A.T. Kearney
Global Business Policy Council

On Thin Ice

Global Economic Outlook 2019–2023

The international economic order is under significant stress, reducing near-term growth prospects and heightening uncertainty about the medium-term outlook.

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We are living in an era of incredible technological innovation. From rapid progress in artificial intelligence and computer processing power to new frontiers in advanced robotics and 3D printing, opportunities for efficiency gains and new growth abound. With the deployment of high-speed 5G networks and imminent breakthroughs in quantum computing, one would expect widespread economic benefits to follow.

Yet our *Global Economic Outlook* tells a different story. Rather than entering an era of unprecedented growth and technology-driven prosperity, the economy is expected to slow. The reason? Despite these rapid technological advances—and perhaps in part because of them—there is now a profound backlash against globalization. An islandized world has emerged in its place, characterized by populism, nationalism, and zero-sum competition. Traditional norms that had governed the global economy are being tested. Against this backdrop, uncertainty and political risk are rising, and trade protectionism is ascendant.

Leading the charge against long-standing free trade practices is their erstwhile champion, the United States. The Trump administration has picked trade fights with traditional allies, including Canada, Mexico, and the European Union. Of course, tensions are greatest between the United States and China. In 2018, Washington imposed tariffs on $250 billion of Chinese imports; Beijing responded with tariffs on $110 billion of US imports and arduous bureaucratic hurdles for US companies operating in China. There seems to be no end in sight for this trade war between the world's two largest economies—which bodes poorly for global growth prospects.

More broadly, the international economic order is facing a crisis of governance. International institutions that have underpinned the global economic order since the end of the Second World War—the World Trade Organization, World Bank, and International Monetary Fund—are being challenged. New institutions are emerging, reflecting long-standing grievances that these traditional multilateral organizations do not represent the current global power structure.

Whither the global economic order? The outcome of this crisis is far from certain, but each of these factors points to a global economy under strain—and on thin ice. Whether traditional norms will be restored through negotiation and reform—or if we are entering a new and undefined era—remains an open question. We anticipate that the economic growth of recent years will slow amid this systemic uncertainty.

Erik R. Peterson
Managing Director, Global Business Policy Council
Partner, A.T. Kearney

Executive Summary

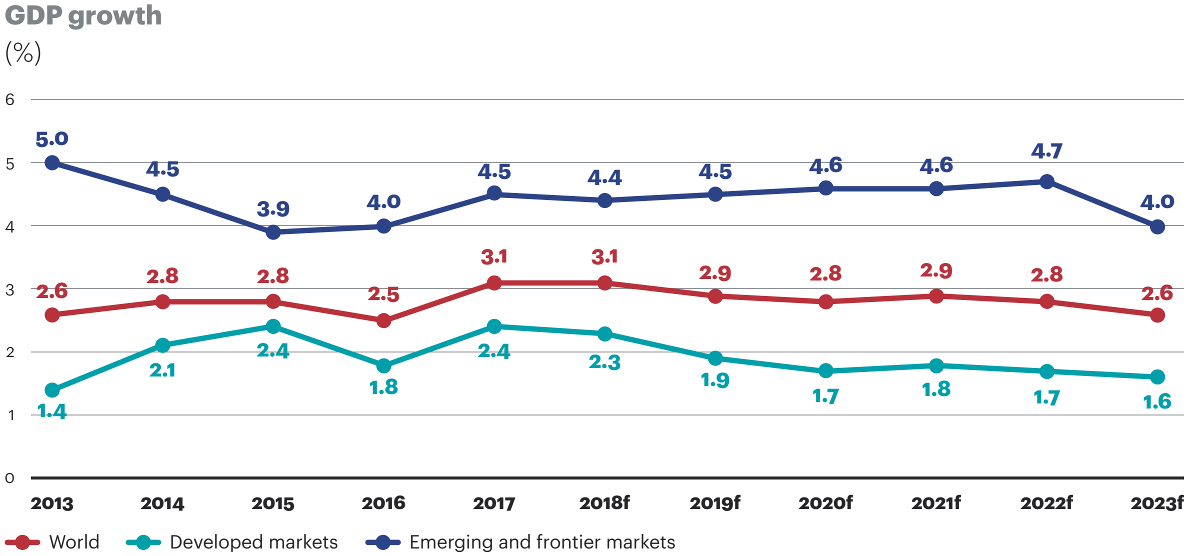
- **Global economic growth will decelerate.** Led by several major economies, the global economy has started to slow, and this deceleration will continue in 2019. The Global Business Policy Council forecasts moderate global economic growth of 2.9 percent this year, followed by slowing growth through 2023. There are cyclical, structural, and political risk factors contributing to this deceleration.
- **Asia will continue to be a bright spot.** The strongest regional economic performance will be in Asia, led by India, which continues to be the fastest-growing major economy. Although China's economy is slowing, its growth rate will remain robust in the coming years. Asia is leading the world in economic integration, with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership recently coming into force and the Regional Comprehensive Economic Partnership still under negotiation.
- **The international economic order is on thin ice.** Governance of the global economy is fragmenting as multilateral institutions become less representative of current realities and economic integration becomes more regionalized. The potential demise of the post-World War II economic order would herald weaker long-term prospects for global economic growth and prosperity as well as a more complicated international regulatory environment for companies.
- **The global trade system is at most acute risk of unraveling.** Protectionist policies, violations of both the rules and the spirit of free trade agreements, and a looming risk that the World Trade Organization's dispute settlement mechanism will cease to function create profound risks for the current system of international trade. In addition, the US–China trade war threatens to weaken global growth prospects while raising costs and creating supply chain disruptions for many companies.
- **Companies need to adjust to slowing growth in a multi-local world.** It is becoming clear that the new age of multi-localism—characterized by the preference for local communities, industries, products, cultures, and customs—is extending into international economic governance. National governments are going it alone to implement policies outside the structures of the traditional multilateral institutions and are pursuing regional economic integration as global agreements become less desirable or untenable. To compete in this environment, companies may need more regional supply chains and greater devolution of management and operations to the local level.

We forecast that global economic growth will fall to a moderate 2.9 percent in 2019 and will continue to slowly decelerate over the next few years. And downside risks to growth are stronger than usual at the end of this business cycle.

The Macroeconomic Outlook

The global economy continues to expand, but the outlook is less positive than it was a year ago. Then, a synchronous upswing had emerged for the first time since the global financial crisis. Over the course of 2018, however, the momentum of key economies began to diverge. The US and Indian economies continued to accelerate, but economic growth slowed in China, the European Union, and Japan. Last year also marked the beginning of a new deceleration trend. In 2019 and beyond, all major economies except India will experience slowing growth rates. As a result, the Global Business Policy Council forecasts that global economic growth will fall to a moderate 2.9 percent in 2019 and will continue to slowly decelerate over the next few years (see figure 1).

Figure 1
Economic growth will slow in 2019 and beyond



Notes: GDP is measured at market exchange rates. Developed markets are those that the IMF characterizes as advanced economies, and emerging and frontier markets are those that the IMF characterizes as emerging market and developing economies.
Sources: International Monetary Fund, World Bank, Economist Intelligence Unit; A.T. Kearney analysis

Some of this deceleration is caused by the business cycle, which is naturally weakening after several years of relatively strong economic growth. But downside risks to growth are stronger than usual at the end of this business cycle. One of the primary concerns is that as economies slow, the growing debt overhang will become a more acute risk for some markets. This is particularly true for markets in which dollar-denominated debt is prevalent because servicing this debt is becoming more expensive as interest rates in the United States rise. An emerging markets credit crisis is likely to result. Argentina and Pakistan are already under significant economic stress, and others may not be far behind.

