2. International Economic Developments

The downtrend in global economic activity continued in the last quarter of 2018, and growth rates decreased compared to the previous quarter. As for advanced economies, the relatively favorable outlook in the US economy continued, while the moderation in growth rates of the euro area and Japan became more evident. On the emerging economies side, growth in China, India and Brazil slowed down. Projections for 2019 suggest that the downtrend in global economic activity will continue in the first quarter of 2019 and assume a gradually rebalancing trend afterwards. It is projected that downside risks to the global growth outlook for 2019 persist as there is limited policy room in case heightened uncertainties over global economic policies continue and the downtrend in economic activity gets deeper.

In the first quarter of 2019, headline inflation rates decreased in advanced economies whereas increased in emerging economies. Commodity prices, which decreased in the last quarter of 2018, partly rebounded in the first quarter of 2019. Risks to crude oil prices for the upcoming period are projected to be balanced. The wage growth in advanced economies due to tight labor markets poses an upside risk to core inflation. Nevertheless, further weakness in the global growth outlook may ease pressures on labor markets of advanced economies. To sum up, global inflation rates in 2019 are projected to remain flat depending on the course of moderate global growth and commodity prices.

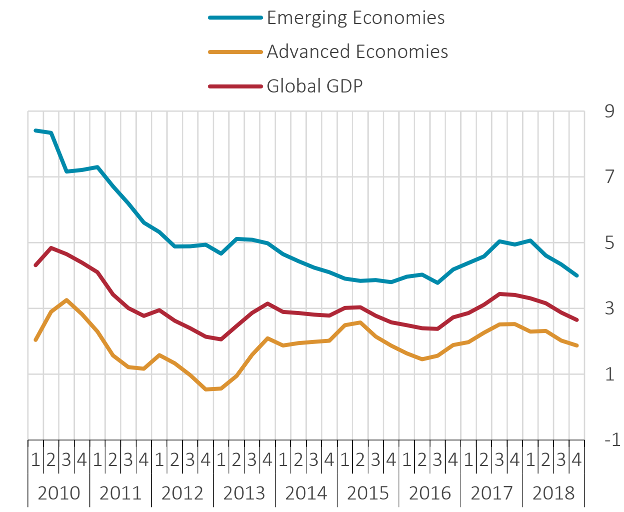
The heightened uncertainties over global economic policies, the downtrend in economic activity and inflation rates consistent with the targets urged central banks to implement more static monetary policies. Accordingly, in this period, the normalization of monetary policies in advanced economies noticeably paused. While the Fed revised its median projection of two rate hikes in 2019 to no hikes; in its forward guidance in the March meeting, the ECB postponed a possible rate hike until 2020. Apparently, the significant moderation in the tones of normalization expressions by advanced economy central banks has led to a decline in long-term bond yields.

As of end-2018, it became apparent that the normalization process in monetary policies of advanced economies would be slower and a partial improvement was observed in risk appetite which together indicate that portfolio flows to emerging economies will likely be more positive. Nevertheless, as of end-April, an optimistic outlook in pricing in emerging economies is not yet solid and portfolio outflows in the equities market were observed. Despite the long-standing quantitative easing programs in advanced economies, growth remained volatile and heightened uncertainties in global economic policies persisted; meanwhile risk factors linked to country-specific conditions in emerging economies are still in place which altogether are believed to be the reason for the mentioned weakening. Therefore, to reduce vulnerabilities, it is important that macroeconomic policies are not only implemented effectively and in a coordinated manner but also supported by structural reforms and appropriate trade policies.

2.1 Global Growth

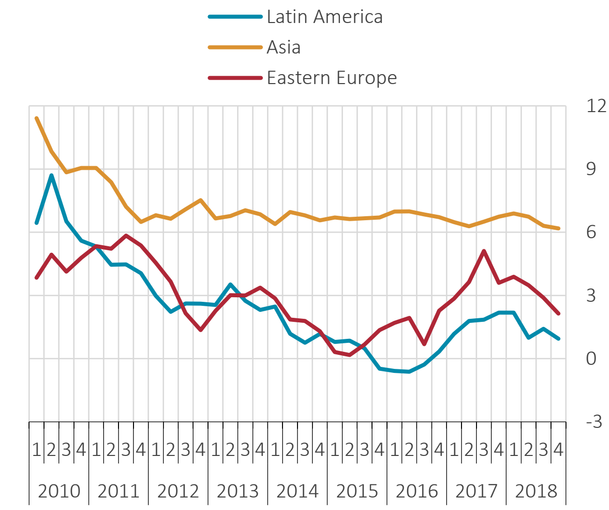
In the final quarter of 2018, the decline in global growth continued; the global growth rate posted a quarter-on-quarter drop due to the slowdown in both advanced and emerging economies. (Chart 2.1.1). In advanced economies, while growth in the euro area and Japan significantly slowed down, the US economy maintained the upbeat growth outlook. As for emerging market economies, the pace of growth in China, India and Brazil - the three countries making the biggest contribution to global growth- was down. In this quarter, growth rates of emerging market economies slowed down across all regions (Chart 2.1.2).

