

WORLD ECONOMY – CHALLENGES AT THE END OF 2024

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Abstract

The world macroeconomic climate slightly improved at the end of 2024, an evolution supported by the positive developments on the international financial markets and the prospects for de-regulation and interest rate cuts in the short-run, with favorable impact for the investments. However, more than 4 years since the outbreak of the coronavirus pandemic and almost 3 years since the outbreak of the crisis in Ukraine the world economy continues to be confronted with multiple risks and challenges, including the high level of the uncertainty and the divergence among the main economic blocks in terms of macroeconomic performance. In this paper standard econometric tools are applied and the database of International Monetary Fund (IMF) is used in order to estimate the annual pace for the structural components of the volume of global trade and of the GDP in the world and main economic blocks (USA and China) for the period 1980 – 2024. The results of the econometric analysis show a weak annual pace of potential output for the world economy (influenced by the challenges in terms of global trade) with divergences among the main economies – upward trend in USA and downward trend in China.

Keywords: world economy, potential output, investments

JEL Classification: C20, E22, F10

1. Introduction

The growth pace of the world economy improved at the end of 2024, towards the best performance since the month of August, according to the PMI Composite indicator estimated by S&P Global (2024), as can be noticed in the following chart.

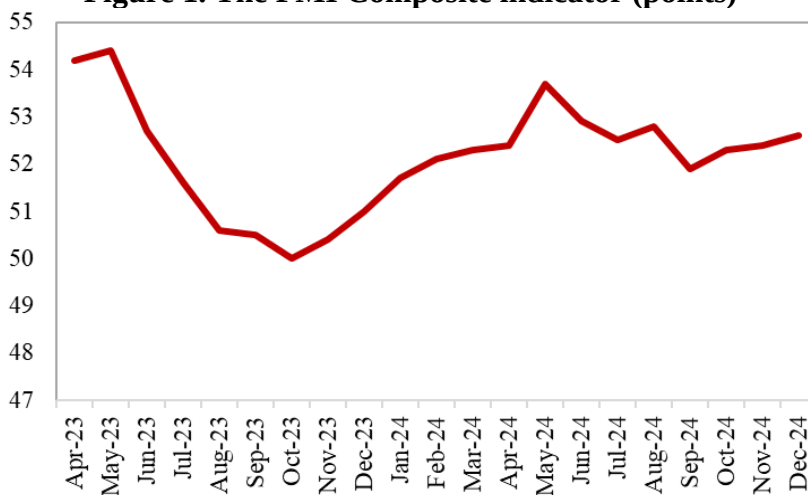
This evolution was supported by several factors, including the positive developments on the international financial markets [the stock market capitalisation / GDP ratio in USA is at record high levels, according to the platform GuruFocus (2024)], supported by the prospects for de-regulation and for the continuity of the interest rate cut cycle in the world in the coming quarters, with favorable impact for the fixed investments in the real economy.

In this respect we point out that in USA (the largest economy in the world, with a nominal GDP of over USD 29tn in 2024, according to the estimates of the Bureau of Economic Analysis) the fixed investments grew by an annual pace higher than the private consumption (the main component of the GDP, and

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also the engine of the world economy in the past decades) over the past quarters.

Figure 1. The PMI Composite indicator (points)



Source: S&P Global (2024)

However, the growth pace of the world economy continues to be weak, in the context of the geo-economic fragmentation, whose impact was estimated by the International Monetary Fund (2023) to range between 0.2% of GDP to 7.0% of GDP.

Furthermore, the uncertainties persist at high levels, being determined by the unknowns regarding the geo-political tensions and the trade tensions among the largest economies in the world, and the risk factors, including the tough stance of the public finance and the high level of the real interest rates in the USA.

This paper applies standard econometric tools and uses the database of the International Monetary Fund (2024) (annual observations) in order to estimate the annual potential growth pace for world trade and for the GDP in the world, USA, and China during the period 1980 – 2024.

The results of the econometric estimates point to the consolidation of the annual pace of the structural component of the world GDP and of the world trade in 2024, at levels below the post-crisis cycle, given the consequences of the exogenous shocks, the coronavirus pandemic and the geo-political tensions.

Furthermore, there can be noticed the divergence between the USA and China in terms of the annual potential growth pace, determined by the dynamic of the investment/GDP ratio.

The rest of the paper has the following structure: chapter two presents the recent developments in the world economy; the third chapter briefly describes

the employed methodology; the results of the econometric estimates are discussed in the fourth chapter; the last chapter briefly presents the main conclusions.

