January 2015

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 recovery not yet robust, falling crude oil prices to provide some relief

The world economy is entering 2015 on a fragile note. The International Monetary Fund (IMF) projects global GDP growth to rise by just 3.8% in 2015 from 3.3% in 2014, largely riding on a re-emergent US. Most other economies, both advanced and emerging, are still struggling to break away from the slowdown pangs. While 2014 did not see any noticeable economic improvement, 2015 is likely to get a boost from the substantial decline in crude oil prices which allows people to spend more on other goods. The slump would also substantially benefit countries importing crude oil such as India and China. According to a recent World Bank report, a 10% drop in crude oil prices would increase gross domestic product in oil-importing countries by 0.1-0.5 percentage points. Besides GDP growth, developing oil importing economies such as India, Brazil, Indonesia, Turkey, etc. would see a drop in inflation, current account deficit (CAD) and fiscal deficit. On the negative side, the plunge in oil prices has made the situation even worse for economies such as the Eurozone and Japan which are facing deflationary pressures, with overall inflation falling faster than core inflation.

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	5.0
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	0.8
Japan#	1.5	1.1	1.0	6.1	-7.3	-1.9
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 grew at an annual rate of 5% in the third quarter of 2014, up from the previous estimate of 3.9%

UK Economy

The UK's current account deficit sank to a record £27 billion (or 6% of GDP) in the third quarter

US Economy

US: Third-quarter GDP growth at a decade high

According to the third advance estimate of GDP, the United States economy grew at an annual rate of 5% in the third quarter of 2014, up from the previous estimate of 3.9%. Growth was supported by higher consumer spending and business investments. The real GDP rate had increased by 4.6% in the second quarter, at its strongest pace in eleven years. Such a trend indicates that the US is well past the 2007-08 financial crisis.

The US ISM Manufacturing Index, which measures national factory activity, dropped to 55.5 in December from 58.7 in November. However, for the entire year, the Purchasing Manager's Index (PMI) averaged 55.8 compared to 53.9 in 2013, in what is the best reading since 2010. A sharp fall in crude oil prices in some part helped offset the weakness in global consumption, shrinking the US's trade deficit to an 11-month low in November. While exports slipped by 1% to $196.4 billion as compared to the previous month, imports fell more sharply by 2.2% to $235.4 billion. Consequently, trade deficit narrowed to $39 billion in November, down 7.7% from a revised October deficit of $42.2 billion.

Consumer Price Index (CPI) Inflation slowed down to 1.3% y-o-y in November, after remaining at 1.7% for previous three consecutive months. On a m-o-m basis, inflation dropped by 0.3% in November after it remained flat in October. Excluding food and energy prices, the so-called core CPI edged up 0.1% after rising 0.2% in October suggesting the slowdown in inflation is largely on account of sharp fall in oil prices. On a y-o-y basis, the core CPI rose 1.7% after increasing 1.8% in October. Overall inflation dropped on account of the plunge in crude oil prices. As this would tend to reverse in due course, and given the strong economic growth momentum, the US Federal Reserve seems to be on track for increasing interest rates in the middle of this year.

Consumer Price Inflation (y-o-y%)

	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14
United States	2.1	2.0	1.7	1.7	1.7	1.3
UK	1.9	1.6	1.5	1.2	1.3	1.0
Eurozone	0.5	0.4	0.4	0.3	0.4	0.3
Japan	3.6	3.4	3.3	3.3	2.9	2.7
China	2.3	2.3	2.0	1.6	1.6	1.4

Source: Statistical Bureau, Respective Countries

Policy Interest Rate (End of Month %)

	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-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	0.15	0.15	0.05	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	5.6	5.6

Source: Central Banks, Respective Countries

UK Economy

UK - Third-quarter GDP growth revised downward

On account of a series of official revisions to the UK's economic output estimates, annual GDP growth in the third quarter has been revised downward to 2.6% from 3%. The downward revision in the annual GDP growth rate was due to lower government and business investment than earlier thought and higher imports. The q-o-q growth rate for Q3, however, remains unchanged at 0.7%. Revised data shows that the UK's current account deficit sank to a record £27 billion (or 6% of GDP) in the third quarter, which is an area of concern. Though the growth in household spending was revised upwards, overall investments declined. The UK's economy, it appears, has started to feel the pinch of the global economic weakness and would therefore have to rely more on domestic demand to keep its recovery afloat.

