



# Global Economy Report

September 2014



## 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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**Report closed on September 9, 2014**



❖ According to IMF's July revision, global income should grow by 3.4%, a lower forecast (3 tenths lower than the previous estimate) due to the slower recovery of major economies (+1.8%, four tenths lower) and due to limited acceleration in emerging economies (4.6%, two tenths less). This highlights concrete suffering for Russia, Brazil, South Africa and Mexico. China (above 7%) and India (between 5 and 6.5%) display a discreet strength in the two year period.

❖ Among major economies, US and Japan are favourably positioned, while Eurozone is at greatest growth risk. There is great pressure due to the crisis in Eastern Europe and for the ongoing financial adjustment phase, which lacks necessary reform processes.



## EXECUTIVE SUMMARY

- ❖ US growth, penalised at the beginning of the year by adverse weather conditions and destocking, accelerated conspicuously in the second quarter of the year, with income growing by 4.2% on an annual basis.
- ❖ The system's macro parameters indicate further strengthening, confirming an evolution of the scenario in line with projections and consistent with an annual average growth at 2% in this year and around 3% in the next.
- ❖ Relatively stable inflation at 2% favours the Fed's gradual activity. In October QE3 will end and the Fed should increase rates around half of next year.



- ❖ Unexpected stagnation in the second quarter and uncertainty on leading indicators in the most recent surveys increased risks on Eurozone's recovery, greatly hit by the Russia-Ukraine crisis, by prolonged fiscal pressure and ongoing credit crunch.
- ❖ Third quarter growth will presumably be positive but below expected levels, with near-recessive development risk in Italy.
- ❖ Growth estimates for aggregate income in 2014 are reduced to 0.8%; in 2015 to +1.2%. Negative price pressure remains aggressive, but deflation risk is still modest.



- ❖ In China, we expect a growth stabilisation between 7-7.5%, as a long term scenario.
- ❖ On the short term, Manufacturing PMI in August dropped to 50.2, minimum of the past three months, just short of the inversion point that divides expansion from contraction. The interviewed firms indicated slowdown in new orders both in domestic and foreign markets. On the other hand, despite a modest decline (9.0% on a yearly basis) at the beginning of Q3, industrial production is at 2014's fastest pace, sales grew by 12.1% annualised and exports confirmed previous recovery.
- ❖ China's consumer price index remained stable in July, registering a 2.3% annualised rate.



- ❖ In Japan, we expect volatility on GDP due to increase in value added tax, around a persistent growth trend.
- ❖ In August PMI registered a strong growth (52.4), returning to levels pre VAT-hike. Surveyed businesses stressed an acceleration in production and new orders. Retail sales return to growth in July, signalling demand kick-off, in line with the positive consumer confidence.
- ❖ Overall, price dynamics signal a stabilisation after the impulsive phase relative to VAT hike.



# EXECUTIVE SUMMARY

	2009	2010	2011	2012	2013E	2014E	2015E
<b>GDP (%YOY)</b>							
US	-2.8	2.6	1.6	2.3	2.2	2.0	2.9
EUROZONE	-4.4	2.0	1.4	-0.6	-0.4	0.8	1.2
GERMANY	-5.1	4.2	3.0	0.7	0.4	1.5	1.6
FRANCE	-3.1	1.7	2.0	0.0	0.4	0.4	1.1
ITALY	-5.5	1.8	0.4	-2.4	-1.8	-0.2	0.7
UK	-5.1	1.7	1.1	0.1	1.7	3.1	2.8
JAPAN	-5.5	4.7	-0.6	2.0	1.5	1.0	1.6
BRASIL	-0.3	7.6	2.8	1.0	2.3	1.0	1.6
RUSSIA	-7.8	4.3	4.3	3.4	1.3	0.5	1.5
INDIA	6.4	8.9	7.5	5.1	4.6	5.4	6.4
CHINA	9.2	10.4	9.3	7.7	7.7	7.4	7.2
AUSTRALIA	1.4	2.6	1.4	3.6	2.4	3.1	3.0
KOREA	0.3	6.3	3.6	2.0	2.8	3.6	3.8
<b>INFLATION (%YOY)</b>							
US	-0.4	1.6	3.2	2.1	1.5	2.0	2.0
EUROZONE	0.3	1.6	2.7	2.5	1.4	0.6	1.0
GERMANY	0.2	1.2	2.5	2.1	1.6	1.0	1.7
FRANCE	0.1	1.7	2.3	2.2	1.0	0.7	1.2
ITALY	0.8	1.6	2.9	3.3	1.3	0.4	0.9
UK	2.2	3.3	4.5	2.8	2.6	1.7	1.9
JAPAN	-1.3	-0.7	-0.3	0.0	0.4	2.9	1.8
BRASIL	4.9	5.0	6.6	5.4	6.2	6.4	6.2
RUSSIA	11.7	6.9	8.5	5.1	6.8	7.0	5.6
INDIA	10.8	12.1	8.9	10.4	10.9	8.0	7.5
CHINA	-0.7	3.3	5.4	2.7	2.6	2.4	3.0
AUSTRALIA	1.8	2.9	3.3	1.8	2.4	2.7	2.5
KOREA	2.8	3.0	4.0	2.2	1.3	1.8	2.6

Banca Aletti Forecast

Cons. Bloomberg (Sept 14)



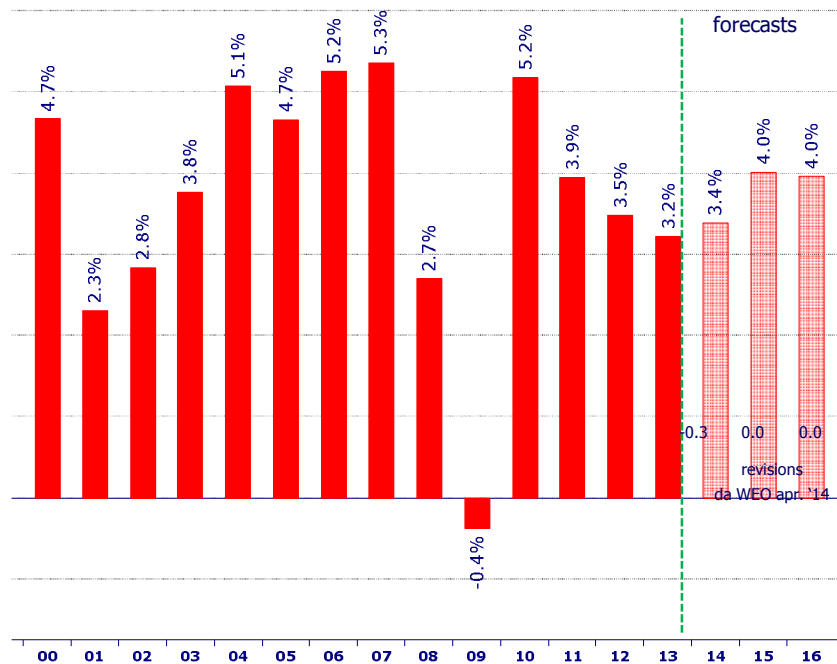
# Global Economic Outlook



According to the July update, IMF trimmed its growth estimates for the current year, whereas the following two years remain unchanged. Growth forecasted for 2014 is at 3.4%, three tenths lower than the previous forecast due to the US's "false start" and a disappointing 2Q in Eurozone... This lower growth estimate is partly due to emerging markets, i.e. China's changing development model, and also due to US's expected monetary policy. Both aspects strongly impacted on domestic interest rates, exchange rates and many emerging markets' aggregate demand. From 3.2% in 2013, this year growth is forecasted at 3.4%.

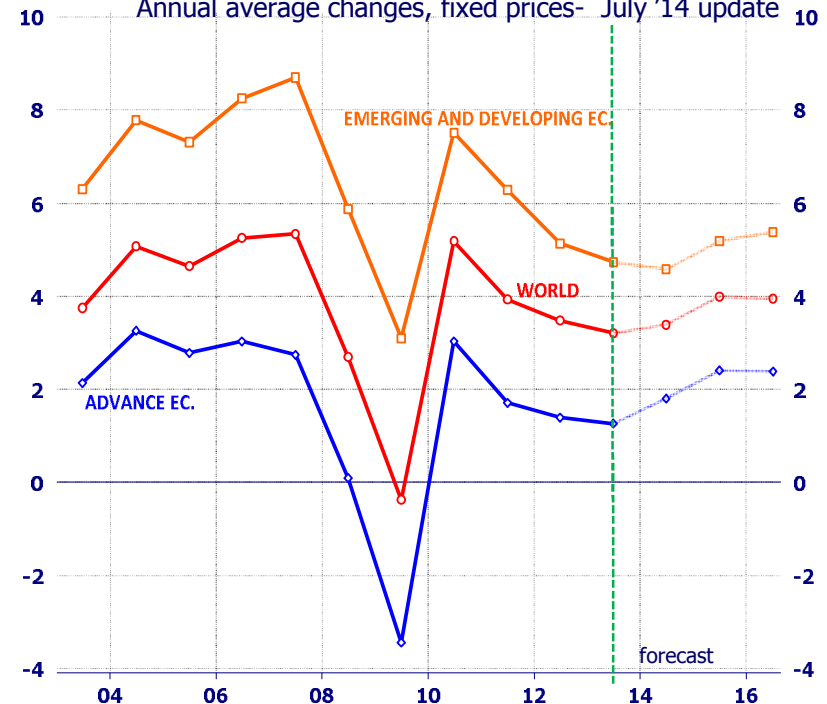
## IMF- GLOBAL ECONOMIC GROWTH

Annual average changes, fixed prices- July '14 update



## IMF- GLOBAL ECONOMIC GROWTH

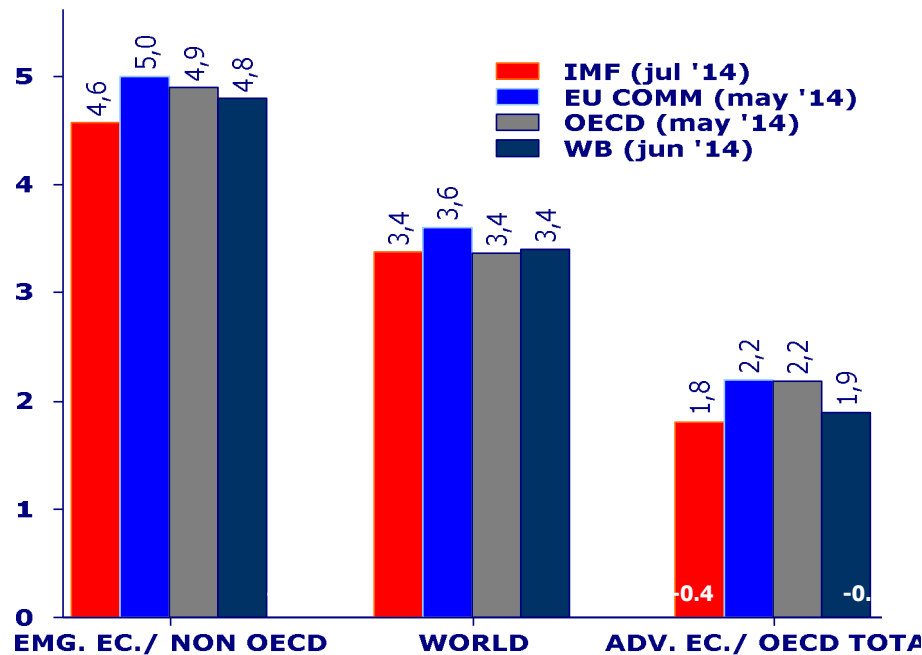
Annual average changes, fixed prices- July '14 update



Global growth's upward trend in 2014 vs. previous years' long slowdown is still valid, but the risk of flattening out is high...The global 3.4% depends on major economies' growth at 1.8% (four tenths less than previous forecast) and emerging economies at 4.6% (two tenths less). For 2015 we assume growth at 4% with 2.4% in major economies and 5.2% in emerging markets.

