

2. International Economic Developments

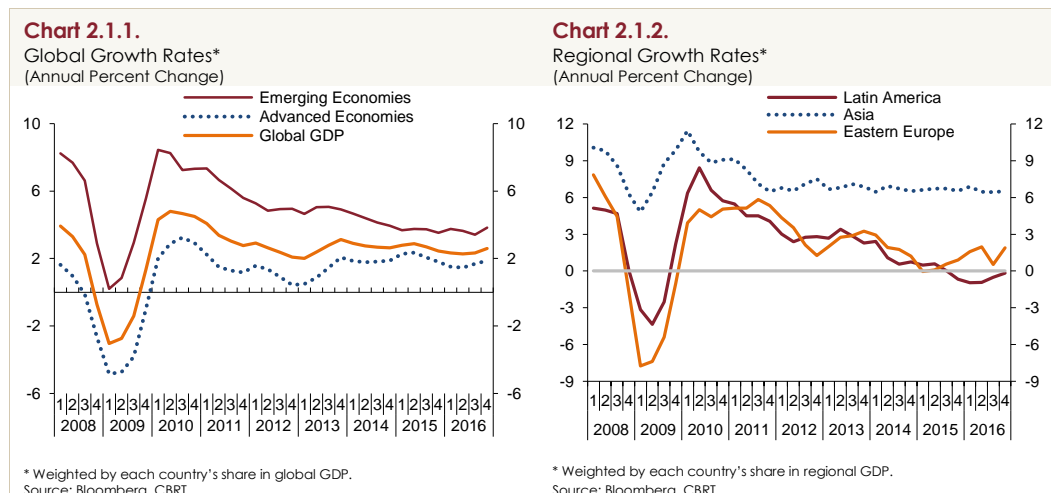
Global growth has been subdued since the global financial crisis and remained sluggish at less than 3 percent in 2016. On the other hand, upbeat consumer and real sector confidence indices and indicators pointing to improvement in economic activity, largely driven by advanced economies, suggest that global growth may see a gradual recovery in 2017. Despite the growing optimism about robust economic activity for the upcoming period, downside risks to global growth are still present due to the increased uncertainty over economic policies. The ambiguities surrounding both the UK's exit from the EU and the post-election economic policies of the US remain key factors affecting the future path of global growth.

Amid mounting prospects of a tighter post-election monetary policy from the Fed, long-term bond rates rose across advanced economies at the end of 2016, remained flat in the first quarter of 2017 and fell following the Fed's meeting in March. Accordingly, emerging economies suffered major capital outflows in the wake of the US presidential elections, but enjoyed a rebound of portfolio inflows as of early 2017 thanks to the waning uncertainty about the Fed's future monetary policy despite the ongoing tightening. In fact, the widely expected Fed rate hike spurred more portfolio flows to emerging economies in March 2017.

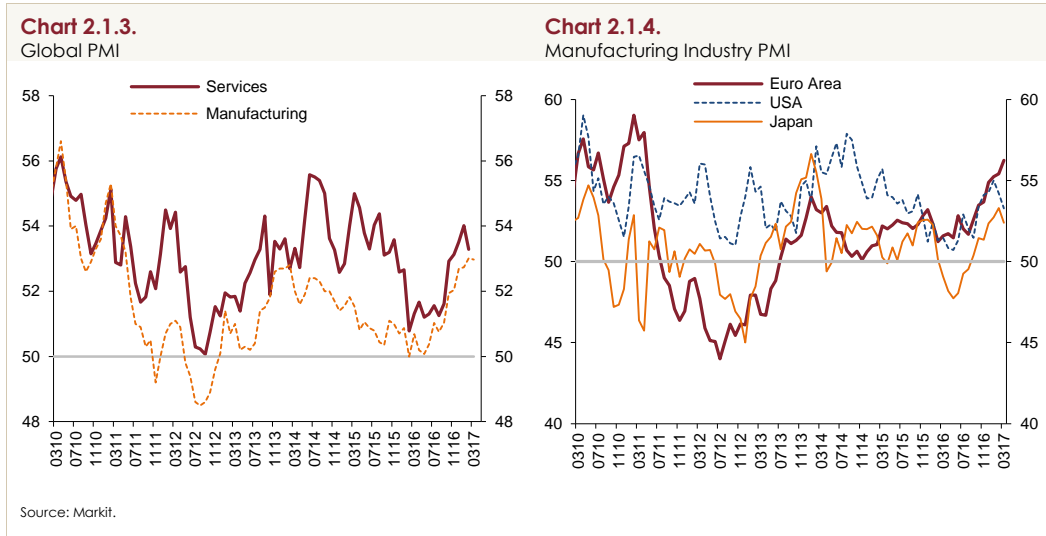
One of the engines of global growth in 2017 will possibly be the implementation of strong fiscal policies, especially in advanced economies, which will stimulate global demand. However, the increased protectionism over foreign trade may dampen global growth by limiting the positive effects of expansionary fiscal policies. In this regard, macroeconomic policies should be used jointly and effectively and be accompanied by structural reforms and suitable trade policies to help veer from the current low-growth path.

