Global Research
& Analytics

CRISIL
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GLOBAL ECONOMY

CRISIL Insights

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The CRISIL Insights Global Economy series represents our outlook on the financial scenario across the world and provides a perspective into how it will shape up in the near future.

Trade war clouds darken

- The United States (US) economy posted a solid 4.1% on-quarter growth in the second quarter of 2018, driven by private and government spending
- In its August meeting, the Bank of England raised its benchmark policy rate by 50 basis points (bps) to 0.75%, in keeping with market expectation
- Brent crude oil prices cooled 20 bps on-month in July, averaging $74.4 per barrel, following a deal to increase output

Global growth parameters indicate the much-vaunted synchronized economic revival continues. However, the continuing protectionism and the tariff spat between the US and China are raising risks. The global economy may yet feel the bite from the trade war.

In the July update of its World Economic Outlook, the International Monetary Fund (IMF) continued to peg global growth at 3.9% in 2018 and 2019, while flagging the rising downside risks. While it expects growth to be solid in the US, the IMF has lowered its growth projections for the euro zone, the United Kingdom (UK), and Japan. Growth in China is expected to moderate, as regulatory tightening of the financial sector takes hold and external demand softens. Overall, the IMF expects growth in emerging market economies to be more uneven, stronger in net oil-exporting countries and slower in net oil-importing economies. The emerging market economies are expected to face pressure from rising oil prices, higher yields in the US, the strengthening US dollar, and escalating trade tensions between the US and its major trading partners.

GDP Heat Map

GDP growth (q-o-q SA annualized %)

	Q1-17	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18
US	1.2	3.1	3.2	2.9	2.0	4.1
UK#	0.4	0.2	0.4	0.4	0.2	0.4
EA#	0.6	0.7	0.7	0.7	0.4	0.3
Japan	2.6	2.0	2.0	1.0	-0.6	1.9
China*	6.9	6.9	6.8	6.8	6.8	6.7

Note: * y-o-y %, #q-o-q, not annualized
Source: Statistical bureau, respective countries

Improvement | Decline | Unchanged

US Economy

Real wage growth declines despite healthy jobs market

Euro Zone Economy

Unemployment rate remains stable

US Economy

US posts solid growth

The US economy put up a stellar 4.1% on-quarter gross domestic product (GDP) growth[1] in the second quarter (Q2) of 2018, up from the 2.2% growth posted in the first quarter (Q1). Q2 growth was driven by personal consumption expenditure (PCE) and government spending. On the employment front, the economy continued to witness a decent 157,000 non-farm job gains in July, although slightly below the market consensus. However, considering the upward revision to data of May and June, this continues to reflect a healthy jobs market at or near-full employment. Meanwhile, nominal wage growth remains short, with the average hourly wage gain at 2.7% on-year for the third month in a row. Real wage growth declined as Consumer Price Index (CPI)-linked inflation outstripped nominal wage growth, coming in at 2.9% in July, stable compared with June. CPI inflation was led by energy inflation, which rose 12.1% on-month.

The core PCE inflation, the US Fed's preferred inflation metric, was stable at 1.9% for the third month in a row in June. In its August monetary policy, the US Fed left its policy rate unchanged, ranging 1.75%-2%. Earlier in June, the Fed had hiked its policy rates by 25 bps. Fed Chair Jerome Powell's positive assessment of the US economy and a take solid Q2 GDP growth boosted the dollar index in July. The index gained 0.5% on-month on average in July.

Consumer Price Inflation (y-o-y %)

	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
US	2.1	2.2	2.4	2.5	2.8	2.9
UK	3.0	2.7	2.5	2.4	2.4	2.4
EA	1.3	1.1	1.3	1.3	1.9	2.0
Japan	1.4	1.5	1.1	0.6	0.7	0.7
China	1.5	2.9	2.1	1.8	1.8	1.9

Source: Statistical bureau, respective countries

Policy Interest Rate (End of Month %)

	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18
US	1.25-1.50	1.50-1.75	1.50-1.75	1.50-1.75	1.75-2.00	1.75-2.00
UK	0.50	0.50	0.50	0.50	0.50	0.50
EA	0.0	0.0	0.0	0.0	0.0	0.0
Japan	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
China	4.35	4.35	4.35	4.35	4.35	4.35

Source: Central banks, respective countries

Euro Zone Economy

Inflation is beginning to pick up in the euro area

The euro area (EA) Q2 2018 GDP growth came in at 0.3% on-quarter (not annualized), slightly below the 0.4% growth clocked in Q1, as per the preliminary flash estimate released by the Eurostat. The region's unemployment rate remained stable at 8.3% in June, the lowest recorded since December 2008.

