



Volume 3 | November 2012

**GLOBAL ECONOMY**

# CRISIL Insights

The CRISIL Insights Global Economy series will represent our outlook on the financial scenario across the world and provide a perspective into how it will shape up in the near future.

## IMF lowers global growth projections

Growth prospects in both advanced and emerging economies continue to remain fraught with downside risks. A worsening sovereign debt crisis in the eurozone and the possibility of sudden sharp fiscal consolidation in the US in 2013 is weighing on business confidence and causing world trade to decelerate. Central banks continue to maintain very low policy rates and are implementing monetary easing programmes to boost investment growth. Low growth and uncertainty in advanced economies is dragging down growth in emerging economies through trade and financial channels. However, greater global liquidity due to monetary easing in advanced economies is creating upward pressure on global commodity and crude oil prices, increasing upside risks to inflation in emerging economies. In October, the IMF lowered its 2012 growth projections for advanced and emerging, and developing economies to 1.3 per cent and 5.3 per cent from 1.4 per cent and 5.6 per cent respectively.



## US Economy

The US Fed has pledged to keep short-term interest rates near zero until 2015 as opposed to 2014 as planned earlier

## Eurozone Economy

In Germany, GDP growth slowed to 1.0% y-o-y in the second quarter from 1.2% in the previous quarter, while in Greece and Portugal, GDP contracted by 6.2% and 3.3%, respectively

US Economy

### Sharp rise in government defence spending lifts US growth in the third quarter

According to the advance estimate released by the US Bureau of Economic Analysis, the country's GDP grew by 2.0 per cent in the third quarter of 2012, as compared to a 1.3 per cent rise in the second quarter. The pick-up in GDP growth was aided by a revival in real personal consumption (PCE) expenditure, a stronger housing market and an increase in government defence spending. PCE, which accounts for nearly 70 per cent of economic activity, grew by 2 per cent in the third quarter compared with 1.5 per cent in the second quarter. The housing market showed signs of recovery as real residential fixed investments growth accelerated to 14.4 per cent from 8.5 per cent in the previous quarter. Furthermore, real federal government consumption expenditure and fixed investment increased by 9.6 per cent in the third quarter from -0.2 per cent in the second quarter, driven by a 13 per cent increase in government defence spending.

Non-residential fixed investments decreased by 1.3 per cent in the third quarter in contrast to an increase of 3.6 per cent in the second quarter as businesses cut down on investments over concerns about a worsening debt crisis in Europe, slowing demand from China and the impending fiscal cliff in the US. Unless an alternate solution for reducing a ballooning federal debt in the US emerges in the next few months, automatic budget cuts are set to take place from 2013 along with the expiry of tax cuts extended by the Bush administration. Anticipation of these fiscal tightening measures (referred to as the fiscal cliff) is dampening investments and adversely impacting growth in the current fiscal.

Exports contracted by 1.6 per cent in the third quarter compared with an increase of 5.3 per cent in the second quarter. While exports will continue to drag down growth in the fourth quarter of 2012, reconstruction activity in the aftermath of Hurricane Sandy might create some upside to the growth figures in the next quarter.

UK Economy

### UK emerges from recession

According to the Office of National Statistics, the UK economy grew by 4 per cent (q-o-q annualised) in the third quarter of 2012 after contracting for three consecutive quarters. The stronger-than-expected recovery was aided by a temporary pick-up in business, transport and hotels services due to the London Olympics. The country's services industry, which accounts for 75 per cent of GDP, grew by 1.3 per cent (q-o-q) in the third quarter, rebounding sharply from -0.1 per cent in the previous quarter.

Output in production industries increased by 1.1 per cent (q-o-q) in the third quarter, following a decrease of 0.7 per cent in each of the previous two quarters. The rebound in growth of production industries was led by a 1.0 per cent increase in the manufacturing sector and 4.1 per cent growth in water supply and sewerage. Economic recovery in the UK, however, remains fraught with downside risks from a worsening recession in the eurozone, a slowdown in China and the impending fiscal cliff in the US.

