



Global Economy Report

February 2013



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 Center 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 January the IMF updated its forecasts for global growth: from a 3.2% increase in 2012, we should move on to a 3.5% for this year (versus the 3.6% expected by the IMF in the October of 2012). Growth should further accelerate in 2014, with an expected value of 4.1% (again a bit less than the 4.2% reported in the previous IMF forecasts).
- ❖ For developed countries, the year 2013 will be a period of slow growth due to the fiscal adjustment and the presence of financial risks related to the debt reduction.
- ❖ In emerging countries there are better perspectives, but the risk of inflation threatens to slow down growth by inducing less expansionary monetary policies and reducing the extent of the fiscal stimulus.



EXECUTIVE SUMMARY

- ❖ In line with the IMF and OECD projections, in the coming months we forecast positive developments for the global economy.
- ❖ Expected growth in the Gross Domestic Product (GDP) of the major economies is still very bland this year, +1.4% (from 1.3% in 2012), with an expected 2.2% in 2014.
- ❖ For emerging economies, the expected growth this year is 5.5% (from 5.1% in 2012) and 5.9% for 2014, with a strong pull from the BRIC countries



EXECUTIVE SUMMARY

- ❖ In terms of main economic areas, we foresee a slowdown for the USA, where GDP should grow by 1.7% in 2013 and 2.8% in 2014. These figures could however change depending on the outcome of the negotiations on Sequestration, a series of automatic, across-the-board cuts to government agencies, totaling about \$1.2 trillion over 10 years.
- ❖ For the USA, we foresee inflation below 2% during most of the forecasted period, thanks to the output gap accumulated during the Great Recession, these three years of very slow recovery, and limited risk of major increases in commodity prices. Towards the end of 2014 we could witness a new acceleration of inflation. Overall, we expect the average headline and core CPI at, respectively, 1.4% and 1.7% in 2013, and at 1.6% and 1.7% in 2014.
- ❖ In this issue of the report we focus on the economic conditions in the USA.



EXECUTIVE SUMMARY

- ❖ In the EU, the new 2014-2020 budget is an unsatisfactory compromise. It still represents less than 1% of EU GDP, and keeps distributing resources according to political convenience rather than economic reasoning. It will be difficult with the available resources to alleviate the negative effects of the cuts in growth enhancing public investment at the national level.
- ❖ For the Eurozone, we expect a growth rate close to zero in 2013, with a slightly better situation in 2014, when growth should be about 1-1.2%. In line with this low growth scenario, the unemployment rate will remain well above 11% at least until 2014.
- ❖ The low growth scenario is also associated with limited inflation. We forecast a headline CPI growth of about 1.8% for 2013 and 1.7% for 2014.



EXECUTIVE SUMMARY

- ❖ For Japan, the more expansionary monetary policy could help the exit of the economy from a recessionary phase. However, there remains substantial uncertainty about 2013 and 2014. We expect growth to be around 0.3% and 0.8%, respectively, in a context of very moderate inflation.
- ❖ For China, the positive January trade data support our expectation of a pick up in the economic cycle. GDP growth should exceed 8% both in 2013 and 2014, while inflation should remain below 3% in 2013.
- ❖ As to the other principal emerging economies, according to the December OECD report, between 2012 and 2013 growth in Brasil should pass from 1.5% to 4.0%, in Russia it should increase from 3.4% to 3.8%, while India supposedly will grow from 4.5% to 5.9%. In 2014, Brasil and Russia should have GDP growing over 4%, while India's growth should reach 7%.

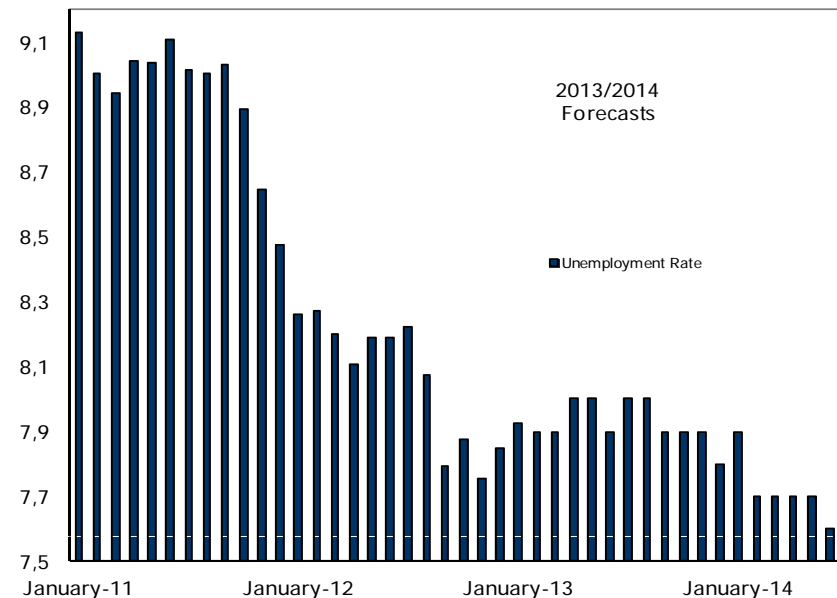
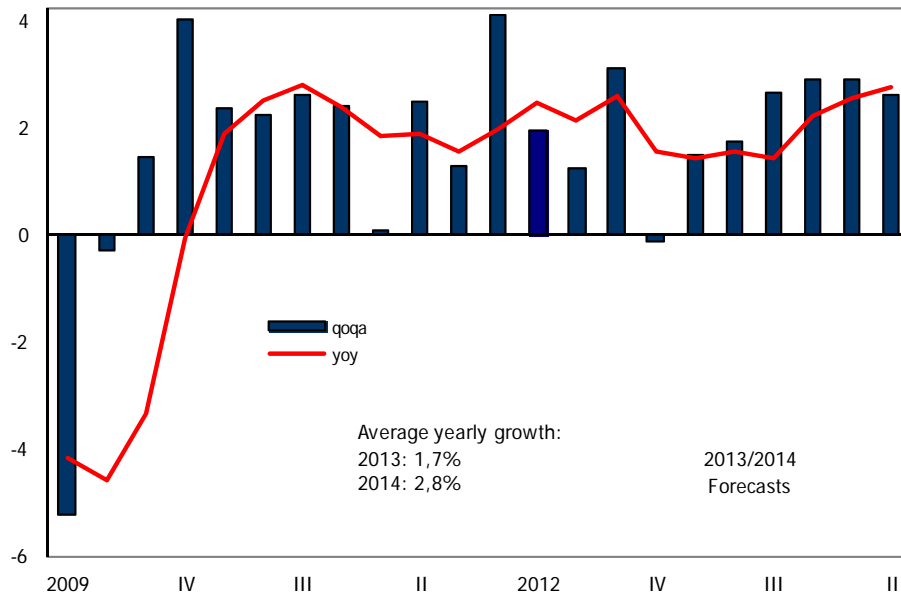


