

GLOBAL ECONOMY

CRISIL Insights

March 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.

Some show of strength

- Strengthening US economy prompted the Fed to raise the policy rate
- The UK records highest inflation rate since July 2014
- China clocks better-than expected trade surplus despite rising protectionist sentiments in trade partner countries
- Rising oil and food prices force inflation up globally

A year back, a floundering global economy was trapped in a vicious cycle of low growth and even lower inflation. Investment was subdued, political risks high, and falling oil prices and unprecedented fiscal stimulus failed to kickstart demand. Today, an uptick in growth suggests a recovery is under way, though risks abound.

Despite the looming uncertainties over protectionist policies in the US and Brexit in the UK, the two economies posted healthy growth in Q4 2016, while the Eurozone clocked stable growth. Even as Japan continued making a modest recovery, China posted better-than-expected growth numbers. Inflation rose in all these economies in January.

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

| | Q3-15 | Q4-15 | Q1-16 | Q2-16 | Q3-16 | Q4-16 |
|-----------------|-------|-------|-------|-------|-------|-------|
| United States | 2.0 | 0.9 | 0.8 | 1.4 | 3.5 | 1.9 |
| United Kingdom# | 0.3 | 0.7 | 0.2 | 0.6 | 0.6 | 0.7 |
| Eurozone# | 0.3 | 0.5 | 0.5 | 0.3 | 0.4 | 0.4 |
| Japan | 0.6 | -1.0 | 1.9 | 2.2 | 1.2 | 1.2 |
| China* | 6.9 | 6.8 | 6.7 | 6.7 | 6.7 | 6.8 |

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

Source: Statistical Bureau, Respective Countries

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

US Economy

Inflation increases

Eurozone Economy

Lowest unemployment rate since May 2009

US economy grows at strong and steady pace

Fourth quarter gross domestic product (GDP) of the US expanded at an annualised 1.9%. Trade deficit widened from \$43.4 billion in January 2016 to \$48.5 billion in January 2017, owing to faster growth of imports (8.3% on-year) than exports (7.4% on-year). S&P Global expects the GDP to pick up to ~2.4% in 2017 and 2.3% in 2018, from 1.9% in 2016.

The economy added a solid 235,000 jobs (net job gains) in February. The annual consumer price index-linked (CPI) inflation rose 2.5%, the largest on-year increase since March 2012, primarily on account of 20.3% on-year increase in gasoline prices.

On account of the rising inflation, the Federal Open Market Committee raised the target range for the federal funds rate by 25 basis points (bps) to 0.75% to 1% in its March meeting. The rate hike marks the first increase in 2017 and third in the last two years. The monetary policy stance of the Fed remains accommodative to enable a sustained return to the inflation target of 2%. The Fed expects the economic conditions to evolve in a manner that may prompt gradual increases in the federal funds rate. S&P Global expects three rates hikes in 2017, by 25 bps each.

US Economy

Consumer Price Inflation (y-o-y%)

| | Aug-16 | Sep-16 | Oct-16 | Nov-16 | Dec-16 | Jan-17 |
|----------------|--------|--------|--------|--------|--------|--------|
| United States* | 1.1 | 1.5 | 1.6 | 1.7 | 2.1 | 2.5 |
| United Kingdom | 0.6 | 1.0 | 0.9 | 1.2 | 1.6 | 1.8 |
| Eurozone | 0.2 | 0.4 | 0.5 | 0.6 | 1.1 | 1.8 |
| Japan | -0.5 | -0.5 | 0.1 | 0.5 | 0.3 | 0.4 |
| China | 1.3 | 1.9 | 2.1 | 2.3 | 2.1 | 2.5 |

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

| | Sep-16 | Oct-16 | Nov-16 | Dec-16 | Jan-17 | Feb-17 |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|
| United States | 0.25-0.50 | 0.25-0.50 | 0.25-0.50 | 0.50-0.75 | 0.50-0.75 | 0.50-0.75 |
| 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

Inflation rises in Eurozone

The seasonally adjusted Euro-area (EA-19) GDP rose 0.4% on-quarter (not annualised) in Q4, same as the previous quarter. While all other EA-19 countries recorded positive growth, Greece recorded negative growth (-1.2%). The unemployment rate in Euro area was 9.6% in January - the lowest rate recorded in the Euro-area since May 2009. While growth remains modest, inflation accelerated 70 bps on-month to 1.8% in January, on account of rise in transport fuel and vegetable prices.

