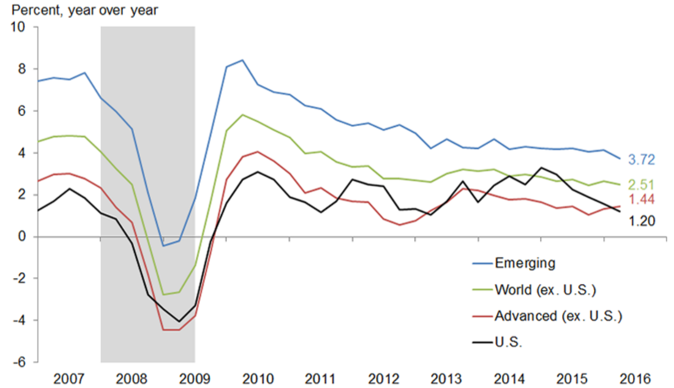
DALLASFED Economic Update
International

Global Growth and Inflation Remain Low; Initial Impact of Brexit Is Muted

September 23, 2016

The global economic outlook has changed little the past two months following Britain's June vote to withdraw from the European Union. Growth continues to be poor, with no particular country or area appearing to have the potential for robust growth *(Chart 1)*. Inflation also remains low, prompting several central banks to cut policy rates and expand quantitative easing (QE) measures.

Chart 1
Low Global GDP Growth Persists

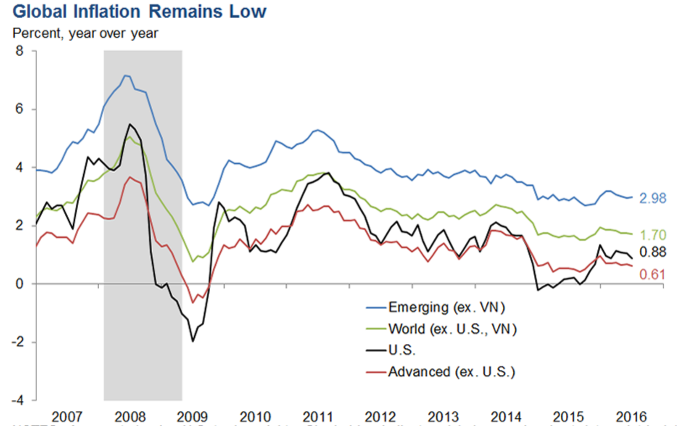


NOTES: Aggregated using U.S. trade weights. Shaded bar indicates global recession. Last data point is second quarter 2016.
SOURCES: Database of Global Economic Indicators; Haver Analytics; authors' calculations.

Inflation Remains Low

Inflationary pressures remain subdued, except for a few emerging economies that continue to face both political problems and the impact of low commodity prices *(Chart 2)*. Global trade and investment have been expanding at low rates, further dampening underlying potential growth. All major central banks continue to have highly accommodative monetary policies.

Chart 2
Global Inflation Remains Low



NOTES: Aggregated using U.S. trade weights. Shaded bar indicates global recession. Last data point is July 2016. VN stands for Venezuela.
SOURCES: Database of Global Economic Indicators; Haver Analytics; authors' calculations.

U.K. Sees Mixed Responses to Brexit

The fallout from the U.K.'s vote to leave the European Union, known as Brexit, has thus far been more muted than expected. The pound has weakened significantly, and U.K. manufacturing output has declined. However, the country's overall industrial production continues to expand, and the Bank of England took strong action in August to offset the impact of Brexit with both a rate cut and QE.[1]

With these new policies—in addition to the recovery from the initial overreaction to Brexit and several better-than-expected data releases—the British pound has recovered 2.3 percent of its value against the U.S. dollar since its post-Brexit low on Aug. 15, and the British stock market is up 12.6 percent *(Chart 3)*.

While the full effects of Brexit will take years to be realized, available third-quarter data have been mostly positive. Retail sales increased at a 4.5 percent annualized rate in July over their second-quarter average. Following positive August results in the main services, manufacturing and construction purchasing manager surveys, Credit Suisse revised its 2016 U.K. growth forecast from 1 percent to 1.9 percent and its 2017 forecast from −1 percent to 0.5 percent. Likewise, Morgan Stanley updated its 2016 forecast from 1.2 percent to 1.9 percent and its 2017 forecast from 0.5 percent to 0.6 percent. The 1.9 percent average 2016 growth rate across the two forecasts is a significant improvement over the initial estimates but is well below the 2.5 percent 2016 growth forecast released a year ago.