FOCUS ON THE UNITED STATES



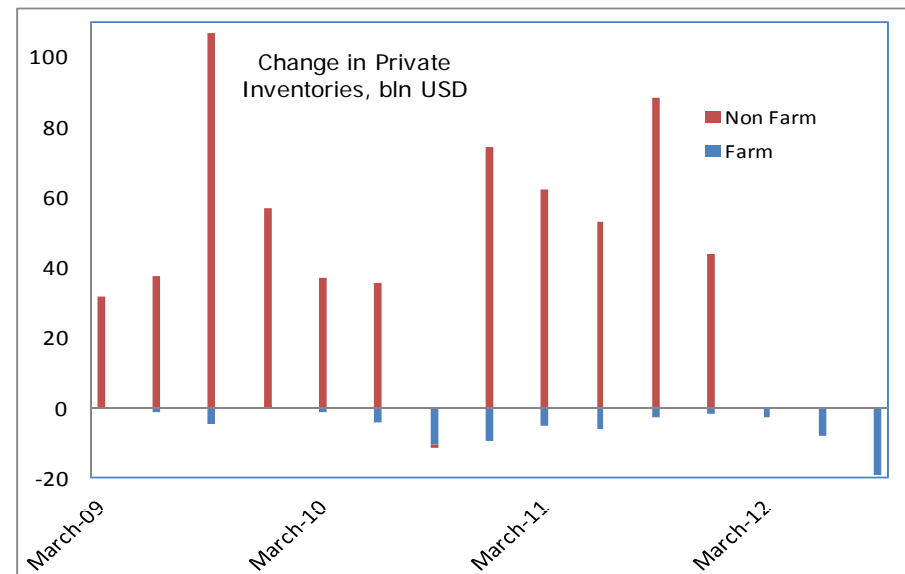
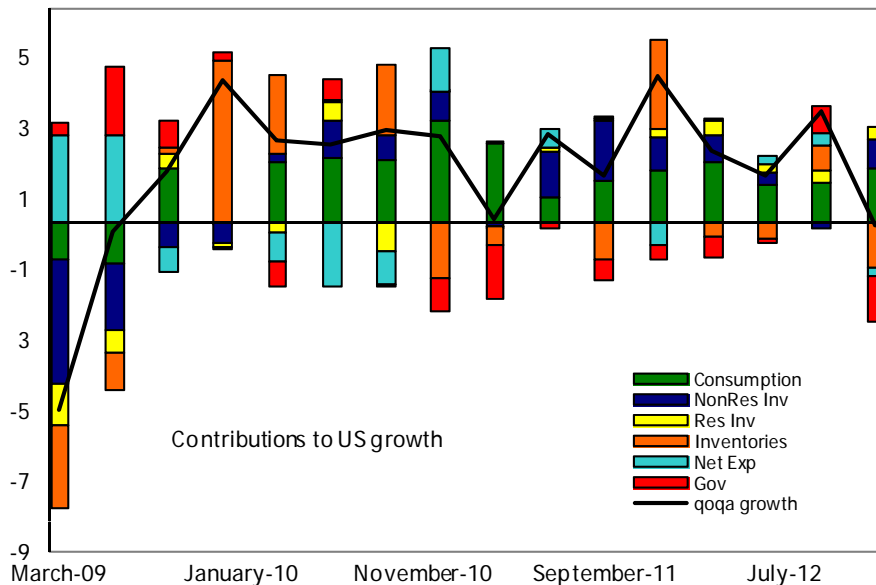
GROWTH

❖ **Growth.** In the three and a half years since the formal end of the recession, the US economy has grown at an average of 2.1% in real terms. The slow down in Q4 2012 is partly due to temporary factors, such as Hurricane Sandy, uncertainty due to the Fiscal Cliff that induced businesses to decrease stocks, and contraction in public expenditures. For Q1 2013 we assume a modest pick up in inventories, with still substantial uncertainty related to a possible start of Sequestration in March. Moreover, private consumption should slow down due to the end of the Payroll Tax Holiday. We expect a stronger growth in the second part of 2013, once a long term Fiscal Reform is decided upon by Congress, with a rebound of Capex. Overall, our growth forecasts are at 1.7% for 2013 and at 2.8% for 2014, not sufficient to bring unemployment below the 6.5% value announced as a FED target. There remains substantial uncertainty related to the outcome of negotiations on Sequestration, developments in the Eurozone, and global growth.



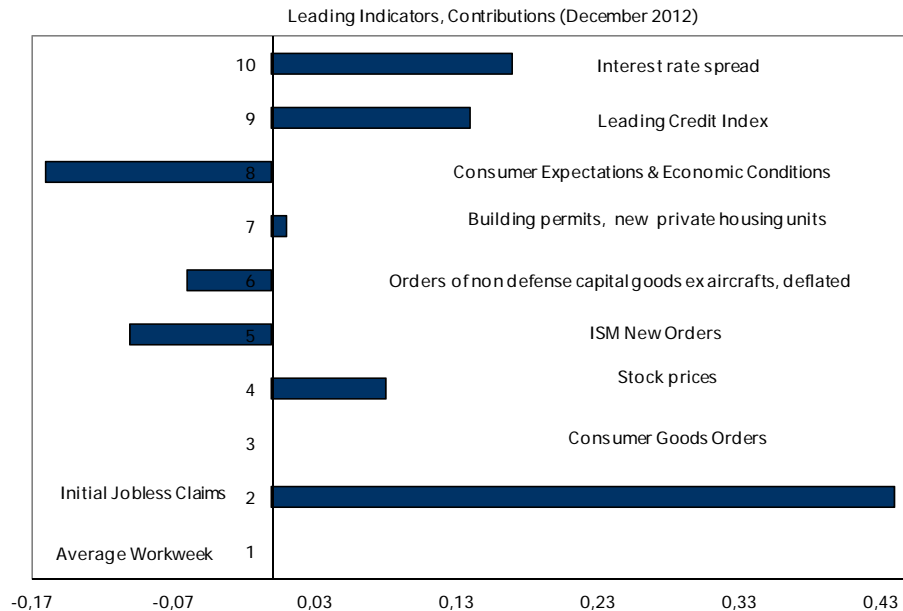
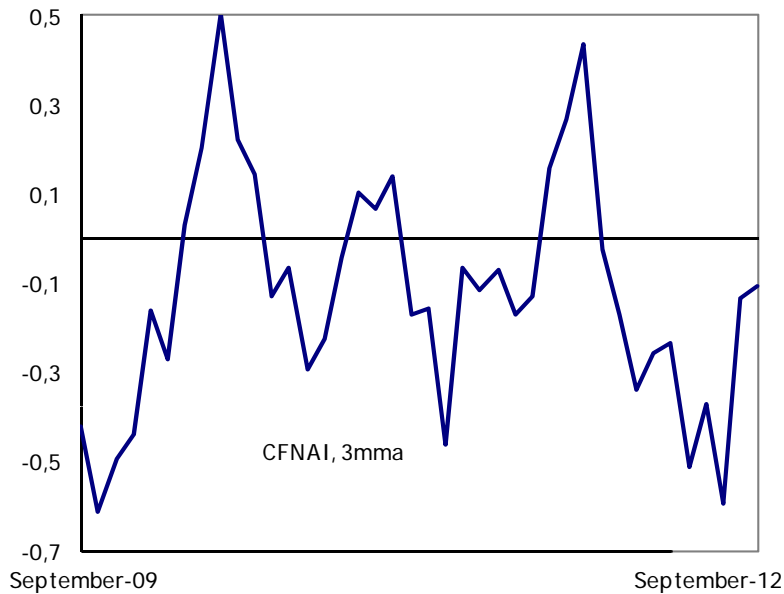
GROWTH

