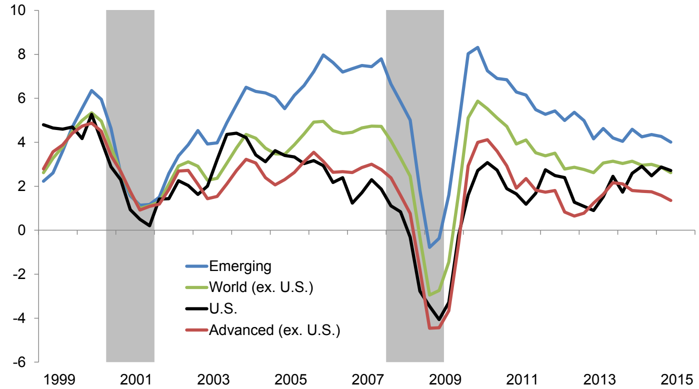
DALLASFED Economic Update
International

Global Growth Weak, Stock Markets Stabilize

October 29, 2015

The global real output growth outlook deteriorated slightly. Second-quarter gross domestic product (GDP) growth for the world (excluding U.S.) was the slowest since second quarter 2013[1]. Both advanced (excluding U.S.) and emerging market aggregates showed a further slowdown of yearly growth rates in the second quarter (*Chart 1*).

Chart 1
Real GDP Growth Slows in the Second Quarter
Percent, year/year



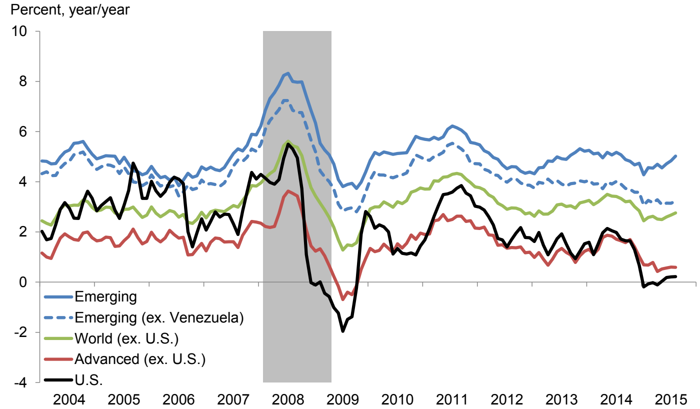
NOTES: Calculations are based on a representative sample of 40 countries. Data are aggregated using U.S. trade weights. Shaded bars indicate global recessions.
SOURCES: Database of Global Economic Indicators; Haver Analytics; author's calculations.

Economic performance has not been equal across countries. Russia, Brazil and Venezuela are in recession, while most advanced countries are experiencing low or moderate growth. Conversely, countries like China and India still exhibit relatively strong real output growth. The factors contributing to this uneven performance since the summer are low oil and other commodity prices, the slowdown in China and exchange rate developments. However, the International Monetary Fund's (IMF's) latest World Economic Outlook forecasts global growth to rise slowly through the end of 2016. Large exchange rate movements could give rise to rebalancing of global trade, leading countries whose currencies have depreciated to experience stronger export demand.

Low Inflation Persists

Headline consumer price index (CPI) inflation in the U.S. and advanced economies remains lower than the desired 2 percent target rate due to falling food and energy prices (*Chart 2*). The Bank of Japan and the European Central Bank (ECB) continue to fight low inflation and weak growth through quantitative easing. At the ECB's Oct. 22 meeting, President Mario Draghi expressed the ECB's openness to further stimulus.

Chart 2
Headline Consumer Price Index Inflation Is Uneven
Percent, year/year



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

Inflation in emerging economies remains uneven as Venezuela's inflation is expected to exceed 150 percent in 2015. Russia and Argentina are also experiencing relatively high levels of inflation; however, some emerging countries such as Poland and Thailand are facing deflation. Overall, the aggregate CPI of emerging economies, excluding Venezuela, appears to be relatively stable since the end of 2014, as seen in Chart 2.

Foreign Exchange Fluctuations Affect Foreign Reserves

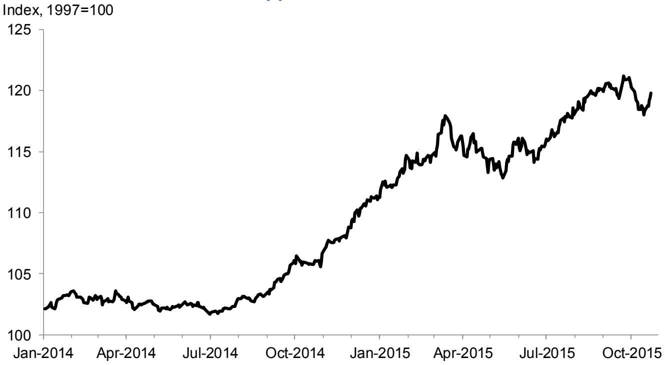
While the nominal broad U.S. dollar index has depreciated by 2.2 percent from its peak on Sept. 29, the index is still up 12.9 percent year over year in late October (*Chart 3*).