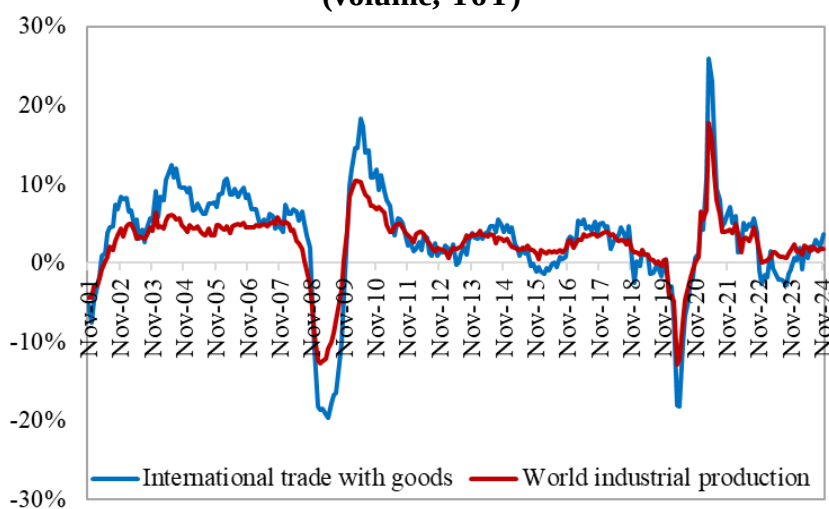
2. The Recent Macroeconomic Developments in the World Economy

The performance of the world economy was impacted by the consequences of the geo-economic fragmentation, the persistence of the geo-political tensions, the high level of the real interest rates, the upward trend for the public debt, and the electoral context in 2024.

However, the growth pace of the global economic activity stabilised last year, as reflected by the World Economic Forum (2024), an evolution supported by the slowing-down inflationary pressures, and the resilience of international trade.

In this respect, we underline that the volume of the international trade with goods grew by an accelerating pace of 3.6% in November 2024, the best performance since October 2022, according to the statistics of the Netherlands Bureau for Economic Policy Analysis (CPB, 2024) and reflected in the following chart.

Figure 2. International trade with goods vs. world industrial production (volume, YoY)



Source: Netherlands Bureau for Economic Policy Analysis (2024)

During January-November 2024 the volume of the international trade with goods advanced by an annual pace of only 1.7%, a rebound after the contraction by around 1.2% YoY in 2023. Despite this improvement, the growth pace of the international trade with goods was weak last year, at least compared to the developments during the previous economic cycles, an evolution determined by

the populist economic measures implemented in many countries, as pointed out by the World Bank (2024, a).

In this context, the volume of the world industrial production rose by an annual pace of around 1.7% during the period January – November 2024, an acceleration after an estimated increase by only 1.0% YoY in 2023.

We point out to the divergences among the largest economies in the world [USA and China, with a cumulated contribution of over 40% to the global GDP, according to the estimates of the IMF (2024)] in terms of the evolution of the volume of exports of goods and of the volume of the industrial production.

For instance, the volume of the exports of goods grew by an average annual pace of 3.1% in the USA during January-November 2024, slowing-down from 3.2% in 2023, according to the estimates of CPB (2024).

On the other hand, the volume of the exports of goods of China [the second largest economy in the world, with a nominal dimension of over USD 18tn, according to IMF (2024)] increased by an average annual pace of 11.0% in the first 11 months of 2024, accelerating from 2.9% in 2023.

Furthermore, the volume of industrial production contracted in the USA by an average annual pace of 0.4% during January-November 2024, following the increase by around 0.2% in 2023.

In China the volume of industrial production advanced by an accelerating average annual pace to 5.6% in the period January-November 2024, from 4.4% in 2023, according to the CPB (2024) database, as can be seen in the following chart.

Figure 3. The volume of the industrial production in USA and China (MA12, YoY)



Source: Netherlands Bureau for Economic Policy Analysis (CPB) (2024)

3. Methodology

In this paper the econometric filter Hodrick-Prescott (1997) is applied in order to distinguish between the structural and the cyclical components of the annual pace of world trade and of the annual pace of the GDP (world, USA, and China) during the period 1980 – 2024.

The database of the World Economic Outlook of October 2024 of the International Monetary Fund (IMF, 2024) was used, with annual observations for the annual dynamic of world trade and GDP (world level, USA, and China).

