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World Economy Expected to be Hardly Affected by UK's Exit from EU

Medium-term Forecast Until 2021

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Global economic growth is set to gain only little momentum over the medium term. The US economy should expand at a solid pace, driven by buoyant domestic demand and an increasing labour force. Activity in the euro area will be more subdued, as the institutional shortcomings of Monetary Union undermine business confidence and the active population broadly stagnates. The UK exit from the EU will primarily affect the British economy itself, and to a lesser extent its trading partners. The growth momentum of the emerging markets keeps slackening further. Demand and output in China are slowing down, while Russia and Brazil recover only gradually from the current crisis, given the low raw material prices.

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At a projected annual rate of 3.5 percent, global economic growth in the next five years will pick up only little from the previous period, while remaining below its long-term average. Growth prospects for the USA are comparatively favourable, as private indebtedness has receded, the jobless rate is low and the labour force increasing. The strength of the dollar is weighing on output growth, albeit to a limited extent given the low export/GDP ratio. Against this background, we expect the US economy to expand by 2.4 percent p.a. over the medium term. The welfare gap of the euro area vis-à-vis the USA that has opened up since the EMU crisis of 2012-13 is set to widen further. The labour force is stagnating in the euro area and unemployment is likely to go down gradually. With private demand being subdued, inflation will stay below the ECB target, while the scope for higher public demand is constrained by tighter fiscal rules. Medium-term growth for the euro area is projected at 1.5 percent p.a.

The negotiations for the withdrawal of the UK from the EU ("Brexit") will add to uncertainty and thus dampen internal demand. Britain's shares in EU exports and foreign direct investments will decline to an extent depending on the restrictions that will be imposed on bilateral trade. The adverse effects on growth will be largely confined to the British economy itself and – due to the close trade links – to Ireland. For the other EU economies, the negative repercussions of "Brexit" are likely to be minor altogether.

The growth momentum in the major emerging market economies is further losing steam. The Chinese economy suffers from excess productive capacity and will face heightened financial market risks in coming years, when capital controls will be relaxed. Recovery from recession promises to be slow in Russia and Brazil, since global

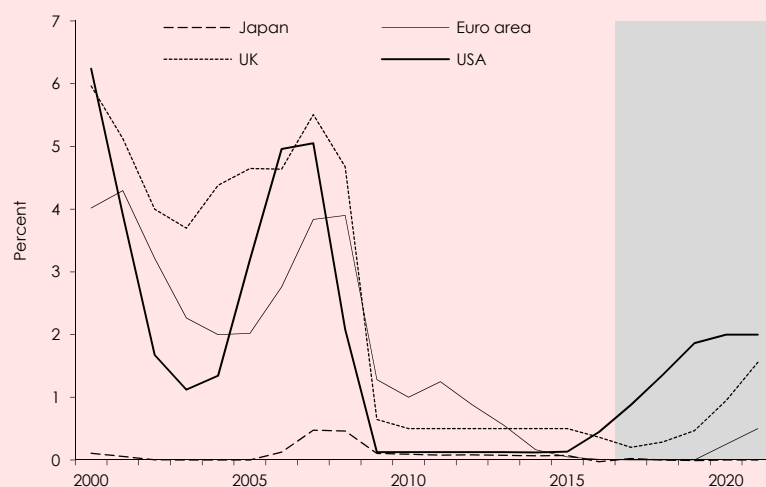
demand for raw materials will rise only gradually. The implicit moderation of commodity prices may, for its part, benefit the Indian economy provided it can escape further negative effects resulting from the interest rate turnaround in the USA.

Table 1: The international environment

	Ø 2001-2006	Ø 2006-2011	Ø 2011-2016	Ø 2016-2021
Year-to-year percentage changes				
GDP, volume				
World	+ 4.6	+ 3.6	+ 3.2	+ 3.5
USA	+ 2.9	+ 0.6	+ 2.1	+ 2.4
Japan	+ 1.5	- 0.1	+ 0.8	+ 0.5
EU	+ 2.1	+ 0.5	+ 1.0	+ 1.7
Euro area	+ 1.8	+ 0.5	+ 0.6	+ 1.5
Germany	+ 0.9	+ 1.2	+ 1.2	+ 1.4
CEE5 ¹	+ 4.4	+ 2.8	+ 2.0	+ 2.7
China	+ 10.7	+ 10.7	+ 7.3	+ 6.0
World trade (goods), volume	+ 6.7	+ 2.4	+ 1.8	+ 2.9
\$ per barrel				
Oil price (Brent)	42	84	83	61
\$ per €				
Exchange rate	1.16	1.39	1.23	1.10

Source: Oxford Economic Forecasting, WIFO. – ¹ Czech Republic, Hungary, Poland, Slovenia, Slovakia.

