2. International Economic Developments

Global economic activity has continued to recover at a weaker-than-expected pace since the global crisis. Projected to be 2.5 percent by end-2016, global growth rate remains well below the pre-crisis level. Accordingly, the growth rate of global trade has also hovered at low levels. Economic activity remains subdued for emerging economies, especially for commodity exporters. Across advanced economies, economic activity has seen quite a tepid pickup. Low commodity prices and loose monetary policies continue to bolster economic activity in many economies, while the ongoing volatility in financial markets poses a downside risk to growth prospects. Additionally, the UK's end-June decision to leave the EU poses a downward risk to global growth, the EU growth in particular, over the upcoming period.

Commodity prices posted a quarter-on-quarter upsurge in the second quarter, which is mainly driven by energy prices. The energy price index jumped by about 24 percent quarter-on-quarter due to supply shocks in the crude oil market. In particular, quotes of end-2017 futures on Brent crude oil were up about 10 USD from the previous reporting period. However, the recent shale oil boom in the US and the OPEC's growing oil production may keep a lid on rising oil prices.

Global monetary policy remains accommodative to support economic activity as it has yet to follow a persistent upward track. Nevertheless, the fact that global growth is still below pre-crisis levels despite the implementation of expansionary monetary policies also affects prices. Accordingly, general price level remained flat in the second quarter across both advanced and emerging economies. Except for likely upside pressure from certain commodity prices, global inflation is expected to remain weak in the upcoming period, leaving room for further monetary easing. Yet, in order to achieve the desired rate of global growth and inflation, accommodative monetary policies should be backed with expansionary fiscal policies, which would boost public investments across industries with growth potential. In addition, these macroeconomic policies should also be supported with structural reforms, which would spur long-term productivity and provide permanent improvement in labor markets.

2.1. Global Growth

Global economic activity picked up, albeit slightly, in the first quarter, helping the global economy to grow at a faster pace than in the previous quarter. This change is largely due to the more robust growth performance in both advanced and emerging economies compared to the previous quarter (Chart 2.1.1). In this period, the US, Canada and the UK provided a positive contribution to the growth in advanced economies, while the Euro area continued to expand modestly. On the other hand, Japan's growth rate slowed quarter-on-quarter. Among emerging economies, China's growth rate recorded a quarterly drop of 0.1 point, whereas India, Mexico and Chile contributed positively to the emerging market growth. Moreover, the Russian and Brazilian recessions were less acute in the first quarter, helping to fuel the growth in emerging economies. On a more regional level, the growth rate returned to positive for Eastern Europe in the first quarter, while Latin America's recession has abated (Chart 2.1.2). The Chinese economy, which is the key engine for the emerging market growth, lost some momentum in the first quarter, yet this was mostly offset by the rapid growth in India, thereby causing the Asian growth outlook to remain barely changed.

Chart 2.1.1.
Global Growth Rates*
(Annual Percent Change)

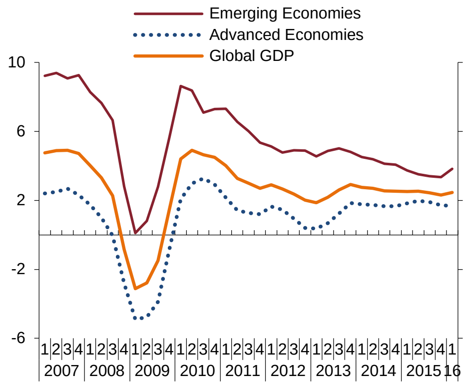
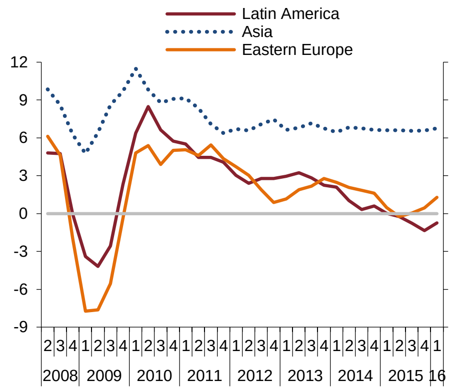


Chart 2.1.2.
Regional Growth Rates**
(Annual Percent Change)



* Weighted by each country's share in global GDP.
** Weighted by each country's share in regional GDP.
Source: Bloomberg, CBRT.