Chart 2.1.1: Global Growth Rates* (YoY Change)



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

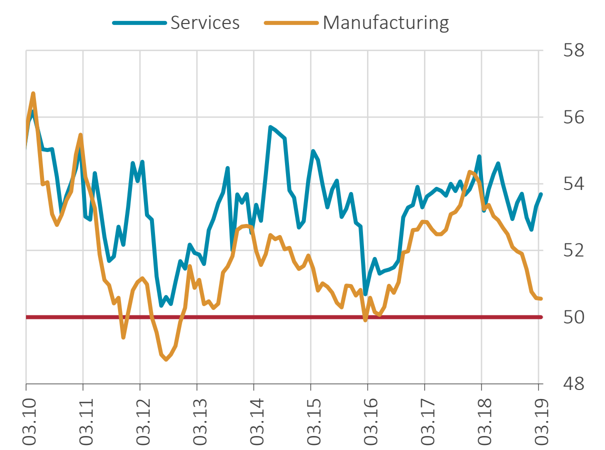
Chart 2.1.2: Regional Growth Rates for Emerging Economies* (YoY Change)



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

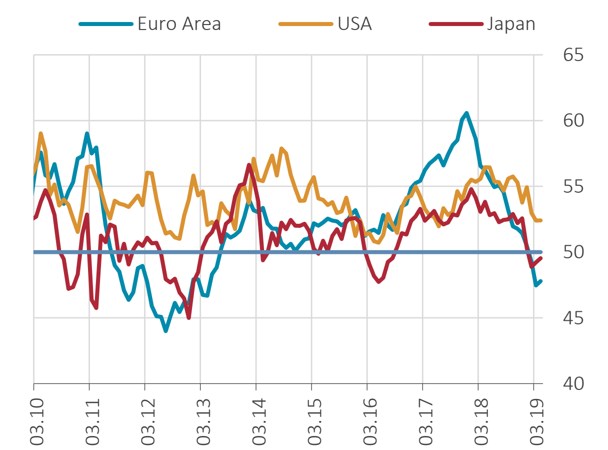
Global PMI data for the first quarter of 2019 suggest that the slowdown in global growth continues and the growth performance deteriorated compared to the previous quarter (Chart 2.1.3). In this period, manufacturing PMI for advanced economies continued to decline and manufacturing PMI for the euro area and Japan dropped below the 50 threshold level (Chart 2.1.4). This implies that the deceleration in growth rates of advanced economies continues in the first quarter and that growth rates are likely to be lower than the previous quarter. The economic slowdown driven by the uncertainties over international trade and domestic politics in the euro area are expected to persist throughout the year (Box 2.1). The annual growth in manufacturing production in Japan dropped in January and February. Therefore, the slowdown in the Japanese economy is expected to further accelerate in the first quarter and annual Japanese growth is expected to remain at a level close to zero.

Chart 2.1.3: Global PMI



Source: IHS Markit.

Chart 2.1.4: Manufacturing Industry PMI in Advanced Economies

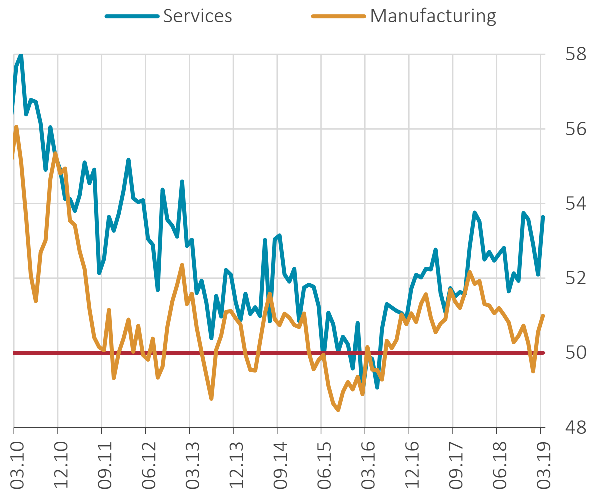


Source: IHS Markit.

Manufacturing industry PMI for emerging economies decreased quarter-on-quarter. (Chart 2.1.5). In this period, expectations for a Fed rate hike in 2019 decreased significantly and thus, this slightly reduced volatility and uncertainty in financial markets compared to the previous quarter. However, uncertainty over global trade policies and geopolitical risks persist and capital flows towards emerging economies are slowing down. Therefore, in the first quarter of 2019, emerging economies are expected to deliver a less favorable growth performance compared to the previous quarter.

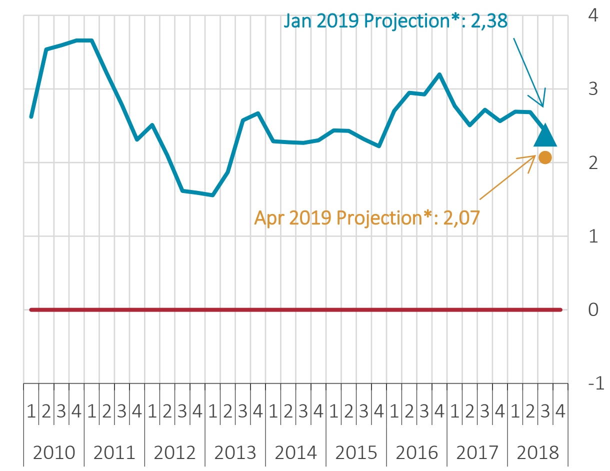
In sum, it is projected that global economic activity will lose pace in the first quarter due to developments in both advanced and emerging economies, and growth rate will likely be below that of the previous quarter. This is backed by the April Consensus Forecasts that revised the global growth forecast for end-2019 downward compared to the previous reporting period (Table 2.1.1).

Chart 2.1.5: Emerging Markets PMI



Source: IHS Markit.

Chart 2.1.6: Export-Weighted Global Production Index[1]
(Annual Average % Change)



Source: Bloomberg, CBRT.
* Average growth forecast for 2019.

In April Consensus Forecasts, growth forecasts for the euro area and Japan were revised downward by 0.4 percentage points (Table 2.1.1). On the emerging economies front, while growth forecasts for the Asia Pacific region remained intact, forecasts for Latin America and Eastern Europe were revised downward. Similarly, global growth forecasts in the IMF World Economic Outlook April 2019 report were revised downward compared to January forecasts. Thus, the annual growth forecast of the export-weighted global production index for 2019 decreased compared to the January reporting period[1] (Chart 2.1.6).