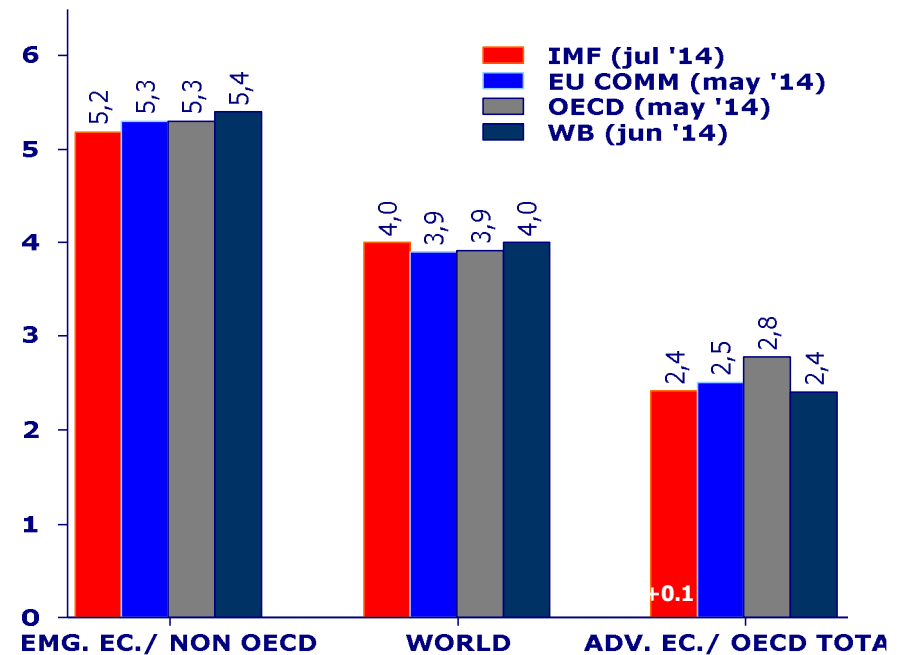
## 2014 IMF\* - EU COMM. – OECD – WB

Average annual changes – fixed prices



## 2015 IMF\* - EU COMM. – OECD - WB

Average annual changes – fixed prices



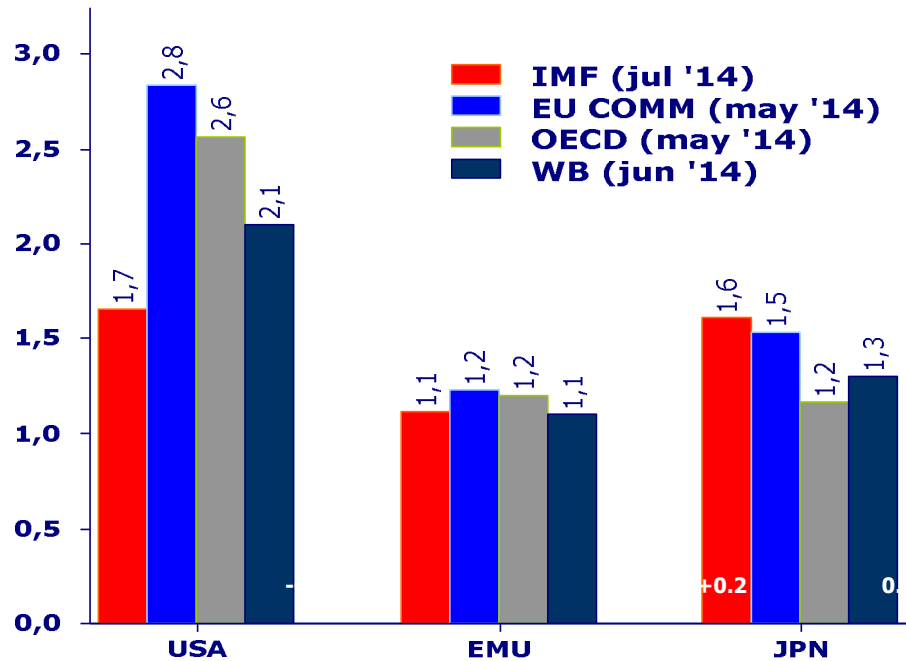
\* IMF data July 2014, WEO Apr. '14 Update; revision is reported at the bottom of the chart



In 2014, major economies' downward revision in forecasts is mostly due to the US, that not only don't reach 3%, but who will close under 2%. Eurozone should grow slightly over 1%, but there still are downward risks. Japan's growth should be over 1.5%. In 2015 the US should finally reach 3% growth, Eurozone should be at about 1.5%, while Japan should stabilise at 1%.

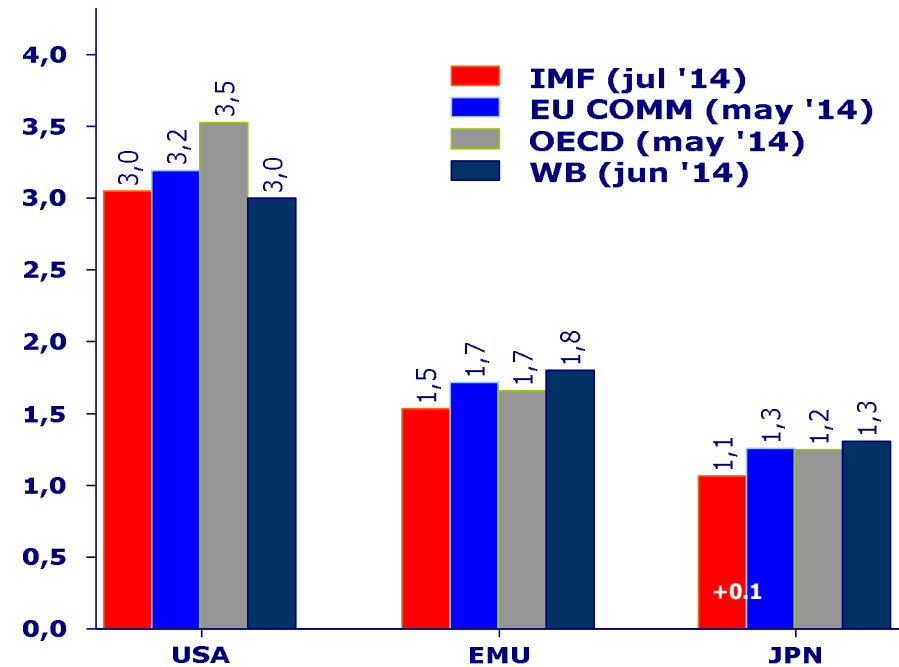
## 2014 IMF\* - EU COMM. - OECD - WB

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Average annual changes – fixed prices



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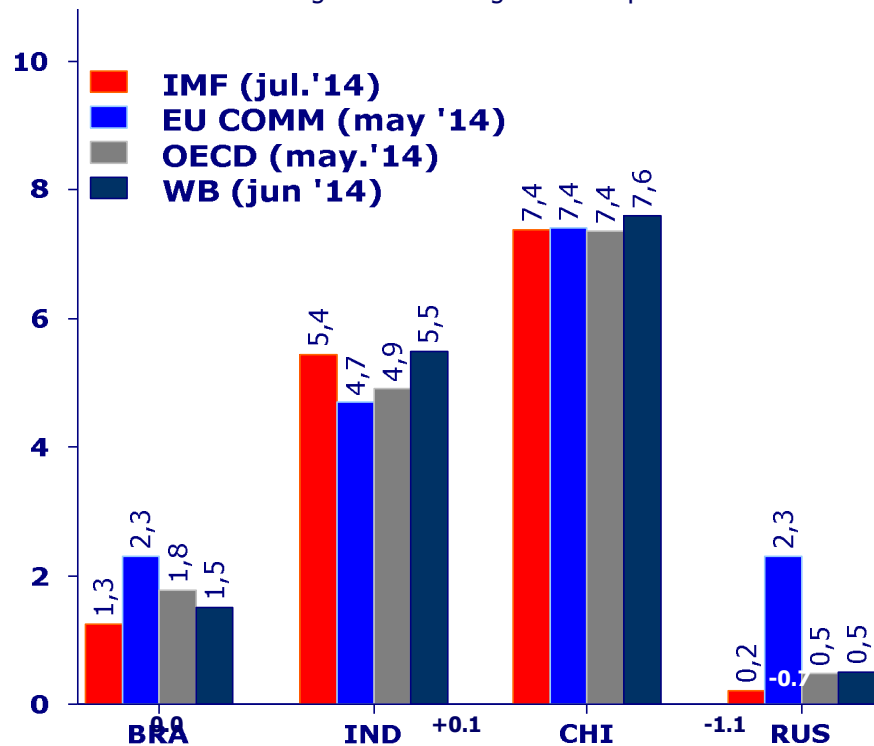


# ECONOMIC GROWTH FORECASTS

Brazil and Russia (but also South Africa and Mexico) among emerging markets are the ones with the most critical dynamics. The process of forecast revisions in the past months has brought Brazil's forecasted growth for 2014 under 1.5% and Russia's close to zero. Both still face downside risks: Brazil, with elections in October, may follow in its negative inertia; Russia, with the Ukraine crisis, is risking heavier western sanctions. Also South Africa and Mexico this year had a hefty cut (six-tenths): the former should grow at 1.7% and the latter at 2.4%.

