

THE CONTINENTAL ECONOMICS INSTITUTE

The world economy in early 2017

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INDUSTRIALIZED ECONOMIES

Presidential transition

The transition in the United States from President Barack Obama to Donald Trump does not run smoothly and adds to the general uncertainty that clouds the beginning of 2017. As the inauguration of the new president gets nearer, the controversies mount. While fierce disputes marked already the electoral campaign, these became even more severe after the election. The quarrels are not confined to the United States. Already during his campaign, the incoming president has provoked severe concerns in Mexico, China, and Europe. Trump has put the role of NATO into doubt and stands for a complete turn-around as to its relation with Russia. Across the globe, concerns are on the rise that the United States will lead the world toward the abyss of protectionism.

New populism

With economic growth relatively weak in most places of the world, protectionism gains popularity. Populism is on the rise also in countries that have seemed immune. The Brexit vote came as a shock. More news that is unpleasant can be expected with the elections that are scheduled in Europe in 2017, particularly in Germany and France. Concerns are on the rise that the European Union will not be sufficiently resilient to wither the storms while at the same time a deep split divides the United States.

Protectionism

The greatest concern for the world economy refers to protectionism. As economic conditions deteriorate and domestic controversies rise, governments tend to resort to protectionism as a way to safeguard domestic jobs. Protectionism is ruinous not only because it invites retaliation but also because it tends to escalate. In the end, each country will be worse off.

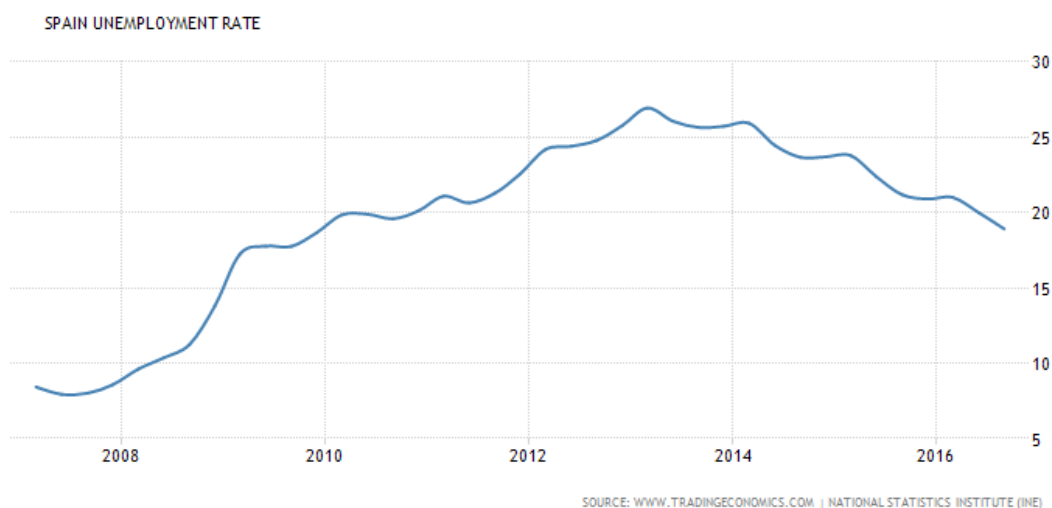
Historically, such beggar-thy-neighbor policies have often been the prelude to wars. During the Great Depression, protectionism has massively contributed to the length and depth of the crisis.

Employment

While in some countries, such as in the United States, the official unemployment rates have come down, employment has remained weak. Long-term unemployment brings with it, that more and more people leave the labor market and the official statistics does no longer register these persons as unemployed. This has happened in the United States where the unemployment rate has fallen over the past couple years below five percent, relative employment has hardly recovered and the so-called labor participation rate is still below 63 percent.



With the exception of Germany, most countries in the Euro Area suffer from persistently high unemployment rates. In Spain, unemployment has shot up to over 25 % and has only come down to under 20 % in the past year.