Many economists, including the former deputy governor of the Bank of England, Sir Charlie Bean, warn that it is still too early to say whether the U.K. economy has shrugged off its exit from the European Union. Further market turmoil is likely during negotiations between the U.K. and EU over particulars of Brexit—and when Article 50 of the Lisbon Treaty governing member departures is invoked.

Low Commodity Prices Affect Some Emerging Economies

In addition to reduced demand from advanced economies, emerging economies are facing economic issues from low commodity prices and political challenges.

Brazil, the world's seventh-largest economy, has been hit especially hard by both of these factors, with a 3.8 percent drop in year-over-year growth in the second quarter—its ninth consecutive quarter of decline. This was only a minor improvement over its 5.4 percent year-over-year contraction in the first quarter. In what might be a turning point for Brazil, former President Dilma Rousseff was officially voted out of office by the senate on Aug. 31. The acting president since May, Michel Temer, said in his first address as president that he will focus on reducing the deficit and restoring the economy's health.

Advanced-Economy Central Banks Still Accommodative

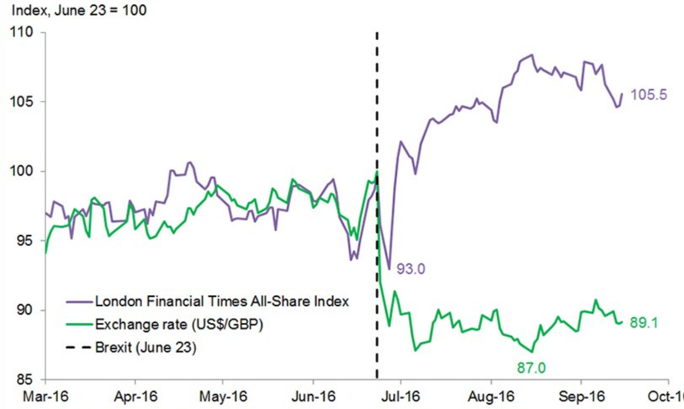
Monetary policies across most advanced economies remain accommodative *(Chart 4)*. A recent major change was the Bank of England's decision to lower its policy rate by a quarter percentage point and authorize QE of up to £60 billion in gilts, or government bonds, and £10 billion in corporate bonds at its August meeting. The Bank of England will begin its corporate bond purchase program on Sept. 27 and will continue buying for an initial period of 18 months.

Among other policy actions, the Bank of Japan expanded its exchange-traded fund-buying program by $26 billion a year and doubled its dollar lending program to $24 billion at its July 28 meeting. During the European Central Bank (ECB) meeting Sept. 7, President Mario Draghi declined to extend the bank's €80 billion monthly asset-purchase program beyond its current end date of March 2017. Also, the Reserve Bank of Australia lowered its cash rate by 25 basis points to 1.50 percent on Aug. 2.

Given the low levels of inflation for most major economies, weak global demand, low investment and low commodity prices, it is likely that global monetary policy will remain accommodative in the near term.

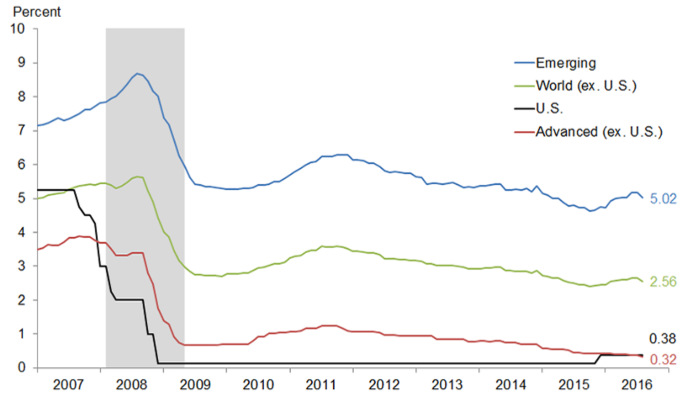
–Everett Grant and Kelvin Virdi

Chart 3
London Stock Market Bounces Back from Initial Brexit Decline



NOTE: Post-Brexit lows and most recent observations are labeled.
SOURCES: *Financial Times*; Bank of England; Haver Analytics.

Chart 4
Central Bank Policy Rates Remain Accommodative



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

About the Authors

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Note

1. The U.K.'s index of production measures the volume of production for the manufacturing, mining, energy supply, water management and waste management industries.