2.1. Global Growth

In the final quarter of 2016, global economic growth gained further momentum on a yearly basis amid the favorable growth performance in both advanced and emerging economies (Chart 2.1.1). In this period, annual growth accelerated in the US and Japan but hardly changed from a quarter ago in the Euro area and the UK. On the emerging economies front, the recession in Latin America has lost considerable momentum, while growth re-accelerated in Eastern Europe and turned slightly more favorable in Asia compared to the previous quarter (Chart 2.1.2).



The benign outlook of the global economic activity is expected to continue into the first quarter of 2017. In fact, the global PMI rose further in this period (Chart 2.1.3). Manufacturing PMI for the US, the Euro area and Japan signal an increasingly more promising growth across advanced economies for the first quarter, while emerging markets PMI display a similar outlook (Charts 2.1.4 and 2.1.5).



Overall, following the upturn in the fourth quarter of 2016, economic activity is likely to improve further across both advanced and emerging economies in the first quarter of 2017 and global growth is expected to post a quarter-on-quarter increase. According to April Consensus Forecasts, the end-2017 global growth forecast is 0.4 points higher than the end-2016 realization of growth at 2.5 percent. The global economy is expected to grow at an accelerated pace in 2018 as well (Table 2.1.1). Accordingly, the export-weighted global growth rate for 2017 was revised upward by April forecasts in line with the awaited improvement in global growth, which is projected to be higher compared to 2016 (Chart 2.1.6). Therefore, the external demand outlook for Turkey is likely to be brighter in 2017 than in 2016.

