DALLASFED Economic Update
International

New Global Events Lead to More Uncertainty

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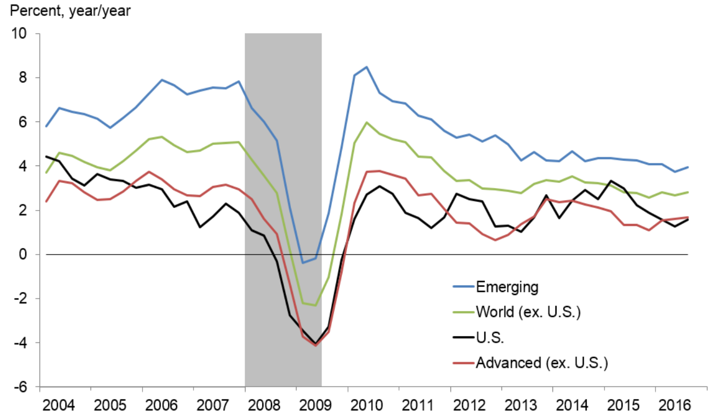
Events in the last month and a half such as the U.S. presidential election result, the rejection of the Italian referendum and India's currency reform have increased uncertainty in the global outlook. Additionally, the impact of "Brexit" still remains uncertain because final separation agreements between the U.K. and its European trading partners have yet to be formulated. Most recent data do not yet reflect the latest global events, with the outlook for global growth (excluding the U.S.) little changed since the November Federal Open Market Committee (FOMC) meeting.[1]

Chart 1
Global Growth Remains Relatively Unchanged in Third Quarter



NOTES: Aggregated using U.S. trade weights. Shaded bar indicates global recession. Last data point is third quarter 2016.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Global Economic Outlook Remains Relatively Unchanged

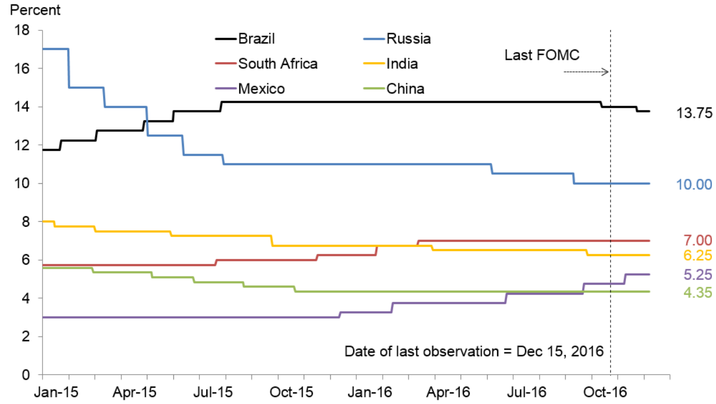
The Dallas Fed's Database of Global Economic Indicators (DGEI) global gross domestic product (GDP) growth aggregate (excluding the U.S.) shows growth at 2.8 percent year over year for the third quarter *(Chart 1)*. Most of the global GDP growth can be attributed to two emerging-market economies, China (6.7 percent) and India (7.1 percent). Since the last FOMC meeting, expectations for 2016 GDP growth were revised up for the U.K. but were offset by downward revisions to Brazil. Even with the lower expectations for Brazilian GDP growth, the country's economy is still expected to exit from recession next year.

The Dallas Fed's DGEI consumer price index (CPI) indicates year-over-year growth of 2 percent for the global aggregate (excluding the U.S.) in October. Inflationary pressures remain highest in emerging-market economies but low in advanced economies. However, inflation in advanced economies has seen a year-over-year increase in the three months ending in October, largely due to stabilization in energy prices.

Vulnerability in Emerging-Market Economies Persists

President-elect Donald Trump has talked about tax cuts and a stimulus package, and many are speculating on what this will mean for the global economy. Chart 2 shows policy rates for emerging-market economies. On Dec. 1, Brazil lowered its policy rate 25 basis points from 14 percent to 13.75 percent—the second such move in two months.

Chart 2
Policy Rates in Emerging-Market Economies Likely to be Influenced by U.S. Rates



SOURCES: Haver Analytics; Banco Central do Brasil; Central Bank of Russia; Reserve Bank of India; People's Bank of China; South African Reserve Bank; Banco de México.

The current appreciation of the U.S. dollar (USD) is another source of concern for emerging economies with extensive dollar-denominated debt, triggered by expectations of combining loose fiscal policy and tight monetary policy. The trade-weighted value of the USD, the exchange rates of foreign countries weighted using trade data, has been appreciating since Trump's victory on Nov. 8. Mexico has been the hardest hit from the dollar appreciation, which has appreciated 9.1 percent against the Mexican peso since the U.S. presidential election and 17.1 percent since the beginning of 2016 *(Chart 3)*. On Nov. 17, Banco de México raised its policy rate 50 basis points amid peso weakness.

