



# Global Economy Report

January 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 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 January 13 2014**

## EXECUTIVE SUMMARY

- ❖ 2013 was a low growth year, but with progressively favourable trends. 2014 begins with rosier perspectives for most economies and hopefully will see the turning point in terms of intensity of average income growth.
- ❖ A still very accommodative monetary policy (although to a lesser extent than in 2013) and a less restrictive fiscal policy will give the fundamental impulses for a stronger development in advanced economies, with positive effects also for emerging economies.
- ❖ According to the OECD, global growth should be 2.7% in 2013, increasing to 3.6% in 2014 and 3.9% in 2015.

## EXECUTIVE SUMMARY

- ❖ US Q3 growth was stronger than expected mainly due to a strong inventories accumulation, which will weigh on Q4 growth. This, together with the indirect impact of the Government Shutdown, makes us forecast a temporary slowdown in Q4 growth. However, in 2014 we foresee a strong rebound thanks to a lower fiscal drag compared to 2013 (at 1.6% GDP in 2013 and around 0.4% in 2014) and also thanks to the budget agreement which increases public spending by 45 bln this year, thus eliminating further Shutdown risks.
- ❖ The unemployment rate will further decrease, but will remain well above NAIRU. It is forecasted at 6.2% at the end of 2014. If Congress in the coming weeks will not approve of the retroactive renewal of emergency unemployment benefits, we could witness a stronger drop in the unemployment rate in early 2014 due to the drop in participation rate.

## EXECUTIVE SUMMARY

- ❖ In the US, we expect inflation below 2% for most of the forecasting period, thanks to the output gap accumulated during the Great Recession and these four years of weak recovery. Also risks stemming from commodities are modest in a slower global growth environment. We do not foresee risks of deflation, with headline CPI's trend growth at a cyclical low in October (1.0% yoy), which has started accelerating since November. We forecast average headline CPI at 1.5% in 2013 and at 1.8% in 2014, while average core CPI is forecasted at 1.8% in 2013 and at 1.9% in 2014.
- ❖ The Fed decided to mildly reduce its quantitative easing programme, lowering assets purchases from January, from 85 bln USD per month to 75 bln USD. We expect this gradual reduction to continue during the year, as the recovery and growth perspectives improve, to finally conclude QE3 in Q4 2014. The "data dependence" rule is still valid: if new macro and labour data are worse than expected, tapering will be put on hold. The Forward Guidance, however, has not been modified: Fed Funds will stay at the current low levels at least until unemployment will be well below 6.5%.

## EXECUTIVE SUMMARY

- ❖ In the Euro area, qualitative indicators closed 2013 with new peaks at levels compatible with a marked improvement in growth forecasts for the current year, that we have thus revised to +1.4%. Our 2015 estimate is at +1.8%. This dynamics is generated from a robust growth in Germany (constantly above 2% all over our forecasting period), a gradual recovery in Italy and includes a low growth scenario for France in the first half of this year.
- ❖ As for inflation, we confirm a decidedly modest retail price evolution, without risks of structural deflation in the Euro area. The inflation rate will remain around 1% at least in the first three quarters of the current year.
- ❖ In its December and January meetings, the ECB made no changes to its monetary policy stance and firmly confirmed its intention to keep rates low for a long period of time and to intervene with all possible means if necessary.

## EXECUTIVE SUMMARY

- ❖ After more than a year of stagnation, the UK recovery accelerated in 2013 and Q3 registered growth above potential. Growth originates mainly from Private Consumption, sustained by the improving labour market, house prices increases and low interest rates, thus leading to a new build up of private debt. Furthermore, the public sector remains in a weak position to absorb eventual new shocks. The rapid pound appreciation is beginning to weigh on exports. Our real GDP growth forecasts are at 1.4% in 2013, at 2.6% in 2014 and at 2.3% in 2015.
- ❖ Inflation in the past year has been supported by a series of one-off shocks and by particularly low labour productivity, which pushes up ULC. Recently the pound appreciation has limited the impact of commodities prices increase. We expect CPI to stay above target for most of the forecasting period. Our forecasts for average headline CPI are at 2.6% in 2013, at 2.1% in 2014 and at 2.2% in 2015.
- ❖ Regarding Monetary Policy, the MPC December meeting was a non-event but, given the improvement in labour market conditions during the past months, we continue to foresee the risk of official rates hikes before the BOE currently forecasts, probably in early 2015.