Eurozone Economy

### Recession deepens in the eurozone

According to the second estimate released by Eurostat, GDP growth in the eurozone stood at -0.2 per cent (q-o-q annualised) in the second quarter of 2012, after having been flat in the previous quarter. In Germany, GDP growth slowed to 1.0 per cent y-o-y in the second quarter from 1.2 per cent in the previous quarter, while in Greece and Portugal, it contracted by a staggering 6.2 per cent and 3.3 per cent, respectively. Spain's GDP growth decelerated further to -1.3 per cent in the second quarter from -0.6 per cent in the first quarter. A slowdown in most economies within the eurozone has led S&P to revise its 2012 growth forecast for the region to -0.8 per cent from an earlier estimate of -0.7 per cent.

Among Asian economies, China's GDP declined for the seventh consecutive quarter to 7.4 per cent in the third quarter of 2012. Growth in investment, retail sales and industrial production were all higher than expected, suggesting that the worst may be over. The Chinese central bank has lowered policy rates twice and cut banks' reserve requirement ratio three times this year, in a bid to boost lending and buoy the slowing economy which has been dragged down by weak domestic demand and a decline in exports, especially to the US and Europe. While easing of monetary policy is estimated to have released 1.2 trillion yuan for lending, the government has been simultaneously fast-tracking infrastructure projects to boost investment.

### Post-earthquake reconstruction boosts Japan's GDP growth

Japan's GDP grew by 3.3 per cent in the second quarter of 2012, up from 2.8 per cent in the first quarter. An increase in reconstruction activities following the earthquake in 2011 has driven economic growth in Japan.

### US exports fell to lowest levels in 6 months

Goods and services exports from the US fell to \$181.3 billion in August 2012 from \$183.2 billion (revised) in July. Imports remained almost unchanged at \$225.5 billion in August compared to \$225.7 billion in July, reflecting low demand for consumer goods, automotive parts and capital goods, due to a slow economic recovery. In the medium term, growth in exports is expected to remain weak due to a slower growth in emerging economies and recession in the eurozone. Overall, the US' trade deficit increased marginally to \$44.2 billion in August from \$42.5 billion (revised) in July. On a y-o-y basis, however, exports from the US were higher by 1.6 per cent in August, while imports increased by 1.0 per cent.

### UK trade deficit widens sharply

The UK's trade deficit widened sharply to £4.2 billion in August from £1.7 billion in July 2012. A goods deficit of £9.8 billion was partly offset by a surplus of £5.7 billion in services. In August, exports of goods to non-EU countries fell by £1.0 billion or 7.2 per cent, while exports to EU countries decreased

## Asian Economy

China's GDP declined for the seventh consecutive quarter to 7.4 per cent in the third quarter of 2012. Growth in investment, retail sales and industrial production were all higher than expected, suggesting that the worst may be over. Japan's GDP grew by 3.3 per cent in the second quarter of 2012, up from 2.8 per cent in the first quarter. An increase in reconstruction activities following the earthquake in 2011 has driven economic growth in Japan.

by less than £0.1 billion or 0.5 per cent as compared to July. The declining trend in exports is likely to continue in the short-term due to the ongoing recession in the eurozone and slower-than-expected recovery in the US.

### Trade deficit narrows in Japan

In September 2012, Japan's trade deficit narrowed to ¥561.7 billion from ¥763.8 billion in the previous month, as exports grew faster than imports. On a monthly basis, exports rose by 6 per cent while imports grew by 2 per cent. Exports fell by 10.3 per cent y-o-y to ¥5,358 billion, reflecting slowing global demand. In contrast, imports increased by 4.1 per cent y-o-y to ¥5,920 billion.

China's trade surplus increased to \$27.7 billion in September from \$26.7 billion in August. On a monthly basis, exports grew by 4.7 per cent, almost similar to imports, which grew by 4.9 per cent during September. Exports are not expected to gain momentum in the coming months due to slower-than-expected recovery in the US and the ongoing recession in the eurozone. On a y-o-y basis, exports rose by 9.8 per cent to \$186.3 billion in September 2012, while imports rose by 2.3 per cent to \$158.7 billion.

