the accelerator and is on track to enjoy several favourable years.

Synchronise: *vb.* 1. to occur or recur or cause to occur or recur at the same time or in unison.

The second adjective in this brief lexicon is «synchronised», the participle of the verb «synchronise». This highlights a unique feature of the current point in the cycle: the very similar growth enjoyed by different economies. For instance, the IMF expects only six countries to post negative growth rates. More sophisticated measures to evaluate the degree of synchronisation also come up with the same conclusion. Calculating the deviation between growth across countries and world growth, the degree of synchronisation in 2018 and subsequent years will be the highest since 1980. The only year that comes close to this figure is the one occurring during the recovery in growth in 2000.¹

Mature: *adj.* 1. relatively advanced physically, mentally, emotionally, etc.

The third essential feature of the current cycle concerns its degree of maturity. In everyday usage, «mature» generally has a positive connotation. However, a mature economic cycle is not, *per se*, better or worse than a cycle that is not mature. This state is merely associated with a number of specific features. Typically, a country at this stage of the economic cycle is more likely to have inflationary tensions because of the extensive use of its production factors and the emergence of bottlenecks. Determining the point in the cycle is complex enough for advanced economies providing high quality statistical information. But this calculation becomes even more unreliable for the global economy as a whole. Nevertheless, several measures suggest that the world's economy is slowly entering a more mature phase of the cycle.² The number of countries registering a positive output gap

1. Formally, the synchronisation indicator is calculated as follows:

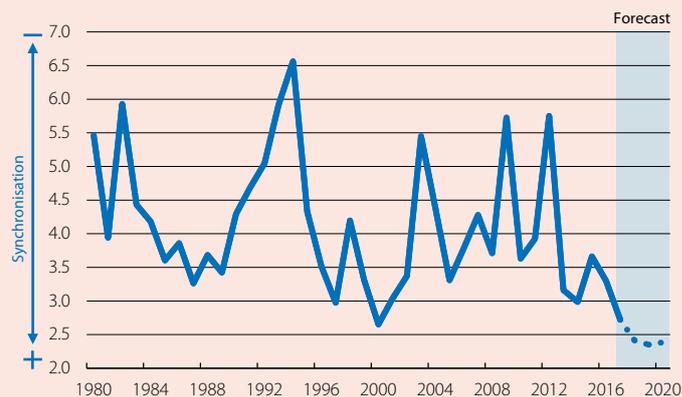
$$synchro_t = \sqrt{\sum c [s_{c,t} * (\dot{Y}_{t,c} - \dot{Y}_{world,t})^2]}, \text{ where } t \text{ denotes time and } c \text{ country.}$$

The variable $synchro_t$ represents the level of global synchronisation in the year t , $s_{c,t}$ corresponds to the share of country c of global GDP in purchasing power parity terms in year t , $\dot{Y}_{t,c}$ is the GDP growth in country c during the year t and, finally, $\dot{Y}_{world,t}$ is global growth during the same period t .

2. Specifically, output gap data suggest that the current point in the economic cycle is the one called «phase 1» by Fernandez, E., (2013), «Potential GDP and the output gap: what do they measure and what do they depend on?», MR 05/2013. In other words, with a positive and increasing output gap, which can be associated with the initial stages of a mature phase in the cycle.

Synchronisation of the economic cycle *

Index



Note: * The indicator is the standard deviation of each country's GDP growth minus world growth, where each country's relative weight is that country's share of global GDP in purchasing power parity terms for each year.

Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

(i.e. with real GDP exceeding potential) in 2018-2020 will therefore be the largest since 2008, before the Great Recession. Similarly, the world's average unemployment rate will be the lowest since 1990.

Sustainable: *adj. 2. (of economic development, energy sources, etc.) capable of being maintained at a steady level without exhausting natural resources or causing severe ecological damage.*

So far three adjectives have been used to describe the point in the cycle. But when it comes to analysing the quality of growth, i.e. when moving from a description to a forecast, the key is whether this expansion is sustainable or not. Although the adjective «sustainable» tends to be used in the environmental sense, here we are interested in sustained economic growth in the sense that it can be maintained over time. There are several reasons to conclude that the current growth rate is sustainable.