## EXECUTIVE SUMMARY

- ❖ In China, the economic system is finding an equilibrium on more modest growth rates than in the recent past. GDP growth rate for 2013 is limited at 7.6% and this year may be even lower to 7.3%. Excluding food prices, inflation remains mostly stable, in line with the monetary policy neutral stance. A downward risk stands in the necessity to calibrate policy to stabilise housing prices.
- ❖ In Japan, we forecast a persistence in the expansive impulse, with a relatively uniform intensity in 2014 and 2015, with average income increases between 1.5% and 2%. This is the result of extraordinary expansionary economic policies, with an evident impact on the dynamics of qualitative indicators in the area. The inflation rate remains positive, at its 5-year high.



## EXECUTIVE SUMMARY

- ❖ The Australian economy is enduring a weak phase, as shown by GDP Q3 growth rate, confirmed at 0.6% q/q, in line with the first quarter result. The yearly growth rate stands at 2.3% from 2.5% in Q2 2013. Also, labour market signals are not positive, as unemployment rate rised to 5.8%.
- ❖ National account data mark a progressive acceleration of the Korean economy, with Q3 2013 growth at 1.1% q/q, the same result we had in Q2. This trend seems to have turned positive, benefitting from a consumption recovery sustained by Government measures to support growth and from low interest rates.

# EXECUTIVE SUMMARY

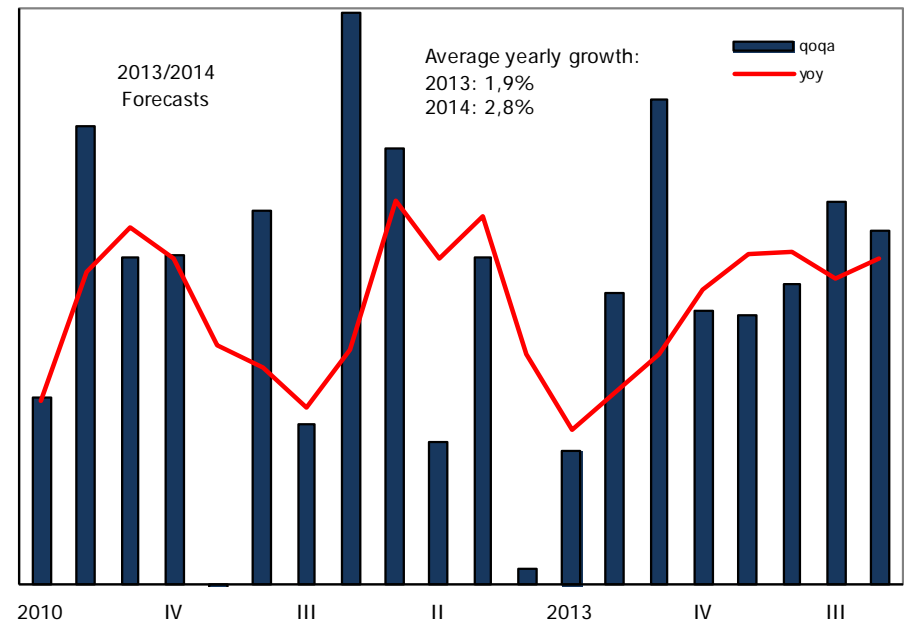
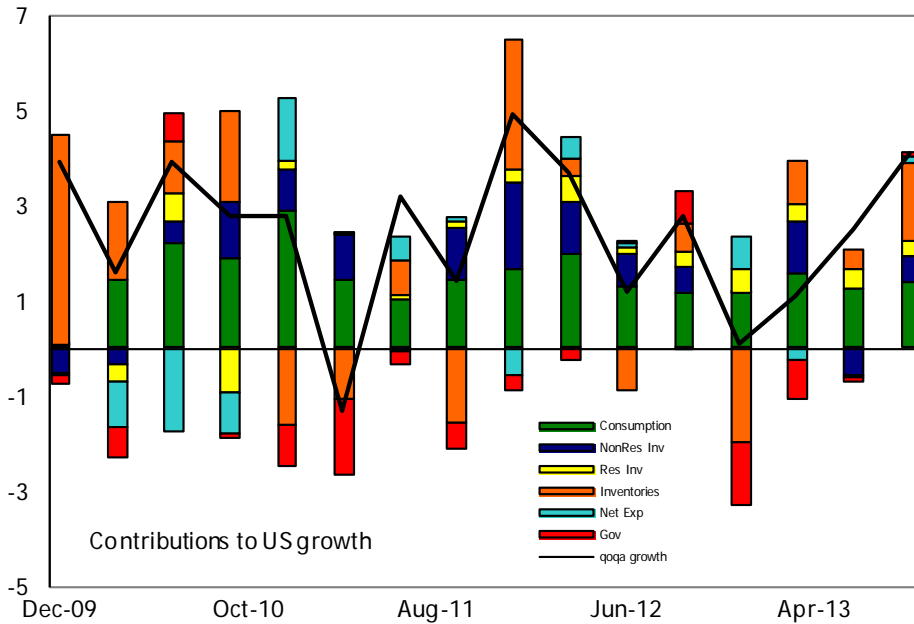
## GENERAL MACRO SUMMARY