Prospective risk factors in the upcoming period can be listed as: extended trade disputes between the USA and China, persisting political uncertainties in the euro area, the additional vulnerabilities on the banking sector that may be triggered by expansionary policies that China introduced to support domestic activity, and geopolitical tensions. The listed risk factors emphasize downside risks to global economic activity outlook for 2019 by increasing the sensitivity pertaining to global financial markets and increasing global economic uncertainty.

[1] The coverage of export-weighted global production index as an external demand indicator has been expanded in this reporting period. To enhance data quality and expand the coverage, the IHS Markit database has been added to the existing data sets. Thus, the number of countries covered by the index increased from 86 to 110, and the representation rate of total exports increased from 79% to 92% (according to averages of 2018). Almost all of the expansion stemmed from the inclusion of the formerly less-represented Middle East and Africa group countries in the index. Moreover, the new index includes both the annual forecasts of Consensus Economics as well as quarterly forecasts of Markit.

Table 2.1.1: Growth Forecasts for 2019 and 2020 (Annual Average % Change)

	January		April	
	2019	2020	2019	2020
Global	2,9	2,8	2,7	2,8
Advanced Economies				
USA	2,5	1,8	2,4	2,0
Euro Area	1,5	1,4	1,1	1,3
Germany	1,4	1,6	0,8	1,5
France	1,5	1,4	1,3	1,3
Italy	0,5	0,7	0,0	0,5
Spain	2,2	1,9	2,2	1,9
Japan	1,0	0,4	0,6	0,5
UK	1,5	1,6	1,3	1,5
Emerging Economies				
Asia Pacific	5,5	5,4	5,5	5,4
China	6,2	6,1	6,2	6,1
India	7,3	7,4	7,2	7,3
Latin America	1,9	2,5	1,6	2,5
Brazil	2,4	2,6	1,9	2,6
Eastern Europe	2,1	2,6	1,9	2,6
Russia	1,5	1,8	1,5	1,8

Source: Consensus Forecasts.

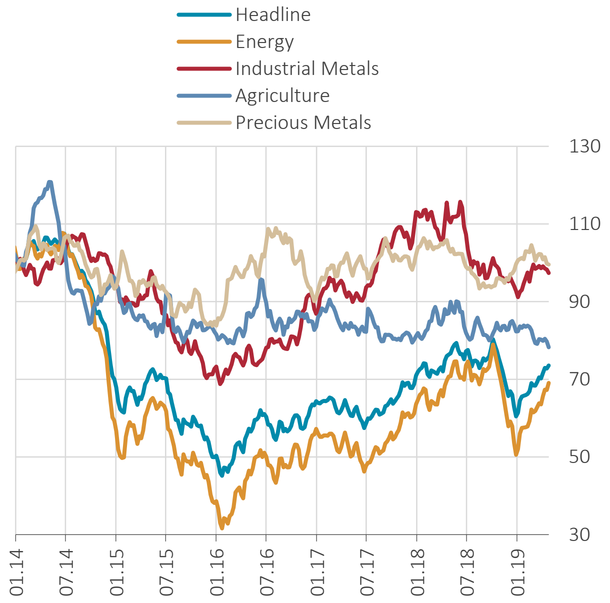
2.2 Commodity Prices and Global Inflation

The sudden drop in the headline commodity price index in the final quarter of 2018 was reversed in the first quarter of 2019. The upward move was mainly driven by energy and industrial metal prices. Meanwhile, in the first quarter, prices of energy, industrial metal and agricultural products decreased by 8.3%, 0.2% and 1.6% quarter-on-quarter. In the same quarter, precious metal prices were up 6.1% (Chart 2.2.1).

Industrial metal prices, which decreased in 2018 due to the trade dispute between the USA and China, and the economic slowdown in China, displayed a limited rise in the first quarter of 2019 on the back of the expansionary policies introduced by China to boost economic activity, the improvement in global risk appetite and the supply squeezes in industrial metal market since 2018. The CBRT evaluates that the upward impact of these developments on prices may become more apparent in the upcoming period; whereas this impact may decrease if the global economic outlook performs worse than expected.

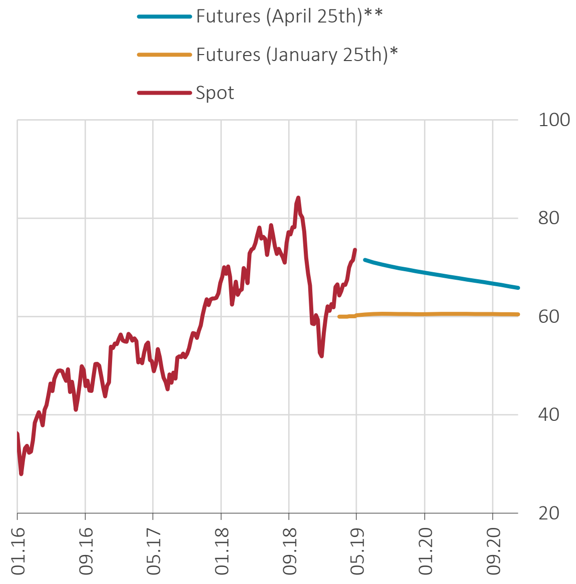
After global agricultural production and grain stocks reached historical highs in 2017, agricultural prices decreased in 2018 due to the decline in global demand. Accordingly, based on projections of further slowdown in global demand, agricultural prices are estimated to remain low. Conversely, if international trade tensions are abated, agricultural prices may move upwards due to an increase in China's demand. The more evident slowdown in the normalization process of advanced economy monetary policies, combined with expected and persisting high levels of uncertainties in global economic policies, fuel expectations for a continued uptrend in gold prices.

