# Global Economy Report

December 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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**Report closed on December 12 2013**

# EXECUTIVE SUMMARY

- National accounts data confirm a moderate growth in Eurozone GDP, even if its pace is slower than expected. Germany is the driving force once again, while many smaller EU countries got out of the recession. However, two of the three major economies of the area - France and Italy - registered a growth contraction in the third quarter.

- Qualitative indicators confirm the upward trend, even if with some uncertainty, confirming our central scenario of a slow recovery. For the last quarter of 2013 we forecast 0.2% qoq GDP growth, with an average yearly contraction at -0.4% for the year. In 2014 growth will accelerate, with an average yearly growth around 1%.

- Inflation decreased to an all-time low at 0.7% yoy in October, below all forecasts, increasing deflation fears, even if we see a very low probability for them to materialize. Our central scenario incorporates the possibility of further deceleration, with inflation close to current levels or evem lower for almost all next year.

# EXECUTIVE SUMMARY

- After a stagnation lasted more than a year, the UK recovery accelerated in 2013 and in Q3 real GDP growth was above expectations. The strongest contributions to growth came from Private Consumption, supported by the Labour market recovery, growth in housing prices and low interest rates, leading to new build up of private debt. However, growth does not seem balanced, driven as it is by the FLS program and the Help-to-Buy scheme. Instead, business credit remains modest. Furthermore, the public sector is in a weak position to absorb new shocks. Also, the rapid appreciation of the pound is starting to weigh on exports.

- Our UK growth forecasts are at 1.4% for 2013 and at 2.2% for 2014. For inflation, our forecasts for average headline CPI are at 2.6% in 2013 and at 2.4% in 2014.

- Given our inflation forecasts and the strong improvement registered in the labour market in the past months, we continue to see a risk of official rates hikes earlier than currently forecasted by the Bank of England.

# EXECUTIVE SUMMARY

- Q3 US GDP growth was stronger than expected, but mainly because of a stronger than expected Inventories accumulation, which will negatively weigh on growth in Q4. The underlying trend in private consumption remains modest. This, together with the impact of the Government Shutdown, brings us to forecast a slowdown in Q4. Unemployment will decrease further, but will stay well above NAIRU. Growth forecasts are at 1.7% for 2013 and at 2.6% for 2014. Unemployment rate is expected at 7.2% at the end of 2013 and at 6.8% at the end of 2014.

- We expect US inflation below 2% for most of our forecasting horizon, thanks to the huge output gap accumulated during the Great Recession and these four years of weak recovery. Also, risks from commodities are moderate with a modest global growth. We do not see any risks of deflation, with yoy growth in headline CPI that should have registered a cyclical low in October and should start a modest acceleration from November. Overall, we forecast average headline CPI at 1.4% in 2013 and at 1.7% in 2014, while average core CPI is seen at 1.8% in 2013 and at 1.9% in 2014.

# EXECUTIVE SUMMARY

❖ About US monetary policy, incoming data have been quite strong, especially the October and November job market reports. We think the most likely outcome is that the FOMC will start tapering its asset purchases and enhance its forward guidance changes at the January 2014 meeting, with a risk of an earlier start in December. Tapering should then continue gradually as the recovery strengthens, for a complete end in Q4 2014. The "data dependence" rule is still valid: if new data come out below Fed's expectations, tapering will be postponed. We expect that Tapering kick off will come together with a change in Forward Guidance, i.e., a lowering in the unemployment rate threshold. We expect the first increase in Federal Funds rate in mid-2015, when unemployment will probably be well below 6.5%.

❖ On December 10th Congressman Paul Ryan and Senator Patty Murray announced a small-scale budget agreement. The deal will increase government spending by about 45 bln USD over the remainder of FY2014 (through September) and by 18 bln USD in FY2015. The agreement also includes about 85 bln USD in savings over ten years, reportedly through: increases in fees for airline travelers, cuts to federal-worker and military pensions, higher payments for federal insurance of private pensions and additional spending cuts in 2022 and 2023 primarily in payments to Medicare providers. This agreement next requires congressional approval by passing a budget resolution in both the House and Senate, which should be unproblematic.

# EXECUTIVE SUMMARY

- The third quarter national accounts data signal an acceleration in Chinese growth. Compared to the previous quarter, GDP increased by 2.2%, the fastest quarterly rate in nine quarters. The year on year growth is at 7.8%, three tenths higher than Q2 growth. The Government leading indicator has been broadly flat in Q4, projecting income growth in the next few quarters in line with actual data.

- In Q4 we assume GDP growth at 7.7% yoy, which would imply average growth at 7.6% in the current year (slightly down from 7.7% in 2012). If realized, this would be the weakest yearly growth since 1999. We forecast growth at 7.2% next year, slightly below consensus (7.4%).

- Growth forecasts for Japan have been updated to take into account the Q3 preliminary growth data. In 2013 GDP growth is now forecasted at +1.9% and at +1.8% in 2014. Inflation is growing after the last measurement at 0.9%. CPI is now expected to reach +2.6% at the end of 2014, including the planned Consumption Tax Hike.

# EXECUTIVE SUMMARY

- 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. There is a slight correction of the downward trend, with yoy growth at 2.6% from 2.5% in Q1 2013. Among weakness factors, we highlight consumption slowdown, although consumer confidence has turned up, promising positive signals in coming months. The housing sector is benefiting from an increasing demand due to lower mortgage rates. As for investments, despite the expected decline in the mining sector, strong foreign demand for iron is supporting the sector, which has entered the cyclical slowdown phase. Overall, the Australian economy is weak and 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

| | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E |
|---|---|---|---|---|---|---|
| **GDP (%YOY)** | | | | | | |
| US | -3.1 | 2.4 | 1.8 | 2.8 | 1.7 | 2.6 |
| EUROZONE | -4.4 | 2.0 | 1.4 | -0.6 | -0.4 | 1.1 |
| GERMANY | -5.1 | 4.2 | 3.0 | 0.7 | 0.5 | 1.7 |
| FRANCE | -3.1 | 1.7 | 2.0 | 0.0 | 0.2 | 0.9 |
| ITALY | -5.5 | 1.8 | 0.4 | -2.4 | -1.9 | 0.5 |
| UK | -5.1 | 1.7 | 1.1 | 0.1 | 1.4 | 2.2 |
| JAPAN | -5.5 | 4.7 | -0.6 | 2.0 | 1.9 | 1.8 |
| BRASIL | -0.3 | 7.6 | 2.8 | 0.9 | 2.5 | 2.5 |
| RUSSIA | -7.8 | 4.3 | 4.3 | 3.4 | 1.7 | 2.7 |
| INDIA | 6.4 | 8.9 | 7.5 | 5.1 | 4.8 | 4.7 |
| CHINA | 9.2 | 10.4 | 9.3 | 7.8 | 7.6 | 7.4 |
| AUSTRALIA | 1.4 | 2.6 | 1.4 | 3.6 | 2.5 | 2.7 |
| KOREA | 0.3 | 6.3 | 3.6 | 2.0 | 2.6 | 3.5 |
| **INFLATION (%YOY)** | | | | | | |
| US | -0.4 | 1.6 | 3.2 | 2.1 | 1.6 | 1.8 |
| EUROZONE | 0.3 | 1.6 | 2.7 | 2.5 | 1.4 | 1.4 |
| GERMANY | 0.2 | 1.2 | 2.5 | 2.1 | 1.6 | 1.6 |
| FRANCE | 0.1 | 1.7 | 2.3 | 2.2 | 1.0 | 1.5 |
| ITALY | 0.8 | 1.6 | 2.9 | 3.3 | 1.3 | 1.3 |
| UK | 2.2 | 3.3 | 4.5 | 2.8 | 2.7 | 2.4 |
| JAPAN | -1.3 | -0.7 | -0.3 | 0.0 | 0.3 | 2.6 |
| BRASIL | 4.9 | 5.0 | 6.6 | 5.4 | 6.1 | 5.8 |
| RUSSIA | 11.7 | 6.9 | 8.5 | 5.1 | 6.6 | 5.3 |
| INDIA | 10.8 | 12.1 | 8.9 | 9.3 | 9.2 | 9.1 |
| CHINA | -0.7 | 3.3 | 5.4 | 2.7 | 2.7 | 3.2 |
| AUSTRALIA | 1.8 | 2.9 | 3.3 | 1.8 | 2.3 | 2.6 |
| KOREA | 2.8 | 3.0 | 4.0 | 2.2 | 1.4 | 2.6 |

Banca Aletti Forecast

Cons. Bloomberg (Nov 13)

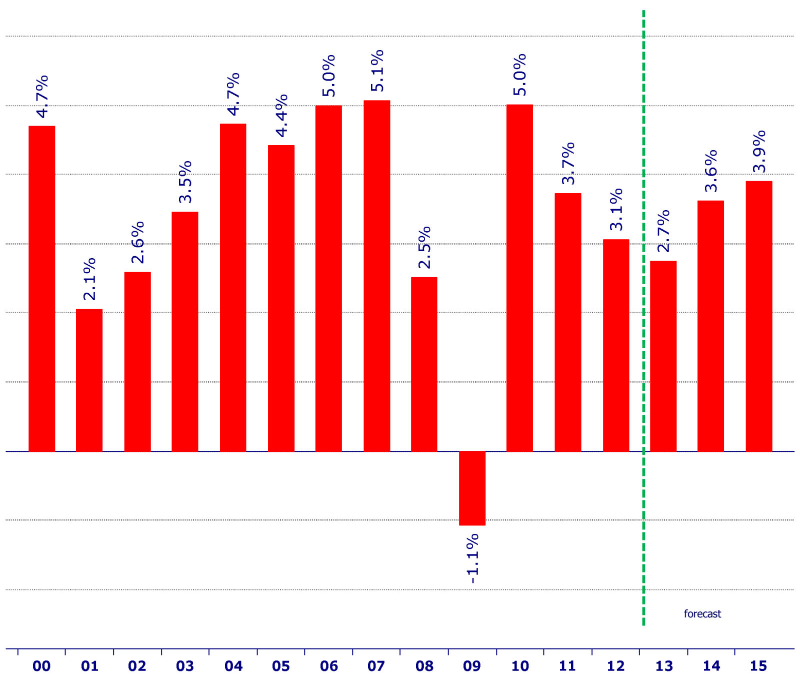
# FOCUS ON THE GLOBAL ECONOMY

# ECONOMIC GROWTH FORECASTS

In its November report, the OECD assumes lower global growth than the IMF estimates for the current year (two tenths lower), while for 2014 its forecast is at 3.6%. The Expected growth was trimmed compared with its previous outlook, with a four tenths cut both for this year and for 2014. According to the OECD, the acceleration forecasted for 2015 will not be enough to bring the growth rate above 4%.

