HIGHLIGHTS from Box 1.1

LONG-TERM GROWTH PROSPECTS: DOWNGRADED NO MORE?

Key Points

- *Consensus forecasts for long-term growth appear to be stabilizing after a series of downgrades since 2010. This may signal that the period of post-crisis gloom about growth prospects may be coming to an end.*
- *However, while well below levels expected a decade ago, long-term forecasts have proven systematically over-optimistic. Should similar forecast errors materialize once again, incomes a decade from now might be 9 percent lower than otherwise.*
- *Long-term forecasts are above potential growth, which is overshadowed by adverse structural forces.*

Evolution of long-term expectations. A prolonged period of downgrades in long-term growth forecasts seems to have come to an end. For the first time since 2010, the 10-year-ahead consensus forecast for global growth appears to have stabilized (Figure 1A). From 1998 to 2007, 10-year-ahead global growth forecasts improved slightly (from 3 percent to 3.4 percent). Subsequently, however, they steadily declined to 2.5 percent in 2017. Forecasts currently envisage global growth in 2028 at 2.6 percent. The stabilization in 10-year-ahead growth forecasts may signal that the legacies of the global financial crisis may be fading.

Systematic over-optimism. During 2008-17, 10-year-ahead growth forecasts made a decade earlier exceeded actual growth outcomes in all years except in 2010, suggesting that forecasts were systematically overly optimistic. Moreover, the longer the forecast horizon, the larger the degree of over-optimism (Figure 1.B). On average, 10-year-ahead growth forecasts disappointed by 1.2 percentage points and 5-year-ahead growth forecasts disappointed by 0.8 percentage point.

Factors associated with higher long-term growth forecast. Historically, during sustained periods of above-potential growth, 10-year-ahead growth forecasts were, on average, 0.3 percentage point higher than during sustained periods of below-potential growth (Figure 1.C). Similarly, 10-year-ahead growth forecasts were, on average, 1 percentage point higher during investment surges than during investment slowdowns.
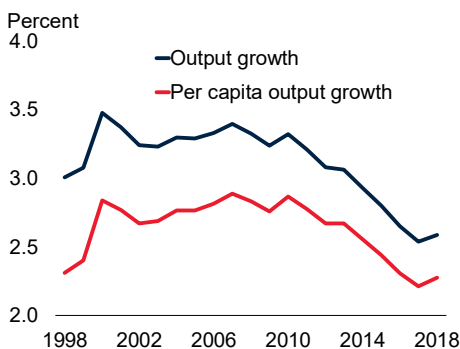
Implications for growth in the next decade. If forecast errors of the magnitude observed in the past materialize yet again, growth in the coming decade may turn out to be well below current long-term growth forecasts, around 2.1 percent instead of 2.8 percent. Over a decade, such seemingly small differences in growth outcomes translate into significant changes in global income and living standards (Figure 1.D). For example, should global growth average current consensus forecasts, incomes a decade from now would be, cumulatively, 31 percent higher than in 2018. This income gain could turn out to be 9 percentage points lower should growth fall short of consensus forecasts by the average historical forecast error. These factors warn that the recent stabilization in long-term growth forecasts may be fleeting and suggest that an urgent need to press ahead with growth-enhancing reforms and build policy buffers.
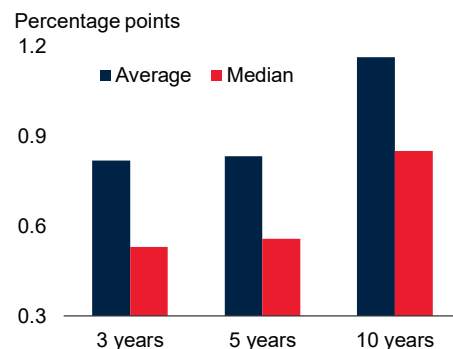
Figure 1. Long-term global growth forecasts

After a prolonged period of downgrades, long-term forecasts of global growth appear to have stabilized. Forecast optimism is stronger for longer-term forecasts than shorter-term forecasts. Ten-year-ahead growth forecasts were higher during sustained growth spurts and investment surges. Over a decade, growth disappointments can make a major difference in incomes
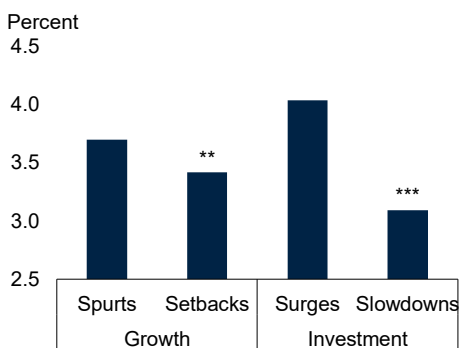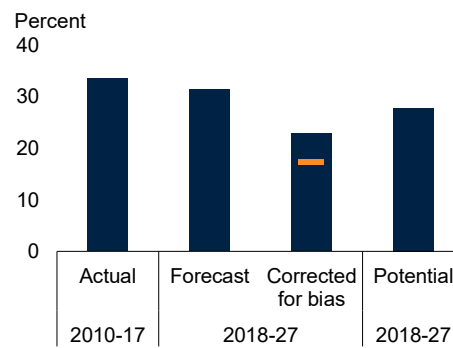
A. Ten-year-ahead global growth forecasts

B. Global growth forecast errors, by different forecast horizon

C. Ten-year-ahead growth forecasts during strong growth and investment episodes

D. Cumulative change in global GDP, 2018-27

Sources: Consensus Economics, Kilic Celik et al. (2018), United Nations, World Bank.

Note: Annual averages of results from multiple surveys conducted in each year are presented. Global growth is computed with constant 2010 U.S. dollar GDP weights. Sample includes 38 countries (20 advanced economies and 18 EMDEs) in all panels except in Panel C, which includes seven more countries for which consensus forecasts are available over the shorter period.

A. The horizontal axis refers to the year of consensus forecast surveys. Per capita global output growth is computed as the difference between 10-year-ahead global growth forecasts and population growth estimates in the years for which forecast surveys are conducted.

B. A forecast error is defined as a difference between growth forecasts at different horizons (over 3 years, 5 years, and 10 years) and actual growth. Averages and medians are computed from available observations up to 2017.

C. Bars show average growth forecasts during events. *** and ** denote that average forecasts between two events are statistically significantly different at the 1 percent and 5 percent levels, respectively. Growth spurt and setback events are defined as, respectively, at least three consecutive years of actual growth above and below potential growth): 55 spurts in 37 countries and 49 setbacks in 36 countries. Investment surge and slowdown events are defined as, respectively, at least three consecutive years of positive and negative investment growth from the previous year: 88 surges in 42 countries and 41 slowdowns in 26 countries.

D. Cumulative change in global GDP since 2018, when growth in every year during 2018-27 is assumed to be as follows. Actual growth (2010-17) and potential growth (2018-27) are period averages. A bar for "forecast" is an average of growth forecasts for 2018-27 surveyed in 2018. Bias in forecast is corrected in the following ways: A bar refers to an average of consensus growth forecasts for 2018-27 after an average forecast error for each time horizon (as partly shown in Panel B) is adjusted; and an orange ticker shows average forecast growth corrected for the average error over 10 years. Potential growth is measured by production function.