Chart 2.2.1: S&P Goldman Sachs Commodity Index (January 2014=100)



Source: Bloomberg.

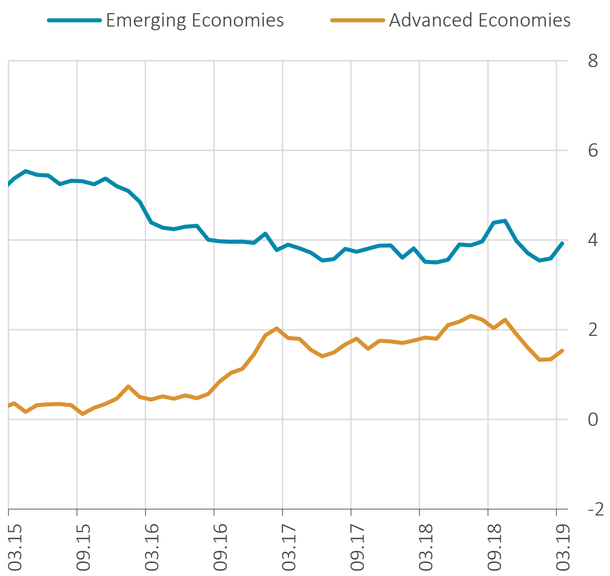
Chart 2.2.2: Brent Crude Oil Prices (USD/ bbl)



Source: Bloomberg.
* Average futures prices, between January 1st and 25th.
** Average futures prices, between April 1st and 25th.

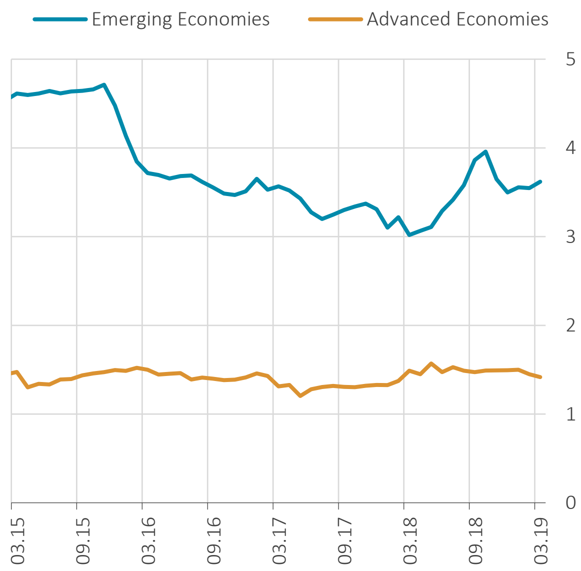
After the rapid fall in crude oil prices in the last quarter of 2018, oil prices increased due to supply-side factors in the first quarter of 2019. The rise was driven by the implementation of the OPEC decision to cut oil production and Russia's move in conformity with the decision, decline in USA shale oil production, and decline in oil production due to political tensions in Venezuela and Libya. Meanwhile, the slowdown in global economic activity contained any further rise in oil prices.

Chart 2.2.3: CPI Inflation in Advanced and Emerging Economies (YoY, %)



Source: Bloomberg, CBRT.

Chart 2.2.4: Core Inflation in Advanced and Emerging Economies (YoY, %)



Source: Bloomberg, Datastream, CBRT.

A likely positive outcome in US-China trade negotiations, a sustained slowdown in US shale oil production and continued geopolitical tensions in Venezuela, Iran and Libya pose upside risks to crude oil prices. If the Russia-OPEC talks on production cuts in June result in a decision to raise output, the trade tensions between the USA and China are not resolved and the slowdown in global economic activity continues, these factors will pose downside risks to crude oil prices. In sum, upside and downside risks on crude oil prices are balanced. Thus, as suggested by the Brent crude oil futures contracts, crude oil prices are expected to average around USD 67 throughout 2019 (Chart 2.2.2).

In the first quarter of 2019, headline inflation rates decreased in advanced economies whereas they increased in emerging economies (Chart 2.2.3). In this period, core inflation rates inched down in advanced economies but were up across emerging economies (Chart 2.2.4). Inflation forecasts for 2019 have been revised downwards for most of the advanced economies in the inter-reporting period (Table 2.2.1).

In the USA, despite the rise in wages that increased on the back of the historically low unemployment rates and the unfavorable effect of the increment in crude oil prices, both survey and market-based inflation expectations hover around 2%, consistent with the target. In the euro area, despite tighter labor market and rising wages, headline consumer inflation in 2019-2021 period is expected to get closer to 2% at a slower pace than stated in the previous Inflation Report. In Japan, headline inflation, which has been hovering below 1% amid positive output gap and increased long and short-term inflation expectations, is projected to rise to 2% gradually. Meanwhile, in the UK, inflation has been hovering around 2% notwithstanding a tighter labor market and increased unit labor costs.

Table 2.2.1: Inflation Forecasts for 2019 and 2020 (Annual Average % Change)

	January		April	
	2019	2020	2019	2020
Advanced Economies				
USA	1,9	2,2	1,9	2,2
Euro Area	1,5	1,5	1,3	1,4
Germany	1,8	1,7	1,4	1,6
France	1,3	1,5	1,2	1,4
Italy	1,1	1,3	0,9	1,3
Spain	1,4	1,6	1,2	1,5
Greece*	0,9	1,1	0,7	1,1
UK	2,0	2,1	2,0	2,1
Japan	0,9	1,3	0,6	1,0
Emerging Economies				
Asia Pacific (excl. Japan)	2,4	2,4	2,2	2,3
China	2,2	2,2	2,1	2,1
India**	4,5	4,7	3,9	4,3
Latin America (exlc. Venezuela)	7,1	5,8	7,9	6,3
Brazil*	4,1	4,0	4,0	4,1
Eastern Europe	6,7	5,6	6,4	5,5
Russia*	4,7	4,1	4,6	4,1

Source: Consensus Forecasts.
* Annual percentage change.
** Based on fiscal year.