The global PMI data of the second quarter of 2016 signal a lackluster growth performance for the global economy compared to the previous quarter (Chart 2.1.3). The US manufacturing PMI posted a quarter-on-quarter fall in the second quarter. Likewise, second-quarter data on industrial production, capacity utilization and the labor market suggest that the US growth might see a quarterly slowdown, albeit at a marginal pace, in the second quarter. The Euro area manufacturing PMI hints at a slight quarter-on-quarter rebound in the Euro area growth for the second quarter, which is confirmed by the continued fall in unemployment in May. Meanwhile, Japan's sluggish manufacturing PMI indicate that the economy remained in recession during the second quarter (Chart 2.1.4).

Chart 2.1.3.
Global PMI

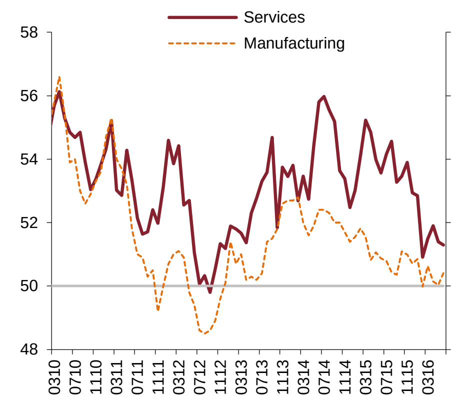
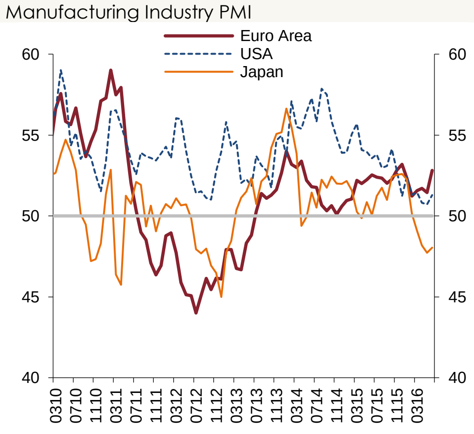


Chart 2.1.4.
Manufacturing Industry PMI



Source: Markit.

Manufacturing PMI across many emerging economies signal lower growth rates in the second quarter (Chart 2.1.5). More specifically, the manufacturing PMI for Brazil recorded a substantial fall in this period. Leading indicators suggest that the recession in Brazil continued into the second quarter, while the economic meltdown in Russia has lost considerable momentum. As for China, the manufacturing PMI followed a more favorable course in the second quarter, yet still remains below the critical 50-mark. The Chinese economy is expected to decelerate further in the second quarter amid the PMI indices as well as the slowing annual growth of industrial production, external trade volume and fixed asset investments. In short, growth prospects look gloomier for emerging economies in the second quarter than in the first quarter.