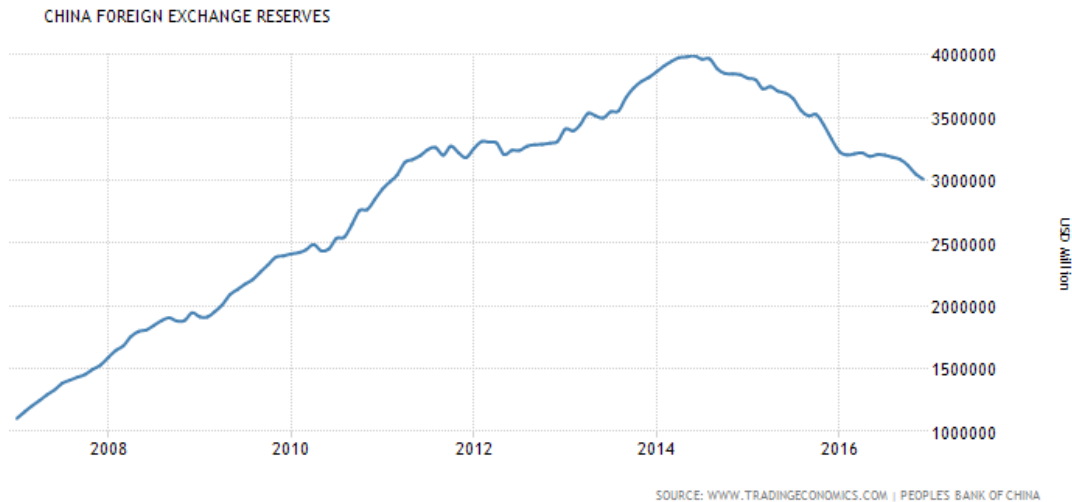


Exchange rate and current account

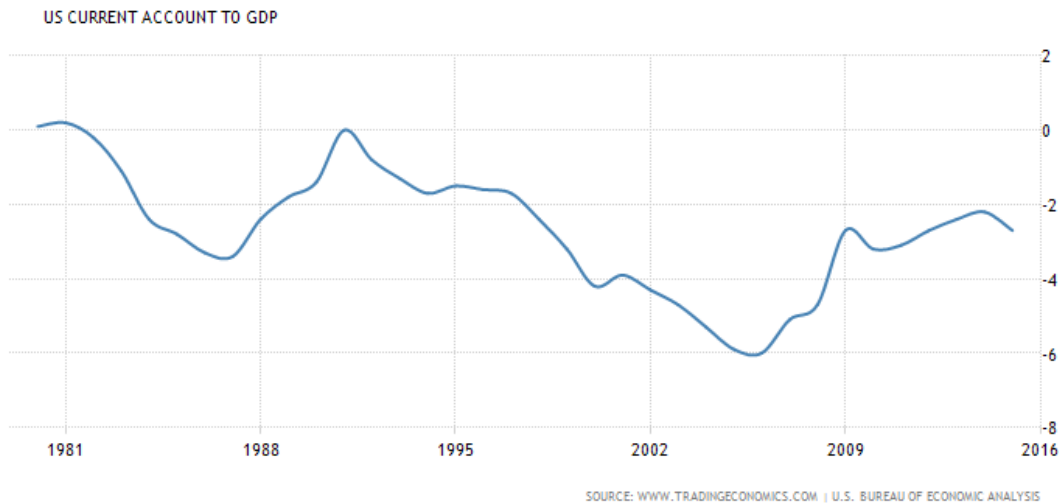
The dollar continues being strong and correspondingly other currencies, particularly the euro and the Chinese yuan have been weak. See US dollar index, euro exchange rate (dollars per euro) and yuan exchange rate (yuan per dollar) below:



In order to stabilize its currency, China sold part of its dollar assets and thereby diminished considerably its stock of foreign exchange reserves by one trillion US-dollars to three trillion.