Structural factors are also contributing to the growth deceleration. The aging global population is increasingly weighing on economic prospects, particularly in developed markets such as Japan and Germany. And a talent gap is hindering business output around the world as educational systems fail to equip students with the skills required in the workforce. Many economies are also in need of structural reforms to modernize their regulations for the 21st century digital economy, enable greater efficiency in business operations, and reduce barriers to investment.

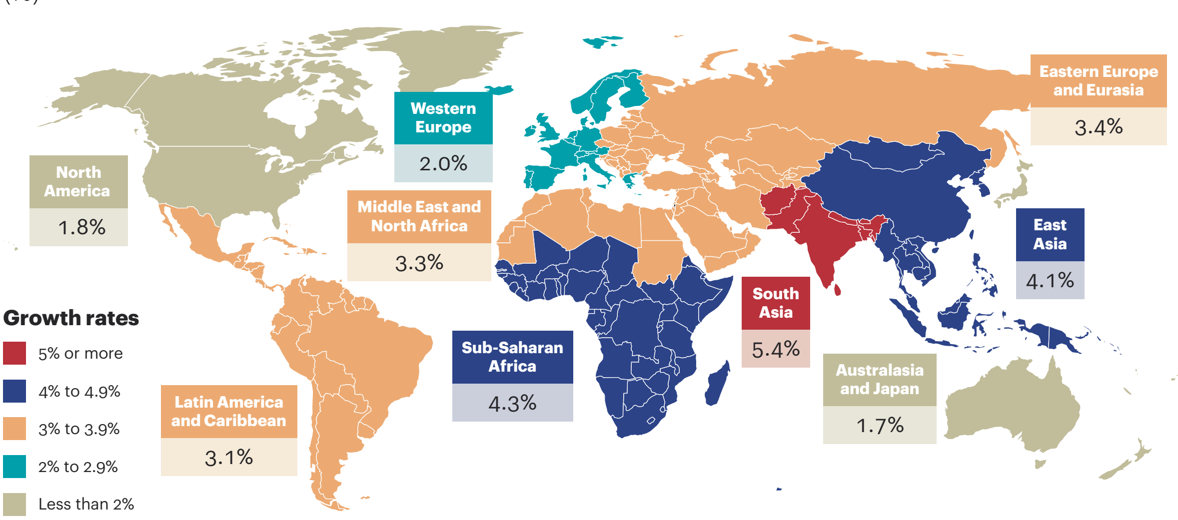
Cutting across both the cyclical and structural determinants of the lower economic outlook is weak productivity growth, which we highlighted in our economic outlook last year. Productivity gains continue to be sluggish across all major economies, which impedes stronger economic output in both the short and long term. Not only do more productive economies produce more and more of today's goods and services with greater efficiency, but they also have excess resources to produce new types of goods and services, creating new opportunities and jobs. Sustaining economic growth in the medium to long term therefore depends on improving productivity growth in the near term. But so far, governments and businesses have been unable to kickstart productivity growth—a challenge that will become more acute as economic growth slows.

Perhaps the most significant reason for the deceleration in global economic growth in the past year is the "islandization" of the global economy and the stress it places on the international economic order. The norms and institutions that have governed cross-border economic flows since the mid-20th century are being violated or discredited. Importantly, this turn away from the long-standing international economic architecture is being led by the very country that ensured its initial adoption and its perpetuation over the subsequent decades: the United States. As a result, the prospect we face is what one prominent political scientist calls the "G-zero world," in which no single country or bloc of countries has the political and economic leverage—or the will—to drive a truly international agenda.

Just as the post-World War II economic architecture enabled a dramatic rise in global prosperity and sustained economic growth, its potential demise would herald weaker long-term prospects for the global economy. Such a demise is by no means a certainty, but the system is clearly on thin ice. We explore the reasons for this frailty and the efforts to reinvigorate the institutions governing the global economy in the following section. But first, we analyze how the global growth deceleration is playing out at the regional level (see figure 2).

Figure 2
Asia continues to lead the global economy as expansion slows

Real GDP growth, 2019–2023
(%)



Notes: GDP growth is measured at constant prices. GDP figures are the 2019–2023 simple average of the annual average growth rate projections of the economies within each region.

Sources: International Monetary Fund World Economic Outlook October 2018; A.T. Kearney analysis

As has been the case in recent years, **Asia** will maintain its status as the central engine of world economic growth on the back of strong consumption and investment. Growth will also be supported by increasing digitalization and connectivity between Asian economies. Regional trade agreements will continue to play a role in such connectivity, including most notably the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which went into effect on December 30, 2018. In addition, China's Belt and Road Initiative (BRI) for pan-Asian infrastructure development will continue to promote economic integration—although it will be subject to greater scrutiny and transparency demands, especially following Malaysia's recent pushback against BRI projects. Geopolitical tensions throughout the broader Indo-Pacific region, however, threaten to diminish this economic connectivity. China's continued efforts to control much of the territory in the South China Sea, for instance, are exacerbating tensions there, which may hinder integration.

> Asia will maintain its status as the central engine of world economic growth on the back of strong consumption and investment.

Emerging markets in Asia are expected to sustain robust growth in the medium term. Although the escalation of trade tensions between the United States and China will contribute to the deceleration of the Chinese economy, China will nevertheless maintain a growth rate above 5.5 percent in the medium term. And East Asia will grow at more than 4 percent in the next five years. In part, this strong growth projection reflects the fact that Vietnam, the Philippines, and Cambodia are expected to benefit the most from the supply chain adjustments resulting from prolonged US–China trade tensions. The sustained path of monetary policy tightening by the US Federal Reserve is expected to dent growth prospects over the medium term, however. Vulnerable currencies in markets such as India, Indonesia, and the Philippines have already triggered interest rate increases in an attempt to prevent capital outflows, which may weigh on economic prospects. And energy-importing countries, most notably India, will continue to be vulnerable to rising global energy prices. Nevertheless, annual economic growth in South Asia will be strong in the coming years, exceeding 5 percent.

The economic outlook for developed markets in Asia is also positive, although there are signs of weakness as well. Australia's low wage growth may put pressure on consumption and government spending, but the country's economic growth is expected to remain constant at around 2.8 percent. The aging Japanese population may similarly decrease consumption growth there and weigh on the recent gains from mild acceleration of consumption and inflation. Nevertheless, Japan's economic growth will likely remain in positive territory. A looming risk is the potential imposition of US tariffs on automotive imports, which would undermine growth prospects in markets with large auto-export industries, such as Japan and South Korea.

The **Middle East and Africa** region is forecast to grow modestly in 2019 and over the medium term. This growth will be driven in no small part by the recovery of global oil prices. Although prices will remain volatile, they are unlikely to return to the depressed levels of the 2014 to 2017 period. Among the reasons for this projection are the expectation of continued global oil supply coordination beyond the Organization for the Petroleum Exporting Countries (OPEC) and the effect of US-led sanctions on Iran. Although global macroeconomic uncertainty and US shale production remain strong countervailing forces, the outlook for oil producers is much improved from recent years.

In the Middle East, higher global oil prices have diminished the fiscal pressure on oil exporters and increased the capacity for public investment. The previous downturn did, however, accelerate economic diversification efforts and spur important structural reforms that will continue to pay dividends. Bahrain will soon join Saudi Arabia and the United Arab Emirates (UAE) in introducing a value-added tax (VAT), and Kuwait, Qatar, and Oman are also likely to follow suit. Such efforts will lead to more diverse government revenues, which will act as a stabilizing force for these economies during any downturn in oil prices. Iran, on the other hand, is expected to face a worsening economic outlook under US sanctions.

