GLOBAL ECONOMY

CRISIL Insights

May 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.

Global growth in a slow grind-up

- Tepid growth in consumption expenditure in the United States and services sector output in the United Kingdom slowed overall GDP growth in these economies in Q1 2017
- In China, higher government spending and booming property market pushed up secondary sector growth in Q1 2017
- Energy commodity prices rose in April riding on the increase in crude oil

Most economies grew at slow pace in Q1 2017. While growth mellowed in the United States and United Kingdom, and remained stable in the Euro area, it was better than expected in China.

Despite slower growth recorded in Q1 2017, the International Monetary Fund (IMF) expects world growth to improve this year compared with the last. In its April outlook, the IMF revised the world growth projections upwards by 10 basis points (bps) to 3.5% for 2017. However, the projections are subject to downside risks, the key being an inward shift in policies, including trade protectionism. With persistent structural problems - low productivity growth and high income inequality - popular and political pressure for inward-looking policies is increasing in advanced economies, threatening global economic cooperation. Although the recent victory of the centrist Emmanuel Macron in the French presidential election, signals hope for global (or at least European Union) integration, the threat of protectionism from other large economies still looms large.

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	0.7
United Kingdom#	0.7	0.2	0.6	0.5	0.7	0.3
Eurozone#	0.5	0.5	0.3	0.4	0.5	0.5
Japan	-1.0	1.9	2.2	1.2	1.2	N/A
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

Trade deficit widens

Eurozone Economy

Highest inflation rate since September 2013

US Economy

Growth slows in US

The advance estimate released by the Bureau of Economic Analysis indicated the US economy grew 0.7% in Q1 2017, slowest since Q1 2014. Positive contribution from fixed investment, personal consumption expenditure, and exports helped. However, these were offset by a decline in private inventory investment and government (federal, state, local) spending. The slowdown is mainly on account of lower consumption expenditure and private inventory investment. The trade deficit widened $6.4 billion on-year to $43.7 billion in March 2017 as imports grew (8.8%) faster than exports (7%). S&P Global expects gross domestic product (GDP) growth to pick up ~2.3% in 2017 and 2.4% in 2018.

Annual consumer price index-linked (CPI) inflation rose 2.4% in March, primarily on account of the energy index, which increased 10.9%, capturing the gasoline price rise. Core inflation (all items except food and energy) rose 2.2%, driven by a 3.5% gain in the shelter and medical care indices. The dollar index weakened 0.73% on-month, partly attributed to appreciation of the euro, which has the largest weight in the index. In addition, lack of clarity regarding the execution of President Trump's proposed corporate tax cuts kept sentiment subdued even as weak US macroeconomic data weighed on investors. The Federal Open Market Committee (FOMC) kept policy rates unchanged at 0.75-1% in its May meeting. The policy stance remains accommodative to support further strengthening in labour market conditions and a sustained return to the 2% inflation target. The Fed expects economic conditions to evolve warranting gradual increases in the federal funds rate

Consumer Price Inflation (y-o-y%)

	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
United States*	1.6	1.7	2.1	2.5	2.7	2.4
United Kingdom	0.9	1.2	1.6	1.8	2.3	2.3
Eurozone	0.5	0.6	1.1	1.8	2.0	1.5
Japan	0.1	0.5	0.3	0.4	0.3	0.2
China	2.1	2.3	2.1	2.5	0.8	0.9

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17
United States	0.25-0.50	0.50-0.75	0.50-0.75	0.50-0.75	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

Stable growth in Eurozone

As per the preliminary flash estimate of Eurostat, the statistical office of the European Union, Euro-area GDP grew 0.5% on-quarter (not-annualised) in Q1 2017, same as the previous quarter. Goods trade surplus was €17.8 billion in February, compared with €18.2 billion trade surplus a year ago, as imports grew more than exports. Unemployment rate was 9.5% in March, same as in February, but down from 10.2% in March 2016. This remains the lowest rate since April 2009. Annual inflation was 1.5% in March, compared with 2% in February. According to Eurostat, annual inflation is expected to rise 40 bps on-month to 1.9% in April owing to a rise in the energy index. The euro closed at 0.92 per dollar, appreciating 1.8% on-month in April. With a modest recovery in view, the European Central Bank (ECB) is maintaining easy monetary conditions. The ECB intends to continue the net asset purchases at the new monthly pace of €60 billion until the end of December 2017, or beyond, if necessary.