The strength of the US-dollar will further deteriorate the persistently high US current account deficit and exert additional pressure that the new US administration may resort to protectionist measures.



China still depends on its exports to keep its economy going while Germany's export performance is strongly linked to both the US and the Chinese economy.

Prices and Money

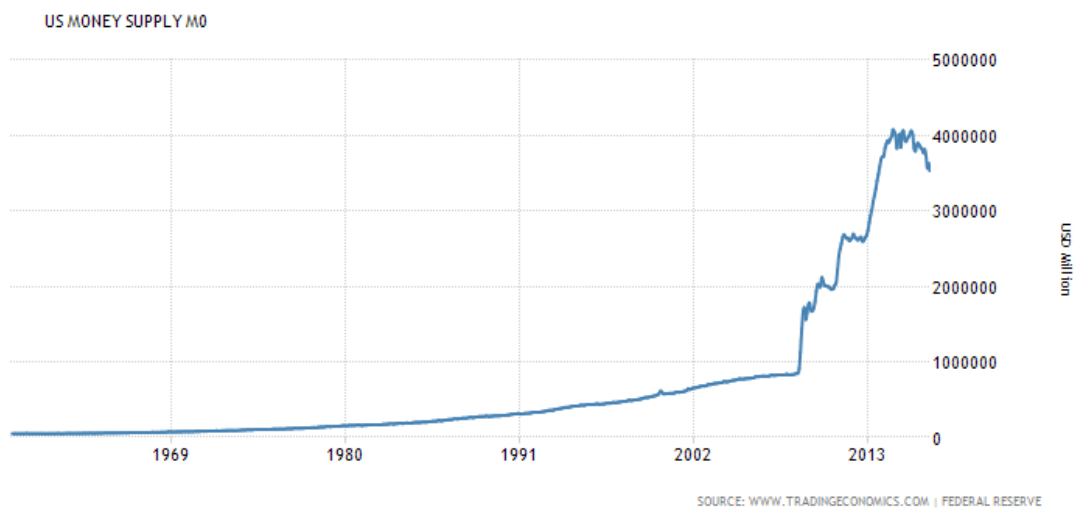
There are signs that consumer price inflation is on the rise. Since July 2016, the American inflation rate has risen from below one percent to close to two percent.



In the euro area, the deflationary trough in the first semester of 2016 has ended and inflation rate have now risen to over one percent.



There is a huge monetary overhang in the world just waiting to get rolling. Over the past ten years, the major central banks has flooded the globe with base money.

