

International

Broad Global Recovery Emerges Despite Uneven First Quarter

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The International Monetary Fund (IMF) projects an upswing in global trade, with volume increasing to 3.8 percent in 2017 and 3.9 percent in 2018 from 2.2 percent in 2016. However, there are many risks to the outlook, mostly in the medium term.

After many false starts, a broad-based and stable recovery has emerged. Advanced economies are entering a steady growth path, while emerging-market economies are experiencing a relatively more diverse range of growth paths.

Global Growth Increase Likely

Gross domestic product (GDP) growth rates were mixed during the first quarter. Historically, the first quarter has been the slowest quarter of the year; 2017 appears to be no exception. The United Kingdom economy expanded at a 0.3 percent annualized rate, while the United States grew at a 0.7 percent pace—both underperforming expectations.

By comparison, China's growth met first-quarter expectations at 6.9 percent—its strongest quarter in two years, benefiting from a notable uptick in industrial production (*Chart 1*).

Despite a relatively strong performance, China's dependency on very rapid domestic credit growth has prompted financial stability concerns. Meanwhile, IMF forecasts increased for Japan, reflecting greater industrial production, and for the euro area because of improved economic sentiment.

The Bank of Canada recently boosted its 2017 GDP forecast from 2.1 percent in its January monetary policy report to 2.6 percent in its April outlook, the latest available.¹ Canada's upgraded prospects coincide with diminished impacts from low oil prices, as output-based growth increased strongly at the beginning of the year.

The IMF projects global GDP will increase 3.5 percent in 2017 and 3.6 percent in 2018—up from 3.1 percent in 2016. Global market optimism could confront headwinds, most notably political uncertainty, in advanced economies. "One salient threat is trade protectionism, leading to trade warfare ... this would result in a self-inflicted wound that would lead to higher prices for consumers, lower productivity and, therefore, lower overall real income for households," IMF Chief Economist Maurice Obstfeld said in a prepared statement before the release of the April IMF World Economic Outlook (WEO) report.²

Energy, Food Prices Boost Advanced Economies' Inflation

Rising food and energy prices are driving higher expectations for headline consumer price index (CPI) inflation in nearly all advanced economies so far this year. Although headline inflation is ticking upward, core inflation remains

Chart 1
Industrial Production Rise Boosts China's Gross Domestic Product

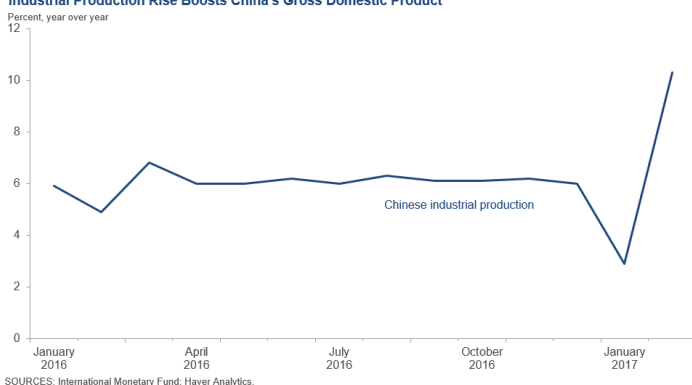
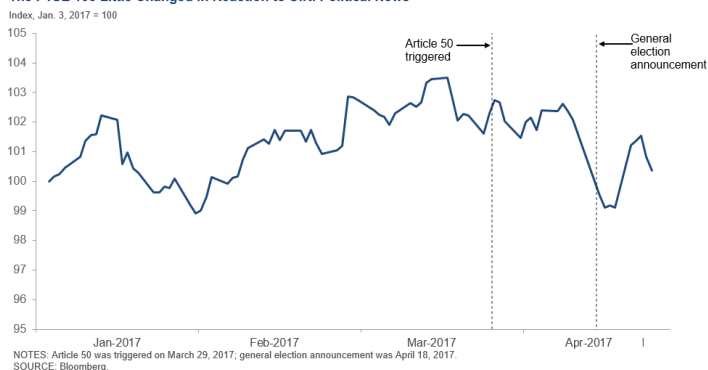


Chart 2
The FTSE 100 Little Changed in Reaction to U.K. Political News



stagnant. The U.K. appears on track to overshoot its 2 percent inflation goal before gradually converging on the target inflation rate. This is largely due to the British pound's depreciation against major currencies and increasing energy prices. Emerging markets confront a more diverse set of scenarios, as do their growth outlooks (*Table 1*).

