Box 2.2

Medium-term growth outlook of major economies

With the rise of trade protectionism and unilateralism among the major economies, the global economy has been facing a new set of challenges in recent years. Looking back to 2017, the global recovery from the Great Recession of 2009 had finally appeared to be on firmer ground, with the global economy showing its fastest growth since 2011 and the US Federal Reserve (Fed) making steady progress on bringing interest rates closer to pre-crisis levels. But in 2018, the tide turned once more as the US began to introduce additional tariffs on steel products of its major trading partners for national security reasons, and later also targeted at a wide range of Mainland products. Brexit also started to run into difficulties. Last year, the major economies experienced a synchronized growth slowdown, with global economic growth softening to a decade low. Partly in response to trade uncertainty, the Fed lowered interest rates thrice in the second half of 2019, and central banks in other advanced and developing economies also eased their policy stance. With trade-related conflicts being more prevalent, and longer-term headwinds such as population aging and rising debt still on the horizon, the growth outlook for major economies over the next few years is fraught with considerable uncertainty.

The Mainland economy saw growth deceleration through most of 2019. While its reliance on external demand has diminished significantly over the years as a result of structural transformation, the near-term economic performance will still hinge on the pace of the global economic recovery and how the trade relations with the US evolve. The development of the novel coronavirus infection, especially its duration, is another crucial factor. Looking further ahead, growth is expected to be increasingly driven by innovation, domestic consumption and the services sector, but will inevitably settle at a more moderate pace as the Mainland economy is steadily making the transition towards high-quality and sustainable development. Taking these factors into account, the International Monetary Fund (IMF) projected that the Mainland economy would grow at an average annual rate of 5.7% in 2020-2024, while the Organisation for Economic Cooperation and Development (OECD) projected 5.6%. With its economy projected to grow much faster than the global average, the Mainland is well positioned to remain a key growth driver and stabilising force for the global economy.

Despite the escalation of US-Mainland trade tensions in 2018, the US economy performed quite well that year, with output eventually surpassing the US Congressional Budget Office's estimate of its long-term sustainable level. Overall growth remained decent in 2019. The unemployment rate has steadily declined, recently to lows not seen since the 1960s, thereby underpinning the resilience of private consumption. In the coming few years, as the effectiveness of monetary policy is approaching its limit, barring any significant boost from fresh fiscal stimulus, growth in the US is expected to progressively decelerate towards its long-run potential level, at somewhat below 2% per annum, which is largely based on the underlying trends in productivity, capital investment, and the labour force (***Chart 1a***).