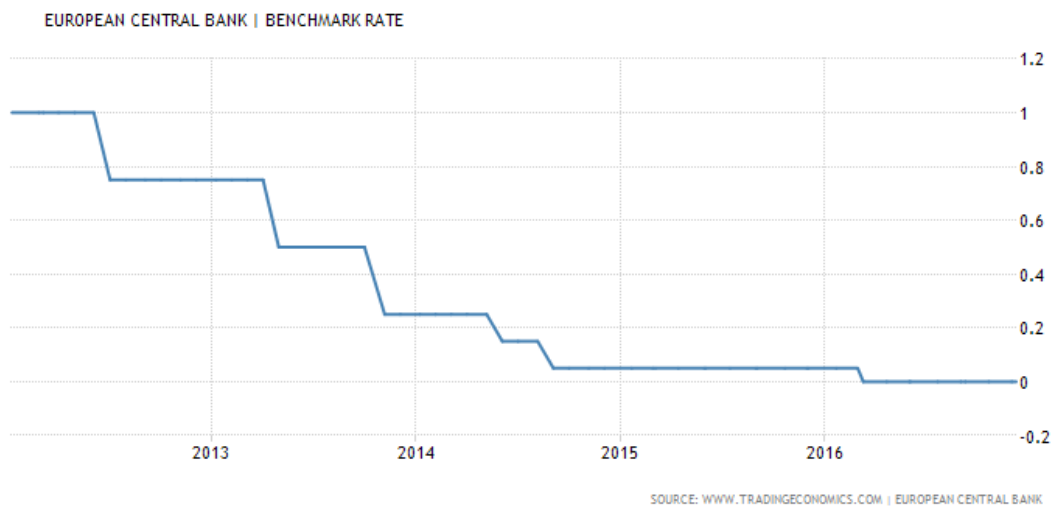
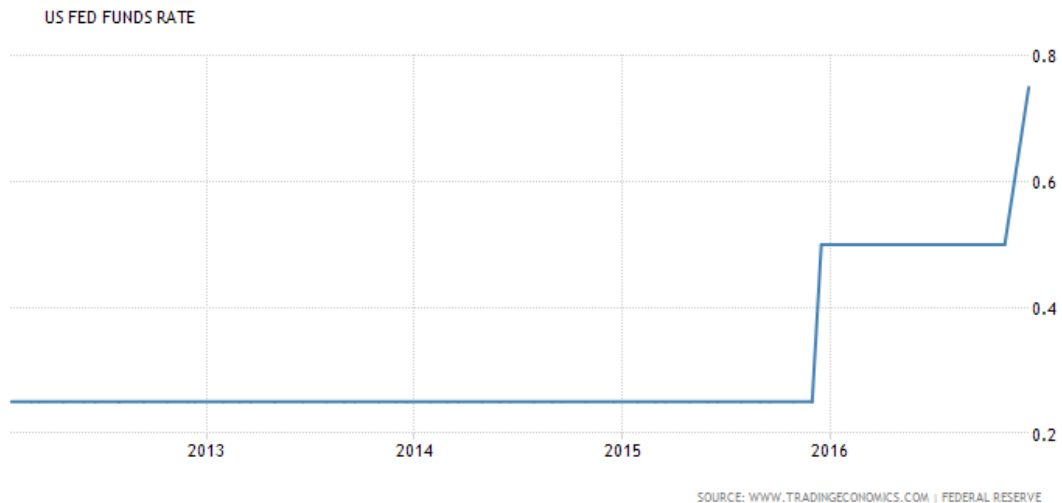


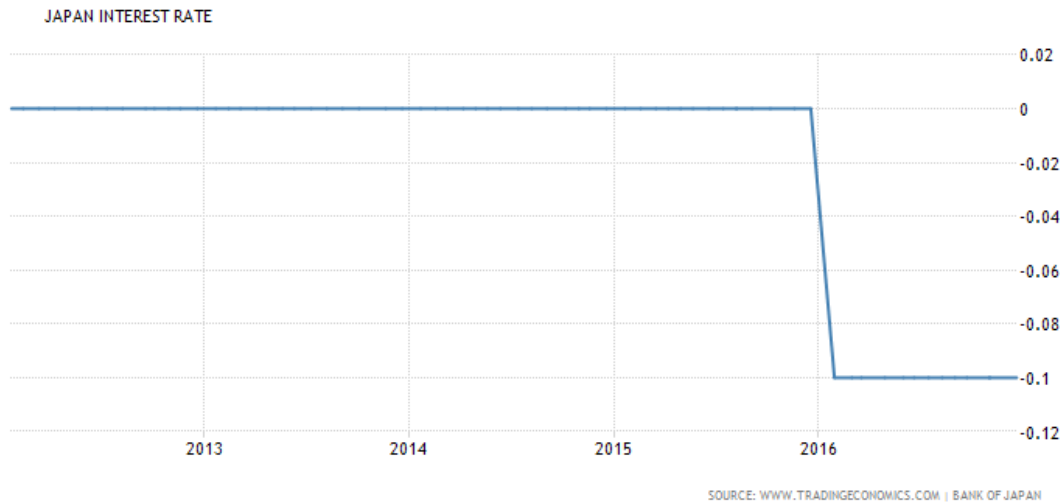
A large part of these funds has been used to bolster the balance sheets of commercial

banks. This way, there has been little transmission to the real economy. This, however, could easily change, once inflation rates pick up more markedly.

