BANCA ALETTI
GRUPPO BANCO POPOLARE

Global Economy Report

September-October 2015

European University Institute
ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

GLOBAL GOVERNANCE Programme

Global Economy Report

The Global Economy Report is prepared in cooperation by the Macroeconomic Research Division of Banca Aletti and the Global Governance Programme of the Robert Schuman Centre for Advanced Studies of the European University Institute.

The objective of the Report is to provide an analysis of the current and expected macroeconomic and financial conditions at the global level, with also a focus on key economic areas such as Europe, the USA and ASIA.

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EXECUTIVE SUMMARY

- In the USA, industrial activity experienced a strong rebound in July but there was a generalised worsening in business confidence in August. Recovery is well under way, but affected by substantial global uncertainty.

- Internal demand is healthy, mostly indifferent to global uncertainty. Consumer confidence further grew in August, reaching the highest level in several years. The job market is headed towards full employment.

- Inflation remains far from target under all measures. A downward revision on general inflation's profile is expected, after recent raw materials' price drop.

- Summary forecasts: growth at 2.7% in 2015, 3.0% in 2016; inflation at 0.1% in 2015, 1.1% in 2016.

EXECUTIVE SUMMARY

- In Q2 2015, Eurozone's aggregate income grew by 0.3% compared to the previous period, one tenth below expected, growing however for the ninth consecutive quarter. The figure is slightly lower than in the previous period (+0.4%). On an annualised basis, income has accelerated at +1.2% (from +1.0%), the highest annual rate since Q3 2011.

- In Germany, income grew by 0.4%, lower than expected (+0.5%), but higher than in the previous quarter (+0.3%). In France, income registered null growth, against an expected 0.2% growth. In Italy growth was at +0.3%, in positive territory for the second quarter in a row, after the upward revision by one tenth on preliminary estimate. Spain confirms growth rhythms over three times as high as the European average, with GDP growth at +1.0%, highest since beginning of 2007

EXECUTIVE SUMMARY

- The ongoing improving trend in the job market continued during the summer months. The leading indicator on employment conditions is still in expansive territory, close to four-year highs.

- August preliminary estimates point to a stable inflation rate at 0.2%, as in the previous month, in positive territory for the fourth consecutive month and in line with forecasts. Also core inflation is stable at 1%, higher than consensus forecasts (+0.9%).

- Our forecasts are for a further moderate growth, with inflation below the ECB target. For growth, we forecast 1.3% in 2015 and 1.7% in 2016, for inflation around zero in 2015 and 0.9% in 2016.

EXECUTIVE SUMMARY

- In Japan, after Q2's growth decrease, the expectations for the Government's and BoJ's intervention are increasing.

- The productive system suffers a stagnation of internal and external demand, due to China's slowdown, Japan's second commercial partner, coupled with domestic consumption weakness.

- The combination of raw materials' prices drop and yen's strength on the dollar, are increasing the risk of BoJ missing its inflation target. This could induce it to decide on an intervention as early as October, when new growth and inflation forecasts will be released.

EXECUTIVE SUMMARY

- In China, PBoC acted on the exchange rates market, changing parity with the dollar, with an overall devaluation of approximately 4.6%.

- Following the stock market's upheaval, the Central Bank reacted with liquidity injections and a cut on reference rates and on the required reserve coefficient. It also removed the cap on short term deposits (under one year).

- Fears persist of a marked slowdown in economic activity, which would have negative effects on a global level, and in particular on emerging markets. On the other hand, there remains substantial space for expansionary fiscal and monetary policy.

- In this report we present a special focus on economic conditions in China and Japan.

EXECUTIVE SUMMARY

	2009	2010	2011	2012	2013	2014	2015E	2016E
GDP (%YOY)								
US	-2.8	2.5	1.6	2.3	2.2	2.4	2.7	3.0
EUROZONE	-4.5	2.0	1.6	-0.9	-0.4	0.9	1.3	1.7
GERMANY	-5.6	4.2	3.6	0.4	0.1	1.6	1.6	2.0
FRANCE	-2.9	2.0	2.1	0.2	0.7	0.2	1.1	1.4
ITALY	-5.5	1.7	0.6	-2.8	-1.7	-0.4	0.8	1.5
UK	-4.3	1.9	1.6	0.7	1.7	3.0	2.6	2.3
JAPAN	-5.5	4.7	-0.4	1.7	1.6	-0.1	0.7	1.2
BRAZIL	-0.2	7.6	4.0	1.8	2.8	0.2	-1.7	0.5
RUSSIA	-7.8	4.5	4.3	3.4	1.3	0.6	-3.6	0.5
INDIA	6.4	8.9	7.5	5.1	4.6	5.8	7.4	7.6
CHINA	9.2	10.4	9.3	7.7	7.7	7.4	6.9	6.7
AUSTRALIA	1.5	2.3	2.7	3.6	2.0	2.7	2.5	2.8
KOREA	0.7	6.5	3.7	2.3	2.9	3.3	2.7	3.3
INFLATION (%YOY)								
US	-0.3	1.6	3.2	2.1	1.5	1.6	0.1	1.1
EUROZONE	0.3	1.6	2.7	2.5	1.4	0.4	0.0	0.9
GERMANY	0.2	1.1	2.5	2.1	1.6	0.8	0.5	1.6
FRANCE	0.1	1.7	2.3	2.2	1.0	0.6	0.2	1.2
ITALY	0.8	1.6	2.9	3.3	1.3	0.2	0.2	1.0
UK	2.2	3.3	4.5	2.8	2.6	1.5	0.3	1.6
JAPAN	-1.3	-0.7	-0.3	0.0	0.4	2.7	0.7	1.2
BRAZIL	4.9	5.0	6.6	5.4	6.2	6.3	8.7	6.1
RUSSIA	11.7	6.9	8.5	5.1	6.8	7.8	15.0	7.0
INDIA	10.8	12.1	8.9	10.4	10.9	7.8	6.1	5.5
CHINA	-0.7	3.3	5.4	2.7	2.6	2.0	1.5	2.0
AUSTRALIA	1.8	2.9	3.3	1.8	2.5	2.5	1.8	2.6
KOREA	2.8	3.0	4.0	2.2	1.3	1.3	0.8	2.0

Banca Aletti Forecast

Cons. Bloomberg (Set 15)

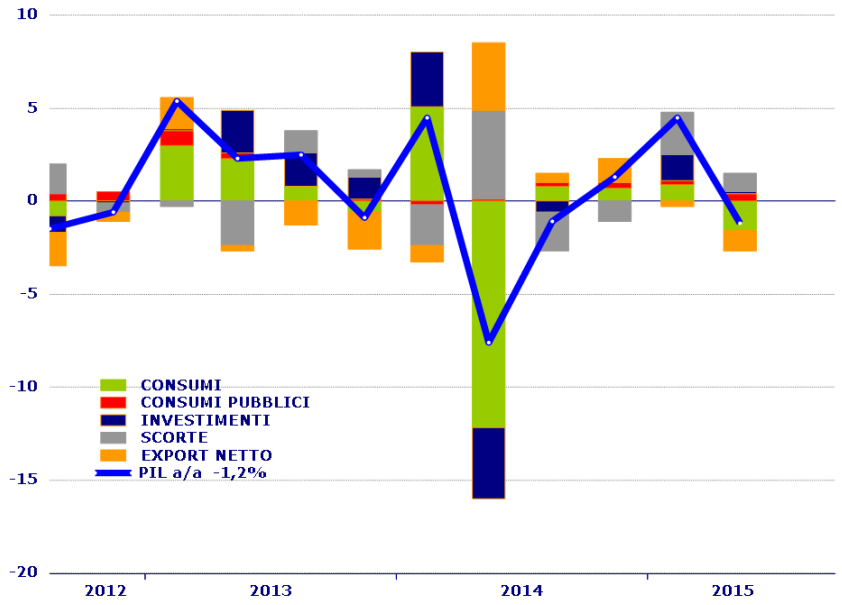
Historical Data

The Japan Outlook

GROWTH

Japan's Q2 figure registeres a drop in GDP by 0.3% on a quarterly basis. On the other hand, Q1 estimates were revised upward, with an annualised quarterly growth at 4.5%, up from previous 3.9%. Once again, the negative contribution came from domestic demand, with consumption decreasing by 0.7% QoQ, cutting growth by 0.4%. Also foreign demand weakness weighed down on Q2 growth, with a contribution to net exports worth -0.3%. The capex contribution was negative as well, but with only a correction of -0.9% after the strong rebound in Q1 (2.8%). A positive signal came from the real estate sector with a 1.9% QoQ growth from previous 1.7%.

GDP contributions



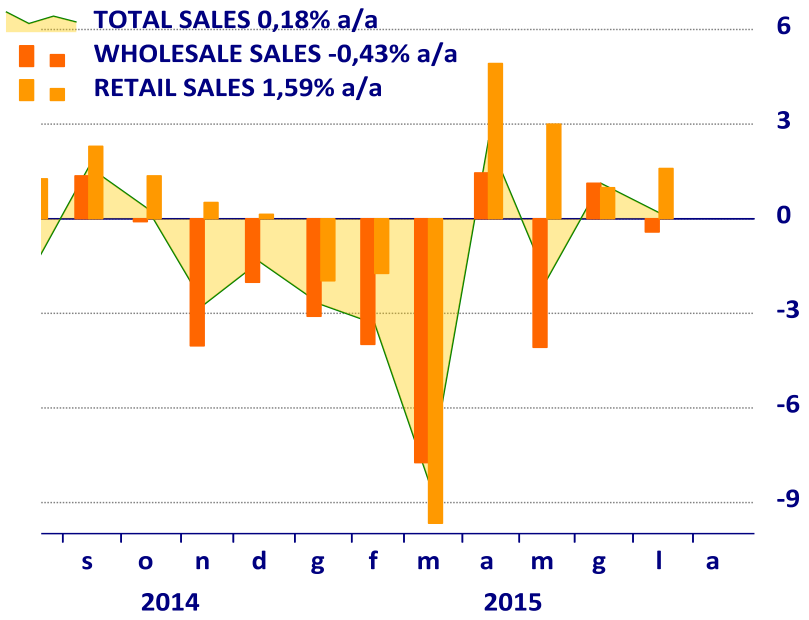
GDP growth

	2Q 2015 Final	2Q 2015 Prelim	2Q 2015 SAAR	2Q 2015 YoY%	Contribution to GDP	1Q 2015 QoQ%	4Q 2014 QoQ%
GDP - real	-0.3%	-0.4%	-1.2%	0.8%	n/a	1.1%	0.3%
Domestic demand	0.0%	-0.1%	-0.1%	0.7%	0.0%	1.1%	0.0%
Private demand	-0.3%	-0.4%	-1.1%	0.5%	-0.2%	1.5%	-0.1%
Private consumption	-0.7%	-0.8%	-2.7%	0.3%	-0.4%	0.4%	0.3%
Household consumption	-0.7%	-0.8%	-2.8%	0.2%	-0.4%	0.4%	0.3%
ex-imputed rent	-0.9%	-1.0%	-3.6%	0.1%	-0.4%	0.4%	0.3%
Residential investment	1.9%	1.9%	8.0%	-3.3%	0.1%	1.7%	-0.6%
Capital investment	-0.9%	-0.1%	-3.6%	1.5%	-0.1%	2.6%	0.1%
Private inventories	n/a	n/a	n/a	0.1%	0.3%	0.5%	-0.2%
Public Demand	0.7%	0.8%	3.0%	1.4%	0.2%	0.0%	0.2%
Government consumption	0.5%	0.4%	2.0%	1.4%	0.1%	0.3%	0.3%
Public investment	2.1%	2.6%	8.9%	2.2%	0.1%	-1.4%	0.2%
Public inventory	n/a	n/a	n/a	0.0%	0.0%	0.0%	0.0%
Fixed capital formation	0.2%	0.8%	0.6%	0.8%	0.0%	1.6%	0.1%
Net Exports	n/a	n/a	n/a	0.1%	-0.3%	-0.1%	0.3%
Exports, goods & services	-4.4%	-4.4%	-16.6%	1.5%	-0.8%	1.6%	2.8%
Imports, goods & services	-2.6%	-2.6%	-10.1%	0.7%	0.6%	1.8%	0.8%

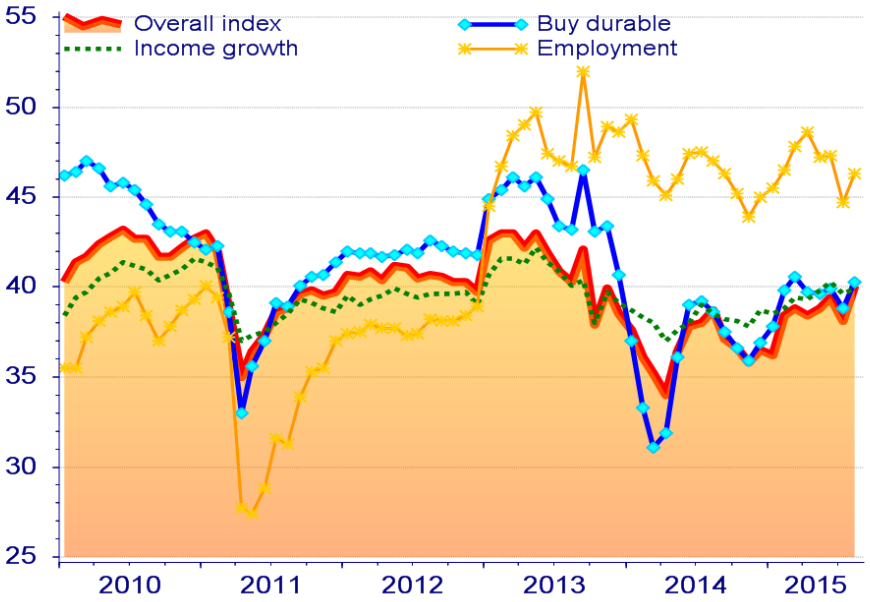
CONSUMPTION LEADING INDICATORS

The beginning of the quarter registered a positive turn in retail sales, after the negative surprise of consumption contraction in Q2, despite increases in real wages and lower energy costs would have let us suppose higher spending. Signals of weak domestic demand persist, with consumer confidence's downturn, also as an effect of falling stocks, creating a negative wealth effect.