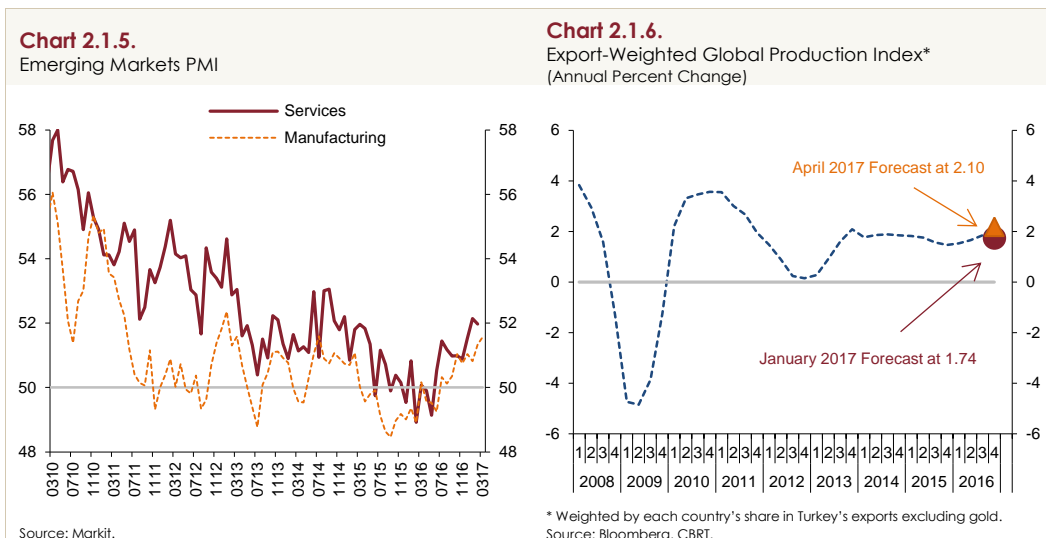


Table 2.1.1.
Growth Forecasts for end-2017 and end-2018
(Average Annual Percent Change)

	January		April	
	2017	2018	2017	2018
Global	2.8	2.9	2.9	3.0
<i>Advanced Economies</i>				
USA	2.3	2.3	2.2	2.4
Euro Area	1.4	1.5	1.7	1.5
Germany	1.3	1.5	1.5	1.6
France	1.3	1.4	1.3	1.4
Italy	0.7	0.9	0.9	0.9
Spain	2.4	2.0	2.6	2.2
Japan	1.1	0.9	1.3	1.0
UK	1.4	1.4	1.7	1.3
<i>Emerging Economies</i>				
Asia-Pacific	5.6	5.5	5.7	5.5
China	6.4	6.1	6.5	6.2
India	7.5	7.7	7.3	7.6
Latin America	1.7	2.6	1.6	2.6
Brazil	0.7	2.4	0.6	2.5
Eastern Europe	2.2	2.5	2.4	2.6
Russia	1.1	1.5	1.2	1.7

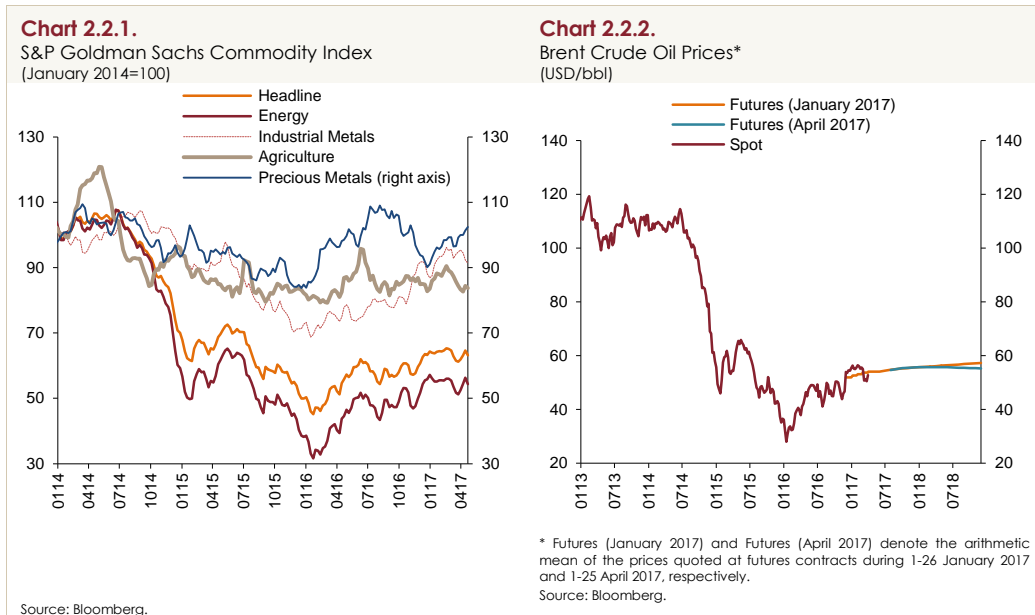
Source: Consensus Forecasts.

2.2. Commodity Prices and Global Inflation

The headline commodity index picked up after hitting an all-time low in the first quarter of 2016 and remained on the rise in the first quarter of 2017, increasing by an average of 5.1 percent from a quarter ago. In this period, industrial metals, energy and agriculture indices rose by 8.4, 4.9 and 2 percent on average, respectively, whereas precious metals remained flat (Chart 2.2.1).