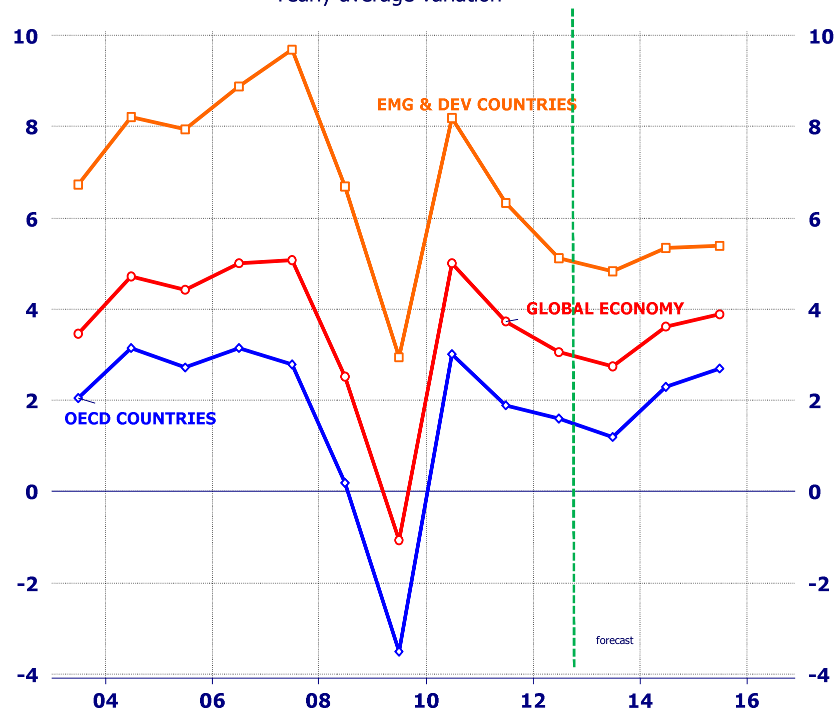
**OECD - GLOBAL ECONOMIC GROWTH**

Yearly average variation




**OECD - GLOBAL ECONOMIC GROWTH**

Yearly average variation

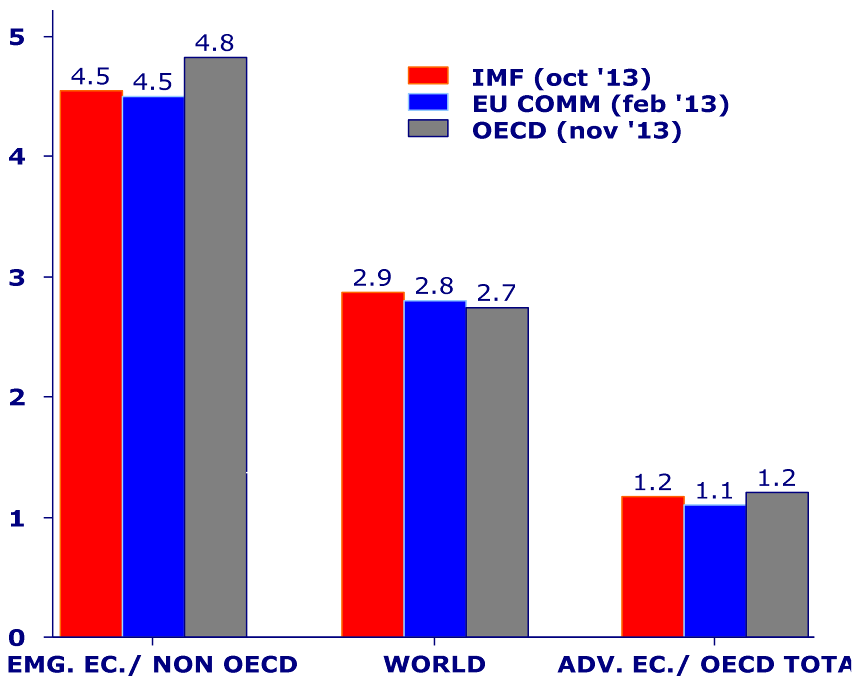


# ECONOMIC GROWTH FORECASTS

According to OECD economists, slower growth is almost completely due to lower estimates for the emerging markets. While in the past few months downward revisions were mainly centred of estimates on developed economies, since May the crisis has hindered the more fragile merging economies. The slowdown of emerging markets and the increased degree of disequilibrium for others represents one of the greatest risks for the acceleration of growth. Another risk factor is the Fed's exit strategy. Also, so far there is no plan to reduce Japanese public debt, while the ECB should consider other strategies to contribute to the solution of the euro crisis.

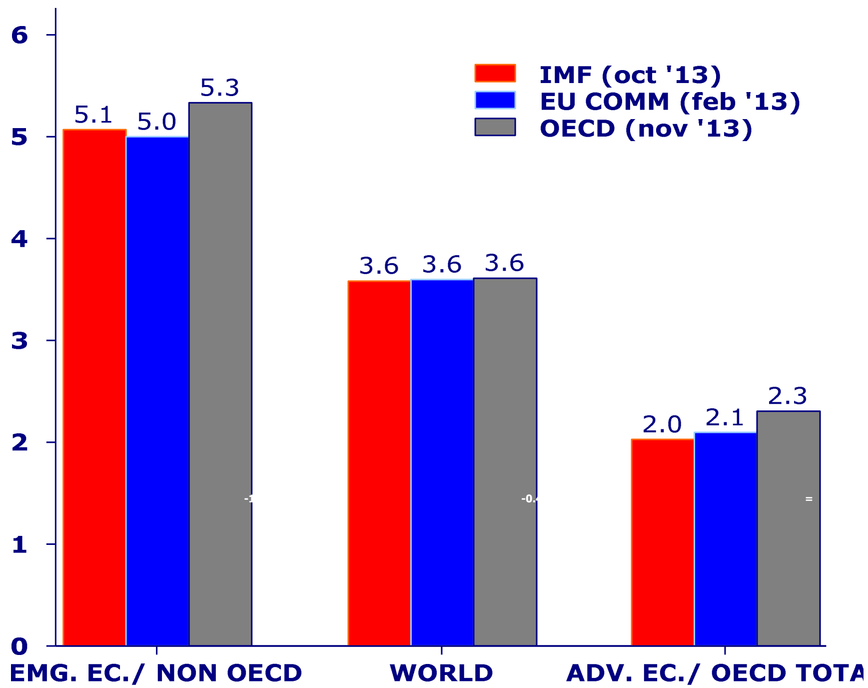
**2013 IMF - EU COMM. - OECD**

Yearly average variations- fixed prices




**2014 IMF - EU COMM. - WB**

Yearly average variations- fixed prices

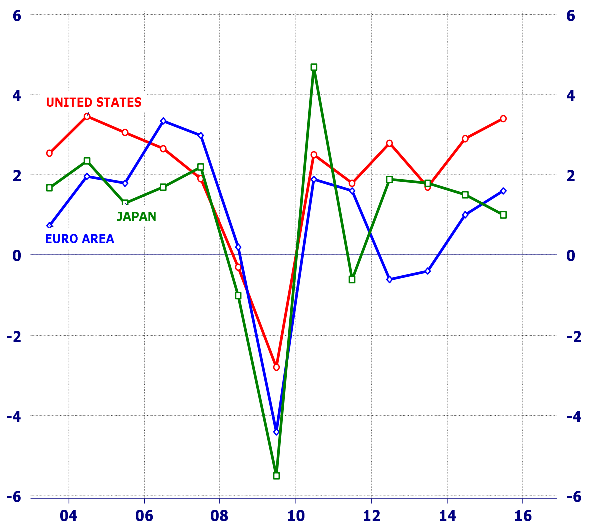


# ECONOMIC GROWTH FORECASTS

As for the US, the OECD downwardly revised its growth forecast for this year by two tenths to 1.7%, while it increased by two tenths its Eurozone estimate (forecasting a lighter recession at -0.4%) and Japan estimate (1.8%). For next year, the US will grow a little more than previously assumed (one tenth, at 2.9%), while Eurozone and Japan forecasts are slightly reduced (by one tenth to 1.0% and 1.5% respectively).