SALES



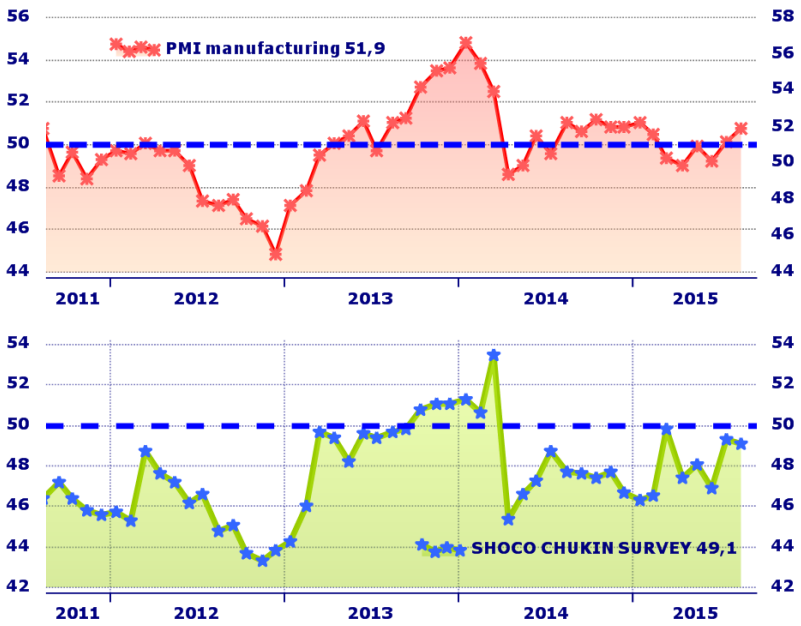
CONSUMER CONFIDENCE INDEX



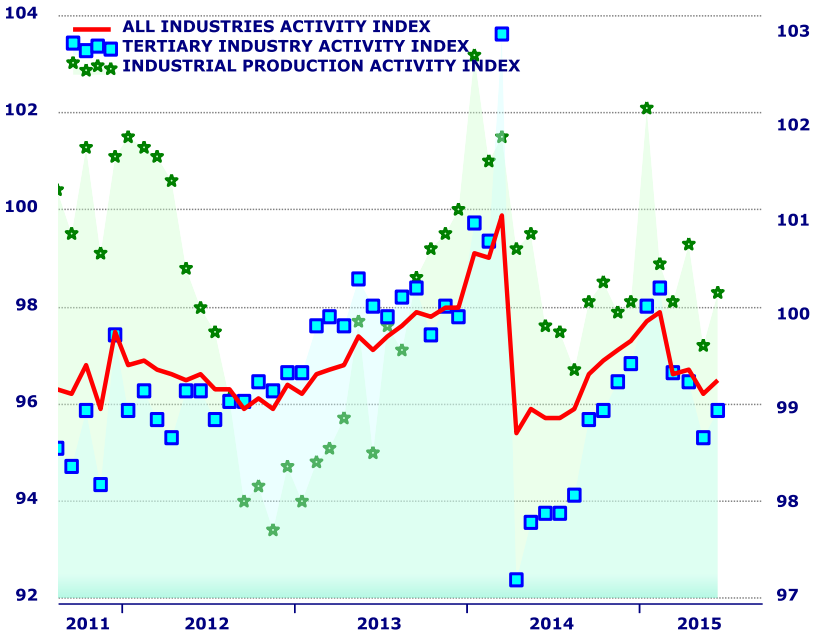
INDUSTRIAL SECTOR

Japan's Manufacturing PMI index in August was up at 51.7, registering some improvement in the sector's operating conditions. New orders accelerated, reaching the second highest growth rate of the year. A negative note comes from slowdown in new orders intended for export, with businesses registering diminishing volumes exported to China. As for prices, the survey highlighted a contraction in input prices for the first time since November 2012, due to falling raw materials' prices and in particular, oil. Output prices, on the other hand, are growing, with a change in direction.

LEADING INDICATORS
Manufacturing

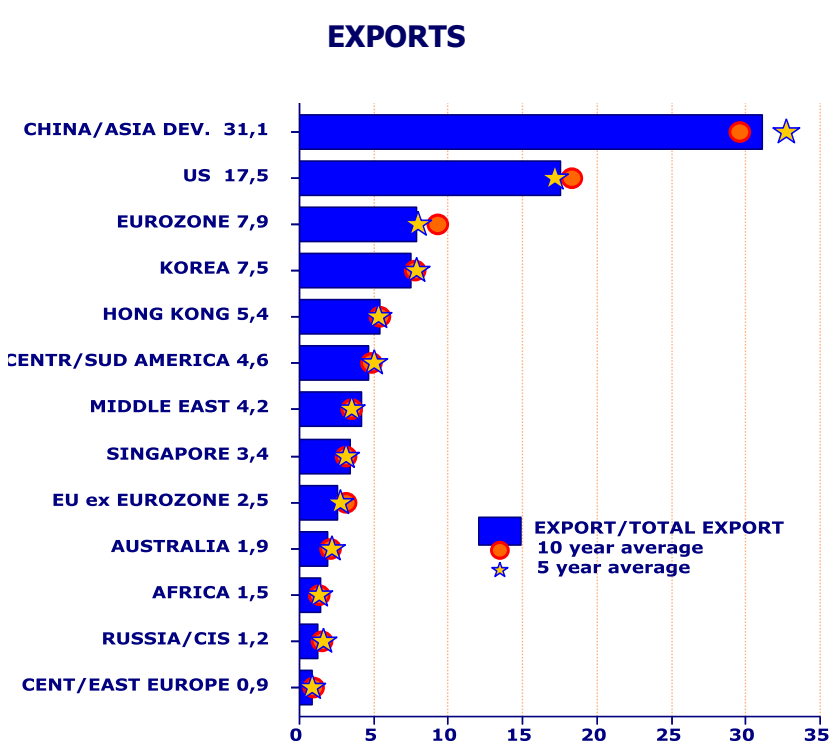


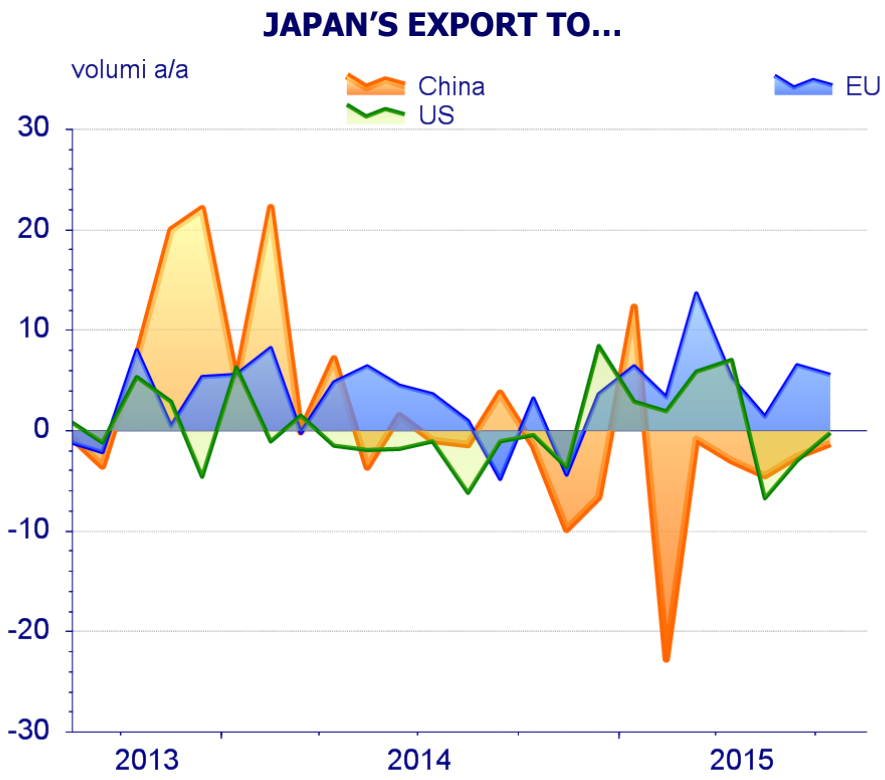
LEADING INDICATORS
Tertiary and industrial production



EXPORTS

Japan's economy is suffering due to China's slowdown, which is one of its main trade partners, directly and indirectly, as Asia represents the greatest market for Chinese products (54% of goods 2014 directed to Asia).





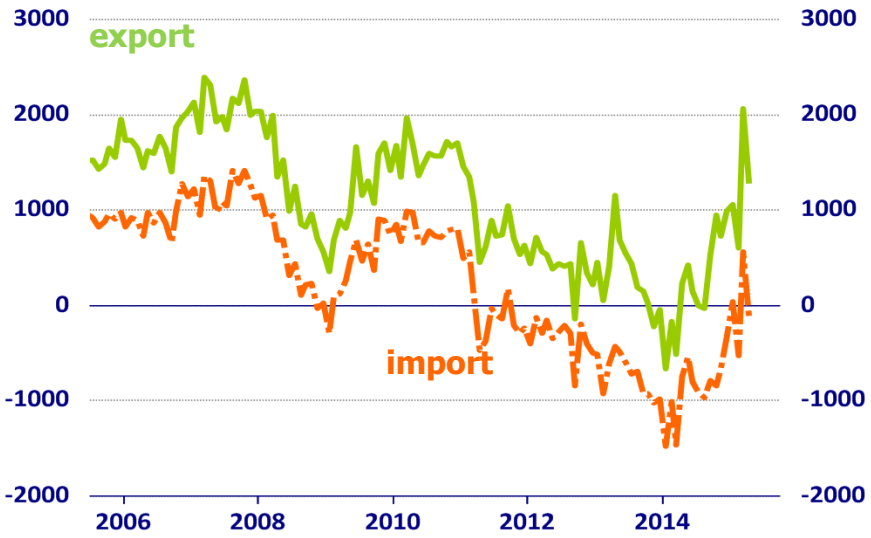
Fonte: Thomson Reuters Datastream / Fathom Consulting

EXPORTS

Japan's exports in July grew by 7.6% YoY. There was a slowdown on the previous month, when an annualised change at 9.5% was registered. On a monthly basis, exports opened the third quarter with a 0.2% correction, after the 4.4% in June, confirming the weakness signals already clear in the Q2 estimate.