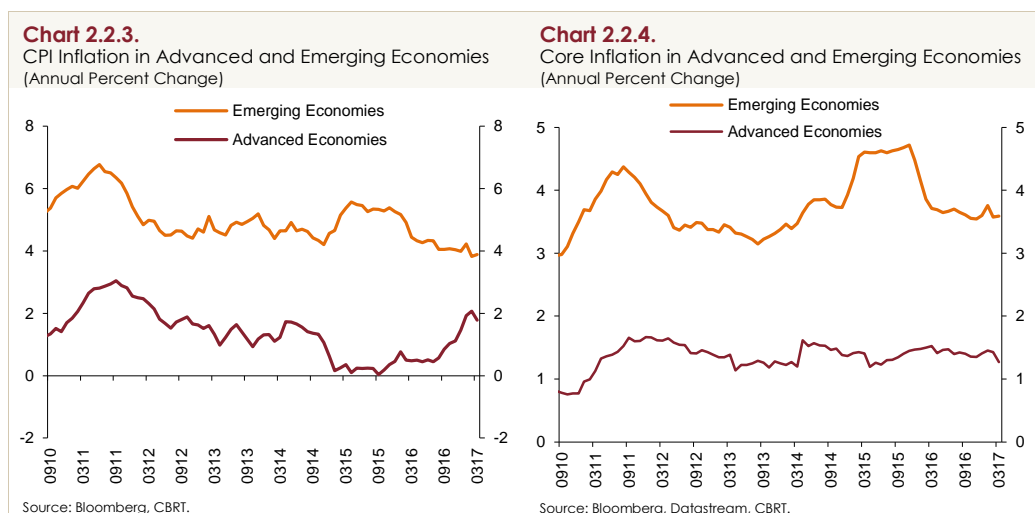
The improved global economic activity, signs of a turnaround for the Chinese economy and hopes of stronger construction demand in line with the recovering US economy were the main drivers of higher industrial metal prices. The energy index, on the other hand, barely increased from the previous quarter, largely due to the partial fulfilment of the OPEC output cut deal and the increase in US shale oil supply and inventories in the face of rising global demand. Global agricultural production proved more buoyant than anticipated in the first quarter of 2017 thanks to milder-than-expected weather, and thus, agricultural prices only inched up.

After a modest increase in early 2017, gold prices began to slide in early March due to the recovering US economy, the Fed's rate hike decision at its March meeting and the appreciating US dollar. Therefore, the precious metals index rose only slightly, by an average of 0.5 percent quarter-on-quarter in the first quarter of 2017 (Chart 2.2.1).



The December 2017 contract for Brent crude oil was traded at 51.2 USD on average as of 25 April 2017, down from an average of 57.4 USD in the previous reporting period. Implied prices for Brent crude oil futures due for delivery in December 2017 and December 2018 show a flat and converging pattern, signaling a moderate increase in oil prices for the upcoming period (Chart 2.2.2).

Against this background, inflation rates were up in advanced economies but slightly down in emerging economies in the inter-reporting period (Chart 2.2.3). On the other hand, core inflation rates fell in advanced economies but edged up in emerging economies (Chart 2.2.4). Inflation forecasts for end-2017 were revised upward for advanced economies and downward for emerging economies compared to the previous reporting period. Meanwhile, forecasts for end-2018 hardly changed from the previous reporting period (Table 2.2.1).



The higher consumer inflation rates in advanced economies were driven by the base effect stemming from record-low oil prices in January 2016. The US dollar first began to appreciate amid fiscal stimulus expectations after the US presidential election in November and later weakened slightly. The minor appreciation of the US dollar muted the fall in US inflation. Additionally, the Euro area inflation is expected to stabilize below 2 percent after the recent rise driven by energy prices, and Japan's inflation rate will possibly remain below the target over the medium term. On the other hand, the weakened and fluctuating British pound caused by the uncertainty over post-Brexit relations between the UK and the EU creates inflationary pressure in the UK. As a result, the UK's inflation rate is estimated to hover above the 2-percent target in 2018, before nearing the target afterwards. Major factors to pose upside risks to global inflation over the upcoming period are possible hikes in commodity prices, particularly for oil, and possible depreciation in emerging market currencies triggered by expectations about the Fed's monetary policy decisions.