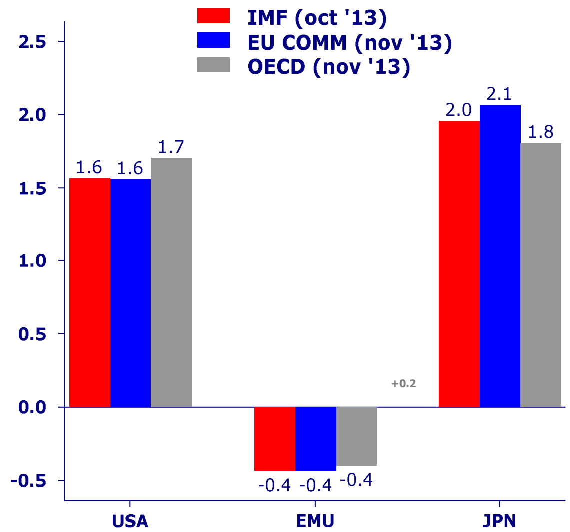
**OECD – GDP TREND**

Yearly average variations



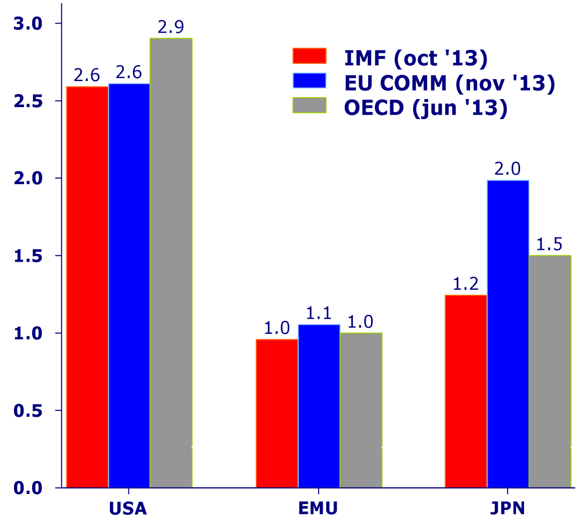

**2013 IMF - EU COMM. - OECD**

Yearly average variations




**2014 IMF - EU COMM. - OECD**

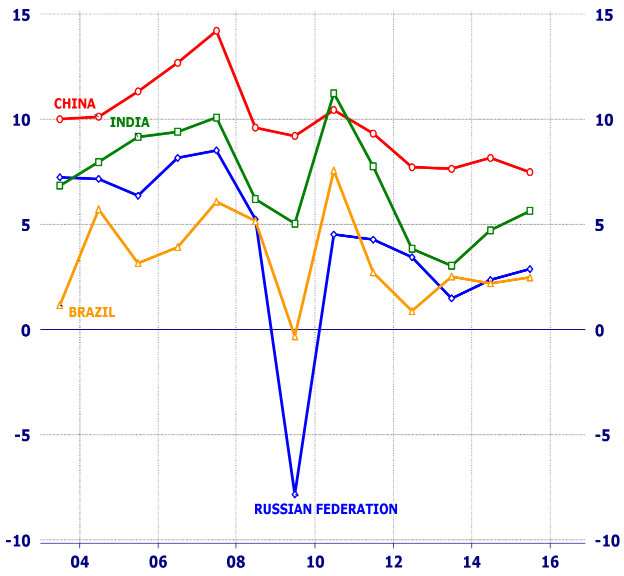
Yearly average variations



# ECONOMIC GROWTH FORECASTS

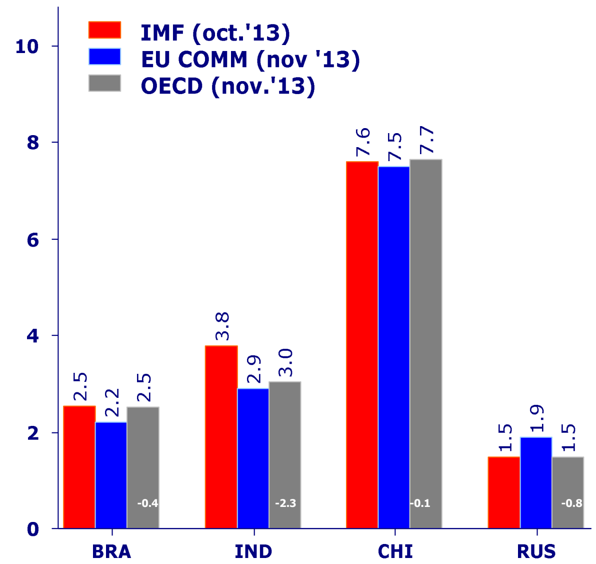
As for BRICs, OECD cut significantly India and Russia growth forecasts (4 and 2.1 points respectively). Its growth forecast for Brazil was cut by 1.7% (1.3% less in 2014), while China forecast was cut in a slighter way (three tenths less, of which two next year).

## OECD – GDP TREND



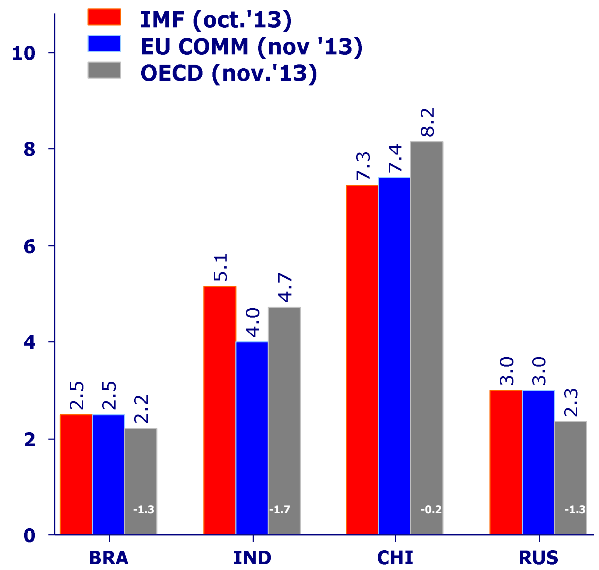

## 2013 IMF - EU COMM. - OECD

Yearly average variations – fixed prices




## 2014 IMF - EU COMM. - OECD

Yearly average variation– fixed prices

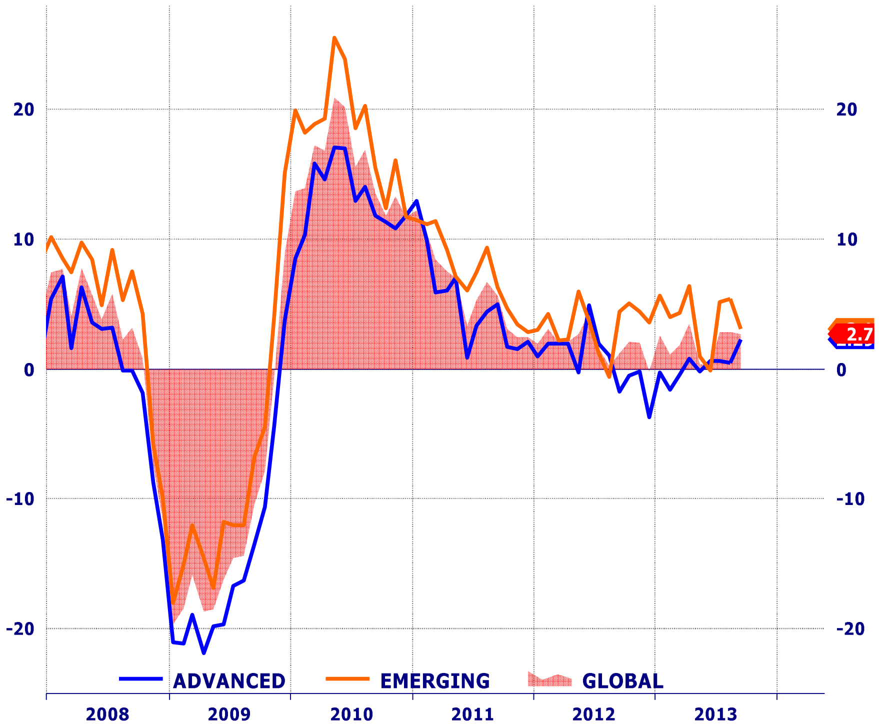


# INTERNATIONAL TRADE

International trade in terms of export volumes points to a 2.7% yearly increase (with data up to September 2013), an indication of the importance of trade between major economies. The leading indicator (global manufacturing PMI – new orders subcomponent) signals conditions in line with future intensification of trade. In dynamic terms, the analysis indicates that this trend could continue and register a slowdown in the long term.

## INTERNATIONAL TRADE – EXPORT

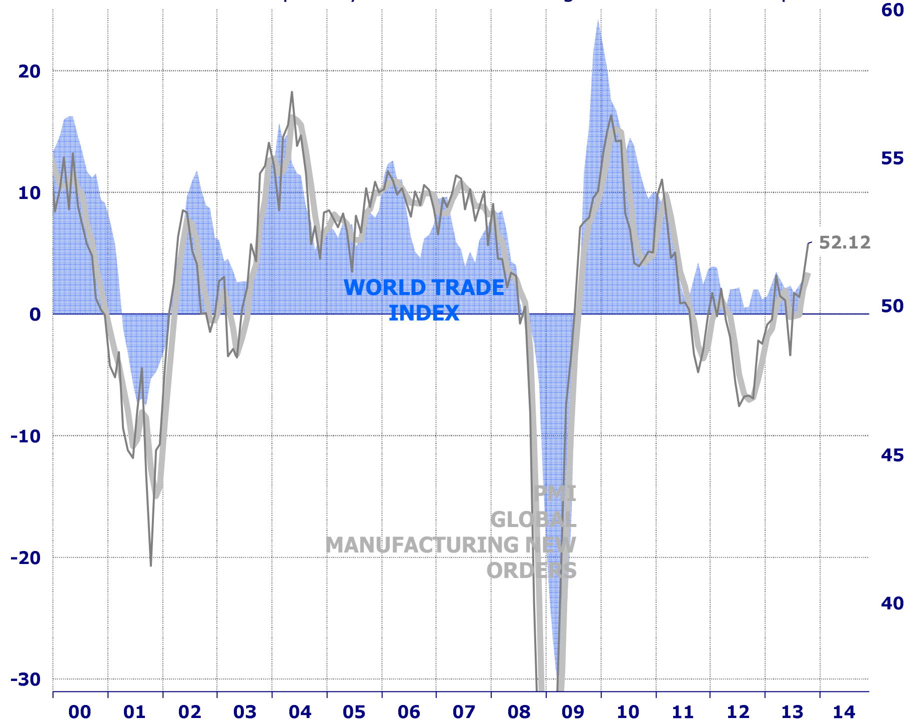
CPB index Export Volume, yearly variation




2.57 -12.54 16.03 5.92 1.98
Average yearly EXPORT data

## INT. TRADE AND LEADING INDICATOR

World trade index quarterly annualised 6m average– PMI new orders export




13.1 -0.2 3.1 5.8 10.4 7.3 8.9 6.7 2.3 -12.6 15.1 5.8 2.2
Average yearly INTERNATIONAL TRADE data

# GLOBAL INDUSTRIAL ACTIVITY

Global industrial activity in September registered a 3.3% yoy growth, marking its strongest growth since May 2012! Among emerging markets, production grew by 4.4% (slight acceleration from the previous data, but a flat trend on compressed values), while among major economies growth was at 2.25% (its best reading since April 2012). These signals indicate conditions compatible with an improvement in the trend.