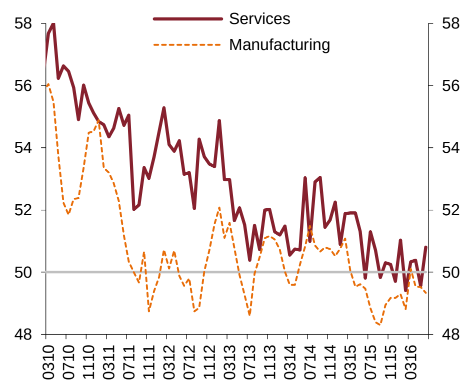
Against this background, the global economy might slow down in the second quarter due to both advanced and emerging economies and register a lower quarter-on-quarter growth. For the period ahead, the end-2016 growth forecasts of the July Consensus Forecasts hint at a dimmer outlook for advanced economies and a more upbeat outlook for emerging economies compared to the previous reporting period. On the advanced economies front, growth forecasts were revised downward for the US, Japan and especially the UK, and left unchanged for the Euro area (Table 2.1.1). Meanwhile, the global growth forecast was kept unchanged in the inter-reporting period. Accordingly, the annual growth rate of the export-weighted global production index revised by July forecasts declined from the previous reporting period (Chart 2.1.6). Thus, Turkey's external demand appears to have weakened further in the second quarter.

Table 2.1.1.
Growth Forecasts for end-2016 and end-2017
(Average Annual Percent Change)

	April		July	
	2016	2017	2016	2017
Global	2.4	2.8	2.4	2.7
Advanced Economies				
USA	2.0	2.4	1.9	2.2
Euro Area	1.5	1.6	1.5	1.3
Germany	1.6	1.5	1.6	1.3
France	1.3	1.5	1.5	1.3
Italy	1.1	1.2	0.9	0.9
Spain	2.7	2.3	2.8	2.1
Japan	0.6	0.5	0.5	0.8
UK	2.0	2.2	1.6	0.7
Emerging Economies				
Asia-Pacific	5.6	5.6	5.6	5.5
China	6.5	6.3	6.5	6.3
India	7.6	7.7	7.6	7.6
Latin America	-0.6	2.0	-0.5	2.0
Brazil	-3.8	0.6	-3.3	0.8
Eastern Europe	1.1	2.3	1.3	2.3
Russia	-1.3	1.1	-0.8	1.2

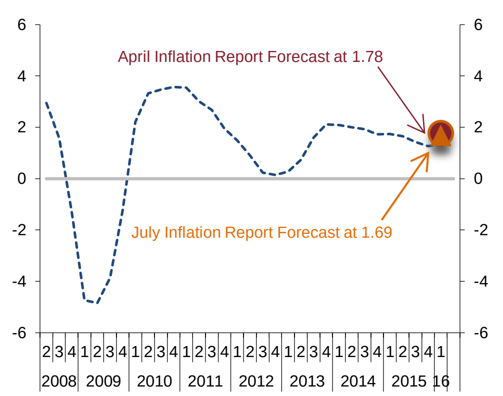
Source: Consensus Forecasts.

Chart 2.1.5.
Emerging Markets PMI



Source: Markit.

Chart 2.1.6.
Export-Weighted Global Production Index*
(Annual Percent Change)

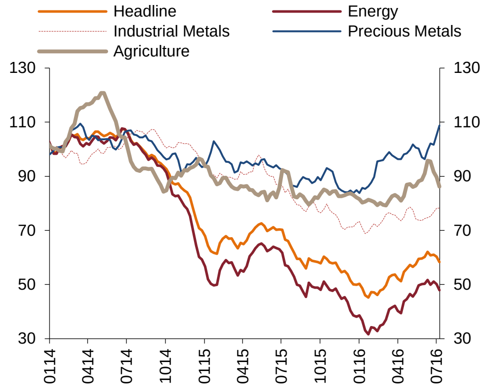


* Weighted by each country's share in Turkey's exports.
Source: Bloomberg, CBRT.

