DALLASFED Economic Update
International

Global Growth Slows, Inflation Low as Oil Prices Decline

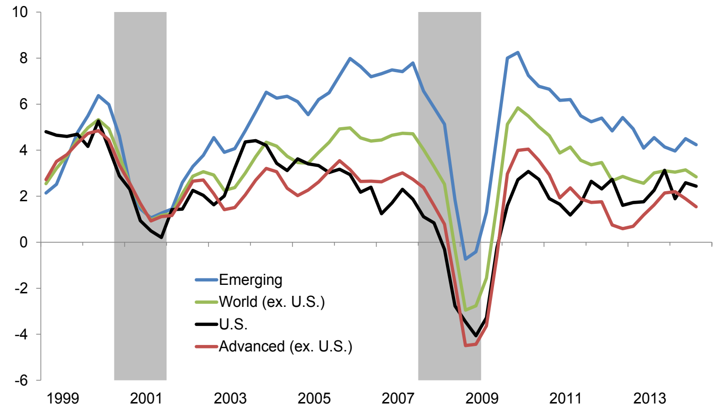
December 22, 2014

The global growth outlook has deteriorated slightly, with the performance of both advanced and emerging economies mixed. Inflationary pressures are still low due to falling energy prices as well as economic slack in many countries. Global risks include possible stagnation in the euro area and a potential slowdown in China.

World Output Growth Down

World output growth slowed to 2.8 percent year over year in the third quarter (*Chart 1*). Year-over-year growth was 1.5 percent in advanced economies and 4.2 percent in emerging economies. Among the advanced economies, Canada and the U.K. saw solid output growth of 2.8 percent on an annualized basis in the third quarter. Increases in household spending and exports were the key contributors to Canada's performance, which exceeded market expectations. In the U.K., the Bank of England is expected to start increasing policy rates in 2015 even though weakness in the euro area is dragging down demand for U.K. exports.

Chart 1
Real GDP Declines in Advanced and Emerging Economies
Percent, year/year

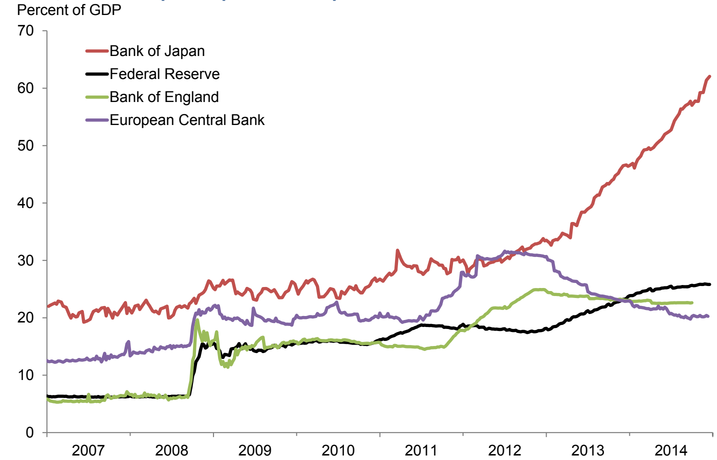


NOTES: Calculations are based on a representative sample of 40 countries; aggregated using U.S. trade weights. Shaded bars indicate global recessions.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Advanced Economy Weakness Prompts Easing

Third-quarter gross domestic product (GDP) in the euro area came in marginally better than expected at an annualized 0.6 percent, but growth in the largest euro-area economies was weak. In fact, the periphery appears to have come out a bit stronger than the core in the third quarter. Nevertheless, the euro area will likely see sluggish growth in the fourth quarter and into 2015. Prices increased only 0.3 percent year over year in November despite stimulus measures designed to boost inflation. The European Central Bank now intends to expand its balance sheet by €1 trillion to €3 trillion—from the current level of about 20 percent of euro-area GDP to about 30 percent (*Chart 2*).