Inflation is beginning to pick up, led by rising energy and services inflation. In June, the annual harmonized indices of consumer prices came in at 2%, up from 1.9% in May. As per the Eurostat's flash estimate, inflation will likely rise to 2.1% in July as energy prices remain high. On the currency front, the euro gained 0.1% on-month in July against the dollar as investors cheered the progress in the Trump-Juncker trade negotiations.

The UK Q2 GDP growth came in at a modest 0.4% on-quarter (not annualized), following weak Q1 growth of 0.2%. Services industries and construction increased in Q2, by 0.5% and 0.9%, respectively, while production decreased by 0.8%. In June, the CPI inflation came in at 2.4% for the third month in a row, driven by rising energy prices. As a result of this, the Bank of England (BoE), in its August meeting, raised its benchmark policy rate by 50 bps to 0.75%. This marks the first rate hike in 2018 and was in line with market expectations. The BoE had last raised rates in November 2017. The pound weakened 0.9% on-month on average in July over a stronger dollar.

[1] **All growth numbers are seasonally adjusted and annualized, unless stated otherwise**

Japan Economy

Annual CPI inflation stable

China Economy

GDP growth remains strong

Japan's growth recovers in Q2

Japan's Q2 GDP growth picked up to 1.9% on-quarter, after contracting 0.6% in Q1, supported by private consumption and private non-residential investment. As a result of the Q1 contraction and sluggish consumer spending, S&P Global revised down its 2018 growth forecast. Growth is now pegged at 0.9% (earlier 1.4%), while for 2019 it is at 1.2% compared with 1.7% in 2017.

Japan's unemployment rate (seasonally adjusted) was 2.4% in June, up from 2.2% in May. The real average monthly household consumption expenditure fell 1.2% on-year in June, compared with a 1.4% decline in May. This marks the fifth consecutive month of contraction.

Annual CPI inflation was stable at 0.7% in June, led by fuel and medical care inflation. CPI inflation excluding fresh food, the Bank of Japan's (BoJ) target inflation rate, was 10 bps higher on-month at 0.8% in June. The BoJ left its policy rate unchanged in July at -0.1%. It declared it would continue quantitative and qualitative monetary easing with yield curve control until inflation reaches 2%. In addition, the central bank stated it will reduce the size of the policy-rate balance that financial institutions maintain with the BoJ, to which a negative interest rate is applied.

On the currency front, the yen weakened 1.3% on average on-month against the strengthening dollar in July.

China's trade surplus narrows in July

China's Q2 GDP growth was marginally lower at 6.7% on-year, compared with 6.8% in Q1, although in line with the government's 6.5% growth target for 2018. GDP growth remains strong despite evidence of steady deleveraging of the corporate sector and the intensifying trade war with the US. The composition of growth was unchanged from Q1, with domestic consumption the primary driver. In July, although China's Purchasing Manager's Index (PMI) was above 50% (indicating economic expansion), it fell on-month for both manufacturing and non-manufacturing activity.

In June, China's trade surplus increased 0.9% on-year to $41.6 billion. While exports grew 11.3% on-year, imports grew 14.1%. However, July trade data was dismal and below market consensus, with China's trade surplus narrowing sharply to $28.1 billion in July 2018 from $44.9 billion a year ago.

CPI inflation was up 10 bps on-month at 1.9% in June, largely due to a pick-up in fuel inflation. Meanwhile, producer price inflation edged up for the second straight month to 4.7% in June from to 4.1% in May, lifted by a sharp rise in mining and raw material prices. In July, CPI inflation was at 2.1% compared with 1.9% in June, largely due to an uptick in fuel and healthcare inflation. Producer price inflation eased to 4.6% from 4.7% in June due to slight lowering of raw material prices.

The yuan weakened 3.9% on-month on average in July against the dollar. This was since investors sensed a weakness in China's growth story amid the ongoing trade war and the weak PMI data.

Crude oil prices continue to ease on-month

Energy prices eased marginally in July, averaging $74.3 per barrel compared with $74.4 per barrel in June. Prices declined following the deal between the Organization of the Petroleum Exporting Countries and Russia to increase crude oil output from July in an attempt to balance the impact of falling output from Venezuela, Libya and Iran. However, Libya's oil ports re-opened mid-July, leading to a further decline in prices. CRISIL Research expects crude at $68-73 per barrel in fiscal 2019, compared with $57.4 last fiscal.

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