DALLASFED Economic Update
International

Advanced Economies Lead Moderate Global Growth

August 4, 2015

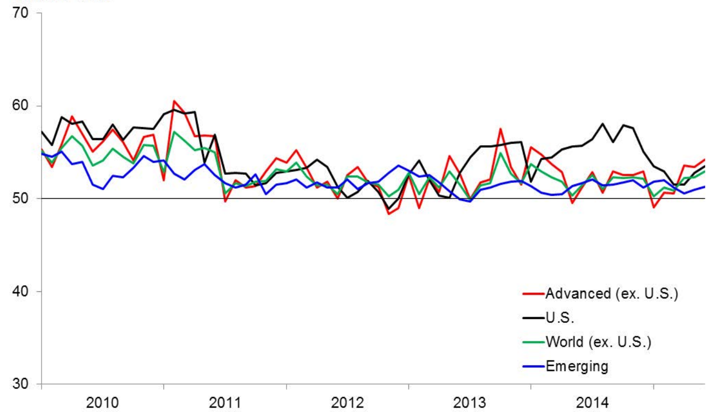
Forward-looking indicators point to a modest global expansion. The Purchasing Managers Index (PMI), which reflects the growth of the manufacturing sector, reached 52.9 for the world (excluding the U.S.) in June, its highest level since February 2014. The PMI for advanced economies (excluding the U.S.) was also at its highest level since February 2014. The PMI for emerging markets was expansionary at 51.3, due in large part to a high reading for Mexico. Many other emerging economies, including Brazil and Russia, were weaker because of low commodity prices (*Chart 1*).[1]

July forecasts for real global gross domestic product (GDP) growth in 2015 were revised downward by the International Monetary Fund (IMF). Forecasts for advanced economies were lower than in April because of slower-than-expected growth in the U.S. and Canada in the first quarter. On a high note, growth in the euro area, particularly in the periphery (excluding Greece), strengthened in recent months. Growth forecasts for emerging economies were revised downward for 2015 because of low commodity prices. Growth forecasts for 2016 remained unchanged and are higher than for 2015.

June inflation data for advanced economies were higher than in previous months, while readings for emerging markets were slightly lower. Annualized producer price index (PPI) numbers showing inflation from January to June—and excluding most of the decline in oil prices at the end of 2014—were 1.4 percent for advanced economies and 1.1 percent for emerging economies. That compares with 0.1 percent and 1.7 percent, respectively, year to date in June 2014. Of note, inflation in the periphery has risen year to date, quelling fears of deflation in the euro area.

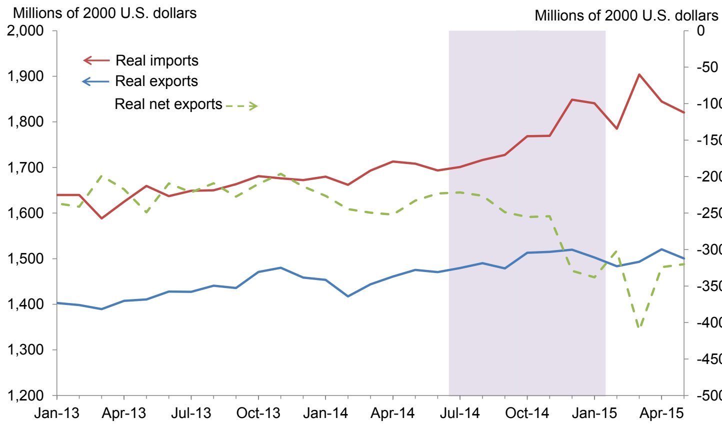
There are several risks to the current global outlook. A significant one to the U.S. is a potential appreciation of the dollar resulting from divergent monetary policies among major central banks. In China, a volatile stock market and subdued growth pose notable risks. Doubts about Greece's place in the euro area are an important geopolitical concern but pose little economic threat.

