Frigid Growth: Global Growth Slowing More than Forecast

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Growth is slowing everywhere!

In my December 2014 article I wrote that the IMF over-estimated global economic growth and needed to revise their estimate downward. They did revise their global growth projection downward by 0.3% to 3.5% in January 2015. Unfortunately the batch of high frequency economic data released during Q1 2015 was disappointing, especially about growth in the US economy, which had been a key pillar upon which the IMF constructed their optimistic forecast for 2015. They had forecast that US GDP would grow 3.4% Q4 over Q4 in 2015, which now seems impossible to attain. Once again the IMF needs to lower their global growth forecast.

Cold blast from the past for the US economy?

Frigid Arctic air gripped most of the US at the start of 2014 with ice storms and snowstorms causing massive traffic disruptions and many missed workdays. As a result, US GDP growth dropped by 2.1% in Q1 2014. The US economy did rebound in Q2 and Q3, growing 4.6%, and 5%, respectively, and it prompted many professionals to predict continued rapid growth in 2015. Growth however slipped in Q4 to 2.2% and has started 2015 off in even slower fashion.

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1 CAMRI Research Digest, Issue 19, December 2014
“Year-end Look Ahead and Backward"
In spite of the rapid rebound in growth in the second and third quarters of 2014, GDP growth averaged only 2.4%, no better than the pre-crisis average over the previous 5 years.

2015 is starting the same dismal way

Growth in Q1 2015 will probably be less than 1.5%. Here is why.

- Manufacturing activity has slumped causing significant pain for the business sector. The regional economic production indexes have stalled. All of the indexes, including the national ISM index, have been declining (Philadelphia, Empire State) and some precipitously (Dallas, Richmond, and Kansas City). Actual industrial production has declined 0.5% in the past 3 months. Similarly, factory orders have declined in three of the past four months.

- Weak industrial output has coincided with the significant appreciation of the dollar. The stronger dollar against virtually all important counter parties has eroded US international competitiveness. Once the effects from the drop in oil prices washes through the trade data, the appreciating dollar will begin to widen the trade deficit later this year, it will be a negative for GDP growth.

- Fiscal spending has been flat for several years due to the gridlock between political parties in Congress and the recent shift in the composition of Congress towards conservative values. As a result of the political stalemate and expected quagmire, this important sector of the economy is likely to continue to be a significant drag to overall economic growth.

- Business investment is also not accelerating. Monthly factory orders have been in decline for the past 4 months, implying that businesses are not presently addressing needs to enlarge their operations.

- Payroll gains slowed dramatically in March after months of very steady large increases. This could be monthly volatility, or the beginning of a more significant slowdown in new job creation reflecting the downbeat character of the monthly industrial data.

Consumers Stopped Spending Recently

- Personal consumption has also eroded. In the past three months real spending has increased by just 0.5%
at an annualized rate. And, monthly retail sales have decreased in each of the past three months. Since real consumption accounts for almost 70% of GDP, it indicates a massive deceleration in total economic growth.

- In contrast, personal income growth has continued to expand at a healthy pace, but if non-farm payroll growth remains below trend, then it too will slow and reduce consumption potential.
- Consumer confidence remains close to a cycle high, but it too will depend on the future of payroll growth. Continued below-trend payroll growths will likely damage confidence, and therefore, undermine spending further.
- The growth dividend from lower oil prices has not kicked in. Perhaps, because the previous rapid buildup in shale and other energy sources’ investment has been dulled by the dramatic drop in oil prices; and that this negative impact on employment has offset the positives from oil price reduction on consumption.

The other advanced economies aren't growing either

Japan and the EU have accelerated their policy support for their respective economies. However, after 6 months of aggressive QE, little actual growth has resulted. Both economies are stagnant and both are in the grip of deflation. Yes, their currencies have depreciated significantly and eventually that should improve their external trade competitiveness. Yes, too, oil prices for these oil import-dependent economic regions have fallen and improved their current account surpluses, but cheaper oil has not contributed to internal GDP growth.

What does it mean for Asian economies?

Conventional wisdom among economists, who wanted to be right about China’s economic growth, has always been to predict whatever growth the government says it wants. That wisdom may still be true in 2015, but the real economic growth rate may be far lower than the announced one, just as 5 to 10 years ago it was always greater than announced.

