Economic Update
INTERNATIONAL
Federal Reserve Bank of Dallas

Global Growth Continues but with Higher Uncertainty

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First-quarter GDP growth has been disappointing in a number of economies, and growth appears to be less synchronous than anticipated earlier in the year. Higher uncertainty is arising from trade frictions and downside risks in emerging markets caused by monetary policy divergence.

GDP Forecast Unchanged but Risks to Outlook Increase

World (excluding U.S.) real gross domestic product (GDP) growth was 3.4 percent in the first quarter of 2018. The Dallas Fed's database of global economic indicators forecasts 2018 world real GDP growth at 3.1 percent, 10 basis points lower than the May forecast (*Table 1*). Advanced economies (excluding U.S.) are expected to grow 2 percent, while emerging countries are expected to expand 4.3 percent.

The International Monetary Fund's World Economic Outlook did not adjust the 2018 or 2019 global real GDP forecast in its July update; however, it stated that growth had become more uneven and downside risks had increased since the April release.[1]

First-Quarter GDP Growth Disappointing

First-quarter real-activity growth numbers were disappointing in some economies, driving downward revisions to the global outlook over the course of the year. Growth appears to be less synchronous than anticipated at the beginning of the year. Manufacturing purchasing managers' indexes (PMIs), which are survey-based monthly indicators of global economic activity, have been trending down but remain in expansionary territory. The 2019 projection for world GDP growth is unchanged at 3.0 percent from May.

Euro-area GDP growth slowed from an annual rate of 2.8 percent in the fourth quarter to 1.4 percent in the first quarter. Growth prospects for 2018 have been revised down 20 basis points; however, the 2019 forecast was revised up 30 basis

Table 1: Real GDP Growth

	Observed			2018 Consensus Forecasts		
	Y/Y	Q/Q	Quarter	Latest		Since last year
United States	2.8	4.1	Q2	--	--	--
World (ex. U.S.)	**3.4**	**3.5**	**Q1**	**3.1**	**Jul**	**0.1**
Advanced (ex. U.S.)	**2.2**	**1.4**	**Q1**	**2.0**	**Jul**	**0.2**
Canada	2.3	1.3	Q1	--	--	--
Euro area	2.2	1.4	Q1	--	--	--
Japan	1.1	-0.6	Q1	--	--	--
United Kingdom	1.2	0.9	Q1	--	--	--
Emerging	**4.6**	**5.8**	**Q1**	**4.3**	**Jul**	**0.1**
China	6.7	6.4	Q2	--	--	--
Mexico	2.3	4.6	Q1	--	--	--
India	7.7	10.1	Q1	--	--	--
Brazil	1.6	1.8	Q1	--	--	--
Russia	1.3	2.7	Q1	--	--	--
South Africa	1.5	-2.2	Q1	--	--	--

NOTES: Calculations are based on a representative sample of 40 countries aggregated using U.S. trade weights. Observed growth uses quarterly data, while consensus forecasts are of annual growth. Y/Y field contains the most recent year-over-year growth. Q/Q field contains the most recent quarter-over-quarter annualized growth rate. India forecasts are based on fiscal year.

SOURCES: Database of Global Economic Indicators; Haver Analytics; consensus forecasts.

points. Manufacturing new orders, which had been trending down since the beginning of the year, increased modestly in May.

In the first quarter, the Japanese economy contracted for the first time in three years. Manufacturing activity was relatively flat in April and May, and the second-quarter Tankan survey showed that business confidence among large manufacturers fell for the second consecutive quarter. Consumer confidence has also been trending down since the beginning of the year. Conversely, the unemployment rate in May declined to 2.2 percent—its lowest level since 1992—and the Bank of Japan estimates that the structural rate of unemployment in Japan is around 2.0 percent.

In the United Kingdom, real GDP grew at a 0.9 percent annual rate in the first quarter and has been steadily slowing since fourth quarter 2016. Gross fixed capital formation contracted 5.3 percent, the biggest decline since third quarter 2015.
In its July policy statement, the Bank of Canada stated that the impact of trade uncertainty on Canadian investment and exports had increased over the course of the second quarter. Nevertheless, GDP continued to expand at a 1.3 percent annual rate.

