Global Research
& Analytics

CRISIL
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GLOBAL ECONOMY

CRISIL Insights

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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.

Trade war flags risks for global growth

- The United States (US) Fed raised the federal funds rate by 25 basis points (bps) in March
- On-going tariff war between US and China poses a downside risk to China's growth
- Tension in the Middle East regarding Iran sanctions raised energy indices in March

The world dived for cover as the US and China indulged in retaliatory trade action, pushing global trade along the path of uncertainty. The Trump administration slapped tariffs on its major Chinese imports as a counter to China's alleged unfair trade practices and intellectual property theft. China fired a salvo by imposing tariffs on its US imports. S&P Global has flagged that a trade war involving China could affect Asia-Pacific business activity and growth, given regional supply chains and China's sheer economic weight.

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	2.9
UK#	0.5	0.7	0.3	0.2	0.5	0.4
EA#	0.4	0.6	0.6	0.7	0.7	0.6
Japan	0.9	1.1	1.9	2.4	2.4	1.6
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

US Economy

US posts strong growth in 2017

Eurozone Economy

UK GDP posts solid growth despite Brexit commotion

US Economy

US Fed hikes federal funds rate by 25 bps

The US gross domestic product (GDP) growth for Q4 of 2017 was revised to 2.9% (earlier 2.5%) on-quarter, lower compared with 3.2% in Q3. The deceleration was on account of a downturn in private inventory investment and net exports, which was partially offset by an increase in private consumption expenditure, government spending, and fixed investment. Overall, in 2017, the economy posted strong 2.3% growth compared with 1.5% in 2016, led by a pick-up in private consumption expenditure and fixed investment. The annual Consumer Price Index (CPI)-linked inflation rose to 10 bps on-month to 2.2% in February, led by a sharp spike in gasoline prices. In its March meeting, the Federal Open Market Committee (FOMC) raised the target range for the federal funds rate by 25 bps to 1.50-1.75%, in line with market expectations, citing strengthening economic and labor market conditions.

The dollar index gained 0.5% on-month on average in March as the markets cheered the strong economic data, including the jobs data for February, and the FOMC rate hike. However, further gains were capped by the Sino-US spat, which dampened investor sentiment.

Consumer price inflation (y-o-y %)

	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18
US	2.2	2.0	2.2	2.1	2.1	2.2
UK	2.8	2.8	2.8	2.7	2.7	2.5
EA	1.5	1.4	1.5	1.4	1.3	1.1
Japan	0.7	0.2	0.6	1.0	1.4	1.5
China	1.6	1.9	1.7	1.8	1.5	2.9

Source: Statistical bureau, respective countries

Policy interest rate (end of month %)

	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18
US	1.00-1.25	1.00-1.25	1.25-1.50	1.25-1.50	1.25-1.50	1.50-1.75
UK	0.25	0.50	0.50	0.50	0.50	0.50
EA	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

Eurozone Economy

UK and EU agree on a 21-month transition period post Brexit

Euro The euro area (EA) GDP moderated to 0.6% on-quarter (not annualized) in Q4, from 0.7% in Q3. Over 2017, GDP rose by 2.3% in the EA, compared with 1.8% in 2016, aided by the global economic and trade recovery. The EA recorded the lowest seasonally adjusted unemployment rate since December 2008 of 8.5% in February, down from 8.6% in January. The EA's goods trade surplus increased to €3.3 billion in January, compared with a deficit of €1.4 billion a year ago, as exports rose faster (9.1% on-year) than imports (6.3%). Despite the strong pick-up in overall GDP, the annual Harmonised Indices of Consumer Prices inflation remained below the European Central Bank's (ECB) target of 'close to but below 2%' in February. Inflation was at 1.1%, down from 1.3% in January. However, the March flash estimate sees the inflation rising to 1.4%, led by an uptick in food and energy indices. The euro lost 0.1% on-month against the dollar on average on the back of a stronger dollar and weakened investor sentiment. This was after the inflation slipped in February, reducing the probability of an ECB rate hike.