Chart 2
ECB, Bank of Japan Expected to Expand Balance Sheets
Percent of GDP



SOURCES: Haver Analytics; author's calculations.

The Bank of Japan (BoJ) is also loosening its policy in an effort to increase inflation and output. On Oct. 31, the BoJ announced a new target to expand its balance sheet by 83 trillion yen per year. This increase amounts to adding about 17 percent of Japan's GDP to its balance sheet, which is already more than 60 percent of GDP. Japan's GDP contracted 1.9 percent in the third quarter on an annualized basis, substantially below market expectations of 2.2 percent growth. With the economy now in a recession, the government announced it was delaying the implementation of a second consumption-tax hike from October 2015 to April

2017. Despite the weak performance, Japan is expected to rebound in the fourth quarter.

Dollar Advances as Foreign Currencies Slide

Japan's easy monetary policy has also contributed to the recent appreciation of the U.S. dollar, which has gained more than 4.5 percent against a trade-weighted basket of currencies since the end of October (*Chart 3*). The Japanese yen, euro, Mexican peso, Canadian dollar and Russian ruble have made up more than two-thirds of the trade-weighted appreciation of the U.S. dollar since the end of August.

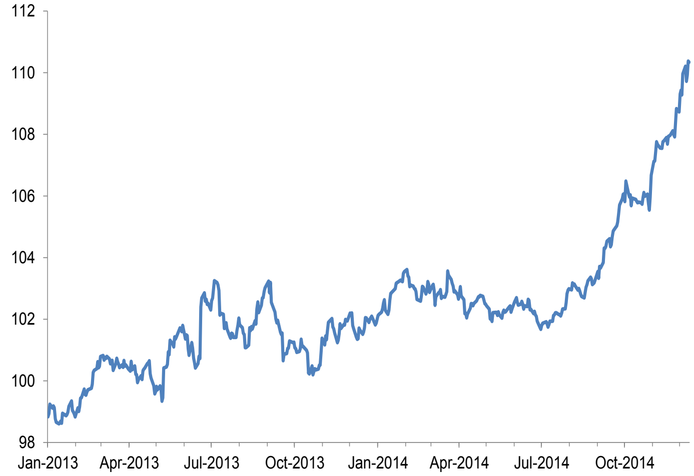
While Russia is not the largest contributor to the appreciation based on its trade weight, the U.S. dollar has appreciated the most against the ruble. On Dec. 11, the Central Bank of Russia (CBR) raised its policy rate from 9.5 to 10.5 percent to support the ruble and contain inflation. After the ruble dropped 9 percent on Dec. 15, the CBR hiked its policy rate from 10.5 percent to 17 percent in an emergency meeting. The recent tumble in oil prices has played a large part in the weakness of the Russian ruble-—as well as the Mexican peso and Canadian dollar—against the U.S. dollar.

China's Growth Slows with Housing Market

The recent state of global exchange-rate markets is putting some pressure on China as well. Continued appreciation of the dollar along with a weak yen will further appreciate the trade-weighted renminbi, which has strengthened 9.4 percent since the end of June. A surprise asymmetric policy rate cut by the People's Bank of China (PBoC) on Nov. 21 should help to ease China's currency squeeze. The PBoC cut the one-year deposit rate 25 basis points to 2.75 percent and the one-year lending rate 40 basis points to 5.6 percent. This is the first adjustment to the main policy rates since July 2012, with the cuts intended to raise inflation and output growth.