Manufacturing activity, which accounts for around 10% of economic output, fell to a 3-month low in December. Although manufacturing activity has increased for 22 straight months in a row, the slowdown is a blow to the government's hopes of boosting exports. According to manufacturing PMI data, companies continued to win new orders, but largely as a result of domestic demand, rather than export orders. Data also showed that UK manufacturing employment rose for the twentieth month in a row during December. To add to the concerns that the UK economic revival may be losing momentum, the Services PMI suffered its biggest drop for more than 3 years, falling to 55.8 in December from 58.6 in November. Consumer Price Index (CPI) inflation fell to 1% in November - the slowest pace in last 12 years - from 1.3% in October. CPI inflation is now at half the Bank of England's 2% target, largely because of the slide in crude oil prices and is expected to soften further in the months ahead. Low inflation is not only good for households as their real income levels improve, but it also allows the Bank of England to keep interest rates at record low levels of 0.5%.

Euro zone Economy

December CPI inflation came in at - 0.2% y-o-y compared to 0.3% in November

Asian Economy

China's real GDP growth in the 4th quarter is estimated at a little less than 7.3% - the rate at which it grew in the third quarter.

Euro zone economy

Euro zone - Political uncertainty weighs on economy

The Eurozone economy ended 2014 with its worst quarter for over a year, the latest set of data suggests. The region is estimated to have grown by 0.1% q-o-q in the fourth quarter, down from 0.2% growth in the previous quarter. However, the possibility of Greece leaving the Euro Area has fuelled negative sentiments. Some effect - in the form of increased bond yields - is already evident, which makes sovereign debt costlier. Another fallout of such a situation is that the ECB, which is set to hold its monetary policy meeting on January 22 would likely hold back the start of its quantitative easing programme amid such uncertainty. The impending elections in Greece on January 25 would be decisive in this regard. Business activity in the euro zone also remained lacklustre in December.

The Eurozone composite PMI - which combines manufacturing and services - for December came in at 51.4, lower than the consensus 51.7. Fears of a deflation in Eurozone have finally come true. December CPI inflation came in at - 0.2% y-o-y compared to 0.3% in November, for the first time in more than five years. The main reason was plunging crude oil prices, which were 6.3% lower than a year earlier. If energy costs were stripped out, Eurozone inflation would be at 0.6%. Even though this adds to the urgent need for the ECB to start buying bonds as part of its quantitative easing programme, the uncertainty about Greece exiting the region would force to hold it back. The overall unemployment rate was unchanged at 11.5% in November for the fourth straight month.

Asian Economy

China - Slowdown seems to be getting worse

The Chinese economy had a rough 2014 and things are not expected to improve much going ahead. China's real GDP growth in the 4th quarter is estimated at a little less than 7.3% - the rate at which it grew in the third quarter. At that rate, the full year growth would be less than the government's target of 7.5% and would be the weakest expansion in almost a quarter century. A housing market slump and attempts to rebalance China's heavily investment-dependent economy towards consumption have held back growth this year.

Growth in China's manufacturing sector has been slowing down recently. The slowdown in manufacturing activity underlines the challenges that the country's manufacturers face as they fight rising costs and softening demand in a cooling economy. There was however some positive news on the services front. China's services sector grew at its fastest pace in three months in December.

Consumer price index (CPI) inflation fell to a five-year low in November 2014 at 1.4%. At this level, inflation is much below the central bank's annual target of 3.5%. The continuously low inflation levels confirm the slowdown in the Chinese economy and would encourage policymakers to ease their monetary policy stance further and cut the RRR (bank reserve requirement ratio) in the near term. To spur growth and keep borrowing costs down, the central bank on November 21, 2014, unexpectedly cut interest rates for the first time in more than two years. It has also injected more funds into the banking system in recent months and relaxed restrictions to persuade risk-averse banks to lend more. In addition, China is speeding up the execution of 300 infrastructure projects valued at 7 trillion yuan ($1.1 trillion) this year.

Japan - Re-elected Abe government infuses more stimulus

The Shinzo Abe government government approved a ¥3.5 trillion ($29.2 billion) stimulus package to boost consumer spending and regional activity, focused specifically on small businesses, rural communities and post-disaster reconstruction. Along with this, the government also decided to cut the overall effective corporate tax rate by 2.51 percentage points to 32.1% from April and then to 31.3% the following year. This will corporates an estimated ¥400 billion ($3.32 billion) and would encourage them to raise wages and invest more. All these fresh measures, along with the low crude oil prices, have made the government hopeful of achieving 1.5% real growth in 2015-16, up from the 1.4% they had projected earlier.

Manufacturing activity in Japan showed sustained growth in December, suggesting that domestic demand has also started supporting the order from abroad. The trade deficit surged in November despite falling energy prices and a weaker yen, widening to ¥891 billion in November from a ¥737 billion gap a month ago. The rate of increase in core consumer price index fell to 0.7% y-o-y in November from 0.9% in October largely due to falling oil prices. The annual core consumer inflation declined for the fourth consecutive month and is at its lowest level since September 2013, highlighting the Japanese central bank's challenge of moving towards the desired 2% target. Inflation is likely to remain subdued in the coming months, before the gains from savings, and thereby increased consumer spending, eventually start exerting some demand-side pressures.

Source: CRISIL Research

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