Chart 1
Purchasing Managers Indexes Indicate Modest Global Expansion



NOTES: Aggregated using U.S. trade weights. Shaded bar indicates global recession. Manufacturing PMI data are used for all countries except Canada, for which composite PMI data are used.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Chart 2
Net Exports Fall After Dollar Appreciates



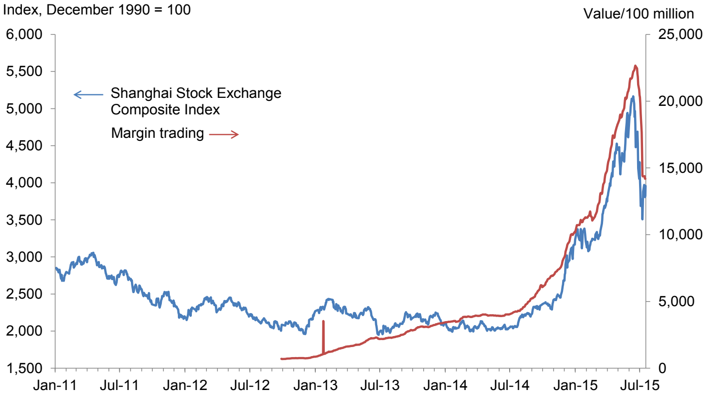
NOTE: Shaded region indicates 11 percent appreciation of the trade-weighted value of the U.S. dollar.
SOURCE: Haver Analytics.

Diverging Monetary Policy Poses Risks to U.S. Dollar

The European Central Bank, Bank of Japan, People's Bank of China and Bank of Canada have all continued to loosen monetary policy. This is diametrically opposed to the intentions of the Federal Reserve, which is considering when to raise policy rates. Continued divergence in monetary policy may lead to a further appreciation of the dollar and lower net exports. But it may also benefit consumers and firms through lower import prices and boost domestic consumption and investment.

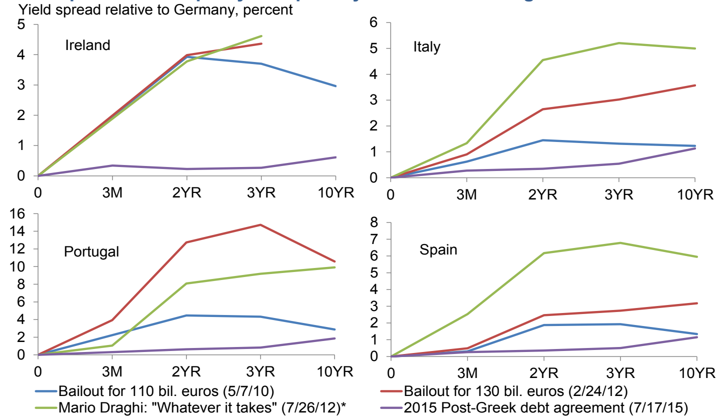
The appreciation of the dollar between July 2014 and January 2015 affected real (inflation-adjusted) imports and exports. Real imports increased in the first quarter by 6.8 percent year over year as imports became relatively cheaper. Real exports also grew by 3.4 percent year over year as global demand increased (*Chart 2*). As imports grew faster than exports, net exports fell. Net exports are an important component of GDP and contributed 54 fewer basis points to U.S. GDP in the first quarter than in the same quarter last year. Still, in April and May, net exports increased and contributed positively to second-quarter GDP growth.

Chart 3
Margin Trading Follows Steep Rise and Fall in Chinese Stock Prices



NOTE: Value/100 million = value of margin trades per 100 million yuan worth of total trades
SOURCE: Bloomberg.

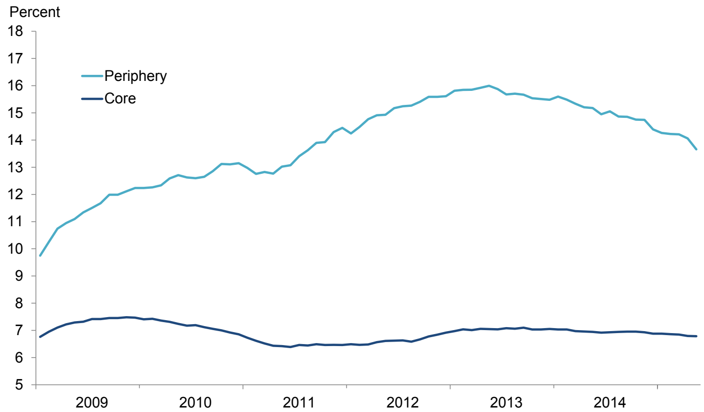
Chart 4
Yield Spreads in Periphery Comparably Low After Debt Agreement



* Mario Draghi, president of the European Central Bank, said in a London speech that the ECB will do "whatever it takes" to preserve the euro.