- ❖ The US Q4 2012 GDP is below our expected value, registering a -0.1% annualized qoq growth, the first negative result since the end of the Great Recession. The consistent drag of public spending, defense in particular, reduced annualized qoq growth by 22.2%, the greatest correction since the end of the Vietnam War in 1972. Overall, public spending subtracted 1.3% to growth, due to the risks connected to Sequestration in Q1. Growth has also been hindered by Net Trade, partly compensated by positive inputs from Private Consumption, Residential Investments and Capex. Consumption was still slightly lower than expected, at 2.2% qoqa after the 1.6% qoqa in Q3. Fixed investment was higher than forecasted, at 9.7% qoqa up from 0.9% qoqa in Q3.



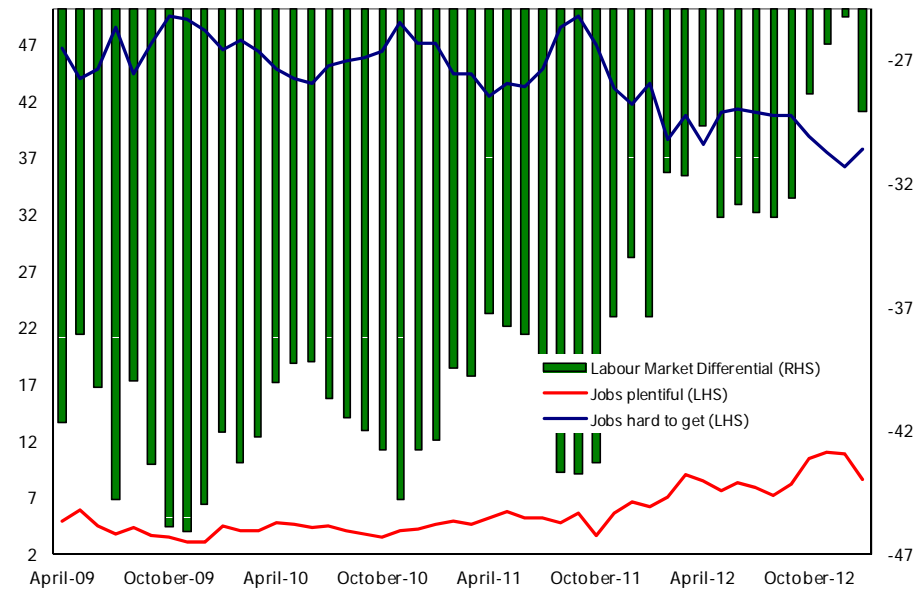
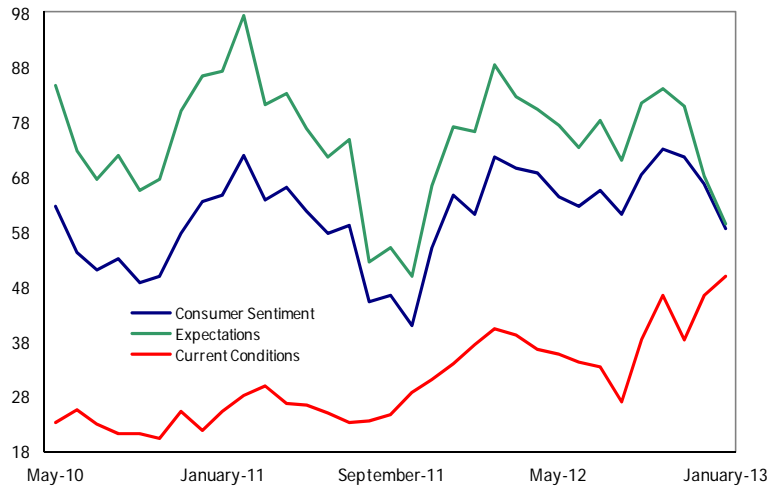
LEADING INDICATORS

- ❖ The US economic activity slowed down in December according to the Chicago Fed National Activity Index, passing from 0.2666 in November to 0.0197, while its three months moving average improved at -0.1087 up from -0.1340 in November. The index is an average of 85 national indicators grouped into four categories: production, labor market, consumption and real estate market and level of sales, stocks and orders. A value of the three month moving average lower than -0.7 is linked to a strong probability of entering a Recession. The Leading Indicator del Conference Board has registered a positive signal in December (0.5% m/m) after the 0% in November.