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 March meeting.

UK's economy continued to grow at a robust rate despite the passage of the Brexit. The economy grew 0.7% in Q4 2016, up by 10 bps from the preliminary estimate. Private consumption expenditure grew 0.7% on-year. On an annual basis, private consumption expenditure growth increased to 3% in 2016, the strongest since 2004. Annual CPI inflation for February at 1.6% was at its highest since July 2014, but below the targeted 2%.

Euro zone economy

Japan Economy

Annual CPI inflation remains positive

China Economy

Better-than-expected trade surplus in January

Japan continues to grow at a modest pace

Japan's economy continues on its modest recovery path. Q4 GDP grew at 1.2% (annualised) on-quarter driven by higher private non-residential investment and exports.

Household consumption expenditure continued to fall, with January's average monthly household expenditure declining 1.2% on-year. Annual CPI inflation remained positive for four months in a row, at 0.4% in January, increasing 10 bps over the previous month. Prices of food, clothes and footwear, and education were the major contributors. Balance of trade turned unfavourable for Japan in January as increase in imports outpaced exports. While the latter increased 1.3% on-year in January, imports fell 8.5%.

In its January meeting, the Bank of Japan (BoJ) decided to continue with its quantitative and qualitative monetary easing stance along with yield curve control to achieve the 2% inflation target. 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.

China continues its growth momentum

China's GDP grew 6.8% on-year in Q4, compared with the 6.7% growth clocked in the previous three quarters, primarily on the back of its secondary and tertiary industries. The economy grew 6.7% in 2016, lower than the 6.9% growth in 2015, and achieving the targeted 6.5% to 7% growth. As per the official Purchasing Managers' Index (PMI), both manufacturing and non-manufacturing economies continued expanding in February with the pace of expansion increasing for former and declining for the latter. Manufacturing PMI was 51.6 in February, increasing 30 bps over the previous month while non-manufacturing PMI was 54.2%, decreasing 40 bps.

The annual CPI-linked inflation rose 2.5% in January, 40 bps higher on-month. While prices of all goods and services rose, food prices were the major driver, contributing to a nearly 75 bps increase. The annual producer price index-linked inflation for industrial products was at 6.9%, increasing primarily on the back of rising producer prices for mining and quarrying industry (31%), raw materials industry (12.9%) and manufacturing and processing industry (5.9%). China posted a better-than-expected trade surplus for January at \$51.4 billion, \$10.5 billion higher than the previous month, which was mainly driven by exports. On-year, exports grew by 7.9% and imports surged by 16.1%.

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 repo rate for 7-day and 14-day by 10 bps each to 2.35% and 2.5%, respectively. It also raised the rate for the 28-day contracts to 2.65%, respectively. The rate hike may signal a gradual tightening of monetary policy.

Commodity prices start the year on a high note

As per the World Bank's pink sheet, all commodity price indices, except beverages, rose in February. Energy and non-energy prices increased 0.7% and 1.4%, respectively. Brent crude averaged \$54.9 per barrel, compared with \$54.6 in the previous month. Crude prices have been rising since the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC producers agreed to reduce output by nearly 1.8 million barrels per day in the first half of 2017. CRISIL Research expects OPEC to continue to reduce output beyond June if global inventories don't fall sufficiently. Further, CRISIL Research expects Brent to range \$50-\$55 per barrel in 2017, compared with \$43.6 in 2016.

In non-energy, prices of agricultural commodities and food rose 0.2% and 0.1%, respectively, while beverages fell 3.5%. Prices of fertilisers and raw materials increased 0.9% and 2.3%, respectively. Likewise, prices of metals and minerals rose 4.6% and precious metals 4%.

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Last updated: April 2016

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