

GLOBAL ECONOMY

CRISIL Insights

June 2018

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.

Growth-inflation mix worsens in advanced economies

- The United States (US) Fed hiked rates by 25 basis points (bps) to 1.75–2% in its June meeting
- Trade surplus in China continued to narrow in May, printing below the market expectations at \$24.92 billion from \$40.51 billion a year ago, as imports surged 26% on-year
- Rising tension in the Middle East after the US scrapped the nuclear deal and renewed sanctions on Iran, sent the Brent crude oil price shooting past \$80 per barrel (bbl) in May - the highest since November 2014

The global growth engine has been revving up for some time and the much-touted synchronous recovery has entered the lexicon of mainstream media. However, rising geopolitical uncertainties in the Eurozone and the US-China trade war have raised red flags. Real gross domestic product (GDP) growth has moderated across most advanced economies in the first quarter (Q1) of 2018. However, China's robust performance continued in Q1, with the Purchasing Manager's Index (PMI) data indicating continued strong growth momentum in Q2 as well. Separately, rising crude oil prices over the past three months have been exerting inflationary pressure, worsening the growth-inflation mix in most advanced economies.

Gross Domestic Product (GDP) Heat Map

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

	Q4-16	Q1-17	Q2-17	Q3-17	Q4-17	Q1-18
US	1.8	1.2	3.1	3.2	2.9	2.2
UK [#]	0.7	0.3	0.2	0.5	0.4	0.1
EA [#]	0.6	0.6	0.7	0.7	0.7	0.4
Japan	0.9	2.6	2.0	2.0	0.6	-0.6
China [*]	6.8	6.9	6.9	6.8	6.8	6.8

Note: * y-o-y % [#]q-o-q, not annualized

Source: Statistical bureau, respective countries

Improvement Decline Unchanged

US Economy

Lowest unemployment rate in 18 years

Eurozone Economy

ECB to end bond-buying program in Dec

US Fed hikes rate in June

The US GDP growth¹ for Q1 2018 was revised down to 2.2% on-quarter (earlier 2.3%). Growth in Q1 moderated compared with 2.9% in the previous quarter, largely on account of a slowdown in consumer and government spending.

In May, the economy added a higher-than-expected 223,000 non-farm jobs, with job gains being broad-based. The unemployment rate declined to its lowest level in 18 years to 3.8%, and wage growth inched up to 2.7% on-year compared with 2.6% in April.

Annual Consumer Price Index (CPI)-linked inflation was 2.5% in April, compared with 2.4% in March, led by a sharp spike in energy inflation (7.9%). Inflation measured by the personal consumption expenditure (PCE) price index came in at 2% for second straight month. Core PCE inflation, the inflation rate targeted by the Fed, was stable at 1.8% in April, closer to Fed's target rate of 2%. In its June meeting, the Federal Committee of Open Market raised the federal funds rate by 25 bps to 1.75-2%, in line with market expectations. This marks the second rate hike by the Fed this year after the one in March. The dollar index gained a marginal 2.7% on-month on average in May in anticipation of the June rate hike by the Fed.

Consumer Price Inflation (y-o-y %)

	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18
US	2.2	2.1	2.1	2.2	2.4	2.5
UK	3.0	3.1	3.0	2.7	2.5	2.4
EA	1.5	1.4	1.3	1.1	1.3	1.2
Japan	0.6	1.0	1.4	1.5	1.1	0.6
China	1.7	1.8	1.5	2.9	2.1	1.8

Source: Statistical bureau, respective countries

Policy Interest Rate (End of Month %)

	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18
United States	1.25-1.50	1.25-1.50	1.25-1.50	1.50-1.75	1.50-1.75	1.50-1.75
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

