

GLOBAL ECONOMY

CRISIL Insights

February 2018

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.

Growth, employment head up

- Expanding 2.3% in 2017, the United States (US) economy is headed for strong growth in 2018, aided by a tax package, which prescribes lower taxes, but weighed down by the government shutdown due to funding constraints
- At 73.1%, the employment rate for the September to November period in the United Kingdom (UK) was the highest since 1971
- In December, China clocked its highest level of trade surplus of \$54.7 billion, in 2017

Global economic activity got off to a strong start in 2018, with the International Monetary Fund (IMF) pegging global gross domestic product (GDP) growth at 3.7% in 2017 compared with 3.2% in 2016. The pickup in growth has been broad based, with notable upside in Europe and Asia. The IMF has also revised up its global growth forecasts for 2018 and 2019 by 20 basis points (bps) each, to 3.9% in both the years. The IMF attributed the upward revision to increased global growth momentum and the expected impact of the recently approved US tax policy changes. However, the IMF has cited rich asset valuations and very compressed term premiums, which raises possibility of financial market correction, as the downside to its growth forecast.

GDP heat map

GDP growth (q-o-q seasonally adjusted annualized %)

	Q3-16	Q4-16	Q1-17	Q2-17	Q3-17	Q4-17
US	2.8	1.8	1.2	3.1	3.2	2.6
UK [#]	0.5	0.7	0.3	0.3	0.4	0.5
Euro area [#]	0.4	0.6	0.6	0.7	0.7	0.6
Japan	0.9	1.4	1.5	2.9	2.5	N/A
China [*]	6.7	6.8	6.9	6.9	6.8	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

Trade deficit widens

Eurozone Economy

UK posts solid on-quarter growth in Q4 2017

US government shutdown may chip off gains from tax package

US GDP growth for Q4 2017 came lower at 2.6% on-quarter compared with 3.2% in Q3. The annual GDP growth for 2017 stood at a solid 2.3% compared with 1.5% in 2016. Trade deficit widened to \$53.1 billion in December from \$44.6 billion a year ago as imports growth (9.5% on-year) outpaced exports (7.3%).

Annual Consumer Price Index (CPI)-linked inflation stood at 2.1% compared with 2.2% in November with a surge in the gasoline price driving up the numbers. Core inflation (all items less food and energy) rose 1.8%. CPI inflation rose 2.1% in 2017 unchanged from 2016 and was boosted by a spike in the energy index. Inflation measured by the personal consumption expenditure (PCE) index was at 1.7% in December compared with 1.8%. Core PCE inflation, which is the inflation rate targeted by the Fed, was stable at 1.5%.

In its January meeting, the Federal Open Market Committee left the target range for the federal funds rate unchanged at 1.25-1.50%, maintaining its accommodative stance for a sustained return to 2% inflation target.

Consumer price inflation (y-o-y %)

	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17
US	1.7	1.9	2.2	2.0	2.2	2.1
UK	2.6	2.7	2.8	2.8	2.8	2.7
Euro area	1.3	1.5	1.5	1.4	1.5	1.4
Japan	0.4	0.7	0.7	0.2	0.6	1.0
China	1.4	1.8	1.6	1.9	1.7	1.8

Source: Statistical bureau, respective countries

Policy interest rate (end of month %)

	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18
US	1.00-1.25	1.00-1.25	1.00-1.25	1.00-1.25	1.25-1.50	1.25-1.50
UK	0.25	0.25	0.25	0.50	0.50	0.50
Euro area	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 records highest employment rate in 46 years

Q4 2017 GDP growth for euro area was pegged at 0.6% on-quarter, slightly lower than the 0.7% (revised up from 0.6%) posted in Q3. Over 2017, GDP grew 2.5%. Goods trade surplus widened in November to €26.3 billion compared with €23.8 billion a year ago, as exports grew (7.7%) faster than imports (7.3%). The annual harmonized indices of consumer prices inflation came in at 1.4% in December, down from 1.5% in November. In its January meeting, the European Central Bank left its policy rates – main refinancing rate – unchanged at 0%. It also maintained interest rates on the marginal lending facility and the deposit facility at 0.25% and -0.4%, respectively.

