Economic Update
INTERNATIONAL
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# Downside Risks Imperil Prospective Gains from Globalization

**June 15, 2018**

Downside risks to the global economy could diminish its recent steady performance. Threats include challenges to existing trade arrangements, instability in the euro area and possible global blowback from Federal Reserve benchmark rate increases. Positives include steady growth with overall modest inflation in both advanced and emerging economies.

### Global Output Growth Little Changed in First Quarter

Global output growth expanded at a relatively modest 3.4 percent rate in the first quarter on a year-over-year basis, recently released data show (Table 1).[1] Underlying data indicate less-robust activity in advanced economies and greater activity within emerging-market economies.

Advanced economies grew 2.1 percent on a year-over-year basis in the first quarter, compared with 2.6 percent in fourth quarter 2017. Canada's growth ticked down to 2.3 percent from 2.9 percent in the fourth quarter; similarly, Japan's real output growth slowed to 1.0 percent from about 2.0 percent the previous quarter. The performance in both countries can be partially attributed to lower consumption and investment.

By comparison, emerging-market economies expanded 4.7 percent year over year in the first quarter, up from 4.3 percent in fourth quarter 2017. Expansion in Mexico was notable, reaching 2.3 percent from 1.5 percent the prior quarter. Higher energy prices and a strengthening peso contributed to the performance (*Chart 1*), though the economy is running below trend growth. China and India experienced the greatest expansion among emerging-market economies at 6.8 percent and 7.7 percent, respectively.

### Global Inflationary Pressures Relatively Unchanged

Global inflationary pressures were mixed, with little indication

## Table 1: Real GDP Growth and Headline CPI Inflation

| | GDP | | | | | CPI | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Y/Y | Q/Q | Quarter | 2018(f) | 2019(f) | Y/Y | 3M/3M | Month | 2018(f) | 2019(f) |
| United States | 2.8 | 2.2 | Q1 | -- | -- | 2.4 | 2.5 | April | -- | -- |
| **World (ex. U.S.)** | **3.4** | **3.5** | **Q1** | **3.2** | **3.1** | **2.4** | **2.0** | **April** | **2.6** | **2.5** |
| | | | | | | | | | | |
| **Advanced (ex. U.S.)** | **2.1** | **1.3** | **Q1** | **2.1** | **1.9** | **1.6** | **1.8** | **April** | **1.8** | **1.7** |
| Canada | 2.3 | 1.3 | Q1 | -- | -- | 2.2 | 2.9 | April | -- | -- |
| Euro area | 2.2 | 1.4 | Q1 | -- | -- | 1.8 | 1.5 | April | -- | -- |
| Japan | 1.0 | -0.6 | Q1 | -- | -- | 0.6 | 0.0 | April | -- | -- |
| United Kingdom | 1.2 | 0.4 | Q1 | -- | -- | 2.3 | 1.7 | April | -- | -- |
| | | | | | | | | | | |
| **Emerging** | **4.7** | **5.9** | **Q1** | **4.3** | **4.4** | **3.2** | **2.2** | **April** | **3.4** | **3.3** |
| China | 6.8 | 7.2 | Q1 | -- | -- | 1.6 | 1.0 | April | -- | -- |
| Mexico | 2.3 | 4.6 | Q1 | -- | -- | 4.5 | 2.8 | April | -- | -- |
| India | 7.7 | 10.1 | Q1 | -- | -- | 4.6 | 2.8 | April | -- | -- |
| Brazil | 1.6 | 1.8 | Q1 | -- | -- | 2.8 | 1.4 | April | -- | -- |
| Russia | 1.3 | 5.8 | Q1 | -- | -- | 2.5 | 2.3 | April | -- | -- |
| South Africa | 1.9 | 3.1 | Q4 | -- | -- | 4.4 | 2.7 | April | -- | -- |

NOTES: Calculations are based on a representative sample of 40 countries, aggregated using U.S. trade weights. Venezuela is excluded from the inflation aggregates. The euro-area aggregate includes the nine countries that are in DGEI. Y/Y contains the most recent year-over-year value, while the Q/Q field contains the most recent quarter-over-quarter annualized growth rate. 3M/3M inflation is the annualized growth of latest-month consumer price index (CPI) over CPI three months ago. (f) represents Consensus Forecasts from May 2018, aggregated using trade weights.