First, expansion is taking place without large macroeconomic imbalances being generated. Unlike the growth observed in the first half of the 2000s, economies are accumulating smaller current account imbalances and forecasts suggest this pattern might continue in the coming years. Another important aspect is related to what is probably the most distinctive feature of the current expansion, namely its high degree of synchronisation. Synchronised growth is, *a priori*, more sustainable because, should idiosyncratic shocks occur that only affect certain countries, other economies would be able to offset the negative impact. This diagnosis, recently repeated by ECB members when referring to Europe's expansionary cycle, can also be applied to the global growth cycle as a whole. However, if such synchronisation is due to a common factor and this factor deteriorates, the impact would also be more generalised than in a less synchronised situation. As has been argued several times, the global factor behind the current expansionary cycle is likely to be the global accommodative financial conditions. The CaixaBank Research main scenario predicts that a combination of very gradual normalisation with good forward guidance will help those countries most dependent on financing to steadily adapt to the somewhat tougher financial conditions.

Uncertain: *adj. 5. liable to variation; changeable.*

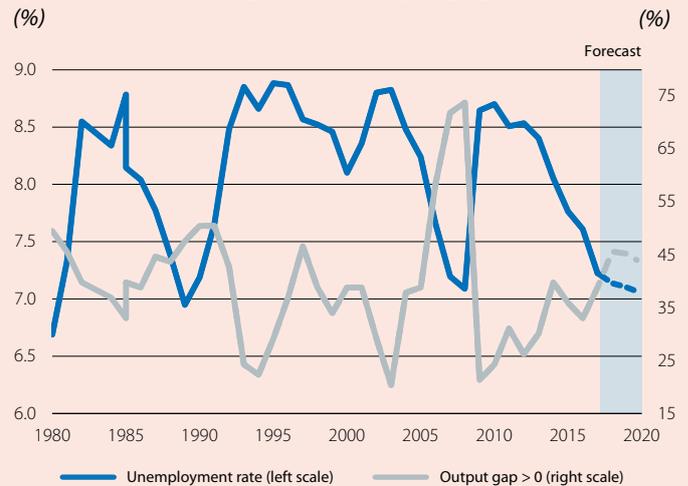
When trying to make economic predictions, we must remember that the future is, by definition, uncertain, although perhaps less so than it used to be. Nevertheless, given all the above, we can conclude that the situation and outlook are favourable. Growth will be strong and of a higher quality than in recent years. This same conclusion has been reached by several organisations. For example, in its latest outlook the IMF states that the upside and downside risks are balanced. For many years the concluding remark made by the IMF and other agencies had always been a variant of «but there are downside risks». Nevertheless, although risks have certainly become more balanced, the remaining sources of uncertainty should not be taken lightly. Global growth faces two main types of risk. Firstly, those of a macrofinancial nature, with the accumulation of debt as a major factor, a weakness that could come to the fore if global financial conditions tighten up more sharply than expected. Secondly, there are also political risks in the broadest sense, including geopolitical and a potential protectionist shift. Both these types of risk are covered by the other articles in this Dossier.

To conclude, let's return once more to the master wordsmith. Along with his requirement for a clear, intelligible and precise adjective, Josep Pla also demanded that writing should be as closely based on reality as possible. This is obviously not so far removed from the requirement imposed on economists and the description and forecasts presented here have attempted to follow this principle. Ultimately, time will tell whether our analysis, and its translation into adjectives, has also come up with an accurate prediction.

Àlex Ruiz

Macroeconomics Unit, Strategic Planning and Research Department, CaixaBank

World: unemployment rate and percentage of countries with a positive output gap



Source: CaixaBank Research, based on data from Thomson Reuters Datastream.