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

- January IMF growth forecasts for the major economies foresee favourable conditions in 2014, with upward revisions with respect to the previous release, while some of the major emerging economies have seen downward revisions.

- In aggregate terms, advanced economies should grow this year by 2.2% (+0.2 compared to the previous forecast), sustained by a more widespread recovery, although still fragile in some areas. Forecasts for emerging markets remain unchanged for a 5.1% growth, due to local issues, but also to the global crisis, whose negative effects weigh on international trade.

- Overall, after the 3% growth estimate for 2013, the global economy should grow this year by 3.7% according to the IMF, accelerating to 3.9% in 2015.
In the US, consumption accelerated in Q4 despite the Shutdown, while housing and capex investment slowed down. However, part of the slowdown is due to adverse weather conditions, especially extending in Q1 2014. Thus, we continue to expect a steady growth in both the housing and manufacturing sector in 2014. Our Growth forecasts are at 2.8% for 2014 and 2.9% for 2015.

Unemployment is expected to fall below the 6.5% threshold by mid 2014, continuing its gradual decrease. By the end of 2015 it should be below 6%.

We still expect inflation below 2% for most of the forecasting period, thanks to the output gap accumulated during the Great Recession and these years of weak recovery. We expect a gradual acceleration in the coming months. Forecasts: average headline CPI at 1.6% in 2014 and at 2.1% in 2015, average core CPI at 1.7% in 2014 and at 2.1% in 2015.
For the first time since 2011, the four major Eurozone economies recorded simultaneous positive growth in Q4 2013. Germany is still the leader, with GDP growth at 0.4% compared to the previous quarter and at 1.4% on a yearly basis. France is recovering from its summer recession, growing at +0.3% on a quarterly basis and at +0.8% yoy. Italy and Spain recorded positive GDP growth as well (+0.1% and +0.3% respectively), that however left the trend dynamic unaltered.

Indications of consolidation came also from smaller economies of the area. The strongest qoq growth came from the Netherlands (+0.7%), the strongest trend growth was recorded for Portugal (+1.6%).

Since last October, the number of unemployed in the whole Euro area decreased by 207K units, finally stabilising unemployment, but at its highest historic levels.
In its March meeting, the ECB Governing Council decided not to change monetary policy, despite mounting pressure for further expansive measures, with the Refi Rate unchanged at 0.25% and the deposit rate at 0%. The Council confirmed its forward guidance on maintaining rates at their current levels or even lower for an extended period of time. Also, regarding the SMP programme, sterilisation of assets detained by the ECB was confirmed.

The inaction on the ECB’s part reflects its confidence in its scenario for a gradual recovery in growth and a mild acceleration in inflation in the medium term. The inflation scenario is confirmed, with forecasts in the Euro area at 1% for 2014 and at 1.3% in 2015. Growth forecasts for 2014 were revised slightly upwards, at 1.2% for 2014 and 1.5% for 2015.
At its February Meeting The Bank of England thoroughly modified its forward guidance, broadening it to a wider series of economic and labour market indicators - instead of only the unemployment rate - and signalling the intention of maintaining rates at the current levels despite the recovery being stronger and faster than expected.

The Bank of Japan left its monetary policy unchanged, but doubled the amount of resources for credit support programmes, extending their duration to one year.

Many Central Banks in Emerging countries increased official rates to limit funds outflows and to sustain their currencies. Among these, the Turkish Central Bank increased its official rate from 4.5% to 10%. The Chinese central bank (PBoC) keeps the Government’s rigid monetary policy.
The Fed’s gradual tapering and a series of disappointing economic data are the main reasons behind the USD general weakness. On the other hand, a more favourable evaluation of the EMU recovery supported the euro. The euro-dollar exchange rate, thus, remained at high levels, between 1.36 and 1.38, even surpassing the 1.39 threshold in early March.

On the other hand, the euro weakened versus other main currencies, especially versus the yen and the Swiss franc, which suffered from the increased uncertainty and risk aversion attracting safe-haven flows, while the pound appreciated more strongly, fostering expectations of increasing interest rates and benefiting from the buoyant recovery.
EXECUTIVE SUMMARY

- For the next months we expect Euro-Dollar at 1.33-1.32, with downward risks. Euro-Pound at 0.83-0.82, Euro-Yen at 138-141, Euro-Swiss franc at 1.23-1.24.

- The extreme weakness of Emerging markets currencies persists, although with different dynamics. In the past three months the Russian Ruble was the weakest currency among BRICs countries. The Chinese renminbi (Yuan), so far mostly untouched by the currencies’ turbulence, could weaken a bit soon, especially after the PBoC move in mid-March to widen the daily fluctuation band around the official fixing. We foresee general weakness for all cross rates.

