

GLOBAL ECONOMY

CRISIL Insights

September 2017

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.

Developing economies lending thrust to growth

- US puts forth strongest growth since 2015 in Q2 2017 at 3%
- China's annual consumer price index (CPI)-linked inflation shoots up to an eight-month high of 1.8% in August
- Commodity prices rose as crude oil and metal prices picked up

Even as the global economic engine is revving up, it is the emerging and developing economies that are providing the power in keeping with the International Monetary Fund's outlook. While China registered impressive growth in the first half (H1) of 2017, the performance of most advanced economies, especially the United States (US) and the United Kingdom (UK), was lackluster. However, the Euro area and Japan saved the blushes for the advanced economies by posting solid H1 growth. Global commodity prices have also been on the upswing with the pick-up in crude oil and metal prices.

Gross Domestic Product (GDP) Heat Map

GDP Growth (Q-o-Q SA annualised %)

| | Q1-16 | Q2-16 | Q3-16 | Q4-16 | Q1-17 | Q2-17 |
|-----------------|-------|-------|-------|-------|-------|-------|
| United States | 0.6 | 2.2 | 2.8 | 1.8 | 1.2 | 3.0 |
| United Kingdom# | 0.2 | 0.6 | 0.5 | 0.7 | 0.2 | 0.3 |
| Euro Area# | 0.5 | 0.3 | 0.4 | 0.6 | 0.5 | 0.6 |
| Japan | 2.3 | 1.4 | 1.3 | 1.7 | 1.5 | 4.0 |
| China* | 6.7 | 6.7 | 6.7 | 6.8 | 6.9 | 6.9 |

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

Source: Statistical Bureau, Respective Countries

| | | |
|-------------|---------|-----------|
| Improvement | Decline | Unchanged |
|-------------|---------|-----------|

US Economy

Dollar index weakens

Eurozone Economy

Imports grow faster than exports

US posts strongest on-quarter growth in two years

The Bureau of Economic Analysis revised up US growth data by 40 basis points (bps) to 3% (not annualized). This marks the strongest GDP growth since the first quarter (Q1) of 2015. S&P Global expects the economy to grow at 2.2% in 2017 and 2.3% in 2018, compared with 1.6% in 2016. While Q2 GDP appears solid, the same cannot be said about the on-going Q3. Trade deficit in goods and services widened \$2.4 billion on-year (and 0.1 billion on-month) in July to \$43.7 billion. Exports expanded 4.9% on-year (down 0.3% on-month), while imports grew 5.1% on-year (falling 0.2%). The economy added a tepid 156,000 non-farm jobs in August.

The annual CPI-linked inflation rose 1.9% in August, up from 1.7% in July, on the back of rising gasoline prices. The energy index shot up 6.4%, while the food index inched up 1.1%. Core inflation was 1.7%, for the fourth month in a row, led by the rise in motor vehicle insurance, shelter and medical care prices.

The dollar index weakened an average 1.2% on-month in August. Rising tensions between the US and North Korea, the exit of Carl Icahn as a special adviser on regulations, removal of White House chief strategist Steve Bannon, and President's Trump's declaration regarding government shutdown given the failure in receiving funds for the US-Mexico border wall, dampened investor sentiment, leaving the dollar weak.

Consumer Price Inflation (y-o-y%)

| | Feb-17 | Mar-17 | Apr-17 | May-17 | Jun-17 | Jul-17 |
|----------------|--------|--------|--------|--------|--------|--------|
| United States | 2.7 | 2.4 | 2.2 | 1.9 | 1.6 | 1.7 |
| United Kingdom | 2.3 | 2.3 | 2.6 | 2.7 | 2.6 | 2.6 |
| Euro Area | 2.0 | 1.5 | 1.9 | 1.4 | 1.3 | 1.3 |
| Japan | 0.3 | 0.2 | 0.4 | 0.4 | 0.4 | 0.4 |
| China | 0.8 | 0.9 | 1.2 | 1.5 | 1.5 | 1.4 |

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

| | Mar-17 | Apr-17 | May-17 | Jun-17 | Jul-17 | Aug-17 |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|
| United States | 0.75-1.00 | 0.75-1.00 | 0.75-1.00 | 1.00-1.25 | 1.00-1.25 | 1.00-1.25 |
| United Kingdom | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| Euro Area | 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 area stays steady on its recovery path

Euro area GDP grew 0.6% (not annualized) in Q2, 10 bps higher on-quarter. Goods trade surplus was €26.6 billion in June, lower than €28.9 billion a year ago as imports grew faster than exports. The unemployment rate was 9.1% in July, same as in June, and down from 10% in July 2016 and also, the lowest rate since February 2009. Annual inflation was 1.3% in July, same as in June. Inflation was led by a rise in the prices of accommodation services and air transport. The European Central Bank (ECB) kept interest rates on main refinancing operations, marginal lending facility, and deposit facility unchanged at 0.00%, 0.25%, and -0.40%, respectively, in its September meeting. This points to rates remaining unchanged till December 2017 or beyond. Strong macroeconomic indicators coupled with a weak dollar, buoyed the euro an average 2.4% on-month in August.

