Global Economy Report

November 2013
Global Economy Report

The Global Economy Report is prepared in association 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 goal of this Report is to provide an analysis of the current and expected macroeconomic and financial conditions at a global level, with also a focus on key areas such as Europe, the US and ASIA.

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The October issue of the World Economic Outlook published by the IMF saw a downward revision to its global economy growth estimates both for this year and next, compared to their July forecasts. In 2013 global GDP should grow by 2.9% (-0.3%), while in 2014 the growth should be 3.6% (-0.2%). The trend remains upward, but weaker.

The downward revisions are due to the persistence of several negative factors, including fiscal consolidation in the main economies, excess public and private debt and uncertainty about “Tapering” in the US, which have negatively impacted emerging economies in particular.
For the US, we trimmed our Q4 GDP growth forecasts because of the Government Shutdown, which should impact Government Spending, Private Consumption and Investments in the short term, while we expect a rebound in Q1 2014. Our GDP growth forecasts are 1.5% for 2013 and 2.6% for 2014.

The unemployment rate will fall further, but it will remain well above NAIRU. The unemployment rate is forecasted at 7.2% at the end of 2013 and at 6.7% at the end of 2014.

Inflation: We expect inflation below 2% for most of the forecasting horizon, reflecting the effects of the output gap accumulated during the Great Recession and these four years of subpar growth thanks to the accumulated output gap. Also risks from commodities prices are limited in an environment of less robust global growth. We do not see deflation risks though, with a stabilisation of inflation measures later this year and a modest acceleration in 2014. We currently project headline CPI to average 1.6% yoy in 2013 and 1.8% in 2014, while core CPI is seen at 1.8% in 2013 and at 2.0% in 2014.
 EXECUTIVE SUMMARY

- After the missed Tapering kick-off in September, we expect the first reduction in purchases in Q1 2014 due to the uncertainty related to fiscal policy. The reduction will gradually go on all over 2014 as the recovery strengthens and growth prospects improve, to completely halt QE3 in Q4 2014. “Data dependence” is still valid: if new data are not up to Fed’s expectations, we could well see Tapering postponed further.

- We expect the first increase in FF around mid 2015, when unemployment rate will be well below 6.5%.

- After the temporary agreement in Congress on October 16, we expect fiscal negotiations to still be difficult as we get closer to the new deadline in January.
The trend in the Eurozone recovery remains intact, but in Q3 there will be a temporary set-back, with growth lower than previously estimated, in particular in the industrial sector.

The slowdown is bound to be temporary though. Already from the final quarter of the year, GDP growth will accelerate, benefiting from increasing confidence, also in peripheral economies, and from a gradual acceleration in domestic demand. A limit to expansion capability will be the job market, still clearly under pressure.

GDP growth will benefit from the likely end of the Italian recession, for which we foresee a modest expansion (but constantly below the Eurozone average) beginning in the final quarter of the year.
EXECUTIVE SUMMARY

- Our forecast for aggregate GDP growth has been downwardly revised by one tenth as 2013 average (-0.5%), penalised by the slowdown in manufacturing activity in the summer months and by the severe contraction forecasted for Italy (-1.8%). Also forecasts for Germany (+0.5%) and France (+0.2%) were trimmed by one tenth. In 2014 the cycle should consolidate in a more marked way, generating an increase in aggregate GDP to around 1% and in German GDP by a little less than 2%.

- In September, Eurozone’s inflation fell to its lowest level since February 2010 (1.1% yoy) and went further down in October (0.7% yoy), under the impulse of decreasing energy prices and, to a lesser extent, of food prices. In Spain, a statistical effect determined a fall in inflation to 2009 levels. Core dynamics remained decidedly more stable. Our inflation forecast for the Eurozone is at 1.4% in 2013 and 2014 on average.
On October 2\textsuperscript{nd} the ECB Governing Council left interest rates unchanged at 0.5%. This decision was based on the analysis of the economic conditions, with the idea of a gradual recovery in the second part of the year that should consolidate further in 2014. In this context, and with inflation expected to stay well below 2%, we assume monetary policy to stay accommodative.

In line with the ECB’s forward guidance, interest rates will stay at current levels. We do not expect further rate cuts, though the October inflation value increases a bit their chance.

For money market, the gradual reduction in excess liquidity because of LTROs anticipated repayments is a symptom of improving confidence in financial markets and a reduction of fragmentation. However, it also represents a risk for some unintended EONIA rates increases.

In this report we present a special focus on the euro area.
In the UK the recovery accelerated in 2013, with Q3 GDP growth at 0.8% qoq. The main contribution to growth comes from Private Consumption, sustained by an improving job market, by increases in House prices (through Wealth Effects) and by still low interest rates. Instead, business loans remain modest and thus Capex decreased in Q2. Our real GDP growth forecasts are at 1.3% in 2013 and at 1.8% in 2014.