After years of subpar growth, the outlook for sub-Saharan Africa is also more positive. It will be the second-fastest growing regional economy in the near to medium term thanks in part to improved intra-regional connectivity. At 8.5 percent growth, Ethiopia is expected to be the fastest growing economy in the region in 2019, amid new leadership, the promise of economic reforms, and a historic peace deal with Eritrea. Angola, which had been contracting since 2016, will return to growth in 2019 thanks to both the commodity price upswing and economic reforms. But some African countries, such as Zambia, face unsustainable debt burdens. And the region's two largest economies are likely to continue to underperform in the near term. South Africa's efforts to improve its public finances and clean up a deep public corruption scandal will require time to gain traction. And Nigeria's economy is weighed down by high unemployment, corruption, and a persistent terrorist threat. Across sub-Saharan Africa, economic diversification and modernization plans are required to bolster sustainable private sector activity and economic growth.

The economic outlook in **Europe and Eurasia** is positive, although momentum is slowing. Unemployment rates will continue to fall in much of the region, strong private-sector performance will drive investment in key economies, and oil exporters will continue to benefit from higher commodity prices. Yet a range of headwinds, including uncertainty surrounding Brexit, lingering trade disputes with the United States, geopolitical tensions between Russia and the West, and aging populations, will weigh on regional economic performance in 2019 and beyond.

In Western Europe, low financing costs remain in place for companies and governments, driving business investment. Private consumption is also strong, supported by a tightening labor market and strengthening household balance sheets. In a sign of the solidifying economic recovery, the European Central Bank ended its quantitative easing in December 2018. As it begins to raise interest rates in the coming years, higher financing costs could create a drag on economic growth. And the external environment provides both headwinds and tailwinds. The EU reached a landmark trade agreement with Japan in July 2018 and continues to pursue several others, which should boost economic growth. Yet US tariffs on EU steel and aluminum and persistent uncertainty regarding the future of trade between the EU and UK after Brexit could weaken economic activity.

In eastern Europe, Poland will experience slowing growth, held back by demographic and structural challenges to the economy, as will Romania, where fiscal stimulus is winding down. Turkey will suffer an even more pronounced slowdown as the country remains vulnerable to currency depreciation, rising borrowing costs, and geopolitical risks. In Eurasia, higher commodity prices will continue to bolster growth in Russia, supported by continued real wage gains and improved private consumption. Kazakhstan's new Kashagan oil field will increase production, helping to sustain steady growth. And as the violent conflict in eastern Ukraine ebbs, its economic outlook is also showing signs of recovery—although this could be jeopardized by a reescalation of the conflict in the Kerch Strait or elsewhere. Yet sanctions against Russia by the United States and Europe following the poisoning of Sergei Skripal have weakened the ruble and could cause regional growth headwinds. Eurasia also faces an aging work force and the risk of heightened currency and financing pressures, particularly as the US dollar continues to strengthen.

The economic outlook for the **Americas** is mixed. On the upside, the North American economies will be among the fastest-growing developed markets in the near term. In addition, Latin American economic growth will accelerate significantly in 2019 from its very low growth rates of recent years. On the downside, the North American economic expansion is expected to slow in the medium term as US fiscal stimulus is withdrawn. And although Latin America is improving relative to its recent performance, it remains the laggard among other emerging market regions.

> The North American economies will be among the fastest-growing developed markets in the near term, but the expansion is expected to slow in the medium term as US fiscal stimulus is withdrawn.

In North America, the US economy is firing on all cylinders, and the Canadian economy is enjoying similarly strong performance. Higher global oil prices are boosting both countries' fossil fuel industries. Recent tax cuts in the United States are stoking higher demand there, which also supports the Canadian economy, as it is the United States' largest trading partner. And although the rebranded United States–Mexico–Canada Agreement (USMCA) is not expected to have substantial direct economic growth effects, it has removed a significant source of uncertainty, which should pave the way for more business investment in North America in the coming years. But regional economic growth will nevertheless decline in the medium term as US fiscal stimulus wanes, interest rates continue to rise, and the business cycle naturally turns down after the second-longest period of economic expansion in American history.

The trajectories of Latin American economies are more varied. Brazil's economy will accelerate in 2019, and this expansion could be sustained if the new Jair Bolsonaro administration successfully implements its "Chicago boys"-style economic reform program (subscription required). The Mexican economy will also accelerate this year as trade tensions with the United States recede, but it too faces an uncertain policy environment after President Andrés Manuel López Obrador spooked investors with the cancellation of the new Mexico City airport in October 2018. The outlook is decidedly negative for two of Latin America's other large economies. Argentina is in the middle of a multi-year recession as it works with the International Monetary Fund (IMF) to reduce the government's budget deficit, tame inflation, and promote job growth. The IMF expects the economy to return to growth in 2020 though. In contrast, there is no end in sight for the severe economic crisis in Venezuela. The convulsive economic contraction that began in 2014 is forecast to continue through at least 2023 unless significant policy changes are enacted. This crisis will have regional spillover effects, particularly as people continue to flee into neighboring countries, adding to the more than 3 million Venezuelan refugees and migrants who have left the country in recent years.

National governments are going it alone to implement policies outside the structures of the traditional multilateral institutions and pursuing regional economic integration as global agreements seem out of reach. Such continued fragmentation of the international economic order would create a dramatically different pattern of global economic flows and result in weaker medium-term economic prospects.

Fragmentation of the International Economic Order

In the wake of World War II, the leaders of the international community set up a group of multinational institutions to promote economic cooperation and establish commonly accepted international rules for cross-border commerce. These institutions were the World Bank, the IMF, and the General Agreement on Tariffs and Trade, which later became the World Trade Organization (WTO). Together, they helped to foster the dramatic rise in global prosperity, expansion of multinational companies, and growth in global economic output that the world has enjoyed since the 1950s.

The continued viability of these institutions is now being called into question, however, as a result of two forces. The first is the dramatic shifts in global economic power and structure that have not been addressed in the governance of the IMF, World Bank, and WTO. The second is the proliferation of smaller alternative institutions. Together, these two forces are eroding the authority and influence of the traditional multilaterals and threatening to fragment the international economic order.

The latter force is reflective of the age of multi-localism within global governance. Multi-localism is characterized by the preference for local communities, industries, products, cultures, and customs. This new age has arrived, in part because of the "islandization" of the global economy in which governments are pushed inward by nationalist and protectionist sentiments and every economy becomes more of its own island. In terms of international governance, multi-localism is manifesting itself as national governments going it alone to implement policies outside the structures of the traditional multilateral institutions and pursuing regional economic integration as global agreements seem out of reach.

Continued fragmentation of the international economic order would result in weaker medium-term economic prospects. The rising cross-border economic integration that the multilateral institutions have fostered over the past seven decades has boosted productivity growth through the diffusion of technologies and knowledge, rising competition, and the creation of larger markets. Without these global institutions, worldwide productivity growth—and therefore overall economic growth—would suffer. The lack of global economic governance would also create greater downside risks in the event of another systemic crisis because it would be more difficult to coordinate a swift and effective response. And business models based on economies of scale, globally integrated value chains, and the sale of mass-market products would become increasingly unviable without global regulatory coordination. The fragmentation of the international economic architecture would therefore create a dramatically different pattern of global economic flows, raising the level of uncertainty about the medium- to long-term outlook.

In contrast, if the governance of international trade, financial and monetary stability, and development financing remains largely at the multilateral level, the global economic outlook will be relatively positive and remain in line with the forecasts presented in the previous section. When assessing the medium-term economic outlook, it is therefore necessary to understand the challenges facing the multilateral economic institutions, how they are evolving, and the effect these shifts in the international economic architecture will have on economic growth prospects.