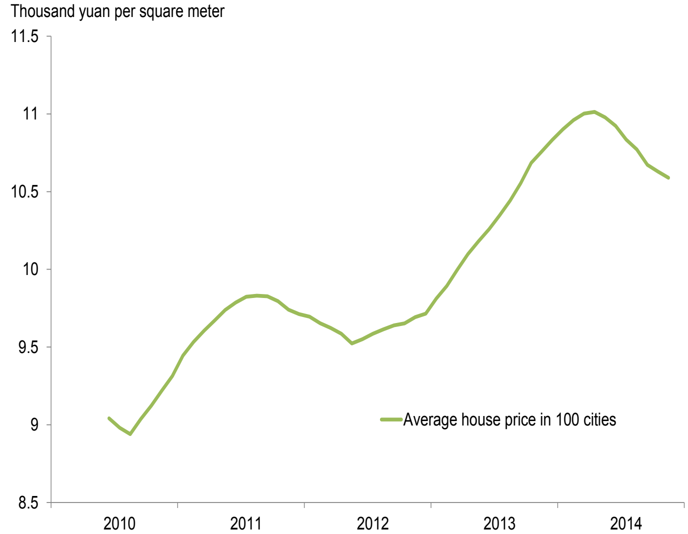
China's GDP growth slowed to 7.3 percent year over year in the third quarter, its weakest pace in over five years, but it still exceeded market expectations. The reduced third-quarter growth, along with weaker trade and industrial production numbers in November and a contracting housing market, will make reaching the government's 7.5 percent growth target for 2014 more difficult. China's house prices have been slowly decreasing since April, but risks remain for the Chinese economy if prices start to decline

Chart 3
U.S. Dollar Continues to Appreciate
Index, 1997 = 100



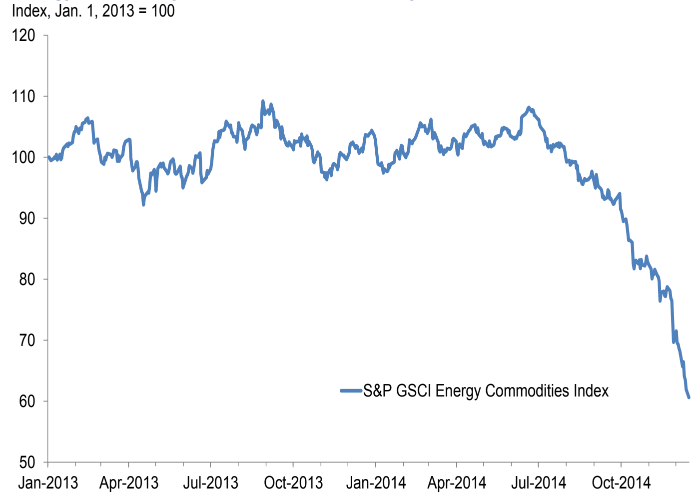
NOTE: Nominal broad trade-weighted exchange value of the U.S. dollar.
SOURCES: Haver Analytics; Federal Reserve Board.

Chart 4
Chinese House Prices Still on the Decline
Thousand yuan per square meter



SOURCE: Haver Analytics.

Chart 5
Energy Commodity Prices Down Substantially Since June Peak
Index, Jan. 1, 2013 = 100



NOTE: The index is world-production weighted and includes crude oil, Brent crude, unleaded gasoline, heating oil, gas oil and natural gas.
SOURCE: Haver Analytics.

sharply. The average house price in China dropped 1.6 percent year over year in November. The pace of the decline seems to be relatively stable, and the risk of a hard landing appears contained for now (*Chart 4*).

Low Oil Prices Have Mixed Effect

Given the slowdown in the euro area, Japan and China, the recent decline in crude oil prices could be good for global economic activity. Since its June peak, the S&P GSCI Energy Commodities Index has fallen 44 percent (*Chart 5*). The effect of a dip in oil prices will vary for individual economies. Low oil prices are beneficial for oil importers like the U.S., China and Japan. But oil-exporting countries could suffer, especially the ones that depend on oil revenues for public finance such as Venezuela, Russia and Iran.

The net impact of the fall in prices depends in part on whether supply or demand effects are stronger. Because it appears supply-side effects are currently the driving force, cheap energy prices should boost global consumption and real output. Meanwhile, decreasing oil prices will continue to pass through to low headline consumer price inflation.

—Valerie Grossman

About the Author
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