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Outlook 2017: Optimism despite multiple risks

Elections in France, Germany and the Netherlands, the move of the US President-elect Donald Trump into the Oval Office, the start of Brexit negotiations – given the elevated uncertainty hanging over political and economic developments next year, there is really only one thing that is certain: 2017 will be an eventful and interesting year.

A host of unknowns

Forecasters are yet again faced with the daunting task of predicting the impact of political uncertainty on economic developments. In the past year, the economy proved fairly resilient in the face of unexpected shocks, with neither the Brexit vote in the UK, nor the election of Donald Trump, nor the failed referendum in Italy shaking the economic foundations with any lasting impact. Although the global economy reported growth of only 2.4%, the economic slowdown in Asian emerging markets and the recessions in Brazil and Russia shoulder a much bigger share of the blame for this development. So does the economic resilience witnessed in 2016 mean that we can be optimistic about 2017, which presumably has its fair share of political turbulence in store, as well?

We believe that the answer is yes. The global economy is in relatively good shape and stands to get off to a positive start to the new year after a modest acceleration in the closing quarter of 2016. Given the improvements seen in many up-and-coming economies over the past few months and growth conditions in the developed countries that are favorable overall, we predict economic growth to the tune of 2.8% for 2017 as a whole.

There is no doubt that this does not signal the end of the "new normal", i.e. the environment of sub-par economic growth and low inflation that has prevailed since the economic crisis. The first signs of a tentative turnaround, however, are starting to emerge – with long-term interest rates and inflation now edging upwards – and this is expected to continue in 2017.

Naturally, there will be quite a few unknown factors at play in 2017 as well: the future US economic policy pursued by Donald Trump, the outcome of the elections in Germany and France, the manner in which the Brexit negotiations progress. The fact that the US and European central banks are currently pursuing very different monetary policy paths and the mounting personal debt levels in many emerging markets create additional economic uncertainty and financial market risks. So once again, the accuracy of the forecasts for Germany and Europe will depend on whether the assumptions regarding political and global economic developments prove to be correct.

US economic policy set to be more expansive

As far as future US economic policy is concerned, it is still unclear which election promises Donald

Trump will ultimately opt to keep, especially since the future US President does not appear to subscribe to any consistent economic policy concept. Rather, it would appear that his leadership will result in a new policy mix: monetary policy will provide somewhat less of a boost to economic development, whereas fiscal policy will do much more to prop up the economy. Although the scale of the measures is not yet clear, Trump will remain true to his pledges to cut taxes and launch investment initiatives. These measures are likely to stoke economic growth in the course of 2017 – despite the dampening effect of rising inflation, slightly higher interest rates and the resulting appreciation of the US dollar. Our forecast does not include the prospect of an extended trade war between the US and China or other key trading partners. Unfortunately, the US is likely to go down the road of implementing individual protectionist measures and making threats in reaction to its rising trade deficit. An escalation of these trade conflicts would, however, create a major downside risk for the US as well, which is why the country is well advised to avoid them.

The eurozone is headed for choppier waters

So far, the eurozone economy has remained stable in spite of the major political challenges in its path. Looking ahead to the coming year, economic growth is likely to remain close to the potential rate, i.e. the long-term growth trend, for the third year running. Domestic demand will continue to be the main driving force. Although consumers are likely to be slightly less keen to spend due to rising inflation and the rebound in oil prices, the ongoing increase in employment is likely to provide an additional boost. The specter of deflation is expected to disappear for the time being in 2017.

2017 looks set to be a particularly turbulent year for the euro currency markets. Unlike the Fed, the ECB is not expected to shift down a gear, but rather is likely to stick with its ultra-loose monetary policy. Given this major policy divergence, the weakness of the euro is likely to persist. This is anything but welcome. Although the weak euro will make exports from the eurozone more competitive in terms of price, consumers will lose out as a result of higher import prices. And in the long term, depreciation tends not to be a good thing for competitiveness, because it encourages a lax attitude to improving efficiency and promoting innovation.

The transatlantic interest rate relationship is of major significance for German and European households and savers. The ECB's expansive monetary policy is unlikely to sever the ties between European and US interest rates completely. This would be a good thing – for savers and their retirement assets, but also for the stabilization of the euro.

The main challenges facing the single currency area in 2017 are likely to be political ones. In addition to the Brexit negotiations, the spotlight will be on the parliamentary elections in key EMU member states, such as the Netherlands, France and Germany. These elections could result in a real shake-up of the European political landscape, because parties with anti-European and xenophobic tendencies have recently been gaining ground across the board. This would have an impact on the member states' willingness to push ahead with reforms, which is already fragile enough, both nationally and at the eurozone level. It is crucial for the member states to plough ahead with reforms and consolidation in order to keep the growth process intact in the longer term and create more jobs in the eurozone.

Emerging markets back on the path to expansion, but still not as sustainable as they need to be

As far as the world's up-and-coming economies are concerned, next year is likely to bring a moderate acceleration in growth: This development will be encouraged primarily by the economic stabilization in the two emerging market heavyweights, Russia and Brazil, as well as by ongoing expansive economic and fiscal policy in China. But the good news for 2017 comes with a warning for the medium term: the expansive economic policy has created growing macroeconomic imbalances in many emerging markets, mainly in the form of galloping corporate debt and inflationary real estate prices. This is not something that the economy will be able to withstand year after year, and the risk of dramatic corrections is mounting.

All in all, the global economy is expected to show an improvement in 2017 compared with 2016. The forecasts are, however, subject to considerable uncertainty given the number of political and economic risks lurking in the background. This

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Wachstum wichtiger weltwirtschaftlicher Regionen
Veränderung des realen Bruttoinlandsprodukts gegenüber Vo

	2011	2012	201
Industrieländer	**1,5**	**1,1**	**1,2**
Europäische Union	1,8	-0,5	0,2
Euroraum	1,6	-0,8	-0,2
Deutschland	3,7	0,5	0,5
USA	1,6	2,2	1,7
Japan	-0,1	1,5	2,0
Emerging Markets	**6,4**	**4,7**	**4,7**
Asien	7,7	6,3	6,5
Lateinamerika	4,5	2,7	2,7
Osteuropa	4,0	2,3	1,5
Welt	**3,3**	**2,5**	**2,5**

Growth rates in main economic
GDP, real % change over previous year

	2011	2012	2013	2014	2015	2016e	2017f
Industrialized countries	**1,5**	**1,1**	**1,2**	**1,8**	**2,1**	**1,6**	**1,8**
European Union	1,8	-0,5	0,2	1,4	2,0	1,8	1,6
Euro area	1,6	-0,8	-0,2	1,2	1,9	1,6	1,6
Germany	3,7	0,5	0,5	1,6	1,7	1,9	1,7
USA	1,6	2,2	1,7	2,4	2,6	1,6	2,1
Japan	-0,1	1,5	2,0	0,3	1,2	1,0	1,2
Emerging markets	**6,4**	**4,7**	**4,7**	**4,2**	**3,6**	**3,6**	**4,2**
Asia	7,7	6,3	6,5	6,3	6,0	5,9	5,7
Latin America	4,5	2,7	2,7	0,5	-0,7	-1,4	1,7
Central and Eastern Europe	4,0	2,3	1,5	1,5	-0,8	1,0	2,2
World	**3,3**	**2,5**	**2,5**	**2,8**	**2,7**	**2,4**	**2,8**

e = estimate, f = forecast

These assessments are, as always, subject to the disclaimer provided below.

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