According to the seminal article of Hodrick-Prescott (1997), this method highly used in the macroeconomic literature is synthesized by the following relation:

$$\text{Min} \sum_{t=1}^T (\ln Y_t - \ln Y_t^*)^2 + \lambda \sum_{t=2}^{T-1} ((\ln Y_{t+1}^* - \ln Y_t^*) - (\ln Y_t^* - \ln Y_{t-1}^*))^2 \quad (1)$$

where the Y_t , Y_t^* and λ are the macroeconomic indicator, its structural component (the trend), and the smoothness parameter.

In this paper we employed a value of 100 for the smoothness parameter, as this is the value recommended by the authors, while working with annual observations.

Although this is a transparent method, several authors, including Bouthevillan et al. (2001), emphasized its short-comings, namely the leakage and the compression effects, whose dimension is dependent on the parameter λ .

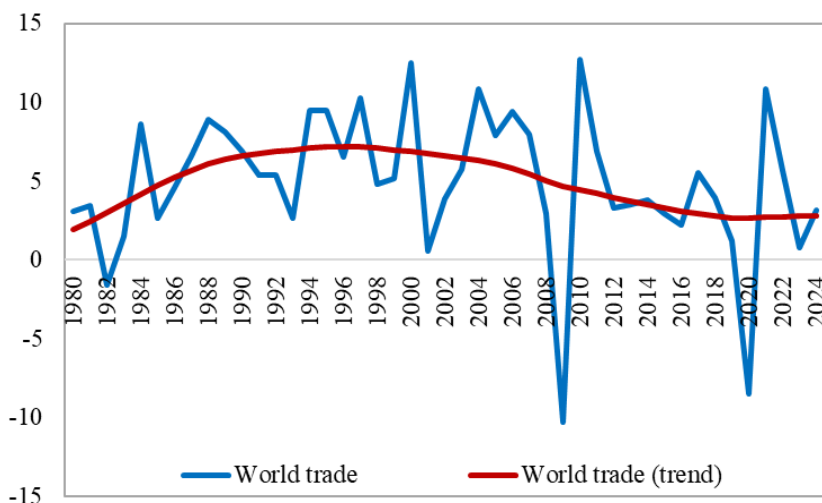
In this paper the econometric software E-Views was used.

3. The Interpretation of the Results

According to the results of the econometric analysis, the annual potential pace of world trade consolidated at 2.8% in 2024. This is the highest level since 2017, the year before the Trump 1.0 Administration implemented the first wave of the tariffs.

However, this is a lower level compared to 3.1% in 2016 (at the end of Obama Administration) or 5% in 2008 (at the end of Bush Administration), and also very close to the lowest level since the beginning of the 1980s, as can be noticed in the following chart.

Figure 4. Annual pace of the world trade and of the trend component of the world trade (%)



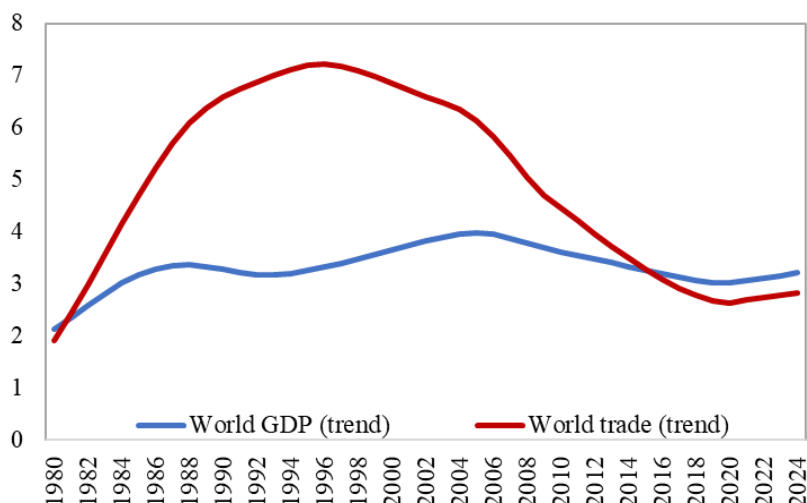
Source: econometric using the database of International Monetary Fund (2024)

Furthermore, it is easily noticed that the implementation of the tariffs by the Trump 1.0 Administration in 2018 determined the deterioration of the annual potential pace for world trade in the following years, to as low as 2.6% in 2020, the minimum since 1981.

On the other hand, we point out that the deterioration of the annual potential pace of world trade had a negative impact for the evolution of the potential growth pace of the world economy, as reflected in the following chart.

In this respect, we underline that the annual potential pace of world trade presented lower levels than the annual potential growth pace of the world economy for the ninth year in a row in 2024. Therefore, world trade ceased to be an important engine of growth for the world economy, after several decades, an evolution determined by the changes of paradigm in terms of trade tariffs, starting with the Trump 1.0 Administration in the USA.