	2009	2010	2011	2012	2013E	2014E	2015E
<b>GDP (%YOY)</b>							
<b>US</b>	-3.1	2.4	1.8	2.8	1.9	2.8	3.1
<b>EUROZONE</b>	-4.4	2.0	1.4	-0.6	-0.4	1.4	1.8
<b>GERMANY</b>	-5.1	4.2	3.0	0.7	0.6	2.2	2.1
<b>FRANCE</b>	-3.1	1.7	2.0	0.0	0.1	0.7	1.6
<b>ITALY</b>	-5.5	1.8	0.4	-2.4	-1.8	0.6	1.3
<b>UK</b>	-5.1	1.7	1.1	0.1	1.4	2.6	2.3
<b>JAPAN</b>	-5.5	4.7	-0.6	2.0	1.7	1.9	1.5
<b>BRASIL</b>	-0.3	7.6	2.8	1.0	2.3	2.3	2.8
<b>RUSSIA</b>	-7.8	4.3	4.3	3.4	1.5	2.4	2.6
<b>INDIA</b>	6.4	8.9	7.5	5.1	3.8	4.8	5.5
<b>CHINA</b>	9.2	10.4	9.3	7.7	7.6	7.5	7.2
<b>AUSTRALIA</b>	1.4	2.6	1.4	3.6	2.4	2.7	3.0
<b>KOREA</b>	0.3	6.3	3.6	2.0	2.7	3.5	3.5
<b>INFLATION (%YOY)</b>							
<b>US</b>	-0.4	1.6	3.2	2.1	1.6	1.8	2.0
<b>EUROZONE</b>	0.3	1.6	2.7	2.5	1.3	1.1	1.5
<b>GERMANY</b>	0.2	1.2	2.5	2.1	1.6	1.6	1.9
<b>FRANCE</b>	0.1	1.7	2.3	2.2	1.0	1.3	1.4
<b>ITALY</b>	0.8	1.6	2.9	3.3	1.3	1.2	1.4
<b>UK</b>	2.2	3.3	4.5	2.8	2.7	2.4	2.2
<b>JAPAN</b>	-1.3	-0.7	-0.3	0.0	0.3	2.6	1.8
<b>BRASIL</b>	4.9	5.0	6.6	5.4	6.1	5.8	5.6
<b>RUSSIA</b>	11.7	6.9	8.5	5.1	6.8	5.5	4.9
<b>INDIA</b>	10.8	12.1	8.9	10.4	9.2	9.2	8.0
<b>CHINA</b>	-0.7	3.3	5.4	2.7	2.7	3.1	3.2
<b>AUSTRALIA</b>	1.8	2.9	3.3	1.8	2.4	2.6	2.5
<b>KOREA</b>	2.8	3.0	4.0	2.2	1.3	2.3	2.8
<b>Banca Aletti Forecast</b>							
<b>Cons. Bloomberg (Gen 14)</b>							