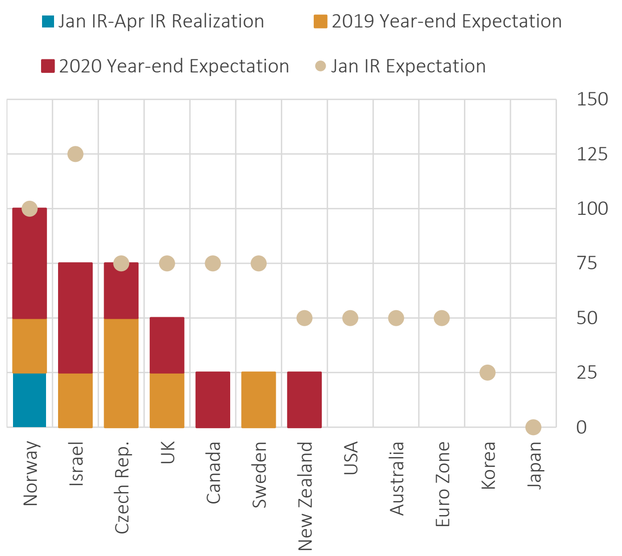
The risks to crude oil prices for the upcoming period pose an upward risk to inflation as well. The accelerating wage increases in advanced economies stand out as an upside risk factor on inflation. Nevertheless, further weakness in the global growth outlook may ease pressures on labor markets of advanced economies.

2.3 Global Monetary Policy

In the first quarter of 2019, normalization processes in global monetary policies stalled, and advanced economy central banks' cautious stance towards tightening became stronger. In this period, when interest changes were quite rare, expectations for interest rate hikes were significantly revised downwards compared to the previous Report period (Chart 2.3.1 and Chart 2.3.2). The weaker growth outlook both in advanced and emerging economies coupled with stable core inflation led to a relative sluggishness in monetary policy outlook. This had implications on financial markets and bond yields as well. Actually, the spread between options-implied interest rates of the three leading central banks decreased compared to the last Report period while it remained unchanged for the Bank of Japan (Table 2.3.1).

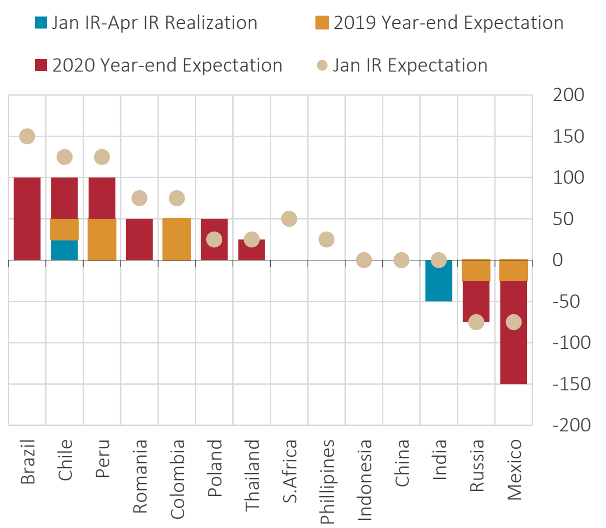
In its March meeting, the Fed kept rates steady and made two important decisions: it cut median rate projections by 50 basis points and announced that it would conclude its balance sheet reduction process in September. Even if there is no significant deterioration in economic activity in the US economy, the Fed halted the normalization process due to the deceleration in global economic outlook, developments in financial markets and the inverted slope of the yield curve (Box 5.1). After the Fed's announcement that it decreased median rate projection to a level that would allow no rate hikes in 2019, market pricing became more pronounced. Although by the end of March the market fully priced a prospective rate cut in 2019, the options-implied interest rates have been volatile throughout April. On 26 April, this rate was still lower than the current rate of 2.5% and this implies that the possibility of a rate cut by the Fed till the end of the year on the market is put at 63%.

Chart 2.3.1: Policy Rate Changes and Year-End Policy Rate Expectations in Advanced Economies: January 2019 – December 2020* (Basis Points)



Source: Bloomberg.
* Realizations are by 26 April 2019.

Chart 2.3.2: Policy Rate Changes and Year-End Policy Rate Expectations in Emerging Economies: January 2019 – December 2020* (Basis points)

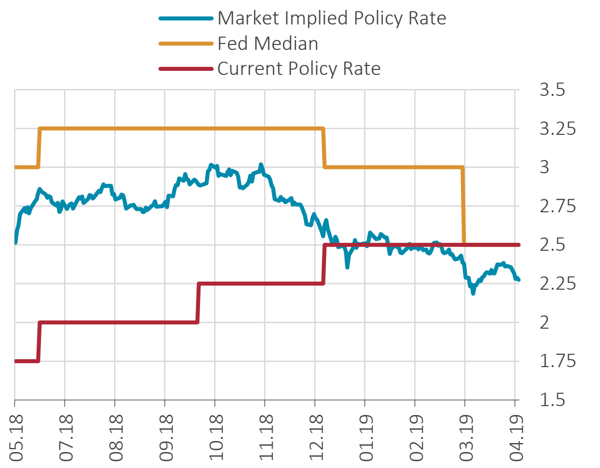


Source: Bloomberg.
* Realizations are by 26 April 2019.

At its March meeting, the ECB kept policy rates unchanged and changed its forward guidance. The ECB, which communicated in its previous meeting that it would keep policy rates unchanged at least through mid-2019, stated in its March meeting that it would keep them steady until at least end- 2019 and postponed a likely rate hike to 2020.