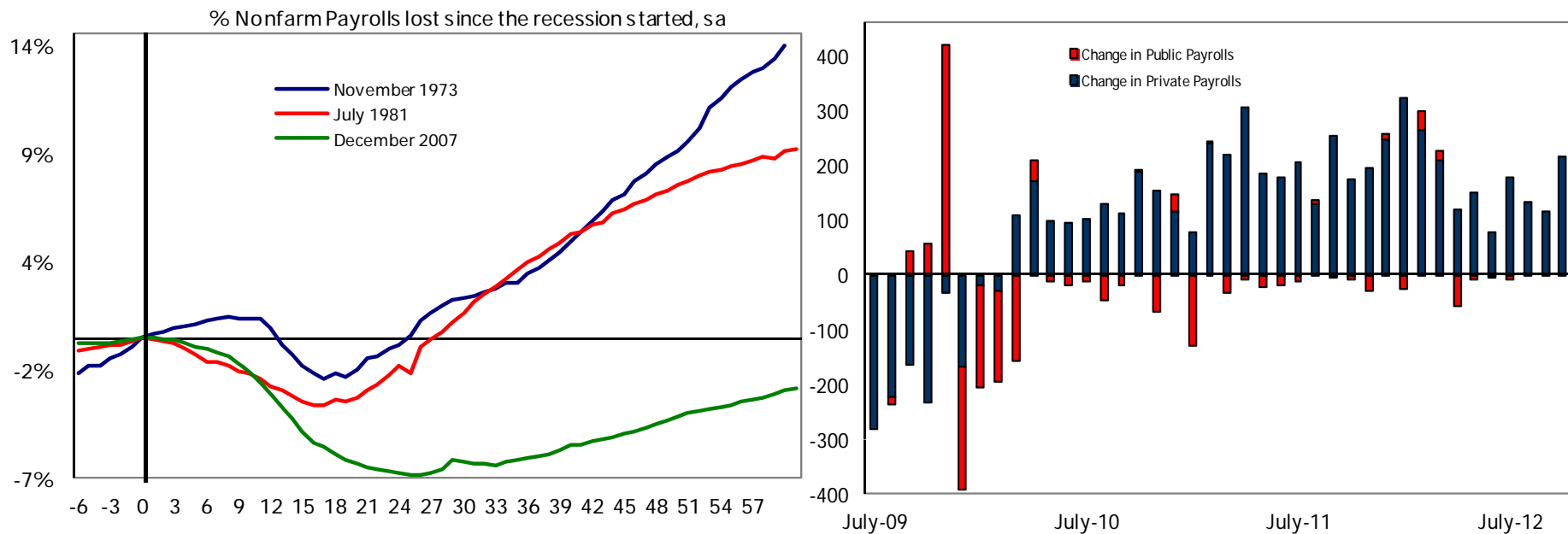
CONSUMER CONFIDENCE, CONFERENCE BOARD

❖ January Consumer Confidence fell again at 58.6 from 66.7, reaching the lowest level since 2011 and incorporating tax increases due to the 31 December Mini Deal between the two parties. In particular, the end of Payrolls Tax Holiday created a reduction in net retribution of the great majority of workers, consequently influencing their confidence. The uncertainty due to decisions dealing with budget and Sequestration also mattered. As to the perception of the current situation, the answers show a worsening of Business Conditions. Also the current views on the job market are negative. The percentage of people experiencing difficulties to find a job increased (from 36.1% in December to 37.7% in January). Regarding expectations for the coming six months, the percentage of who foresee positive changes in Business Conditions is decreasing, but also the pessimists are fewer (20.6% vs. 21.1% in December). There's an increase in the group expecting the situation to remain the same. The chances of finding a job in the next 6 months are considered positively by a mere 14.3%, while 27.0% expect a contraction in jobs. The real estate market suffers less from the fall in confidence. In fact, 5.3% continue to want to buy, but only 0.9% vs 1.3% in December are aiming to buy a new home.



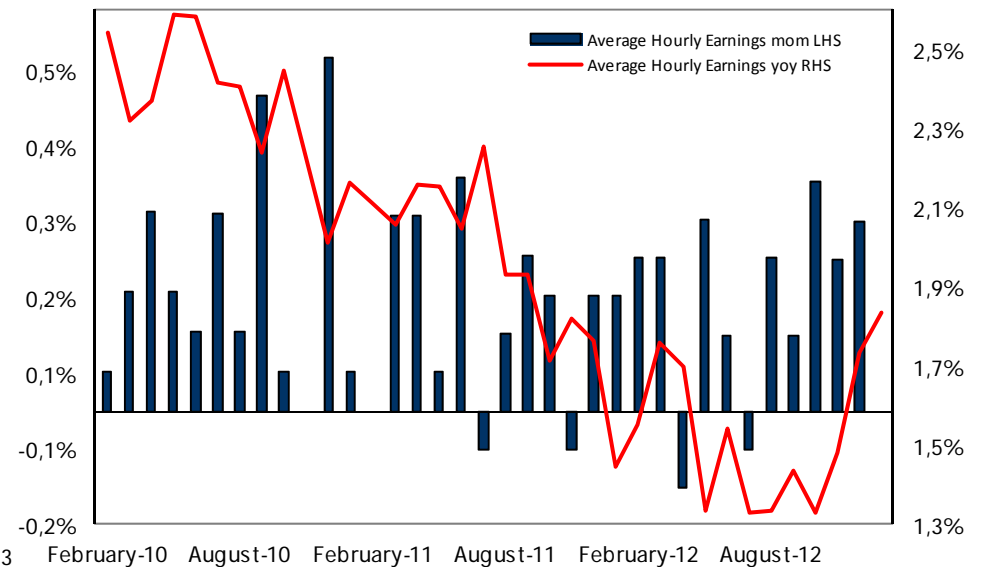
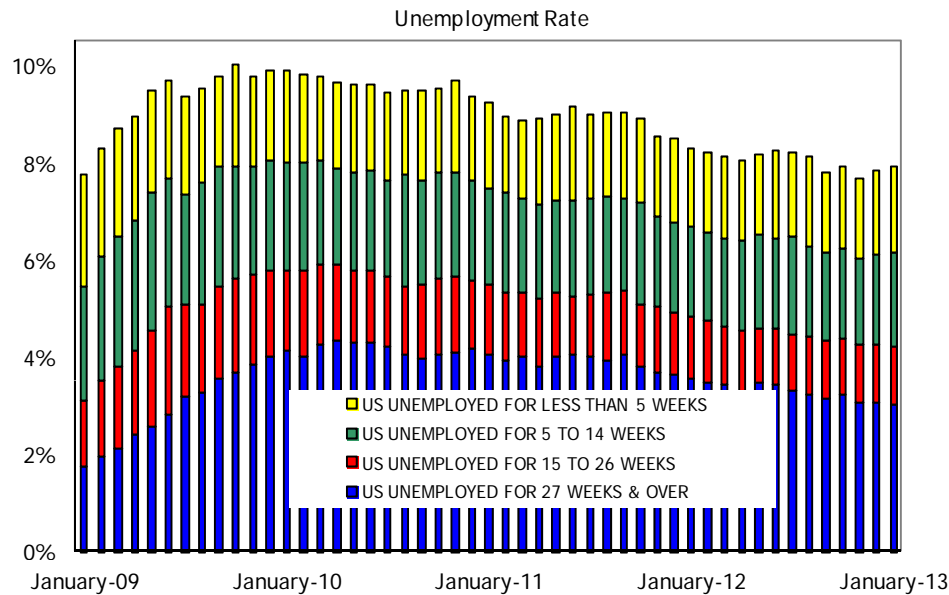
JOB MARKET, NEWLY EMPLOYED

- ❖ The January Employment Report records a creation of 157K jobs in the month, in line with the past months' trend and, despite volatility due to revision of the final benchmark for March 2012.



