

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.

Tariff war clouds recovery

- The United States (US) Federal Reserve hiked policy rates by 25 basis points (bps) in September
- The People's Bank of China in October decided to cut its reserve requirement ratio by 100 bps in an effort to support the Chinese economy to lower financing cost and boost market sentiment
- Crude oil prices surged 8.9% on-month in September on concern of US sanctions on Iran

The global economy broke through in 2017 after years of contraction. Soon, a synchronized recovery was underway, with the International Monetary Fund (IMF), in its October 2017 edition of the World Economic Outlook (WEO), upgrading the world growth forecast citing a broad-based cyclical upswing. But that was before rapidly tightening monetary policies, trade wars, geopolitical strife, and high crude prices threw a dampener on the global growth party for many countries. In its October 2018 update of the WEO, the IMF has revised down its global growth projection by 20 bps to 3.7% each for 2018 and 2019, stable compared with 2017. The revision owes to rising incidences of downside risks to the projections. Key among these are rising trade barriers and reversal of capital flows to emerging market economies with weaker fundamentals and higher political risk. While highlighting the risks, the IMF warns with shrinking excess capacity and mounting downside risks, many countries need to rebuild fiscal buffers and strengthen their resilience in an environment where financial conditions could tighten suddenly and sharply.

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	4.2
UK [#]	0.4	0.2	0.4	0.4	0.1	0.4
EA [#]	0.6	0.7	0.7	0.7	0.4	0.4
Japan	2.6	2.0	2.0	1.0	-0.6	3.0
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

Q2 GDP growth strong

Euro Zone Economy

APP to conclude by December-end

US Fed hikes policy rate for the third time this year

The third estimate released by the Bureau of Economic Analysis confirmed the US economic growth¹ for Q2 2018 to be the strongest since Q3 2014. Gross domestic product (GDP) growth for Q2 stood at 4.2% on-quarter, up from 2.2% in Q1. The growth picked up on a surge in household spending and net exports. On the employment front, the US economy added 134,000 jobs, below the market consensus. Hurricane Florence affected the September jobs gains with ~300,000 workers unable to work due to bad weather. On the bright side, the unemployment rate declined to 3.7% in September, the lowest since December 1969, from 3.9% in August. The annual average hourly earnings rate came in at 2.8% on-year, 10 bps lower on-month.

The annual Consumer Price Index (CPI)-linked inflation eased 20 bps on-month to 2.7% in August, as energy and core inflation eased. The US Fed's preferred inflation metric – the private consumption expenditure (PCE) deflator-based core inflation (excluding food and energy) - continued to stay at the Fed's target range of 2% in August.

As expected, during its September meeting, the Federal Open Market Committee (FOMC) unanimously raised its policy rate by 25 bps to 2-2.25%. This marks the third rate hike of 2018 and ninth since December 2015, when the Fed first raised its policy rate since the global financial crisis. In addition, the FOMC removed the reference to policy being 'accommodative' from its statement. Chairman Jerome Powell later clarified the policy is still accommodative. He said the reason for not including it in the statement was because the word had simply outlived its usefulness as a signal to the markets of what the Fed was trying to achieve.

Consumer price inflation (y-o-y %)

	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18
US	2.4	2.5	2.8	2.9	2.9	2.7
UK	2.5	2.4	2.4	2.4	2.5	2.7
EA	1.3	1.3	1.9	2.0	2.1	2.0
Japan	1.1	0.6	0.7	0.7	0.9	1.3
China	2.1	1.8	1.8	1.9	2.1	2.3

Source: Statistical bureau, respective countries

Policy interest rate (end of month %)

	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
US	1.50-1.75	1.50-1.75	1.75-2.00	1.75-2.00	1.75-2.00	2.00-2.25
UK	0.50	0.50	0.50	0.50	0.75	0.75
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 bank, respective countries

Unemployment rate declines in euro zone in August

The euro area's (EA) Q2 2018 GDP growth came in at 0.4% on-quarter (not annualized), stable compared with Q1. Growth was supported by an acceleration in capital spending and private consumption, which was partly offset by negative contribution from net exports. The region's unemployment rate was 10 bps lower on-month at 8.1% in August, the lowest recorded since November 2008.

In its September meeting, the European Central Bank (ECB) maintained its main refinancing rate at 0%. The ECB tapered its asset purchase programme (APP) in October to a monthly pace of €15 billion from €30 billion. This would be the last round of the APP, which is expected to conclude by December-end.

The United Kingdom's (UK) Q2 GDP growth came in at a modest 0.4% on-quarter (not annualized), following weak Q1 growth of 0.1%. Growth was driven by the services sector, which increased by 0.6%, due partly to an increase in retail sales. The Bank of England left its benchmark policy rate unchanged in September. In August, it had raised the policy rate by 50 bps to 0.75%, marking the first rate hike in 2018.

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

Japan Economy

BoJ to continue quantitative and qualitative monetary easing

China Economy

GDP growth remains strong

Japan posts trade deficit in August on double-digit import growth

Japan's Q2 GDP growth came in at 3% on-quarter, after contracting 0.6% in Q1, supported by strong domestic (private) demand and pick-up in capital spending.

Japan's unemployment rate (seasonally adjusted) was 2.4% in August, down from 2.5% in July. The real average monthly household consumption expenditure was 2.8% on-year in August, up from 0.4% in July.

Japan posted a trade deficit of ¥438.4 billion in August compared with a surplus of ¥96.8 billion a year ago. This was as imports posted double-digit growth (15.3% on-year) against meek exports growth (6.6%). Annual CPI inflation was 1.3% in August, up from 0.9% in July, mainly led by food and fuel inflation. CPI inflation excluding fresh food, the Bank of Japan's (BoJ) target inflation rate, was 10 bps higher on-month at 0.9%.

The BoJ left its policy rate unchanged in September at -0.1%. It declared it would continue quantitative and qualitative monetary easing with yield curve control until inflation reaches 2%.

Manufacturing PMI slows in China

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. Domestic consumption continues to be the primary driver of growth.

In September, China's non-manufacturing sector continued to advance at an improved pace, while the manufacturing sector expanded at a slower pace on-month. The official non-manufacturing Purchasing Managers' Index (PMI) was at 54.9%, up 70 bps on-month, while the manufacturing PMI was 50 bps lower on-month at 50.8% – the lowest in seven months.

The People's Bank of China (PBoC) kept its benchmark lending rate unchanged at 4.35%. However, it decided to cut its reserve ratio requirement (RRR) by 100 bps from October 15 in an effort to lower financing cost. The change in policy is an effort to support the Chinese economy and boost market sentiment in the wake of the US-China tariff war. Currently, the RRR, which is the level of cash that banks must hold as reserves with PBoC, is at 15.5% for large commercial lenders and 13.5% for smaller banks.

Commodity prices were mixed in September

According to the World Bank's pink sheet, commodity prices were mixed in September with energy prices rising 5% on-month and non-energy declining 1.9% on-month.

Crude oil prices rose 8.9% on-month in September, averaging \$78.9 per barrel. Crude flared on concerns of US sanctions on Iran with market participants speculating about Iran's oil supply going off the market. The falling output from Iran, Libya and Venezuela coupled with the Organization of Petroleum-Exporting Countries and Russia's decision to bridge this shortfall further pushed up oil prices. CRISIL Research expects crude oil prices at \$74 per barrel in fiscal 2019, compared with \$57.4 last fiscal.

Non-energy indices were dragged down by the agriculture and metals and minerals indices, which fell 1.9% and 0.9%, respectively. Precious metals weakened 1% and prices of gold and silver fell.

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