2.2. Commodity Prices and Global Inflation

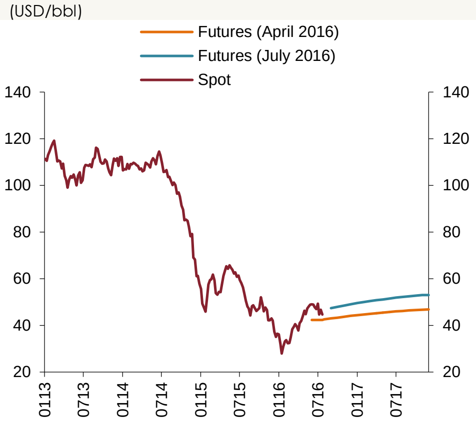
In the second quarter of 2016, the headline commodity price index soared by a marked 15.6 percent from the end of the previous quarter on account of the energy prices that rose by 23.9 percent quarter-on-quarter. Moreover, all other sub-indices saw notable increases as well. Accordingly, agriculture, industrial metals and precious metals were up 9.6, 5.6 and 8.3 percent, respectively. Energy price increases were mostly attributed to the supply shocks in the oil market, while rises in agricultural prices were driven by adverse weather conditions. Yet, with waning supply shocks, both prices lost some momentum towards the end of the quarter. In addition, China's expansionary monetary policies supported industrial metal prices in the second quarter, whereas precious metal prices surged due to the global economic slump (Chart 2.2.1).

Chart 2.2.1.
S&P Goldman Sachs Commodity Price Indices
(January 2014=100)



Source: Bloomberg.

Chart 2.2.2.
Brent Crude Oil Prices*
(USD/bbl)

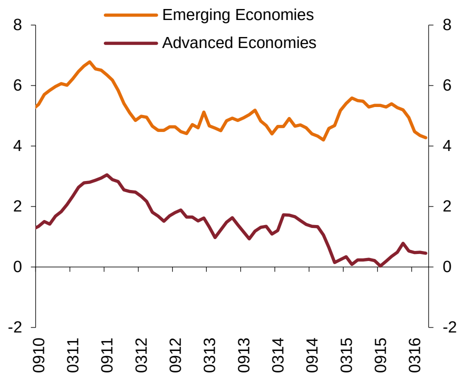


* Futures (April 2016) and Futures (July 2016) denote the arithmetic mean of the prices quoted at futures contracts during April 1-22 and July 1-21, respectively.
Source: Bloomberg.

Amid wildfires curbing Canada's oil production and the wave of attacks on Nigerian oil fields, oil prices continued to rise in the second quarter. The drop in the US crude oil production and inventories also pushed oil prices higher. On the other hand, the OPEC's continued growth in crude oil production forced Brent crude oil prices to remain below 50 USD. As a result, December 2017 contracts for Brent crude oil, which were traded at 46.9 USD on average in April, have been trading at 53 USD on average as of July 21 (Chart 2.2.2). However, the oil price upsurge might decelerate over the upcoming period as OPEC ended the June meeting with no decision on an oil production freeze and the US started to add driller rigs for shale oil amid rising oil prices.

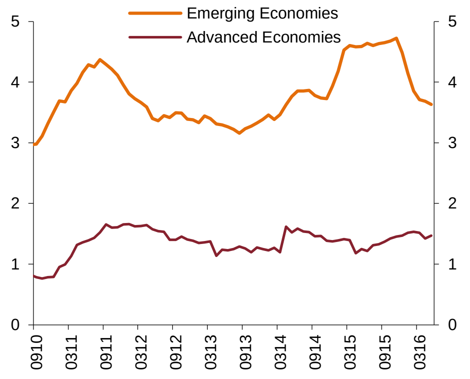
In the inter-reporting period, both headline inflation and core inflation remained basically unchanged for advanced economies, but posted a slight decrease across emerging economies. China, Russia and Turkey were the key drivers of the decline in the emerging market headline inflation, while Russia and Turkey alone accounted for most of the fall in core inflation (Charts 2.2.3 and 2.2.4). Meanwhile, except for the dramatically changed end-2017 prospects for the UK and Japan after recent developments, both end-2016 and end-2017 inflation expectations remained broadly unchanged for advanced economies. On the emerging economies front, inflation expectations were revised upwards for Latin America and downwards for Eastern Europe (Table 2.2.1).