Interest rates

Knowing that an increase of interest rate may abort economic recovery, central banks in the industrialized countries have been very reluctant to raise interest rates. Central banks are still behind the curve. While the U.S. central bank has lifted the FED rate to 0.75 %, the European Central Bank still sets its basic rate at zero percent, while Japan has kept its policy rate at -0.1 %.

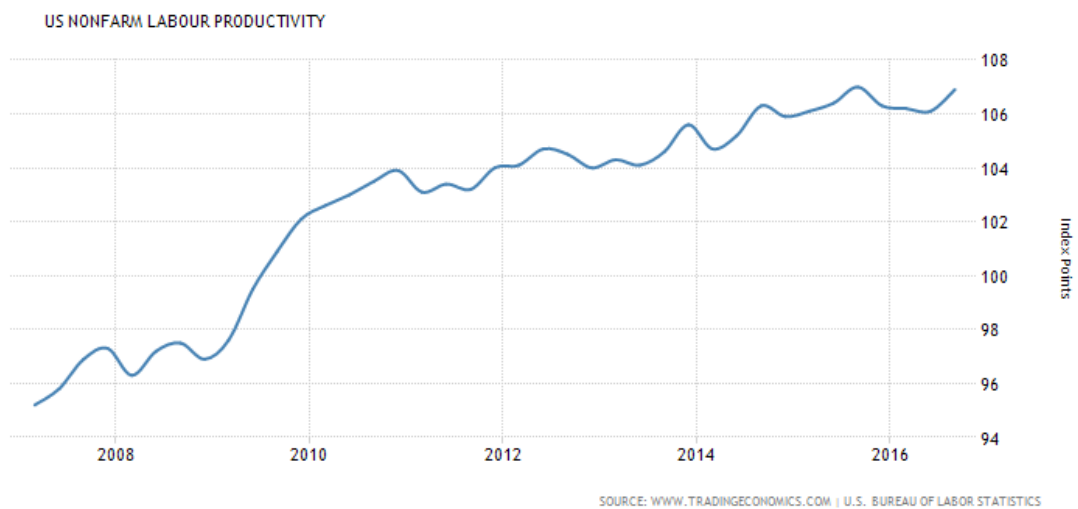


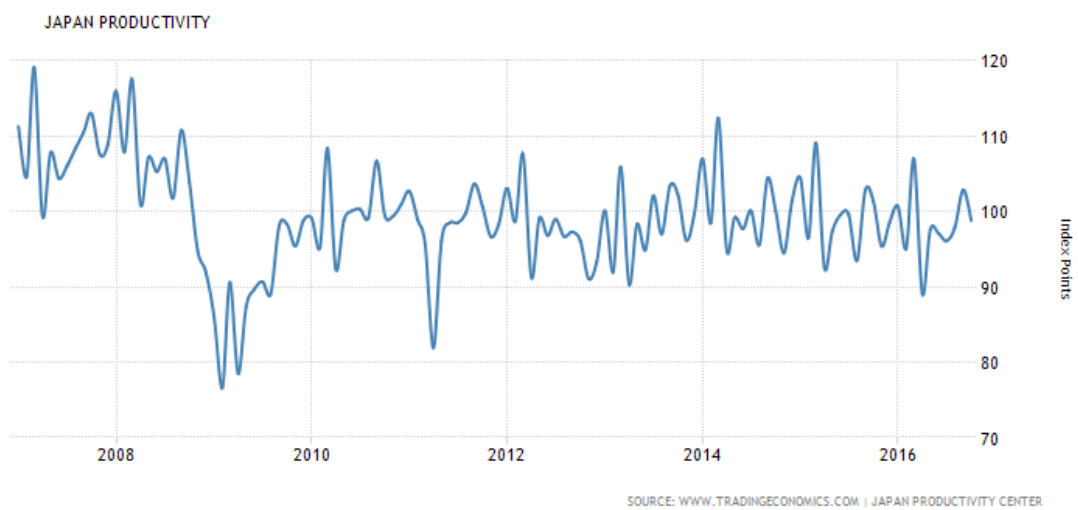


Historically, a massive monetary overhang has always led to price inflation, which has come upon the countries like an avalanche.