Figure 1: Key interest rates up to 2021



Source: Oxford Economic Forecasting, WIFO.

The medium-term projections for the world economy have been established using the Oxford Economics Global Economic Model. The model includes a total of 80 countries, of which the economies of China, the USA, most EU countries, India, Japan, Russia and Brazil in a highly disaggregated form.

1. Sluggish demand dampens global trade

The momentum of world trade has been decelerating significantly since spring 2015. One major factor was the slump in activity and foreign trade in Russia, another one the slowdown of China's external trade. Contrary to the expectation underlying the WIFO forecast for the world economy of October 2015 (Schiman, 2015), world-wide trade has so far failed to rebound, but has decelerated further. The weakness has meanwhile spread across all major economic zones. Merchandise trade is stagnat-

ing, as aggregate demand is deficient for a number of reasons. Hence, imports are largely flat and so are the exports of the respective trading partners. In addition, the removal of still existing trade barriers is becoming more and more difficult ("Brexit", resistance against CETA and TTIP). Any medium-term recovery of world trade therefore promises to be sticky.

Oil prices have barely picked up from the slump in 2014-15 since dampening factors continue to prevail: on the one hand, sluggish business activity worldwide is holding demand for oil down, notably from the larger emerging market countries with major commodity-intensive industries. Oil supply, on the other hand, has been further expanding, since "fracking", due to efficiency gains, appears to be profitable even at low oil prices and with traditional oil producers trying to maintain their market shares by engaging in price competition. As global business activity recovers and the supply side consolidates, the price-dampening effects should gradually subside and allow oil prices to follow a moderate upward trend in the medium term.

Sagging industrial activity in China and producers' fight for market shares keep oil prices down.

2. Euro area: no dominating impact of UK's exit from EU and inflow of asylum seekers

The withdrawal of the UK from the EU ("Brexit") and the massive inflow of refugees in 2015, while currently being widely debated in policy circles, are unlikely to shape medium-term developments of the euro area economy in an important way. The potential macroeconomic effects of "Brexit" are of sizeable scope only for the British and the Irish economy, but probably much less so for the other EU member countries, depending on their bilateral trade relations and the future trade policy framework to be found with the UK (see also chapter 2.1).

Table 2: Key economic indicators for the euro area and Japan

	Euro area		Japan	
	Ø 2011-2016	Ø 2016-2021	Ø 2011-2016	Ø 2016-2021
Year-to-year percentage changes				
Gross fixed investment, volume	+ 0.1	+ 1.9	+ 1.3	+ 0.5
Population of working age	+ 0.2	- 0.1	- 1.1	- 0.8
GDP, volume	+ 0.6	+ 1.5	+ 0.8	+ 0.5
GDP per capita, volume	+ 0.2	+ 1.4	+ 0.9	+ 0.8
Consumer prices	+ 0.9	+ 1.1	+ 0.7	+ 0.8
Real-effective exchange rate	- 2.1	- 0.8	- 4.5	- 2.8
Percent				
Unemployment rate, as a percentage of labour force	11.2	9.2	3.7	2.7
Long-term interest rate	2.2	2.5	0.5	0.3
World market export share	28.0	28.0	4.3	3.9
As a percentage of GDP				
Current account balance	2.5	2.9	2.0	3.4
General government financial balance	- 2.6	- 1.4	- 6.9	- 5.5
Gross government debt	91	90	226	245

Source: Oxford Economic Forecasting, WIFO.