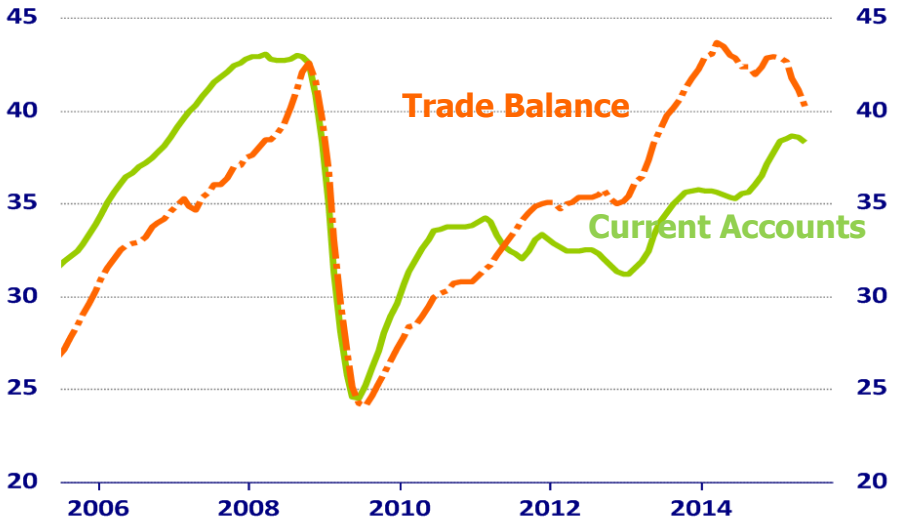
FOREIGN TRADE

6-month cumulated values – Billion yen



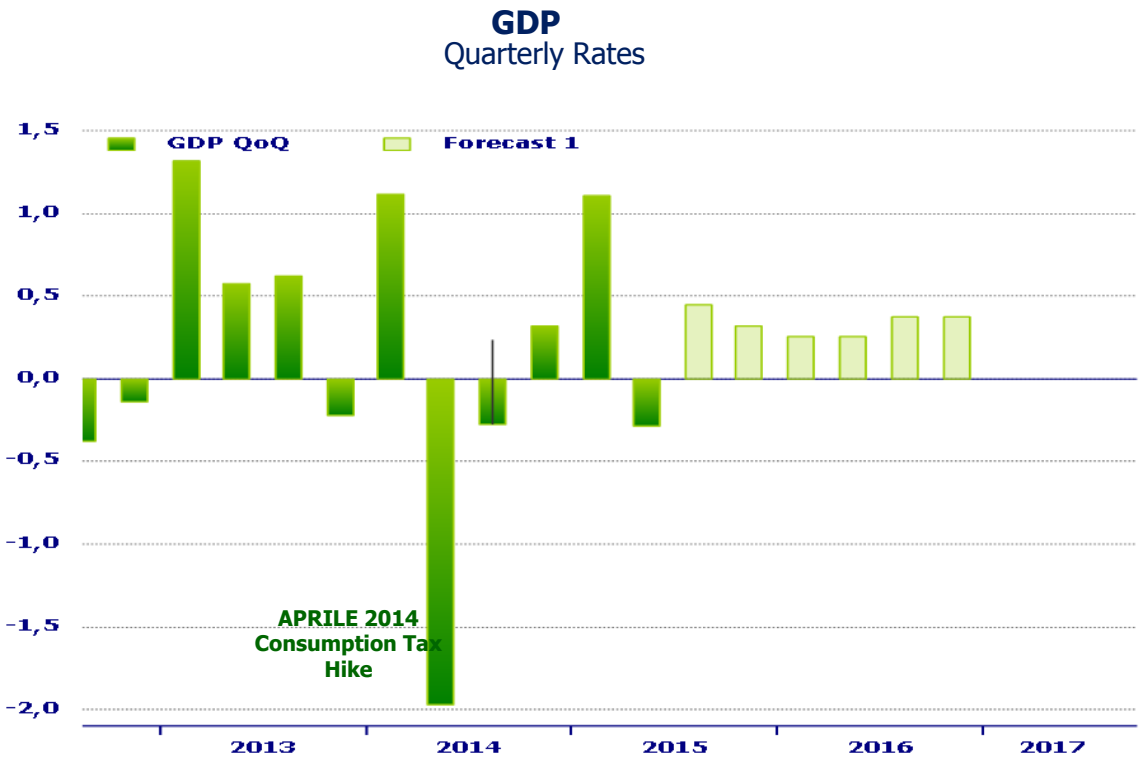
FOREIGN TRADE

Billion yen



GROWTH FORECASTS

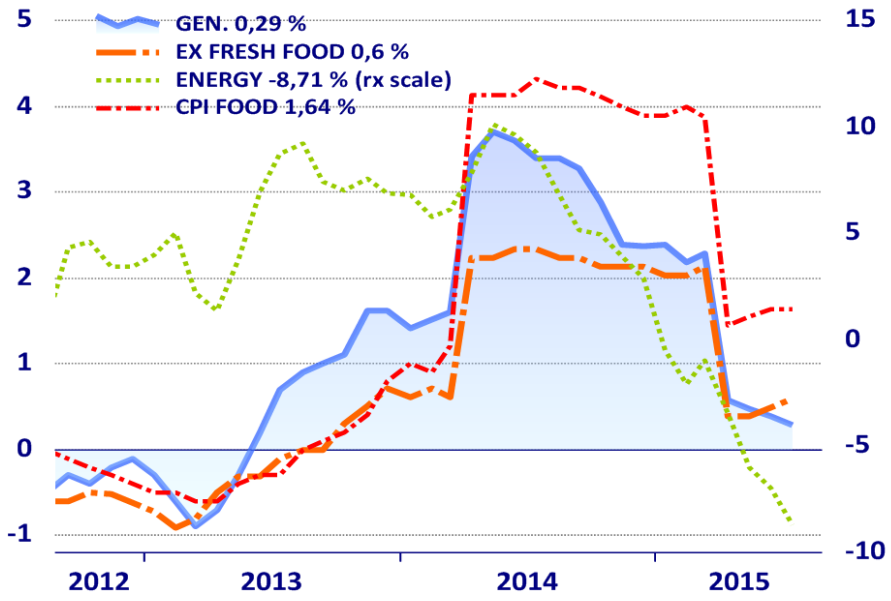
Growth forecasts have been changed to take into account Q2's growth figure, which registers a 1.6% quarterly annualised contraction. Estimates for 2015 and 2016 are at +0.7% and +1.2% respectively, with a downward revision for the current year and for 2016.



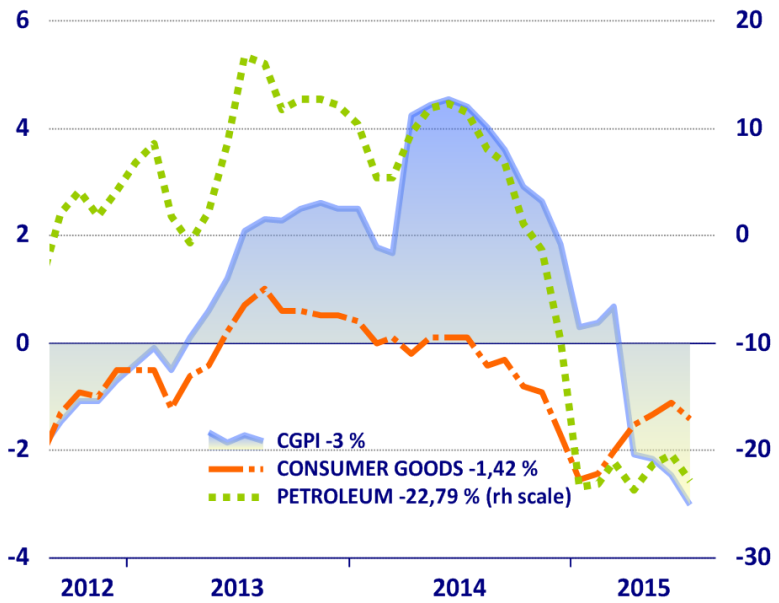
INFLATION

Japan's consumer price index, in July, has further slowed down at 0.2% YoY from 0.4% YoY, still influenced by the energy component. Core index, that is net of volatile food and energy components, is stable at 0.6%, while next month it could slightly accelerate, in line with what happened with Tokyo's index, whose core August estimate accelerated, for the second consecutive month, at 0.4% from 0.3% YoY.

NATIONAL CPI

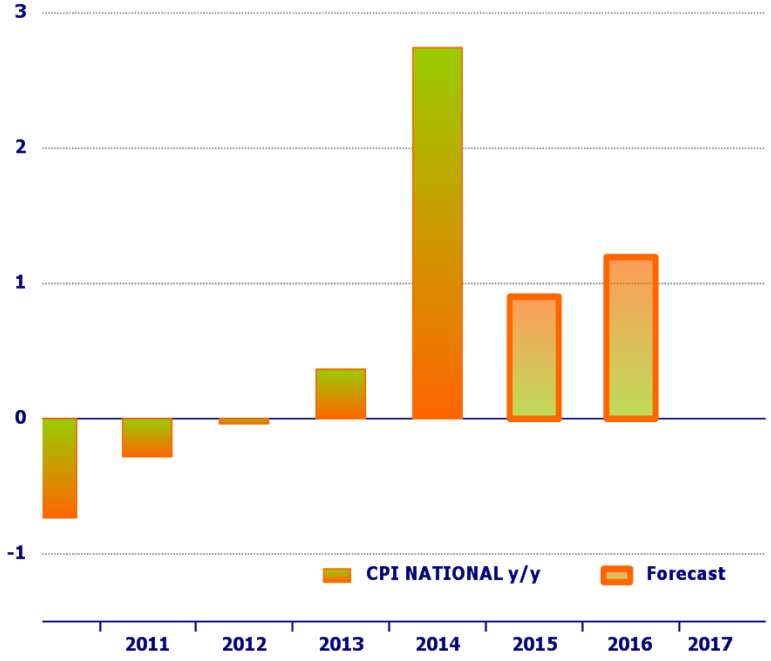


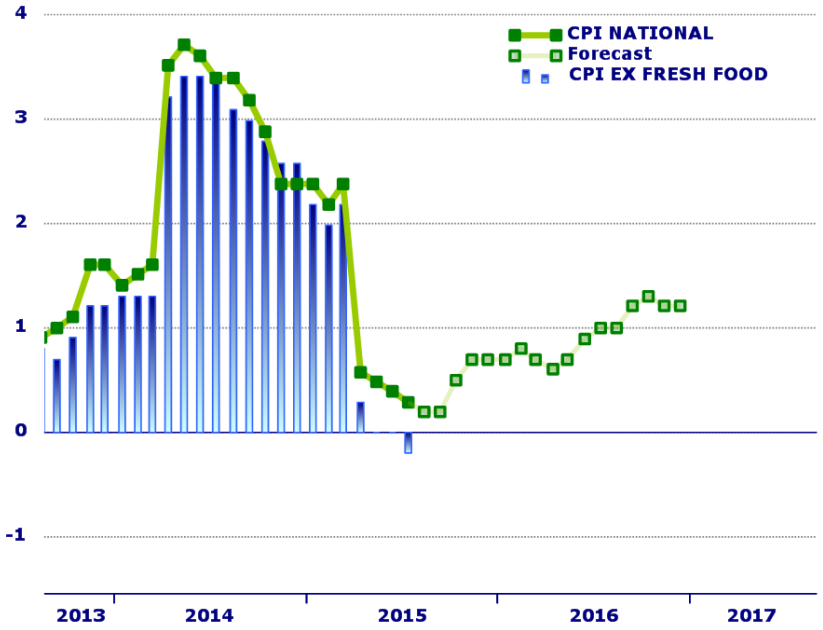
PRODUCTION PRICES



INFLATION FORECAST

In 2014 the average yearly inflation rate was at 2.7%, in net acceleration compared to previous years, following the consumption tax hike, whose contribution was estimated between 1.8%-2.0% and import prices that suffered the yen's depreciation. For the current year, a moderation in inflation is expected due to base effects and to energy prices (0.9%), while for next year we should see a modest acceleration (1.2%).

