Global growth outlook positive despite softer data in US and Europe

Highlights

- The global economy remains in decent shape, but recent data suggests that growth in both the US and Europe has moderated from earlier highs.
- The combination of still-strong growth and rising inflationary pressures should encourage the Fed to continue the normalization of monetary policy, though it left interest rates on hold in May.
- In a surprise move, the Japanese central bank abandoned its 2% inflation target date of 2020 in a sign that it expects the battle to boost prices to be a long one.

The global economy remains in decent shape, but recent data suggests that growth in both the US and Europe has moderated from earlier highs. An easing in US-China trade tensions helped major equity markets stabilize and recover in April after sharp falls in February and March, though the stances of both sides appear to have hardened since. Recent turmoil in Argentina has raised concerns about vulnerabilities in emerging markets amid tighter monetary policy and a strong US dollar, though many seem better placed to weather shocks than in previous decades.

In the US, the flow of recent economic data has remained positive, but generally points to an easing in activity from the very robust levels of late last year. GDP growth in 1Q18 slipped to an annualized pace of 2.3% in 1Q18 from 2.9% in 4Q17 – largely due weaker growth of 1.1% in the consumer sector versus Q4’s breakneck 4.0%. (Chart 1.) But the dip may have been affected by seasonal factors, and expectations remain that growth will recover in 2Q18 against a backdrop of a tight labor market and as the impact of recent tax cuts begins to be felt more fully.

Survey evidence meanwhile suggests that business activity may have peaked, with the ISM manufacturing and non-manufacturing headline indices pulling back to a still-solid 57 in April from around 60 in February. The surveys reveal increasing pressure on capacity and that businesses are becoming more concerned about the impact of recent tariffs on activity and costs.

There are also indications that amid strong growth and capacity concerns, inflationary pressures are gradually building. Core personal consumption expenditures ("PCE") price inflation – the most closely watched inflation measure – jumped to 1.9% y/y in March from 1.6% in February and just short of the Federal Reserve’s 2% target. (Chart 2.) For now, wage growth remains subdued. But with job growth still strong (non-farm payrolls rose 200,000 per month on average in January-April) and unemployment falling to a 17-year low of 3.9% in April, expectations are that it will pick up this year.
The combination of still-strong growth and rising inflationary pressures should encourage the Fed to continue the normalization of monetary policy, though it left interest rates on hold at 1.50-1.75% at its May meeting. While analysts are divided over whether there will be two or three or further rate hikes this year (the next probably in June), the Fed’s latest statement downplayed the recent slowdown in activity, supporting the more hawkish interest rate outlook. The bullish climate helped push the yield on US 10-year treasuries – a key global benchmark bond – briefly above 3% in late April for the first time since 2014. (Chart 3.)

There is mounting evidence that growth in the Eurozone – while still decent – is losing momentum after outperforming last year. GDP rose by a disappointing 0.4% q/q in 1Q18 versus 0.7% in 4Q17, with the annual rate dipping to 2.5% from 2.8%. (Chart 4.) Some of the slowdown may be linked to temporary factors including strikes and poor weather, but soft April PMIs suggest that weakness continued into Q2. The strong euro (still up 9% y/y versus the US dollar in early May) and global trade tensions may be exerting a drag on the region’s key export sector.

In a surprise move, the Japanese central bank abandoned its 2% inflation target date of 2020 in a sign that it expects the battle to boost prices to be a long one. The central bank had already pushed back its 2% target date six times since 2013, and the repeated shifts were impacting its credibility and market expectations for additional stimulus. Inflation slowed to just 1.1% y/y in March. Although the economic recovery remains broadly on track, GDP growth may have stumbled to near-zero in 1Q18, dragged down by weaker exports and temporary factors. Growth is expected to pick up in 2Q18 and reach around 1% in 2018.

April saw Brent crude oil prices post a second successive month of gains, rising 7% to a near three-and-a-half year high of $75/bbl. (Chart 5.) Prices continue to benefit from tighter market fundamentals, linked to a combination of buoyant global oil demand and supply cuts from OPEC and its Russian-led partners. But geopolitics have also played a role, including the news that President Trump will withdraw the US from the Iran nuclear agreement in May and ‘snap back’ energy sanctions, which could lead to the loss of up to 500 kb/d of
Iranian exports. Meanwhile, US production continues to surge to new highs (10.6 mb/d in April) and poses the most serious challenge to OPEC’s production cut efforts.

**Chart 5: Brent crude oil price**

Source: Thomson Reuters Datastream

**Rise in oil prices boosts growth prospects in the GCC**

The rise in oil prices has underpinned improving economic prospects in the Gulf. In its latest report on the MENA region, the IMF revised up its forecast for GCC non-oil growth in 2018 to 2.7% from 2.4% last October, citing the easing pace of fiscal consolidation as the main reason for the upgrade. However, recent data suggest the pace of improvement is uneven across the region. The April PMI index in the UAE, for example, rose to a solid 55.1 from 54.8 in March helped by gains in the travel & tourism and export sectors. But in Saudi Arabia the index hit an historic low of 51.4 – close to the 50 ‘no change’ level – on still subdued domestic and foreign demand.