Is Global Growth Slowing?

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Recently, foreign exchange and equity markets in major regions of the world have experienced sharp swings in their positions, reflecting the interconnectedness of financial markets and growing concerns over a slowdown in the global economy, particularly in China and other emerging markets. Some projections indicate that global economic growth in 2016 could be slightly weaker for emerging markets, primarily Latin America, and developed economies, except the United States and the United Kingdom. During the turmoil, the U.S. stock market reportedly lost more than $2 trillion in value, although much of that value was subsequently regained. Movements in exchange rates have sparked concerns of a "currency war" and competitive devaluations, while sharp drops in equity and commodity markets (particularly oil and metals) may reflect broader concerns over the state of global economic growth and the timing and mix of economic policies among national governments.

The recent financial market volatility likely will have a mixed impact on the United States. The turn toward Treasury securities as a safe haven investment could hold down interest rates and complicate assessments of when the Federal Reserve will begin moving away from monetary easing by raising interest rates. Also, movements in the foreign exchange market could further strengthen the dollar and reduce the cost of imports (which would restrain inflation), but reduce exports and add to concerns of potential deflation. Congress has long-standing interest in the foreign exchange value of the dollar and the overall performance of the economy.

As is often the case, the recent turmoil in financial markets has spawned a number of different explanations. The most prominent of these fall into four general categories:

- **Correction in foreign exchange and international financial markets**: The dollar has appreciated about 17% and 14% year-over-year relative to the yen and the euro, respectively, and 12% relative to a broad basket of currencies. This has increased pressure on currencies, such as the renminbi (RMB), that are tied to the dollar. The recent market correction was fueled in part by the Chinese central bank's actions on August 11, 2015, to lower the reference rate of the RMB, effectively depreciating the currency by about 4%, and adopting a new method for determining the currency's value. Since this action, China reportedly has spent more than $200 billion in foreign exchange markets to support the RMB, and it lowered interest rates. China's actions followed a sharp contraction in its stock markets in July 2015. The depreciation of the Chinese currency, although minor in relative terms, increased uncertainty about the value of currencies of countries that trade with China.
- **Uncertainty over the direction and mix of economy policies:** Differences in monetary policy between the Federal Reserve (anticipated tightening) and the European Central Bank and the Bank of Japan (expansionary), plus questions about how aggressively China's central bank is willing to act to calm markets, have created uncertainties in the international financial markets.
- **Sluggish growth in developed economies**: The lack of traction in most developed economies, except the United States, has raised concerns that stimulative monetary policies in Europe and Japan may not provide the same kind of economic boost the United States experienced. Productivity has slowed in all major economies and corporate investment has shown minimal signs of life, factors which are restraining current rates of economic growth and could negatively affect future economic expansion. Falling import prices are likely to positively affect the real incomes of consumers, but could add to concerns over the prospect of deflation and slower economic growth in most geographic regions. Annual rates of inflation in Europe and the United States are running at about half the

target rate set by their respective central banks, while the rate of unemployment remains above pre-crisis levels in most European countries except Germany.

- **Slowing growth in key emerging markets:** Economic growth in China, Brazil, Russia, and India helped shore up the global economy after the 2008-2009 financial crisis, but those markets now face challenges of their own. In particular, some, but not all, analysts are concerned that the Chinese economy is slowing faster than projected and that China may have difficulty navigating the challenges of a slowing economy, an equity market asset bubble, and potential continued market pressure on the RMB. The International Monetary Fund (IMF) argues, however, that China is transitioning to a slower, but more sustainable rate of growth. Financial market reaction also may reflect concerns that potential weaknesses in the Chinese economy could pose additional challenges for continued economic reform and to future global economic growth. Falling commodity prices, particularly for crude oil, could improve consumers' real incomes and aid producers. Falling commodity prices also are causing a redistribution of income from commodity-producing economies to commodity-consuming economies, raising the potential for additional economic pressure on the commodity-producing countries, such as Brazil.

For the United States, the market turbulence has fueled conflicting assessments over prospects that the Federal Reserve's Open Market Committee will raise interest rates before the end of the year. Lower petroleum prices and depreciated currencies abroad will make imports cheaper, which improves the real purchasing power of consumers, but also adversely affects the competitive position of some domestic producers and potentially reduces export sales. At the same time, the loss of stock market value, if sustained, may erode the overall wealth of consumers and could restrain consumer spending, negatively affecting economic growth.

The impact on Treasury securities and interest rates also is uncertain. Some foreign investors likely will turn to the safety of Treasury securities until equity markets stabilize. At the same time, some foreign governments may reverse course and pare back their holdings of Treasury securities over the longer term. China, the second-largest holder of Treasury securities behind the Federal Reserve, could reduce its holdings of dollar-denominated assets over time in accordance with guidance from the International Monetary Fund (IMF) as it aims to have a market-determined exchange rate as a step toward having the RMB recognized as an international reserve currency.