Table 2.2.1.

Inflation Forecasts for end-2017 and end-2018
(Average Annual Percent Change)

	January		April	
	2017	2018	2017	2018
Global	3.0	2.8	3.1	2.9
<i>Advanced Economies</i>				
USA	2.4	2.3	2.5	2.3
Euro Area	1.4	1.4	1.6	1.4
Germany	1.7	1.7	1.8	1.7
France	1.2	1.4	1.3	1.4
Italy	0.9	1.1	1.3	1.3
Spain	1.6	1.4	2.2	1.5
Greece	0.7	1.1	1.0	1.0
UK	2.5	2.6	2.6	2.7
Japan	0.6	0.9	0.7	1.0
<i>Emerging Economies</i>				
Asia-Pacific	2.2	2.2	2.2	2.3
China	2.2	2.2	2.3	2.3
India	5.0	5.1	4.8	5.0
Latin America	10.9	8.2	11.2	9.5
Brazil*	4.9	4.7	4.2	4.4
Eastern Europe	5.0	4.7	5.2	4.7
Russia*	4.8	4.5	4.2	4.2

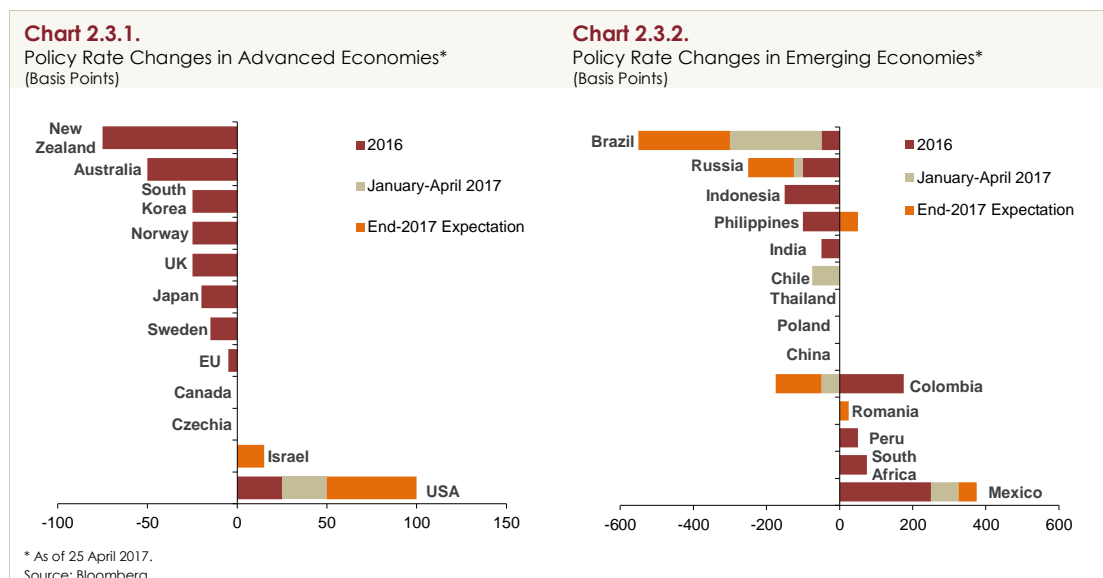
* December-on-December.
Source: Consensus Forecasts.

2.3. Global Monetary Policy

The Fed's March meeting marked the year's first rate hike and confirmed further policy normalization. The US economy shows stronger signs of recovery, while the rate of increase in the overall price level as well as the upsurge in core inflation indicators prompted this Fed decision. According to the median FOMC forecast announced in December, members expected three rate hikes for 2017. With one rate hike already delivered in the first quarter, markets now strongly believe that two more rate hikes are coming within the year. However, policy rates are quite constant across other major central banks and are expected to remain unchanged until at least the end of the year (Chart 2.3.1).