Whether or not the European economies will benefit from the inflow of refugees will to a great deal depend on the economic policy response to the implicit increase in labour supply. Should the latter remain idle, unemployment and the squeeze on private incomes (particularly the low ones) would increase, thereby weakening consumer demand. The negative impact on aggregate demand would be exacerbated if governments would cut services and social benefits for asylum seekers. If, in addition, labour market integration of refugees would displace existing workforce or undercut wage levels (e.g., via "one-euro jobs"), no extra demand would be generated. An increase in aggregate demand requires expansionary policy measures in favour of new job and income opportunities. Moreover, the insertion of asylum seekers into education and employment calls for appropriate public and private ini-

tiatives, in order to bring to bear the longer-term benefits of the migration movement. For the time being, these macroeconomic benefits are altogether small for the EU at large (albeit varying widely between countries due to the unequal distribution of the refugees). The *European Commission* (2016) anticipates until 2020 an annual increase in employment by 0.2 percent to 0.3 percent and of GDP by 0.1 percent to 0.2 percent, hence a reduction in GDP per capita by 0.1 percent. The IMF expects a medium-term increase of EU GDP by some 0.2 percent and of the unemployment rate by 0.05 to 0.12 percentage points (Aiyar *et al.*, 2016).

Figure 2: Per-capita income and unemployment rate for the USA and the euro area



Source: Oxford Economic Forecasting, WIFO.

Irrespective of "Brexit" and the wave of refugee immigration, the underlying growth dynamics of the euro area remains weak and productive capacity under-utilised (negative output gap). Only the German economy whose growth is accompanied by high surpluses on foreign trade, is approaching full employment. The weakness of aggregate demand in the euro area is rooted in the efforts of private households and companies to step up their savings in order to make up for the losses in income and wealth incurred during the crisis periods of 2008-09 and 2012-13. Since governments are likewise seeking to save more (reduce their budget deficits) or – like the periphery countries – were compelled to do so, overall demand and output were sapped. Without fresh demand stimulus, the welfare lag of the euro area vis-à-vis the USA that developed in recent years, will not be made up in a medium-term perspective (Figure 2).

A symptom of sluggish demand is the slow pace of inflation. The core rate (excluding energy and unprocessed food) has been below 1 percent for the last three years. This complicates the unwinding of accumulated debt and counters Central Bank efforts to lower real interest rates, thereby reducing the profitability of investment. As the ECB is unsuccessful in accelerating inflation by conventional means, it has since March 2015 embarked on a large-scale euro-area government bond purchasing programme. In June 2016, the tune of monthly bond purchases was raised from 60 billion € to 80 billion € and extended to include corporate bonds. The monetary expansion pushed down the euro exchange rate and facilitated new borrowing. Still, euro area governments do not make use of the easier credit conditions; like in the years before, they rather aim at reducing their debt burden. Going forward, tighter fiscal rules will further constrain governments' fiscal room for manoeuvre. Under the new deficit rule, the general government deficit, adjusted for cyclical and one-off effects (structural budget deficit) of an euro area country must not exceed 0.5 percent of GDP. Furthermore, the government debt ratio ought to be reduced each year by one-twentieth of its excess over 60 percent of GDP. Apart from the euro depreciation that has already occurred, the government bond purchases by the ECB are therefore unlikely to make any further expansionary and inflation-accelerating impact.

The gap in welfare between the euro area and the USA that opened up during the financial market crisis and the recession will not close over a medium-term horizon.

The expansionary monetary policy shows little effect on the real economy. Government budgets face heightened constraints from tighter fiscal rules.

Not only the weakness of aggregate demand, but also the deficiencies of the EMU architecture are likely to persist in the foreseeable future. A deeper integration within the Monetary Union that would compensate the loss of national sovereignty in monetary matters and would be a prerequisite for an effective stabilisation policy, is not in sight given the rise in nationalistic tendencies across Europe. The fragile institutional framework keeps uncertainty high and the investment climate subdued, although the lacking growth momentum in recent years has created a sizeable backlog of the need for physical capital replacement. Moreover, macroeconomic challenges keep being addressed at the national level, without due consideration being given to the implications of policy action for the euro area as an economic entity. Thus, while the crisis has in many countries led to a swing of current account balances into positive territory, the high German surplus has not narrowed; a reduction of intra-euro-area current account imbalances has failed to materialise.

In the absence of a deeper EMU integration, an effective stabilisation policy and a reduction of current account imbalances will not be achieved.

Medium-term GDP growth in the euro area is projected at 1.5 percent p.a., while inflation remains below the ECB target of an annual 2 percent and the unemployment rate gradually abates, as the labour force stagnates in the near future and slightly declines thereafter.

2.1 Macroeconomic consequences of "Brexit"

In a referendum on 23 June 2016, British voters opted by a majority of 51.9 percent (at a participation rate of 72.2 percent) for a withdrawal of the UK from the EU. Since nearly all previous economic forecasts had been based on the assumption of Britain remaining a member of the EU, the vote and the subsequent exit procedure require an adjustment of the projection to the new situation.