- In this report we present a special focus on China.
## EXECUTIVE SUMMARY
### GENERAL MACRO SUMMARY

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### INFLATION (%Y/Y)

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Banca Aletti Forecast
Cons. Bloomberg (Mar 14)
FOCUS ON CHINA
In Q4 2013, Chinese GDP increased by 1.8% QoQ, 7.7% on a yearly basis, basically in line with the previous quarter (7.8%), but slightly above consensus (7.6%). The pace of growth at the end of last year is in line with the past eight quarters’ trend (7.7%) and exactly the same as average growth rate in 2013 and 2012, confirming that the system seems to have found a new equilibrium on lower growth levels than in the past. Given this and considering possible risks, we assume a constant slowdown, modest in intensity, that will gradually bring GDP growth rate from 7.5% in Q1 to about 7.0% at the end of the year. Our forecast for 2014 is at 7.2%.
In February the general economic climate in China weakened for the third month in a row. The PMI index for the whole economy dipped below the 50 threshold for the first time in the past seven months (49.8). This reflects a significant loss for manufacturing, not completely offset by the rebound in services (51).
Real activity indicators decreased in February: Industrial Production growth fell significantly to an average of 8.6% yoy in January-February (combined to remove lunar new year distortions) from 9.7% in December 2013, substantially below market consensus of 9.5%. Fixed asset investment growth also fell significantly, to 17.9% y-o-y ytd in February from 19.6% in December. Property investment growth also slowed, but just slightly to 19.3% y-o-y ytd from 19.8%.
Retail sales growth came off sizeably as well, to an average of 11.8% yoy in January-February from 13.6% in December. Electricity production was weak at 5.5% y-o-y, down from 8.3%. The delivery value of industrial production for export purposes rose, on average, by 2.7% y-o-y in January-February, slowing substantially from a rise of 5.8% in December, suggesting that the significant drop in exports in February also partly reflects weakening fundamentals. These data shows very weak economic momentum.
In February, Chinese exports registered a significant fall, decreasing by 18.1% on a yearly basis, worst data since 2009. This is partly due to seasonal distortions (Chinese New Year), but nonetheless worries international investor.
Shipping decreased strongly to all four major Chinese Export markets, with balances ranging from -11% towards Japan to -24.3% to Hong Kong. The simultaneous stability of imports produced a stark imbalance in the trade balance, generating a 23 bln US dollar deficit, first negative figure in two years.
On the other hand, Imports haven’t changed, confirming the gradual acceleration begun at the end of last year and giving signals of internal demand strength. The increase was at +10.1% on a yearly basis in February, an eight-month high.
The US, Japan and Eurozone overall absorb a little less than 40% of total Chinese exports, thus assuring a valid cushion on exports in 2014.
The persistent deflationary condition, upstream of the supply chain, is a worrying effect of the economic weakness. Producer prices fell by 2% yoy in February, marking the fastest decline since last July, decreasing for the 24th month in a row. In 2009 deflation was stronger, but for a shorter time span. The leading indicator for the cost of productive inputs is at 47.7, an eight-month low, letting us expect further downward pressure.
The Chinese CPI slowed down below expectations in February, recording a 2% yoy growth, marking their 13-month low. The leading indicator for retail prices was at 45, its eight-month low, but the underlying trend is flat or moderately rising. Overall, the scenario is compatible with moderate inflationary pressures in the coming months.
Inflation moderation comes mainly from a fall in food prices. Apart from that, the trend in price dynamics remains stable below 2%.
The main worrying issues discussed so far:

- Fall in exports
- Increasing deflationary pressures
- PMI index below the 50 threshold

In addition:

The first default on the bond market in the recent history of the system (Shanghai Chaori Solar)
The Chinese slowdown must be considered in the light of the local authorities’ attempt to create the greatest change in political economy in the past twenty years, rebalancing growth, inflation and employment targets. During the Communist Party’s Official Congress, Premier Li Keqiang confirmed Government’s 2014 growth target at 7.5%, the same as last year. Target inflation is also confirmed at 3.5%, above current levels, thus allowing scope for monetary policy to support the economy.

THE PARTY’S OFFICIAL TARGETS

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GROWTH

INFLATION
MONETARY POLICY

Given the price evolution showed above, we assume monetary policy to remain neutral in the coming months. Expansive policies seem out of discussion, given the need to stabilise the housing market. The Chinese renminbi (Yuan), so far mostly untouched by the currencies turbulence, could weaken a bit soon, especially after the PBoC move in mid-March to widen the daily fluctuation band around the official fixing. We foresee general weakness for all cross rates.
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