## FOCUS ON THE U.S.A.

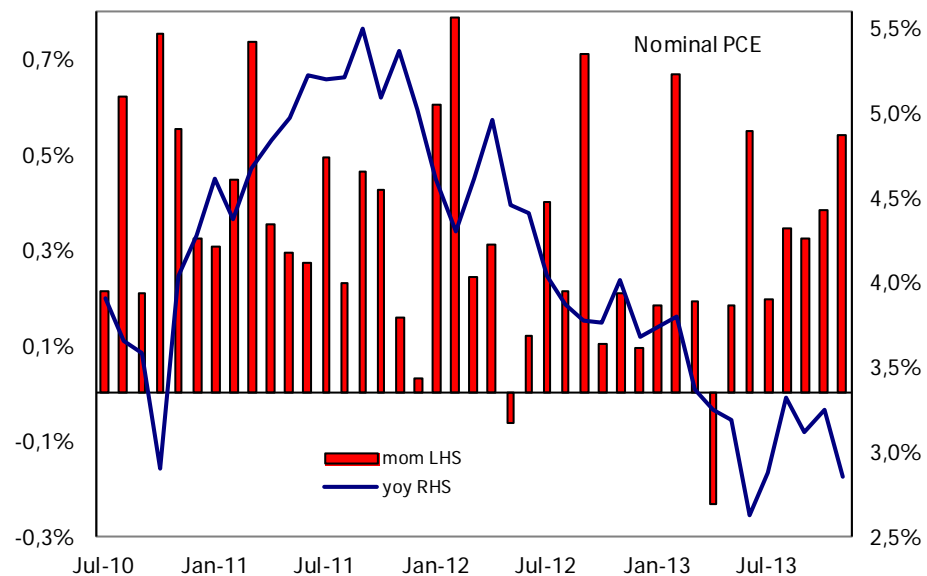
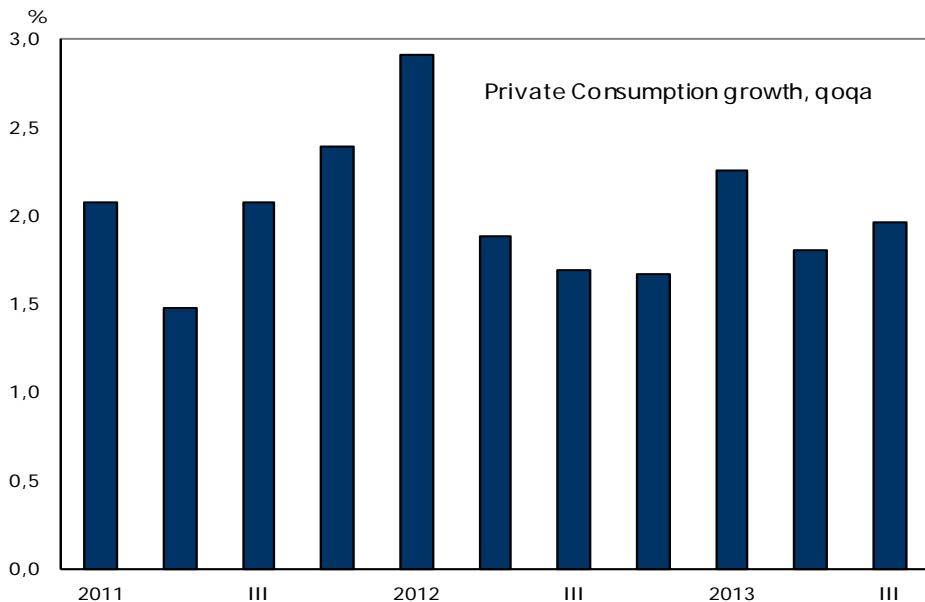
# 2014: GDP ACCELERATION ABOVE TREND

In 2013 Real US GDP should have grown by about 1.9% according to our estimates, despite a total fiscal drag of around 250 bln USD (1.6% of GDP). In 2014 we expect only a 0.4% fiscal drag. If private sector underlying growth remains at its 2013 level, as incorporated in our forecasts, GDP growth should accelerate, in line with our forecasts. We foresee a positive contribution from the decrease in the saving rate, from major housing investments and from a reduction in net business savings, with Net Trade providing a partial downward compensation.