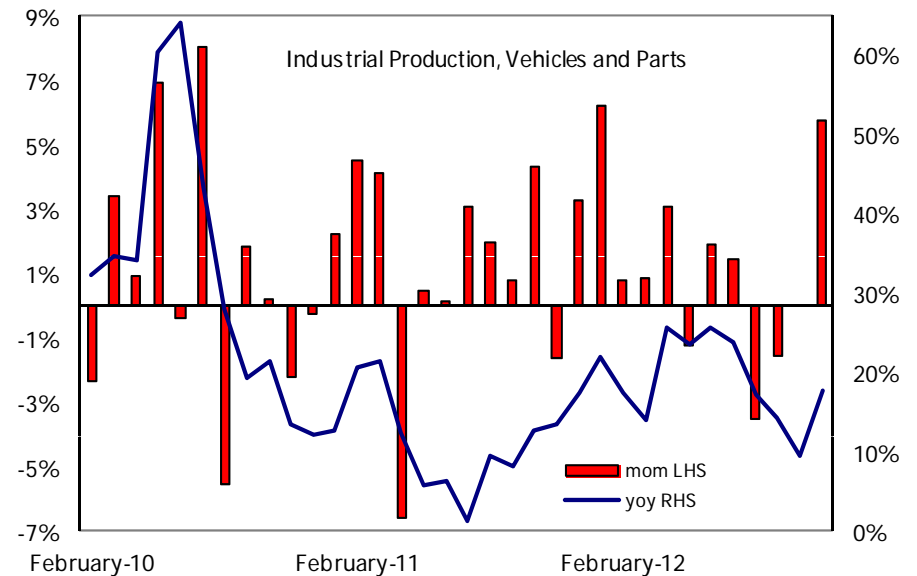
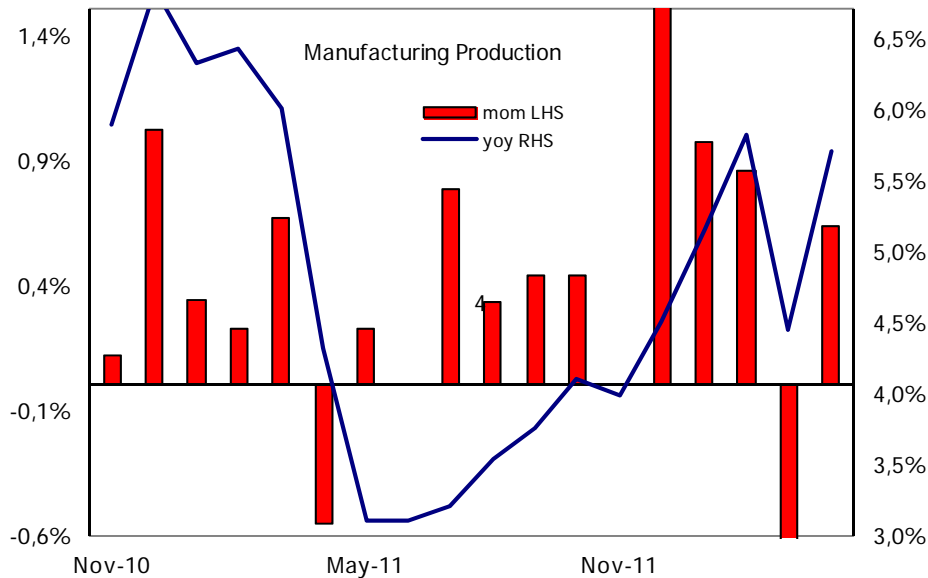
JOB MARKET, HOUSEHOLD SURVEY AND INCOME

- ❖ The unemployment Index grew to 7.9% from 7.8%, still far from the 6.5% level indicated by the Fed to maintain interests at the current historic low. The Participation Rate remained constant at 63.6%, with an increase of 143K, split between 17K in Civilian Employment and 126K in Civilian Unemployment. Positive news from the fall in Long Term Unemployment (over 27 weeks unemployment), gone down to 3.0% from 3.1%. Unaltered number of Part-time job holders who cannot find Full-time jobs. The average hourly earnings raised by 0.2% after the +0.3% mom in December. The average working week remains the same at 34.4.



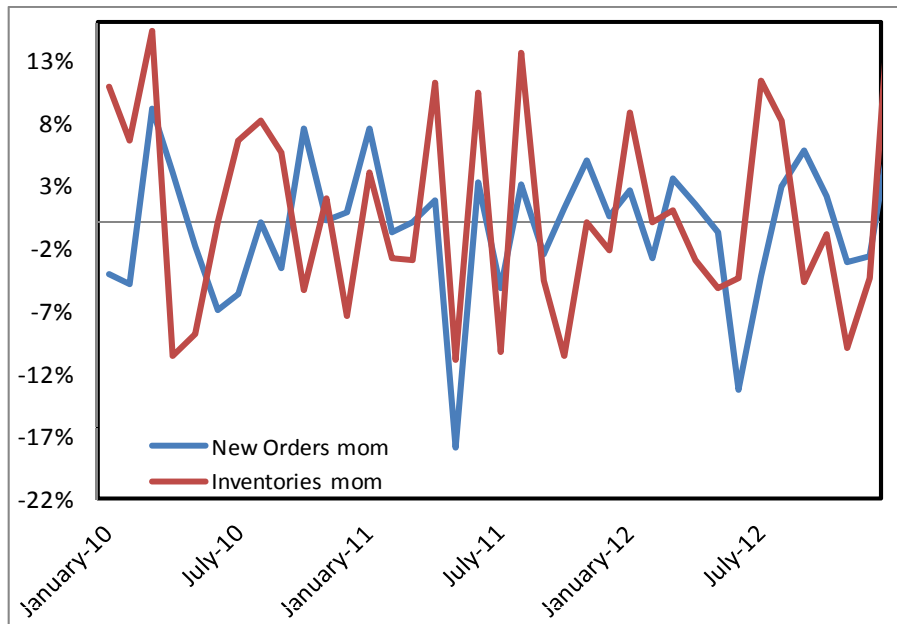
INDUSTRIAL SECTOR, PRODUCTION

- ❖ The US Industrial Production in December grew 0.3% m/m after the 1.1% m/m growth in November, corrected yesterday at 1.0% m/m, extending the rebound post hurricane Sandy. The manufacturing sector in December grew much less than in the previous month (0.8% m/m vs 1.3% m/m). In particular, the auto production and components slowed down at 2.6% from 5.8% in November.



MANUFACTURING INDUSTRY CONFIDENCE

- ❖ The January Manufacturing ISM grew at 53.1 vs 50.7 in December. It's the second time manufacturing production is on the rise. Both production and new orders are growing. In fact, for the former the index passes from 52.6 in December to 53.6 in January, while the New Orders Index grows from 49.74 to 53.3 shifting from a contraction to an expansion. There's a decrease on the index of orders from exports, that passes from 51.5 in December to 50.5, Positive signs for the job market, with the index growing for the third month in a row and at its highest since June 2012 (54.0). Last but not least, the component of prices paid that from 52.5 in November reached 55.5 in December and 56.5 in January.