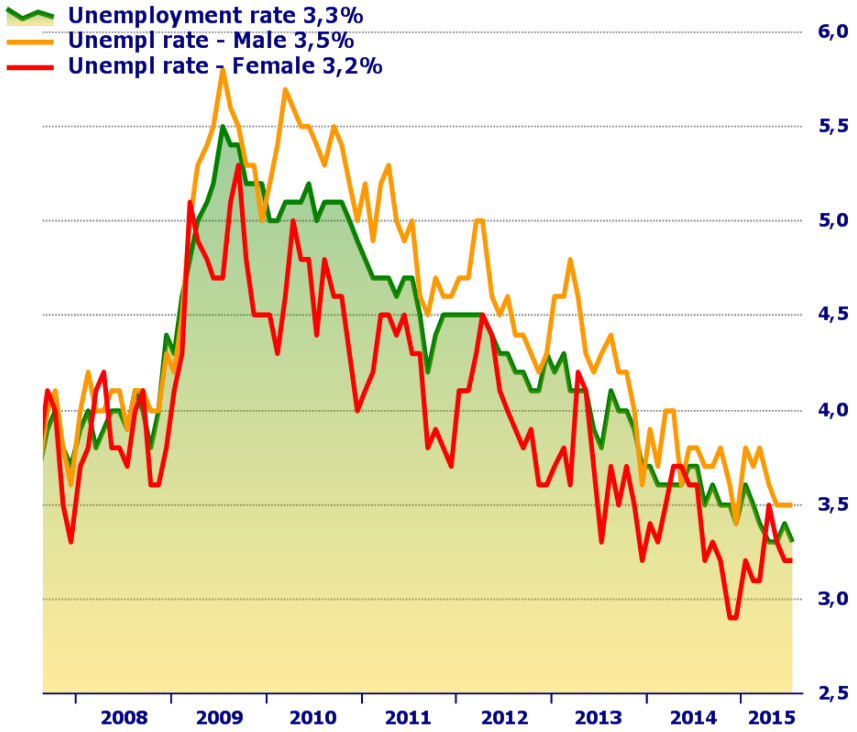




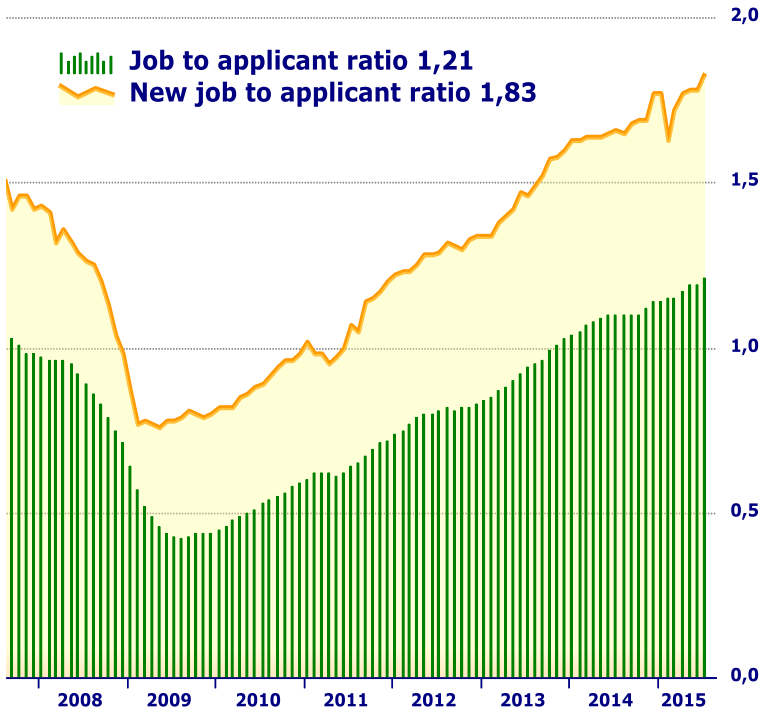
LABOUR MARKET

The unemployment rate continues to be at a historical low, while job offers increase, suggesting further increase in employment in coming months. Unemployment decreased in July at 3.3% from previous 3.4%. Such a decrease however hides a drop in participation rate, at its lowest since April (59.6% from 60.0%) and a contraction in employment by 130k units, correcting May and June increases by 190k and 340k respectively.

UNEMPLOYMENT RATE



JOB TO APPLICANT RATIO

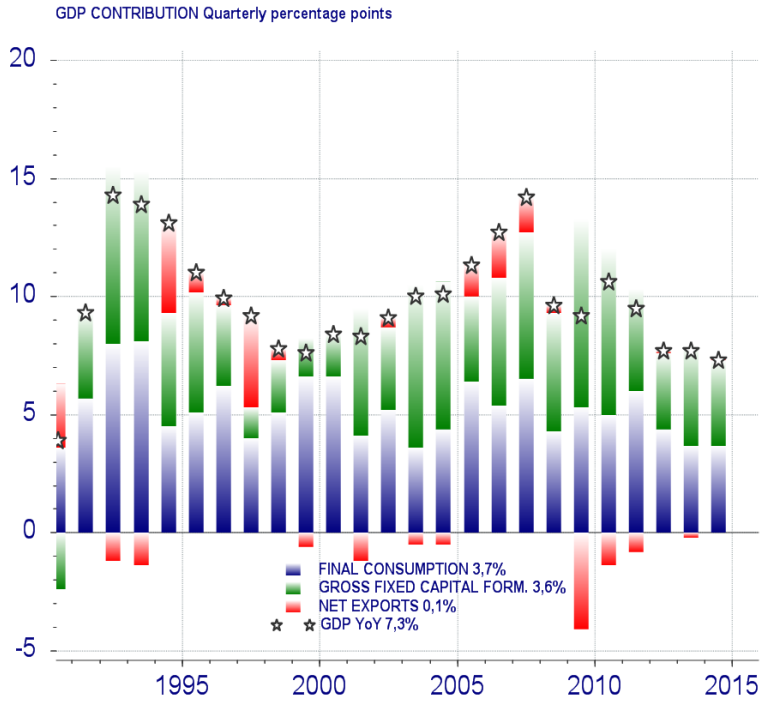


The China Outlook

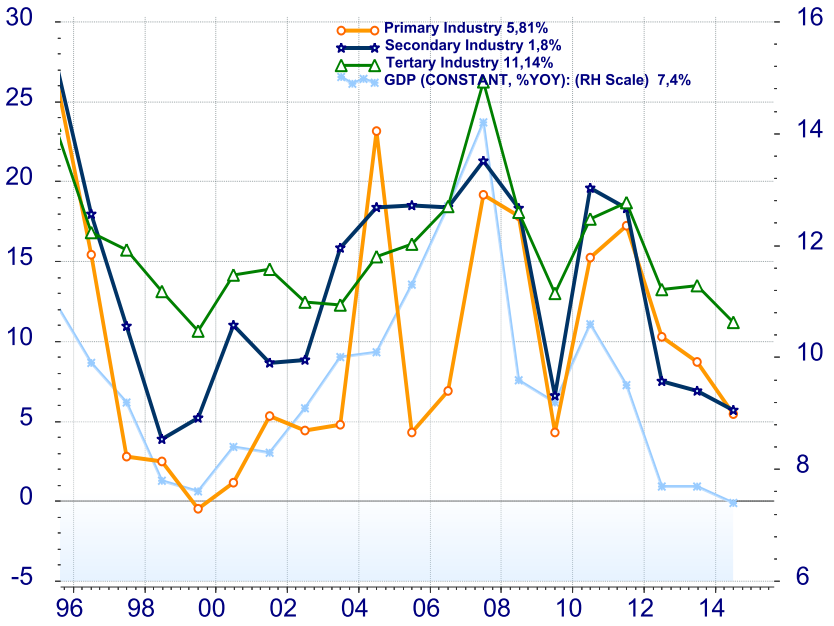
GROWTH SLOWDOWN

China's slowdown is related to the current change in growth model: the moderation in GDP growth rates ia accompanied by an improved quality in its composition. This slowdown, far from being unexpected, is necessary for a sustainable growth in a medium term perspective. The latter also requires corrective measures to eliminate excessive productive capacity, to limit local government debt and shadow banking.

GDP: GROWTH CONTRIBUTIONS



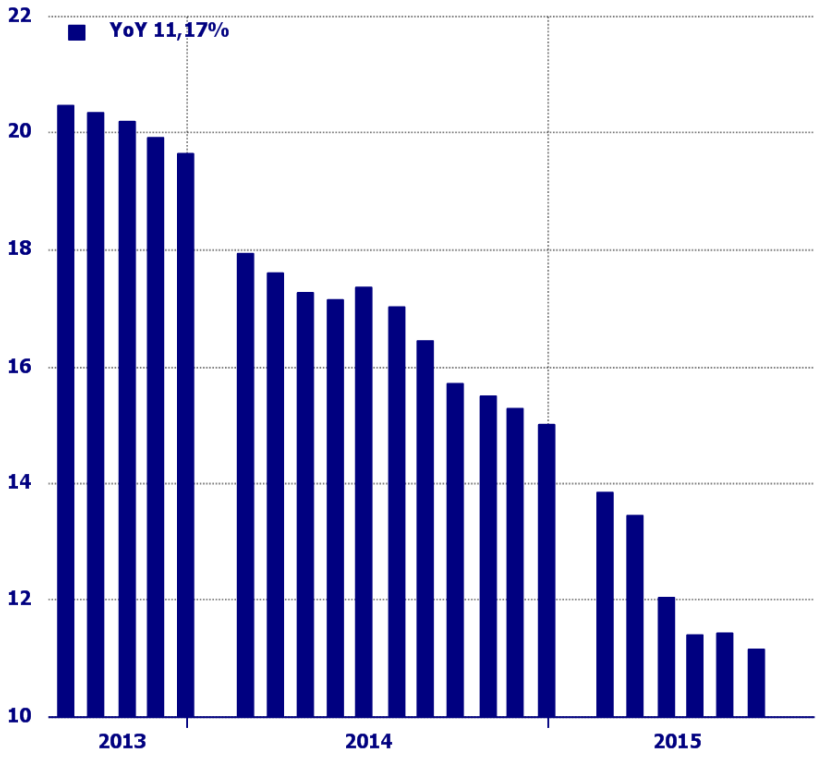
GDP: GROWTH CONTRIBUTIONS



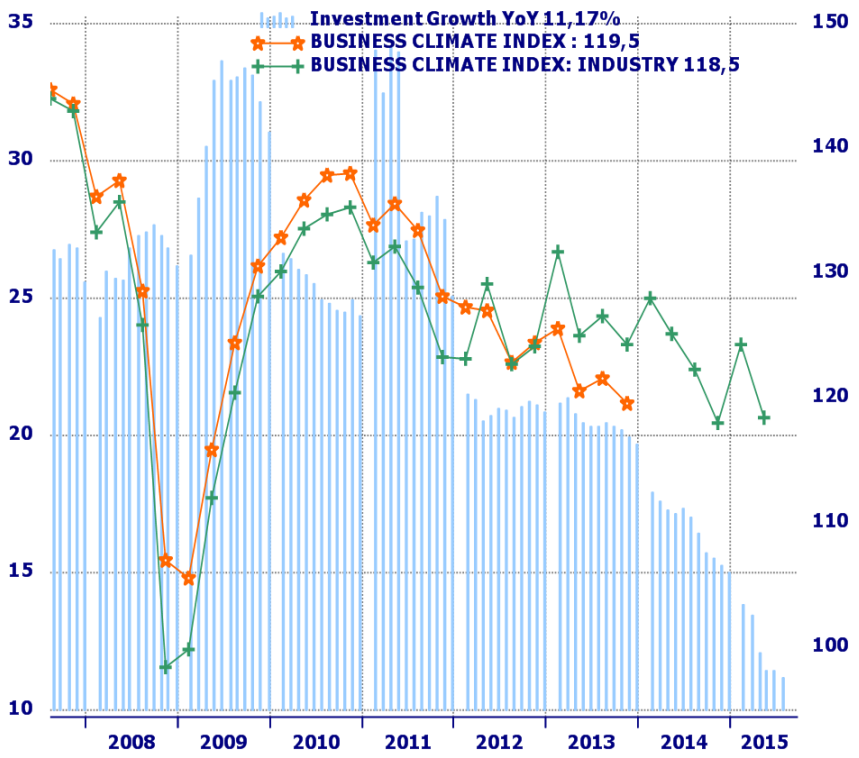
ECONOMIC ACTIVITY

In July Capex registered a slowdown at 11.2% from 11.4%: the data continued its decreasing trend, uninterrupted since the beginning of 2014.