SOURCE: Bloomberg.

Chart 5
Unemployment in Euro-Area Periphery Falls



NOTE: Core includes Austria, Belgium, Finland, France, Germany and the Netherlands. Periphery inlcudes Greece, Ireland, Italy, Portugal and Spain.
SOURCES: Haver Analytics; author's calculations.

Volatility in Chinese Stock Markets Accompanied by Middling Growth

After a precipitous rise in stock prices starting in July 2014, the Shanghai Composite Stock Index has plummeted, losing about a third of its total value in June 2015. Margin trading, or buying stocks using borrowed money, became popular in 2014. This likely contributed to both the run-up and rapid decline in stock prices (*Chart 3*).

To stem the selloff, the People's Bank of China and securities commission enacted significant measures, setting up a fund to buy over $209 billion in stocks and indirectly lending money to investors to buy shares, among other measures. Stocks are owned mostly by wealthy individuals, so the decline will likely not affect consumption. But long-term volatility in the stock markets may impact the economy by reducing investment.

The U.S. impact so far has been minimal because China restricts trading on its markets. In an extreme tail event, China, which owns a significant portion of U.S. debt, may need to sell its foreign reserves to fund bailouts of banks or financial markets. This would decrease Chinese reserves of U.S. dollars and increase yuan holdings, leading to appreciation of the yuan against the dollar and hurting China's export sector.

Stock market volatility did not seem to affect second-quarter Chinese GDP growth, which was 7 percent year over year, beating expectations of 6.8 percent growth. Still, growth in investment and net exports as a share of GDP fell in the second quarter. The higher-than-expected GDP number does not overcome a long-run trend of declining growth in China. Long-run sustainable growth will be achieved only through higher domestic consumption and investment, which have yet to materialize.

Euro Area Grows Moderately Despite Greek Malaise

After contentious negotiations, Greece and its creditors settled on a third bailout package on July 12, allowing Greece to avoid default and stay in the euro area. The negative effects of a default or continued turmoil in Greece are self-contained because a majority of its debt is held by public, international financial institutions rather than by private banks in the euro area. Other euro-area periphery countries are most likely to be vulnerable to the turmoil in Greece. But spreads of their short- and long-term government bonds, an indicator of a country's financial stability, show that these countries have been largely unaffected, in contrast to earlier periods of uncertainty (*Chart 4*).

In fact, the euro-area core and periphery have seen moderate growth in 2015. Excluding Greece, PMI data indicate expansion in the euro area. Inflation (excluding prices of food and energy) in the periphery countries was up to 0.8 percent year over year in June 2015, compared with 0.5 percent in June 2014. Annualized, year-to-date inflation in Spain and Portugal was robust at 2 percent and 1.2 percent, respectively, in June. These are signs that the risk of deflation in the euro area is diminishing. Unemployment is also down in the periphery (*Chart 5*)—specifically, around 2 percentage points in Spain, Portugal and Ireland since last year. The IMF raised its projection for growth in Spain and Italy in July from 2.5 percent and 0.5 percent, respectively, to 3.1 percent and 0.7 percent.

—Kuhu Parasrampuria

Note:

1. PMI and PPI data for aggregates—world (ex. U.S.), advanced (ex. U.S.) and emerging—come from a representative sample of 40 of the largest economies, ranked by their importance as trading partners of the U.S. See "A New Database of Global Economic Indicators," by Valerie Grossman, Adrienne Mack and Enrique Martínez-García, *Journal of Economic and Social Measurement*, vol. 39, no. 3, 2014, pp. 163–97.

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About the Author

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