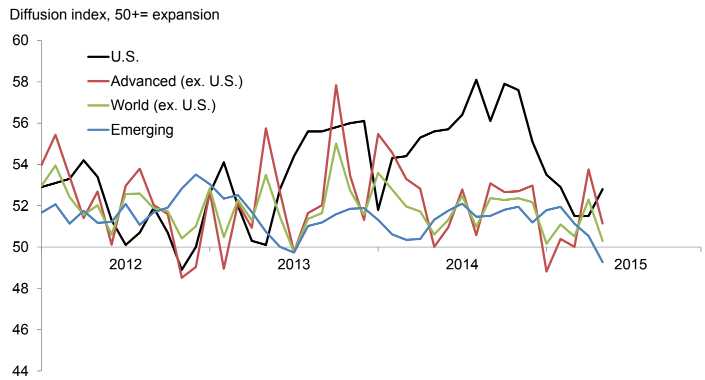
DALLASFED Economic Update
International

Emerging Market Slump Highlighted by Slowdown of Chinese

June 23, 2015

Heading into the second half of 2015, conditions improved in the U.S., among other advanced economies, while growth prospects for most emerging markets remain challenging and have even deteriorated. The most recent Purchasing Managers Index (PMI), labor market and inflation data reveal a reversal of the weakening trend seen in the first quarter. PMIs for the U.S. and other advanced economies continue to bounce above the neutral line of 50 but have slid below 50, into contraction territory, for emerging markets (*Chart 1*). The fear of deflation in the euro area has eased with a firming of oil prices, a weakening of the euro and a rebound in economic growth. However, most emerging markets are experiencing sluggish growth, and some are also facing inflation issues due to rising food prices and currency depreciation.

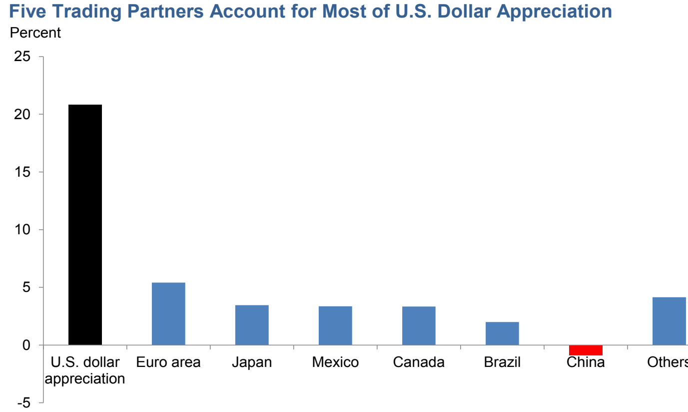
Chart 1
Emerging Economies Purchasing Manager's Index in Steady Decline



NOTE: Aggregated using U.S. trade weights. Manufacturing PMI data is used for all countries except Canada, for which composite PMI data is used.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Policy rates in most advanced economies remain unchanged. Among emerging economies, China and India have loosened monetary policy to boost economic growth. Brazil, on the other hand, has raised its policy rate to fight inflation. While current conditions are less murky than earlier in the year, there remain three major risks to the global outlook: the negative spillover effects of the appreciation of the U.S. dollar, the slowdown of the Chinese economy and the uncertainty regarding the Greek sovereign debt crisis.

Chart 2
Five Trading Partners Account for Most of U.S. Dollar Appreciation

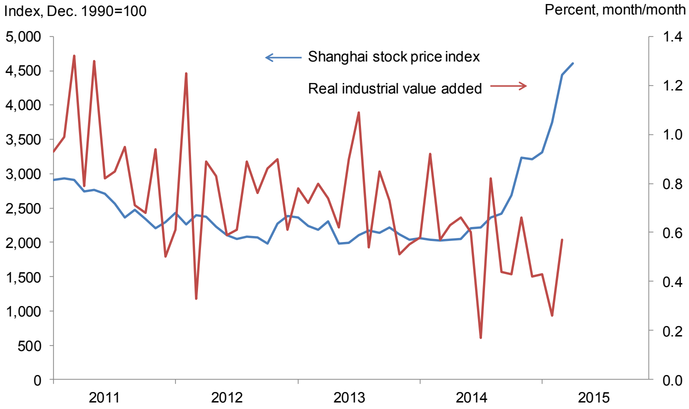


NOTE: The dollar appreciation is from June 2011 to April 2015. The euro area, Japan, Mexico, Canada and Brazil are the five largest contributors to the appreciation during this period.
SOURCES: Federal Reserve Board and the International Monetary Fund.