CAPEX
Short Term



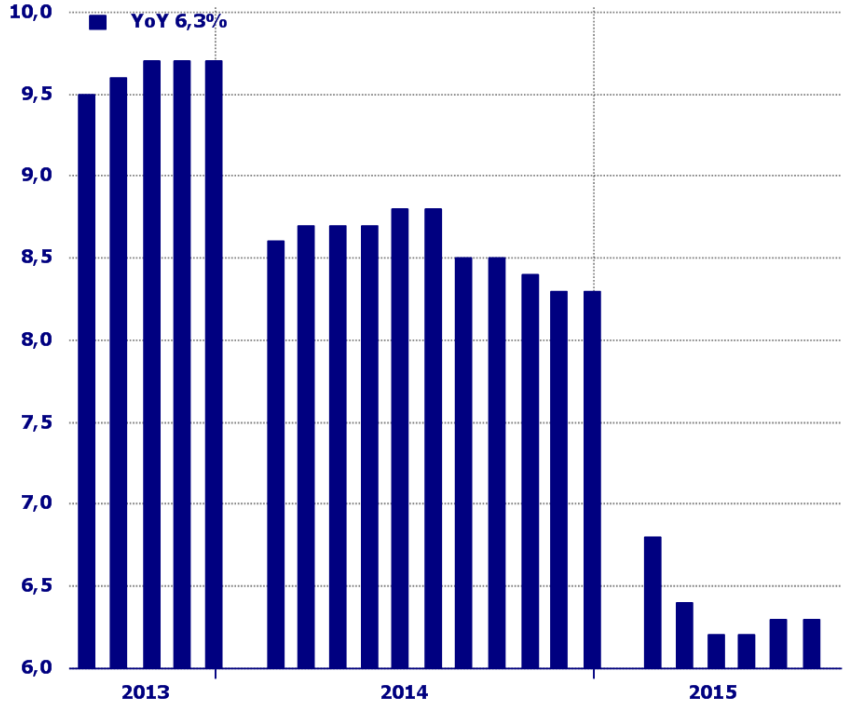
CAPEX
Long Term



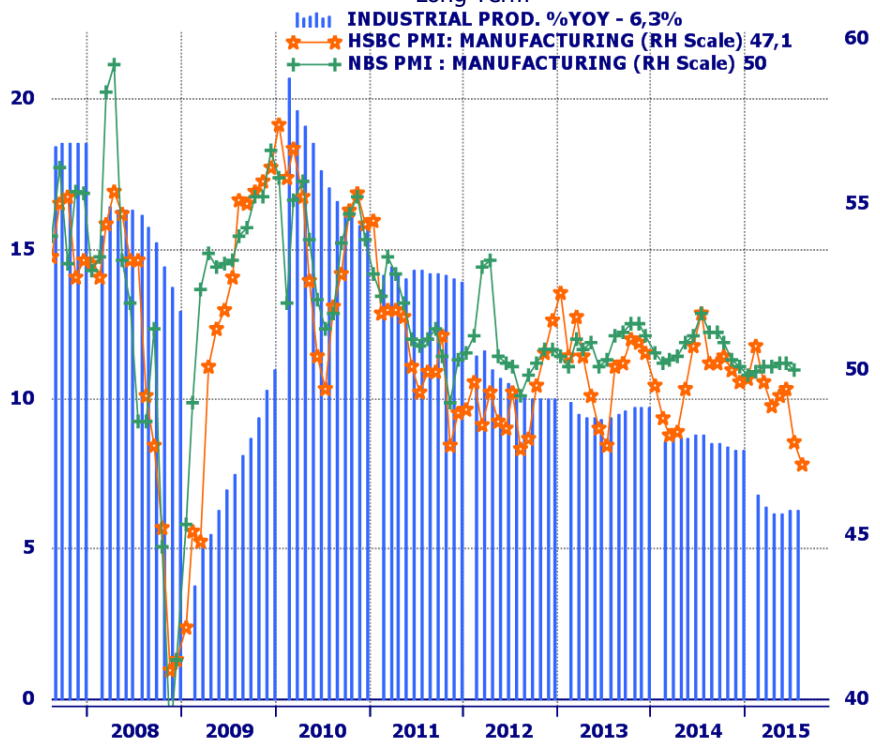
INDUSTRIAL SECTOR

In July Industrial Production registered a brusque slowdown, from 6.8% in June to 6.0% YoY. The slowdown must be attributed to the fall in steel production (-4.6% YoY) and in cement (-4.7% YoY), although in partial recovery compared to the previous months, as these are building materials connected to a sector already in crisis. Also a strong decrease in auto production (-11.2% YoY, corrected from 0.2% YoY) was registered, with auto production contracting by 26.3%, due to weak demand.

INDUSTRIAL PRODUCTION
Short Term

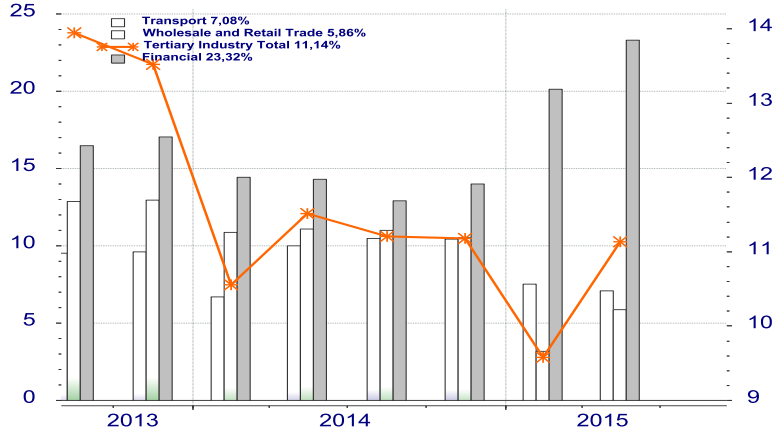


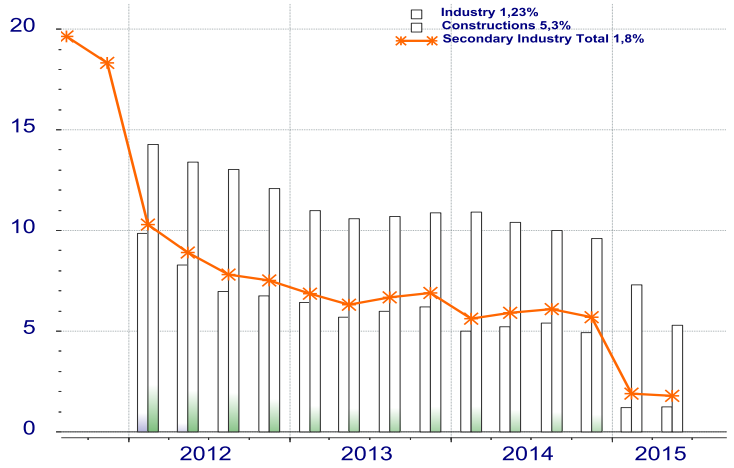
INDUSTRIAL PRODUCTION
Long Term

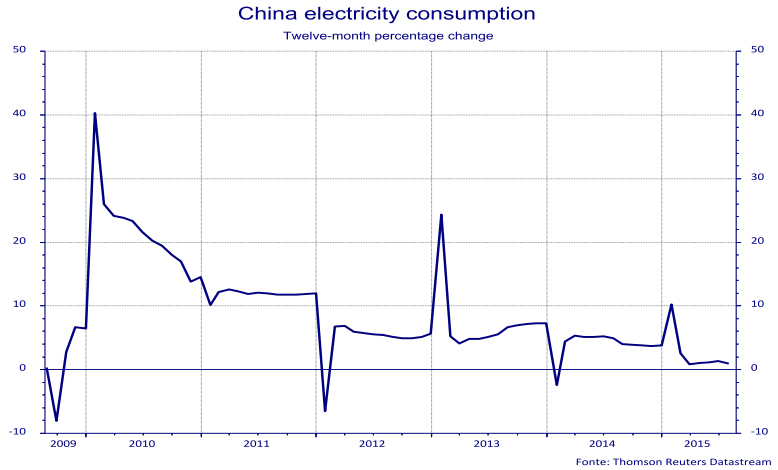


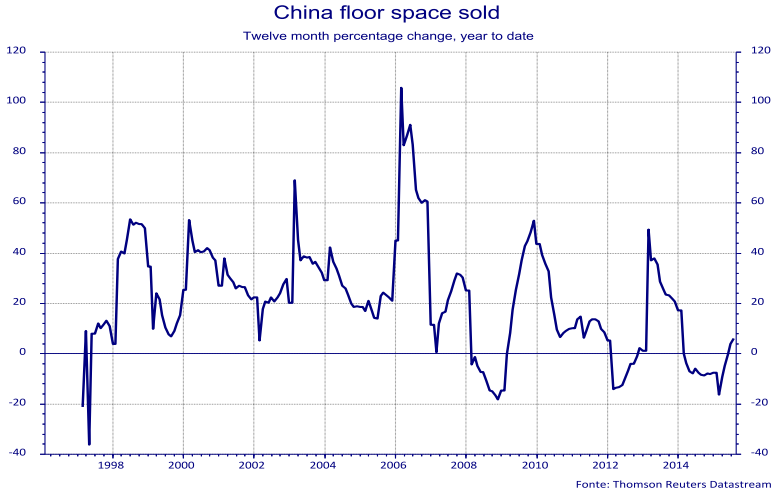
INDUSTRY vs SERVICES

While the adjustment phase is evident in the industrial sector and the real estate crisis, there is a favourable context for the tertiary sector, that in 2014 contributed by almost 50% to GDP growth. Specifically, The industrial sector continues to suffer from excessive productive capacity, connected to the adjustment process in the real estate sector and the deceleration in export growth. The services' sector is instead growing, in particular financial services.



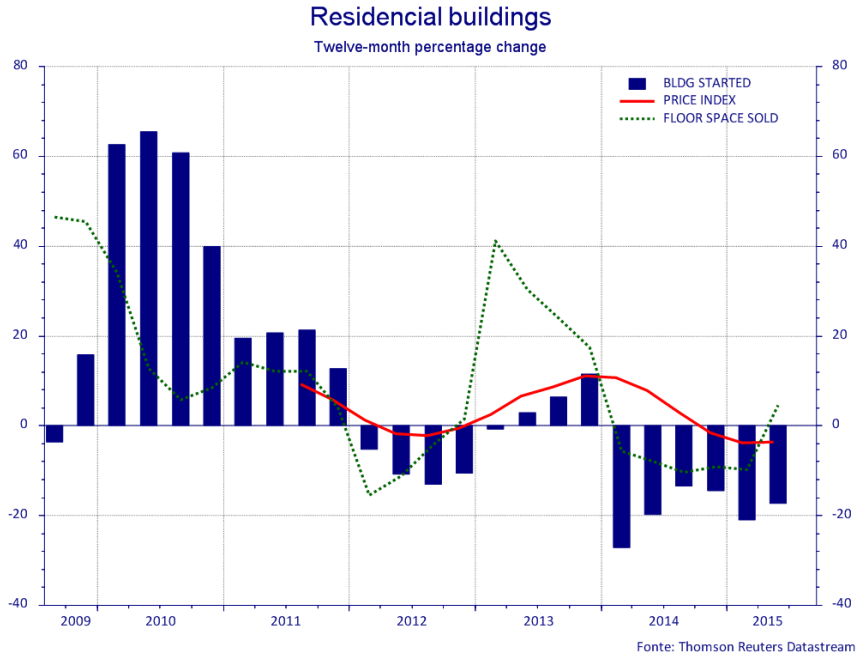


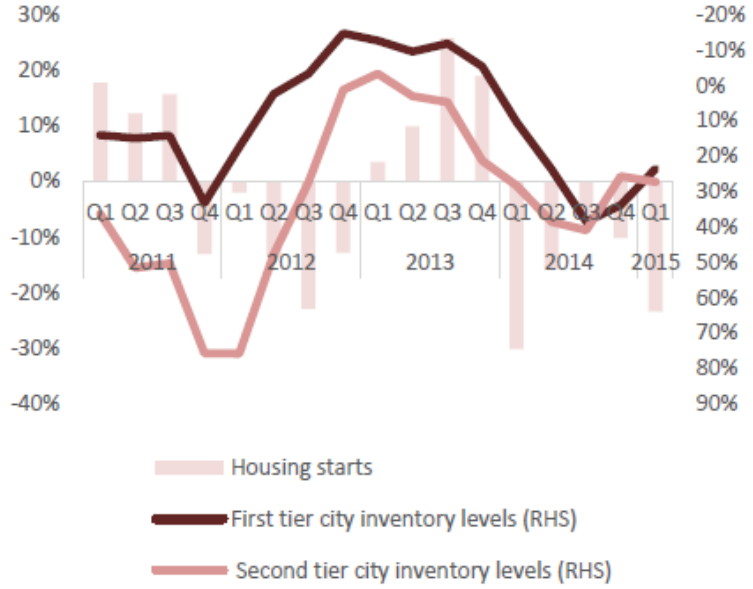




REAL ESTATE

The correction in the real estate sector is related to the excessive offer in particular in second and third tier cities, where housing inventory levels are still high and a contraction in new building sites and investments is registered. A stabilisation signal comes from sales' data, that returned in positive territory, while in first tier cities housing prices have begun again to increase.



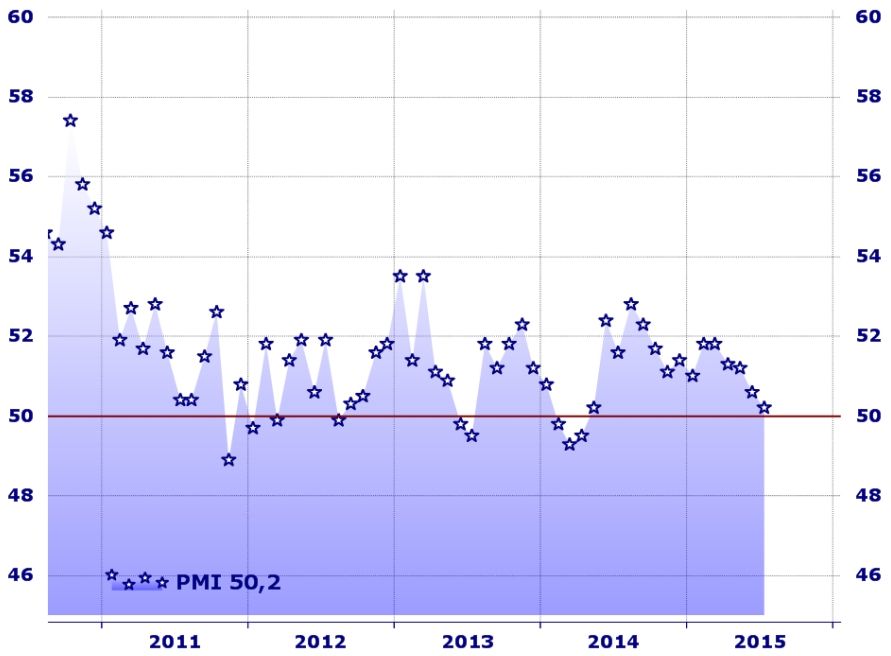


Source: World Bank staff calculations based on Wind Info data and Soufun.