An assessment of the macroeconomic consequences is largely determined by the high degree of uncertainty surrounding the exit procedure. Since no member country has ever left the EU, it is not possible to resort to past experience. The only certain element derives from Art. 50 Treaty on European Union (TEU), whereby the withdrawal from the EU shall enter into force within two years from the British government's notification to the European Council of its intention to do so (an extension of the deadline is possible). The British government has announced to submit this notification by March 2017. It is still unclear how the exit procedure, once initiated, will evolve, to which regulatory reforms (notably with regard to trade, migration and fiscal policy) it will give rise, and which bilateral arrangements the British government will be able to achieve.

In the following sections, we sketch potential economic effects of a withdrawal from the EU, as discussed in the literature. We distinguish between short-term effects setting in during the negotiation procedure, and medium- to long-term effects deriving from changes in the regulatory framework. The key driver of the short-term economic effects is the heightened uncertainty relating to the exit procedure, while longer-term effects should largely be expected from restrictions to bilateral trade.

2.1.1 Short-terms effects from higher uncertainty

During the exit procedure, the implicit uncertainty operates via different channels, particularly via rising risk premia on exchange rates and interest rates. They lower the value of the Pound Sterling vs. other currencies, thereby driving up import prices and overall inflation. To date, the Bank of England has already responded to the higher risk premia and refinancing costs (interest rates), by cutting the key interest rate from 0.5 to 0.25 percent. The interest rate reaction to higher uncertainty may affect individual economic sectors in a rather different way. Thus, the government sector may benefit from a shift of financial capital from higher-risk securities towards government bonds. However, companies and private borrowers are clearly adversely affected by rising risk premia. Portfolio shifts, possibly accompanied by downgrading from rating agencies, would make it more expensive for firms to raise fresh foreign or equity capital. Banks may face a squeeze of their equity capital base.

Apart from the rising risk premia, higher uncertainty also has direct macroeconomic effects. Ambiguity about future trade policy settings complicates an assessment of future earnings and weighs on investment that usually implies high launching cost. In

the same vein, it will detract from job creation. If labour and physical capital is longer bound to obsolete and less efficient production processes, overall productivity growth will be impaired, with negative repercussions on private incomes and consumption. The latter will also be dampened by households' greater caution towards spending, the decline in (real estate) asset values and higher credit cost. The negative repercussions of higher uncertainty on domestic private demand will inhibit output growth. Currency depreciation, on the other hand, should lead, with a certain time lag, to higher net exports as imports from the UK will become cheaper – an effect that should cushion the downturn, at least temporarily. Yet, the benign exchange rate effect is doubtful: although the value of the Pound Sterling against the euro between 2009 and 2014 was down by up to 25 percent from its pre-crisis level, export growth failed to pick up. Hence, foreign demand is either rather price-inelastic, which may hold particularly for (financial) services, or exporting firms used the improvement in price competitiveness for widening their profit margins. In both cases, UK GDP growth would suffer from heightened uncertainty.

2.1.2 Long-term effects from changes in the regulatory framework

In the medium and longer run, trade and direct investment between the UK and the EU member countries are set to decline in the wake of "Brexit", since the Internal Market offers maximum freedom of trade. The degree of such "trade destruction" will depend on the regulatory agreement that will replace EU membership. Several alternatives are possible:

- Continued membership in the European Economic Area (EEA status): like with Norway, Iceland and Liechtenstein, the "four freedoms" of the Internal Market would continue to apply (free movement of goods, services, capital and labour). It would be incumbent on the UK to renegotiate tariffs and trade agreements with third countries. The UK would still be liable to contributions to the EU Budget which would, however, be reduced by about one-tenth of full EU membership contributions.
- "Swiss model" (bilateral agreements, possibly re-entry into EFTA): between the EU and Switzerland (the only one of four EFTA countries that is not also member of EEA) free movement of goods prevails, but not of services and therefore no unlimited access of Swiss financial service providers to the EU financial market (financial passporting rights). The right of free movement of EU citizens is (still) in force. For the UK this model would mean that agreements would in principle have to be negotiated on a bilateral basis. The UK could also or would have to renegotiate tariffs and trade agreements with third countries. The country would still have to contribute to the EU Budget, to an amount roughly equivalent to 50 percent of EU membership contributions.
- Continued membership in the European Customs Union: in a similar way as for Andorra, Monaco, San Marino and Turkey, the tariffs and trade agreements settled by the EU with third countries (e.g., CETA or TTIP) would apply. Vis-à-vis the EU countries themselves, there would be no restrictions to merchandise trade, but some restrictions to trade in services (in particular, no financial passporting rights would be granted). The free movement of persons may be restricted. No contributions to the EU Budget would be due.
- Free trade zone: in this case that is otherwise similar to a customs union, the UK may or would have to renegotiate tariffs and trade agreements with third countries.
- Most-favoured nation clause according to WTO: this scenario would amount to Britain's greatest possible alienation from the EU. As a member of WTO, the country would merely "benefit" from the most-favoured nation clause and enjoy an advantage only vis-à-vis the handful of countries that are not members of WTO.