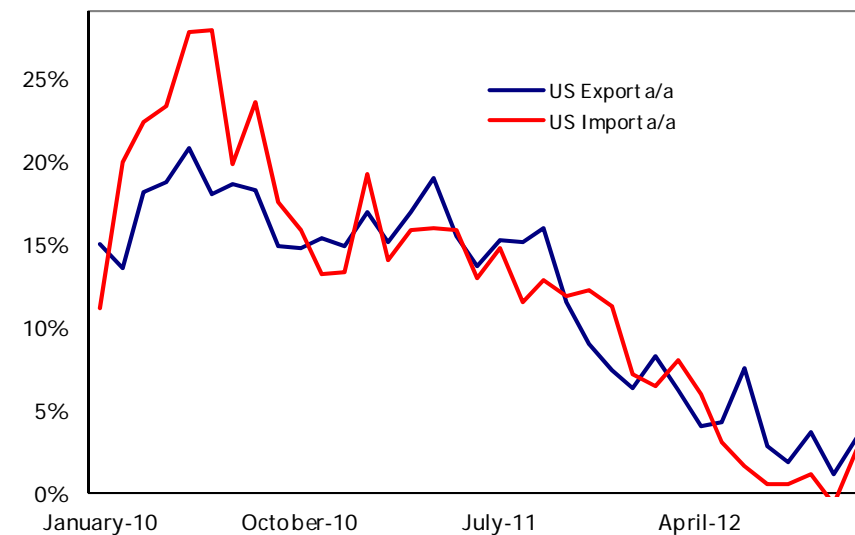


	ISM Man	New	Prod-	Employ-Delivery	Invent-	Prices	
Month	Index	Orders	uction	ment	Time	ories	
Weights	100%	20%	20%	20%	20%	20%	
Feb-12	51,9	54,9	54,8	52,1	48,4	49,5	61,5
Mar-12	53,3	56,8	55,9	55,6	48,0	50,0	61,0
Apr-12	54,1	57,6	59,0	56,8	48,7	48,5	61,0
May-12	52,5	57,2	54,1	55,9	49,2	46,0	47,5
Jun-12	50,2	49,6	52,4	55,7	49,5	44,0	37,0
Jul-12	50,5	47,5	53,3	53,2	49,7	49,0	39,5
Aug-12	50,7	48,9	48,9	52,6	50,2	53,0	54,0
Sep-12	51,6	51,7	51,4	53,7	50,5	50,5	58,0
Oct-12	51,7	52,8	53,3	52,3	49,9	50,0	55,0
Nov-12	49,9	51,1	53,1	50,1	50,1	45,0	52,5
Dec-12	50,2	49,7	52,6	51,9	53,7	43,0	55,5
Jan-13	53,1	53,3	53,6	54,0	53,6	51,0	56,5



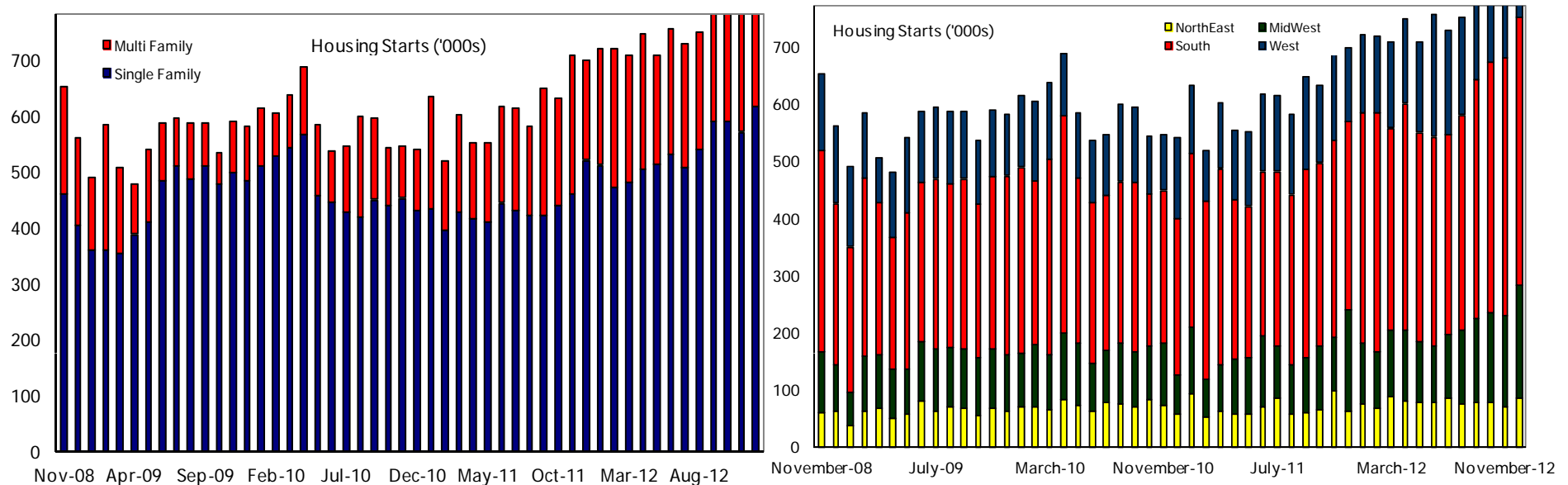
TRADE BALANCE

- ❖ The trade deficit narrowed sharply in December to -\$38.5bn, much smaller than market consensus of -\$46.0bn. The December trade gap was the narrowest since January 2010. Helping to narrow the deficit was a lower petrol import price—\$95.16 per barrel compared with \$97.45 in November (down 8.6% yoy). The petrol trade deficit in December was the lowest since August 2009. Exports jumped by 2.1%, while imports dropped by 2.1%. Imports tend to reflect movements in inventories and the large inventory drawdown in Q4 suggested that imports had declined. In 2012, the trade deficit was \$540.4bn compared with \$559.9bn in 2011.