We examine the challenges and future prospects for each of the three major multilateral economic institutions below. The future of the WTO, IMF, and World Bank is uncertain. To remain relevant in the 21st-century economy, significant reforms will be necessary at all three institutions. The emerging competition from newer, nimbler players only increases the urgency of these reforms and the need to modernize. Global economic prospects therefore depend on the ability of these three institutions to retain their role as the stewards of the international economic order.

The World Trade Organization

Economic growth over the medium term will be shaped by the ongoing realignment of global trade rules. The deficiencies of the global trade system and the WTO have come under the spotlight as a result of US President Donald Trump's protectionist rhetoric and actions. But emerging efforts to reform global trade rules are likely to take years to negotiate and implement. This growing uncertainty will accelerate the fragmentation of the global trade landscape, pushing countries toward regional, bilateral, and plurilateral trade arrangements rather than multilateral ones.

Out of date and under pressure

Most rules governing international trade date back to 1995, when the WTO was first established. Since then, the WTO's consensus-based system, which requires the consent of every single member state to implement significant changes, has prevented any meaningful attempts to update global trade rules. As WTO Director-General Roberto Azevêdo has observed, "WTO rules were conceived in a world with no Internet connection." As a result, the rules largely fail to address issues of the modern economy, including the rising importance of services trade, the emergence of e-commerce, and the advances in technology that underpin today's trade flows. In addition, despite initial expectations that free trade would quickly help equalize development levels, the interests of emerging and advanced economies continue to diverge significantly.

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The WTO is also under pressure because the policies of some of its members are violating the rules or the spirit of the institution. Protectionist measures, for example, are on the rise globally. In the United States, the Trump administration's unilateral protectionist approach and its imposition of tariffs represent the most significant challenges to the multilateral rules-based trade framework in this regard. But while much attention has focused on US protectionist actions—for good reason given the US economy's global significance—many other countries are also perpetuating or erecting barriers to trade. India, for instance, is hesitant to open up its IT sector to foreign competition, and Brazil is similarly protective of its automotive industry. The EU is also quietly "islandizing" by implementing strict data privacy rules.

The distortionary market policies implemented by some WTO members, such as subsidies and other preferential treatment for domestic firms, forced technology transfers, and currency devaluations, have also increased pressure on the WTO by creating doubts about the fairness and effectiveness of the global trade system. The most notable tension point in this regard is US criticism of Chinese policies. Under the Trump administration, the United States has begun to take unliteral action outside the WTO system to counteract these policies.

For instance, the United States imposed blanket tariffs on imports of steel and aluminum in an effort to call attention to China's overproduction, which is contributing to a global glut of steel and other metals.

Several countries have challenged the US tariffs by initiating proceedings against the United States before the WTO. These disputes represent a defining challenge for the organization. Siding with the United States' national security rationale for these tariffs could prompt protectionist behavior elsewhere around the globe, further eroding multilateral trade rules. But a WTO decision against the United States would likely be ignored by Washington, undercutting the WTO's authority. Indeed, the Trump administration takes general issue with the WTO's dispute settlement mechanism. Washington has consistently blocked the appointment of judges to the Appellate Body, the WTO's highest dispute settlement institution, arguing that the institution is compromised by "judicial overreach," an alleged tendency by the judges to interpret rules loosely or not abide by various constraints imposed on their activities by the organization's rules. As a result of these perceived inadequacies of the global trade order, the United States has shifted from being one of the main backers of the WTO to being one of its primary critics.

Reform proposals

There is growing momentum to reform the WTO and update global trade rules amid these looming threats to the rules-based trade system. With their own economies under pressure from US tariffs and in recognition of China's unfair trade practices, both the EU and Canada are urging measures to update the WTO. Their proposals call for strengthening the effective supervision of subsidies because member countries broadly fail to comply with the existing subsidy notification process. In addition, their proposals seek to equalize the rules for emerging and developed markets by limiting exemptions from certain WTO commitments, addressing forced technology transfers, and establishing rules for digital and services trade. There are also proposals to reform the dispute settlement mechanism, which may be the most urgent of the proposed reforms given that the US is blocking judicial appointments. Both Canada and the EU support measures to narrow the mandate for appellate judges—a key US demand. The EU has also proposed to extend judicial term limits and allow judges to complete a ruling after their term expires, however, which is likely a non-starter for the United States.

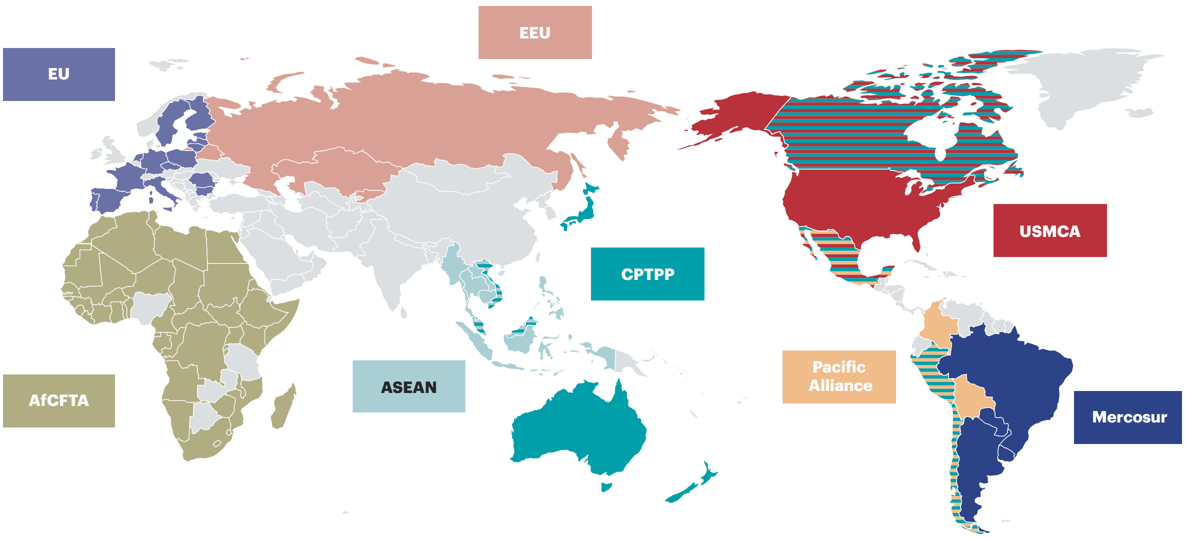
While these proposals are light on specifics, they offer a starting point for debate about how to tackle the WTO's challenges. The WTO reform movement is gradually gaining traction, but there is a long road ahead. The difficulty in achieving consensus was apparent at the November 2018 Asia Pacific Economic Cooperation (APEC) summit, where the United States and China clashed over their positions on WTO issues, including state-owned enterprises and China's developing country status. This tension led to the first-ever failure by APEC countries to produce a joint statement outlining future priorities. In contrast, world leaders expressly called for WTO reform at the G20 summit in December 2018 (although for the first time since the G20's creation, a commitment against protectionism was omitted from the communiqué). But with emerging and frontier markets unlikely to accept constraints on their current trade practices, the likelihood for meaningful reform is low in the near term. And in December 2019—when the terms of the last two judges on the WTO's Appellate Body expire—the dispute settlement mechanism will essentially stop functioning. Increased unilateralism, retaliatory tactics, and a race by more powerful countries to shape international trade rules to their own liking are the likely consequences of such WTO gridlock.

