

GLOBAL ECONOMY

CRISIL Insights

July 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.

Momentum remains weak

- The US economy added 22,000 non-farm jobs in June, exceeding expectations signalling revival of labour demand in the United States (US)
- Growth slows in the United Kingdom (UK) as its services sector records the slowest on-quarter growth since Q1 2015 led by decline in retail sales and housing sales
- China's services sector continued to grow at a robust pace in June as indicated by the non-manufacturing Purchasing Managers' Index which stood at 54.9%
- Crude oil prices plunged to a seven-month low of \$46.4 per barrel in June as production increased in the US, Libya and Nigeria

The green shoots of global recovery are becoming healthier, but the pace of growth is not evenly distributed. While the on-quarter growth in the US, UK and Japan was slower in the first quarter (Q1) of 2017, the Euro area and China showed resilience. Two major events in June helped temper the fear of protectionism and raised expectations of stronger growth in the Euro area. First, was the victory of French President Macron's pro-Europe party, En Marche, in the French Parliamentary elections and second was the failure of the pro-Brexit Conservative Party – led by UK Prime Minister May – to win a majority in the parliamentary elections. In its Global Economic Prospects report (June 2017), the World Bank forecast global growth will strengthen to 2.7% in 2017 from 2.4% in 2016 and gather increased momentum to 2.9% during 2018 and 2019. While advanced economies are projected to grow at 1.9% in 2017 (from 1.7% in 2016), emerging markets and developing economies are likely to recover to 1.4% (from 2.5% in 2016).

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	1.4
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

CAD inches up

Eurozone Economy

Highest CPIH inflation rate recorded since April 2012

Fed to implement balance sheet normalisation programme in 2017

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%.

The current-account deficit (CAD) increased to \$116.8 billion in Q1 from \$114 billion in the previous quarter, on the back of an increase in goods trade deficit. The annual consumer price index-linked (CPI) inflation in May was 1.9%, compared with 2.2% in April. Core inflation (all items except food and energy) was 1.7%.

The Federal Open Market Committee (FOMC) in its June meeting raised the target range for the federal funds rate by 25 basis points (bps) to 1-1.25%. During the meeting, the FOMC also expressed its intent to begin implementing a balance sheet normalisation programme this year, should the economy evolve in line with its expectation. Under this, the Fed intends to reduce its Treasury and agency securities holdings over time by decreasing reinvestment of principal payments it receives from securities held in the system open market account. This will result in a decline in the reserve balances. Through the proposed programme, the Fed expects its reserve balances will reduce over time to a level below that seen in recent years, but larger than before the global financial crisis.

Consumer Price Inflation (y-o-y%)

	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17
United States	2.1	2.5	2.7	2.4	2.2	1.9
United Kingdom	1.6	1.8	2.3	2.3	2.6	2.7
Eurozone	1.1	1.8	2.0	1.5	1.9	1.4
Japan	0.3	0.4	0.3	0.2	0.4	0.4
China	2.1	2.5	0.8	0.9	1.2	1.5

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17
United States	0.50-0.75	0.50-0.75	0.75-1.00	0.75-1.00	0.75-1.00	1.00-1.25
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

Strengthening euro aids trade surplus in euro area

The revised estimate of Eurostat confirmed euro area GDP grew 0.6% (not annualised) in Q1, 10 bps higher on-quarter. Household final consumption expenditure had a positive contribution. Also aiding growth was the impressive current account surplus of €90.8 billion in Q1, up from a surplus of €76 billion in the previous quarter.

The euro area posted a goods trade surplus of €17.9 billion in April, compared with a trade surplus of €26.6 billion a year ago. Trade surplus was lower than a year ago as imports rose 3% on-year while exports fell 3%. The trade balance was further supported by a strengthening euro.

With a modest recovery in view, the European Central Bank (ECB) is maintaining easy monetary conditions. It continued to make purchases under its asset purchase programme in May at the revised pace of €60 billion a month, which it intends to continue until December-end, or beyond, if necessary. Until March 2017, the ECB was purchasing assets at €80 billion a month. S&P Global expects the ECB to reduce its asset purchase programme only gradually in the first half of 2018.

While growth was stable in the UK in the two quarters following Brexit (Q3 and Q4 2016), it slowed in Q1. As per the revised estimate, UK's GDP grew 0.2%, the slowest since Q1 2016, mainly on account of a slowdown in services sector output – its lowest on-quarter growth (0.1%) since Q1 2015. The annual CPI-inflation was 2.9% in May, up from 2.7% in April. The annual consumer prices index, including owner occupiers' housing costs (CPIH) inflation – the most comprehensive measure of inflation although not the national statistics – printed 2.7% in May, up from 2.6% in April. This remains the highest CPIH inflation rate since April 2012 (2.8%).

Japan Economy

Imports grow faster than exports

China Economy

Government infrastructure spending and property market boom drive GDP

Rising food prices keep inflation positive in Japan

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 average monthly household expenditure down 0.1% on-year in May. Annual CPI inflation was positive for the eighth month in a row, at 0.4% in May, stable from the April. Energy prices (2.2%) are driving up inflation. While core inflation was stable (0%), food prices increased on-year (0.8%).

Japan's trade deficit in May widened to ¥204.2 billion as against ¥47.3 billion posted a year ago, as imports grew (17.8% on-year) faster than exports (14.9% on-year). The Japanese yen appreciated 1.2% on-month against the dollar in June, reflecting rising investment sentiment over the pick-up in economic activity and inflation.

In its June 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.

Non-manufacturing sector continues to grow in China

China's GDP clocked its highest growth in the past five quarters at 6.9% on-year in Q1, driven by secondary industries, which blossomed 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 May trade surplus was \$40.8 billion as against an April surplus of \$38.1 billion and a year-ago surplus of \$50 billion. While exports grew 8.7% on-year, imports rose 14.8%. The annual CPI inflation rose 1.5% in May, up 30 bps from April. While food prices fell (1.6 %), non-food prices increased (2.3%). Core inflation expanded 2.1%, primarily driven by the rising cost of healthcare (5.9%), education (2.6%), and housing (2.5%) services. The annual producer price index-linked inflation for manufactured goods was at 5.5% in May with rising prices of mining and quarrying and raw materials industry being the major contributors.

As per the official Purchasing Managers' Index (PMI), manufacturing and non-manufacturing economies continued expanding in June with the pace increasing more for the latter. Manufacturing PMI was 51.7% in June, stable up 50 bps from the previous month, while non-manufacturing PMI was 54.9%, up 40 bps.

The yuan strengthened 1.1% against the dollar on-month in June as investors cheered the optimistic economic growth data.

Crude oil prices hit seven-month low in June

As per the World Bank's pink sheet, both energy and non-energy process declined in June. While energy prices plummeted to 6.1% on-month, non-energy prices fell by 1.3%.

The energy index plummeted as crude prices hit their seven-month low in June. Brent averaged \$46.4 per barrel (bbl) in June, down from \$50.3/bbl in May, as oil production shot up in US, Libya and Nigeria. Prices fell despite the decision of both the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC countries to restrict their output to ~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.

Amongst non-energy commodities, food prices eased 1.1% while beverages fell 0.7%. While raw material prices fell 3.5%, fertiliser prices increased 1.6%. Metals and minerals slid 0.7%, led by an 8% tumble in iron ore. Precious metals rose 1.1%.

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