On the emerging economies front, commodity exporters diverged from others in their macroeconomic outlook and monetary policies. In view of the improving inflation outlook, the central banks of Brazil, Russia and Colombia lowered their policy rates in the January-April 2017 period. These central banks are expected to deliver further rate cuts over the remainder of the year. On the other hand, Mexico continued to be the most-affected economy by the Fed rate hike. Accordingly, the

Bank of Mexico has raised its policy rate by 75 basis points since early 2017 and is expected to hike rates by another 50 basis points for the rest of the year (Chart 2.3.2).

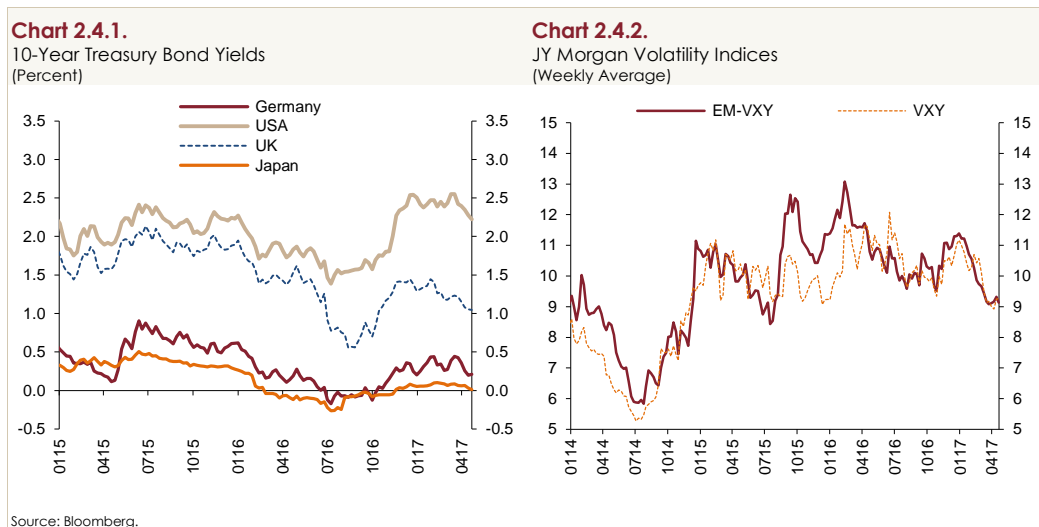


With regards to monetary policy, the highlight of the recent period has been the accelerating inflation rate, particularly across advanced economies. As stated in the previous reporting period, actual and expected inflation increased from 2016 mainly on the back of rising commodity prices. Yet, global consumer demand is also on the rise. It is too early to talk about a permanent upturn in the trend of inflation as core indicators remain flat, except in the US. On the other hand, inflation rates look more likely to stabilize around or slightly below targets in 2017. Thus, monetary policy might be relatively tighter in advanced economies over the coming years, but this tightening will be cautious and slow-paced, especially outside of the US.