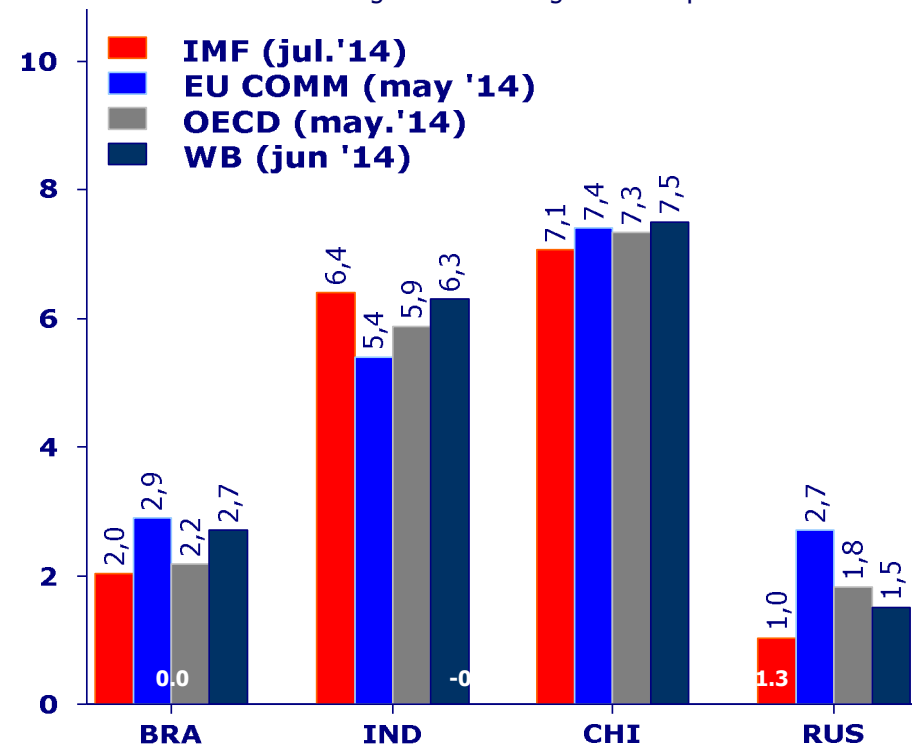
## 2014 IMF\* - EU COMM. - OECD - WB

Average annual changes – fixed prices



## 2015 IMF\* - EU COMM. – OECD - WB

Average annual changes – fixed prices



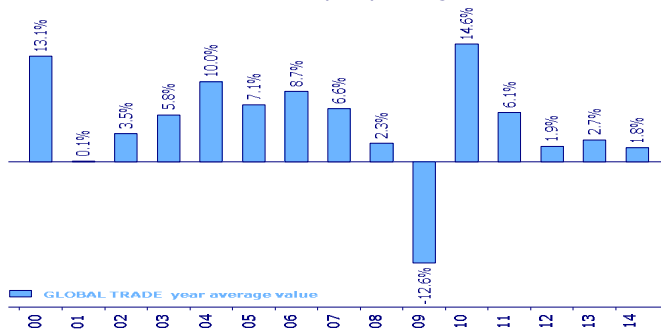
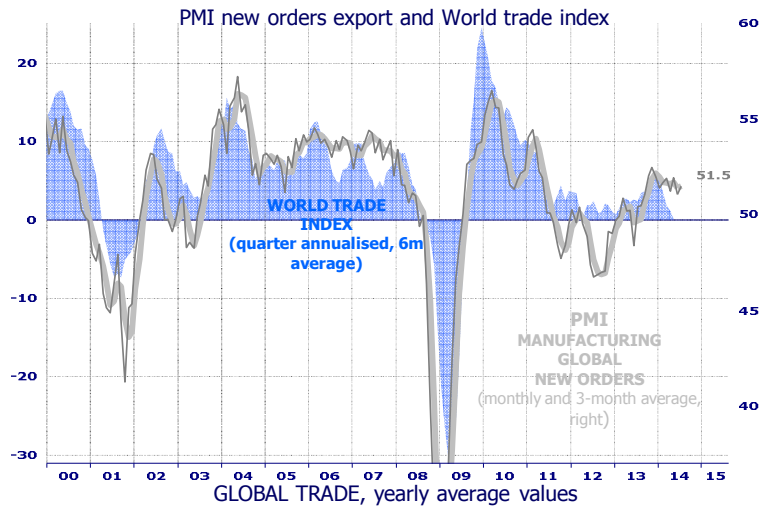
\* IMF data July 2014, WEO Apr. '14 Update; revision is reported at the bottom of the chart



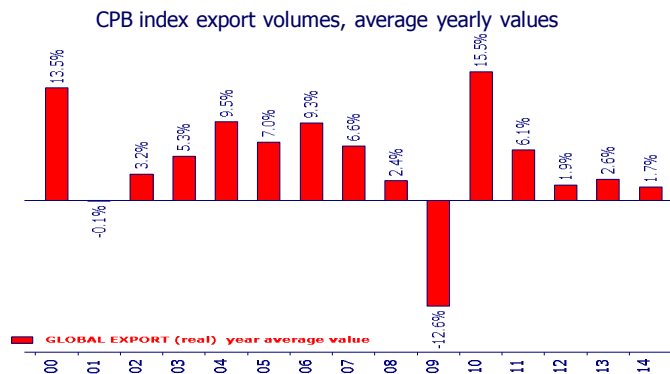
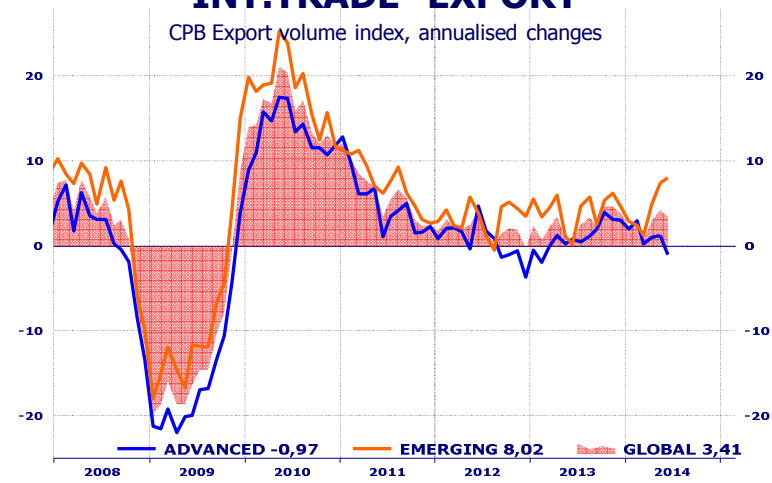
# INTERNATIONAL TRADE

International trade data indicate a still declining real trend, but the leading indicator signals a modest recovery. Annual export growth in June increased by a mere 3.4% in real terms, compared to previous 4.2%, but it is the volume of exchanges between major economies that dropped in a few months, with an annual contraction slightly under 1%. Trade among emerging markets continued to grow, with a yearly increase of 8%. The drop between Spring and Summer in major economies is due to a strong cut in Japanese exports and to the geopolitical situation that, mostly in Europe, has caused a sensible change exchanges.

## INT. TRADE AND LEADING INDICATOR



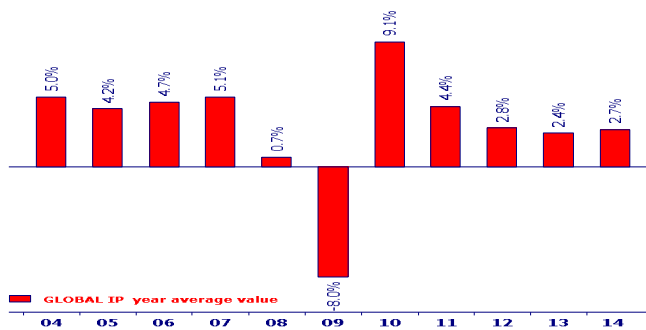
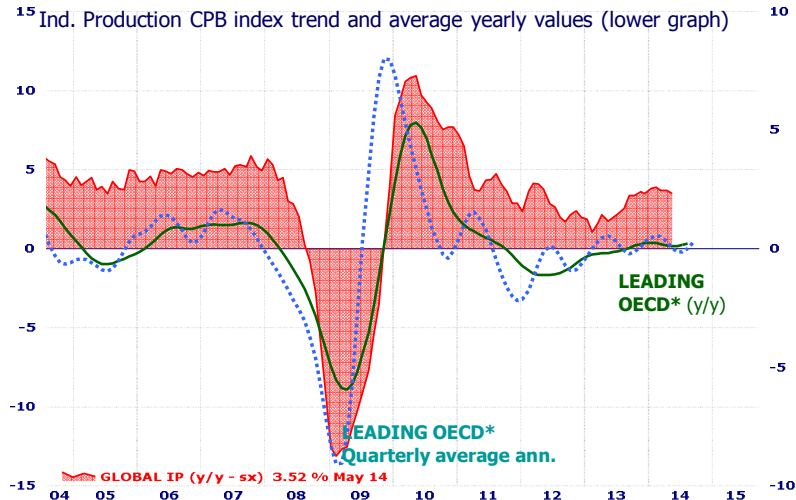
## INT. TRADE- EXPORT



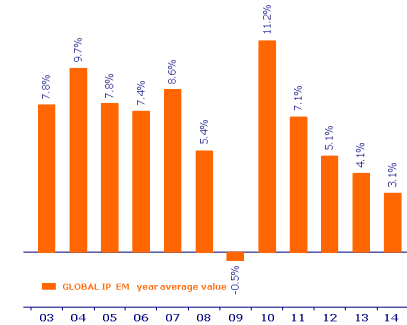
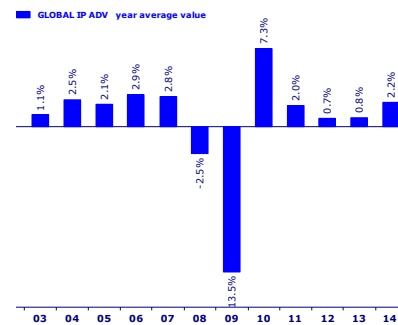
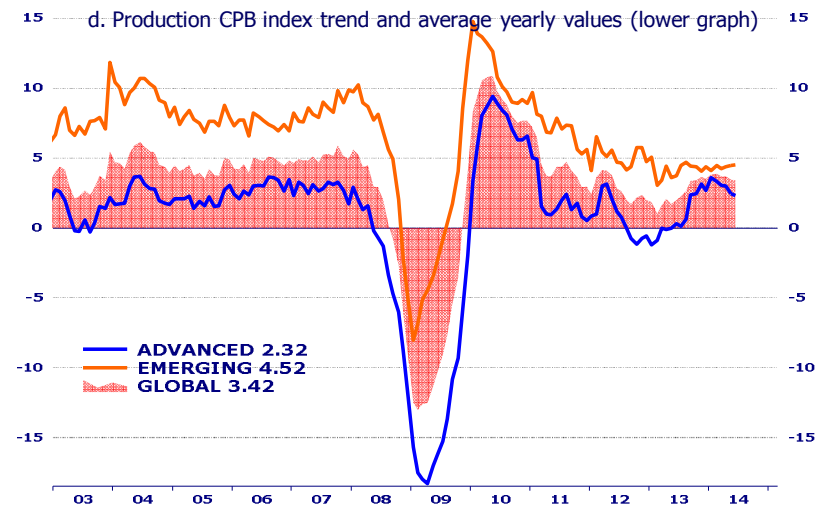
# GLOBAL INDUSTRIAL ACTIVITY

Global industrial production in June showed a 3.4% increase on an annual basis. Among emerging markets, activity continues to register stable growth above 4%, while among major economies the past months' slowdown brought this figure to 2.3%. In the short term, the current trend should carry on, although impulses are losing intensity.