SOURCES: Database of Global Economic Indicators (DGEI); Haver Analytics; Consensus Forecasts.

that they are exerting notable influence on the U.S. economy. Headline consumer price index (CPI) inflation fell to 2.4 percent on a year-over-year basis in April, as seen in Table 1, from 2.6 percent in March. Core CPI inflation, which excludes energy prices, softened largely due to emerging-market currency appreciation against the U.S. dollar. Recently rising energy prices are starting to show up in some of the latest producer price index numbers and may reach consumers in the near future.

Advanced economies' headline CPI inflation stood at 1.6 percent year over year in April, with some near or slightly above their 2.0 percent targets. The U.S. was at 2.4 percent, the U.K. at 2.3 percent, Canada at 2.2 percent and the euro area at 1.8 percent. Headline inflation in Japan was just 0.6 percent. Core CPI inflation in advanced economies was little changed.

Emerging-market headline CPI inflation was 3.2 percent on a year-over-year basis in April, down from 3.5 percent in March. Mexico's headline CPI inflation has trended downward since 2017 after reaching a high of 6.8 percent. It was 4.5 percent in April.

### Uncertainty Remains in the Global Economy

Uncertainty in the global trade arena has grown. With Canada, Mexico and the European Union confronting U.S. steel and aluminum tariff imposition, there may be an extended period of ambiguity.

The formation of a populist government in Italy provided a new reminder of the euro area's vulnerabilities, increasing yields on government notes in the periphery. Although spreads have increased, they remain narrow relative to where they stood during the euro-area debt crisis in 2012 and during the most recent episode in Greece in 2015.

Outstanding sovereign debt in Italy is relatively high—at 132 percent of gross domestic product (GDP)—when compared with other euro-area countries (*Chart 2*). The problems associated with high debt-to-GDP ratios are exacerbated by elevated yields because of costlier repayment requirements. The spread on Italy's 10-year note against the German bund increased by about 100 basis points (100 basis points equals 1 percentage point). The spread subsequently narrowed. The average maturity of Italy's debt is about eight years; 13 percent of obligations are short term, maturing within a year.

Italy's per capita growth rate is roughly where it was in 1999 and 8.3 percent below its pre-global-recession peak (*Chart 3*). The rate has been stagnant since the 2012 euro-area debt crisis. Such slow growth complicates efforts to reduce the high debt-to-GDP ratio. Moreover, Italy's banks hold the majority of the nation's debt.

Italy's banking sector itself faces difficulties. It classifies 12 percent of private sector loans as nonperforming. Meanwhile, the national economy was buffeted after the incoming government gave confusing signals regarding the euro.

For emerging nations, outflows of capital are a risk associated with the Federal Reserve continuing to normalize rates. As the interest rates on U.S. Treasuries become more appealing, the need to chase returns and take additional risk in emerging economies is diminished.

—Arthur Hinojosa

### About the Author

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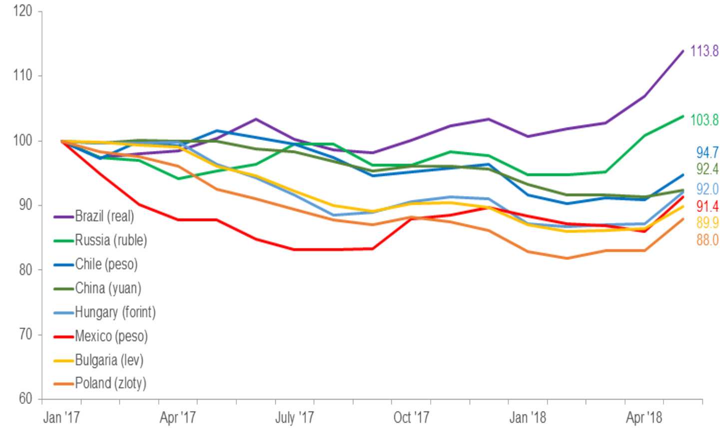
### Note