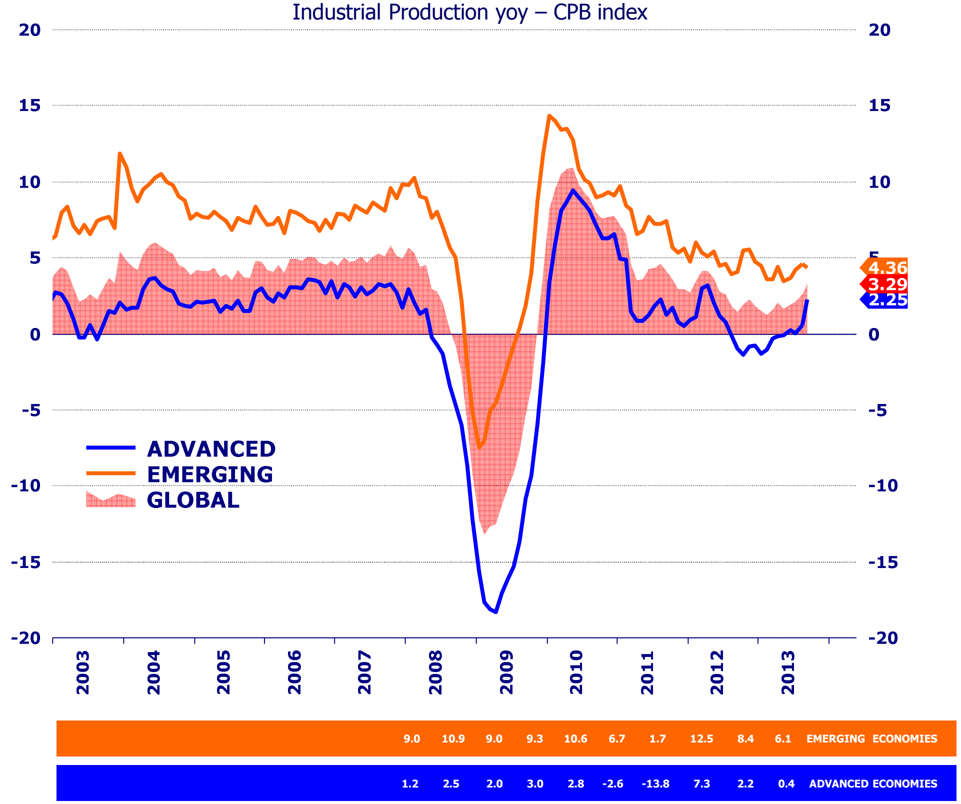
## GLOBAL IND. PRODUCTION AND LEADING

Industrial Production CPB indexes – Leading index OECD


LEADING OECD*: Major economies + BRIC + South Africa+ Indonesia

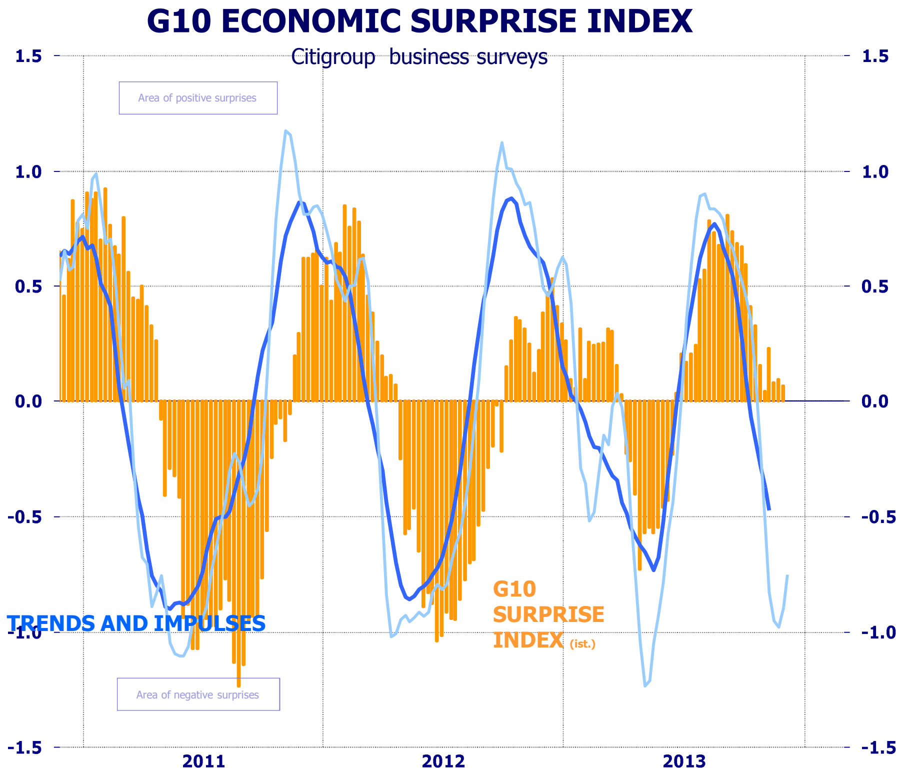
## INDUSTRIAL PRODUCTION

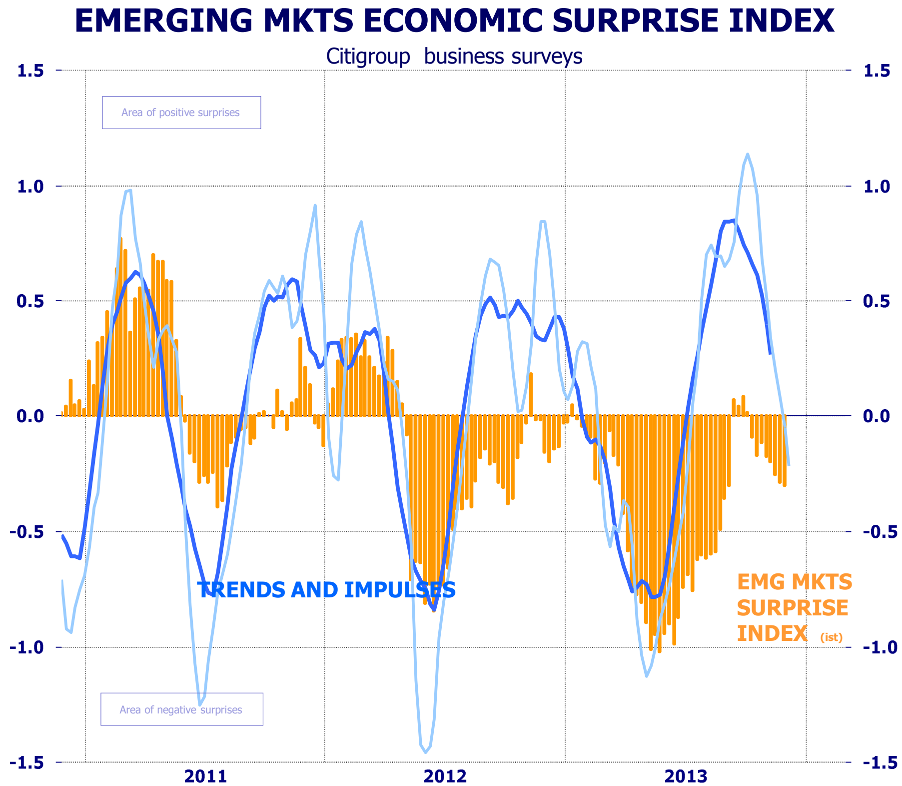
Industrial Production yoy – CPB index



# ECONOMIC ACTIVITY

Analysts forecasts, compared to the published economic data, confirm the prevalence of positive surprises among the ten major economies (although from very low levels) and mostly negative surprises from emerging markets. In dynamic terms, the trend is subject to negative impulses for both sets, implying a low market support for advanced economies and a likely negative pressure for emerging markets.

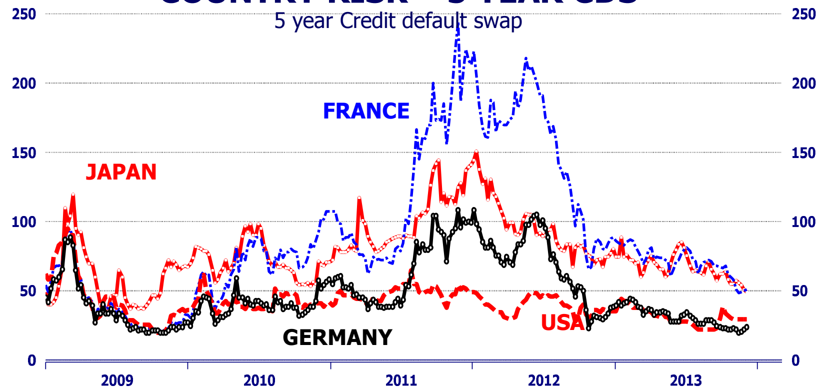


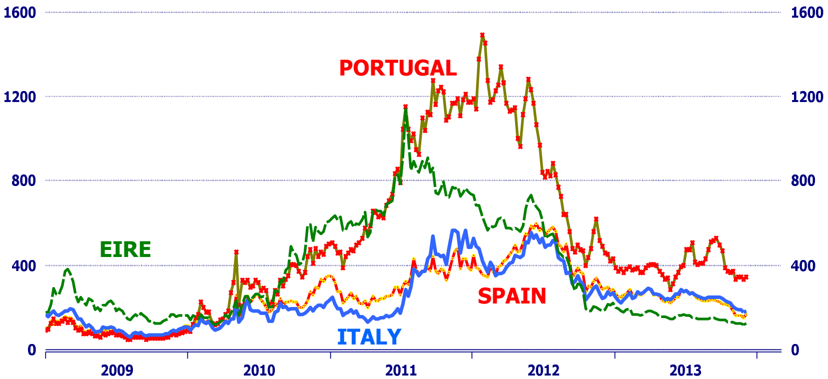



# PUBLIC ACCOUNTS AND SOLVENCY

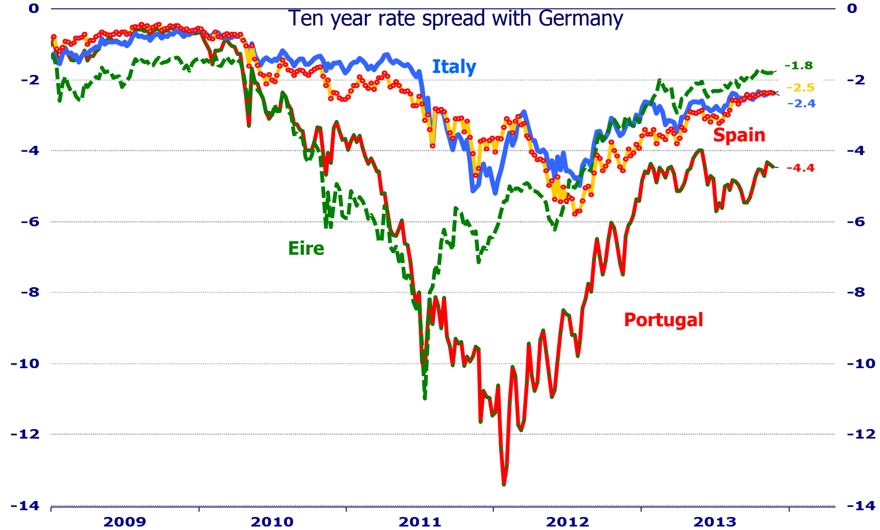
The Eurozone crisis continues to improve thanks to the Governments' commitment to reach the set fiscal targets. However, there are persistent weak spots due to zero growth, i.e. high social unrest risk and political instability. At the end of November, S&P reduced the Netherland' rating to AA+. Thus, the Netherlands lose its maximum reliability status (triple A for the three main rating agencies), that it shared with Germany, Luxembourg and Finland in Eurozone, due to low growth perspectives. Spain got a stable (from negative) outlook, with a still critical BBB- rating.

