DALLASFED Economic Update
International

Deflation Remains Concern, Stock Markets Mostly Improve

December 17, 2015

Global output growth has been weak so far in the second half but is expected to moderately accelerate in 2016, especially for emerging-market countries. Deflationary pressures have decreased but inflation remains low in the euro area. The European Central Bank (ECB) has committed to continuing its quantitative easing program to help fight deflation, but its announced measures were short of market expectations. The turmoil recently experienced by emerging markets has largely subsided as stock prices and exchange rates level out and begin to improve.

World GDP Growth Unchanged

Year-over-year gross domestic product (GDP) growth in third quarter 2015 was 1.5 percent for advanced countries (excluding the U.S.) and 4.0 percent for emerging countries (*Chart 1*).[1] The growth rate for advanced countries fell 0.1 percentage points from the second quarter, while emerging countries' growth was flat. Overall, world growth (excluding the U.S.) was unchanged.

Although, Germany's year-over-year growth increased from 0.22 percent in the second quarter to 0.31 percent in the third, it remains disappointing. Decreased export demand from emerging markets—China in particular—may be partly to blame.

Preliminary data from Japan had shown GDP declined for a second consecutive quarter, which would have indicated a technical recession. However, the GDP data were revised upward from -0.19 percent to 0.39 percent in the third quarter, with Japan narrowly escaping a recession. Japan's preliminary GDP figures have been prone to significant revisions and, in this case, changes to Japanese investment data were responsible for the increase in quarter-over-quarter output growth.

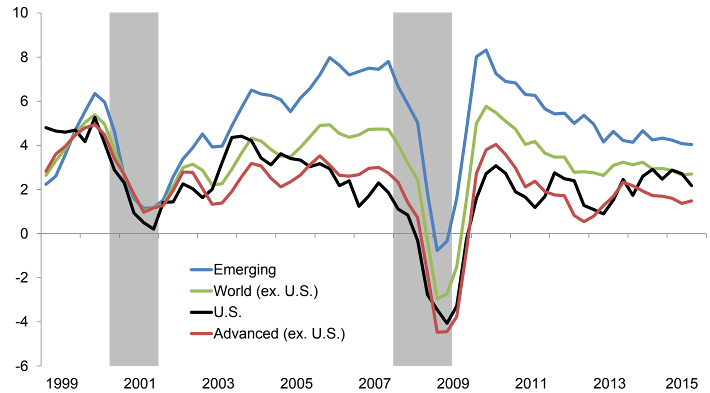
Among emerging markets, third-quarter year-over-year GDP growth was 3.19 percent for Brazil, 0.94 percent for Russia, 5.60 percent for India and 6.02 percent for China. China's growth came in better than expected due to an atypical contribution from its financial services sector. China's stock market experienced a bubble starting in fourth quarter 2014, which may have attracted more investment than usual and could account for the higher output from the financial services sector. This effect is expected to decrease as trading returns to normal levels.

Inflation Pressures Ease

Low global inflation since mid-2014 has mainly been due to low energy prices. The price per barrel of West Texas Intermediate crude oil fell from a high of $103.75 in July 2014 to $36.50 in early December 2015. The deflationary pressure from this price decrease has eased over time, but consumer price index (CPI) inflation is still low (*Chart 2*), particularly for euro-area countries.

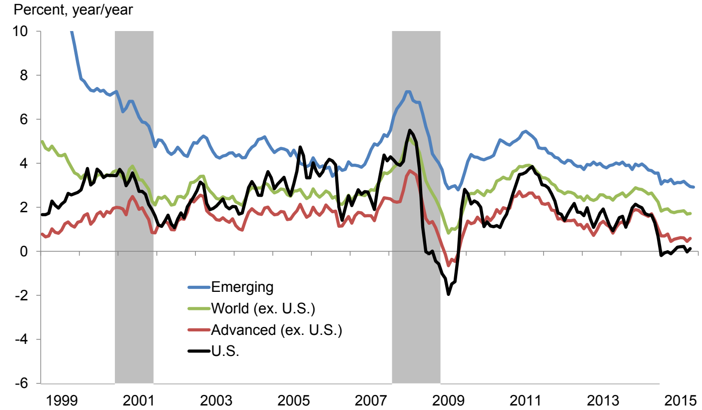
Year-over-year headline CPI inflation for the euro area was 0.13 percent in November 2015. On Dec. 3, the ECB took steps to dissuade potential deflation by cutting the deposit rate from -0.2 percent to -0.3 percent and extended its quantitative easing program. The ECB said it will continue to purchase $64 billion of mostly government bonds every month until March 2017 and did not hint at an increase in

Chart 1
Real GDP Growth Drops for U.S., Stable for Others
Percent, year/year



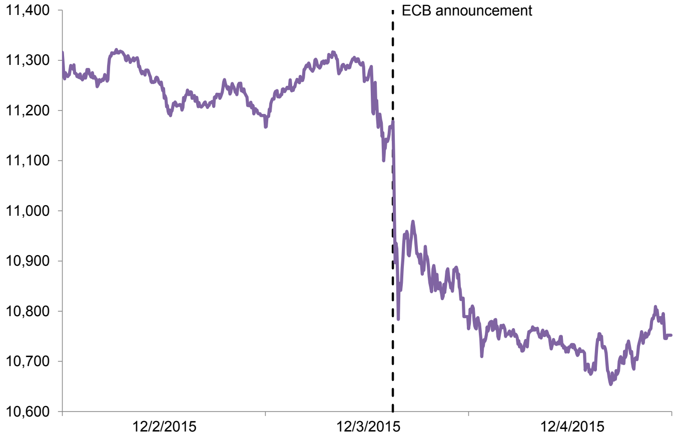
NOTES: Calculations are based on a representative sample of 40 countries (aggregated using U.S. trade weights). Shaded bars indicate global recessions.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Chart 2
Headline Consumer Price Index Inflation Remains Low Due to Oil Prices
Percent, year/year