The UK trudged along the recovery path, clocking a modest growth of 0.3% in Q2 compared with 0.2% in Q1, driven by services. Trade deficit in goods and services narrowed to £2.9 billion in July as against £3.6 billion a year ago as exports grew faster than imports. The annual CPI inflation, including owner occupiers' housing costs, for August was at 2.7%, up 10 bps from July. The depreciation of the sterling pound coupled with an increase in prices of motor fuel, clothing and footwear, and household services drove up inflation during the month. The Bank of England (BoE) expects inflation to rise further in the coming months and peak at ~3% in October as past depreciation of the sterling continues to pass through to consumer prices. In the long run, however, the BoE expects inflation to settle at the target rate of 2%. In its September meeting, the BoE kept its policy rates unchanged at 0.25% to help sustain growth and employment. S&P Global expects the BoE to increase its policy rates only in mid-2019. The dovish stance of the BoE, coupled with the sluggish economic performance, sent the pound tumbling 2.1% on-month (1.8% on-year) in August.

Japan Economy

Trade surplus falls

China Economy

Domestic consumption drives GDP

Japan posts a solid growth in Q2

The Japanese economy posted a solid growth of 4% (on-quarter, annualized) in Q2 driven by strong domestic demand. This was the sixth straight quarter of positive sequential growth and the strongest growth since Q1 2015. The gross fixed capital formation soared, led by a significant rise in public investment and private non-residential investment. However, the high current account deficit weighed on the economy, capping further growth. S&P Global expects the economy to grow at 1.3% in 2017. In July, Japan's trade surplus fell to ¥421.7 billion, compared with ¥504.4 billion a year ago as imports grew faster than exports. In addition, real average monthly household consumption expenditure declined 0.2% on-year in July as expenditure on education, medical care, and housing decreased.

Japan's annual CPI inflation has stayed positive since October 2016 as the prices of energy (4.3%) and food (0.6%) continued to rise. In July, inflation was at 0.4%, stable from the previous four months. Increases in the prices of education and clothes also pushed up inflation. The Japanese yen appreciated 2.3% on-month against the weak dollar in August as investors cheered the stellar growth performance. The yen also benefitted from safe haven flows as geopolitical tension between the US and North Korea escalated.

Inflation shoots up in China

China's GDP grew 6.9% in Q2, unchanged from Q1, beating expectations. Domestic consumption was a major contributor, shifting the growth driver away from the traditionally dominant external sector. As per the official Purchasing Managers' Index (PMI), the non-manufacturing sector (led by services) grew faster than the manufacturing sector in August. The manufacturing PMI was 51.7% in August, down 30 bps from the previous month, while non-manufacturing PMI was 53.4%, down 110 bps. S&P Global revised up its growth forecast by 30 bps to 6.7% in 2017. However, the excess credit growth in the country, which could result in an abrupt growth slowdown, remains a risk.

The August trade surplus was \$42 billion, down from a year-ago surplus of \$48.6 billion, as imports rose sharply (137%) compared with exports (5.5%). Annual CPI inflation rose 1.8% in August, compared with 1.4% in July, mainly driven by an increase in non-food prices. This is the highest inflation rate since January 2017. While non-food prices rose 2.3%, food prices fell 0.2%. The annual producer price index-linked inflation for manufactured goods was at 6.3% in August, with the rising prices of mining and quarrying and raw materials industry being the major contributors. The yuan gained an average 1.5% against the dollar on-month in August as investors cheered the optimistic economic growth and strong PMI data.

Energy and metal prices dominate commodity price hike in August

As per the World Bank's pink sheet, prices of all commodities, except agricultural commodities, rose in August. While energy prices increased 4.4%, non-energy prices rose 1.3%. An increase in oil (4.8% on-month) and coal (9.6% on-month) nudged up the energy indices. Brent crude prices rose to \$51.7/bbl on average in August. Prices picked up on account of increased gasoline and diesel demand in the US led by the peak summer driving season, resulting in a drop in oil inventories. In addition, shutdown of an oilfield in Libya further depleted the global inventories. This, coupled with the Organization of Petroleum Exporting Countries (OPEC) and non-OPEC countries' decision to restrict their output to ~1.8 million bbl/day until March 2018, buoyed crude. CRISIL Research believes Brent will range at \$50-\$55 per barrel in fiscal 2018, compared with \$48.5 in fiscal 2017.

The rise in non-energy commodity prices was primarily led by an 8.2% on-month rise in metal and minerals prices. While all metal prices increased, nickel (14.7%) and iron ore (12.3%) were the major contributors to the rise. Precious metals prices gained 4% led by a 5% in silver prices. Agriculture prices fell 1.7%, as the prices of food (3.4%) and beverages (0.2%) plunged. Among food items, wheat played a dominant role in the price decline. Prices of raw materials increased 2.3%, while prices of fertilizers grew 2.5%.

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