## COUNTRY RISK – 5 YEAR CDS



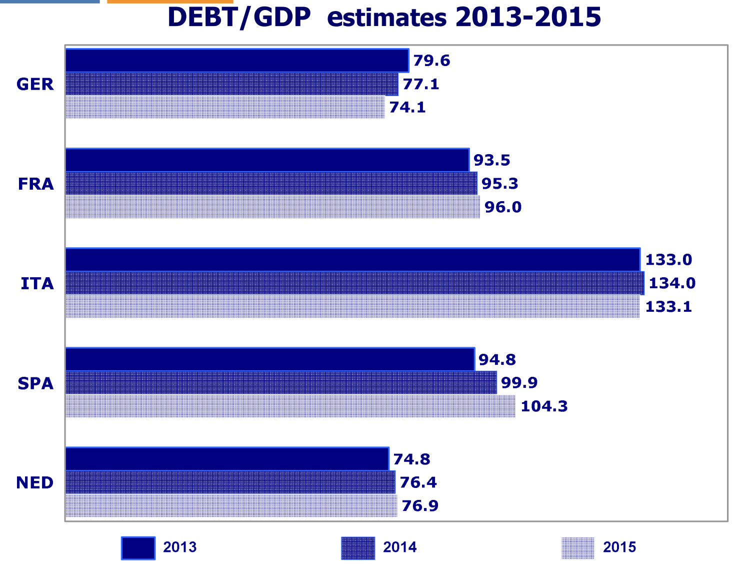

## COUNTRY RISK AND RATING

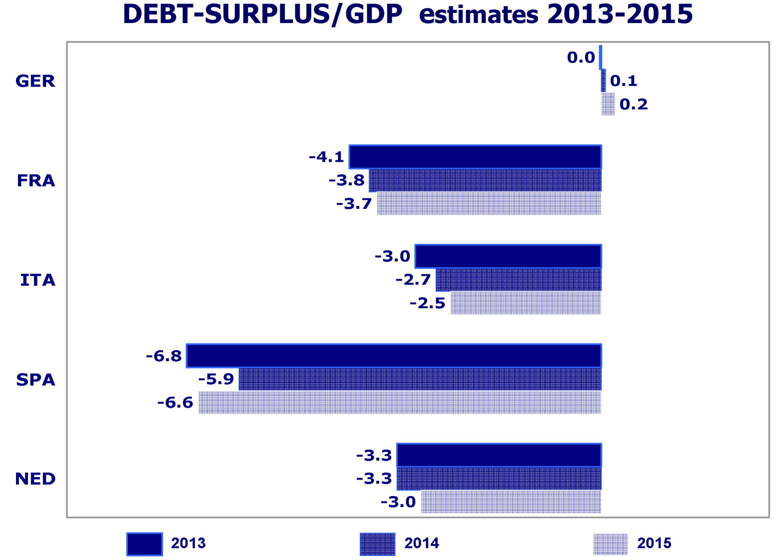


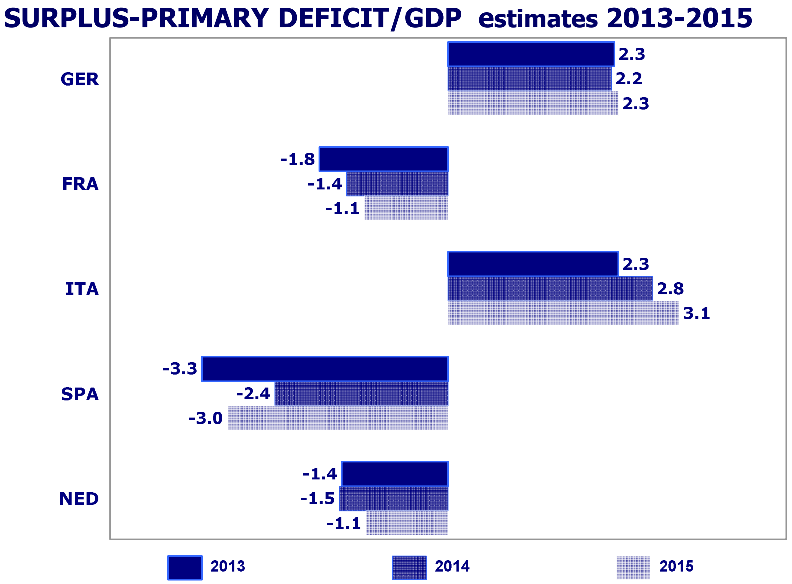

| | Moody's | S&P | Fitch |
|---|---|---|---|
| Italy | Baa2 | BBB | BBB+ |
| Spain | Baa3 | BBB- | BBB |
| Ireland | Ba1 | BBB+ | BBB+ |
| Portugal | Ba3 | BB- | BB+ |
| Greece | C | B- | B- |
| France | Aa1 | AA | AAA |
| Germany | Aaa | AAA | AAA |
| Japan | Aa3 | AA- | AA- |
| USA | Aaa | AA+ | AAA |

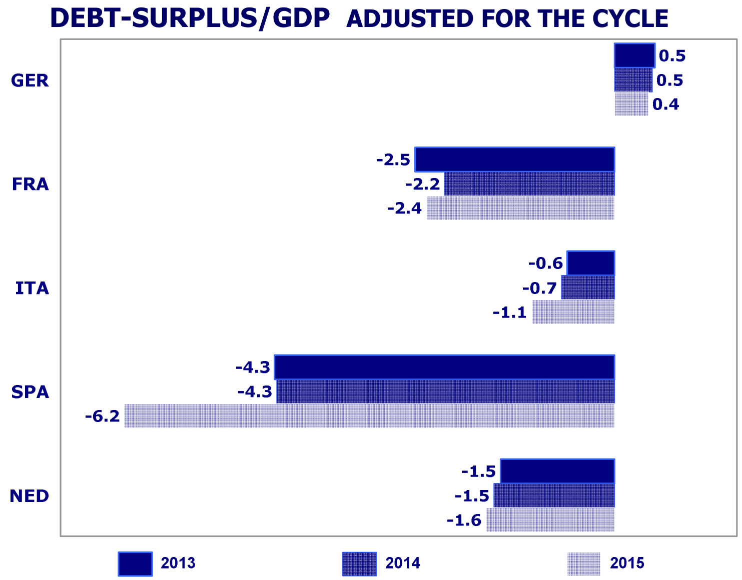
Source Bloomberg, rating 10/20/2013

# EUROPEAN COMMISSION FISCAL INDICATORS



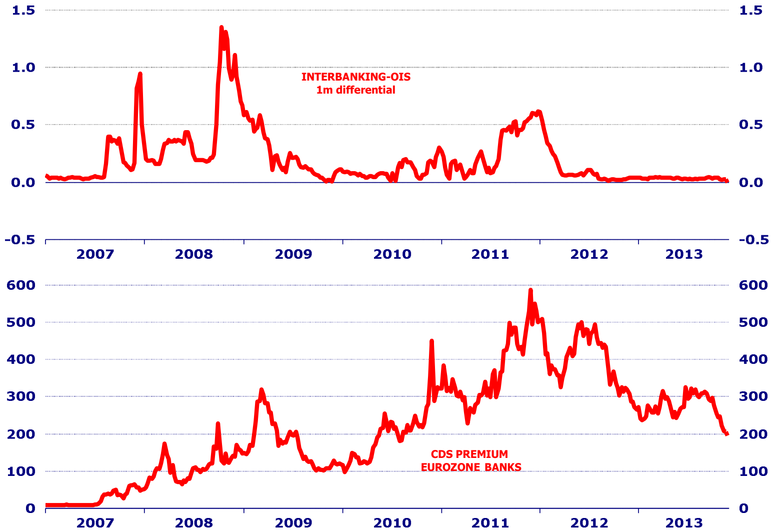



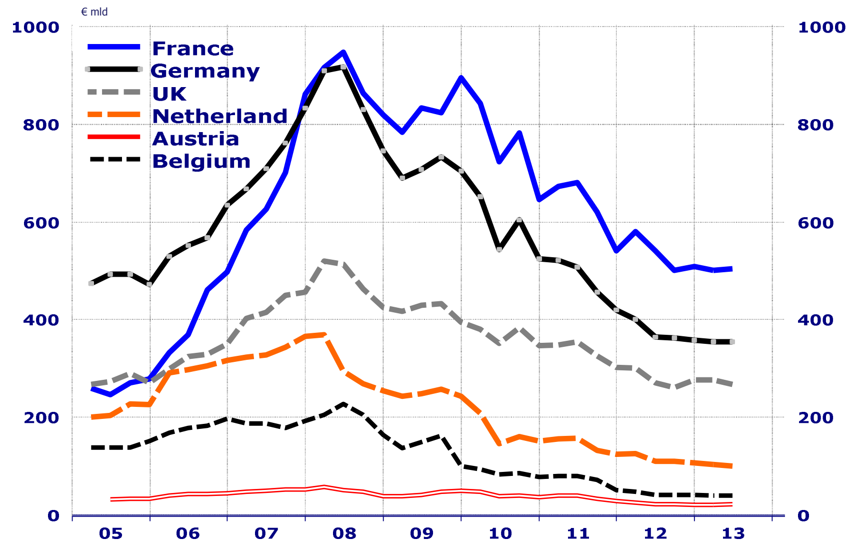
# MONETARY POLICY AND FINANCIAL CONDITIONS