Economic growth

The future course of the world economy depends on economic growth, and economic growth depends on productivity. Over the past couple of years, U.S. productivity growth has been quasi stagnant as has been the case in the Euro Area and has even slightly fallen in Japan.





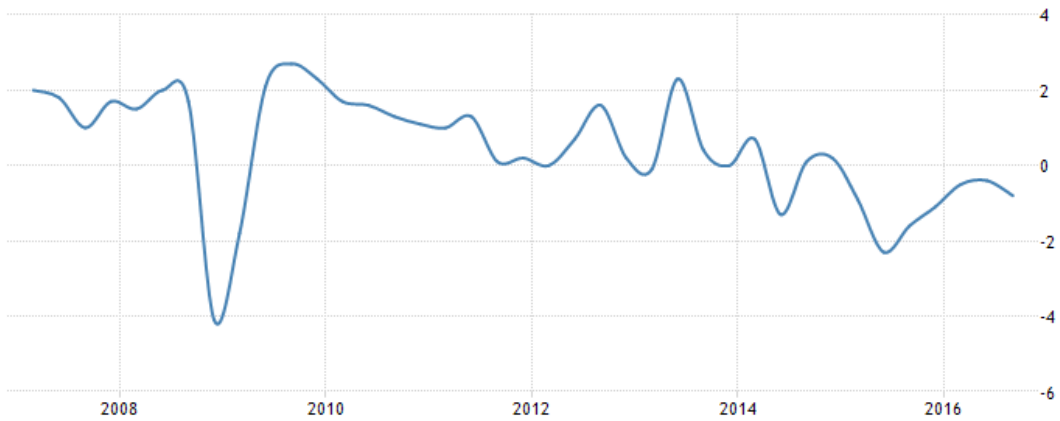
Public expenditure programs will fail to stimulate the economy, when productivity remains low. Likewise, low interest rate will not stimulate economic activity, when the return on investment remains meagre.

EMERGING ECONOMIES

Brazil

The downward trend of the economic growth rates continues. See GDP quarterly rates below:

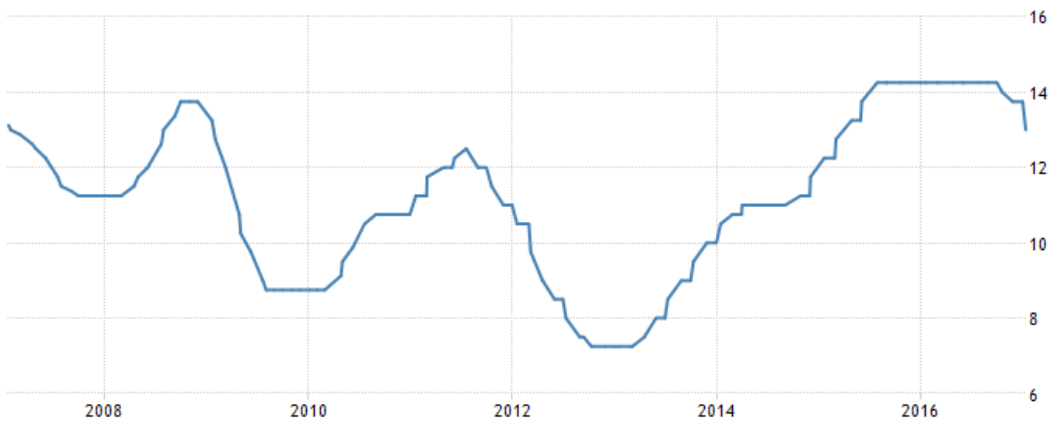
BRAZIL GDP GROWTH RATE



SOURCE: WWW.TRADINGECONOMICS.COM | INSTITUTO BRASILEIRO DE GEOGRAFIA E ESTATÍSTICA (IBGE)

Private investment is paralyzed by uncertainties. Many of big Brazilian companies are deeply involved into the corruption scandals. The present government is almost as unpopular as the preceding one. Private consumption is held back by rising unemployment and high interest.