Proliferation of other trade agreements

The slow pace of WTO negotiations has contributed to the proliferation of bilateral and regional trade agreements—a trend that is accelerating as the WTO becomes increasingly out of date and dysfunctional. This trend is fragmenting the international trade landscape into regional blocs, creating a so-called "spaghetti bowl" of preferential trade agreements and undermining the WTO as the primary governor of global trade (see figure 3). The CPTPP recently took effect in the Asia Pacific region with sweeping tariff eliminations and 21st century rules on digital trade, e-commerce, and services. And talks to finalize the Regional Comprehensive Economic Partnership (RCEP), which would be even larger in terms of GDP and trade flows, are forging ahead. In Africa, 49 countries have signed the African Continental Free Trade Agreement, which the African Union estimates has the potential to boost intra-African trade by 52 percent by 2022. Free trade is forging ahead in Latin America as well, where trade blocs Mercosur and the Pacific Alliance are exploring a free trade agreement.[1] Such an agreement could ignite stronger economic growth in a region in which trade links are underdeveloped: Only 16 percent of exports in Latin America and the Caribbean are intraregional, compared to 64 percent in the EU and approximately 50 percent in both North America and East Asia.

Figure 3
Trade integration is increasingly being pursued through bilateral and regional agreements

Major regional trade agreements



Notes: AfCFTA is African Continental Free Trade Area, ASEAN is Association of Southeast Asian Nations, CPTPP is Comprehensive and Progressive Trans-Pacific Partnership, EEU is Eurasian Economic Union, EU is European Union, Mercosur is Southern Common Market, USMCA is United States–Mexico–Canada Agreement.

Sources: United Nations; A.T. Kearney analysis

The difficulty of reaching a multilateral agreement on WTO reform is also likely to make plurilateral agreements—which cover specific trade issues and only apply to the negotiating countries—more common. While plurilateral agreements help to modernize international trade rules for the 21st century, they complicate the global business environment by creating divergent sets of standards. For instance, negotiations on the plurilateral Trade in Services Agreement (TiSA), an ambitious attempt to put into place a 21st-century regulatory framework aimed at removing

[1] Mercosur members are Argentina, Brazil, Paraguay, and Uruguay. Pacific Alliance members are Chile, Colombia, Mexico, and Peru.

and streamlining regulations affecting trade in services, formally began in 2013. Although the 23 negotiating parties account for more than 75 percent of global trade in services, several major economies—including all the BRICS countries—are not involved.[2] Plurilateral agreements negotiated under the auspices of the WTO, however, allow other countries to come on board in the future. Since its conclusion in 2011, for instance, the updated plurilateral Government Procurement Agreement has continued to attract new members. Over the long term, then, plurilateral trade arrangements have the potential to either help or harm the multilateral trade system.

The International Monetary Fund

The IMF is the world's lender of last resort and one of the anchors of the post-war international economic order. Although not without its critics, the IMF has played an important stabilizing role in many of the most significant financial crises in the past several decades, from the Latin American and Eurozone debt crises to the Asian financial crisis. But the institution is being challenged by the rapid changes in the global economic system, requiring both internal and external adjustments to maintain its relevance and effectiveness in the 21st-century economy.

Mounting challenges to the lending model

The IMF, established at Bretton Woods in 1944, is charged with promoting the stability of the international monetary system. It has played a significant role in the response to all of the major economic crises since its founding, while also adapting as the global economy has undergone major structural changes. Until the 1970s, for example, a core function of the IMF was managing the pegged exchange rate system. But after floating exchange rates were adopted, the IMF broadened its focus. Today, the organization has three crucial functions: surveillance of national economies and cross-border vulnerabilities for systemic risks, financial assistance to countries experiencing balance of payments crises, and technical assistance to strengthen domestic fiscal and monetary policies.

> The IMF is being challenged by the rapid changes in the global economic system.

The changing global economy and the nature of the crises the IMF has dealt with since its inception have raised questions about how the institution is preparing for its next challenge. Take the European debt crisis, which saw developed-market economies enter into IMF programs for the first time in decades. The IMF's intervention during the crisis, in collaboration with the European Central Bank (ECB), helped reduce the contagion risks of the crisis. Indeed, the loans it made to Ireland, Portugal, and Cyprus at the height of the crisis are important success stories. But the loans issued to Greece, Ireland, and Portugal were between three and five times larger than established borrowing limits, making them the largest programs relative to each country's quotas in the history of the IMF. The experience has raised questions about

[2] The BRICS countries are Brazil, Russia, India, China, and South Africa.

the established borrowing limits amid the trend toward higher-magnitude economic crises faced by IMF members. In the 1980s, the median IMF program was 75 percent of a country's quota. In the 2008–2017 period, that median loan size rose to 400 percent.

The issue of repeat borrowers is also casting doubt on the role of the IMF in providing financial and economic stability. One-quarter of IMF member countries—mostly low-income and emerging-market economies—have spent more than half of their membership years in IMF programs. This is in large part because the IMF was not designed to handle the type of crises that the institution has supported members through in the most recent decades, such as banking and debt crises from which it can take years to recover. Rather, the IMF was designed to handle crises such as short-term liquidity challenges stemming from exchange rate imbalances. This change in the type of crises to which the IMF responds, compounded by the increased loan sizes, raises important questions about how IMF programs should be structured and whether their very existence creates systemic risks and moral hazards vis-à-vis repeat borrowers.

Finally, the IMF is struggling to remain representative of the changing global economy. In the past two decades, emerging and frontier markets' share of the global economy has risen from just 43 percent to almost 60 percent. Yet their share of IMF voting rights has not increased in kind, currently accounting for less than 43 percent. Indeed, the voting share distribution within the IMF clearly shows that the large developed markets present at the IMF's founding continue to dominate (see figure 4). And the United States' large voting share still gives it unilateral veto power—the only country that enjoys such a privilege.

Figure 4
IMF founders and developed markets still hold more sway

Ten largest IMF voting members
(%)

Developed markets | Emerging and frontier markets

	Share of IMF votes	Share of global economy
United States	**16.52**	15.17
Japan	**6.15**	4.17
China	6.09	**18.72**
Germany	**5.32**	3.28
France	**4.03**	2.20
United Kingdom	**4.03**	2.24
Italy	**3.02**	1.77
India	2.64	**7.69**
Russia	2.59	**3.09**
Brazil	2.22	**2.49**
Developed markets	**59.11**	39.38
Emerging and frontier markets	42.54	**59.18**

Note: **Bold** data indicates the larger value for each country or group. The share of the global economy is measured in purchasing power parity terms. Developed markets are those the IMF characterizes as advanced economies, and emerging and frontier markets are those the IMF characterizes as emerging market and developing economies.

Sources: International Monetary Fund; A.T. Kearney analysis

Reform proposals

The IMF has already undergone a series of reforms to address the final criticism mentioned above, shifting the internal voting structure to be more in line with the current distribution of global economic power. For example, the 24-member Executive Board, which is heavily involved in the operations of the IMF, became an all-elected body, removing the ability of the United States, Japan, Germany, France, and the United Kingdom to appoint their own directors. And although by tradition the IMF managing director has always been European—which remains a point of consternation among emerging markets—there has been an apparent shift toward more diverse representation below the top position. For instance, in 2011, IMF Managing Director Christine Lagarde appointed Zhu Min to be deputy managing director—the most senior position held by a Chinese national in the IMF's history. At the time, a Chinese newspaper said that Zhu Min bears "the weight of a nation" in his new role.

The quota and voting allocations among member states were also reformed in recent years to increase the influence of emerging and frontier-market economies. Yet critics argue that this change was much too small and too slow. Quota and voting rights reform efforts therefore remain a prominent issue at the IMF, with the focus now on the 15th general review of quotas, which is set to be completed in 2019. On the agenda is revising the formula for calculating quotas, determining whether the quotas should be increased, and establishing how quotas should be disbursed among member states. A more substantial process for reallocating voting rights is particularly important for the emerging market economies that continue to seek greater representation.