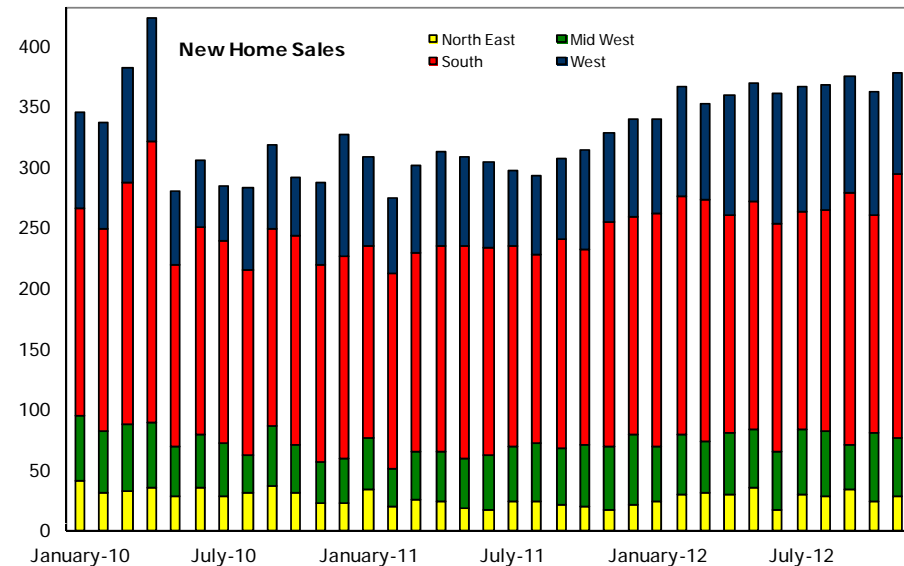
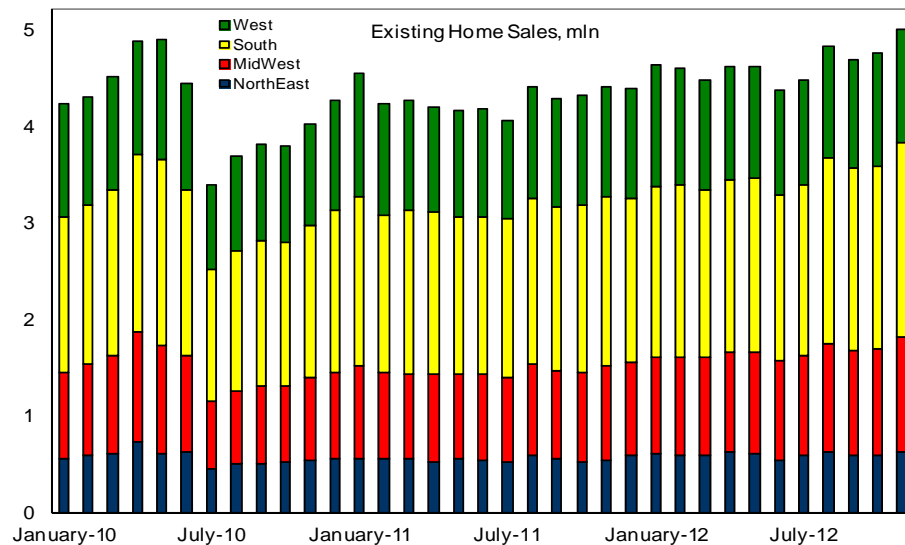
REAL ESTATE MARKET, NEW SITES

- ❖ The December **Housing Starts** have positively surprised us with a 12.1% m/m that followed the -3.0% m/m of the previous period. The year ended with a strong result that closed the 28.1% average growth registered in 2012. Building Permits, however, registered a weaker growth than in the previous month with 0.3% m/m vs 3.7% m/m, leaving little hope for another positive result for Housing Starts in the coming months.



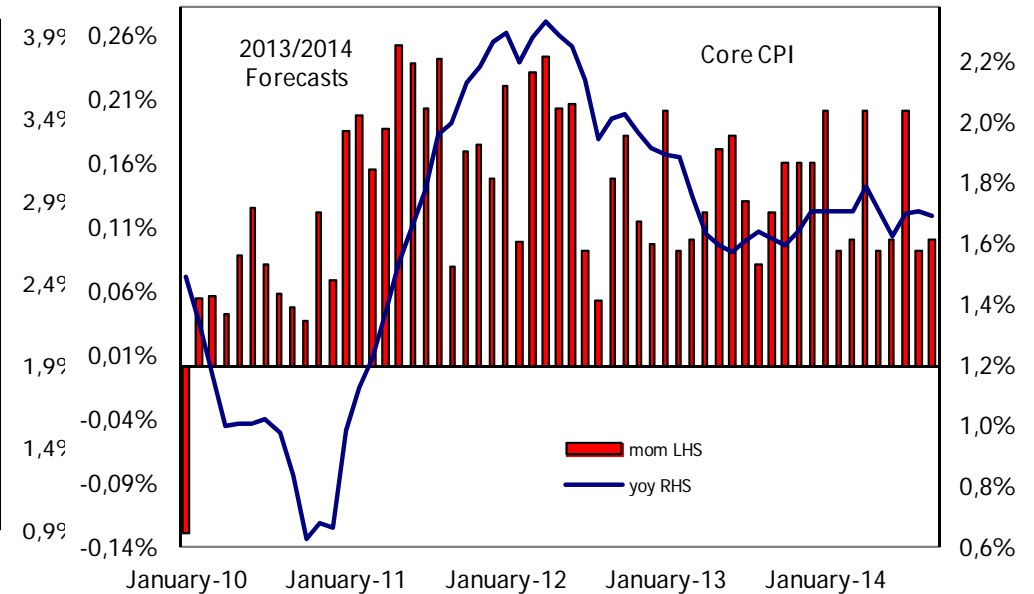
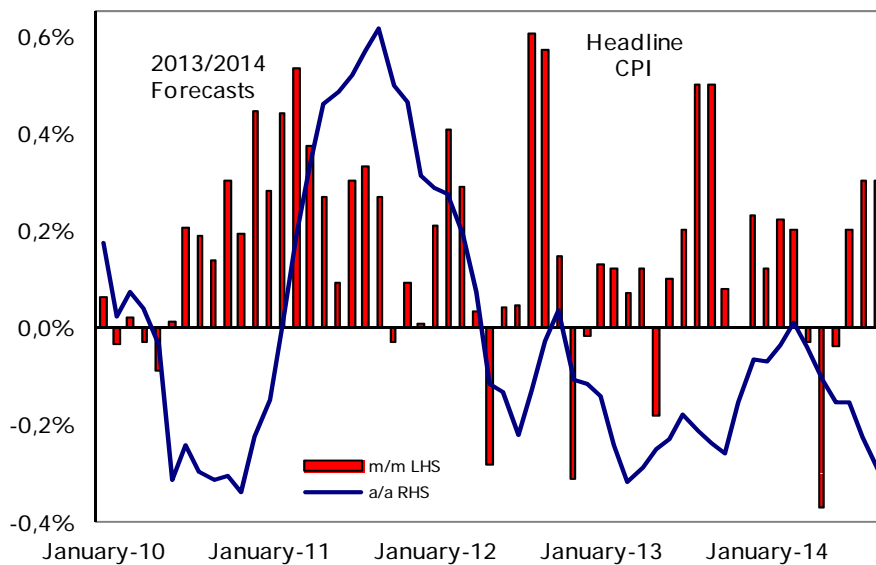
REAL ESTATE MARKET, RESIDENTIAL SALES

- ❖ The December **sales of existing homes** have registered a decrease of 1.1% m/m, despite expectations for results with a different sign. The correction arrived after December that registered a growth in sales at 4.8% m/m. We must specify that the correction regards sales of single homes. In 2012 the sales of existing homes grew by 9.2% at 4.65 mln, the highest level since 2007. Also sales of new homes decreased in December, growing at 7.3% mom. We expect the positive trend to continue in 2013. The December correction doesn't worry us and is probably due to the holiday season, at least partially, that this year resulted in fewer working days than November 2012 and than December 2012.