Figure 5. Annual pace of the trend component for world trade and world GDP (%)



Source: econometric using the database of International Monetary Fund (2024)

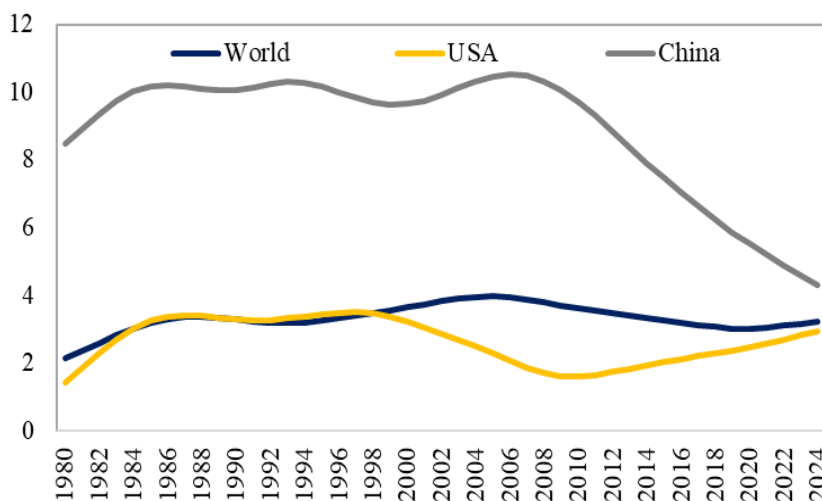
As regards the annual potential growth pace of the world economy, we also notice a consolidation in 2024, at around 3.2%. This is the highest level since 2015, the year before the end of the Obama Administration in the USA.

However, the annual potential growth pace of the world economy continues to be lower compared to the levels of 2010 (in the year following the Great Recession this indicator stood at 3.6%), 2007 (3.9%), and 2005 (around 4%, a record high level for the past decades, at least since 1980 until now), according to the results of the econometric estimates represented in the previous chart.

Last, but not least, we emphasize the divergence among the largest economies in the world (the USA, and China) in terms of the annual potential growth pace.

On the one hand, the results of our econometric analysis point to the acceleration of the annual potential growth pace in the USA from 2.8% in 2023 to 2.9% in 2024, the highest level since 2001, as reflected in the following chart. This was supported by the upward trend for the investments, with the total investments / GDP ratio climbing to around 22% in 2024, the maximum since 2007.

On the other hand, the annual potential growth pace in China decelerated from 4.6% in 2023 to 4.3% in 2024, a record low level for the past decades, at least from 1980 until now.

Figure 6. Annual potential growth pace (%)

Source: econometric using the database of International Monetary Fund (2024)

This deterioration of the annual potential growth pace in China was determined by the downward trend for the total investments/GDP ratio, to around 42% in 2024, the lowest level since 2007, given the challenges across the real estate sector, and the maturity of the economic growth and development model.

4. Conclusions

Our analysis pointed out the consolidation of the annual potential pace of world trade, and of world GDP in 2024. This evolution confirms the high level of resilience of world economy in a complicated context, dominated by the persistence of the unprecedented challenges, including the geo-political tensions, the trade frictions, and the high levels of the real financing costs.

In this respect, it is very important to emphasize the fact that the world economy avoided a recession in 2024, while the global macroeconomic climate slightly improved at the end of the year.

However, the annual potential paces of world trade and of world GDP stood well below the levels of the previous economic cycles in 2024. Furthermore, the annual potential pace of the trade continued to be lower than the annual potential growth pace of the world economy in 2024, expressing the fact that trade is not anymore an engine of global growth.

In this context, of weak annual potential growth pace, the progress in countering global poverty was limited, as also recently reflected by the research of the World Bank (2024, b).

Therefore, there are needed measures in order to promote the acceleration of world trade (remove the trade barriers) and to improve the potential growth pace in the world economy.

On the one hand, a new Bretton Woods momentum is needed more than ever, as multilateralism is the most adequate solution to address the current unprecedented challenges in a sustainable way.

On the other hand, the Administrations across the world should focus more on the acceleration of the structural reforms, while prioritising the measures in order to determine a sustainable relaunch of the fixed investments, while countering the climate change, incorporating the technological progress in a balanced way and promoting peace against the militarisation efforts.

Unless important intelligent and calibrated economic policy measures are implemented in a coordinated way across the world the divergences among the economic block would persist, with negative consequences for the global peace and for the sustainability of the planet.

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