NOTES: Calculations are based on a representative sample of 40 countries (aggregated using U.S. trade weights). Shaded bars indicate global recessions.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Chart 3
German Stock Market Drops After Disappointing Policy Announcement
Index, Dec. 30,1987 = 1,000



SOURCES: Bloomberg; European Central Bank (ECB).

the future. Investors were expecting an expansion of the program and reacted to the news with disappointment, causing the German stock market, the DAX, to dip 3.5 percent that day (*Chart 3*). Many other central banks kept policies unchanged while awaiting responses from other major central banks.

Emerging Markets Stabilize

Since October, financial conditions in emerging markets have improved. The drop in stock prices and sudden currency depreciations seen in the summer had increased the risk of a financial crisis in emerging-market economies. The risk remained until October, but since then, the stock prices and exchange rates of emerging economies have stabilized or improved slightly. This recent stability implies that the fear of such a crisis has dissipated.

The real stock price index of emerging markets has increased 15 percent from its September low (*Chart 4*). The Chinese stock market bubble is evident in the spike seen in the emerging-market stock index aggregate in the chart. The exchange rate index increased 1.5 percent in October and remained even in November (*Chart 5*).

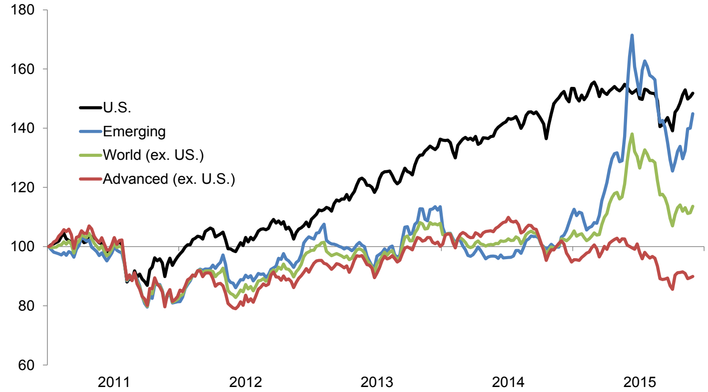
China to Join SDR Basket

On Nov. 30, the executive board of the International Monetary Fund (IMF) decided that the Chinese renminbi (RMB) will be included in the basket of currencies that determine the value of the IMF's special drawing rights (SDR) in October 2016. The SDR is an international reserve asset allocated to IMF member countries to supplement a potential shortfall of preferred foreign exchange reserve assets. The executive board reviews the basket of currencies every five years and has decided that the RMB meets the two necessary criteria.

To be included in the SDR basket, the country must be a major exporter and its currency must be "freely usable." China easily meets the first requirement because it accounted for 12.7 percent of global exports in 2014 and, according to the IMF, it meets the second because the RMB is widely traded in global markets.

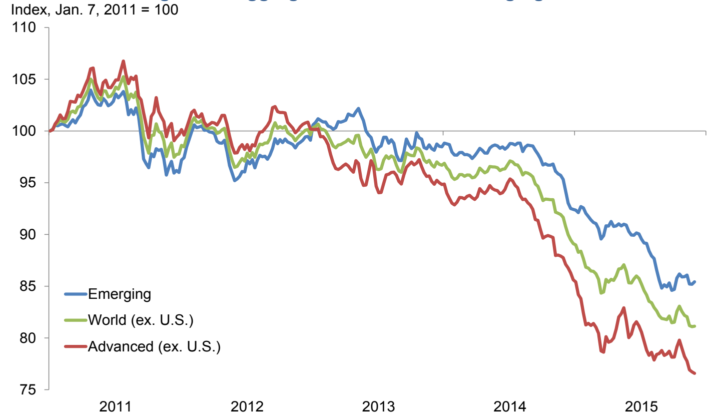
–Kelvin Virdi

Chart 4
Real Stock Index for Emerging Countries Begins to Improve
Index, Jan. 7, 2011 = 100



NOTES: Calculations are based on a representative sample of 40 countries (aggregated using U.S. trade weights). Stock indexes are priced in 2011 dollars. Costa Rica was excluded due to lack of stock exchange.
SOURCES: International stock markets; Haver Analytics; author's calculations.

Chart 5
Nominal Exchange Rate Aggregate Stabilizes for Emerging Countries
Index, Jan. 7, 2011 = 100



NOTE: Calculations are based on a representative sample of 40 countries (aggregated using U.S. trade weights).
SOURCES: National sources; Haver Analytics; author's calculations.

Note

1. Numbers for world and advanced aggregates exclude United States. GDP, CPI and Producer Price Index 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 U.S. trading partners. 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. For the methodology used for dating global cycles, see "A Contribution to the Chronology of Turning Points in Global Economic Activity (1980–2012)," also by Grossman, Mack and Martínez-García, forthcoming in the *Journal of Macroeconomics*. A working paper version of this article appeared as Globalization and Monetary Policy Institute Working Paper no. 169, January 2014.

About the Author

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