## GLOBAL IND. PRODUCTION AND LEADING IND.



## GLOBAL INDUSTRIAL PRODUCTION



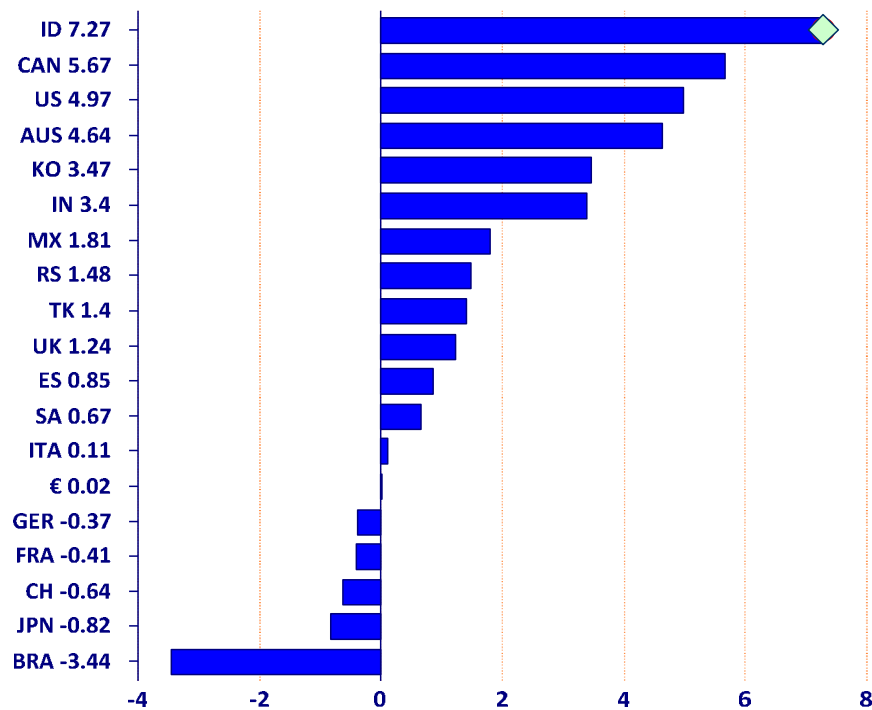
LEADING OECD\*: MAJOR ECONOMIES + BRIC + SOUTH AFRICA + Indonesia



Among major countries, activity data signal strong trend values in Indonesia, Canada, USA and Australia, solid for Korea and India, positive for Mexico, Russia and Turkey; in Eurozone the average data is practically null. This is the result of fractionally positive values in Spain and Italy, negative in Germany and France. Brazil remains the only country where the trend figure remains strongly negative (although recovering).

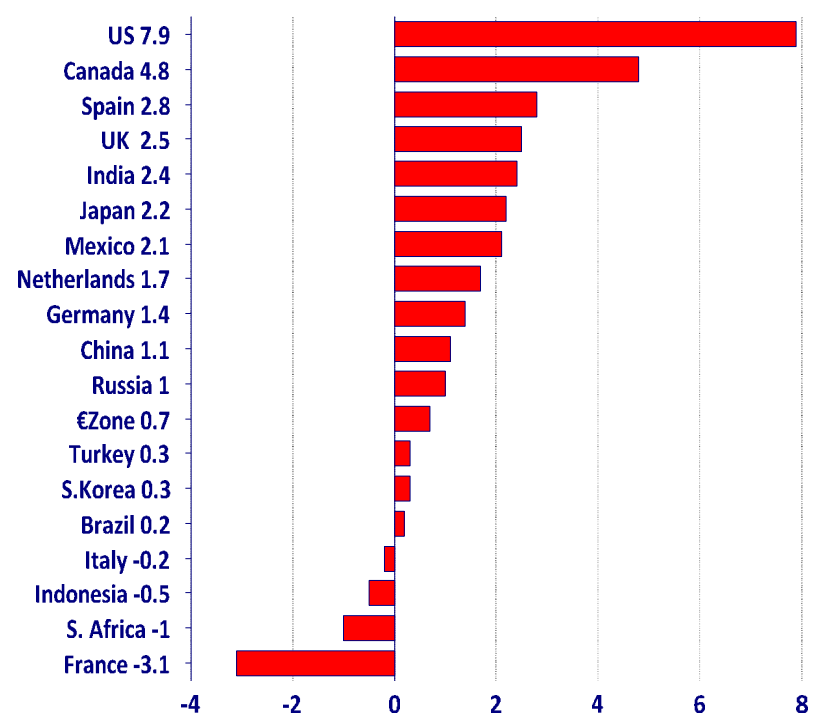
## INDUSTRIAL PRODUCTION BY COUNTRY

Industrial production – last available data – annualised data



## INDUSTRIAL CONFIDENCE BY COUNTRY

Difference between real data and 50 (=stability limit) – Markit PMI, HSBC PMI



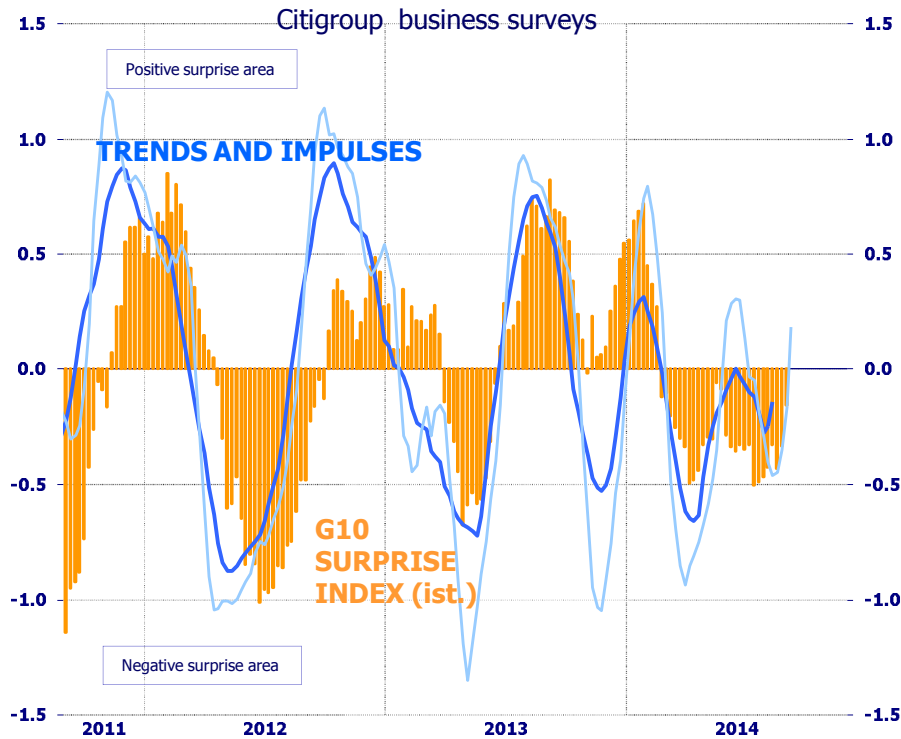




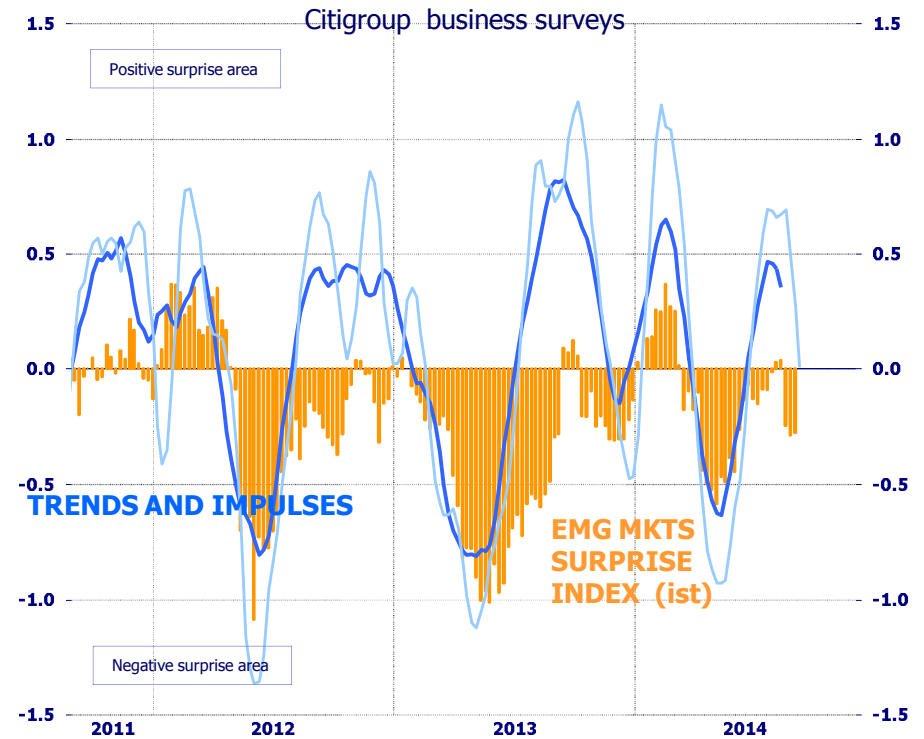
# EXPECTATIONS and REALIZATIONS

Analysts' consensus compared with official economic data yields mostly negative surprises. The G10 index suffers due to disappointing European data (almost a constant element this year) and from Japan, while the US component returned positive. As for emerging markets, data have started to disappoint, triggered by the European-African component and the Latin American one. Asia-Pacific and China gave positive surprises, although nothing outstanding. Dynamic analysis indicates a not yet favourable condition: improving for G10, stable or worsening for emerging markets.