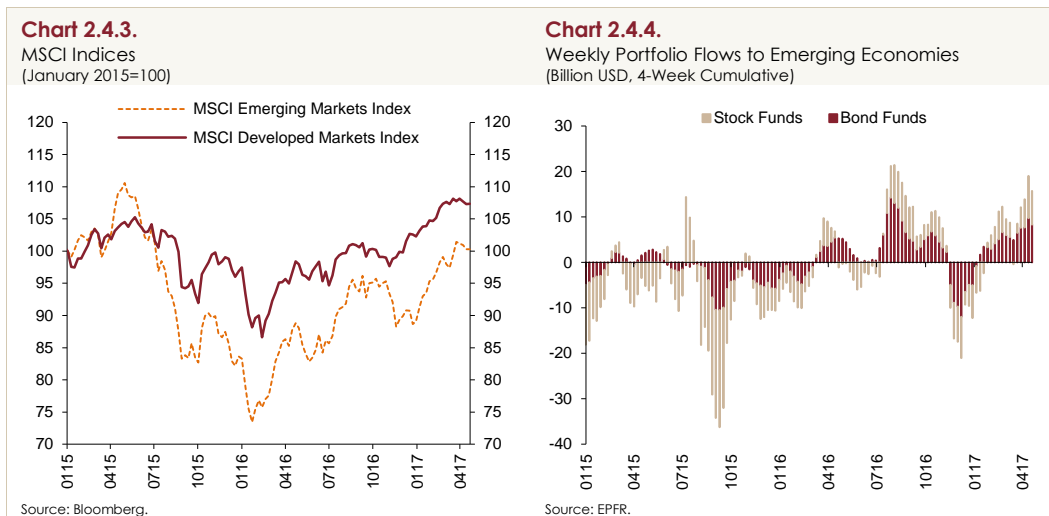
There are three key factors to consider about future monetary policy actions: First, US economic policies continue to be highly uncertain. Thus, the ambiguity over future fiscal and foreign trade policies creates a two-way risk. The second important factor is the Brexit process that started in March. In addition to the political uncertainty surrounding the EU, upcoming Brexit talks might affect economies and monetary policies of both the EU and the UK through investment decisions and exchange rate changes. Lastly, the Fed's plan to shrink its balance sheet that expanded far beyond historical levels during the bond purchase programs appears to have a major influence on the degree and pace of monetary policy in the US, and thus, across the globe.

2.4. Global Risk Indicators and Portfolio Flows

In the first quarter of 2017, global financial markets remained highly responsive to the Fed policy. In the fourth quarter of 2016, long-term interest rates jumped amid expectations of a tighter Fed monetary policy in 2017, whereas in the first quarter of 2017, the rise in long-term interest rates first flattened after the first-round effects of the US presidential election normalized, and later somewhat subsided following the March meeting (Chart 2.4.1).



The normalizing effects of the US presidential election and mounting hopes of global economic recovery brought financial market volatility down in the first quarter (Chart 2.4.2). This optimism over global financial markets sent stock indices rising in both advanced and emerging economies (Chart 2.4.3).



One of the key factors that guides portfolio flows into emerging markets is the course of the Fed's tightening policy. The growing sentiment of a more aggressive post-election tightening triggered massive portfolio outflows from emerging economies in November and December 2016. In the first quarter of 2017, thanks to widespread expectations of a more moderate Fed tightening policy and emerging economies displaying a positive growth outlook, both bond and stock markets saw renewed inflows in these economies (Chart 2.4.4). With Latin America in the lead, all regions enjoyed portfolio inflows in the first quarter (Table 2.4.1). Inflows to bond markets were led by Latin America and Europe, while inflows to stock markets were led by Asia.

Table 2.4.1.Composition and Regional Distribution of Fund Flows to Emerging Economies
(Quarterly, Billion USD)

		Total	Fund Composition		Regional Distribution			
			Bond Funds	Stock Funds	Asia	Europe	Latin America	Middle East and Africa
2015	Q1	-8.6	1.9	-10.5	-8.1	2.2	-2.4	-0.2
	Q2	-8.0	1.4	-9.4	-6.9	0.4	-2.0	0.4
	Q3	-45.3	-16.5	-28.8	-23.8	-6.5	-10.8	-4.1
	Q4	-22.3	-12.7	-9.6	-11.1	-3.0	-6.4	-1.9
2016	Q1	-4.5	-1.2	-1.6	-2.5	-1.4	-0.3	-0.3
	Q2	-1.4	7.3	-8.7	-4.5	0.7	1.9	0.6
	Q3	42.4	26.1	16.3	17.9	7.5	12.4	4.7
	Q4	-17.4	-9.3	-8.1	-12.6	-0.8	-2.7	-1.3
2017	Q1	32.7	19.9	12.8	8.2	7.7	12.4	4.3

Source: EPFR.