HIGHLIGHTS from Box 1.1

IS THE GLOBAL ECONOMY TURNING THE CORNER?

Key Points

- *The year 2018 will likely mark a turning point for the global economy. For the first time since 2008, the negative global output gap is expected to close. Output gaps should approach zero among emerging market and developing economies (EMDEs) thanks to the recent recovery in commodity markets, as well as among advanced economies.*
- *Closed output gaps in major advanced economies will allow normalization of monetary policy after a decade of exceptional easing.*
- *If advanced economies further withdraw stimulus, EMDE policymakers need to be alert to the potential for adverse spillovers even while pursing policies to support strong, sustained growth.*

Closing slack in the global economy in 2018. For the first time in a decade, the global output gap is expected to approximately be closed in 2018. The global financial crisis of 2008-09 substantially widened the global output gap. During 2009-2014, the gap remained sizable and only began narrowing over 2015-17 (Figure 1A). However, there have been substantial differences in the features of output gaps of different country groups and regions.

Advanced economies. Even well after the global financial crisis, output gaps in most advanced economies remained negative, averaging about -1 percent of potential GDP during 2011-16. By 2015, the aggregate gap had narrowed, and was statistically indistinguishable from zero. In 2018, the output gap for advanced economies is expected to turn slightly positive (Figure 1B).

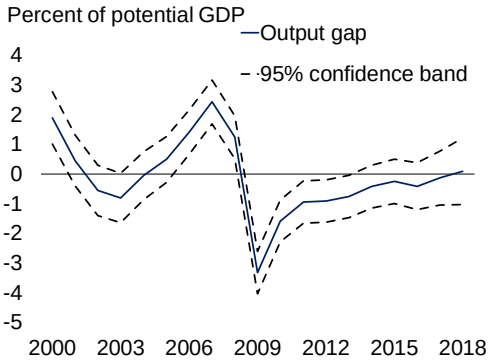
EMDEs. The evolution of output gaps in EMDEs has varied widely depending on whether the economy predominantly exported or imported commodities (Figures 1C). For commodity exporters, the slide in commodity prices since the first quarter of 2011, the sharp drop in oil prices in mid-2014, and weakness among their major trading partners led to an unwinding of large positive output gaps. By 2016, these gaps had turned negative (below -1 percent), on average, and are expected to remain marginally negative (-0.8 percent) in 2018. In contrast, wide negative output gaps emerged among commodity-importing EMDEs during the global financial crisis, but narrowed quickly during a post-crisis economic rebound. With the growth of these economies steady at around potential growth during 2011-17, their aggregate output gap averaged near-zero.

Policy implications for EMDEs. The expected closing of the global output gap signals a return to health of the world economy after a prolonged period of weak growth, which holds the promise of favorable spillovers to EMDEs, including through trade channels. However, it also means that the coming years may witness an unprecedented shift in the stance of cyclical policies among advanced economies, with an attendant risk of missteps or disorderly financial market adjustments. This underscores the importance for EMDEs of continuing to focus on measures to enhance prospects for strong, sustained growth and on measures to ensure the resilience of their domestic financial markets and broader macroeconomic policy frameworks in the face of external shocks.

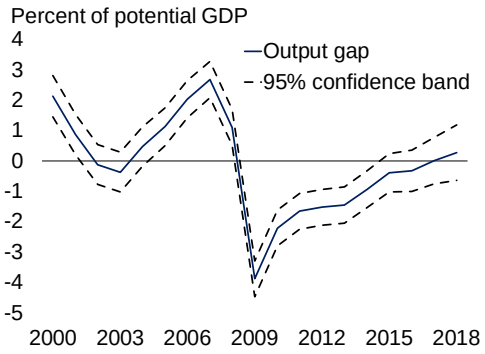
Figure 1: Global and Group-Specific Output Gaps

The global financial crisis of 2008-09 created considerable slack in the majority of countries. Post-crisis, there was wide divergence in the characteristics of output gaps of advanced economies, which were at the center of the crisis, and those of EMDEs, as well as between those of commodity-exporting and -importing EMDEs.

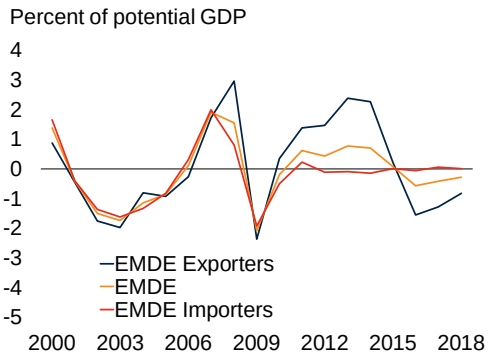
A. Global output gap



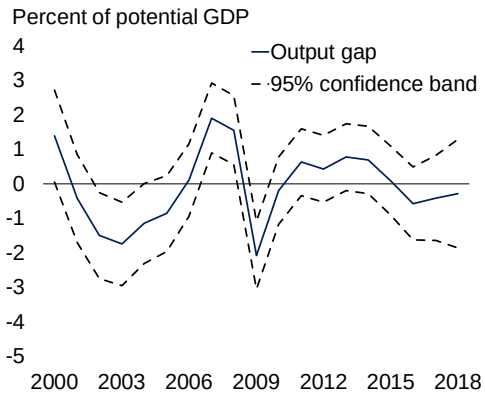
B. Output gap in advanced economies



C. Output gap in commodty-exporting and -importing EMDEs



D. Output gaps in EMDEs



Source: World Bank staff estimates

Notes: Output gaps calculated using multivariate filter. Global, regional, and group output gaps are GDP-weighted averages of individual country output gap estimates using, as weights, real GDP at 2010 prices and market exchange rates. The sample includes 15 advanced economies (Australia, Canada, Denmark, Finland, France, Germany, Italy, Japan, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom, and United States) and 23 EMDEs (Argentina, Bolivia, Brazil, Bulgaria, Chile, China, Colombia, Croatia, Hungary, India, Indonesia, Kazakhstan, Malaysia, Mexico, Peru, Poland, Romania, the Russian Federation, Serbia, South Africa, Thailand, Turkey, and Vietnam).

A. B. D. Dashed lines are 95% confidence interval bounds computed from the Kalman smoother state variances. Global lower and upper bounds are obtained as GDP-weighted averages of individual country lower and upper bounds.

C. "EMDE commodity exporters" include Argentina, Bolivia, Brazil, Chile, Colombia, Indonesia, Kazakhstan, Malaysia, Peru, Russia, and South Africa. "EMDE commodity importers" include China, Hungary, India, Mexico, Poland, Romania, Serbia, Thailand, Turkey, and Vietnam.