## G10 ECONOMIC SURPRISE INDEX



## EMERGING MKTS ECONOMIC SURPRISE INDEX

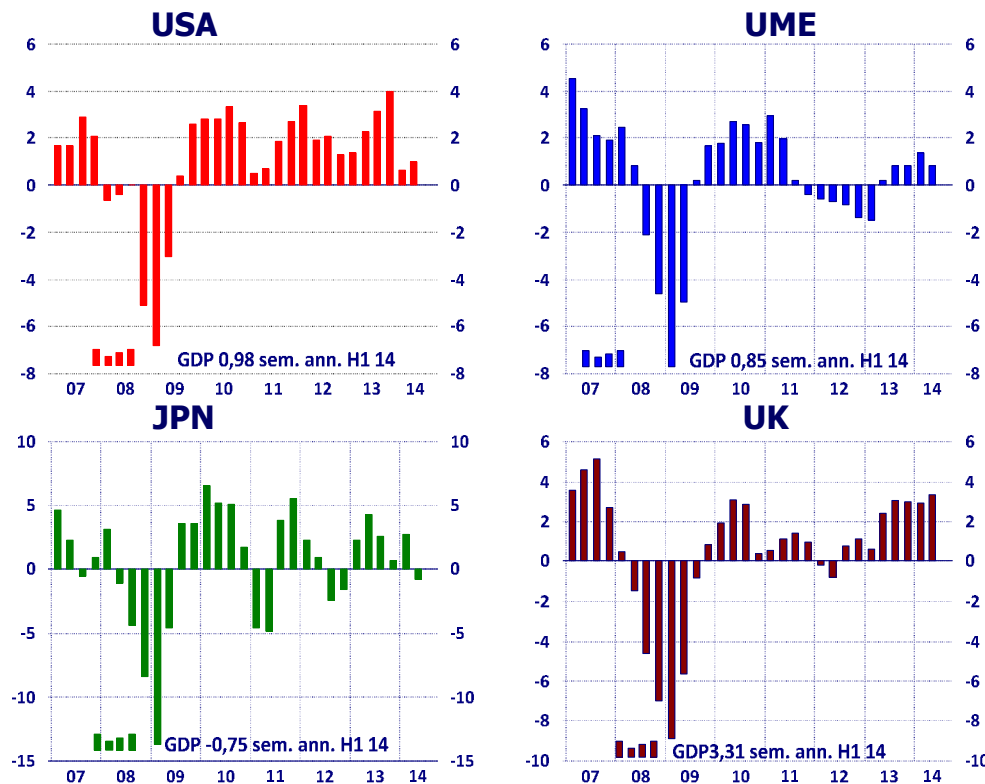


# BUSINESS CYCLES

In the first part of the year, only the UK respected solid growth expectations (well above three percentage points). US and Eurozone haven't even reached 1% annualised, while aggregate Japanese income contracted by half a point. In all three cases, these are consequences of exceptional events, like extreme winter weather (US), increase in value added tax from 5% to 8% (Japan) and the Ukraine crisis. Apart from extraordinary events, Eurozone appears subject to negative impulses connected to stagnation that is present in many countries of the area and to the presence of strong and deep recessive impulses.

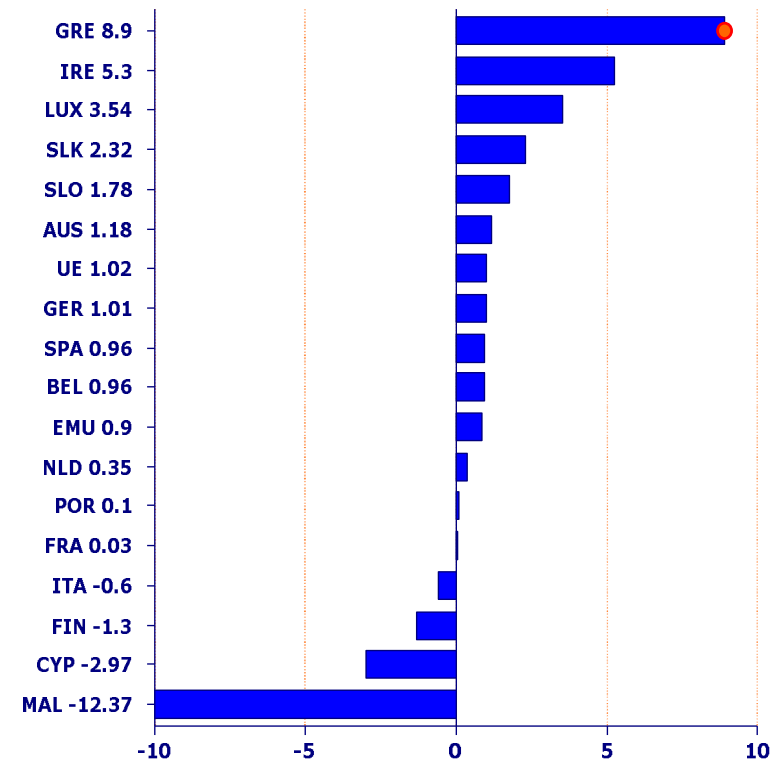
## G4 – ECONOMIC GROWTH

GDP – annualised 6-month values, 2Q data



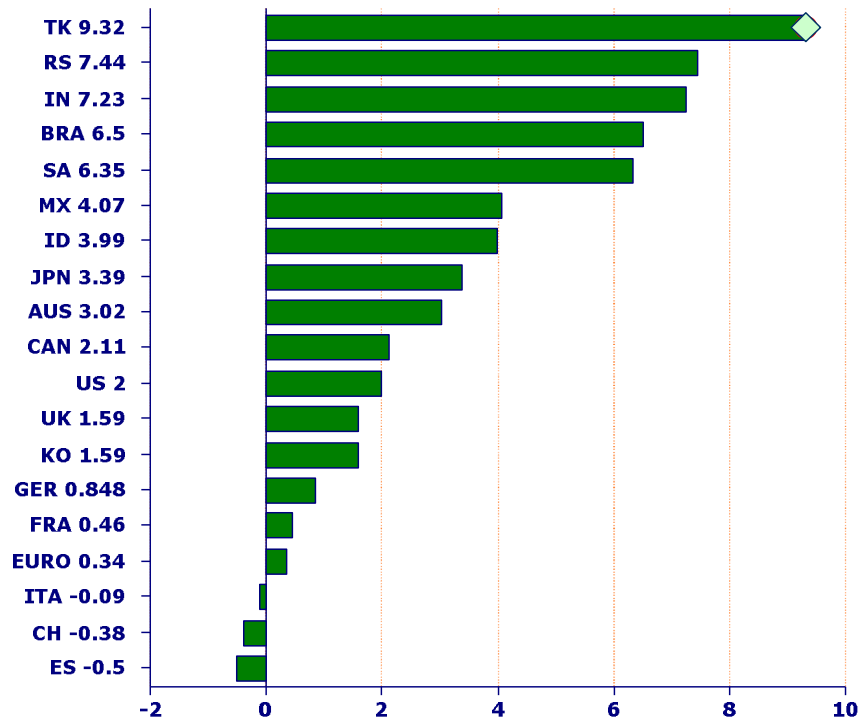
## EUROZONE – ECONOMIC GROWTH

GDP – annualised 6-month values, 2Q data



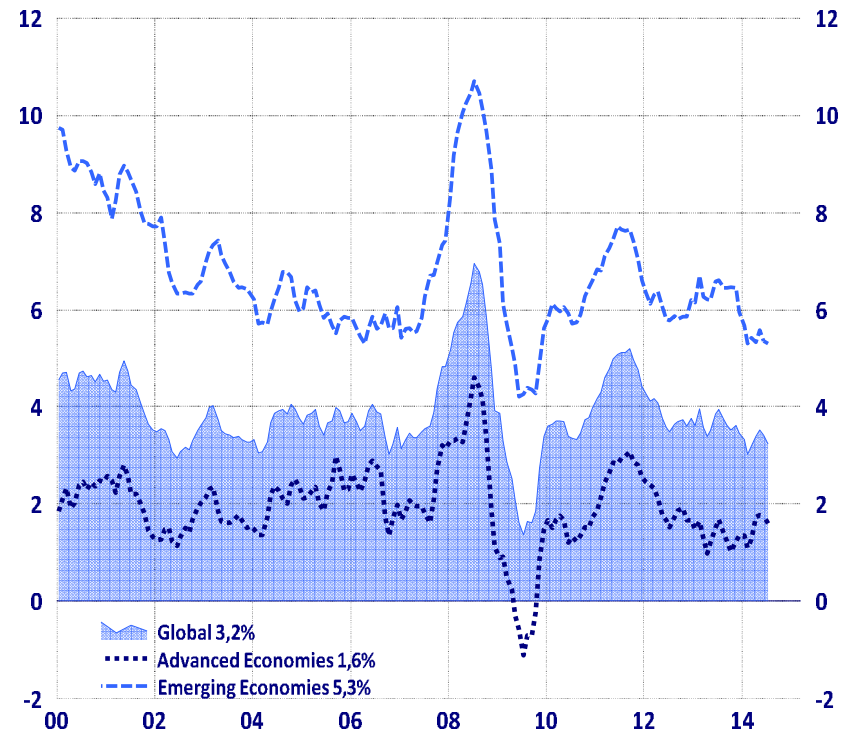
Global inflation slowed down again during the summer, with a value of 3.2% in July. The value for emerging markets was 5.30%, a minimum since 2009, that for advanced economies 1.6%. These values are in line with the expected global lower growth, which also reduced substantially oil, energy and raw material prices.

**INFLATION BY COUNTRY**



**INFLATION**

variazioni % tendenziali



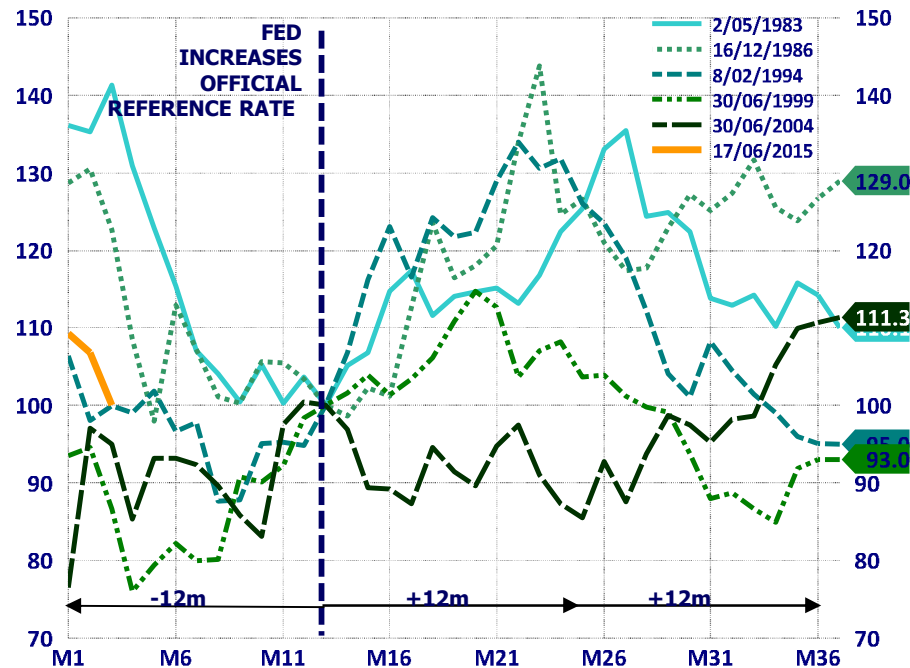


# MONETARY POLICY AND MARKETS

In the past five episodes of restrictive US monetary policy, the increase in official rates determined significant hikes in 10-year earnings in the first 6 months of the first year, except in one case. On the stock market the reaction is less univocal, with three decreases and two increases in share prices. Twelve and twenty-four months after rate increases, S&P500 is always positive except in one case. Naturally, historical comparison is difficult due to different contexts, such as starting real and nominal rates, length of the credit crunch, imbalances to be corrected and the motivations that triggered action from the monetary authority.

