Global Research & Analytics

CRISIL
An S&P Global Company

GLOBAL ECONOMY

CRISIL Insights

June 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.

On a modest growth path

- While the revised US growth number indicated modest recovery for the first quarter (Q1) of 2017, the Fed hiked the policy rate by 25 basis points (bps) in its June meeting
- Unemployment continued to decline in the Euro area in April, with a 9.3% unemployment rate, the lowest since March 2009
- Rising residential rent and healthcare prices in China bumped up April inflation
- Energy commodity prices dipped in May as the US and Libya increase crude oil production

Though challenged by a plethora of uncertainty-inducing variables, the global economy is hanging on. While growth mellowed in the US and UK, it remained stable in the euro area and was better than expected in China.

In its Global Economic Prospects report (June 2017), the World Bank forecast global economic growth will strengthen to 2.7% in 2017, up from 2.4% in 2016, with the emerging market and developing economies playing a key role. The bank expects the pickup in manufacturing and trade, rising market confidence, and stabilising commodity prices to buoy these economies. Despite the reassuring presence of positives, some uncomfortable downside risks remain. These include the possibility of greater trade restrictions and an inward shift in policies, uncertainty over fiscal and monetary policies, and long-term structural problems such as low productivity and investment growth and high income inequality.

Gross Domestic Product (GDP) Heat Map
GDP Growth (Q-o-Q SA annualised %)

	Q4-15	Q1-16	Q2-16	Q3-16	Q4-16	Q1-17
United States	0.9	0.8	1.4	3.5	2.1	2.1
United Kingdom#	0.7	0.2	0.6	0.5	0.7	0.2
Eurozone#	0.5	0.5	0.3	0.4	0.5	0.6
Japan	-1.0	2.5	1.6	1.0	1.4	1.0
China*	6.8	6.7	6.7	6.7	6.8	6.9

Note: * y-o-y % #q-o-q, not annualized
Source: Statistical Bureau, Respective Countries

Improvement | Decline | Unchanged

US Economy

Moderate annual growth continues

Eurozone Economy

Lowest unemployment rate recorded since March 2009

US Economy

Modicum of recovery in the US

In its second estimate, the Bureau of Economic Analysis revised US Q1 growth data to 1.2% (previously 0.7%). Expansion was aided by business investment, housing investment, consumer spending on services, and exports. The upward revision in gross domestic product (GDP) growth reflects better business investment, consumer spending in services, and state and local government spending. However, these were partially negated by a downward revision to inventory investment. The US economy continues on its moderate annual growth path of ~2%. S&P Global expects growth to pick up to 2.3% in 2017 and 2.4% in 2018 from 1.6% in 2016.

The US trade deficit widened $9.2 billion on-year to $47.6 billion in April 2017 as imports grew (8.3%) faster than exports (5%). The annual consumer price index-linked (CPI) inflation slowed in April to 2.2% compared with 2.4% in March. While the energy index increased 9.3% in April, food index rose 0.5%. Core inflation (all items except food and energy) also slowed to 1.9%, with the rising prices of medical care commodities (2.6%) and non-energy services (2.7%) the major contributors.

The Federal Open Market Committee, in its June meeting, raised the target range for the federal funds rate by 25 bps to 1-1.25%. This marks the second rate hike in 2017, with the first rate hike of 25 bps being announced in March. Despite the inflation projection for 2017 being reduced to 1.6% (from 1.9% in March), the Fed decided to raise the policy rate to ensure price stability in the medium term wherein it expects inflation to return to the target 2% level. S&P Global expects another rate hike this year of 25 bps, with the benchmark rate climbing to 1.25-1.50% by December 2017.

Consumer Price Inflation (y-o-y%)

	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17
United States*	1.7	2.1	2.5	2.7	2.4	2.2
United Kingdom	1.2	1.6	1.8	2.3	2.3	2.6
Eurozone	0.6	1.1	1.8	2.0	1.5	1.9
Japan	0.5	0.3	0.4	0.3	0.2	0.4
China	2.3	2.1	2.5	0.8	0.9	1.2

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17
United States	0.50-0.75	0.50-0.75	0.50-0.75	0.75-1.00	0.75-1.00	0.75-1.00
United Kingdom	0.25	0.25	0.25	0.25	0.25	0.25
Eurozone	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

While Euro area strengthens, UK slows down

As per the revised estimate of Eurostat, euro area (EA-19) GDP grew 0.6% (not annualised) in Q1, 10 bps higher on-quarter. Household final consumption expenditure had a positive contribution.