Inflation has been sustained by a series of one-off shocks (tax increases, university tuitions fees and Utilities’ tariffs) and by particularly low labour productivity which is pushing up unit labour costs, while the Pound’s appreciation limits the impact of commodities prices increases. We thus forecast CPI to stay above target for most of our forecasting horizon. Our forecasts for average headline CPI are at 2.7% in 2013 and 2.4% in 2014.
EXECUTIVE SUMMARY

- The latest macroeconomic data signal without any doubt that the Chinese economy is accelerating after a soft patch experienced during the spring and early summer months whose intensity was above expectations. While production and sales continue to show robust growth, uncertainty on qualitative indicators could imply a temporary slowdown in the final months of the year. If we exclude food prices, inflation is overall stable, confirming the neutral stance of monetary policy.

- The economy remains vigorous in Japan. The expansive impulse, very robust in the first three months of the year, toned down only slightly between April and June, but should persist also in the coming quarters, for average growth rates around 2% this year and 1.5% next year. This is the result of extraordinary expansive economic policies known as Abenomics. The headline inflation rate will remain positive.
The Australian economy is weak by historical standards, as real GDP growth rate was just 0.6% qoq in Q2, same result we had in Q1. Overall, average growth for 2013 should print at 2.6%. Recent labour market data show a decline in the unemployment rate, mainly because of a decline in the participation rate though.

National accounts data marked an acceleration in Korean GDP growth for Q2, with real GDP growth accelerating at 1.1% qoq from 0.8% in Q1. The trend here seems to have turned to growth, benefiting from a recovery in consumption which is also sustained by Government stimulus and low interest rates.
## EXECUTIVE SUMMARY

### GENERAL MACRO SUMMARY

### GDP (%YoY)

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<th></th>
<th>2009</th>
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<th>2011</th>
<th>2012</th>
<th>2013E</th>
<th>2014E</th>
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### INFLATION (%YoY)

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*Banca Aletti Forecast
Cons. Bloomberg (Oct.13)*
FOCUS ON THE EUROZONE
In the third quarter we forecast the two major Eurozone economies to remain on an expansionary trend, even if they should slowdown a bit after strong Q2 results. For Germany, our Q3 GDP forecast is at +0.3% qoq, four tenths lower than the previous quarter growth. For France, we currently forecast +0.1% qoq GDP growth, a reduction by four tenths compared to Q2 GDP growth. Italy should register a flat result, after eight consecutive negative quarters. In the final months of the year, growth should accelerate again, even if modestly.
After the downward revisions to Q3 GDP growth forecasts, estimates for the major Eurozone economies have been trimmed for the whole forecasting period. Despite this, we confirm a vigorous growth for Germany, that will accelerate from 0.5% growth in 2013 to 1.8% in 2014, confirming its leadership role in the Eurozone.
In Q3 we forecast Eurozone GDP growth at just +0.1% qoq, one third of the growth pace recorded in the previous quarter, due to the simultaneous slowdown in the two major economies of the area, partially due to temporary factors that inflated growth in the previous period. The underlying trend for aggregate GDP remains positive and growth will start accelerating again in Q4 2013. In terms of yearly averages, our 2013 GDP growth forecast has been cut by one tenth to -0.5%, and the one for 2014 was upwardly revised to +1.0%.