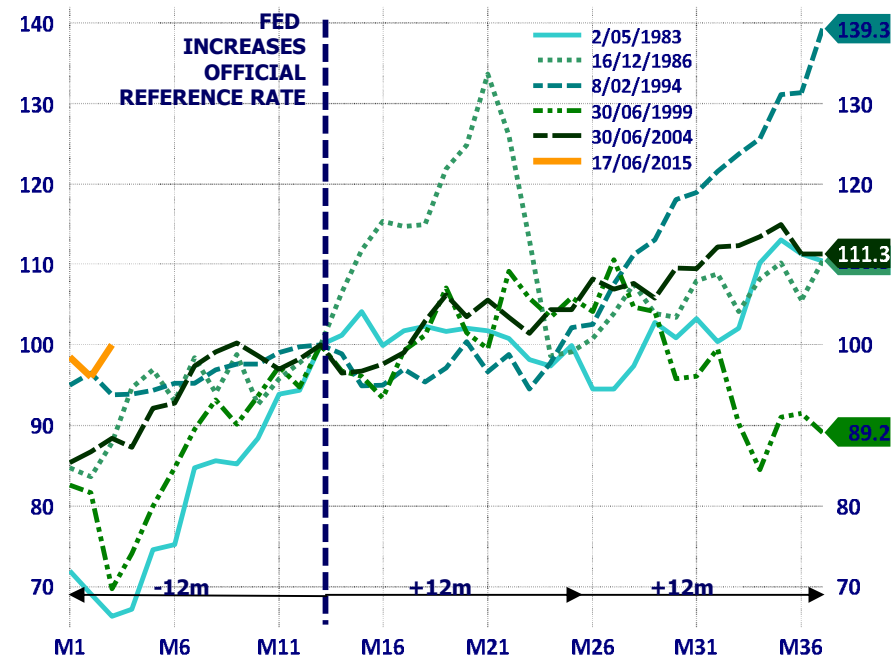
## FED MONETARY POLICY AND 10-YEAR RATES

Data based on 100 and centered on the first rate increase



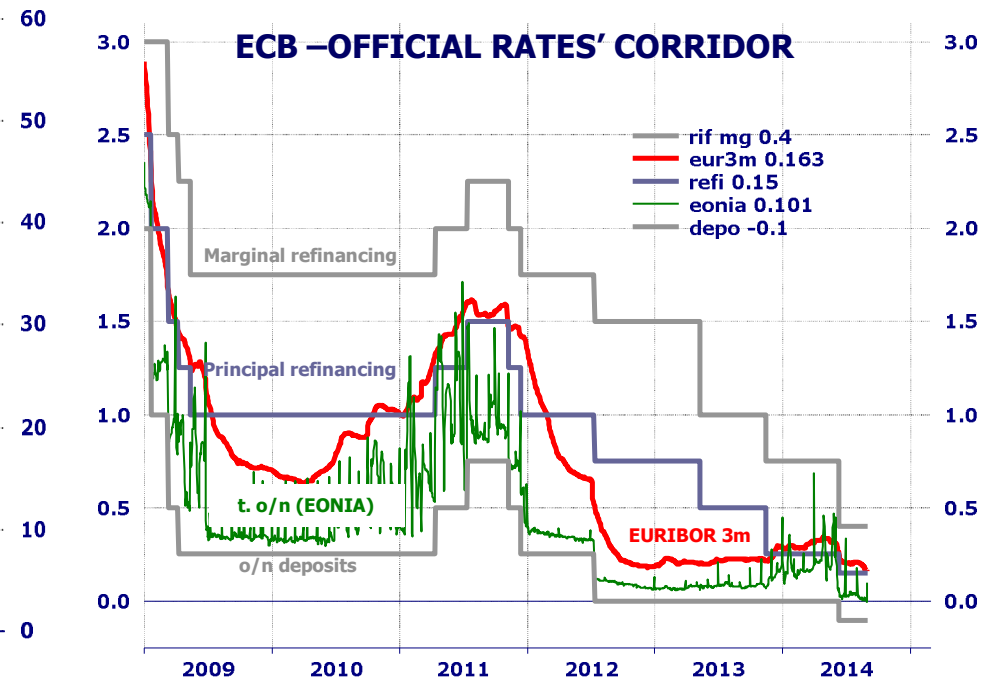
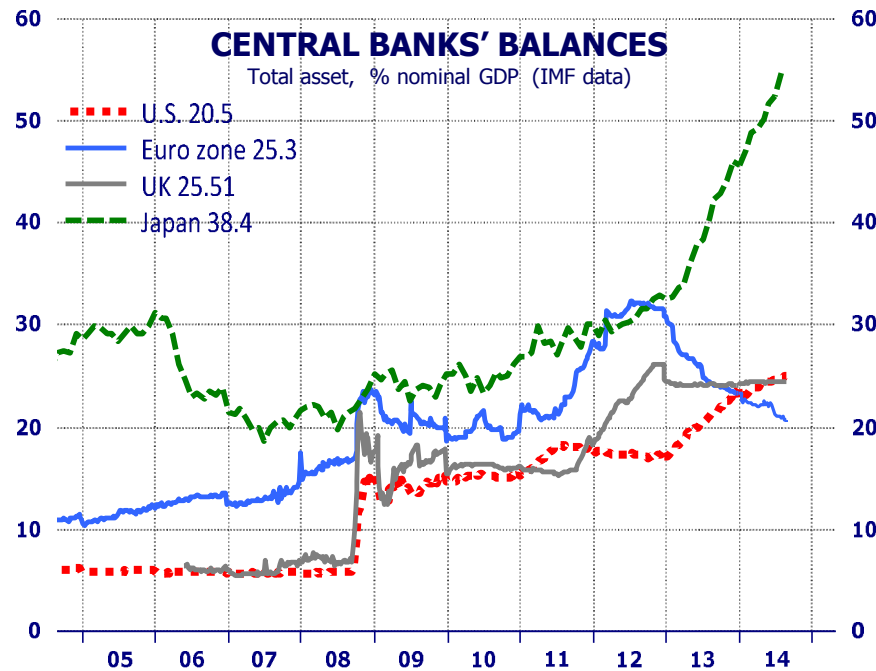
## FED MONETARY POLICY E S&P500

Data based on 100 and centered on the first rate increase



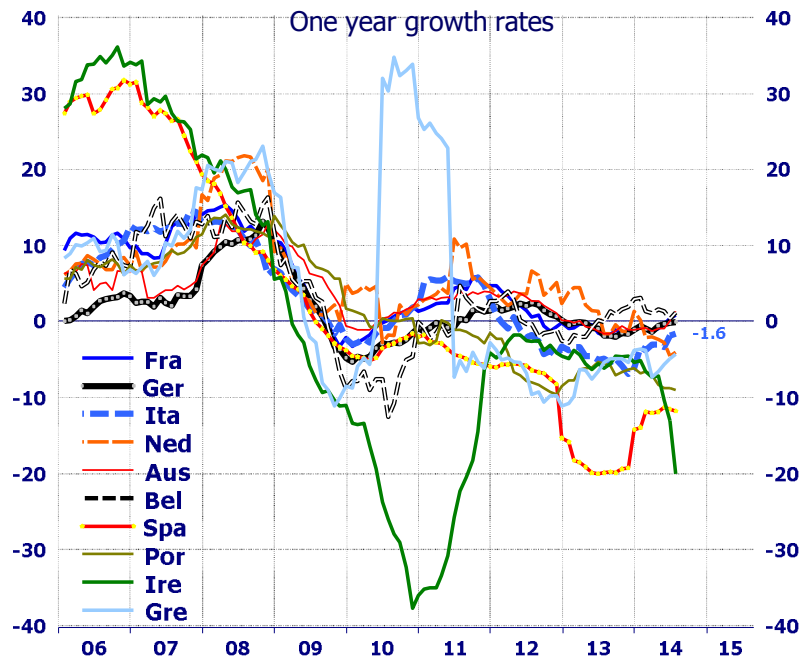
# THE ECB

In the summer meetings, the ECB established new criteria for an expansive monetary policy with even lower reference rates and new long term credit to banks (TLTRO, expiry 2018, starting this October and Dec), conditional on giving credit to private sector, a mechanism that may be repeated in 2015 and 2016 (expiry 2018), for a total amount that could reach 1000 bn. Also, a programme of acquisition of asset-backed securities (ABS) to stimulate alternative financing for the private sector. The measures are accompanied by forward guidance, with rates stable on current levels and if necessary new intervention with unconventional measures. This is to favour credit and face long periods of low inflation, caused by price pressure on food and energy, by strong currency and weak domestic demand.

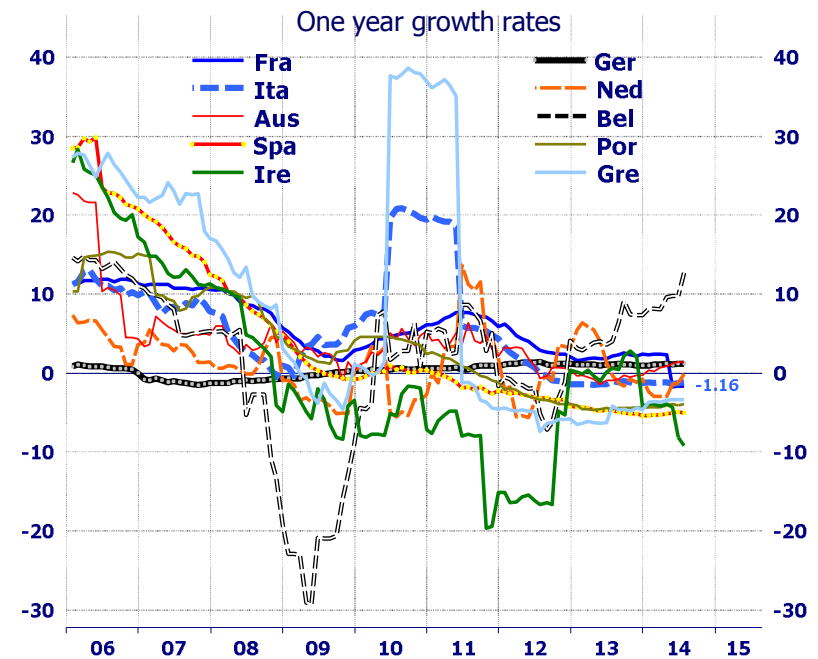


The sanctions mechanism for banks that don't provide credit to the economy on the potential 1000 bn Euro with a very low cost (0.25%) appears very feeble. Thus we don't expect a big improvement on credit crunch. On the contrary, we expect further decreases on government bond yields for carry trade occasions.