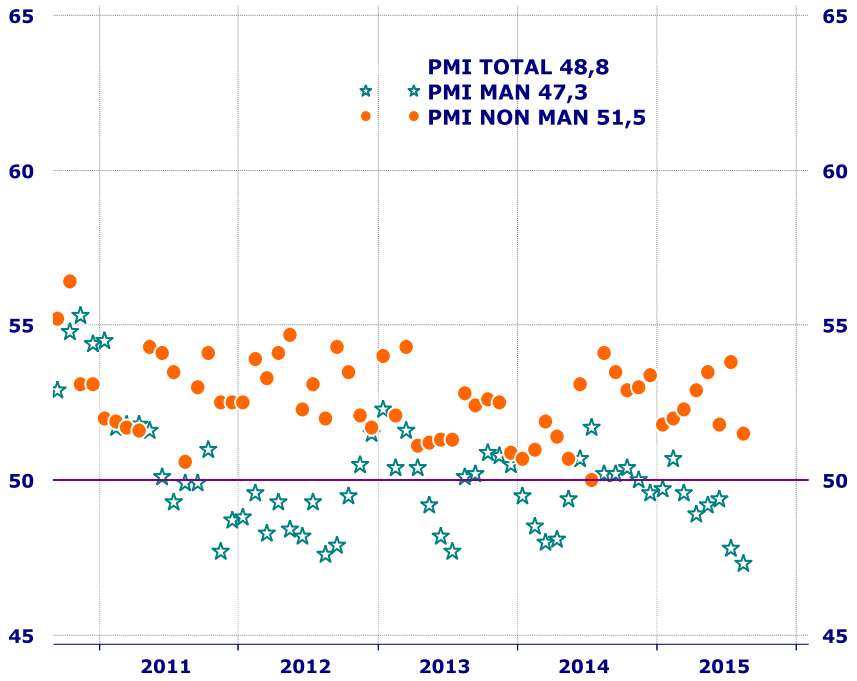
LEADING INDICATORS

The Caixin Composite PMI index is down at 48.8 from 50.2, under the 50 threshold that indicates production expansion, sufferring in August also due to uncertainty in financial markets. The index, that is decreasing since March, highlights growth contracting with some manufacturing sectors forced to cut excessive capacity, while tertiary survey indicates only a slowdown (index from 53.8 to 51.5).

COMPOSITE PMI



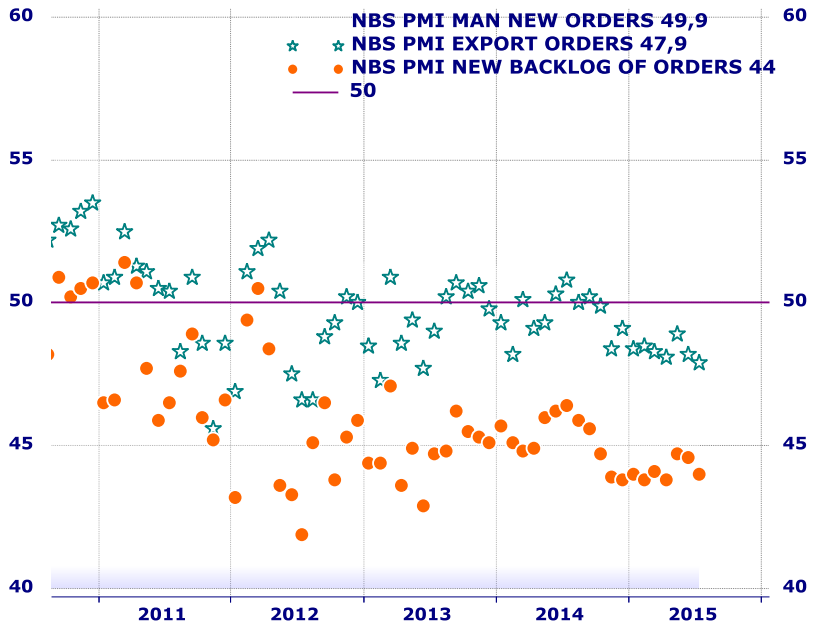
MANUFACTURING AND SERVICES PMI



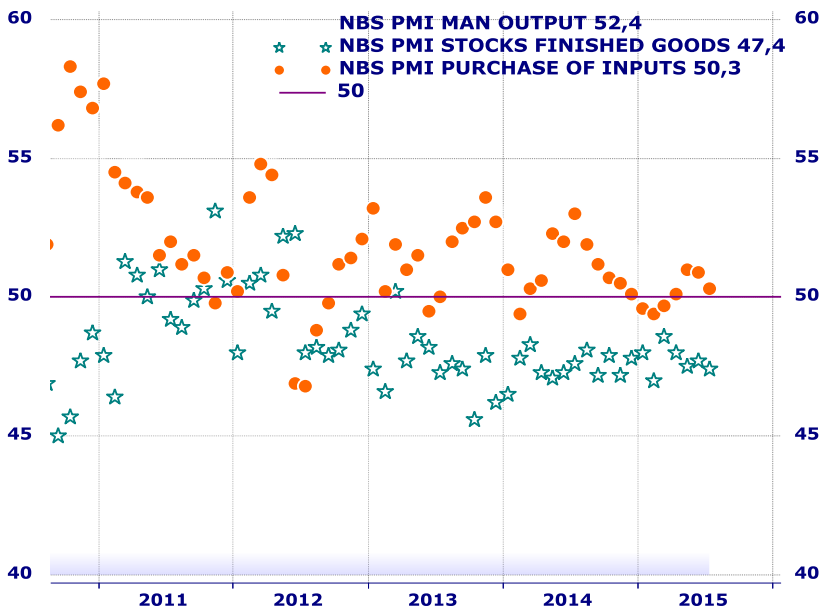
LEADING INDICATORS

The Final Manufacturing Index is thus at 47.3, the strongest contraction of the past six years, with a simultaneous reduction in production, at its lowest since November 2011 and in new orders both domestic and for export. For the second month in a row, businesses registered a drop in new orders, at the strongest rate of the past 17 months. Lower demand forces businesses to decidedly reduce raw materials' acquisitions (index at lowest since March 2009) and employees; at the same time, for the first time in six months, finished goods' stocks are growing. Also the tertiary survey highlighted a slowdown of the sector, connected to a lesser growth in financial services, partly due to turmoil on Asian stocks.

MANUFACTURING PMI



MANUFACTURING PMI

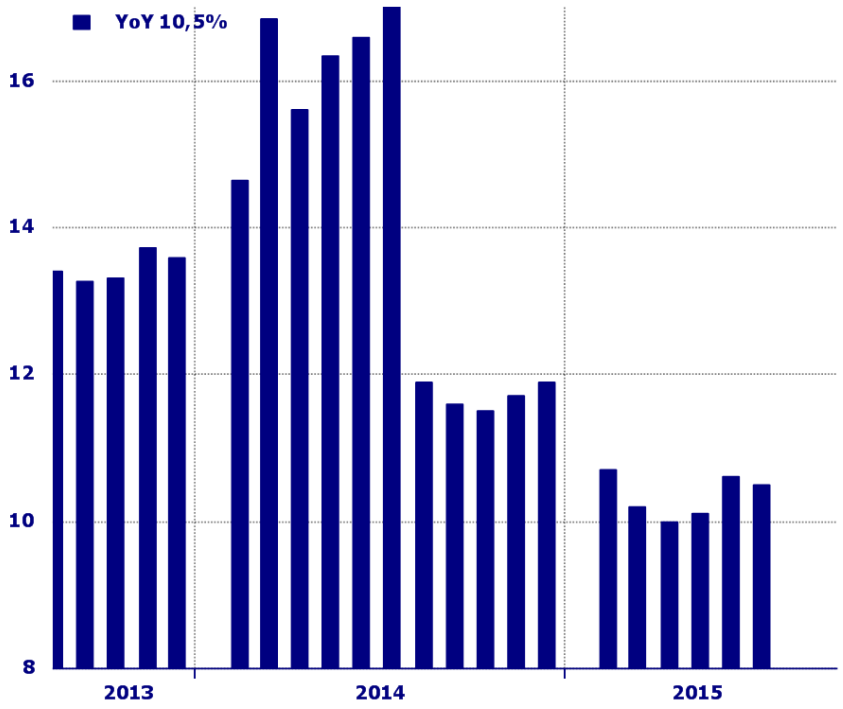


CONSUMPTION

Retail sales in July registered an annualised trend change at 10.5%, slightly lower than previous month's 10.6%. Analysing the detail, there's been a slowdown in: consumer electronics (8.0% YoY from 10.2% in June), office materials (11.6% from 21.4%), furniture (16.0% from 18.5%), communications apparatuses (29.8% from 34.4%) and cars (2.5% from 4.8%), while the major contraction was in oil sales (-7.2% from -4.6%).

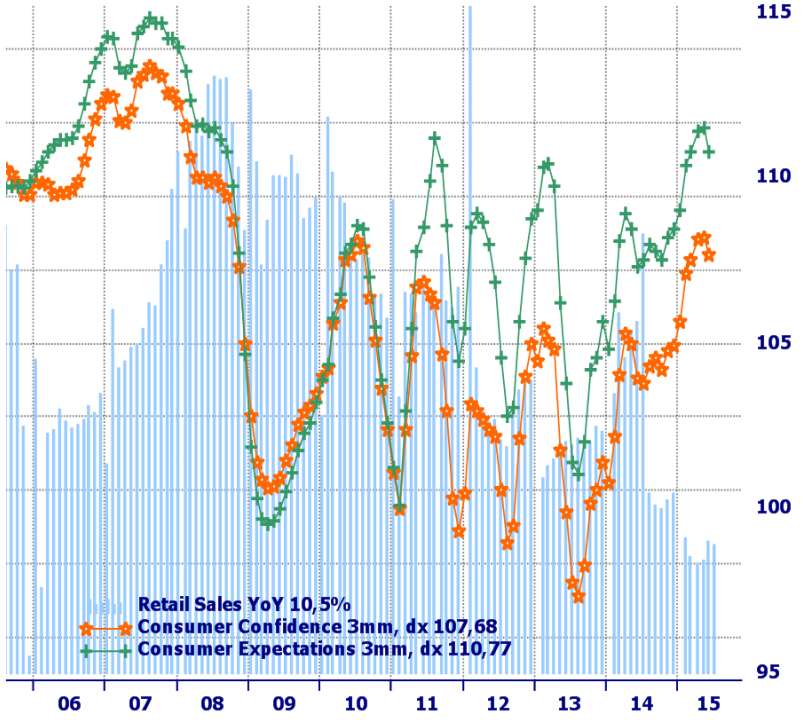
RETAIL SALES

Short Term



RETAIL SALES

Long Term

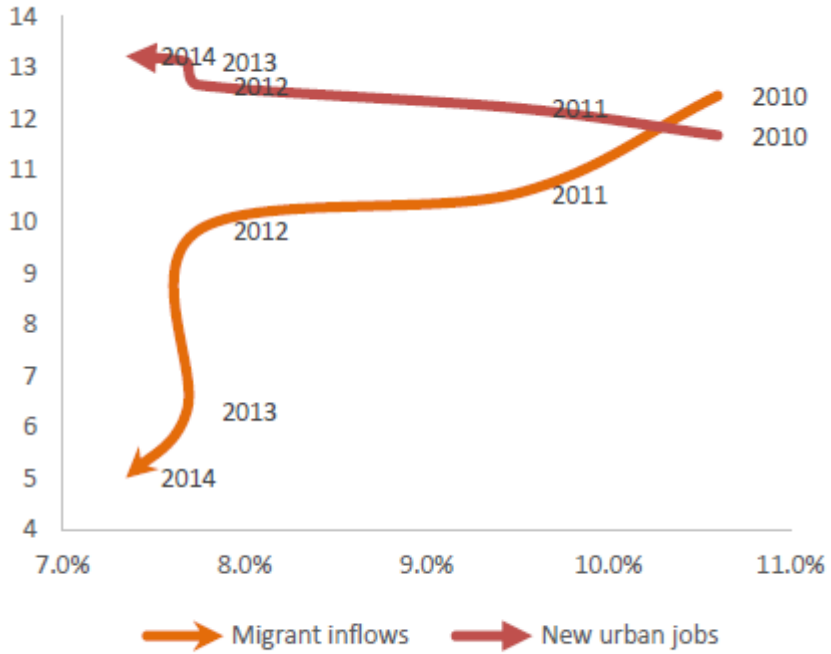


WAGES

The slowdown in economic growth determined an adjustment process in urban wages, while the unemployment rate remained stable with migration decreasing. The major impact was on wages' growth in cities where there was a definite slowdown with effects on consumption, whereas such a phenomenon has not happened in rural areas.