**GDP**

**EUROZONE – Quarterly Rates**

**GDP**

**EUROZONE – Average Yearly Rates**
According to the latest available surveys (Sept 2013), the increasing acceleration in Eurozone leading indicators continues to be vigorous, filling almost completely the gap with the global cycle. At the beginning of Autumn, the Monetary Union’s economic climate is at its highest in two years.
The improvement in the Eurozone Economic Climate is in part a consequence of the net improvement in sentiment in Italy. Actually, the Italian Composite PMI grew by two and a half points in September to 52.8, its highest level since April 2011. Growth was even more pronounced for Services, with a 4 point increase to 52.7, its highest level since March 2011. Hence, there is a ray of hope for Eurozone’s third largest economy, after 26 consecutive months of contraction.
In Germany the economy’s engines are running at full steam. After a temporary setback in April below 50, the Composite PMI quickly recovered reaching 53.8 in September, its highest level since early 2012, mainly thanks to the Services Sector, while Manufacturing has been more uncertain in the latest surveys.
French Composite PMI for September marked a comeback into expansionary area at 50.2, finally signalling the beginning of expansive conditions for the second Eurozone economy after 18 consecutive months of contraction. The data is an average between uncertainty in the industrial sector (Manufacturing PMI at 49.8) and improved sentiment in the Services Sector (51).
The synthetic leading indicator for the Eurozone improved markedly in October as well and is now at its highest level in two years, confirming the indications from the PMI surveys.
Considering only qualitative indicators, estimates of economic activity in Q3 are systematically above official forecasts for all areas: Eurozone aggregate data comes out at +0.4% qoq.
With the only exception of Italy (-0.3% mom), in August industrial production grew in all major Eurozone economies after a negative start for the third quarter: Germany recorded +1.4% mom, France +0.2% mom and Spain +0.6% mom. The output turned positive also at the aggregate level (+1.0% mom), balancing the previous month’s drop.
Despite the August rebound, the average July/August level of aggregate production remains below Q2 average, thus supporting our forecasts for an increasingly negative contribution of industrial activity to Q3 GDP. An evolution in this direction is evident in all countries, with particular intensity in France.
Only in Italy Manufacturing PMI currently signals a likely acceleration in industrial activity in the final months of the year. For France and Germany on the other hand, the indication weakened following the PMIs stagnation at the end of Q3.
The recovery signals in internal demand, already evident from Q2 2013 national accounts, are spreading into the third quarter. Aggregate retail sales for Eurozone rebounded in August, increasing by 0.7% mom, the second consecutive monthly gain after the +0.5% mom in July (the first time since Q2 2012 we record two consecutive months of growth). Trend growth was at -0.3%, its best result since March 2012.
The double July/August growth pushed up the level of aggregate Eurozone retail sales to their highest level in 13 months; the average level of sales in Q3 so far is 0.6% above Q2 average, marking its best performance since the end of 2006. Quarterly averages are positive in France (best figure since Q4 2007) and Spain (best quarter since 2004) as well.
In August the number of unemployed decreased by 5K, third monthly decrease in a row, thus confirming a reversal in the job market’s negative trend that dominated the past two years. The Composite PMI Employment Component for September approached the 50 threshold, marking its best result since early 2012 and signalling for the first time a stabilisation in the Eurozone Labour market.
September inflation data shows a cooling of price pressures in the Eurozone. The most outstanding data is the fall in Spain’s inflation from 1.5% yoy in August to 0.3% yoy, mostly due to statistical effects. In Italy, inflation is at its lowest since November 2009, with the NIC index at +0.9% yoy, three tenths lower than in August. In Germany the decrease is smaller, with inflation one tenth lower than in August, at 1.4% yoy. According to Eurostat estimates, the inflation rate in Eurozone was 1.1% yoy versus 1.3% in August, marking its lowest level since February 2010.
The slowdown in inflation is mainly due to the energy component and, to a smaller extent, to food prices. Net of the most volatile components, Core Inflation growth decelerated by only one tenth in September compared to August, printing at +1.0% yoy, same level we had in April. Core dynamics appear significantly more stable compared to headline dynamics.
DI SI NFLTATI ON RI SKS?

After a few months of stabilisation, disinflationary pressures are growing in the pipeline. According to August surveys, the Eurozone producers price index decreased by -0.8% yoy, more than expected (-0.5%), marking its minimum since early 2010.
The indication of an increase in disinflationary pressure is not confirmed by qualitative indicators though. The leading index for production prices grew markedly in the latest surveys and the Prices Paid Component of Composite PMI increased in September at its 8-month peak. Businesses signal increases in input costs. This upward inversion is evident in both manufacturing and services sectors.
The Prices Received Component of Composite PMI increased in September at its 17-month high. In the Manufacturing Sector, the indicator grew above the 50 thresholds for the first time since early 2012, signalling fewer disinflationary risks than previously observed in the pipeline.
Overall, the return of disinflationary pressures in the production chain and some national inflation data below expectations (e.g., Spain), caused us to trim our inflation forecasts. Thus, from 2.5% as 2012 average, we currently forecast 1.4% yoy average inflation this year (-1 tenth) and in 2014 (-2 tenths). Core dynamics appear more stable. Core inflation should register an average growth of 1.1% both this and next year.
On October 2nd the ECB Governing Council left its interest rates unchanged at 0.5%. This decision was based on the analysis of the economic conditions, with the idea of a gradual recovery in the second part of the year that should consolidate further in 2014. In this context, and with inflation expected to stay well below 2%, we assume monetary policy to remain accommodative. For money market, the gradual reduction in excess liquidity because of LTROs repayments is a symptom of improving confidence in financial markets and a reduction of fragmentation. However, it also represents a risk for some unintended EONIA rates increases.
The crossover to the Single Supervisory Mechanism, which assigns surveillance activities to the ECB, will come with a new series of stress tests and a preliminary Asset Quality Review. This measure is planned by the ECB to accelerate the harmonisation among banks belonging to different credit systems to reach the final target of a Banking Union. Uncertainty remains on how banking crises will be handled in the future, as stronger countries don’t want to “confuse” local debt. The willingness to compromise is limited by upcoming European elections in mid 2014.
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