> Critics argue that IMF reform efforts have been too small and too slow.

Not only is the general review of quotas important for improving the inclusivity of the Fund, but quota increases are also being recommended to replace the $450 billion in bilateral borrowing arrangements that are set to expire in 2020. Without an increase in quotas, the expiration of these arrangements would nearly halve the amount of resources available to the IMF to deploy in times of economic crisis. More broadly, such an increase in the IMF's long-term financial resources would help to address some of the concerns raised above regarding the growth in the size of loans made to member countries in recent years. The challenge of repeat borrowers, however, is not yet being addressed seriously.

Rise of other economic institutions and borrowing arrangements

Questions are also being raised regarding the IMF's historically preeminent role in the governance of the global economy. Although long-standing calls for the abolishment of the IMF have waned since the global financial crisis, the rising importance of other international policy coordinating bodies—such as the G7 and the G20—poses a unique challenge. The global influence of these groups has grown in recent decades and has, in some ways, supplanted the IMF. For example, since 2009, the G20—which is much more representative of the global economy than the IMF—has become the premier forum for international economic coordination.

The proliferation of alternative types of state-to-state lending activity is also testing the IMF's role as the lender of last resort for governments. Bilateral swap arrangements, which allow central banks to exchange currencies, have been proliferating and formalizing in the years since the global financial crisis. For example, a network of swap agreements between the ECB, the US Federal Reserve, the Bank of Canada, the Bank of England, the Bank of Japan, and the Swiss National Bank that had been ad hoc during the global financial crisis was made permanent in 2013. Bilateral agreements between developed and emerging markets have also become more common. Even more notably, in 2010, the Association of Southeast Asian Nations (ASEAN), China, South Korea, and Japan combined a set of individual swap agreements into a single multilateral agreement known as the Chiang Mai Initiative Multilateralization. China also has bilateral swap agreements with more than 30 central banks, which not only provide those central banks with liquidity but also promote the use of the renminbi as an international currency. These agreements therefore have implications for the continued use of the dollar as the primary global reserve currency.

As central bank lending mechanisms outside of the IMF grow in importance, it is unclear whether the IMF will remain central to the resolution of future currency or debt crises. Although countries with such swap arrangements in place may fare well, those that do not could be left to suffer disproportionately from such crises. And it is unlikely that any one country or bilateral swap arrangement can match the IMF's level of financial firepower and technical expertise. The continued fragmentation of global financial and monetary governance would therefore likely create a much more volatile international financial system.

The World Bank

Since its founding in 1944, the World Bank has led efforts to reduce poverty by financing economic development in emerging and frontier markets. But the multilateral development bank is now facing mounting pressure to modernize or risk irrelevancy as new players emerge. Questions are increasing as to the efficacy and relevance of the World Bank, with its strict loan requirements and bureaucratic hurdles. As global power shifts, novel institutions with different requirements and values are being formed. These new players have the potential to rewrite the rules for development financing—and reshape the global economy.

Governance challenges

The World Bank is at a crossroads. On the one hand, its structure continues to offer built-in advantages. With 189 member countries and a capital base of $223 billion, the scale of the bank remains without peer. And with more than 70 years of development experience, the bank is home to an expert workforce of more than 10,000 employees in 120 offices around the globe. The World Bank also represents stability. In contrast to bilateral aid agreements, which may ebb and flow with changes in domestic politics, the World Bank offers reliable flows. This consistency helps to serve long-term development goals and comprehensive country assistance strategies that take a comprehensive approach to development.

On the other hand, there is growing resentment surrounding the bank's leadership structure and representation. Since its founding, the bank's president has always been a US citizen, and developed markets have wielded outsized voting power and representation on the boards of directors. Voting power is determined by the number of shares a country holds in the bank, which is roughly based on economic size. As a result, the United States and European Union control roughly half of the voting power, and the United States has enough leverage to veto key boards of directors decisions. In contrast, all African countries combined have around 6 percent of the bank's voting power. Critics view this governance structure as anachronistic and exclusionary—particularly for the largest emerging-market economies.

> Frustrated with steep requirements, unwieldy bureaucracy, and slow loan processing, important World Bank clients are looking to other lenders.

The World Bank's operations are also under scrutiny. Frustrated with steep loan requirements, unwieldy bureaucracy, and slow loan processing, important bank clients are increasingly looking to alternative lenders. For instance, it takes the bank an average of more than two years to prepare and disburse a loan—a striking contrast to private lenders, which generally take around three months. As digitization enables the global economy to move at ever greater speeds, such slow-moving loan approvals and dispersals are becoming more vexing for would-be borrowers.

Reform proposals

After years of disgruntlement among emerging markets, World Bank reforms are finally beginning to move forward. Despite initial resistance, the United States now supports a $13 billion capital increase to the World Bank as part of an agreement to reform both the bank's lending rules and China's role within it. In recognition of China's dramatically heightened role in the global economy, China's shareholding in the bank will increase to make it the bank's third largest shareholder behind the United States and Japan. The reforms will also raise financing costs for higher-income developing countries, such as China, that can borrow from capital markets. Furthermore, funding will be reprioritized to the poorest countries, including fragile and post-conflict states in urgent need of assistance, rather than higher-income recipients. Additional reforms include developing a more systematic process to "graduate" bank members to non-concessional loans, improving long-term financial discipline and efficiency of operations, and further integrating the private sector in loan financing. While implementation remains a work in progress, the bank's Development Committee agreed to a detailed Capital Package Proposal in April 2018, and the boards of directors advanced its approval process at the annual meetings in October.

Yet advancing these reforms does not guarantee successful implementation or the desired outcomes. The bank's 2009 Zedillo Commission, for example, sought to address many of the same challenges regarding representation, governance, and efficiency. But its key recommendations were never fully implemented, and so the same challenges still plague the bank today. Past efforts at increasing private lending have also yielded mixed results at best. The Global Infrastructure Facility, a World Bank effort to facilitate public–private partnerships, has brought in just $84 million in contributions since it opened in the summer of 2015. Greater urgency and more significant gains across all reform efforts are therefore needed if the World Bank is to maintain its position over the long term.

Emergence of other development banks

The World Bank's modernization efforts may prove too little, too late because of new development banks that have been created in recent years. Traditional regional development banks—including the Asian Development Bank (ADB), African Development Bank, European Bank for Reconstruction and Development, and the Inter-American Development Bank—have functioned more as partners than competitors to the World Bank. But newly created institutions may rewrite the rules of development financing. In fact, both the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB) were formed in part as a response to frustrations with the slow pace of reforms in the existing multilateral development banks (see figure 5).

Figure 5
The World Bank's scale remains without peer, but new players are emerging

	World Bank	New Development Bank	Asian Infrastructure Investment Bank
Year established	1944	2014	2015
Mission statement	End poverty within a generation and boost shared prosperity.	Support infrastructure and sustainable development in BRICS and other underserved, emerging economies.	Improve social and economic outcomes in Asia.
Governance structure	Voting power is weighted based on bank shares held. The United States has an effective veto.	All five members have an equal stake. No one country has veto power.	All members participate in governance. China has veto power.
Member countries	189	5	87
Number of employees	10,000+	About 120	About 180
Funding commitments	$118.7 billion	$5.5 billion	$2.5 billion

Notes: Funding commitments are for fiscal year 2017. The BRICS countries are Brazil, Russia, India, China, and South Africa.
Sources: World Bank, Asian Infrastructure Investment Bank, New Development Bank; A.T. Kearney analysis

The BRICS countries established the Shanghai-based NDB in 2014 with the mission of fostering development for its five members. Specifically, the NDB seeks to achieve development goals "with transparency and empathy ... creating an equal opportunity for all developing countries." Unlike the World Bank, where the United States has effective veto power over major decisions, each of the five NDB members has equal voting power. The NDB has sought independence from traditional lenders, such as the World Bank and ADB, as only 2 percent of its projects have been co-financed. And by lending in local currencies rather than the US dollar, the NDB seeks to protect borrowers from currency exchange losses. While the NDB also aims to provide financing to other "underserved, emerging economies," its handful of members have been the only recipients of the $5.7 billion in loans approved to date.