Unemployment rate and inflation fall in euro area

The euro area (EA) GDP moderated to 0.4% on-quarter (not annualized) in Q1 2018, from 0.7% in Q4 2017, due to temporary factors, such as bad weather and an unusually severe flu season. The seasonally adjusted unemployment rate was 8.5% in April 2018, down from 8.6% in March 2018. This is the lowest rate recorded in the EA since December 2008. The annual harmonised indices of consumer prices (HICP) eased to 1.2% in April from 1.3% in March, led by a decline in the price of services inflation. As per the Eurostat's flash estimate, inflation is expected to quicken to 1.9% in May as a result of an increase in energy inflation. Given the recent pick-up in crude oil prices, the European Central Bank (ECB) expects the inflation to hover ~1.5% for the rest of the year. The euro lost 3.9% on-month in May against the dollar on average owing to a stronger dollar and the geopolitical uncertainty in Italy and Spain. In its June meeting, the ECB kept interest rates unchanged but announced its decision to end net purchases under the asset purchase program in December. The monthly pace of the net asset purchases will be reduced to €15 billion (from present €30 billion) starting October.

The UK GDP came in flat at 0.1% on-quarter (not annualized) in Q1 2018, the slowest growth since Q4 2012. The unemployment rate stood at 4.2% during this period, 20 bps below the Q4 2017 figure. In April, the consumer prices index, including owner occupiers' housing costs (CPIH) inflation, was 2.2%, down from 2.3% in March. CPI inflation, the target inflation rate of the Bank of England, eased to 2.4% in April, from 2.5% in March. The pound weakened 4.5% on-month on average in May over a stronger dollar.

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

Japan Economy

Annual CPI inflation eases

China Economy

CPI inflation softens further

Japan's GDP contracted for the first time in since Q4 2015

GDP contracted 0.6% on-quarter in Q1 2018, following eight consecutive quarters of expansion. Sluggish domestic demand and weak investment dragged down growth in the quarter. Japan's unemployment rate (seasonally adjusted) was stable at 2.5% in April. The real average monthly household consumption expenditure declined 1.3% on-year in April, as against a 0.2% fall in March.

Annual CPI inflation eased to 0.6% in April, after falling to 1.1% in March, largely due to a slowdown in food and transport and communication. CPI inflation excluding fresh food, the Bank of Japan's target inflation rate, also edged down to 0.7% from 0.9% in March, erasing the possibility of the bank changing its policy of quantitative easing with yield curve control in the near term. Japan's central bank left its policy rate unchanged in April at -0.1%. It declared it would continue its quantitative and qualitative monetary easing with yield curve control until inflation reaches its 2% target, dousing market speculation on a rate hike. The yen weakened 1.9% on average on-month against the dollar in May, on weakness in Q1 GDP growth and the divergent monetary policy in Japan and US, triggering capital flight to the latter.

China set on steady growth path

Signaling continued steady growth in Q2, China's PMI remained above 50% (indicating economic expansion) across the board in May, with services and other non-manufacturing activities leading the way. Earlier, the Q1 data had pegged China's growth at a solid 6.8% on-year, unchanged from Q4 2017, supported by both the manufacturing and services sectors.

In April, CPI inflation softened further to 1.8% (from 2.1% in March), below market expectations amid an easing in food inflation. Meanwhile, producer price inflation edged up to 3.4% (from 3.1% in March) after easing for six consecutive months, lifted by a pick-up in commodity prices. On the monetary policy front, the People's Bank of China maintained its benchmark lending rate at 4.35%. The yuan weakened 1.2% on-month on average in May against a strong dollar.

Crude oil price leads commodities price rise in May

As per the World Bank's pink sheet, commodity prices were mostly high in May led by energy.

The energy index gained 7.4% on-month in May, led by a surge in crude oil, US natural gas and coal prices. Brent crude crossed the psychological threshold of \$80/bbl during the month averaging to \$77/bbl, rising for the third straight month. This was due to rising tension in the Middle East after the US President Donald Trump scrapped the nuclear deal and renewed sanctions on Iran. CRISIL Research expects crude at \$68-\$73/bbl in fiscal 2019, compared with \$57.4/bbl in fiscal 2018.

The non-energy index inched up 0.1% in May. Food and beverages gained 0.6% and 1.4%, respectively. Raw materials and fertilizers eased 2% and 1.1%. Metals prices gained 0.4%, led by a pick-up in nickel and aluminum prices. Precious metals indices lost 2.1% due to a decline in gold prices.

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