## OIS SPREAD & CDS €BANKS



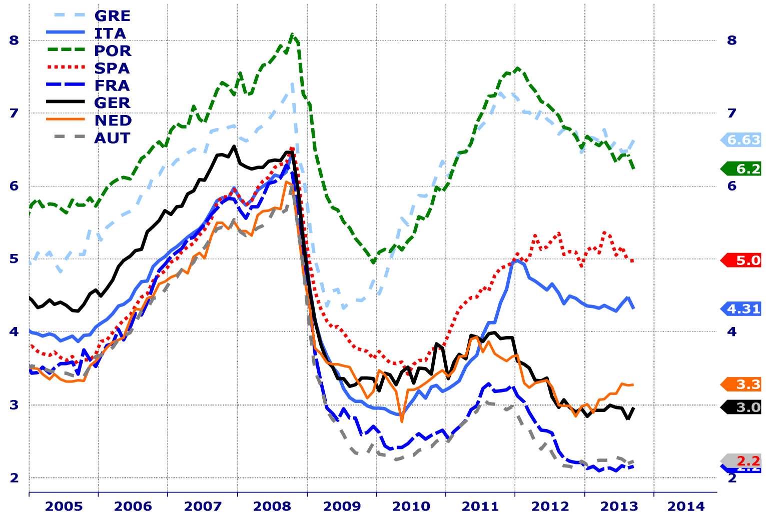

## BANK COMMITMENTS TO PERIPHERALS

Bank aggregate data vs Itally, Eire, Greece, Spain, Portugall



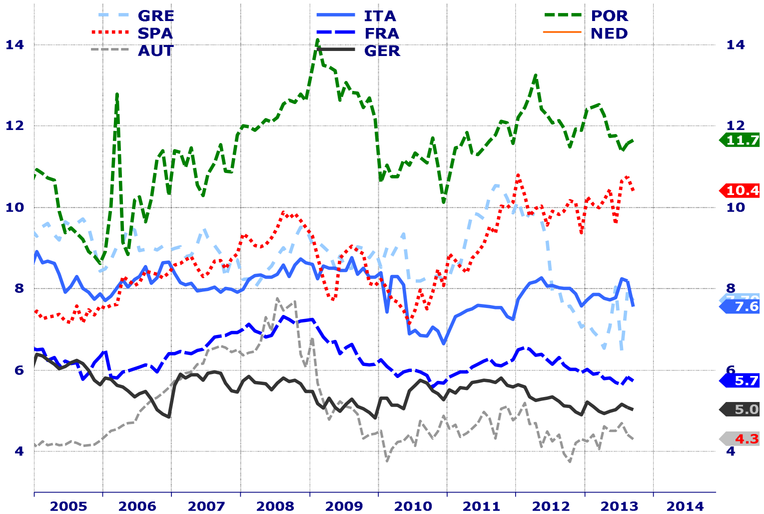

## INTEREST AND CREDIT RATES

Business loans less than 1mln euro




## CREDIT INTEREST RATES

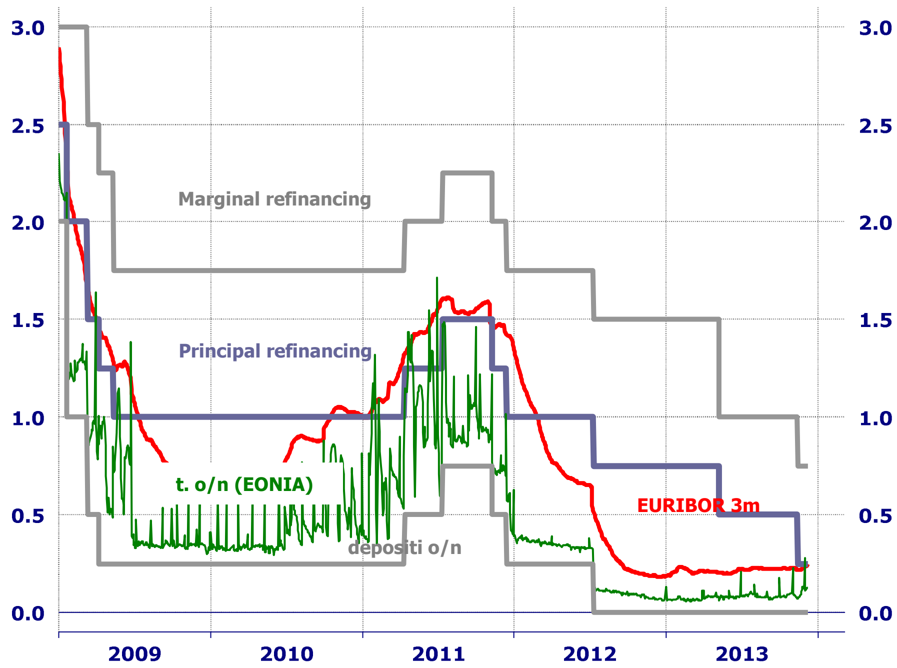
credito al consumo tasso variabile 1-5 anni



# MONETARY POLICY AND FINANCIAL CONDITIONS

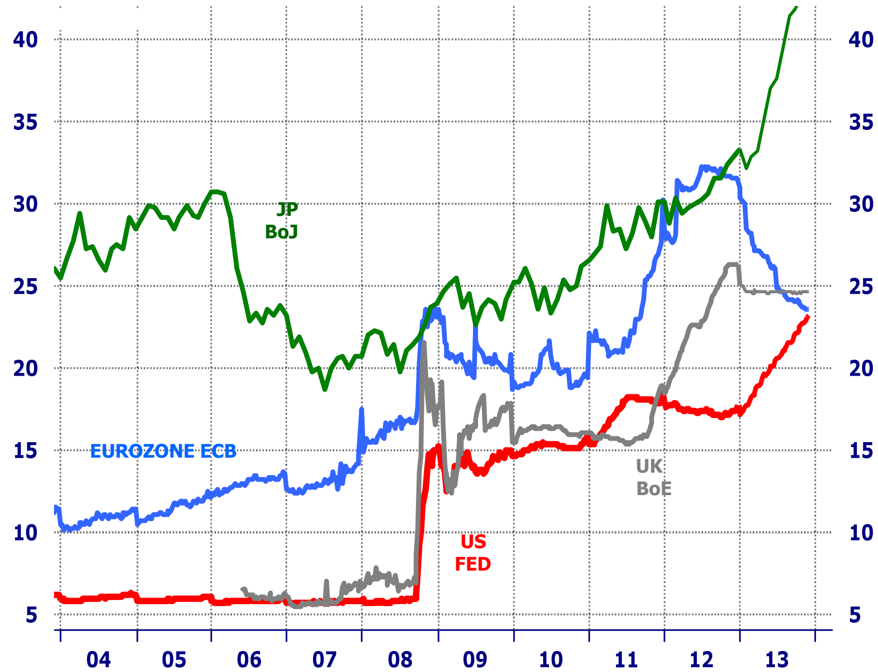
In its November meeting, the ECB cut its main refinancing rate by 25 bp to a new all time low at 0.75%, while it left its deposit facility rate unchanged at 0%. The Fed, BoE and BoJ remain keen on securing the greatest accommodation, waiting for the Fed's reduction of its *quantitative easing program.* The ECB move, definitely unexpected, was motivated by the drop in Eurozone's inflation rate to a four year low at 0.7% in October, in order to offset deflation risks. In its December meeting, the ECB confirmed its accommodating policy, marginally improving its growth forecasts to 1.1% in 2014, while average inflation should drop from 1.4% this year to 1.1% next year due to persistent price pressure.

**ECB – OFFICIAL RATES' CORRIDOR**




**CENTRAL BANKS' ACCOUNTS**

Total asset, % nominal GDP (IMF data)

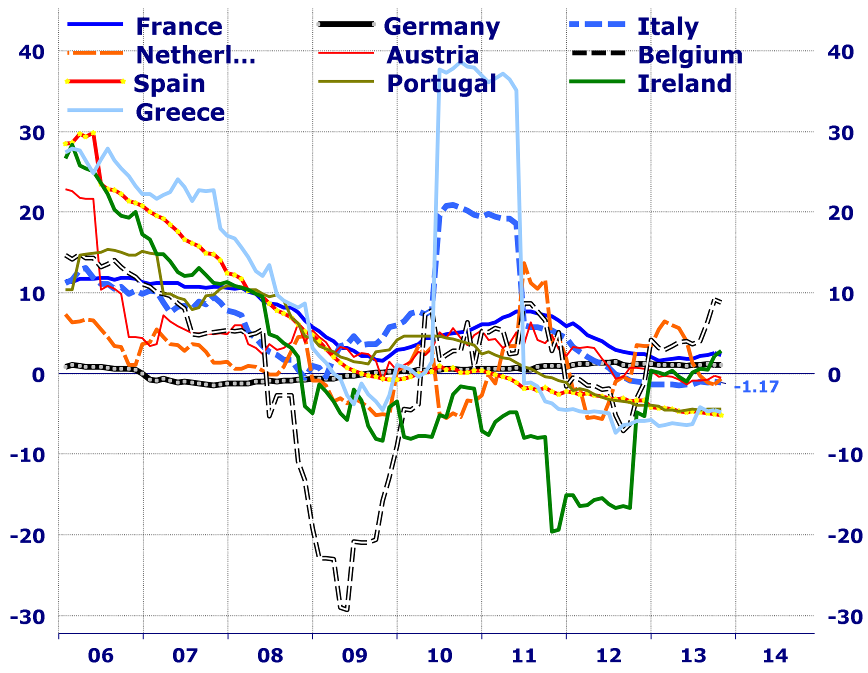


# MONETARY POLICY AND FINANCIAL CONDITIONS

The transition to the Single Supervisory Mechanism, under which the ECB will become Single Supervisor for the European Banking System in a year, will be preceded by a new series of “stress tests” and a preliminary “asset quality review” in order to harmonise the different European banking systems in order to get a Banking Union. The process of standardisation of accounting principles of the 130 major Eurozone banks is a very important step for this program, which is weakened by continous special interests issues and by uncertainty over future handling of banking crises. The main problem is always that strong countries don’t want to proceed to “confusing” local debt, which would happen with the ESM fund’s prerogatives on banks recapitalisation.