**BUSINESS LOANS-TREND**



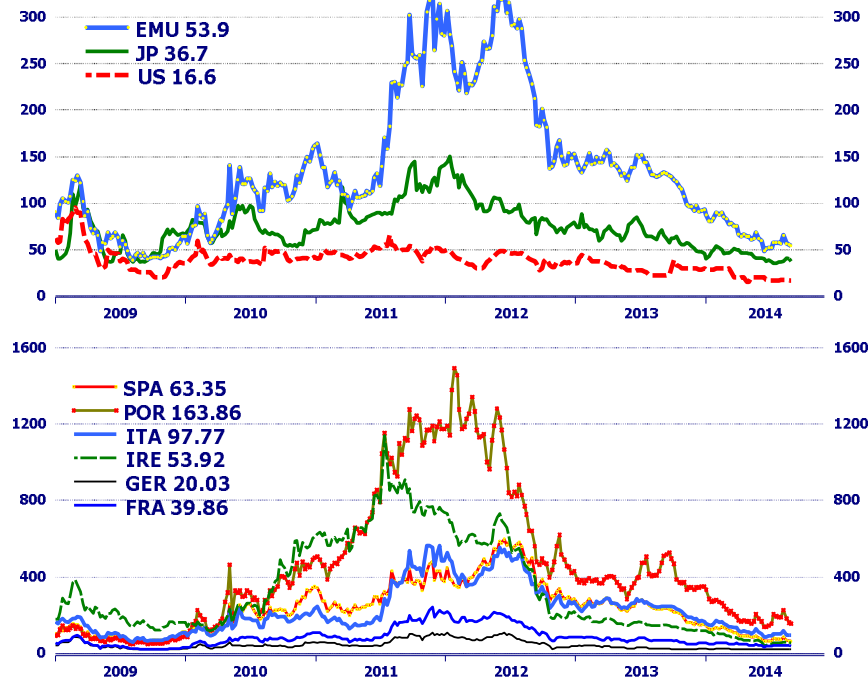
**HOUSEHOLD LOANS – TREND**



The involvement of the first Portuguese bank, the Banco Espírito Santo, in the failure of its major shareholder's holding company, spurred Portuguese and European intervention. The BES has been split in a bad bank and Novo Banco, that contains all BES's assets and deposits. This solution was pretty quick, consistently with the Banking Union's norms. The next step is the most sensitive, with the publication of the Asset Quality Review and the stress test results (October) and with ECB acting as sole supervisor of the 128 resident banks (November).

### COUNTRY RISK-5 YEAR CDS

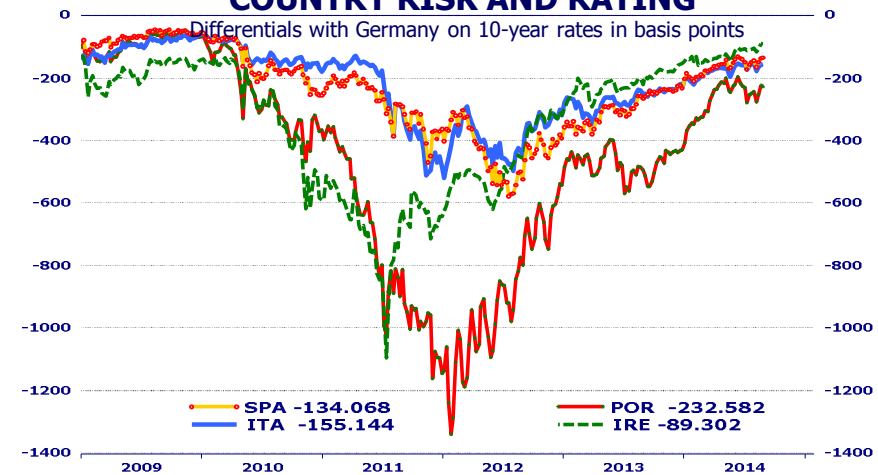
5-year Credit default swap - for Eurozone CDS on Ger-Ita-Fra-Spa



Credit Default Swap 5Y, cost of insuring the debtor from default. For example, 800 means that insuring \$10 mln investment costs \$800,000

### COUNTRY RISK AND RATING

Differentials with Germany on 10-year rates in basis points



	Moody's	S&P	Fitch
France	Aa1	AA	AAA
Germany	Aaa	AAA	AAA
Greece	Caa3	B	B
Ireland	Baa3	BBB+	BBB+
Italy	Baa2	BBB	BBB+
Portugal	Ba1	BB	BB+
Spain	Baa2	BBB	BBB+
Japan	Aa3	AA-	AA-
US	Aaa	AA+	AAA