Chart 2.2.3.
CPI Inflation in Advanced and Emerging Economies
(Annual Percent Change)



Source: Bloomberg, CBRT.

Chart 2.2.4.
Core Inflation in Advanced and Emerging Economies
(Annual Percent Change)



Source: Bloomberg, Datastream, CBRT.

Despite efforts for monetary easing, the general price level remained virtually unchanged in advanced economies on account of the weak outlook. Apart from rising prices of services, advanced economies face an imported inflation that is mostly caused by expansionary monetary policies. This imported inflation is also driven by rising commodity prices that are accommodated by the Chinese economy. Except for a few emerging economies where the weak economic outlook translates into high inflation, emerging economies that mainly grow on the back of external demand are also subject to imported inflation. Thus, the global inflation outlook will remain weak over the forthcoming period despite the presence of upside risks due to particular commodity prices.

Table 2.2.1.
Inflation Forecasts for end-2016 and end-2017
(Average Annual Percent Change)

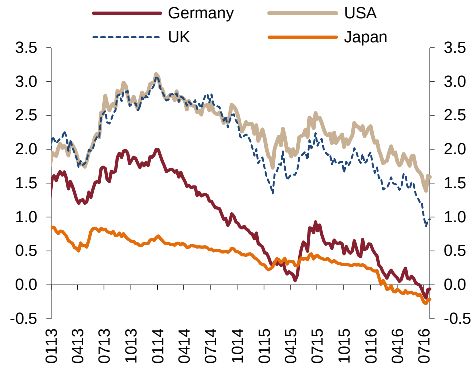
	April		July	
	2016	2017	2016	2017
Global	2.6	2.8	2.7	2.8
Advanced Economies				
USA	1.3	2.2	1.3	2.3
Euro Area	0.3	1.4	0.3	1.3
Germany	0.5	1.6	0.4	1.5
France	0.3	1.2	0.3	1.2
Italy	0.1	1.1	0	0.9
Spain	-0.2	1.3	-0.4	1.3
Greece	-0.1	1.5	-0.2	1.5
UK	0.7	1.7	0.7	2.4
Japan	0	1.6	-0.1	0.6
Emerging Economies				
Asia-Pacific	2.2	2.4	2.3	2.4
China	1.9	1.9	2.0	2
India	5.2	5.3	5.2	5.1
Latin America	13.1	8.2	15.7	9.8
Brazil*	7.1	5.6	7.2	5.4
Eastern Europe	6.0	5.1	5.5	5.0

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

2.3. Financial Conditions, Risk Indicators and Portfolio Flows

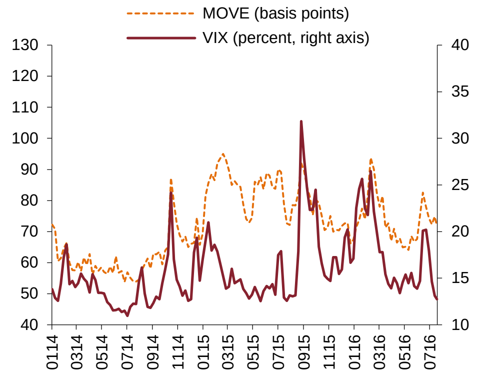
In the second quarter, long-term interest rates continued to fall across major advanced economies largely due to slowing global growth and particularly amid heightened concerns over growth in advanced economies (Chart 2.3.1). Moreover, the sustained stance of the loose monetary policy and the continued easing by major central banks also pulled long-term rates down. In this regard, the increased prospects for a policy rate reduction by the Bank of England after the Brexit referendum as well as signals by the Fed at its June meeting that it would keep rate hikes on hold for some time caused 10-year bond yields to sink in both countries.