BRAZIL INTEREST RATE



SOURCE: WWW.TRADINGECONOMICS.COM | BANCO CENTRAL DO BRASIL

BRAZIL UNEMPLOYMENT RATE



SOURCE: WWW.TRADINGECONOMICS.COM | INSTITUTO BRASILEIRO DE GEOGRAFIA E ESTATÍSTICA (IBGE)

In order to avoid outright government bankruptcy the public sector has frozen expenditures. As of now it is hard to see from where there should come a way out, particularly because Brazil's major trading partners, such as China and the United States are in trouble and Brazil's neighbors such as Argentina and Venezuela experience even deeper crises.

Mexico

Mexico is experiencing a crisis of its development model. The country has relied on an ever-closer relationship with the United States. This strategy is now in doubt. The fallout from the incoming new American president is already severe. Tensions are on the increase. As the Mexican economy deteriorates, domestic conflicts are also on the rise. From around five percent, Mexico's annual economic growth rate has fallen to around two percent.



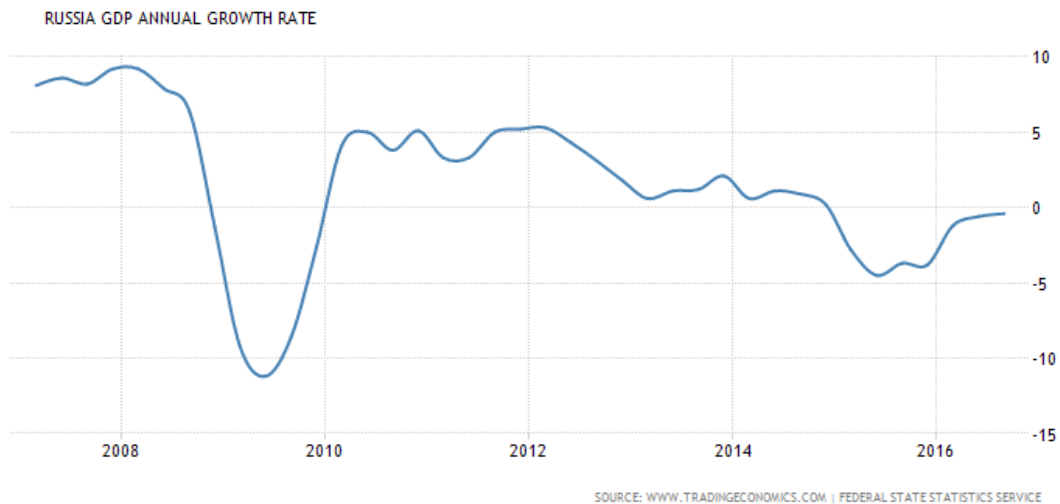
In past couple month there has also been a sharp depreciation of the country's currency.