Exchange rates in emerging markets have remained fairly stable since mid-September, in part due to foreign exchange interventions. For example, China's foreign reserves have declined by an estimated $136 billion in the past two months alone. Foreign reserves of other emerging countries, including Mexico, Brazil, Venezuela and Indonesia, have declined as well over the past few months. However, the foreign exchange reserves in most emerging economies appear adequate to shield them from short-term fluctuations in capital flows.

Growth in China Continues Its Downward Trend

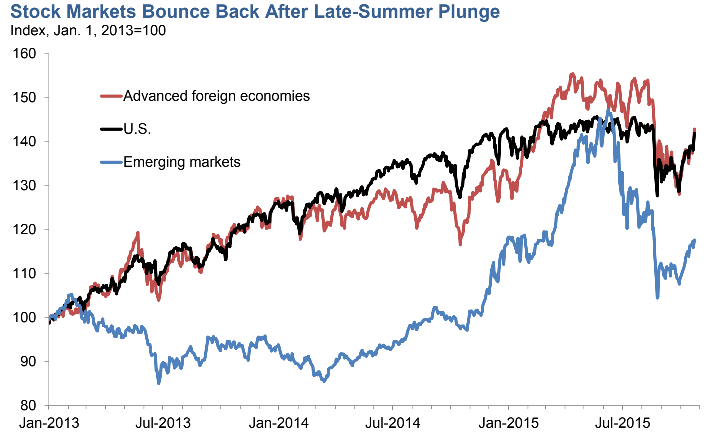
Although Chinese GDP growth has slowed, the Chinese economy still grew 6.9 percent year over year in the third quarter. Even with the slowdown, China is the largest contributor to global growth at roughly 40 percent year over year in the second quarter. Chinese economy is also important to the U.S. because China contributes about 35 percent to U.S. foreign demand growth as proxied by export-weighted GDP aggregate of foreign trading partners. The Chinese economy is expected to continue slowing, albeit gradually. The IMF's World Economic Outlook forecasts 2016 Chinese growth to reach 6.3 percent.

Chart 3
Nominal Broad Dollar Index Appreciation Slows in October



SOURCE: Haver Analytics.

Chart 4
Stock Markets Bounce Back After Late-Summer Plunge



NOTES: Advanced foreign economies include the euro area, U.K. and Japan. Emerging markets include Brazil, India, Russia, China, Mexico, Indonesia, South Africa and Turkey.
SOURCES: Haver Analytics; author's calculations.

The People's Bank of China cut its benchmark one-year lending rate to 4.35 percent and one-year deposit rate to 1.5 percent in hopes of boosting inflation and sparking growth to meet the desired 7 percent output growth target for the year.

World Stock Markets Start to Stabilize

Following the stock market turmoil in August that began in China, global stock markets are showing signs of stability (*Chart 4*).

The major stock market in China, the Shanghai Composite Index, has bounced back 16 percent from its low in August but remains 34 percent below the June high. U.S. stock market volatility measured by the VIX index has also made progress toward normal levels. Credit default swap (CDS) spreads on U.S. dollar-denominated government bonds reflect the risk of a country defaulting on its debt—the cost of insuring against government default. The CDS spreads in emerging economies remain uneven with larger spreads in Venezuela (4,375 basis points [bp]), Brazil (459 bp) and Russia (295 bp), but narrower spreads in Chile (95 bp), China (95 bp) and Poland (67 bp).

Conclusion

The global economy has somewhat deteriorated due to mediocre growth in advanced economies and uneven GDP growth among emerging economies. Downside risks such as a slowdown and potential concerns about financial stability in emerging markets outweigh upside risks such as a stronger-than-expected recovery in domestic demand for many euro-area economies.

–Arthur Hinojosa

Note

1. Unless otherwise noted, numbers for world and advanced aggregates exclude the U.S. GDP, CPI and PPI data for aggregates—world (ex. U.S.), advanced (ex. U.S.) and emerging—come from a representative sample of 40 of the largest economies, ranked by their importance as U.S. trading partners. See "A New Database of Global Economic Indicators," by Valerie Grossman, Adrienne Mack and Enrique Martínez-García, Journal of Economic and Social Measurement, vol. 39, no. 3, 2014, pp. 163–97. For the methodology used for dating global cycles, see "A Contribution to the Chronology of Turning Points in Global Economic Activity (1980–2012)," also by Grossman, Mack and Martínez-García, forthcoming in Journal of Macroeconomics. A working paper version of this article appeared as Globalization and Monetary Policy Institute Working Paper no. 169, January 2014.

About the Author

Hinojosa is a research assistant in the Globalization and Monetary Policy Institute at the Federal Reserve Bank of Dallas.