### Trade surplus falls in the eurozone

The eurozone's trade surplus fell to €6.6 billion in August 2012 from €14.7 billion (revised) in July as exports fell faster than imports. Month-on-month, exports fell by 6.1 per cent to €152.1 billion, and imports fell by 1.2 per cent to €145.4 billion. On a y-o-y basis, imports grew by only 1 per cent, while exports increased by 10 per cent in August 2012. Lower import growth reflects weak demand in the eurozone due to the ongoing recession.

### Rising gasoline prices raise inflation to 2.0 per cent in the US

After declining steadily since September 2011 (when it peaked at 3.9 per cent), inflation in the US reversed course in August 2012, rising to 1.7 per cent from 1.4 per cent in the previous month. In September, the pick-up in inflation gained further momentum as it reached the official Fed target of 2.0 per cent. For the second month in a row, the increase in inflation was the result of an increase in the gasoline index, which rose by 6.8 per cent in September. However, the overall energy index rose by only 2.3 per cent as much of the increase in gasoline prices was offset by a 10.7 per cent decline in piped gas index. The food index (L12 months) rose by 1.6 per cent in September, as compared to a 2.0 per cent increase in August. The core inflation index (index for all items except food and energy) rose by 2.0 per cent in September, marginally higher than the 1.9 per cent increase in August.

### Inflationary risks likely to stay muted in UK, eurozone and China

According to Eurostat, inflation in the eurozone stood at 2.6 per cent in September 2012, unchanged from the previous month. Inflation was the highest in Estonia at 4.1 per cent. On the other hand, inflation in Germany and Greece were the lowest at 2.1 per cent and 0.3 per cent, respectively. The ECB expects inflation in the eurozone to average at 2.4 per cent in 2012 and 1.6 per cent in 2013.

Inflation in the UK moderated to 2.2 per cent in September, from 2.5 per cent in August. This is the lowest rate of inflation in the UK since November 2009. Almost all of the downward pressure was driven by the housing and household services sector where electricity and gas prices were last revised in September 2011, creating a positive base effect in September 2012. This was partially offset by the transport sector, where rising prices of motor fuels fuelled inflation.

Among Asian economies, inflation in China fell marginally to 1.9 per cent in September 2012, from 2.0 per cent in the previous month. Deflation in Japan moderated to -0.3 per cent in September from -0.5 per cent in August 2012. Japan may continue to experience a mild deflation this year as worries about Europe's debt crisis are likely to suppress growth in wages and economic activity.

### Policy rates

#### Policy rates remain low to boost growth

All central banks kept rates unchanged in September 2012. The Bank of England kept its bank rate unchanged at 0.5 per cent. Policy rates in China remained at 6.0 per cent in September. Japan and the US maintained their policy rates close to zero.

The Fed also pledged to keep short-term interest rates near zero until 2015, and not 2014 as planned earlier, to provide further impetus to investments and growth. In September, the Fed had launched its third quantitative easing programme (QE3), under which it is expected to purchase \$40 billion of mortgage-backed assets every month, until there is a sustained improvement in the US job market.

In September, the European Central Bank (ECB) also announced outright monetary transactions (OMTs) - an unlimited bond-buying programme that would help lower borrowing costs for countries with huge, unsustainable, debt burdens such as Greece, Spain and Italy. Through OMTs, the ECB would buy government bonds of ailing economies in the secondary market on the condition that the respective country implements certain economic reforms.

### Commodity price movements

Crude oil prices moderated slightly to \$112.7 per barrel in October 2012 from \$113.3 per barrel in September. After falling to a monthly average of \$95/barrel in June 2012, crude oil prices have risen by 18.5 per cent, driven by geopolitical tensions and increased global liquidity. As per the latest data, soya oil prices fell by 1.7 per cent y-o-y in September, while rising by 2.5 per cent m-o-m. In October, wheat prices rose by 23.5 per cent on a y-o-y basis and by 0.2 per cent m-o-m. Aluminum prices fell by 8.1 per cent in October on a y-o-y basis, while steel fell by 20.6 per cent on an annual basis.

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Last updated: April 30, 2012

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