The UK and European Union (EU) reached an agreement on a 21-month transition period to smooth the way to post-Brexit relations. While the UK would formally exit from the EU on March 29, 2019, there would be a transition period, beginning from then to December 31, 2020. This is to allow businesses and others to prepare for the new post-Brexit rules between the UK and the EU. The UK will be able to strike its own trade deals during the transition period; however, they would come into force only on January 1, 2021.

Despite the Brexit commotion, the UK GDP grew at a solid 1.8% (earlier 1.7%) in 2017, although moderating a bit from 1.9% in 2016. Although the Bank of England left the policy rates unchanged at 0.5% in its March meeting, it signaled hiking of rates at a gradual pace to rein in inflation. On the currency front, the sterling pound gained 0.1% against the dollar as the investors cheered the strong economic data and welcomed the possibility of a rate hike in the near future.

Japan Economy	China Economy
Annual CPI inflation increases	China's economy rebalancing

Trade surplus narrows sharply in Japan

Japan's Q4 GDP improved to 1.6% on-quarter, up from the 0.5% estimated by the government earlier. However, it remained soft compared with the 2.4% growth in Q3. While net exports, government spending, and inventories weighed on growth, private consumption and investment rebounded, supporting economic expansion in Q4. Overall, Japan finished 2017 stronger, with 1.7% GDP growth compared with 0.9% in 2016, with domestic demand driving the growth.

The trade surplus narrowed sharply to ¥2.6 billion in February, from ¥804.5 billion a year ago, as imports growth (16.6% on-year) outpaced exports (1.8%). Annual CPI inflation rose to 1.5% in February compared with 1.4% in January, led by an increase in energy and food prices. In March, the yen gained 1.7% on-month on average as investors considered the currency to be a safe haven amidst the tariff war between US and China.

Wedge between consumer and producer price inflation diminishes in China

China posted a solid 6.8% on-year growth in Q4, stable compared with Q3. Services led the way, suggesting an ongoing rebalancing of the economy. Overall, China's GDP finished strongly in 2017, growing 6.9% for the year, well above the 6.5% target floor, led by services. Credit expansion eased sharply in February, following the normal seasonal pattern. China's official manufacturing and non-manufacturing Purchasing Managers' Index (PMI) increased 120 bps and 20 bps on-month, respectively, in March.

CPI inflation rose to 2.9% in February (compared with 1.5% in January), on food and base effects. The Producer Price Index (PPI)-CPI wedge has almost disappeared, with the PPI inflation rising 3.7% (compared with 4.3% in January).

The People's Bank of China maintained its benchmark lending rate at 4.35%. However, it increased the 7-day reverse repo rate by 5 bps to 2.55%, following the US Fed's federal fund rate hike. On the currency front, the yuan remained stable on average on-month in March against the dollar.

Energy prices rise amid tensions in the Middle East

As per the World Bank's pink sheet, commodity prices were mixed in March, with the energy index rising and non-energy index falling. The energy index gained 0.6% on-month in March, led by an increase in crude prices. Brent crude prices averaged $66 per barrel (bbl) on average during the month, from $65.3/bbl a month ago, owing to tensions in the Middle East regarding renewal of sanctions on Iran. Supply outages in Libya and a declining Venezuelan output contributed to the rise. CRISIL Research expects crude at $63-$68/bbl in fiscal 2019, compared with $57.4/bbl in fiscal 2018. This will be aided by the Organization of Petroleum Exporting Countries (OPEC)-led supply cuts and strong demand from the US and non-OECD (Organisation for Economic Co-operation and Development) nations, including India.

The non-energy index fell 0.7% due to sinking metal prices. Metal indices fell 4.7% led by a sharp drop in iron ore, zinc, lead and aluminum prices. Agriculture and fertilizer indices gained 1.1% and 1.4%, respectively. Precious metals prices were down 0.5% due to a decline in silver prices.

Source: CRISIL Research

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited

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