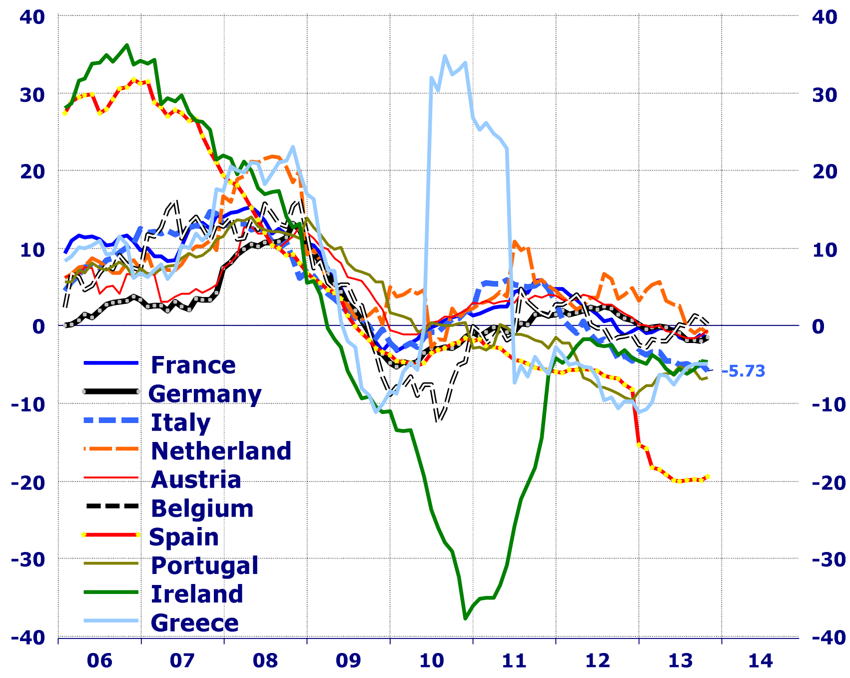
**BUSINESS LOANS**

1 y growth rates




**HOUSEHOLD LOANS**

1 y growth rates

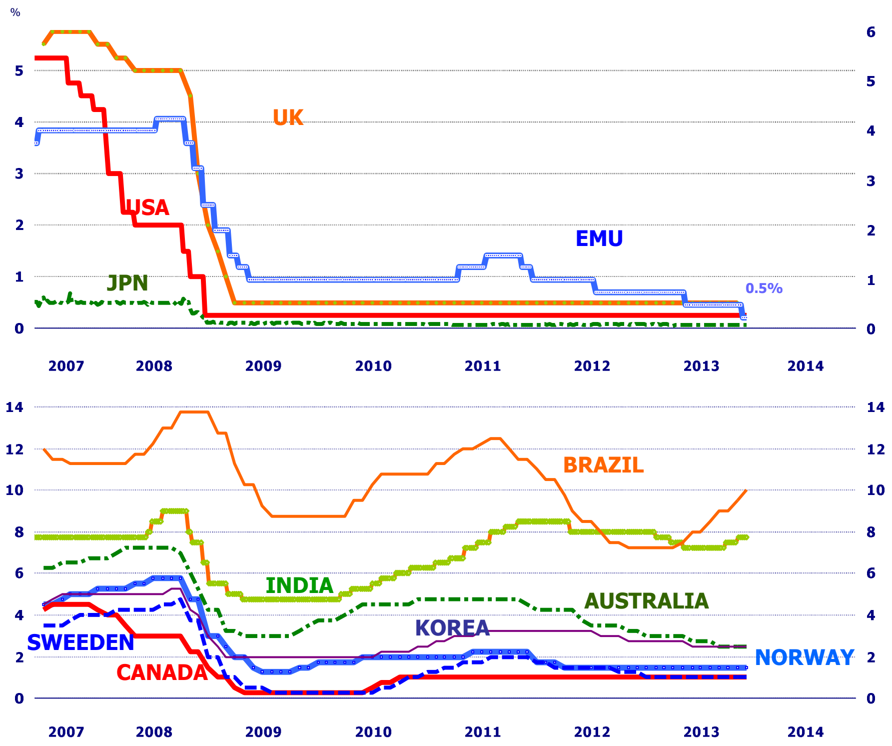


# MONETARY POLICY AND FINANCIAL CONDITIONS

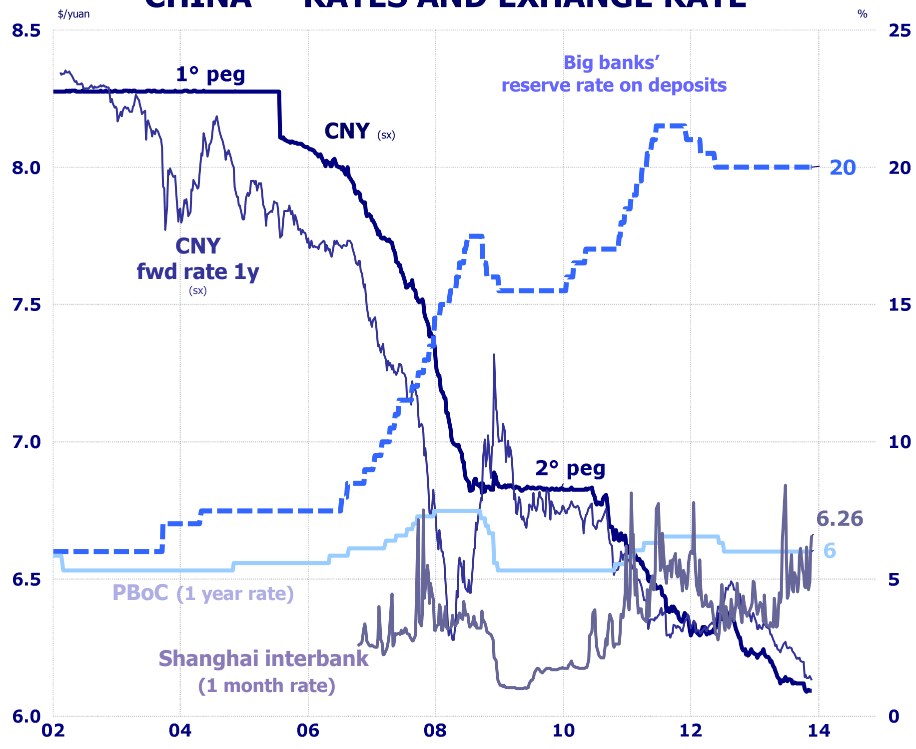


After its November meeting, the BoE unexpectedly put a stop to the *funding for lending* scheme for mortgages financing. Actually, from 2014 the scheme will stay in place only for loans to small and medium businesses, as the real estate market has recovered and can further strengthen without public help. The BoJ is targeting a 2% inflation rate by doubling its monetary base, the amount of JGBs (government bonds) and ETFs held in two years. At the end of November the COPOM (Brazil central bank) raised its official reference rate (Selic rate) by 50 bp to 10%, with the goal of containing inflation and supporting its currency.

## OFFICIAL REFERENCE RATES

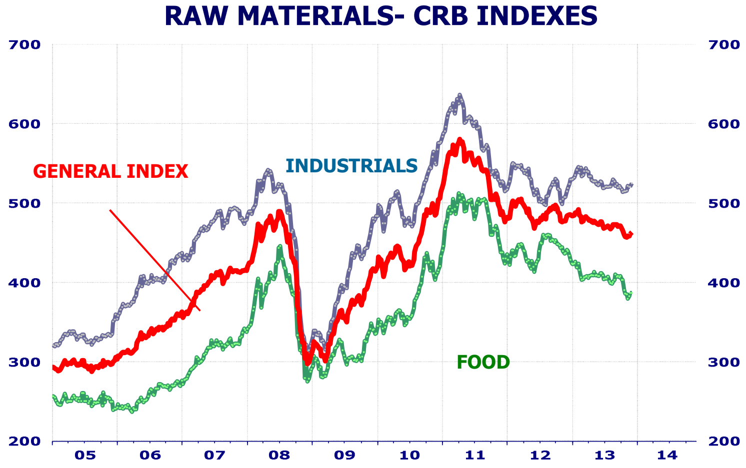


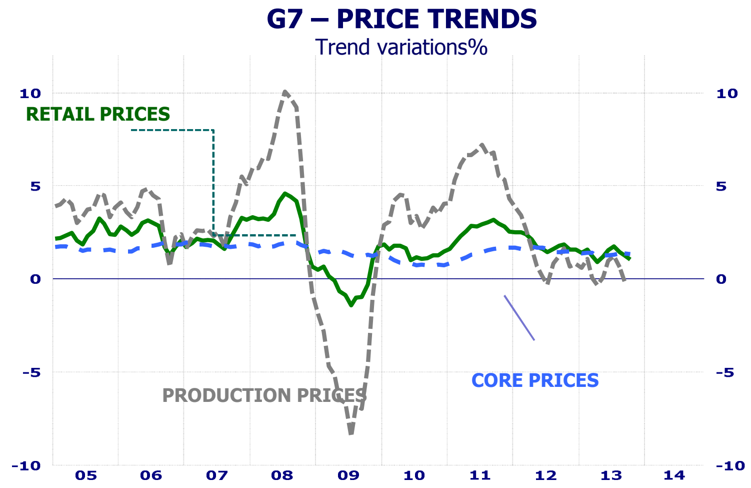

## CHINA - RATES AND EXHANGE RATE

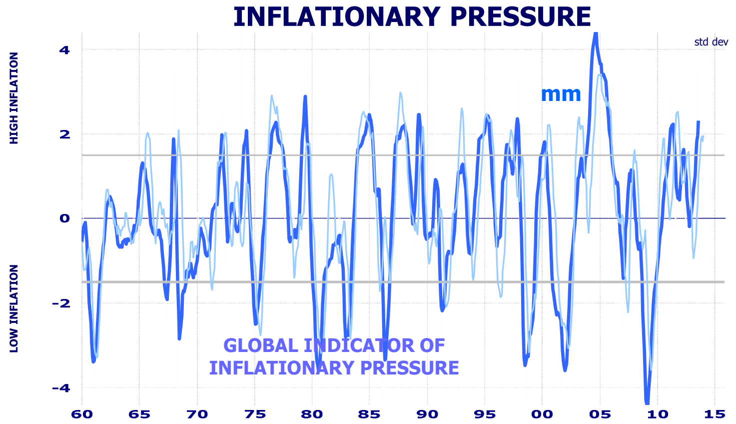


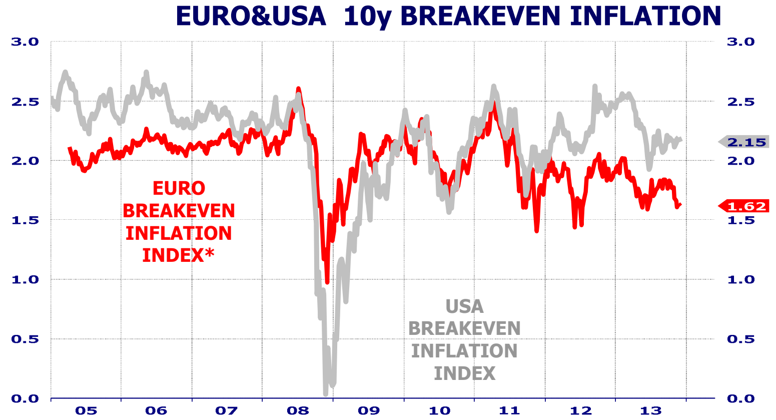
# INFLATION

The general price index of raw materials (CRB) maintained its lateral/downward trend, pushed down by the food component. In major economies the price trend turned negative again, which should be reflected on wholesale prices. The general inflationary pressure index continued its upward trend with short term impulses and more structured impulses, which points in the direction of price recovery.



