# GABRIEL FELBERMAYR

## Director of the Austrian Institute of Economic Research (WIFO), former President of the Kiel Institute for the World Economy (IfW)

**Jean-Claude Trichet, President of the Académie des sciences morales et politiques, former President of the European Central Bank, Honorary Governor of the Banque de France**

I now hand the floor to Gabriel Felbermayr for his discussion.

**Gabriel Felbermayr, Director of the Austrian Institute of Economic Research (WIFO), former President of the Kiel Institute for the World Economy (IfW)**

Thank you, Jean-Claude, for the introduction, and thank you, Thierry de Montbrial, for organizing the event. It is always a pleasure to be here. I am honored to begin the session. Firstly, I shall summarize the state of the World Economy, albeit with a very Euro-centric view, with a discussion of four economies: The Eurozone, the United States, The UK, and China. We observe here a state of fragility. The Eurozone is not growing. The third quarter is just in, and the Eurozone is on the brink of a recession. The United States is surprising us with relatively high growth rates quarter on quarter in the third quarter of 2023. The analyzed growth-rates amount to almost 5%. This is significant. In times where we need to cool down our economies to eliminate inflation, this looks both red-hot and unsustainable. China, the engine of growth for so many years, is not growing steadily; it is now up and down, and resembles the American experience. The United Kingdom looks very much like the Eurozone. The world, as such, is growing at the rate of about 3% in this and next year; certainly more slowly than what was seen prior.

Given recent system-shocks, this comes as no surprise. What we should take away from this is not only divergences across the Atlantic, China and Europe, but a relative lack of collapse. Resilience is what we should see here. The FIAT recession, if it comes to the Eurozone, will be a mild one. We are not facing an imminent disaster.

Next year, we anticipate some improvements in the Eurozone and United Kingdom, a decline in the United States, and a sidewards shift in China. The biggest issue for us economists over the last two years has been inflation. The good news is that headline inflation is coming down in both the Eurozone and United States. Core inflation remains the same, at something like 4.2 or 4.1%. The Eurozone has a longer trajectory to go through, with higher rates, but what is worrying here is that the 2% target is still quite distant. Services inflation remains very high, both in the Eurozone and the United States. Services inflation reflects wage-growth more than the other categories, and so, we must say that the job is not yet done. Central banks are regaining control; that is true. However, I do feel that we are in a "higher for longer" situation, and that the fight against inflation will define the world economy for more than just the next one or two years.

I fear that the strong increase in interest rates will feed into financial risks, and we have not seen everything yet. On top of all the economic struggles we are facing, and the climate-disaster, financial risks are higher. Rates will be higher for longer. We know that monetary policy comes with a leg, which can be substantial. A large share of what monetary policy will achieve is not yet visible in the data. We observe that fiscal policy must again become sustainable; this is true in the Eurozone and very much true in the United States. This will put pressure on growth and the financial markets.

Quantitative tightening has not really fully started, and that will also affect the long-run interest rates from the perspective of growth. Only 20%, according to some estimates of the total impact of monetary policy tightening, is yet in the data; there is more to come. I fear that the financial crisis we have seen showing its face this year is not yet over. Fixed-income assets have come under pressure in recent years due to high interest rates: we need only a big shock that forces insurance companies to liquidate their holdings to see more financial stress on the system. I am fearful about this, and also fearful about the fact that the Eurozone inflation differentials across the zone are huge. In October, inflation rates indicated an enormous difference of 950 basis points between Belgium and Slovakia. This is significantly worrying. We are far away from an operable monetary area in Europe. This should not be possible if we really had an integrated single market.

Interest-rate spread across the Eurozone is up. Take Italy, for example. With almost 150% debt over GDP and interest payments more than doubling, significant stress is put on the system. Looking at the international arena, we are observing a boom in the use of economic sanctions. This translates into economics something we see in the political world: it amounts to war by other means. This is what our political scientists colleagues are saying: “Political conflict that is fought out with economic means”. This trend is certainly not good.

Data from the Global Sanctions Database indicates that exponential growth is something weighing on the growth perspective of the world economy, and illustrates that political risks translate into economic risks, as sanctions imply the disruption of global value-chains, which means decoupling, at least at the bi-lateral level.

Regarding globalization, my preferred measure is to take a quantity index of international goods traded and divide it by the quantity index of industrial production. We see resilience here; the world has not de-globalized, but hyper-globalization has stopped. In fact, it stopped 15 years ago. New data indicates that the world economy is slowing down significantly. Trade is falling faster than industrial production. The World Trade Organization’s trade report is relatively alarmist. The latest version indicates that the decoupling that is happening at the bilateral level between the US and China is also eating into the aggregate data. Trade diversion can only go some way to mitigate the bilateral effects of less trade across the Pacific.

I would also like to bring attention to the enlargement of the BRICS group to six more members. This is significant and under-discussed: there are implications on the world financial system, as the BRICS group have their own bank and are setting up more autonomous currency systems. The enlargement involves the UAE, so I thought this would be important to raise.

With respect to numbers, the share of the BRICS+6 in global GDP enlargement is not changing significantly, but what it does is bring in countries that have been outside of the inner circle of policy-making, such as Iran, into the BRICS. I believe this is a challenge for the world order as we know it, and I hope this does not lead to more polarization. I hope that this event informs us about the situation that the world economy is facing, and I believe we should take heed of this. Thank you all.

**Jean-Claude Trichet**

Thank you very much, Gabriel, for sticking to the concept and providing short, concise messages. On inflation, I would add that I was struck by the fact that core inflation on both sides of the Atlantic is now at the exact same figure. This says something and offers credibility to the idea that the goal and definition of price stability is the same. This is reassuring. However, as you mentioned, the challenges are still present. Thank you again.