GDP, DISPOSABLE INCOME AND CONSUMPTION

GDP AND MIGRANT INFLOWS TO URBAN AREAS

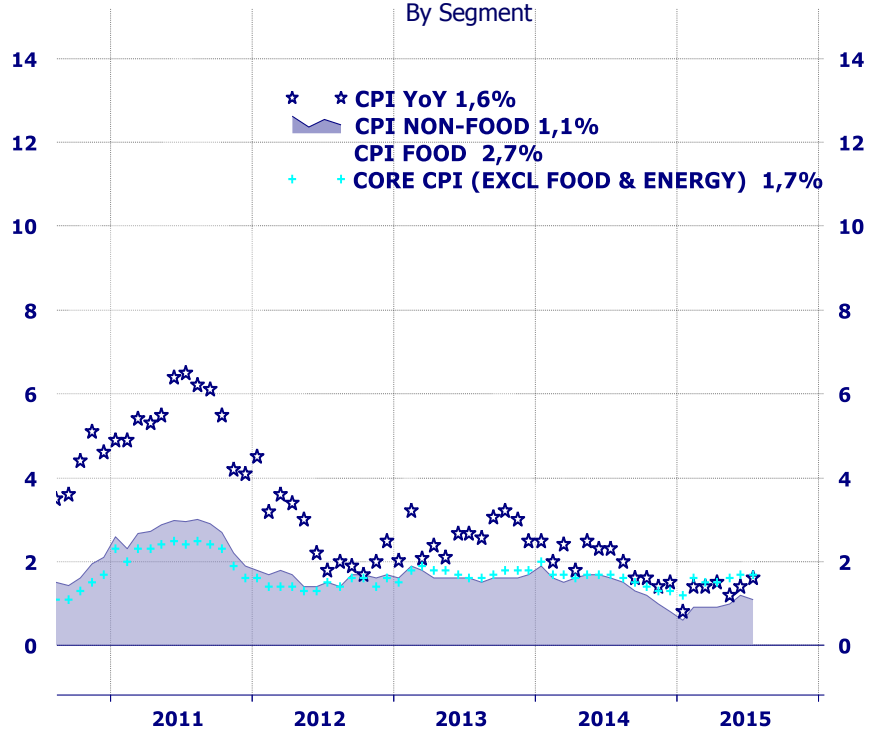


Source: World Bank staff calculations based on CEIC data

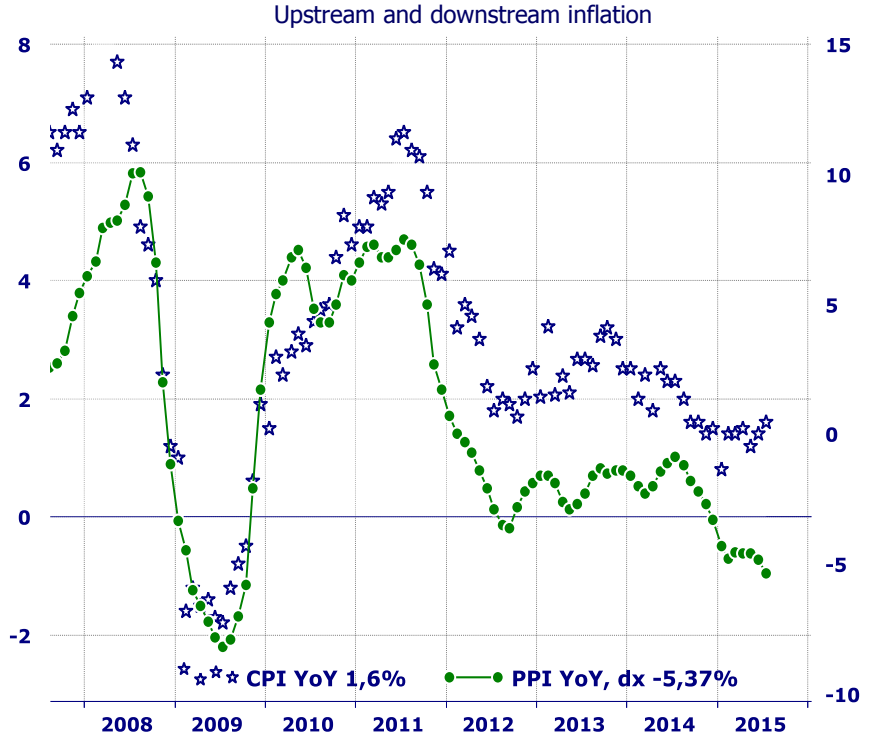
PRICE DYNAMICS

The Chinese Consumer Price Index in July positively surprised us with an acceleration worth 1.6% YoY from 1.4% of the previous survey. On the other hand, production prices accelerated their fall, anticipating downward pressures on consumer prices for the next months. Despite the slight increase, the scenario remains focused on deflationary pressures in line with domestic demand's slowdown. Moreover, the core index, that is net of the volatile food and energy components, is confirmed at 1.7%, only slightly higher than values registered at the beginning of the year. The food component accelerated to 2.7% YoY from previous 1.9% YoY, registering meat price increase, while wheat prices slowed down for the fourth month in a row (1.9% YoY). The energy component gave a negative contribution, again due to fall in oil prices.

RETAIL PRICES



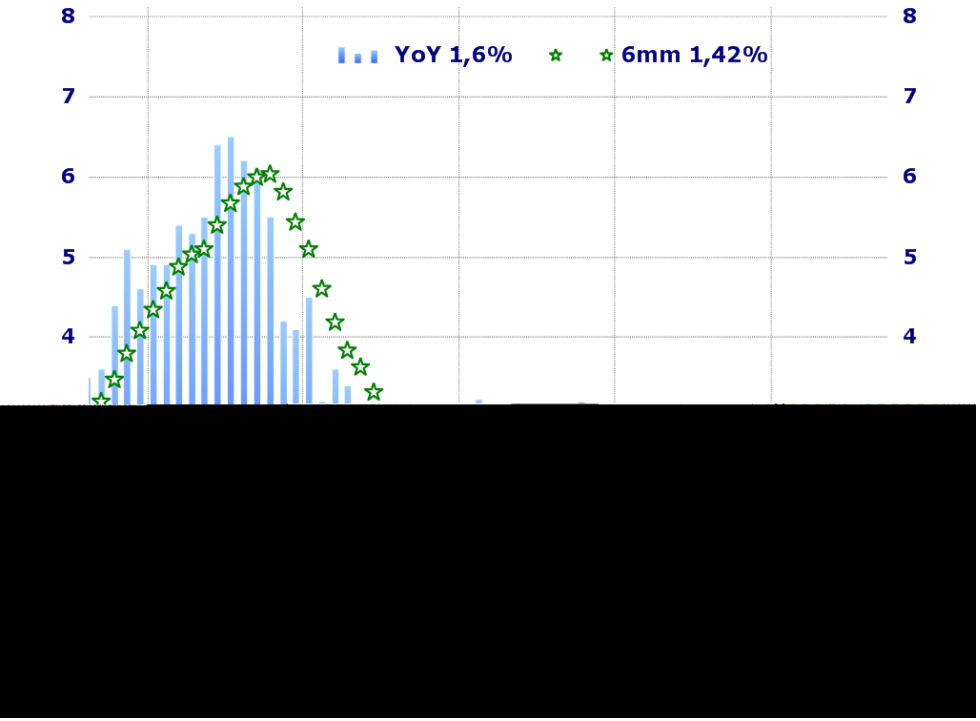
PRICES ALONG PRODUCTION PROCESS



PRICE DYNAMICS

The moderation in consumer and production price growth is accompanied by leading indicators' signals of further decreases in the coming months.

RETAIL PRICES
Short Term

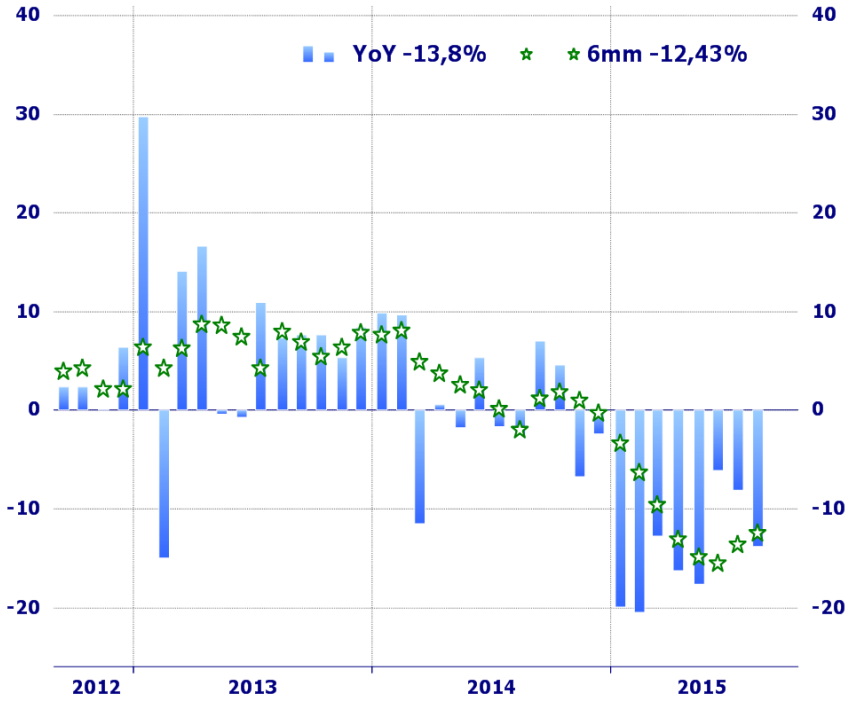


RETAIL PRICES
Long Term

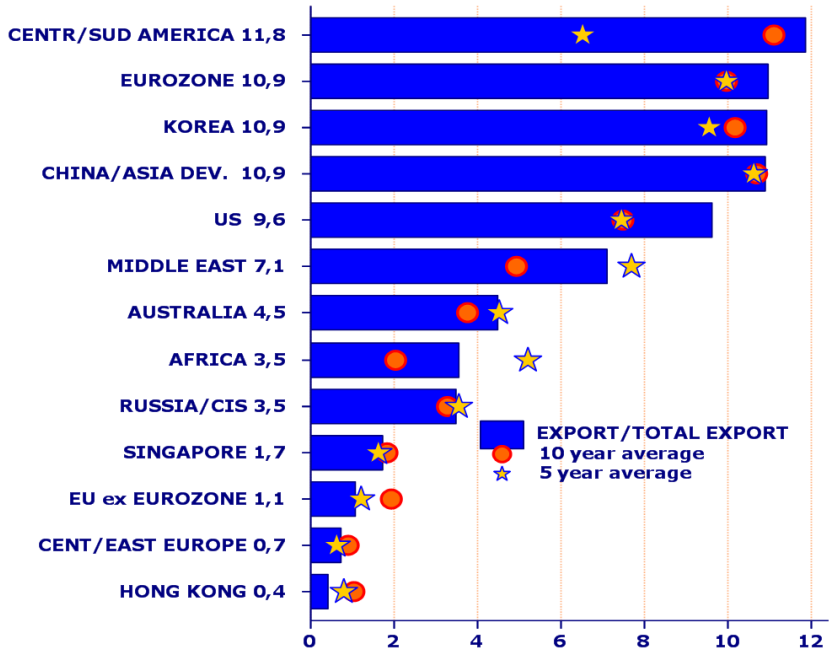
FOREIGN TRADE

Imports decreased by 13.8% YoY, from -8.1% of the previous survey. In June, an import contraction, down at -6.1% YoY from -17.6% of the May survey.