Markets Juggling Uncertainty

The U.K.'s FTSE 100 is experiencing a fair amount of volatility but has emerged little changed from the beginning of the year, gaining 0.36 percent from Jan. 3 to April 28 (*Chart 2*).

The U.K. triggered Article 50 of the European Union's (EU) Lisbon Treaty on March 29, starting the process of exiting the EU. German Chancellor Angela Merkel has been clear that the British should be prepared for the trade consequences of their action.

Elsewhere, India's exports continued improving in February, pushing its trade deficit lower. Electricity production in India still shows signs of lingering demonetization and a subse-

quent output slowdown after Prime Minister Modi deemed the two most widely used banknotes invalid in an effort to curtail the shadow market.

Trade Protectionism Sentiments Pose Global Economy Risk

Populism reflecting trade protectionist sentiment has emerged in several advanced economies. “There are clear downside risks,” IMF Managing Director Christine Lagarde said in a recent speech in Brussels.³ “[There is] ... political uncertainty, including in Europe; the sword of protectionism hanging over global trade; and tighter global financial conditions that could trigger disruptive capital outflows from emerging and developing economies.”

Political turmoil has also appeared in emerging markets such as Turkey and Brazil, as well as in Venezuela, where widespread political unrest continues. Geopolitical factors such as Turkey’s constitutional revamp, terrorism and the refugee crisis have increased emerging markets’ vulnerability to domestic and external shocks. In the U.S., potential fiscal easing, the impact of a proposed corporate tax reduction and monetary policy normalization could impact emerging economies.

Headwind spillovers from China’s slowdown still loom over emerging markets. While China can meet short-term growth forecasts, it remains credit dependent. Longer term, China faces a choice between higher debt and slower growth. Since the Great Recession, China has expanded credit to the nonfinancial sector, helping drive GDP growth (*Chart 3*).

Lastly, financial vulnerabilities still exist in emerging markets—where corporate debt levels are elevated and profits remain under pressure—and in peripheral euro-area countries, notably in Italy, where banking system problems persist, and in Greece, where fiscal problems linger.

Reaching Firmer Ground

The global economy seems to be reaching firmer ground, though downside risks remain. Elections in several advanced economies—France’s presidential election on May 7 and the U.K. general election on June 8—will be closely followed because of their global implications.

–Arthur Hinojosa

Notes

1. Bank of Canada, “Monetary Policy Reports,” January 2017 and April 2017, www.bankofcanada.ca/publications/mpr/
2. “IMF Raises Global Growth Forecast, Warns Against Protectionism,” by David Lawder, Reuters, April 18, 2017.
3. “Building a More Resilient and Inclusive Global Economy,” speech by Christine Lagarde, managing director of the International Monetary Fund, April 12, 2017, www.imf.org/en/News/Articles/2017/04/07/building-a-more-resilient-and-inclusive-global-economy-a-speech-by-christine-lagarde.

About the Author

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Table 1: Headline Inflation Rises in Most Advanced Economies

	Observed		2012–16
	Year-over-year		Period avg.
United States	2.4	Mar	1.3
World (ex. U.S.)	4.1	Feb	2.9
World (ex. U.S., Venezuela)	2.7	Feb	2.2
Advanced (ex. U.S.)	1.8	Feb	1.0
Canada	2.1	Feb	1.3
Euro area	1.7	Mar	0.9
Japan	0.2	Feb	0.8
United Kingdom	2.3	Mar	1.4
Emerging (ex. Venezuela)	3.5	Mar	4.9
China	0.9	Mar	2.0
Mexico	5.4	Mar	3.3
India	3.8	Mar	6.5
Brazil	4.6	Mar	7.0
Russia	4.2	Mar	8.5
South Africa	6.3	Feb	5.6

NOTES: Aggregates are trade-weighted and reported when a sufficient number of countries’ data are available. They are reweighted to account for any missing data. Country data are arranged in descending order of trade weight. Euro-area aggregate includes the nine euro-area countries that are in the DGEI. Observed growth uses quarterly data.

SOURCES: Federal Reserve Bank of Dallas Database of Global Economic Indicators (DGEI); Haver Analytics.

Chart 3
Credit Drives China’s High Gross Domestic Product Growth