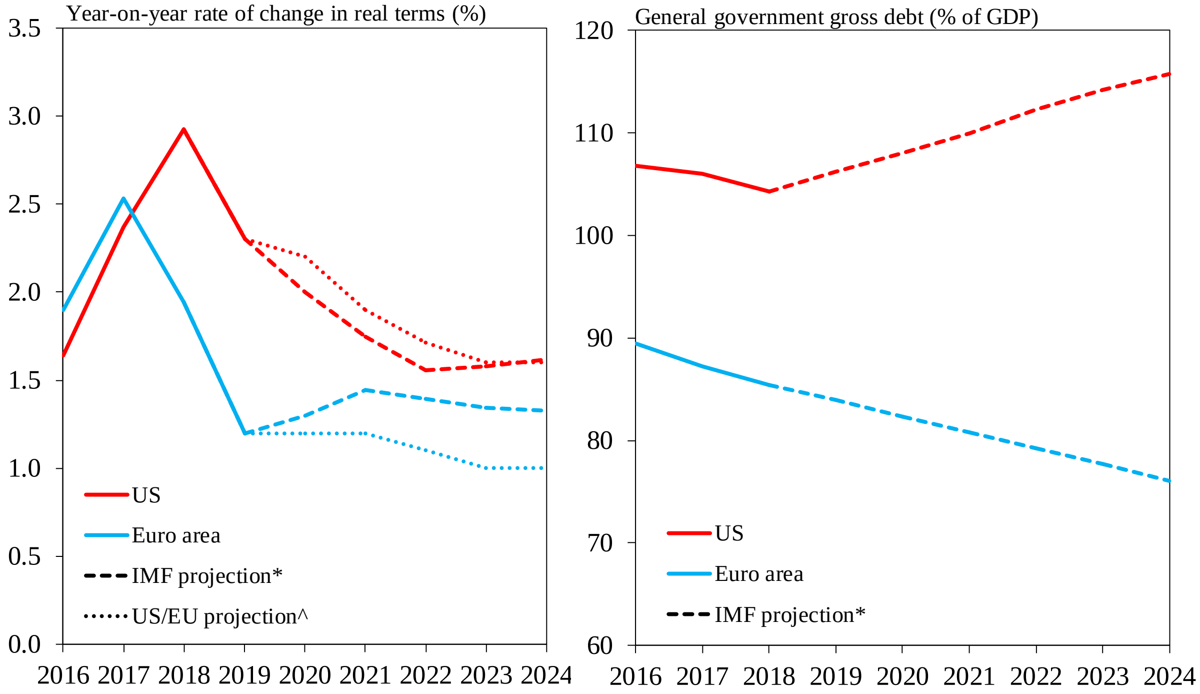
In the euro area, weaknesses in trade and manufacturing activity amid the difficult global economic environment and Brexit-related uncertainties have dampened growth prospects since early 2018, most notably in Germany. Facing a larger-than-expected slowdown in economic growth and persistently weak inflation, the ECB cut interest rates further into negative territory and restarted its asset purchase programme in late 2019. In the medium term, growth of the euro area is likely to stay moderate, given the constraints posed by various structural issues, including a shrinking labour force and the high levels of government debt in some member economies (***Chart 1a***). Much will also depend on the orderly resolution of Brexit during the transition period till the end of 2020. Failing which, the resulting disruptions and uncertainties would inevitably dampen economic activities and sentiment in the euro area, with potential adverse spill-over effects on the global economy.

Box 2.2 (Cont'd)

Chart 1 : GDP and debt projections for the US and the euro area

(a) US economic growth is expected to exceed that in the euro area

(b) ... but the euro area has more room to deploy fiscal measures



Sources: (*) World Economic Outlook October 2019 and January 2020 Update; (^) Congressional Budget Office 10-Year Economic Projections, January 2020; European Commission Winter 2020 Economic Forecast; European Commission Debt Sustainability Monitor 2019

An important caveat about the projections of the international organisations (as depicted in ***Chart 1a***) is that they assume the US' level of public debt as a share of GDP will continue to rise, whereas the euro area is on a path of fiscal consolidation (***Chart 1b***) [(1)]. Under this scenario, US interest rates will be subject to upward pressure over time, which the Fed could only offset at the risk of higher inflation. Fiscal consolidation, through either higher taxes, lower public spending, or a combination of both, will invariably push down the US' economic growth until debt sustainability is achieved. Almost the reverse of the US case, growth potential of the euro area's economy could be boosted by additional fiscal measures, particularly if national authorities with fiscal space take up the ECB's recent call for greater public investment.

Turning back to Asia, the consumption tax hike since October 2019 has dealt an additional blow to economic performance in Japan. In the medium-term, various structural issues such as population ageing and elevated public debts will continue to cap Japan's growth potential. The IMF projected Japan's economy to grow at a trend of 0.5% per annum in 2020-24. Meanwhile, developing economies in ASEAN generally eased slightly in 2019 as exports declined amid weakening demand from the advanced economies. Nonetheless, the dampening effect of the global economic slowdown, which has hit both exports and domestic investment, was to some extent cushioned by the still strong private consumption and in some economies like Vietnam and Malaysia also the deflection of a portion of global demand by the US-Mainland trade conflict. Looking ahead, the OECD projected that ASEAN economies as a whole would grow at an average annual rate of 4.9% in 2020-2024, slightly slower than the 5.0% achieved in 2013-2017 but still considerably above the average of advanced economies.

(1) Projections by US and EU authorities show similar trends but are not based on the same measure of debt.