The other significant new player in development financing is the Chinese-led AIIB, which was established in 2015 with the specific aim of building infrastructure in Asia Pacific. The AIIB has 87 members, including several major economies outside the region such as France, the United Kingdom, and Canada. In fact, the United States and Japan are the only G7 members that have not joined the AIIB. The institution has already approved $5 billion in loans on 28 projects in 13 countries. Unlike the NDB, China holds veto power at the AIIB, ensuring Beijing's leadership of the institution. Although the AIIB is relatively small, it is taking steps to prove its legitimacy as a major international lender. It has received AAA credit scores from the big three rating agencies, mirrors major development banks by lending in US dollars, and has co-financed two-thirds of its loans with established development banks, including the World Bank and the ADB. As a result, the AIIB has the opportunity to glean expertise and adopt best practices from these experienced institutions as it scales up in the years ahead.

Both the AIIB and the NDB raise questions about the future of global economic governance. Supporters of the Bretton Woods order cite concerns that the AIIB and NDB's lack of loan requirements—such as those concerning transparency and environmental protections—will erode the norms and best practices established by the World Bank. They argue there could be a race to the bottom as borrowers opt for faster but often higher interest loans that come without such strings attached. The AIIB also highlights China's rising geopolitical influence. Many of the AIIB's loans have complemented existing projects related to the BRI, for instance. Combined with China's extensive bilateral and regional investments, the new development banks may therefore serve to advance China's standing as a global economic and political power, offering an alternative to Western-led governance standards.

Key Market Growth Paths

Five markets play a particularly significant role in the global economic environment: the United States, the EU, China, Japan, and India. As the five largest economies in the world as measured at both exchange rates and purchasing power parity, these countries account for about two-thirds of global GDP. Understanding the dynamics at work in these markets—particularly how they will both shape and be affected by the fragmenting international economic architecture—goes a long way toward explaining the global economic outlook in the forecast period (see figure 6).

Figure 6
The outlook for the five largest economies is diverging

Forecasts for selected 2019 economic indicators

Economy	GDP growth	Inflation	Unemployment rate	Government budget balance	GDP per capita	Contribution of net exports to GDP growth
China	6.2%	2.4%	4.1%	–4.4%	$19,559	0.2%
European Union	2.0%	1.9%	6.5%	–0.8%	$44,854	0.1%
India	7.4%	4.9%	8.7%	–6.5%	$8,443	–0.1%
Japan	0.9%	1.3%	2.2%	–2.8%	$46,069	0.3%
United States	2.5%	2.1%	4.0%	–5.0%	$65,062	–0.2%

Notes: Government budget balance is expressed in percent of GDP. GDP per capita is expressed in purchasing power parity.
Sources: Economist Intelligence Unit, International Monetary Fund; A.T. Kearney analysis

The economic expansion in the **United States** has been robust in recent years, and this momentum will carry into the first half of 2019. Unemployment will continue to be very low, and more people will be drawn into the labor force as wages continue to rise. A tight labor market will support strong household consumption, which will continue to be the biggest contributor to US economic growth. Consumption growth will slow relative to recent years, though, as the short-term boost from the late-2017 tax cuts wears off, interest rates continue to rise, and the housing market cools.

With a divided government, it is unlikely that public spending will pick up the slack. There is a possibility, however, that the Trump administration and the Democratic House of Representatives could work together to boost spending on infrastructure—something both sides agree is needed. Determining how to fund this new investment will be a challenge, though, particularly as the government budget deficit deteriorates to 5 percent of GDP and government debt balloons to almost 108 percent of GDP in 2019. And after failing to ramp up in the wake of the recent tax cuts, business investment is also forecast to remain relatively steady over the medium term. As a result, US economic growth will slow from 2.5 percent in 2019 to just 1.4 percent in 2023. In fact, many economists even predict that a recession will hit the United States during this period, consistent with the cyclical end to other periods of extended economic expansion.

> Consumption growth will slow in the United States as the short-term boost from the late-2017 tax cuts wears off, interest rates continue to rise, and the housing market cools.

International trade will not boost US economic growth in the coming years either; net exports will actually weigh on the economy in 2019. Despite the tariffs put in place by the Trump administration in 2018, the US trade deficit continues to increase. This imbalance is in part due to the concurrent rise in the value of the US dollar relative to other currencies as the US Federal Reserve raises interest rates. Imports are therefore expected to continue to outpace exports. More broadly, protectionist trade policy is creating headwinds for the US economy. It is missing out on the efficiency gains and increased trade flows expected among the CPTPP members and is proving itself to be an unreliable economic partner for the EU, which is instead minting trade deals with a variety of other key economies.

The **EU** will also experience slowing growth in the coming years, with a gradual but steady decline over the forecast period from the 2.2 percent growth it enjoyed in 2018. More positively, unemployment rates are projected to drop steadily from nearly 8 percent in 2019, the lowest level since the global financial crisis, to 7.3 percent in 2023. Combined with rising wages, higher employment levels are driving consumer confidence and strong domestic demand. But the ECB may begin to raise interest rates from their zero level in the second half of 2019, which could dampen consumption momentum.

Among the EU's largest economies, Germany's outlook is positive, benefiting from strong business investment, rising wages, and the lowest levels of unemployment since reunification.

While Chancellor Angela Merkel's decision not to seek reelection in 2021 introduces a degree of political uncertainty in the coming years, dramatic economic policy shifts remain unlikely. France is also experiencing solid growth, driven in part by President Emmanuel Macron's reform agenda, including deregulation of small and medium-size enterprises, labor reforms, and corporate tax cuts—although his administration is facing strong political headwinds in advancing additional reforms. Italy continues to lag average eurozone growth levels. A controversial budget plan to reduce Italy's public debt—already among the highest in the EU—through increased government spending has been rejected by the European Commission, increasing tensions between Rome and Brussels and chilling investor confidence. The outlook is weaker in the United Kingdom as well, largely because of continued high levels of uncertainty surrounding Brexit. A disorderly "hard Brexit" would present the most damaging scenario for the UK economy, resulting in significant business disruptions and higher costs for consumers.

The EU economic outlook will also be affected by the shifting international economic architecture, particularly trade policies and norms. Rising international protectionism, most notably in the United States, represents a threat to European business and economic growth. The US imposition of tariffs on European steel and aluminum in June 2018 has sewn divisions in the transatlantic relationship and undermined trust. The potential for additional US sanctions targeting the EU auto industry would hit Germany acutely. While the US will remain the EU's top trading partner for the foreseeable future, the erosion of trust may drive the EU to continue to diversify its relationships as it pursues free trade agreements with alternate partners.

