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GLOBAL ECONOMY

CRISIL Insights

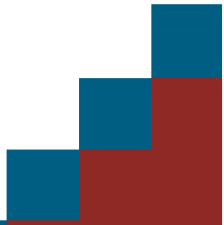
The CRISIL Insights Global Economy series represents our outlook on the financial scenario across the world and provides a perspective into how it will shape up in the near future.

Receding recession risks in the US and euro zone offer some hope

Global growth prospects for 2013 seem to have improved marginally as the risk of a recession in the euro zone and the US during the year has now significantly reduced. Also, recent data on manufacturing activity in China points towards a recovery.

In 2012, governments in the euro zone implemented the much-needed structural reforms such as wage and pension cuts. A few peripheral countries have also reported primary (fiscal deficit excluding interest payments) budget surpluses. While this is comforting, the austerity measures have dragged down growth and raised unemployment drastically in some EU countries, which could slow recovery in the region. In the US, too, the recent deal on averting a fiscal cliff is far from being a permanent solution to the government's rising debt burden.

As negotiations resume after two months, we expect some spending cuts to be implemented, limiting a potential upside to the US's growth in 2013. Japan also seems to have slipped back into a recession, with reconstruction activities losing momentum. Therefore, while downside risks may have temporarily reduced in major economies, there is not much to rejoice about.





US Economy

The US GDP grew 3.1 per cent in Q3 (July-September), faster than the 1.3 per cent growth in the previous quarter.

US Q3 GDP growth revised upwards to 3.1 per cent

According to the latest estimates by the US Bureau of Economic Analysis, the country's GDP grew 3.1 per cent in Q3 (July-September), faster than the 1.3 per cent growth in the previous quarter. The higher-than-expected recovery was largely aided by robust growth in private consumption, a stronger housing market, and an increase in the government's defence spending.

While growth in real personal consumption expenditure remained largely unchanged at 1.6 per cent over the previous quarter, non-residential fixed investments declined 1.8 per cent in the third quarter as businesses cut down investments over concerns about the impending fiscal cliff. A deal between US President Barack Obama and the Republicans has been finalised, mitigating the immediate risk of a recession in 2013. Under the deal, taxes will be hiked only for households with an income of over \$450,000 and individuals earning more than \$400,000 annually. Spending cuts of about \$100 billion have also been postponed for two months.

While these concessions should help the US economy to grow in 2013, they are unlikely to lower its debt burden. Some spending cuts are likely to be implemented during the year. However, the situation will still be managed in order to avoid a recession in 2013.

Inflation in the US eased to 1.8 per cent in November led by lower energy inflation

Consumer price inflation in the US fell to 1.8 per cent in November after rising consecutively for the previous three months. The US overall energy index rose only 0.3 per cent in November 2012, against the 4.0 per cent increase in the previous month. An increase in prices of fuel oil and gasoline was more than offset by a sharp decline in prices of energy services like piped gas and electricity. The food index over the past year remained largely unchanged MoM at 1.8 per cent in November, while inflation in medical care services was high at 3.7 per cent. The core inflation index fell marginally to 1.9 per cent in November from 2.0 per cent a month ago.

Trade deficit expands in the US as exports fell more than imports

Exports of goods and services from the US fell \$6.8 billion MoM to \$180.5 billion in October 2012. Imports also fell by \$4.9 billion MoM to \$222.8 billion, reflecting a decrease in imports. However, on a YoY basis, exports from the US rose 1.0 per cent in October, while imports fell 0.8 per cent. In the medium term, export growth is expected to remain weak led by slower growth in emerging economies and the euro zone. Overall, the US trade deficit expanded to \$42.2 billion in October from \$40.3 billion (revised) in September.

The UK may slip back into a triple-dip recession in the fourth quarter

According to the latest estimates by the Office of National Statistics, the UK's economy grew 3.6 per cent (QoQ annualised) in the third quarter of 2012. Growth in the services industry rebounded to 1.2 per cent (QoQ) in the third quarter from 0.1 per cent in the previous quarter. This recovery was largely driven by a temporary improvement in some segments during the Olympics. In the third quarter, production industries grew 0.7 per cent after contracting 0.9 per cent in the previous quarter. Both manufacturing and mining output rebounded in the third quarter, growing 0.7 per cent and 2.1 per cent respectively, after contracting in the previous quarter.

Household final consumption expenditure increased 0.4 per cent in the third quarter. However, the business environment remained weak as gross fixed capital formation fell 0.2 per cent in the third quarter, the second consecutive quarter of investment contraction. Recent data shows that growth in the UK's services sector slipped into the negative territory in December 2012, for the first time in two years. This has raised concerns that the UK may have slipped into a triple-dip recession in the fourth quarter of 2012.

UK inflation remained unchanged in November

Inflation in the UK was unchanged MoM at 2.7 per cent in November 2012. The largest upward pressure to annual inflation came from food and alcohol and tobacco, where prices rose 3.9 per cent and 5.7 per cent, respectively. Transport services also saw high inflation with airfares rising 7.7 per cent YoY. Further, increase in university tuition fees led to a sharp 19.7 per cent inflation in education services, which further intensified the pressure on Consumer Price Index (CPI).