Chart 2.3.1.
10-Year Treasury Bond Yields
(Percent)



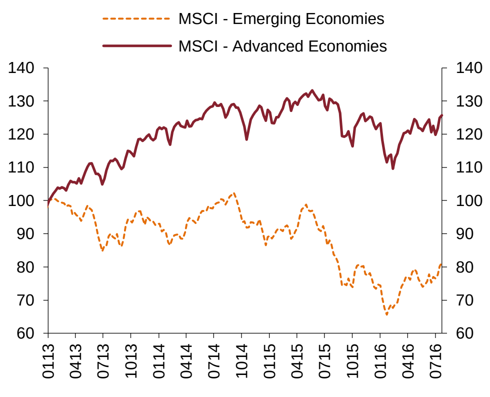
Source: Bloomberg.

Chart 2.3.2.
VIX and MOVE Volatility Indices
(Weekly Average)



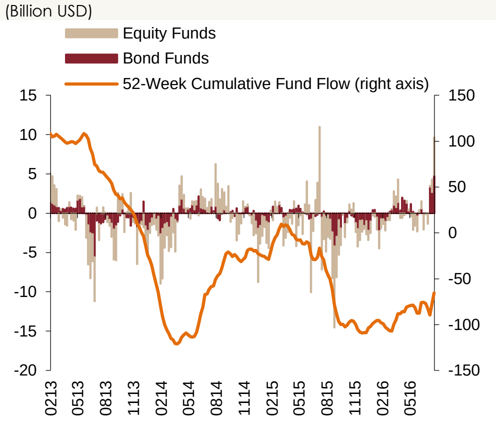
Global monetary policies remained accommodative in the second quarter despite the weakening global growth outlook. Meanwhile, the risk appetite, having remained horizontal for quite some time, deteriorated sharply ahead of the Fed's June meeting and the UK's Brexit referendum, but returned to previous levels in the following period (Chart 2.3.2). In this period, stock markets were flat across advanced economies, whereas emerging market stock indices saw a slight rebound (Chart 2.3.3). Falling short-term and long-term interest rates amid low stock prices signal gloomy market prospects for advanced economies.

Chart 2.3.3.
Exchange Rate Volatility
(January 2013=100)



Source: Bloomberg.

Chart 2.3.4.
Weekly Portfolio Flows to Emerging Economies
(Billion USD)



Source: EPFR.

Sovereign spreads in emerging markets tended to fluctuate while the global risk appetite remained flat and volatile in the second quarter (Chart 5.1.3). Equity funds experienced outflows in May and June especially in emerging economies (Chart 2.3.4). On the other hand, due to the sharp decline in bond yields across advanced economies, international portfolios have recently been flowing back into emerging market equities and bonds. However, continued concerns over the global economy and the weak course of commodity prices add to the downward pressure on emerging market portfolio flows. Still, global monetary policy is poised to remain loose after the Brexit referendum, driving portfolio flows into emerging markets.

2.4. Global Monetary Policy

In the second quarter of 2016, the global monetary policy stance was broadly unchanged quarter-on-quarter, remaining accommodative overall. The Fed kept rates intact in this period, while Reserve Bank of Australia and Bank of Korea lowered policy rates by 25 basis points (Chart 2.4.1). Across emerging economies, the Reserve Bank of India and Bank Indonesia cut their rates by 25 points, while the Hungarian National Bank and the Bank of Russia opted for reductions by 30 and 50 basis points, respectively. On the other hand, the Central Bank of Colombia and the Bank of Mexico raised their policy rates by 100 and 50 basis points, respectively (Chart 2.4.2). The Central Bank of Colombia based its rate hike decision on increasing inflationary pressures while the Bank of Mexico's motive was to hedge against global uncertainty and rising exchange rates.

