CRISIL GLOBAL RESEARCH & ANALYTICS

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GLOBAL ECONOMY

CRISIL Insights

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 economy recovery sluggish

A global economic recovery remains sluggish as US-led growth is getting weighed down by weak growth in other advanced economies such as Japan and the Eurozone and some large emerging economies, particularly China. According to the latest report (released in November 2014) by the Organisation for Economic Co-operation and Development, the world economy is expected to grow by 3.3% this year and go up marginally to 3.7% next year. While the OECD expects the US economy's growth to improve from 2.2% this year to 3.1% next year, growth in the second largest economy 'China is estimated to fall from 7.3% this year to 7.1% next year. Eurozone growth forecasts have already been trimmed to 0.8% from 1.2% for 2014 and to 1.2% from 1.7% for 2015. Japan is also struggling to gather pace and is estimated to grow only by 0.5% in 2014-15, according to Bank of Japan's revised projections.

Gross Domestic Product (GDP) Heat Map

GDP Growth (Q-o-Q SA annualised %)

	2013	Q3-13	Q4-13	Q1-14	Q2-14	Q3-14
United States#	2.2	4.5	3.5	-2.1	4.6	3.5
United Kingdom#	1.7	0.9	0.6	0.7	0.9	0.7
Eurozone#	-0.5	-0.3	0.5	1.0	0.7	NA
Japan#	1.5	1.1	1.0	6.1	-7.1	NA
China*	7.7	7.8	7.7	7.4	7.5	7.3

Note: * y-o-y %

Source: Statistical Bureau, Respective Countries

Improvement | Decline | Unchanged

US Economy

The US economy seems to be on the path of a sustained economic recovery

UK Economy

Job market conditions in the UK improved considerably as the number of jobless people fell by 154,000

US Economy

US: Third quarter GDP reinforces growth momentum

According to the first advanced estimate, the US economy grew at an annual rate of 3.5% in the third quarter of 2014. Though it is lower than 4.6% annualized growth in Q2 2014, it is still robust as it grew on a higher base of 4.5% in the third quarter of 2013. Moreover, this number is subject to two more revisions and recent experience suggests that there could be a change of up to 100 basis points in either direction. Nevertheless, the US economy seems to be on the path of a sustained economic recovery as it is becoming broad-based. The increase in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditure (PCE) which grew by 1.8%, only slightly lower than 2.0% growth a year ago. Within PCE, the highest increase was in the consumer durables category (7.1%).

Exports also did well growing by 7.8% as compared to 5.1% a year ago. While overall investment growth was low at 1% (partly reflecting the high base effect as it grew by 16.8% a year ago), non-residential fixed investment still grew at a healthy 5.5%. Government spending also helped, growing by 4.6% as compared to a muted 0.2% increase a year ago.

Manufacturing activity in the US also accelerated in October. The US ISM Manufacturing Index, which measures national factory activity stood at 59, rising 2.4 points from its September reading. It was the seventeenth consecutive month in which U.S. manufacturing activity expanded. Consumer Price Index (CPI) Inflation in the US stood at 1.7% y-o-y in September, unchanged from August. On a m-o-m basis, inflation rose marginally by 0.1%. At that, US inflation was still below the US Federal Reserve's target of 2% per year, for the 29th successive month. Softening energy prices helped in keeping the overall inflation rate low.

Consumer Price Inflation (y-o-y%)

	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14
United States	2.0	2.1	2.1	2.0	1.7	1.7
UK	1.8	1.5	1.9	1.6	1.5	1.2
Eurozone	0.7	0.5	0.5	0.4	0.4	0.3
Japan	3.4	3.7	3.6	3.4	3.3	3.3
China	1.8	2.5	2.3	2.3	2.0	1.6

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14
United States	0.0-0.25	00.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25
UK	0.5	0.5	0.5	0.5	0.5	0.5
Eurozone	0.25	0.15	0.15	0.05	0.05	0.05
Japan	0.0	0.0	0.0	0.0	0.0	0.0
China	6.0	6.0	6.0	6.0	6.0	6.0

Source: Central Banks, Respective Countries

UK Economy

UK GDP expands again, but may face some headwinds down the line

According to preliminary estimates, the UK economy in the third quarter of 2014 grew by 0.7% over the previous quarter and 0.9% as compared to the second quarter. GDP grew by 3% compared to the same quarter in the last year. The biggest contribution to GDP growth in the third quarter of 2014 came from the services sector, which grew by 0.7% and added 0.6 percentage points to the overall growth. Growth in the manufacturing sector fell to 0.4% compared with 0.5% in the second quarter amid slackening demand from Europe and China.

However, it must be noted that the UK economy still faces some headwinds. These include high household debt levels, on-going fiscal tightening as well as a softening in global demand, especially from the Eurozone, its main trading partner. The UK's manufacturing sector made a promising start in fourth quarter. Manufacturing PMI stood at a three month high of 53.2 in October as compared to a 17 month low of 51.5 in September. The improvement was driven by domestic demand as new exports orders declined. The New Export Order Index fell for the fourth month running, to 48.3 from 49.6, suggesting that manufacturing exports are struggling.