Secondary Effects of U.S. Dollar Appreciation

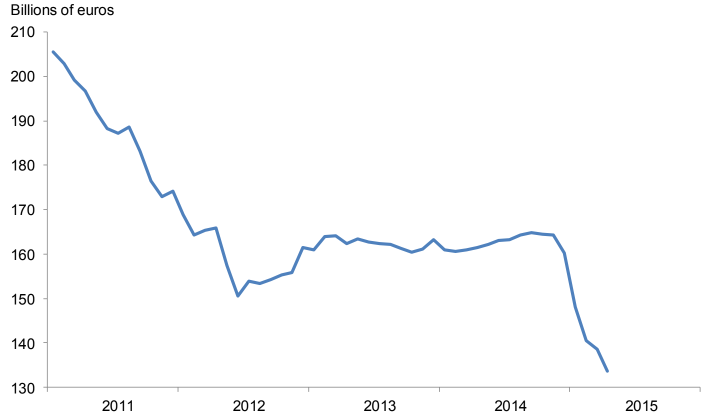
The rising value of the U.S. dollar has been a concern lately. One major issue that needs to be addressed is how it will affect other economies. From July 2014 to the end of April 2015, the nominal trade-weighted value of the dollar has increased about 13 percent, with five major U.S. trading partners (Brazil, Canada, the euro area, Japan and Mexico) accounting for most of the appreciation. The recent dollar rally actually dates back to July 2011, and since then the dollar index (nominal) has increased over 20 percent. The euro area, Japan, Canada, Mexico and Brazil together account for 84 percent of the increase in the dollar index during this period (*Chart 2*). The Chinese yuan, however, is an outlier, appreciating slightly against the dollar. Because of the rising value of the dollar, U.S. products become more expensive, reducing foreign demand for U.S. goods. The euro area, Japan, Canada, Mexico and Brazil all account for 53 percent of total U.S. exports. In the short run, a stronger dollar will slow U.S. economic growth and impose downward pressure on inflation.

Chart 3
Rapid Increase in Shanghai Stock Price Index May Indicate Asset Bubble



SOURCES: Shanghai Stock Exchange; China National Bureau of Statistics.

Chart 4
Deposit Outflows from Greek Banks Continue



SOURCE: Bank of Greece.

Chinese Stock Prices Indicate an Asset Bubble

The uncertainty surrounding the Chinese economy is another concern. In particular, the hasty rise of the stock markets in China and Hong Kong elicits fear of an asset bubble that could cause investors to pull out their finances, posing a threat to the global outlook. China's major stock price indexes have almost doubled since the second half of 2014, with the Shanghai stock price index surging from about 2,000 in summer 2014 to over 4,600 currently (*Chart 3*). Furthermore, there has been a slowdown in overall Chinese economic growth. For instance, China's industrial production growth has declined significantly since 2011, reflecting the country's darkening growth prospects. Also, its gross domestic product (GDP) growth fell to 7 percent year over year in first quarter 2015 from 7.3 percent in the fourth quarter. This is the slowest quarterly GDP growth for the country since first quarter 2009, during the global financial crisis. The newly released monthly data in the second quarter are also largely disappointing and confirm sluggish economic growth in coming months.

The Fate of Greece

A potential default and exit from the euro zone by Greece remains the most significant economic risk in Europe. Private deposits have continued to flow out of Greece since late April as negotiations between Greece and its international creditors went into a deadlock (*Chart 4*). On June 4, Greece requested to delay a 300-million-euro loan payment to the IMF and bundle all of its four June payments into a single lump sum payment of 1.6 billion euros, which is now due at the end of the month. This move could mean that the risk of default and exit of Greece from the euro zone has substantially increased.

While the outlook for advanced economies is optimistic, the spillover effects of the U.S. dollar appreciation on emerging economies remain an issue. China also poses a threat due to its high stock prices and the slowdown in output and industrial production. For the most part, Europe remains steady except for the potential exit of Greece from the euro zone.

—Bradley Graves

About the Author

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