FOREIGN TRADE
IMPORTS – Short Term

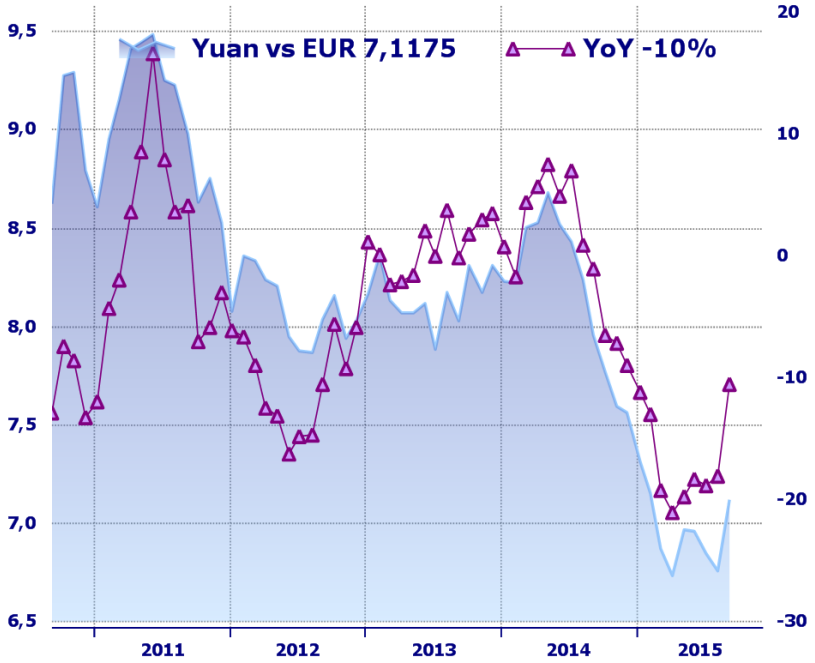


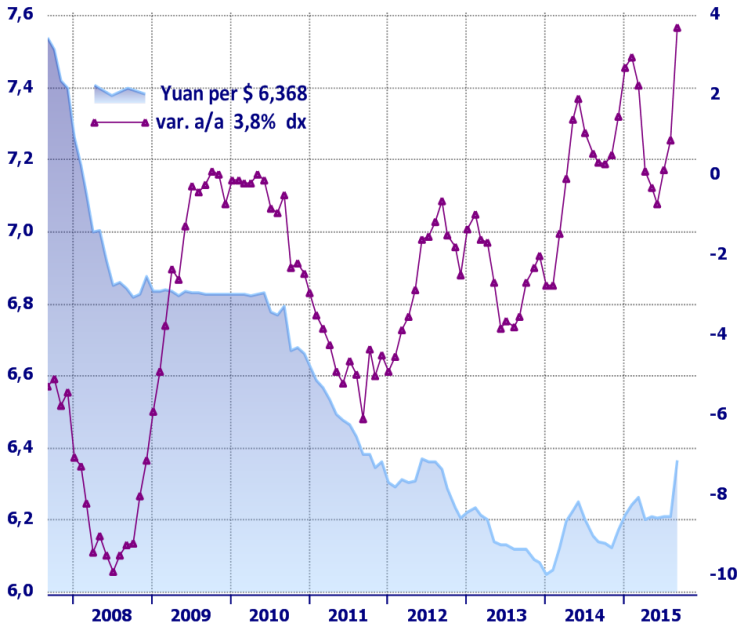
FOREIGN TRADE
IMPORTS – Countries



EXCHANGE RATE AND PBOC

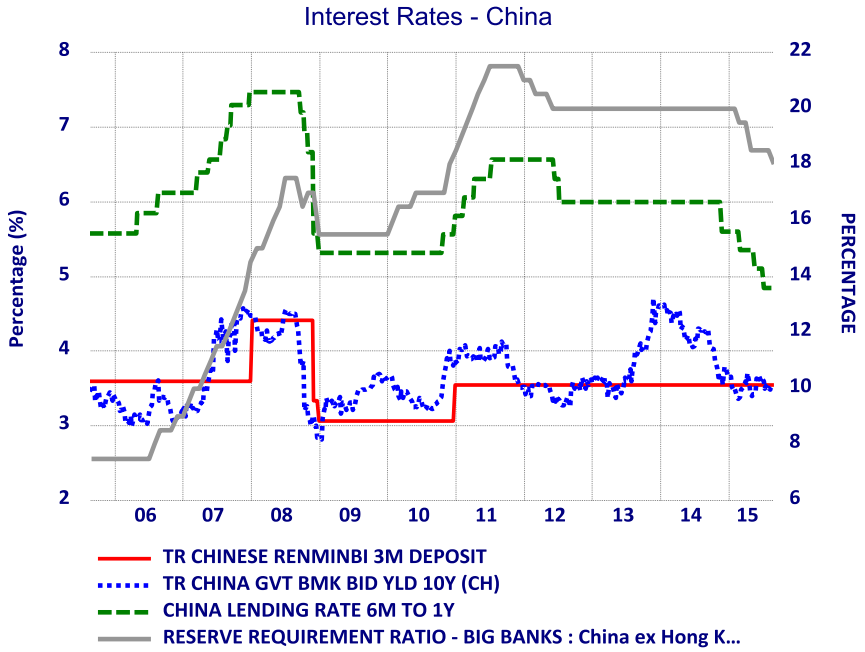
Following the change on parity with USD by the Central Bank, the yuan rose over 7 against the euro. The new exchange rate mechanism implies a centralised parity adjustment to market values: if the previous day's closing differs from the central parity, the following day's parity will be thus changed, including also considerations on the movements in main currencies.

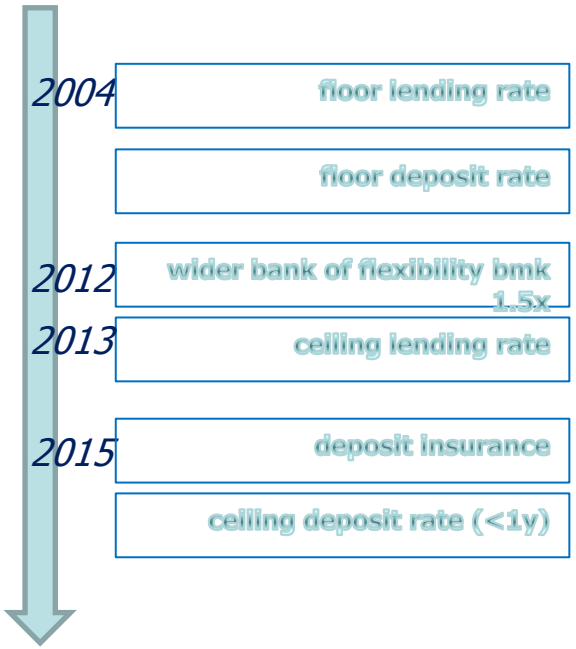




EXCHANGE RATE AND PBOC

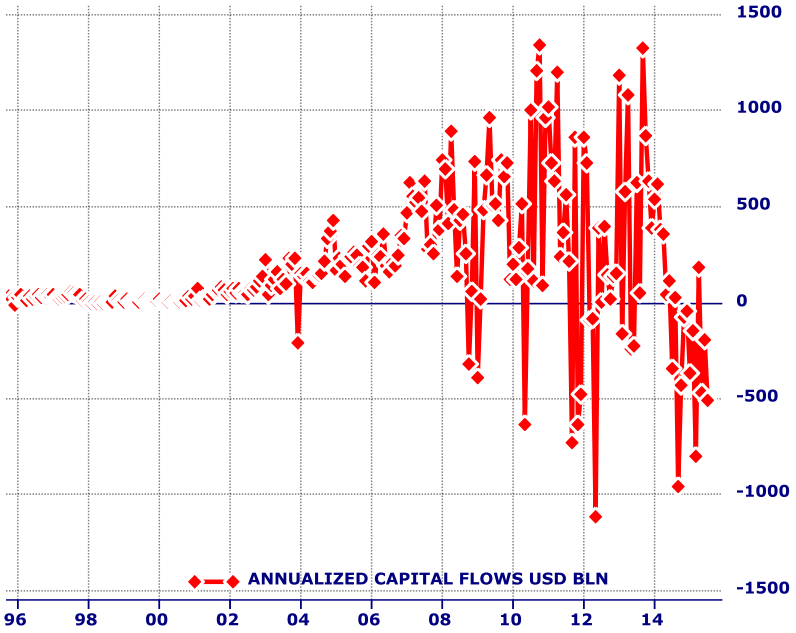
PboC's move must, however, be considered taking into account the Government's goal to establish the Yuan as a global reserve currency. It would thus enter the bundle of currencies that determine the value of the IMF's currency reserves, the Special Drawing Rights (SDR), benefitting from a greater stability and from the status of global currency. The decision will be made by the IMF by the end of this year, under the revision plan for DSP's currency composition, which takes place every five years. This analysis, as stated by Eswar Prasad, IMF's Chief Economist for China, has highlighted that the possible inclusion depends on financial markets' development, on a major flexibility of exchange rates' markets and on the introduction of foreign capital in internal markets, for stocks and Government bonds, in the course of the next year, with a possible further revision of the currency basket by September 2016.

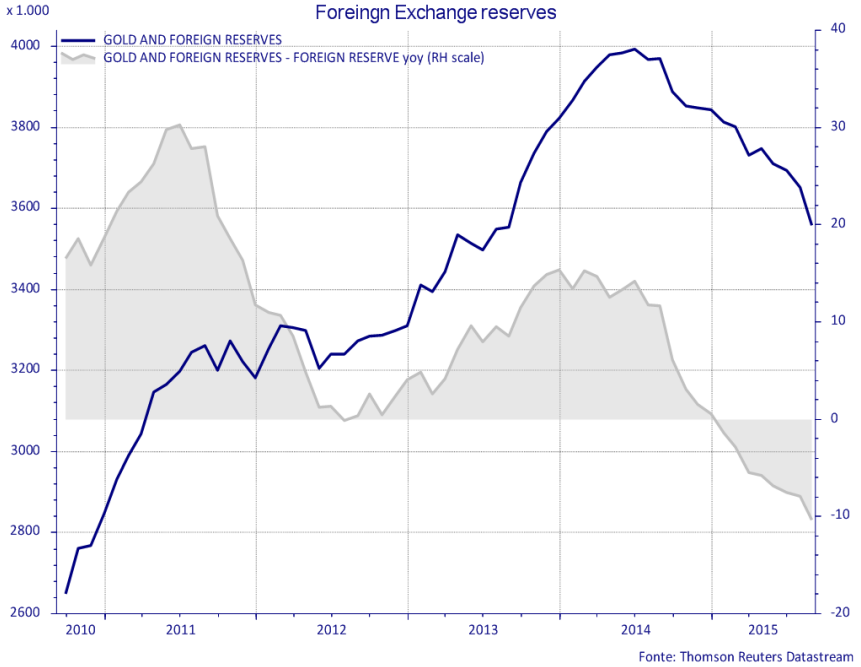




EXCHANGE RATE AND PBOC

Starting in 2014, China changed from being a system with strong capital inflows, accompanied by an increase in Central Bank currency reserves, to being a system with capital outflows and reserve decumulation, necessary to prevent an excessive depreciation of the Yuan. Despite the surplus in current accounts, a capital and investment outflow was registered, only partly balanced by incoming investments in services' sector.





STOCK MARKET AND PBOC

In August, following stock markets' turmoil, China has injected almost 100 billion dollars in two big public banks to strengthen their capital and support the economy, in particular exports and real estate. PBoC has also injected 260 billion Yuan into the country's financial system through 7-day refinancing operations (reverse repo). This is the greatest ammount of liquidity PBoC has injected in 19 months. PBoC has also cut reference rate by 0.25% and has reduced the obligatory reserve coefficient by 0.50%, following stock market turmoil.

November	The State Council announced 10 measures to source the high costs of financing
	PBoC rate cut: 40bp refi rate (5.60%) and 25bp deposit rate (2.75%)
	Rate cut (20bp): refi rate 14gg (3.20%)
December	The PBOC includes loans and deposits with non-financial institutions as regular and therefore subject to the requirements of the ratio between loans and deposits
February	RRR cut for commercial banks (50bp)
	The State Council announced tax breaks for SMEs
	PBoC rate cut: 25bp refi rate (5.35%) and deposit rate (2.50%)
March	The State Council announced the plan that will allow the conversion of local governments debts in municipal bonds purchased by the NSSF
	PBoC e the Governemet adopt measures to promote the purchase of second home
April	The State Council approves the reform of the three main policy banks(China Development Bank, Exim Bank e Agricultural Development Bank)
	RRR cut for commercial banks (100bp)
May	PBoC rate cut: 25bp refi rate(5.10%) and deposit rate (2.25%)
	Deposit rate cap from 1.3x to 1.5x
June	PBoC rate cut: 25bp refi rate(4.85%) and deposit rate (2.00%)
	RRR cut for rural banks

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