The UK economy posted a solid 0.5% on-quarter (not annualized) growth in Q4 2017, marking the strongest quarterly growth in the year. The Q4 growth was driven by strengthening of the services and manufacturing sector, which were partially offset by a decline in construction activity. Following a slow start to the year, the economy gathered steam through the year to record an annual growth of 1.8%, albeit a tad lower than growth in 2016 by 10 bps. On the employment front, estimates from the Labour Force Survey between September and November indicated the employment rate was 75.3%, highest since 1971, driven mainly by an increase in full-time employees. The unemployment rate remained at 4.3%, the joint lowest since 1975. The consumer prices index, including owner occupiers' housing costs inflation, fell to 2.7% in December from 2.8% recorded in each of the preceding three months. Decline in airfares and recreational goods post the holiday season contributed to the easing. Inflation has been above the Bank of England's (BoE) 2% target over the past year because of the sharp fall in the pound triggered by the EU referendum. The BoE believes if the economy can maintain an annual growth rate of 1.5% in the coming years, inflation can settle at its target 2% rate. To help sustain growth, in its February meeting, the BoE kept its bank rate unchanged at 0.5%. However, the BoE also stated if the economy continues to perform in line with its expectations, it will gradually raise the policy rate.

Japan Economy

Annual CPI inflation increases led by energy and food prices

China Economy

Trade surplus reaches highest level in 2017

Inflation picks up in Japan

Japan's Q3 GDP grew 2.5% on-quarter, 40 bps lower than the revised Q2 growth of 2.9%. While private consumption and government investment declined, an increase in private non-residential investment supported growth.

Trade surplus narrowed to ¥358.7 billion in December, down from ¥635.9 billion a year ago, as imports rose faster (14.9% on-year) than exports (9.3%). Annual CPI inflation rose to 1% in December compared with 0.6% in November, led by an increase in energy and food prices. Core inflation (excluding food and energy) was unchanged at 0.3%, driven by a rise in medical care prices.

In its January meeting, the Bank of Japan kept its policy rate unchanged at -0.1%, and the target yield on 10-year Japanese government bonds at ~0%.

China posts a solid 6.9% growth in 2017

In Q4 2017, China posted a solid 6.8% on-year growth, stable compared with Q3. China's GDP finished strongly in 2017, growing 6.9% for the year, well above the 6.5% target floor. Services led the way, suggesting an ongoing rebalancing of the economy. In January, both the manufacturing and non-manufacturing Purchasing Managers' Index (PMI) increased 30 bps on-month to 51.3% and 55.3%, respectively, indicating the faster pace of expansion in service enterprises. The Composite PMI Output Index, which is a weighted summation of the manufacturing output index and non-manufacturing business activity index, was 54.6%, indicating the overall production and operation activities of Chinese enterprises maintained a steady and rapid development trend.

China's trade surplus widened sharply to \$54.7 billion in December from \$40.5 billion a year ago. A sharp drop in imports growth drove China's December trade surplus to the highest level in 2017. While exports growth was solid at 10.9% on-year, imports grew at a modest 4.5%. The annual CPI inflation increased to 1.8%, compared to 1.7% a month ago, led by increase in prices of health care, residence and education.

The People's Bank of China maintained its benchmark lending rate at 4.35%.

All commodity prices rise in January

As per the World Bank's pink sheet, all commodity indices increased in January. The energy index surged 9.1% on-month, seventh monthly gain in a row, led by a 28.5% increase in US natural gas price. Brent crude rose to \$69.1 per barrel (bbl) on average, the highest level since November 2014 (\$78.6/bbl). This was owing to the high level of compliance on production cuts by oil producing countries, which have agreed to continue the cuts till 2018-end. CRISIL Research expects crude prices to range \$55-60/bbl in fiscal 2018, compared with \$48.5/bbl in fiscal 2017.

Non-energy prices also advanced 3.3% on-month. The metals and minerals index increased 5.3%, the seventh consecutive monthly increase, led by an increase in nickel and zinc prices. The agriculture index increased 2.5%, led by a price rise in cotton and rice, while the fertilizer index rose 1.3% owing to an increase in the prices of diammonium phosphate and urea. Precious metals index rose 5.5%.

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