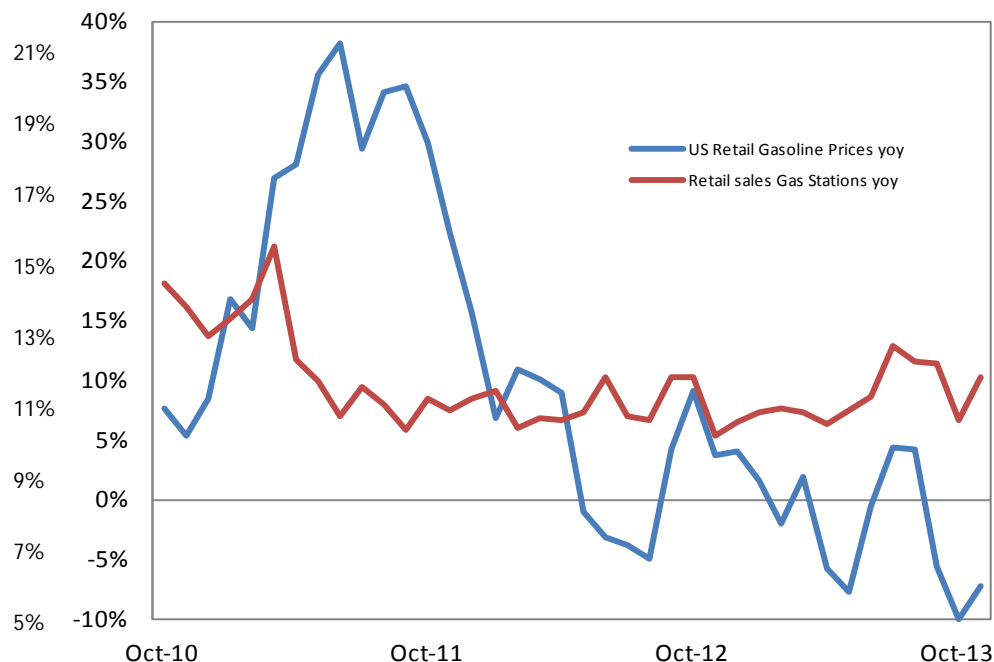
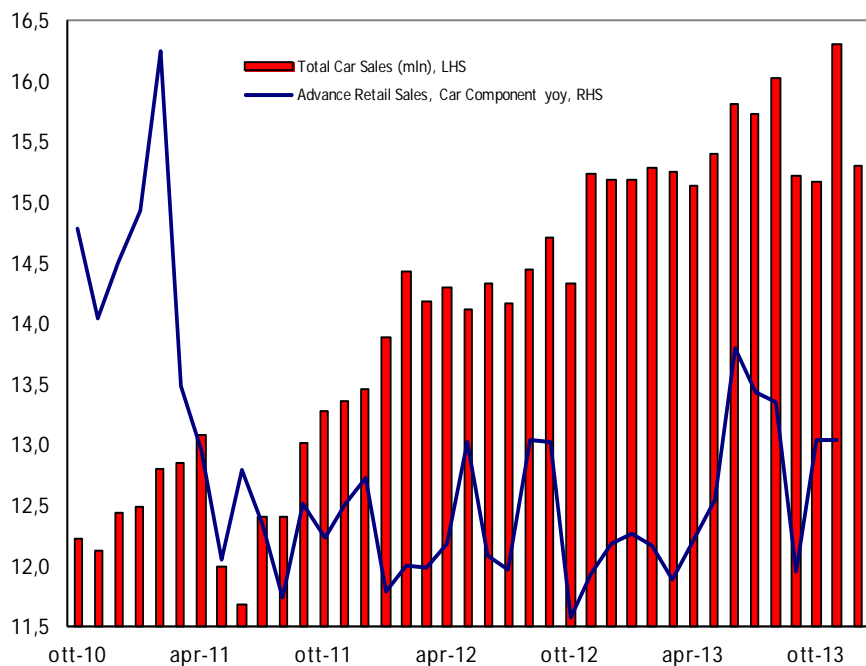
# PRIVATE CONSUMPTION ACCELERATION

The case for optimism partly rests on our expectation that the personal saving rate can decline a bit further this year, thanks to the increased in household wealth, to credit availability and to an improvement in labour market conditions. But the more important swing factor in 2014 is likely to be real income growth. The biggest component of the fiscal drag in 2013 was the increase in payroll and income taxes by about 200 bln USD, which kept the growth rate of real disposable income at an estimated 1% for the year as a whole. In 2014, this drag will disappear and we consequently expect real income growth to accelerate, thanks to a lower fiscal drag, that kept real disposable income growth at 1% for the whole year. In 2014 this drag will fade away and as a consequence we expect an acceleration in real income growth, boosting consumption.