Job market conditions in the UK improved considerably as the number of jobless people fell by 154,000 to 1.97 million in the three months to the end of August. With this, unemployment averaged 6% in the June-August quarter, the lowest in almost six years. A year ago unemployment levels had been 7.7%. Improvement in the labour market conditions, however, does not reflect in the inflation in the economy which dropped to 1.2% in September, the lowest level for five years. Inflation stood at 1.5% in August. The drop was driven not just by further food price deflation but included a decline in 'core' goods and services inflation to its lowest since April 2009.

Euro zone Economy

There has been mounting pressure on the ECB to launch another quantitative easing (QE) programme

Asian Economy

There are doubts whether the Japan government would go ahead with its next planned tax hike in October '15

Euro zone economy

Euro zone: Fragile recovery, economic outlook slashed

Fears about fragile recovery of the Euro zone were reinforced by the European Commission, which slashed its economic outlook for the area from 1.2% to 0.8% for 2014 and from 1.7% to 1.1% in 2015. All three large economies in the region - Germany, France and Italy - sharply reduced their growth forecasts. Germany, the largest economy, is expected to grow by 1.3% this year as compared to the earlier forecast of 1.8%, but higher than 0.4% growth in 2013. The second-largest economy, France is expected to clock only 0.3% growth, down from 1% forecasted earlier. For Italy, predictions are for a negative 0.4% growth compared to 0.6% earlier.

The Euro zone composite PMI which combines manufacturing and services stood at 52.1 for October, broadly unchanged from 52 in September. Both manufacturing and services activity remained lacklustre in October. According to the Eurostat flash estimate, inflation stood at 0.4% in October as compared to 0.3% in September. This is still significantly below the European Central Bank's (ECB's) 2% target. Price cuts across different sectors to spur sales and lower energy and food prices have increased fears of deflation. Persistently low inflation is worrying for the economy and along with the European Commission's downward revision of growth forecast, there has been mounting pressure on the ECB to launch another quantitative easing (QE) programme. Unemployment in the Eurozone was stable at 11.5% in September as compared to August, but a little lower than 12% in September 2013.

Asian Economy

China: Slowdown continues

The Chinese economy grew by 7.3% in the third quarter of 2014. This marked the lowest level since the first quarter of 2009 when growth fell to 6.6% amid a global financial crisis. The third-quarter growth rate was down from 7.5% in the second quarter. The slowing GDP rate means that China may fail to meet its growth target of 7.5% this year.

The consumer price index (CPI) rose 1.6% in September from a year earlier down from 2% in August. While much of the decline was owing to a fall in prices of food, fuel and other commodities data also pointed to broad weakness in the country. Facing mounting risks to growth and rising risks of deflation, China has rolled out a series of targeted fiscal and monetary stimulus measures. Recently, China's central bank confirmed that it pumped 769.5 billion Yuan ($126 billion) through a newly-created Medium-term Lending Facility. Before this the central bank injected 500 billion Yuan in September and another 269.5 billion Yuan in October via this facility.

The weak growth outlook for the world's second-largest economy could turn out to be a big drag on the global economy. China is a major market for commodity producers in Latin America, Asia and Africa and capital-goods makers in the U.S. and Europe, as well as one of the world's largest recipients for foreign investment.

Japan: Increased quantitative easing to circumvent deflation

Japan's GDP shrank by an annualized 7.1% q-o-q in the second quarter of 2014, the biggest fall since 2009. It is partly a result of the increase in consumption tax by the Japanese government in April 2014. To control its ballooning public debt, which is close to 240% of GDP, it became imperative for the government to raise the tax to 8% from 5%. However, this move seems to have impaired economic recovery severely. There are now doubts whether the government would go ahead with its next planned hike to 10% in October 2015.

Consumer Price Index (CPI)-based inflation, after adjusting for the increase in sales tax, slowed to 1% y-o-y in September from 1.1% in August. This is the lowest in last 11 months and has moved further away from the Japanese central bank's target of 2%. Manufacturing activity in Japan expanded at the fastest pace in seven months in October aided by a faster expansion in new business activity and rising exports owing to a weakening yen. Japan's trade deficit also edged up in September. Trade data showed that exports grew 6.9% in September from a year earlier, while imports rose by 6.2%. As on one hand, the exports become cheaper when yen depreciates, on the other hand imports become costlier. The overall impact on the trade balance was that the deficit rose by 1.6% to ¥958.3 billion ($8.96 billion compared to a year ago). Cumulatively, trade deficit between April and September rose to ¥5.4 trillion ($47.8 billion), a record high for any fiscal first-half period since the data became available in 1979.

To prop up its sagging economy and assuage disinflation fears, the government announced the increase in the pace of its quantitative easing programme to ¥80 trillion (around US$700 bn) per annum up from ¥60-¥70 trillion now. The Japanese central bank also announced that it will increase purchases of exchange-traded funds and Japan real estate investment trusts (J-REITs) by three times.

Source: CRISIL Research

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