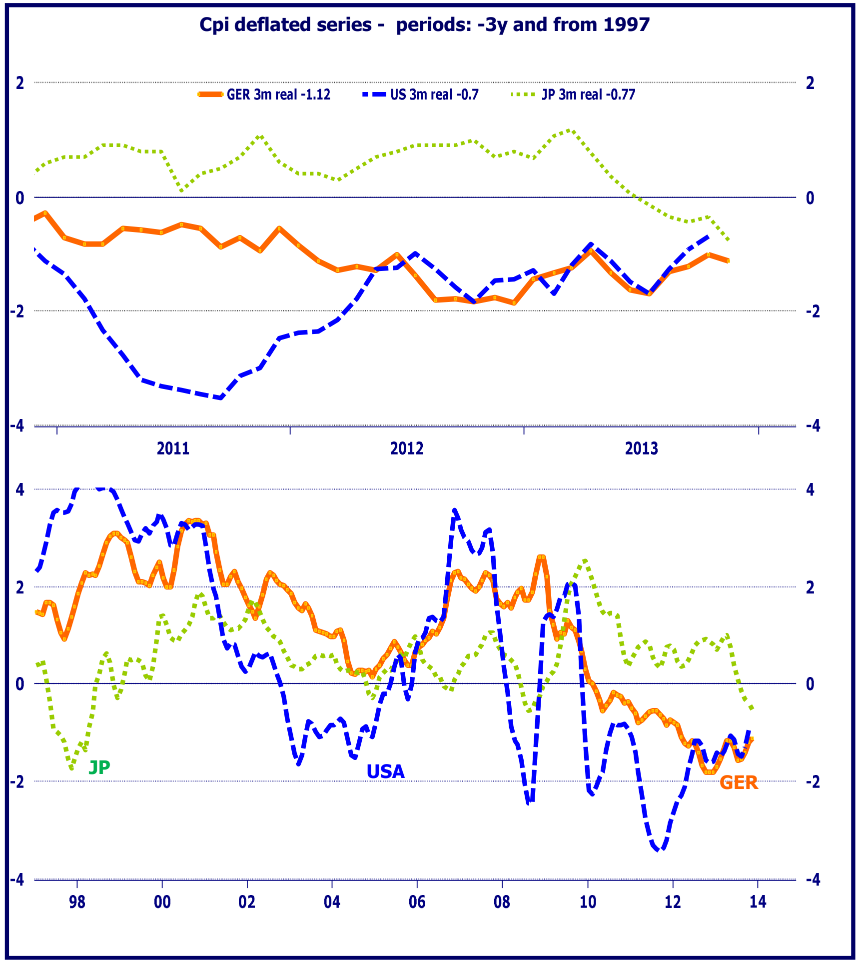




*IEURO INDEX BASED ON FRENCH GOVERNMENT BONDS

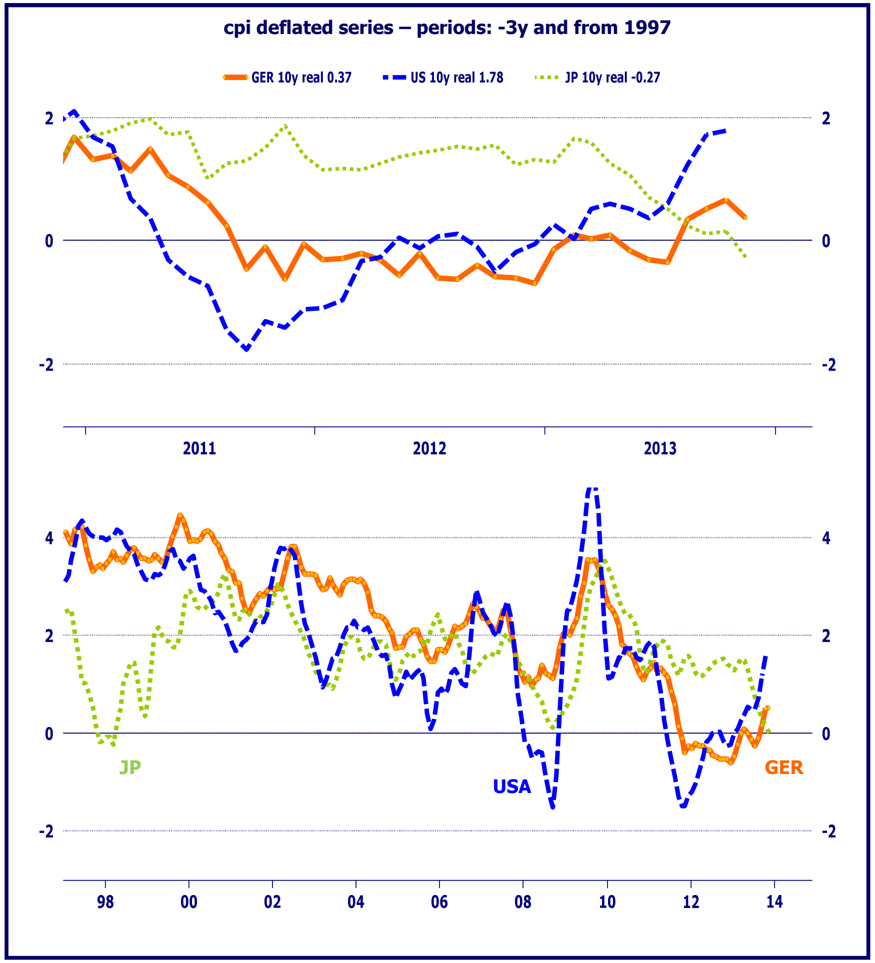
# REAL RATES

The inflation deceleration brought a spike in real rates. German and US three-month real interest rates are still negative, but a quantitative analysis indicates upward impulsive conditions. Real ten-year rates are already positive, with a trend that in the short term seems too strong.

**THREE MONTH REAL RATES**



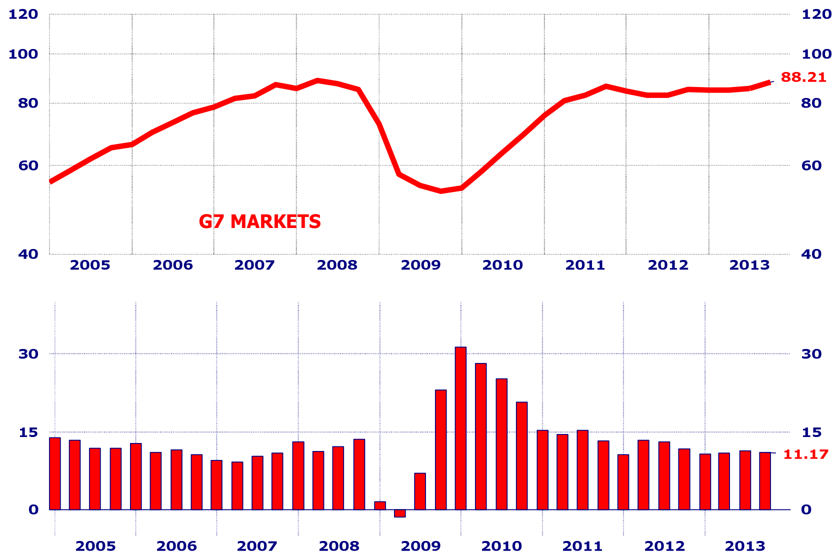

**TEN YEAR REAL RATES**

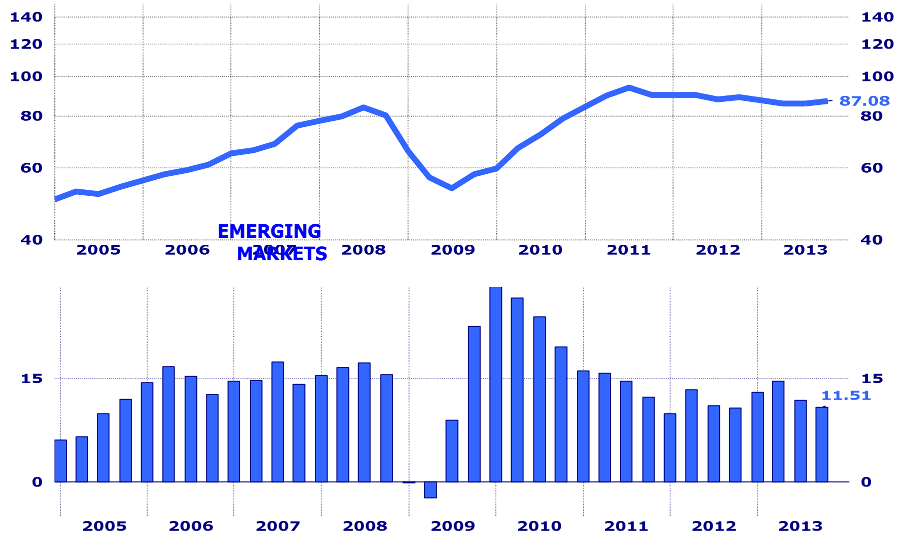


# MSCI WORLD - G7 - EMERGING MARKETS

The postponement of *tapering* (though still incumbent), the agreement on debt in the US and the lowering of ECB rates further diminished market stress, encouraging the stock compartment. However, risk appetite is improving. Year-to-date the MSCI index for the seven major countries is up almost 27%, while MSCI EMERGING MARKETS increased by 1.9%. The expected earnings growth in a year time is at 11.1% for G7, slightly down from last month, and at 11.5% for EM MKTS. The earning momentum is unfavourable for Japan and US, still unfavourable for the Eurozone, while it supports the BRICS indexes (Brazil, Russia, India, Indonesia, China and South Africa).

**STOCK MARKET**
Quarterly earnings and yearly trend



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