Trade deficit expanded in the UK

The UK's trade deficit expanded to £3.6 billion in October from £2.5 billion in September (revised) 2012. The goods deficit of £9.5 billion was partly offset by a surplus of £5.9 billion in services. While exports of goods to non-EU countries decreased by £0.4 billion to £12.1 billion in October, exports to EU countries increased by £0.1 billion to £12.3 billion. With respect to EU countries, exports to Spain increased by £0.1 billion, while among non-EU countries, exports to the US decreased by £0.6 billion during October 2012.

US Economy

UK Economy

Eurozone Economy

According to the Eurostat, inflation in the euro zone eased to 2.2 per cent in November 2012 from 2.5 per cent in October.

Asian Economy

China's trade surplus declined to a six-month low of \$19.6 billion in November as the rise in imports exceeded rise in exports.

S&P raised Greece's credit rating by six notches to B-

According to Eurostat's second estimate, the euro zone's GDP growth stood at -0.1 per cent (QoQ annualised) in the third quarter of 2012. In Germany, GDP growth slowed to 0.9 per cent YoY in the third quarter from 1.0 per cent in the previous quarter, while it contracted by 7.2 per cent and 1.6 per cent in Greece and Spain, respectively.

In 2012, several countries, including Italy, Greece, Spain and Portugal implemented structural reforms. Loans to Greece underwent soft restructuring to reduce its debt to sustainable levels by 2020. A legal framework for a banking union was approved. Most effective of all was the announcement by the European Central Bank (ECB) of its intention to buy short-term bonds of peripheral countries in unlimited amounts conditional on certain reforms. This calmed investor fears and led to a sharp drop in government bond yields in Spain and Italy. The ECB also lifted a ban on the use of Greek sovereign bonds as collateral against loans from the central bank, which sharply lowered the country's borrowing costs. Last week, Standard and Poor's raised Greece's credit rating by six notches to B-.

Euro zone inflation fell to 2.2 per cent in November

According to the Eurostat, inflation in the euro zone eased to 2.2 per cent in November 2012 from 2.5 per cent in October. While inflation in alcohol and tobacco, housing and transport was higher than 3.0 per cent, inflation in recreation and culture was among the lowest at 1.1 per cent. Also, inflation in France and Greece fell to 1.6 per cent and 0.4 per cent, respectively.

Euro zone's trade surplus doubled over the past two months

Euro zone's trade surplus doubled over the past two months to €10.2 billion in October 2012 from €5.2 billion (revised) in August. Both exports and imports rose 10 per cent MoM to €169.4 billion and €159.2 billion, respectively. On a YoY basis, exports increased 14 per cent and imports rose 7 per cent in October. Growth in exports augurs well for the region that's struggling to come out of the recession.

Worst seems to be over for China

Among Asian economies, China's GDP growth continued to decelerate, reaching 7.4 per cent in the third quarter of 2012 the slowest since the first quarter of 2009. However, slowdown in private consumption growth appears to have bottomed out. Growth in retail sales of consumer goods, which had decelerated sharply to 13.2 per cent in August 2012, has been trending at over 14 per cent YoY over the past three months. China's official Purchasing Managers' Index (PMI) rose to a seven-month high of 50.6 in November 2012.

Food inflation eases sharply in China

Among Asian economies, inflation in China rose to 2.0 per cent in November 2012 from 1.7 per cent in the previous month. However, food inflation sharply nosedived to 3.0 per cent in November 2012 from a peak of 10.5 per cent in January. The only cause for concern is housing inflation, which has slowly risen since July 2012 and is now at its highest level since the start of the year.

Trade surplus declined to a six-month low in China

China's trade surplus declined to a six-month low of \$19.6 billion in November as the rise in imports exceeded rise in exports. On a monthly basis, exports rose 2.2 per cent, while imports grew 11.3 per cent in November. On a YoY basis, however, imports declined 0.1 per cent to \$159.7 billion, while exports rose 2.8 per cent to \$179.4 billion in November 2012.

Japan's growth slowed down as reconstruction activities lost momentum

Japan's GDP growth slipped to 0.5 per cent in the third quarter of 2012 from 4.0 per cent in the second quarter, reinforcing concerns that the economy may slide back into a recession.

Deflation likely to persist in Japan as growth slows down

Deflation in Japan stood at 0.2 per cent in November from 0.4 per cent in October 2012. Japan may raise its inflation target to 2 per cent next year and undertake a massive monetary stimulus programme to overcome the problem of persistent deflation.

Japan's trade deficit almost doubled

In November 2012, Japan's trade deficit rose sharply to ¥954.8 billion from ¥554.6 billion on an MoM basis, as exports declined 3.2 per cent, while imports rose 4.1 per cent. On a YoY basis, imports rose less than 1.0 per cent to ¥5,938.5 billion in November 2012. Exports, however, fell 4.1 per cent YoY to ¥4,983.7 billion during the month, as demand from China and Europe slowed. The territorial disputes between China and Japan along with a slowing Chinese economy has impacted the demand for Japanese products in China.



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