Even if the ECB revised its growth forecast for 2019 downwards by 0.6 points compared to its previous forecast, it stated that no stagnation was expected in economic activity and it projected a recovery in growth rates as of 2020. Meanwhile, the ECB put into implementation the third series of refinancing operations encouraging banks to lend private sector in an effort to spur growth.

Chart 2.3.3: Options-Implied Fed Policy Rate for End-2019 (%, Upper Band)



Source: Bloomberg.

Table 2.3.1: Options-Implied Policy Rates of Four Major Central Banks for End-2019 (%)

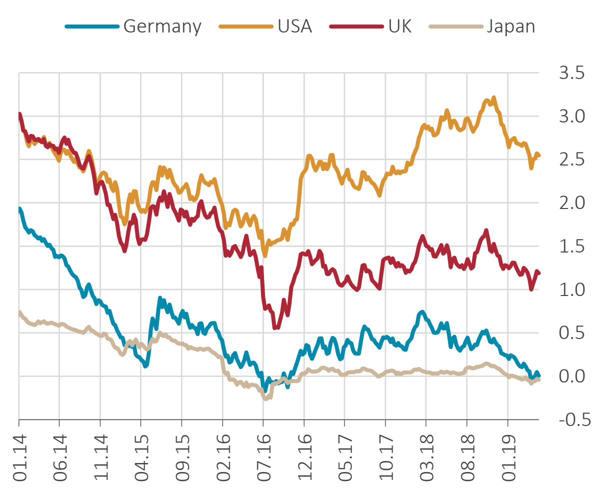
	Current Policy Rate (%)	2019 Year-end Market Implied Policy Rate (%)		Change From January IR (% points)
		Jan IR	26-Apr-19	
Fed	2.5	2.56	2.27	-0.29
ECB	0	0.05	-0.01	-0.06
BoE	0.75	0.84	0.81	-0.03
BoJ	-0.1	-0.12	-0.12	0.00

Source: Bloomberg.

2.4 Global Risk Indicators and Portfolio Flows

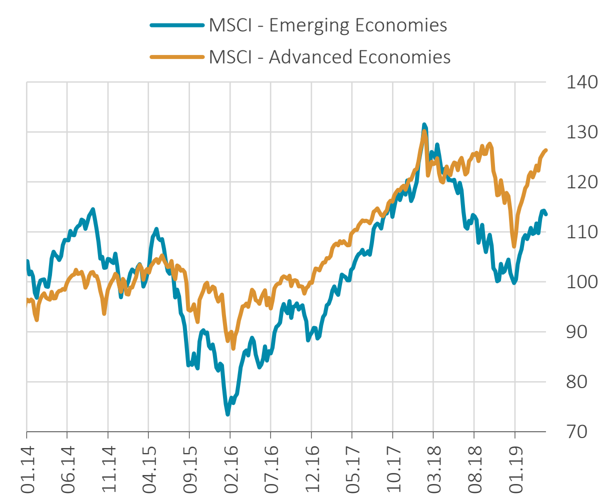
Global financial conditions, which further tightened in the final quarter of 2018 due to the fall in stock prices and the rise in risk premium, became slightly looser in the first quarter of 2019 as the deceleration in normalization processes of monetary policies of advanced economies became clearer. The significant moderation in the tones of normalization expressions by advanced economy central banks led to a decline in 10-year bond yields (Chart 2.4.1).

Chart 2.4.1: 10-Year Treasury Bond Yields (%)



Source: Bloomberg.

Chart 2.4.2: MSCI Indices (January 2015=100)

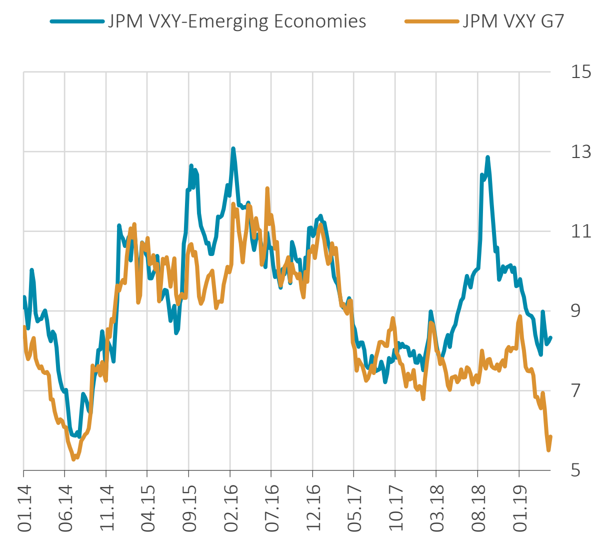


Source: Bloomberg.

In this quarter, uncertainties pertaining to protectionist trade measures and the Brexit process continued; and concerns of a slowdown in global growth led by particularly China and the euro area increased. Despite all these risks, easing monetary policies in advanced economies in the first quarter of the year supported a recovery of losses incurred in the last quarter of 2018 in stock markets both in advanced and emerging economies (Chart 2.4.2). The improvement in risk sentiment that has been observed since the beginning of 2019 helped continue lowering the exchange rate volatilities (Chart 2.4.3).