The growth of the **Chinese** economy will continue to moderate, decelerating gradually from 6.6 percent in 2018 to 5.6 in 2023 as the economy shifts from being export-based to consumption-driven. These developments are apparent in the steady increase of consumption growth and the slowdown of fixed asset investment growth in recent years. Trade tensions are expected to dent business and consumer confidence, though, subtracting up to 0.8 percent of GDP in 2019 followed by an annual loss of 0.4 points thereafter. These negative effects will be partially offset by government support for affected enterprises and efforts to find new markets for Chinese exports. In addition, Beijing's pursuit of technological supremacy as part of its Made in China 2025 industrial strategy—designed to transform China into a high-value-added production economy—is expected to promote economic growthy by achieving higher levels of digitization and technological sophistication in the coming years.

But the international spotlight is on China's distortionary market practices, such as forced technology transfers and preferential treatment of state enterprises. Many countries are encouraging authorities in Beijing to implement market access reforms. Beijing has responded by easing foreign ownership requirements in a number of sectors and has signaled it would increase market access in an effort to attract foreign investment. Trade tensions are also exposing China's vulnerabilities in the export sector, and Beijing will bolster efforts to diversify its trade relationships and sources of economic growth in the near and medium term. For instance, China is a leading negotiator on the RCEP—likely to be concluded in the medium term—which would open new markets for Chinese exports in Asia.

High levels of government and corporate debt will also weigh on economic performance and could raise risks for the financial sector. Beijing's measures to curb shadow financing will present short-term challenges but should contribute to more sustainable growth and financial stability in the long term. In particular, infrastructure spending is expected to decelerate, and small and medium-size enterprises will be negatively affected by reduced access to credit. However, this will be at least partially counteracted by the reduction of reserve requirements for the banking sector and the recently announced personal income tax cuts.

Economic growth in **Japan** is expected to decelerate over the medium term as well. While recent economic indicators are short of the level of growth desired by the government, modest increases in wages, consumption, and inflation are a positive development. Economic performance will be influenced by a continuation of Abenomics, with this set of expansionary economic policies expected to persist in the medium term. Interest rates will also remain very low to stimulate the economy, but they will continue to put pressure on the profitability of the banking sector. The Japanese economy is expected to anchor at around 0.5 percent growth annually by 2023, driven largely by low inflation and consumer spending as a result of an aging population.

On the trade front, the economic benefits of the recently ratified CPTPP free trade agreement will start to materialize in 2019. In addition, the recently concluded EU–Japan Economic Partnership Agreement positions the Japanese economy as a key Asian partner for the EU. This agreement will benefit Japan's auto exports through the elimination of tariffs and is expected to raise Japan's GDP by 1 percent. However, any gains from trade may be held down by the potential imposition of tariffs on Japan's automotive exports by the United States.

> While recent economic indicators are short of the level of growth desired by Japan's government, modest increases in wages, consumption, and inflation are a positive development.

Domestically, the consumption tax increase scheduled to go into effect in October 2019 will mildly curb consumption at the outset and could even spark a short-term recession, as have similar tax increases in the past. Nevertheless, it is expected to support long-term economic growth by enabling increased spending on social security programs for the elderly and free childhood education aimed at boosting fertility rates. This is important because Japan's population is expected to decrease by a quarter in the next four decades, which will progressively harm economic prospects and productivity growth. As aging accelerates, spending on the elderly will rise and so will the government's debt, already the highest in the world. Fiscal constraints, however, may be partially offset by two emerging trends that are expected to boost growth. First, Prime Minister Shinzo Abe's "womenomics" agenda is increasing female participation in the labor force, with 2 million women having gained employment since he took office. Second, the government has begun to reduce restrictions for foreign workers that will ease labor force constraints.

India will maintain its status as the world's fastest-growing major economy and will be the only major economy that will accelerate in the near to medium term. The country will also account for the majority of the world's fastest-growing cities. Economic prospects will be supported by a number of government-led reforms and initiatives to liberalize foreign investment and develop manufacturing, including the Make in India program, the creation of industrial corridors, and the increase in infrastructure investment. The Indian economy is therefore expected to maintain an impressive 7.8 percent annual growth level in the medium term.

Robust investment and consumption levels will continue to support economic growth. The recently announced recapitalization of public banks will enhance financial stability and lending to the economy, and retail and consumer credit growth will continue to rise for India's expanding middle class. The country's infrastructure is also improving, boosted by expanding transportation networks and digital connectivity in rural areas, which will support higher economic growth. Such developments are also expected to encourage higher rates of female participation in the formal labor force, which would increase domestic consumption levels. Furthermore, expectations that transparency will improve and the tax base will expand as a result of India's 2017 tax reform (the Goods and Services Tax) and 2016 demonetization initiative (subscription required) are likely to bolster economic performance. However, emerging political developments, including Prime Minister Narendra Modi government's potential continuation of recent attempts to direct central bank policy, may undermine business confidence.

> India's strong economic outlook will remain vulnerable to external developments.

India's economic outlook will also remain vulnerable to external developments. The gradual monetary tightening in the United States will continue to put pressure on the rupee and other emerging market currencies. And as an energy import-dependent country, the combined effect of rising global oil prices and currency depreciation will weigh on nearly every sector of India's economy and contribute to a worsening of the current account deficit. The government is therefore unlikely to achieve its goal of a 10 percent reduction of imports in the medium term, particularly as the expanding population is driving higher consumer demand growth. Exports are likely to receive a boost from currency depreciation in the near term, though. And India may open new export markets in the medium term with the eventual conclusion of the RCEP trade agreement, which is in advanced stages of negotiation.

Conclusion and Business Implications

The global economy will decelerate in 2019 and beyond. Companies need to incorporate that slowing growth into their business plans and forecasts. But the question is how dramatic the deceleration will be. If the islandization of the global economy continues and the international economic order continues to fragment, growth will fall more rapidly and remain at a lower level for a longer time. In such a multi-local world, companies will need to restructure their global operations to adapt to regional economic blocs, greater financial and exchange rate volatility, and slower economic development in some emerging-market regions.

While the specific implications of this global economic outlook will vary based on a company's home market, geographical footprint, and sector, several high-level implications emerge from our analysis:

Identify markets that are open to integration. While some markets are embracing protectionism or forgoing regional or multilateral economic integration, other markets are pushing in the opposite direction. Several mid-sized markets along the Pacific Rim, for instance, stand out in this regard. Companies should identify such markets to capitalize on compelling opportunities for investment and sales in the near to medium term.

Consider shorter or more regional supply chains. As the global trading system comes under more pressure, the proliferation of regional trade agreements may make regional supply chains more viable than global ones. And in an increasingly uncertain global economic order, a sensitivity analysis for the risk of protectionism and other disruptions on the inputs and products across a company's supply chain is prudent. Such an examination could change the cost–benefit analysis around having multiple product supply locations and establishing production capabilities at the local or regional level.

Prepare for additional exchange rate volatility. As monetary policies continue to diverge in the world's major economies, exchange rates are also likely to continue to move. The realignment of exchange rates is likely to be made more volatile in the short term by the political risks present in many markets. This volatility would likely increase in the medium term if the central role of the IMF diminishes. Companies should prepare for this currency risk by taking appropriate hedging measures.

Pay more attention to compliance. As countries and regions continue to implement their own regulatory standards on a variety of products and services, companies will face a more complicated regulatory environment. Compliance will therefore become more central to maintaining market access and avoiding fines. Indeed, our 2018 Views from the C-Suite survey results indicate that executives already recognize the rising challenge of risk management and compliance.

Authors

Paul Laudicina, chairman emeritus of A.T. Kearney and chairman of the Global Business Policy Council, Washington, D.C.
paul.laudicina@atkearney.com

Erik Peterson, partner and managing director of the Global Business Policy Council, Washington, D.C.
erik.peterson@atkearney.com

Courtney Rickert McCaffrey, manager of thought leadership for the Global Business Policy Council, Washington, D.C.
courtney.mccaffrey@atkearney.com

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