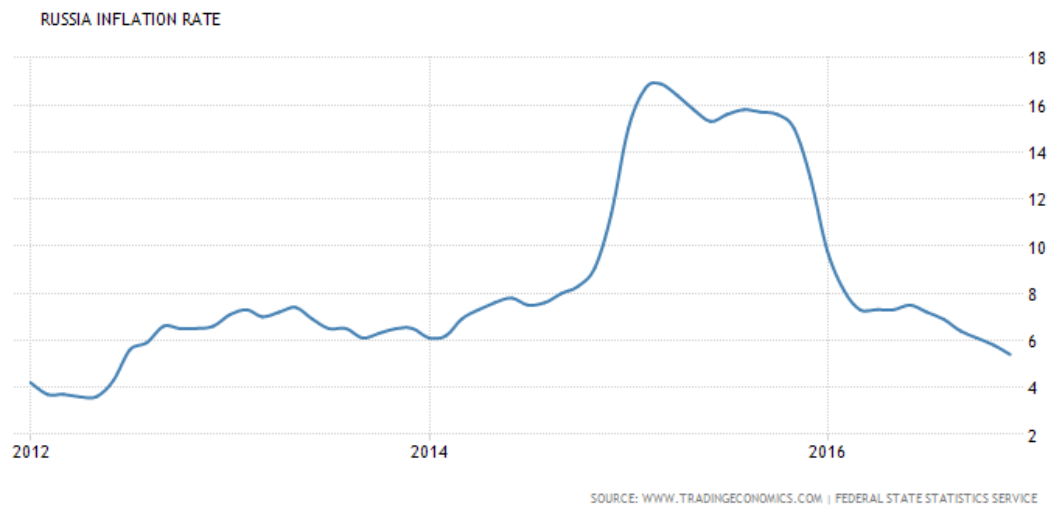
This has forced monetary authorities to raise interest rate from around three percent in 2015 to almost six percent recently.

Russia

Russia suffers from the severe sanctions imposed on it by the Western countries. Additionally, NATO has increased its presence in Eastern Europe and Baltic states. Russia's annual economic growth rates has turned negative since the beginning of 2015.

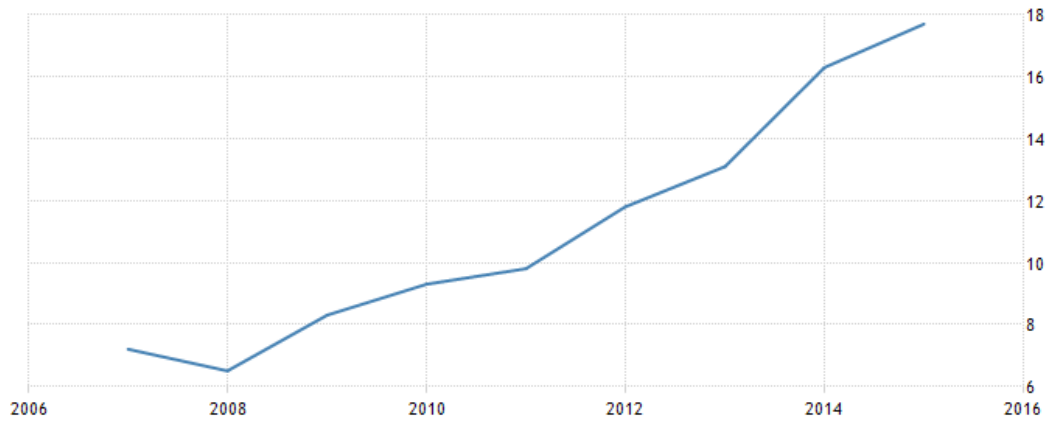


Yet the unemployment is still low and the inflation rate has come down from 17 percent in 2015 to 5.4 percent by the end of last year.



The rate of government debt to gross domestic product has risen drastically over the past years, yet by the end of 2016, this rate is still under 18 percent.

RUSSIA GOVERNMENT DEBT TO GDP



SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL STATE STATISTICS SERVICE

A new chapter in U.S.-Russian relations will most likely begin when Donald Trump will assume his presidency after his inauguration in January 2017. When Western sanctions will be lifted and oil prices will recover, the Russian economy could experience a period of excellent performance.

China

China's annual economic growth rates have come and seem to stabilize around six percent.

CHINA GDP ANNUAL GROWTH RATE



SOURCE: WWW.TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

The official inflation rate has been relatively stable and stands currently at 2.1 percent.



The same holds for the official unemployment rate, which has been steady over the past decades at around four percent. In order to stabilize its currency and counteract the outflow of money, Chinese monetary authorities sold US dollar assets to the amount of one trillion over the past year.

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January 16, 2017