The "EEA status" scenario appears unlikely from today's perspective, since the free movement of persons – the key motive for the exit – would have to be maintained. Equally unlikely should be the fifth ("WTO") scenario, given that a large part of the British society and the corporate sector keep an undiminished friendly position towards the EU. Future changes in trade, regulatory and migration policy settings will

leave their marks in different areas of economic developments: changes to the free movement of persons have implications for labour supply; changes in the regulatory system would influence overall productivity; changes in trade relations, both with the EU and with third countries, will have repercussions on trade volumes and foreign direct investment. The decline of British export market shares in the EU lowers export prices and the exchange rate. Higher import prices weigh on real disposable income and consumer demand. Restraint in foreign direct investment dampens private demand for capital goods and, due to the obsolescence of machinery and equipment, productivity growth. In all, "Brexit" is expected to squeeze UK GDP in the medium and longer run by up to 3½ percent, depending on the new trade policy and regulatory framework that Britain will adopt in response.

Studies that arrive at markedly higher output losses than 3½ percent mostly rest on the assumption that overall productivity in the UK will directly be affected by the reduced openness of the economy. They draw on conclusions from other studies conducted for a large number of countries over long time periods, from which they derive an "average" trend of productivity growth. Yet, since the crisis of 2008-09, UK productivity gains have been unusually low, the reasons of which have not yet been identified. While in the light of such observed sluggishness it is difficult to anticipate the impact of reduced openness, it should be considered as an additional downward risk.

Although the EU member countries account for about half of Britain's foreign trade and for almost half of inward-bound foreign direct investment, they are unlikely to suffer significant output losses from "Brexit". Comparatively more strongly affected should be the Irish economy, due to its closer links with the UK.

2.1.3 The financial sector as particular risk

Any restriction to the financial passporting rights, i.e. the possibility to offer banking services in other EU member countries without the authorisation by the local supervisory authorities, would imply important changes for London as financial hub. With an employment share of 3 percent, the British financial sector is only seemingly a matter of the London elite: on the one hand, it generates no less than 11 percent of total tax revenues, and its export surplus of some 3 percent of GDP, on the other hand, brings down the overall high current account deficit to some 5 percent of GDP. Drastic trade restrictions for the financial sector could therefore exert pressure on both public finances and the Pound Sterling. Another, this time politically induced, destabilisation of European financial markets should be in the interest of neither the UK nor the EU.

2.1.4 A secession of Scotland as collateral risk

A further issue in the context of "Brexit" is the mutual relationship between the British territories: the overall majority for "Brexit" in the referendum was confined to England and Wales (of about 53 percent respectively); in Scotland and Wales, however, only 38 percent and 44 percent respectively of voters were in favour of leaving the EU. Against this background, the independence issue may rekindle in Scotland, the more so as the province is governed by the separatist Scottish National Party. On the other hand, the closer trade links with Britain than with the EU and the low oil price attenuate the risk of a Scottish separation.

3. USA: solid growth keeps unemployment low

Steady and robust GDP growth in the USA is set to continue in the next couple of years, although the strength of the dollar is weighing on exports and investment. This effect should nevertheless be limited since exports account for only 14 percent of GDP (as compared with an export share of 26 percent of GDP for the euro area vis-à-vis third countries). The strong dollar, on the other hand, is supportive of private consumption which also benefits from the unwinding of private household debt during the last few years and from an accelerating wage dynamics. Apart from the consolidated asset balance of the private sector, GDP growth receives sustained support from a rather easy fiscal stance. While the general government deficit has

been cut in less than half since the crisis of 2009 (when it was 12 percent of GDP), the ratio of 4.8 percent expected for 2016 is still rather high when compared with the 2.0 percent of GDP for the euro area. In terms of new government borrowing, fiscal policy will remain expansionary over the forecast period, with an average general government deficit projected at 4.4 percent of GDP.