INFLATION

- ❖ **Inflation.** Thanks to the output gap accumulated during the Great Recession and the subsequent three and a half years of slow recovery, we expect inflation below 2% during most of 2013-2014, with a possible peak above 2% at the beginning of 2014. The risk of a major increase in commodity prices is low. Overall, we forecast the average CPI headline at 1.4% in 2013 and at 1.6% in 2014, and the average core CPI at 1.7% in 2013 and 2014.



MONETARY POLICY

- ❖ The **Beige Book** prepared by the Philadelphia Fed with information available till January 4 in preparation for the FOMC of 29/30 January, illustrates a scenario of strong uncertainty and concern (both for consumers and for industry) regarding the solution of the Fiscal Cliff. In fact, with the closing of the publication on January 4, it wasn't possible to capture the market rally that followed the agreement nor the effects on confidence due to tax increases decided for this year. The job market conditions are described as substantially unvaried at the end of 2012, with particular caution for businesses dealing with Europe.
- ❖ The January **FOMC** was surprise-free. The only news is the acknowledgement of the pause in economic activity in the last months (referred to Q4 GDP). The FOMC confirmed intentions of buying assets for a total 85 bln USD per month in Treasuries and MBS until there will be substantial improvement in the job market. December guidance on rates also confirmed, with 6.5% for unemployment rate and 2.5% for expected inflation in 1 and 2 years, highlighting how monetary policy will remain expansionary for a considerable amount of time after the end of the buying program. With the annual members' rotation that takes place in January, in 2013 Lacker, President of Richmond Fed, who had voted against the majority for all 2012, loses voting rights. The traditionally conservative Kansas City Fed gets voting rights this year. Its President Esther George voted against the majority, worried by the risk of future economic and financial unbalances, making the expectation for long term inflation grow.



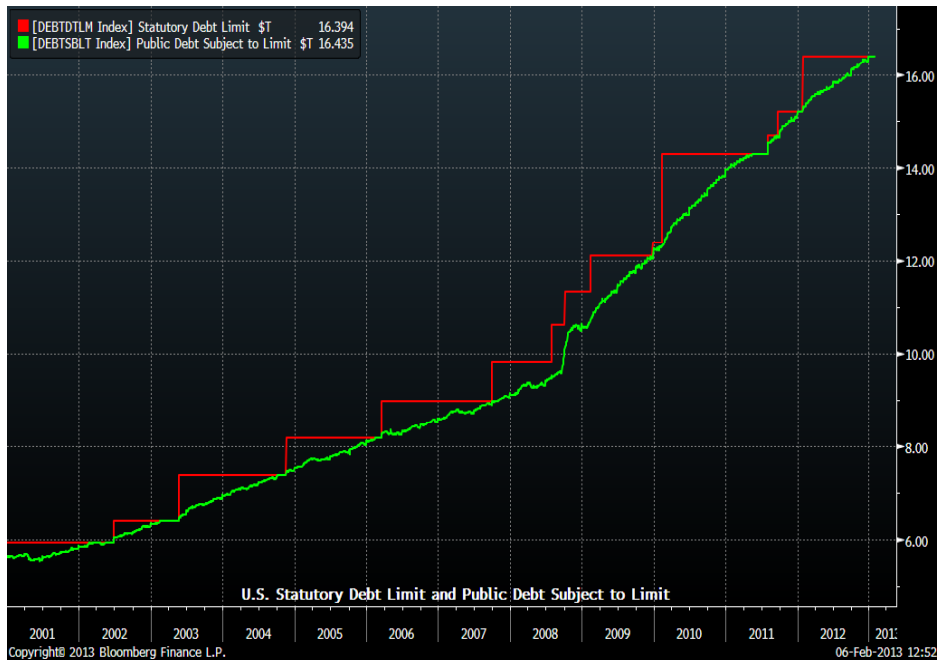
MONETARY POLICY

- ❖ After these moves, **we expect a continuation of acquisitions of Treasuries and MBS for the most part of 2013**, until there will be a substantial improvement in the job market. In a recent speech, the president of the Chicago Fed defined what he means by substantial: creation of at least 200K jobs per month for several months, with a total of 1 million new jobs created in six months. Only twice since March 2010 was the increase in new jobs over 200k for at least three months in a row. During one of these periods, from February to April 2011 the unemployment rate was not able to improve. In fact, Evans emphasized how the reduction in the unemployment rate at 6.5% will require much more time.

NEGOTIATIONS FOR RAISING DEBT CEILING AND SEQUESTRATION

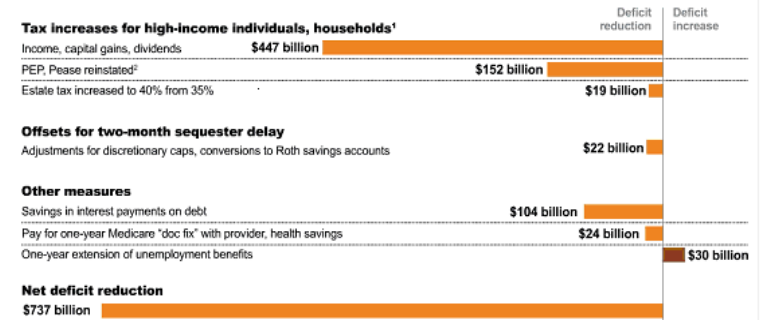
With the temporary suspension of the Debt Ceiling approved by both Houses, the next key dates are:

- ❖ March 1st: kick off of Sequestration, in case of no agreement between parties to pass a bill that suspends it before that date. Immediate impacts: delays in payments to employees and providers of the public sector, cuts in public Transportation, slow down in maintenance of military Buildings.
- ❖ March 27: end of the current Continuing Resolution to finance the US Government. If before that date the Budget will not be approved, there will be a Government Shutdown;
- ❖ May 19: end of the suspension of the Debt Ceiling.



How Budget Deal Reduces the Deficit from 2013 to 2022

Revenues measured against Congressional Budget Office current policy baseline



Note: Numbers may not add to total because of rounding; 1 - Affects individuals with income of \$400,000 or more and couples with income of \$450,000 or more per year; 2 - PEP is Personal Exemption Phaseout; Pease is phaseout of itemized deductions
 Source: Office of Management and Budget
 Graphic: George Petras
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