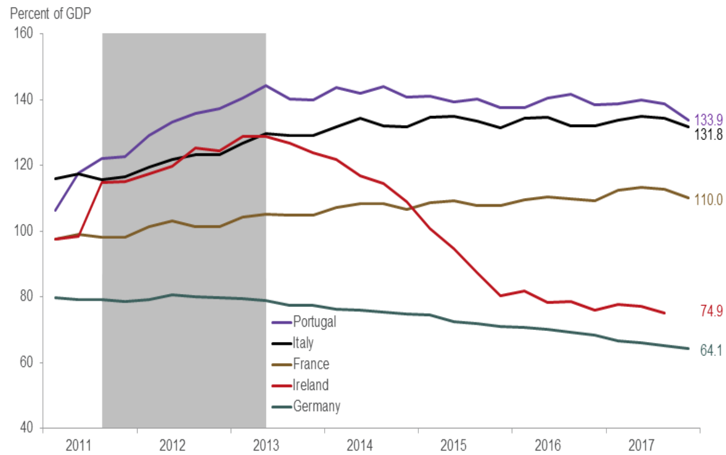
1. Global economy calculations exclude the U.S. and Venezuela unless otherwise noted. Advanced economy calculations exclude the U.S.

**Chart 1**
**Emerging-Market Economies' Currencies Strengthening Against Dollar**



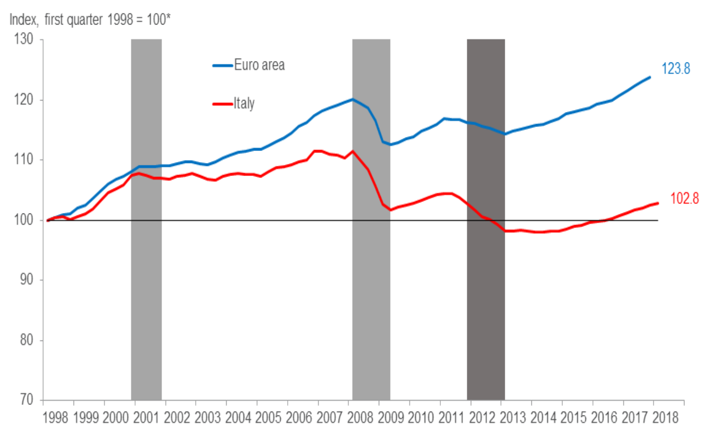

NOTES: The last data point is May 2018. Foreign exchange rates are local currency over the U.S. dollar.
SOURCES: Federal Reserve Board; International Monetary Fund; Haver Analytics.

**Chart 2**
**Italy Debt-to-GDP Ratio High Relative to Other Euro-Area Countries**




NOTES: The shaded area indicates sovereign debt crisis (2011–13). The last data point is fourth quarter 2017, except for Ireland, which is third quarter 2017.
SOURCES: Organization for Economic Cooperation and Development; Center for Economic and Policy Research; Haver Analytics; author's calculations.

**Chart 3**
**Italy GDP Per Capita Is Equivalent to Its 1999 Level**




*Indexed to peak in the euro area.
NOTES: The lighter shaded area indicates global recession. The darker shaded area indicates sovereign debt crisis (2011–13). The last data point for euro-area GDP per capita is fourth quarter 2017. The last data point for Italy's GDP per capita is first quarter 2018.
SOURCES: National Institute of Statistics (Italy); Eurostat; Haver Analytics; authors' calculations.