

GLOBAL ECONOMY

CRISIL Insights

April 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.

Inflation makes a comeback globally

- Rising inflation and strong economic indicators prompt the US Fed to hike its funds rate
- UK invokes Article 50 of Lisbon Treaty, officially triggering the Brexit process
- Rising protectionist sentiments among trading partners bring down China's export growth
- Oil prices fall as US crude oil inventories rise

Are things looking up for the global economy – at last? Growth is strengthening across the world and consumer price index-linked (CPI) inflation is finally rising in all major economies. While the United States registered its highest-ever inflation rate since March 2012, February inflation in the United Kingdom was at its peak since September 2013. Fuel prices were the major factor bumping up inflation in the US, Eurozone, UK, and China, even as rising food and services prices also edged up numbers, especially in Japan. However, the fall in oil prices since the second week of March may bring down inflation in the coming months. Global crude prices rose to \$54.9 per barrel in February, the highest since March 2015, before slipping to \$51.6 per barrel in March 2017.

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	2.1
United Kingdom#	0.3	0.7	0.2	0.6	0.5	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
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US Economy

Rising inflation forces the Fed's hand

Eurozone Economy

UK serves notice of separation from the EU

Rising inflation forces the Fed's hand

Fourth quarter gross domestic product (GDP) in the US grew 2.1% on an increase in consumer spending, private inventory investment, residential investment, business investment, and state and local government spending. The increases were partly offset by a decline in federal spending and a rise in net exports. Trade deficit narrowed \$2 billion on-year to \$43.6 billion in February 2017, as exports grew (6.7%) faster than imports (4.5%).

The economy added 98,000 non-farm jobs during March, the lowest payroll number since May 2016, while average hourly earnings increased 2.7% on-year. The annual CPI inflation rose 2.7%, the steepest rise since March 2012.

The rising inflation prompted the Federal Open Market Committee (FOMC) to raise the target range for the federal funds rate by 25 bps to 0.75-1% on March 15. The hike marks the first increase in 2017 and third in the past two years. The monetary policy stance remains accommodative to support further strengthening in labour market conditions and a sustained return to the inflation target of 2%. The Fed expects economic conditions to evolve to perhaps warrant gradual increases in the federal funds rate. S&P Global expects two more rate hikes in 2017, with the benchmark rate climbing to 1.25%-1.50% by December, and four more hikes in 2018 by 25 bps each

Consumer Price Inflation (y-o-y%)

	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
United States*	1.5	1.6	1.7	2.1	2.5	2.7
United Kingdom	1.0	0.9	1.2	1.6	1.8	2.3
Eurozone	0.4	0.5	0.6	1.1	1.8	2.0
Japan	-0.5	0.1	0.5	0.3	0.4	0.3
China	1.9	2.1	2.3	2.1	2.5	0.8

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

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

UK serves notice of separation from the EU

As per the estimate of Eurostat, the statistical office of the European Union, seasonally adjusted Euro-area (EA-19) GDP rose 0.4% on-quarter (not-annualised) in Q4, same as the previous quarter. The main drivers included household final consumption expenditure and gross fixed capital formation, which rose 0.4% and 0.6%, respectively. The unemployment rate was 9.5% in February, down from 9.6% in January and from 10.3% in February 2016, the lowest rate since May 2009.

While growth remains modest, inflation accelerated 20 bps on-month to 2.0% in February[3]. The rise was mainly on account of the prices of transport fuel and vegetables which rose 16.7% and 16.2% on-year, respectively. However, as per the Eurostat flash estimate, annual inflation is expected to decline 50 bps on-month to 1.5% in March on the back of a fall in energy, food and services indices. With a modest recovery in view, the European Central Bank is maintaining easy monetary conditions.

The UK officially invoked Article 50 of the Libson Treaty on March 29, beginning a two-year negotiation period with the EU before it officially exits the Union. Nevertheless, the British economy grew 0.7% in Q4 2016 and by 1.8% for the whole of 2016.

Japan Economy

Modest recovery trend continues

China Economy

Growth momentum still on in China

Japan continues its modest recovery trend

Japan's economy continued on its modest recovery path. The Q4 GDP grew at 1.2% (annualised) on-quarter, same as growth in Q3. Growth was driven by higher private non-residential investment and exports. Household consumption expenditure continued falling, with February's average monthly household expenditure declining 3.8% on-year. Annual CPI inflation remained positive for five months in a row, at 0.3% in February, falling 10 bps over the previous month. Balance of trade turned favourable for Japan in February as exports growth (11.3% on-year) outpaced imports (1.2%).

In its March 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 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.

Growth momentum continues in China

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 6.9% in 2015, and achieving the targeted 6.5-7% growth.

The annual CPI-linked inflation rose 0.8% in February, 170 bps lower on-month. While food prices fell, non-food items such as fuel and services drove up inflation. The annual producer price index-linked inflation for industrial products was at 7.8%, primarily on account of the carryover effect of last year's prices changes. China posted a trade deficit of \$9.2 billion in February 2017, compared with a surplus of US\$28.1 billion a year ago and \$51.4 billion a month ago. While exports tanked 1.3%, imports grew 38.1% on-year.

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-day 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.

Commodity prices tumbled in March

As per the World Bank's pink sheet, all commodity price indices declined in March. Energy and non-energy prices fell 5.9% and 1.8%, respectively. Brent crude slid for the first time in the past three months to \$51.6 per barrel on average in March, on account of a rise in US crude inventories. CRISIL Research believes Brent will range at \$50-\$55 per barrel in fiscal 2018, compared with \$48.5 in fiscal 2017. Prices of agricultural commodities, food, and beverages plummeted 2.3%, 2.5%, and 0.8% respectively. Prices of fertilisers and raw materials dropped 1.8% and 2.7%. Likewise, prices of metals and minerals as well as precious metals decreased 0.6%.

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