Chart 2.4.1.
Policy Rate Changes in Advanced Economies between January 2014 and July 2016* (Basis Points)

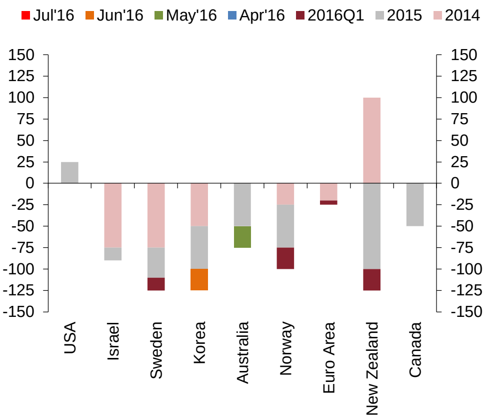
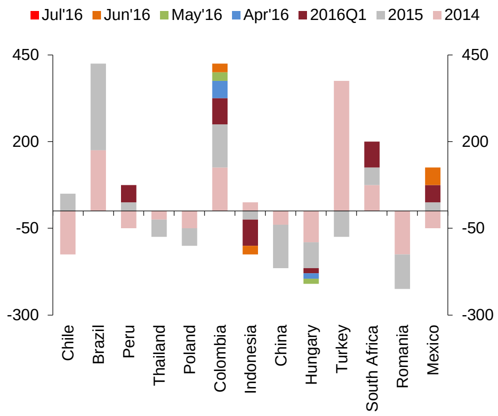


Chart 2.4.2.
Policy Rate Changes in Emerging Economies between January 2014 and July 2016* (Basis Points)



* As of July 25, 2016.
Source: Bloomberg, CBRT.

After a 25 basis points increase at end-2015, the Fed kept its policy rate unchanged in the first half of 2016. Moreover, the Fed struck a significantly more cautious tone on rate hikes. Accordingly, rates on federal funds futures were drastically down from the previous reporting period, especially across medium to long-term maturities (Chart 2.4.3). This was led by both the uncertainty surrounding the US growth and the loosening of the monetary policy by other major central banks (Chart 2.4.4). Accordingly, the ECB continued with monetary easing while the re-election of the incumbent Japanese government prompted expectations of further and stronger monetary expansion. In addition, expectations grew stronger after the Brexit referendum that the Bank of England might soon opt for an easing despite its July decision to keep rates intact. The volatile US labor data, the quarter-on-quarter slowdown in economic growth over the first quarter and mixed signals from economic indicators also urged the Fed to take a more cautious stance on rate hikes. These developments, as well as the mounting expectations for looser monetary policies across advanced economies, resulted in a marked drop in long-term interest rates in these economies (Chart 2.3.1).

Chart 2.4.3.
US Federal Funds Futures
(Percent)

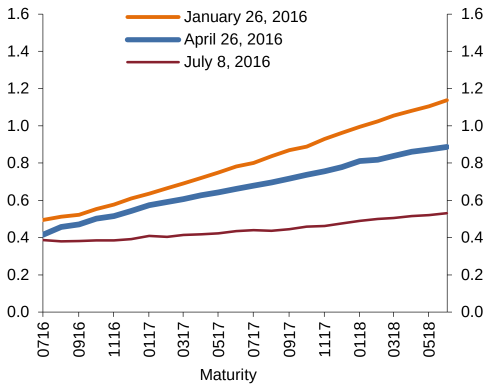
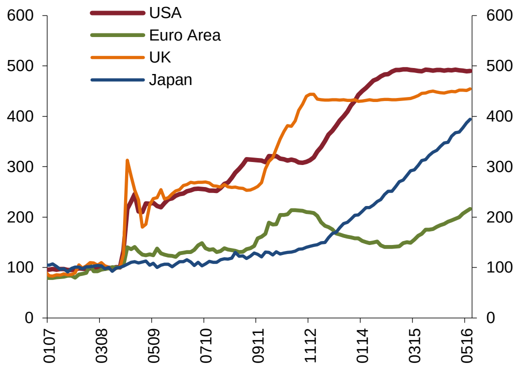


Chart 2.4.4.
Central Bank Assets
(August 2008 =100)



Source: Bloomberg.