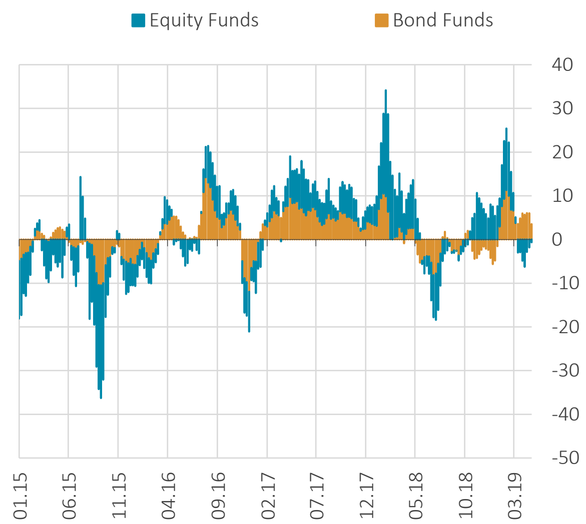
Albeit minimally, portfolio flows towards emerging economies slightly stabilized in the final quarter of 2018. Stock markets and bond markets started to recover as of the beginning of 2019 as it became clear that advanced economies are poised for a less tight path of monetary policy normalization than in the previous period coupled with a partial recovery in risk sentiment. However, as of the end of April, the optimistic outlook in pricing in emerging economies is not yet solid and portfolio outflows in the equities market were observed. (Chart 2.4.4). The weakness is believed to be driven by heightened uncertainty in global economic policies and persisting risk factors linked to country-specific conditions.

Chart 2.4.3: JP Morgan Volatility Indices (Weekly)



Source: Bloomberg.

Chart 2.4.4: Emerging Market Monthly Portfolio Fund Flows (Billion USD, 4-Week Cumulative)



Source: EPFR.

Emerging markets, across all regions, received portfolio flows in the first quarter of 2019 (Table 2.4.1). While bond markets in all regions in emerging markets received inflows, there were outflows from stock markets in Asia, Europe and Latin America regions in March. The strong portfolio flows into Chinese stock markets as of the final quarter of 2018 left for high-volume outflows in March. A similar movement was observed in the Russian stock markets in the same period.

It became apparent that the normalization process in monetary policies of advanced economies would be slower as of end-2018 and a partial improvement was observed in risk appetite which together suggest that portfolio flows to emerging economies will likely be more positive. However, it should be noted that the historically elevated levels of uncertainty over global economic policies, persisting geopolitical problems and vulnerabilities specific to emerging markets may reverse this projection.

Table 2.4.1: Composition of Fund Flows to Emerging Economies (Quarterly, Billion USD)

		Total	Portfolio Composition		Regional Composition			
			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
	Q2	52,6	24,4	28,2	25,2	7,6	14,5	5,4
	Q3	37,1	17,3	19,8	19,4	4,9	9,2	3,5
	Q4	29,5	11,8	17,6	14,8	3,7	8,3	2,7
2018	Q1	57,9	12,0	46,0	34,1	6,5	12,0	5,3
	Q2	-10,4	-10,4	0,0	-0,7	-4,3	-3,3	-2,1
	Q3	-9,9	-3,6	-6,3	-4,6	-1,4	-3,2	-0,7
	Q4	4,5	-14,0	18,5	14,1	-4,5	-3,1	-2,0
2019	Q1	29,8	20,2	9,6	9,7	4,2	10,3	5,5

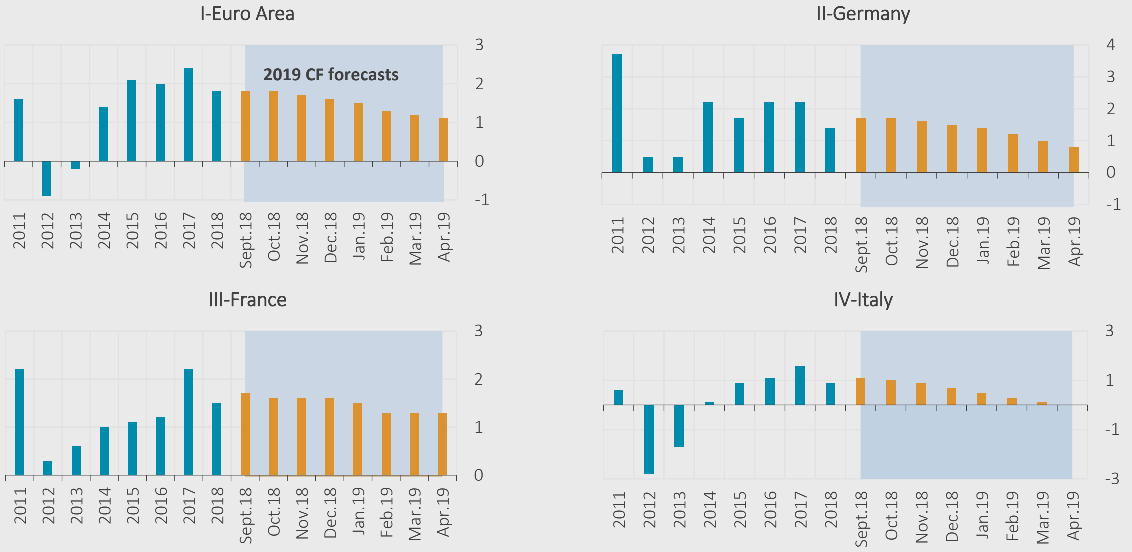
Source: EPFR.

Box 2.1

Euro Area Economic Outlook

Euro Area sustained the favorable economic performance of 2017 during the first quarter of 2018. However, the deceleration in growth in the second quarter became more evident in the second half. In addition to the heightened global economic policy uncertainty due to the US-China trade dispute, Chinese economic slowdown and political uncertainties in the Euro Area such as successive elections and the Brexit process, led to a drop in consumer and investor confidence; a feature of the economic weakening (Figure 1).