The euro area posted a goods trade surplus of €30.9 billion in March, compared with €28.2 billion a year ago. While exports grew 13% on-year, imports rose 13%. The unemployment rate was 9.3% in April, down from 9.4% in March, and down from 10.2% in April 2016. This is the lowest rate recorded since March 2009.

Political tensions eased after Emmanuel Macron won the French presidential elections, defeating Marine Le Pen, who was against immigration and staying in the European Union (EU). Steady economic recovery in the EU further boosted sentiments, booting the euro an average 3% on-month in May.

With a modest recovery in view, the European Central Bank (ECB) is maintaining easy monetary conditions. The 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 June meeting. While growth was stable in the UK in the two quarters following Brexit (Q3 and Q4 2016), it slowed down in Q1. As per the revised estimate, UK's GDP grew 0.2% (previously 0.3%), the slowest since Q1 2016, mainly on account of a slowdown in services sector output.

Japan Economy

Annual CPI inflation was positive for the seventh month in a row

China Economy

Highest GDP growth in the past five quarters

Japan edging ahead

The Japanese economy grew at a modest 1% (on-quarter, annualised) in Q1, driven by higher private non-residential investment and exports. Real household consumption expenditure continued to decline, with March's average monthly household expenditure down 1.4% on-year. Annual CPI inflation was positive for the seventh month in a row, at 0.4% in April, up 20 bps. Prices of food, fuel, and education were the major contributors even as core inflation remained unchanged over the previous year. Balance of trade continued to be favourable in April clocking a surplus of ¥481.1 billion. However, it fell short of the ¥811.3 billion surplus a year ago. Exports grew 7.5% on-year, while imports grew 15.2% on-year.

The Japanese yen appreciated 1.9% on-month in May, reflecting rising investment sentiment over the pick-up in economic activity and inflation. In its April meeting, the Bank of Japan (BoJ) continued with its quantitative and qualitative monetary easing stance along with yield curve control to achieve the 2% inflation target. The short-term policy interest rate is at -0.1% and the target level of yields on the 10-year Japanese government bond is at 0%. The BoJ stated it would continue expanding the monetary base until the on-year CPI rate increase exceeds 2% and stays above the target in a stable manner.

Trade continues to thrive in China

China's GDP clocked its highest growth in the past five quarters at 6.9% on-year in Q1. The better-than-expected growth was mainly driven by secondary industries, which swelled as a result of higher government infrastructure spending and a property market boom. S&P Global expects China to meet its growth target (~6.5% in 2017) forecasting 6.4% GDP growth in 2017 and 6.1% in 2018.

The April trade surplus was $38.1 billion as against $23.9 billion in March and $45.6 billion a year ago. While exports grew 8% on-year, imports rose 11.9%. The yuan weakened 0.1% on-month in May, with the downgrading of the Chinese Sovereign Rating by Moody's Investor Services eroding its value against the dollar.

China kept its benchmark lending rate unchanged at 4.35%. At the beginning of the Chinese New Year (on February 3), the People's Bank of China, for the first time in four years, raised the 7- and 14-day repo rate by 10 bps each to 2.35% and 2.5%, respectively. It also raised the rate for the 28-day contracts to 2.65%. The rate hike may signal a gradual tightening of monetary policy.

Surge in shale output sinks energy prices

As per the World Bank's pink sheet, energy prices declined 4.1% in May led by a fall in crude and coal prices. Brent averaged $50.3 per barrel in May, down from April's $52.3, as oil production shot up in US and Libya. Prices fell despite the decision of the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC countries to extend the output cut (~1.8 million bbl/day) until March 2018. CRISIL Research believes Brent will range at $50-$55 per barrel in fiscal 2018, compared with $48.5 in fiscal 2017.

Non-energy commodities grew marginally at 0.1% on-month. Food prices increased 2.4% while beverages eased 1%. Fertiliser prices receded nearly 6%. Metals and minerals slid 2.4%, led by an 11% tumble in iron ore. Precious metals also dipped 2.6% compared with April.

As per its quarterly Commodity Markets Outlook report released in April, the World Bank expects prices for most industrial commodities, notably energy and metals, to rise slightly in 2017. While energy prices are expected to increase owing to growing demand and OPEC's output cuts, the resilience of the US shale oil industry may keep the prices in check. The World Bank expects metal prices to be swayed by the increasing demand from China, coupled with numerous supply-side constraints, including contractual disputes and export policies.

Source: CRISIL Research

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