Table 3: Key economic indicators for the USA and the UK

	USA		UK	
	Ø 2011-2016	Ø 2016-2021	Ø 2011-2016	Ø 2016-2021
	Year-to-year percentage changes			
Gross fixed investment, volume	+ 3.6	+ 3.8	+ 3.1	+ 4.0
Population of working age	+ 1.1	+ 1.0	+ 0.8	+ 1.0
GDP, volume	+ 2.1	+ 2.4	+ 2.1	+ 2.0
GDP per capita, volume	+ 1.3	+ 1.6	+ 1.3	+ 1.3
Consumer prices	+ 1.3	+ 2.1	+ 1.5	+ 1.9
Real-effective exchange rate	+ 3.8	- 0.5	+ 0.7	+ 1.1
	Ø 2012-2016 Ø 2017-2021 Ø 2012-2016 Ø 2017-2021			
	Year-to-year percentage changes			
Unemployment rate, as a percentage of labour force	6.3	4.6	7.1	5.2
Long-term interest rate	2.1	2.7	2.0	2.0
World market export share	10.5	10.0	3.7	3.7
	As a percentage of GDP			
Current account balance	- 2.5	- 3.0	- 4.8	- 2.6
General government financial balance	- 5.7	- 4.4	- 5.5	- 1.9
Gross government debt	125	124	87	87

Source: Oxford Economic Forecasting, WIFO.

Despite a slight downward revision, the projected GDP growth for the USA of 2.4 per cent p.a. from 2016 to 2021 is the highest rate among the industrialised countries. Potential growth is fostered by the labour force expanding at an average 1 percent per year, while the active population will decline in the euro area, China and Japan. Given the altogether benign growth outlook, monetary policy will gradually raise the key interest rate, albeit to a moderate extent since inflation risks should remain low. The unemployment rate will subside to an average 4.6 percent.

4. Growth in key emerging markets losing momentum

Chinese financial markets have recovered from the slump in stock market values of summer 2015, whose impact on the real economy was limited. More serious challenges for demand and output prospects are the sizeable excess capacities in the real estate sector as well as in mining and steel production, which are belated repercussions of the global recession of 2009 that severely hit the Chinese export industry as the driver of growth since China's WTO accession in 2001. China countered the slump in exports with a large-scale investment programme: the investment/GDP ratio has by now climbed to an extremely high 45 percent. In view of the self-imposed compulsion to growth – per-capita income shall by 2020 be twice as high as in 2010 – the government is likely to take further expansionary measures in the next years, although their effectiveness diminishes with the prevailing excess capacity and the mounting debt burden of state-controlled enterprises risks destabilising financial markets.

A further risk for financial market stability may arise from the potential liberalisation of capital movements (current account transactions have been deregulated already since the 1990s). Capital controls have enabled the Chinese Central Bank to keep the exchange rate low, thereby fuelling the export-led catching-up process. While the exchange rate has been continuously adjusted and the current account surplus been brought down from almost 10 percent of GDP in 2007 to 3 percent in 2015, China's financial markets are poorly developed and the government expects incen-

Going forward, the Chinese economy is facing the dilemma of excess productive capacity and new stimulation measures. A relaxation of capital controls would lead to higher financial market risks.

tives for growth from an opening of capital markets (and the implicit liberalisation of the exchange rate). Negative experiences with financial market deregulation, such as the stock market crisis of summer 2015, may however delay reforms along these lines.