In China, GDP continued to track lower in the second quarter, growing at a 6.4 percent annual rate. Retail sales growth increased to 9.0 percent in June following May's 8.6 percent growth—the lowest level since 2003. Some slowdown had been expected as a result of a previously announced reduction in tariffs on imported cars that took effect July 1. However, even excluding sales of autos, retail sales slowed significantly between the first and second quarters. Industrial production and fixed-asset formation, which are high-frequency indicators of real activity, recovered in June. While the overall manufacturing PMI remained in expansionary territory in June at 51.5, the new-export orders component dipped into contractionary territory.

Diverging Monetary Policy

The stance of monetary policy around the world has diverged over the course of the year (*Chart 1*). The Bank of Canada began raising interest rates in mid-2017 and has made four rate increases of 25 basis points each. The latest rate increase in July was prompted by the bank's assessment that the U.S. economy was performing stronger than expected.

The European Central Bank (ECB), Bank of England and the Bank of Japan all left their policy rates unchanged. The ECB affirmed that it will scale back the monthly pace of its asset purchase program from €30 billion ($35 billion) to €15 billion ($17 billion) in September and end the program in December. The ECB also confirmed that it expects to maintain the policy rate at its current levels through summer 2019.

With inflation continuing to run above its 3.0 percent inflation target, the Bank of Mexico raised the overnight interbank funding rate 25 basis points at its June 21 meeting. The Reserve Bank of India also tightened policy by 25 basis points at its June 4–6 meeting. Headline consumer price inflation has been running at around 5.0 percent for most of 2018, while core consumer price inflation has picked up from around 5 percent at the end of 2017 to over 6.0 percent in June.

On June 24, the People's Bank of China (PBOC) announced a 50-basis-point cut in the required reserve ratio for the Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, Bank of Communications and another dozen large banks with the objective of facilitating the debt-to-equity swap program intended to help clean up China's state-owned enterprise sector. The PBOC also cut the required reserve ratio by 50 basis points for other depository institutions with the objective of increasing the supply of credit to small- and medium-sized businesses, which are the most dynamic part of the Chinese economy and have a harder time accessing bank credit. The cut will add 700 billion Renminbi in additional liquidity to the Chinese banking system.

Global Uncertainty Due to Recent Tariffs

Previously announced U.S. tariff measures took effect July 6, and a new set of proposed tariffs was announced by the U.S. administration July 11 in response to Chinese retaliation. However, there are still few signs of trade-induced weakness in the hard data. In a Dallas Fed *Economic Letter*, Michael Sposi and Kelvinder Virdi estimate the state-level impacts of all announced tariffs as of June 21 (*Map 1*).[2]

Export-heavy states, including Texas, are estimated to be more sensitive to tariff-related uncertainty. However, the predicted change in GDP remains small for all states but Washington. It is important to note that this model is long run and does not account for transition difficulties, perhaps underestimating the real impacts of tariffs.

—Daniel Crowley

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About the Author

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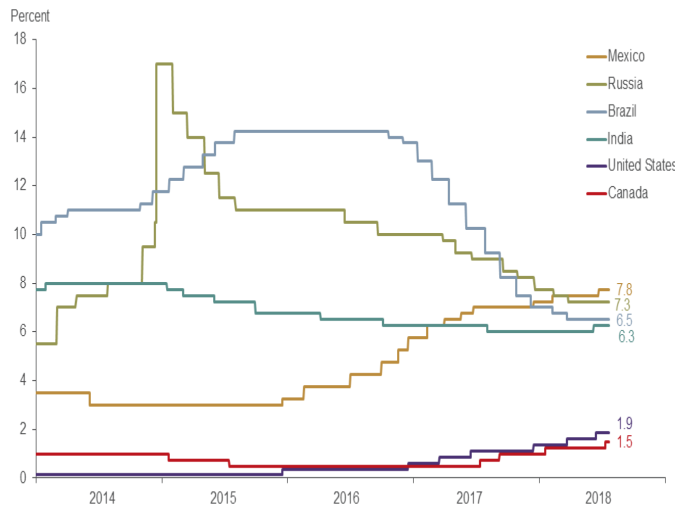
Notes

1. *World Economic Outlook Update*, International Monetary Fund, July 2018.
2. "Steeling the U.S. Economy for the Impacts of Tariffs," by Michael Sposi and Kelvinder Virdi, Federal Reserve Bank of Dallas, *Economic Letter*, vol. 13, no. 5, April 2018.

Chart 1
Global Policy Diverges



SOURCES: Haver Analytics; national sources.

Map 1
Tariffs Will Negatively Impact Growth in Most U.S. States