While growth was stable in the UK in the two quarters following Brexit, Q1 2017 witnessed a slowdown. UK's GDP expanded at only 0.3% in Q1 2017, the slowest growth rate since Q1 2016, mainly on account of a slowdown in services sector output. In addition, the trade deficit (goods and services) in Q1 2017 widened by £5.7 billion on-quarter to £10.5 billion, on account of a significant increase in imports (5.6% on-month) as against the marginal rise in exports (1.3% on-month). The annual CPI inflation for March was at 2.3%, unchanged from February. This remains the highest inflation rate since September 2013 (2.4%). Core CPI inflation (excluding energy and food) has also been rising since end-2015.

Japan Economy

Balance of trade continued to be favourable

China Economy

Benchmark lending rate unchanged

Inflation remains positive in Japan

Japan's economy continued on its modest recovery path. Driven by higher private non-residential investment and exports, Q4 GDP grew at 1.2% (annualised) on-quarter, same as in Q3. Household consumption expenditure continued to decline. Annual CPI inflation remained positive for six months in a row, at 0.2% in March, falling 10 bps over the previous month. Prices of food, clothes and footwear, and education were the major contributors. Balance of trade continued to be favourable in March, clocking a surplus of ¥614 billion. However, it fell short of the ¥744.9 billion surplus a year ago. Exports grew 12% on-year, while imports grew 15.8% on-year.

The Japanese yen closed at 111.46 per dollar, down 0.1% on-month, 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 rate increase in CPI exceeds 2% and stays above the target in a stable manner.

Better-than expected growth in China

China's GDP clocked its highest growth in the past five quarters at 6.9% on-year in Q1, compared with 6.8% in the previous quarter. The better-than-expected growth was mainly driven by secondary industries, as a result of higher government infrastructure spending and a property market boom. The growth was supported by a recovery in the trade balance in March, which had printed a February deficit. The March trade surplus was $23.9 billion as against a deficit of $9.2 billion in February and a surplus of $29.9 billion a year ago. While exports grew 16.4% on-year, imports rose 20.3%. The annual CPI inflation rose 0.9% in March. While food prices fell, non-food prices increased.

As per the official Purchasing Managers' Index (PMI), manufacturing and non-manufacturing economies continued expanding in April with the pace of expansion increasing more for the former. Manufacturing PMI was 51.2% in April, falling 60 bps over the previous month, while non-manufacturing PMI was 54%, down 110 bps. The Chinese Yuan closed at 6.89 per dollar, down 0.1% on-month, appreciating 0.1% on-month and weakening 6.4% on-year. China kept its benchmark lending rate unchanged at 4.35%. 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.

Energy prices rise in April

As per the World Bank's pink sheet, energy prices rose 2.7% in April, while non-energy prices declined 2.4%. Brent crude averaged $52.3 per barrel in April, up from March's $51.6 per barrel. Crude prices have embarked on an upward trajectory since December 2016, with the exception of March, as a result of the ~1.8 million barrels per day output cut enforced by the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC producers until June 2017. CRISIL Research expects OPEC will continue lowering output beyond June if global inventories don't fall sufficiently. Further, we believe Brent will range at $50-$55 per barrel in fiscal 2018, against $48.5 in fiscal 2017.

Metals and minerals prices slid 4.3%, led by a fall in iron ore prices. Prices of agricultural commodities, food, and beverages fell 1.4%, 2.1%, and 1%, respectively. While prices of fertilisers dipped 6%, raw materials increased 0.3%. Precious metals prices also rose 2.7%. The World Bank expects prices for most industrial commodities, notably energy and metals, to rise in 2017. While energy prices are expected to rise on account of growing demand and OPEC's output cuts, metal prices would be swayed by the increasing demand from China coupled

Source: CRISIL Research

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