Table 4: Key economic indicators for China and India

	China		India	
	Ø 2011-2016	Ø 2016-2021	Ø 2011-2016	Ø 2016-2021
	Year-to-year percentage changes			
Gross fixed investment, volume	+ 7.6	+ 4.7	+ 4.4	+ 7.0
Population of working age	+ 0.1	- 0.3	+ 1.7	+ 1.4
GDP, volume	+ 7.3	+ 6.0	+ 6.7	+ 6.9
GDP per capita, volume	+ 6.7	+ 5.7	+ 5.4	+ 5.7
Consumer prices	+ 2.2	+ 2.6	+ 7.2	+ 5.0
Real-effective exchange rate	+ 4.0	+ 1.8	+ 2.1	+ 1.6
	Ø 2012-2016	Ø 2017-2021	Ø 2012-2016	Ø 2017-2021
	Percent			
Unemployment rate, as a percentage of labour force	4.1	4.0	5.5	5.5
Long-term interest rate	3.5	3.6	8.0	6.5
World market export share	10.5	11.3	0.3	1.8
	As a percentage of GDP			
Current account balance	+ 2.4	+ 1.2	- 2.1	- 1.0
General government financial balance	- 2.3	- 4.0	- 4.6	- 3.6
Gross government debt ¹	16	27	48	53

Source: Oxford Economic Forecasting, WIFO. – ¹ Central government.

Further policy challenges arise from the design of the public social welfare system. An extension of social income maintenance and of pay-as-you-go-based retirement provisions may contribute towards a reduction of the high private household saving ratio and raise the share of private consumption in GDP that is currently below 40 percent. A gradual shift from export- and subsequently investment-led growth towards greater reliance on consumer demand will lead to a decline in the GDP share of manufactured goods in favour of service production, implying a slowdown in productivity growth. With the active population shrinking in the medium term, GDP growth will decelerate from the strong pace observed in the past. This will also be reflected by the officially released GDP figures which are deemed highly exaggerated and have prompted the Conference Board to replace them with own calculations. The WIFO projection for China's GDP growth is 6 percent on annual average over the period from 2016 to 2021.

Slower growth in China and the concomitant decline in raw material prices have major adverse repercussions for other emerging markets, notably for the two large economies of Russia and Brazil. As the world's prime supplier of natural gas and second-largest oil producer, Russia has for many years profited from high oil prices on world markets. Also government finances greatly rely on revenues from the oil business. In a similar way, the Brazilian economy highly depends on exports of commodities, prices of which have fallen drastically since 2014. The earlier boom had crowded out forward-looking investment in other sectors of the economy. In addition, capital outflows and rising inflation forced these countries' Central Banks to keep interest rates high. The consequences of this "Dutch disease" manifest themselves not only in the current crisis hitting both countries, but will also hold back GDP growth in the years to come (Russia +1.3 percent p.a.; Brazil +2.5 percent p.a.).

India on the other hand, as an importer of commodities, benefits from low prices. A risk element, in this instance, is the turnaround in US interest rates. The present forecast assumes nevertheless that the direct impact of the imminent rate hikes will be less disruptive than the announcement of monetary tightening by Fed-President Bernanke in 2013 that had triggered major portfolio shifts and notably capital outflows from India. Indeed, due to the skilful handling of the crisis under Governor

The slump in commodity prices puts strain on the economies of Russia and Brazil, while benefiting India.

Rajan at the time, the Indian Central Bank has gained reputation among market participants. Assuming persistently low commodity prices and the absence of financial market turbulence, India can expect to enjoy firm economic growth averaging 6.9 percent per year.

Table 5: Key economic indicators for Brazil and Russia

	Brazil		Russia	
	Ø 2011-2016	Ø 2016-2021	Ø 2011-2016	Ø 2016-2021
	Year-to-year percentage changes			
Gross fixed investment, volume	- 5.1	+ 4.8	- 1.7	+ 0.6
Population of working age	+ 1.2	+ 0.9	- 0.7	- 1.0
GDP, volume	- 0.5	+ 2.5	+ 0.1	+ 1.3
GDP per capita, volume	- 1.3	+ 1.8	+ 0.1	+ 1.4
Consumer prices	+ 7.1	+ 4.4	+ 8.5	+ 4.6
Real-effective exchange rate	- 5.3	- 1.4	- 6.4	+ 2.8
	Ø 2012-2016	Ø 2017-2021	Ø 2012-2016	Ø 2017-2021
	Percent			
Unemployment rate, as a percentage of labour force	7.9	12.6	5.5	5.2
Long-term interest rate	12.0	11.2	9.0	6.6
World market export share	1.3	1.3	2.4	2.3
	As a percentage of GDP			
Current account balance	- 2.9	- 0.6	+ 3.5	+ 5.9
General government financial balance	- 6.0	- 5.6	- 1.6	- 0.7
Gross government debt	60	78	10	10

Source: Oxford Economic Forecasting, WIFO.

5. References

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