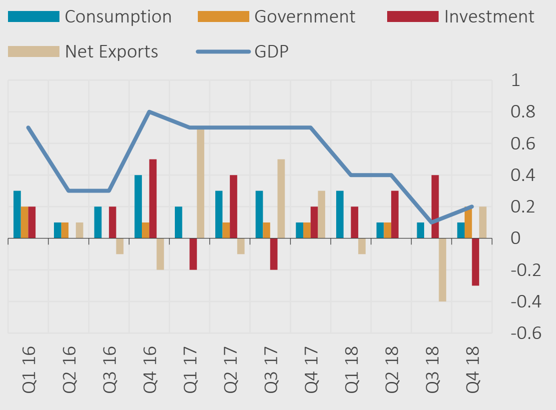
Figure 1: Euro Area Growth Rates and 2019 End-Year Consensus Forecasts (CF) Updates (%)



Source: Bloomberg, Consensus Forecasts.

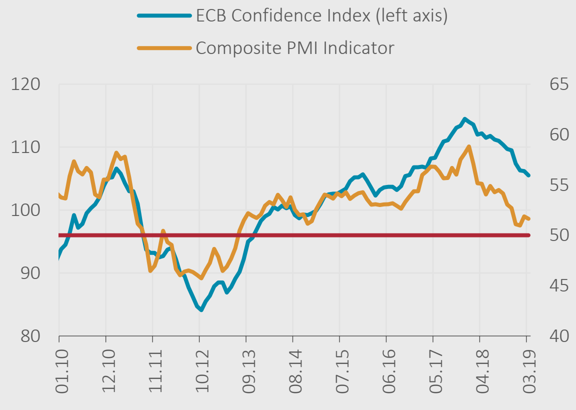
The weakening in manufacturing industry stemming from external demand moderation, stands out as a major factor in the slowdown in the economic activity (Figure 2). Nevertheless, there is no uniform moderation across the Euro Area countries. While the Italian slowdown was mainly due to domestic developments stemming from fiscal policies, the slowdown in Germany, which has the strongest economic activity in the Euro Area, was mainly driven by weakening exports. On the other hand, the political tension in France is thought to have had an unfavorable impact on economic growth.

Figure 2: Euro Area Contributions to Growth (GDP %, contributions percentage points)



Source: EUROSTAT.

Figure 3: Leading Indicators of Economic Activity

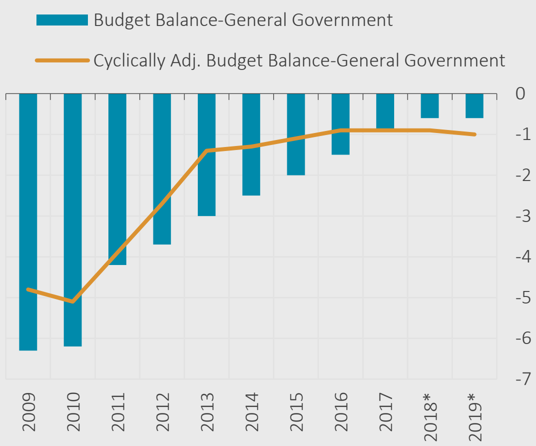


Source: ECB, Markit.

The whys and wherefores of the Euro Area slowdown is not expected to improve in 2019, and by extension the slowdown in the economic activity of the Euro Area either. The uncertainties in the world trade originating from the US trade policies are anticipated to be at the forefront of this year's agenda as well. In particular, the uncertainties over whether the US may impose customs duties on automobile exports from the Euro Area and delays in the implementation of new emission standards in Germany may adversely affect economic activity in the Euro Area, the most important automobile manufacturer and exporter in the world economy. As a matter of fact, the World Trade Organization has revised its 2019 global trade volume growth forecasts downwards significantly.[1] Similarly, political uncertainties remain in the region. The European Parliament elections due in in May, and the Brexit process are considered as the most important sources of political uncertainty in 2019.

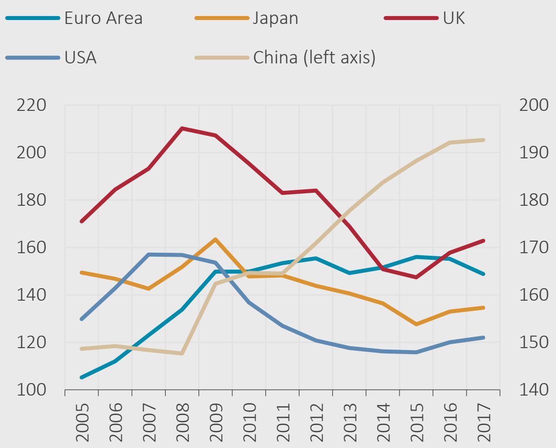
On the other hand, the positive developments in the labor market, notably the ongoing decrease in the unemployment rate and the improvement in budget balance (Figure 4), are factors that may positively affect the growth of the Euro Area. In addition, the Euro Area presents a relatively more affirmative outlook for private sector indebtedness than other major economies of the world (Figure 5). Despite these advancements, uncertainties originating from global trade and regional politics are expected to be more decisive on growth of the Euro Area in 2019. Leading indicators show that the slowdown in economic activity crystallized in the first quarter of the year (Figure 3). Indeed, the fact that the 2019 growth forecasts in the Consensus Forecasts Bulletins have been down across the Euro Area as well as in countries individually in every update period since September 2018, supports this expectation (Figure 1).

Figure 4: Euro Area Budget Balance (%)



Source: EUROSTAT.
* Forecast.

Figure 5: Private Sector Debt/GDP



Source: BIS.

All in all, due to the lingering uncertainties regarding global trade and regional politics, the economic slowdown in the Euro Area is expected to continue in 2019 and the growth rate to decline.

[1]The World Trade Organization, which announced its global trade volume growth forecast as 3 percent, revised its forecast down to 2.6 percent. https://www.wto.org/english/news_e/pres19_e/pr837_e.htm.