Source Bloomberg, last update 18/09/2014

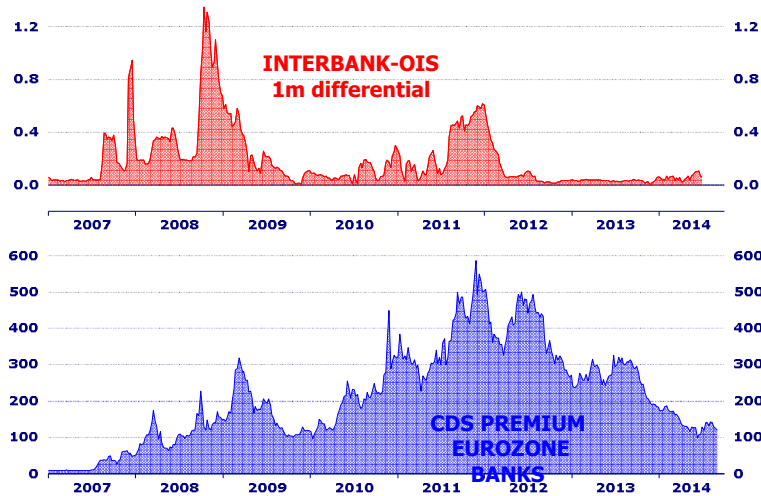






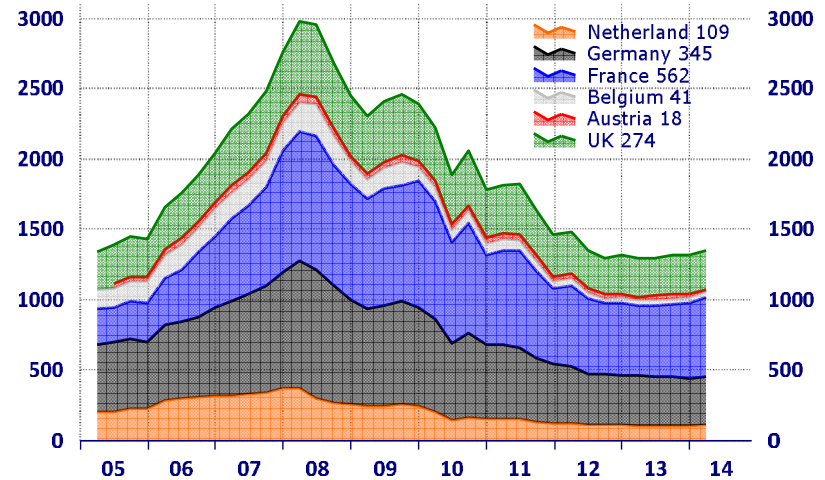
# MONETARY POLICY AND FINANCIAL CONDITIONS

### OIS SPREAD & CDS €BANKS



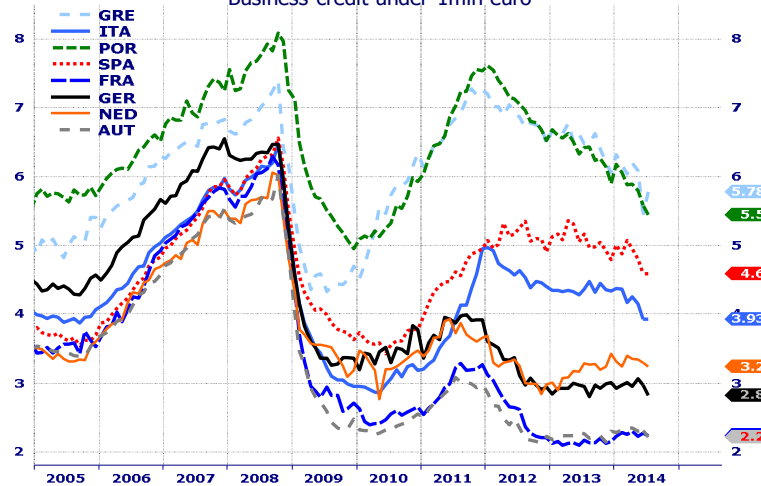
### BANKS' COMMITMENTS TO PERIPHERALS

€ mld Aggregate banking data vs. Italy, Eire, Greece, Spain, Portugal



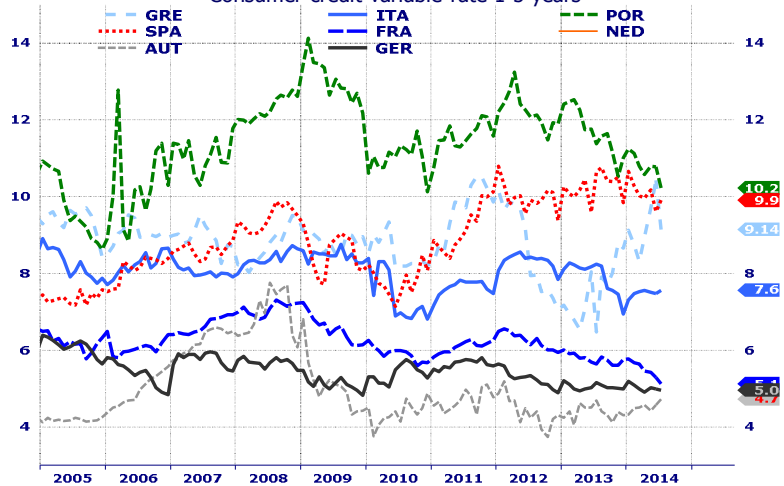
### CREDIT INTEREST RATES

Business credit under 1mln euro



### CREDIT INTEREST RATES

Consumer credit variable rate 1-5 years

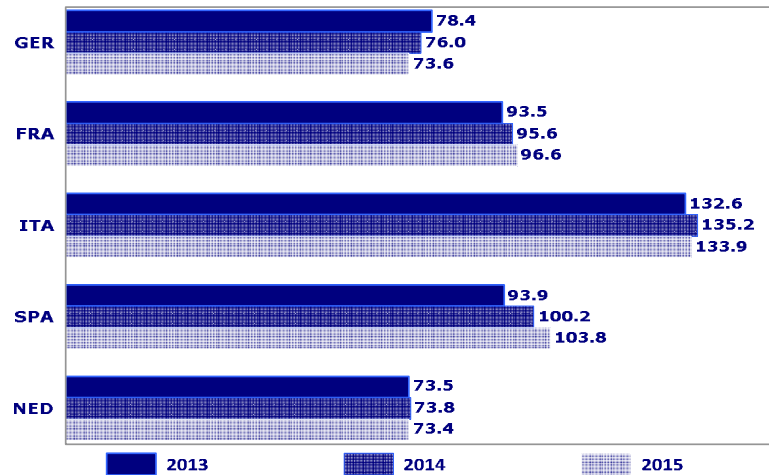




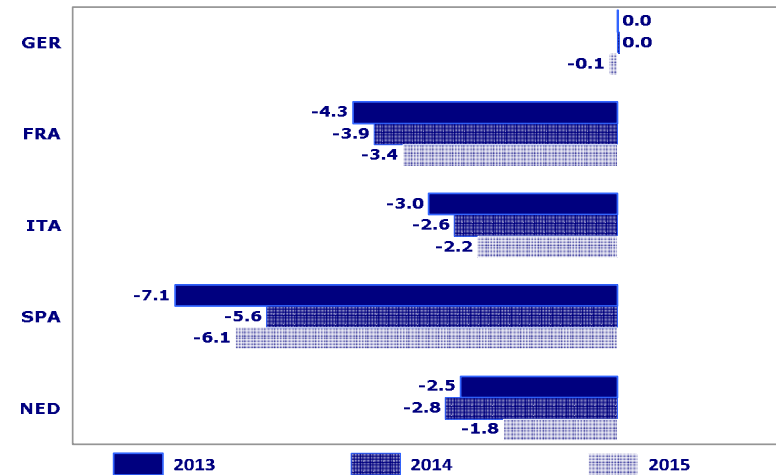


# FISCAL INDICATORS - EURO AREA

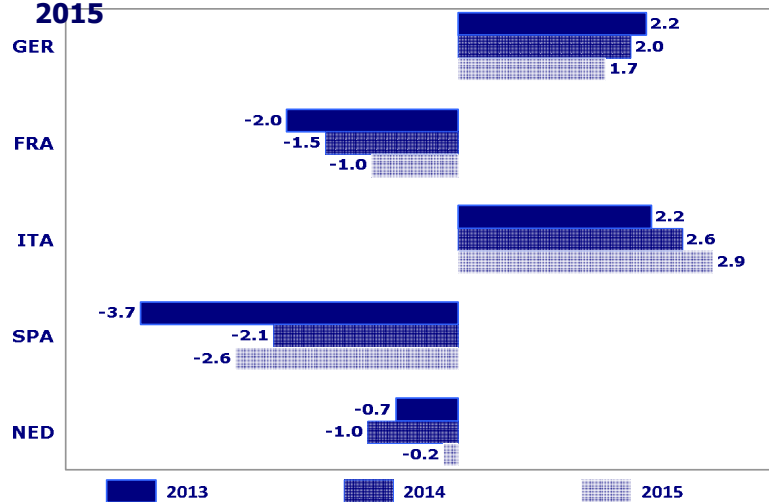
### DEBT/GDP estimates 2013-2015



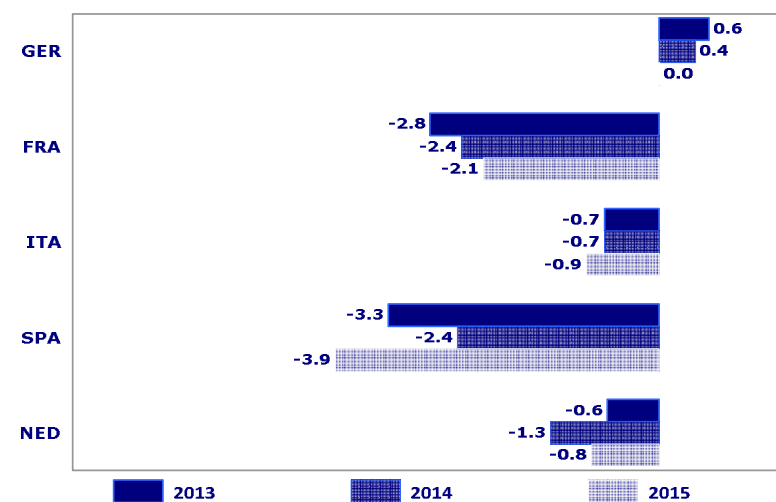
### DEBT-SURPLUS/GDP estimates 2013-2015



### SURPLUS-PRIMARY DEFICIT/GDP estimates 2013-2015

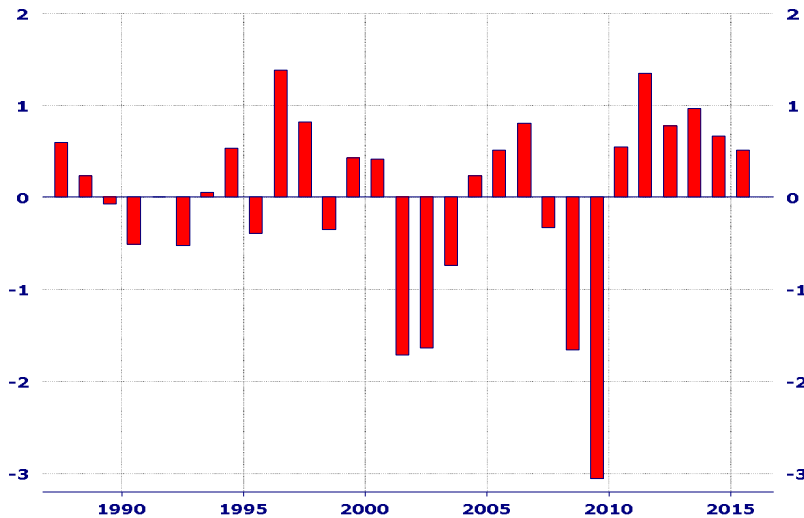


### DEBT-SURPLUS/GDP ADJUSTED FOR THE CYCLE



# FISCAL INDICATORS

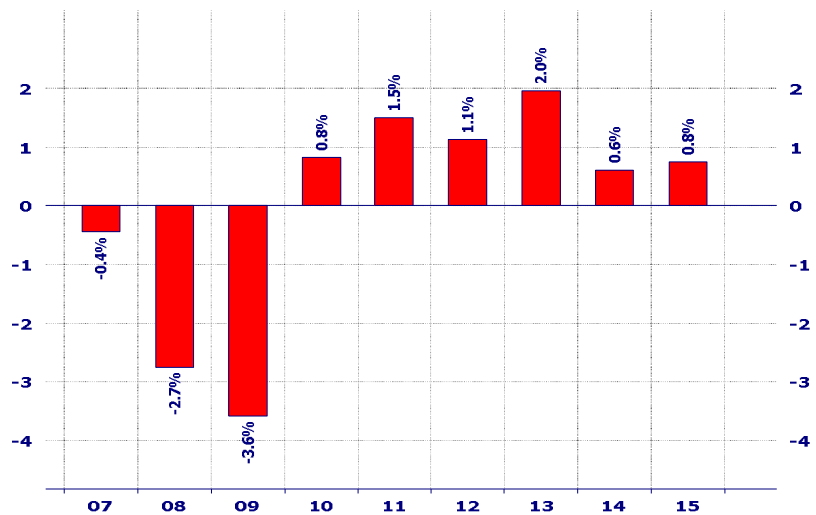
**OECD COUNTRIES – PRIMARY BALANCE ADJ. FOR THE CYCLE**  
OECD data –% change on potential GDP



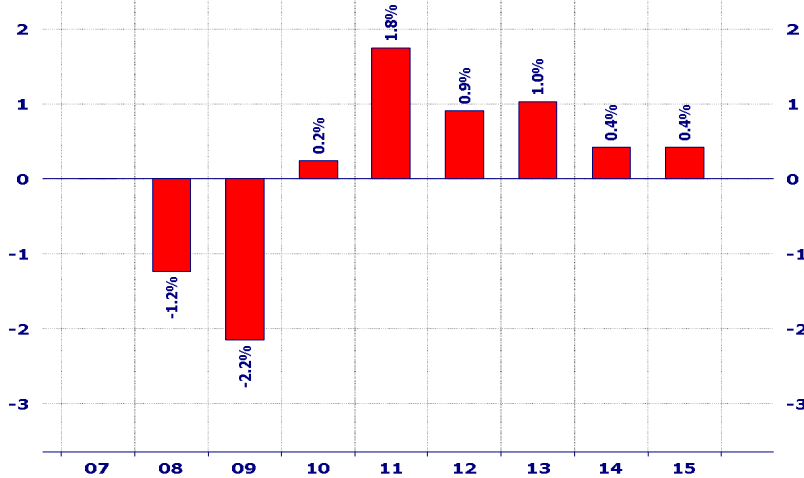
FISCAL RESTRICTION

FISCAL EXPANSION

**USA – PRIMARY BALANCE ADJ. FOR THE CYCLE**  
OECD data –% change on potential GDP



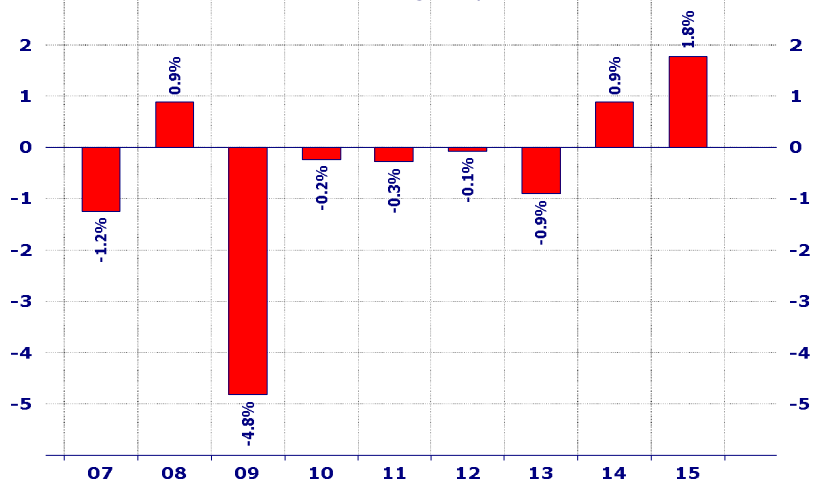
**EUROZONE – PRIMARY BALANCE ADJ. FOR THE CYCLE**  
OECD data –% change on potential GDP



FISCAL RESTRICTION

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**JAPAN – PRIMARY BALANCE ADJ. FOR THE CYCLE**  
OECD data –% change on potential GDP



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