New Risks Affecting the Global Economy

The appreciation of the USD isn't the only new risk to the global economy. On Dec. 4, Italy rejected the referendum put forward by Prime Minister Matteo Renzi, which now puts the European banking system back at the forefront of perceived global problems. The world's oldest bank, also Italy's third-largest bank, Banca Monte dei Paschi di Siena, recently had the worst assessment from the European Central Bank's stress tests due to a large portion of nonperforming loans. With the rejection of the Italian referendum, a bailout, if needed, appears less likely. As seen in Chart 4, Italy has the largest debt burden in Europe at 136 percent of GDP, excluding Greece (180 percent).

India is also adding uncertainty to global markets due to an effort to bring "black money" back into the taxable economy. India's announcement on Nov. 8 caught the world by surprise, including the people of India. The decision to do away with the 500 and 1,000 rupee notes has caused a rush to deposit household cash into banks. The deadline for conversion of these two types of banknotes to new usable notes is the end of December, which has led to long lines at banks as people try to preserve their savings. It has been estimated that the two banned banknotes account for 80 to 85 percent of the cash in circulation. With India's economy being a key driver of world growth, this can have a significant impact on markets, with potential spillover effects being felt globally.

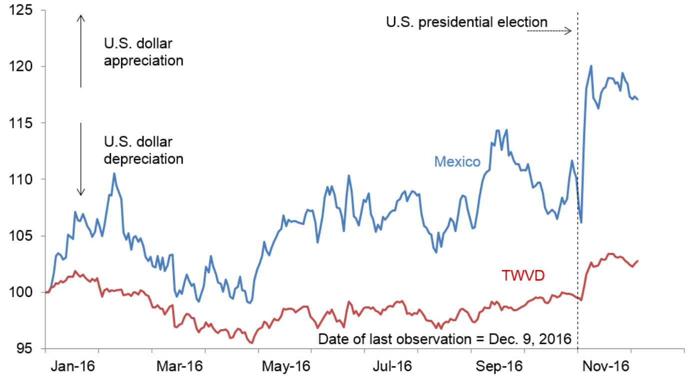
Uncertainty Likely to Linger in the Near Term

Weak economic growth keeps a lid on prices. Therefore, inflation in advanced economies, although on an upward track, is likely to remain below central bank targets. Dollar appreciation and a potentially faster pace of policy tightening in the U.S. are being viewed as downside risks to emerging-market economies with significant outstanding dollar-denominated debt.

Old risks still exist in the background such as China's high debt-to-GDP ratio and aging population in advanced economies, as new risks have emerged leading to greater uncertainty in the global economy. As we wait to see how these events play out, forecasting the future global economy remains challenging.

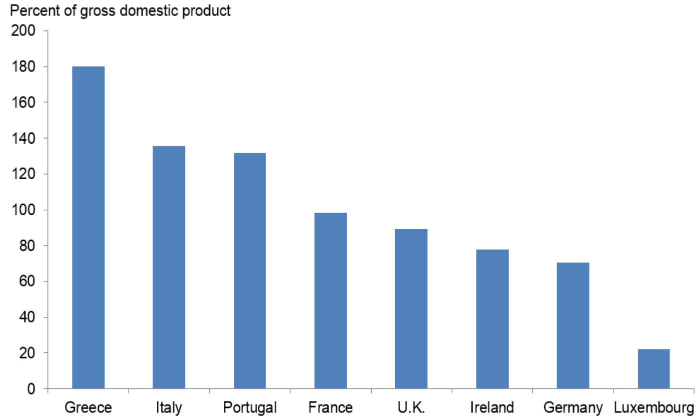
–Arthur Hinojosa

Chart 3
U.S. Presidential Election Result Drives Dollar Appreciation
Index (Jan. 4, 2016 = 100)



NOTES: The start date is Jan. 4, 2016. Currencies used are the Mexican peso and the trade-weighted value of the U.S.dollar (TWVD).
SOURCES: Haver Analytics; Federal Reserve Board.

Chart 4
Government Debt Remains an Issue in Europe
Percent of gross domestic product



NOTE: Adjusted nominal value of general government debt as a percent of GDP (end of period).
SOURCES: Haver Analytics; Bank for International Settlements.

Notes

1. Risk, Uncertainty Separately Cloud Global Growth Forecasting," by Alexander Chudik, Enrique Martínez-García and Valerie Grossman, Federal Reserve Bank of Dallas *Economic Letter*, vol. 11, no. 9, 2016.

About the Author

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