Recent high frequency data from China indicate that industrial production is diminishing, especially in the big iron and steel making industries as demand for infrastructure projects from local jurisdictions have plunged. No new funding from Beijing and ongoing corruption investigations have led to a significant reduction in demand and in output.
Consequently, for the rest of Asia (ex-Japan) the impetus for economic growth will not come from manufacturing and exports to send to the developed countries, or to China. Growth will have to come from internal sources and that implies significantly less growth than in the past.

Singapore is a good example of an open economy suffering from diminished demand for its exports. Industrial production growth has shrunk and Q1 2015 GDP growth is estimated to be flat, implying that the government’s growth target for this year will be very hard to achieve.

Financial markets in US reflect uncertainty and doubt

Financial markets in the US have turned flat in the past few months coincident with the ongoing stream of negative economic data. For example, the stock market has appreciated 1.6% this year, nearly all in the first few days of the year and subsequently it has declined 1.2% from its early March peak.

The Treasury yield curve has stopped flattening recently. The yield curve traditionally flattens on expectations of the Fed tightening policy by raising short-term interest rates. The curve did flatten significantly at the end of last year when market participants were universally predicting that the Fed would soon begin raising interest rates. The stability in the yield curve over the past few months reflects a shift in their expectations toward uncertainty and a postponement of the anticipated tightening. The bond market now expects only one tightening this year and that to occur in October.
Even the dollar on foreign exchange markets has begun to retreat from its rapid appreciation over the previous 6 months. Foreign exchange professionals that believed that US interest rates would rise immediately and favor the dollar have tempered their enthusiasm for the dollar as it now seems that the Fed will be much more cautious in raising its official rate this year. Consequently the dollar will probably be trendless for a while before resuming its appreciation later in the year.

**Conclusion**

All the financial markets in the US are responding to the recent weakening in high frequency economic data, and they are signaling that current and near prospective economic growth do not warrant an immediate monetary tightening, nor higher stock market valuations. Therefore, the Fed’s long signaled interest rate rise will likely be delayed, and the trajectory of their subsequent rate increases will be much shallower than originally anticipated.

The implications for the rest of the world’s developing economies, including China’s, is that there will be smaller external demands for their exports than previously thought, and that they will need more fiscal and monetary stimulus to boost internal growth.

*For more information, please contact camri@nus.edu.sg*
KEY INDICATORS TABLE (AS OF 13 APRIL 2015)

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<th>INDEX</th>
<th>LEVEL (LC)</th>
<th>%1MO (LC)</th>
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<th>%1YR (LC)</th>
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Source: Bloomberg

APPENDIX

GLOSSARY OF KEY TERMS (Source: Bloomberg, with tickers in parenthesis. In US$ where applicable)

S&P500: capitalization-weighted index of the prices of 500 US large-cap stocks (SPX)
FTSE: capitalization-weighted index of the prices of the 100 largest LSE-listed stocks (UKX)
NIKKEI: capitalization-weighted index of the largest 225 stocks of the Tokyo Stock Exchange (NKY)
HANG SENG: capitalization-weighted index of companies from the Hong Kong Stock Exchange (HSI)
STI: cap-weighted index of the top 30 companies listed on the Singapore Exchange (FSSTI)
EUR: USD/EUR exchange rate: 1 EUR = xx USD (EUR)
YEN: YEN/USD exchange rate: 1 USD = xx YEN (JPY)
CMCI: Constant Maturity Commodity Index (CMCIPI)
Oil: West Texas Intermediate prices, $ per barrel (CLK1)
3MO LIBOR: interbank lending rate for 3-month US dollar loans (US0003M)
10YR UST: 10-year US Treasury yield (IYC8 – Sovereigns)
10YR BUND: 10-year German government bond yield (IYC8 – Sovereigns)
10YR SPG: 10-year Spanish government bond yield, proxy for EU funding problems (IYC8 – Sovereigns)
10YR SGS: 10-year Singapore government bond yield (IYC8 – Sovereigns)
US ISM: US business survey of more than 300 manufacturing firms by the Institute of Supply Management that monitors employment, production inventories, new orders, etc. (NAPMPMI)
EU PMI: Purchasing Managers’ index for the 17 country EU region (PMITMEZ)
JP TANKAN: Bank of Japan business survey on the outlook of Japanese capital expenditures, employment and the overall economy, quarterly index (JNTGALLI)
CHINA IP: China’s Industrial Production index, with 1-month lag (CHVAIOY)
LC: Local Currency

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