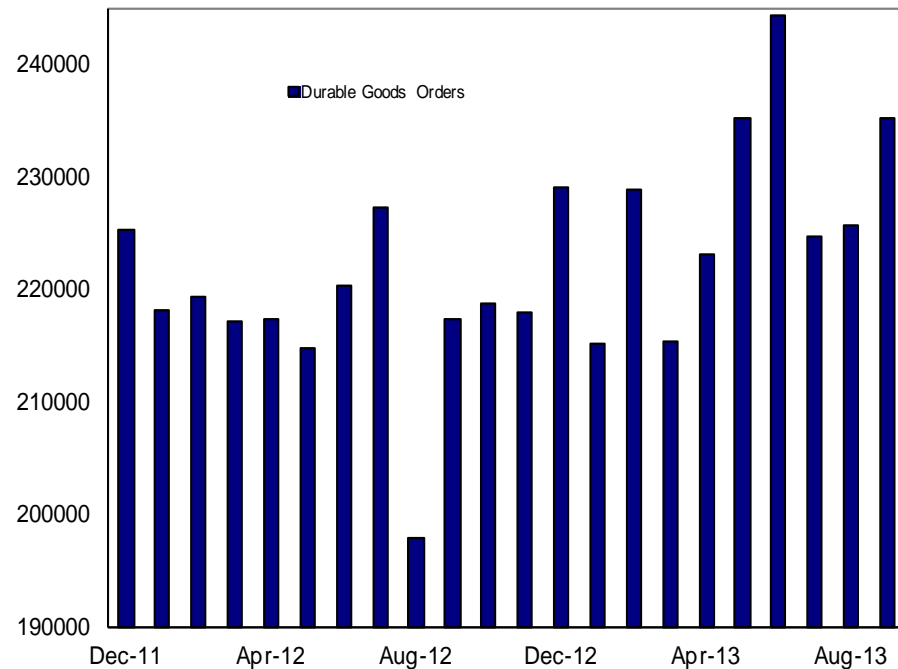
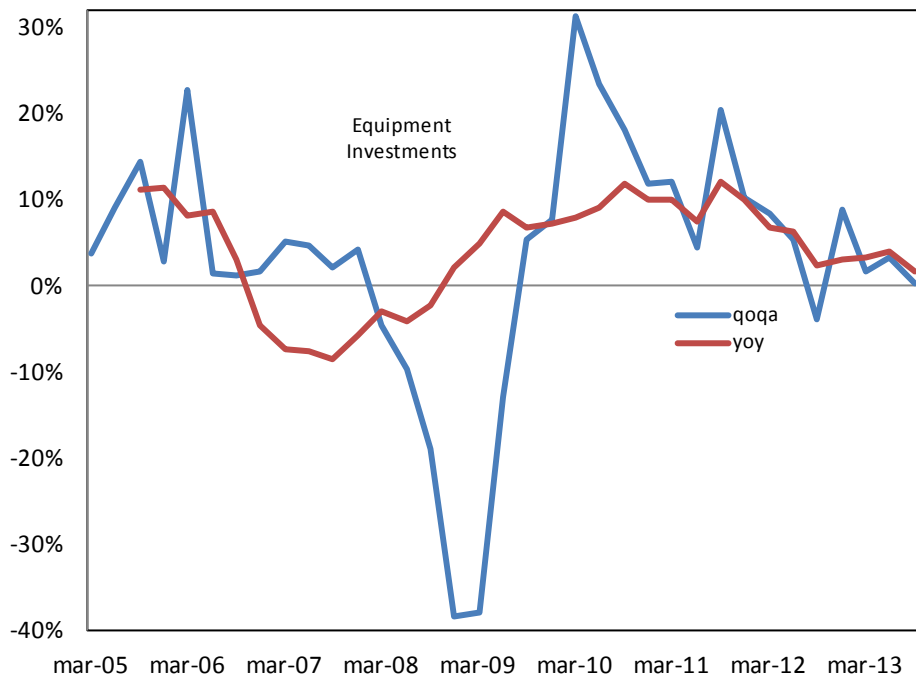
# RETAIL SALES

US retail sales advanced 0.2% in December, higher than the consensus expectation of a 0.1% increase. Total retail sales were revised down to a 0.4% rise in November that was previously reported as a 0.7% increase. The 1.8% drop in motor vehicle and parts sales weighed on headline sales in December, as sales excluding autos rose 0.7%. This category of sales was also revised downwards in November to a 0.1% rise. Core retail sales (excludes autos, food services, building materials and gasoline station sales) advanced 0.7%, above the consensus expectation of a 0.3% increase. November's core retail sales were revised down to a 0.2% rise (previously reported as a 0.5% increase).



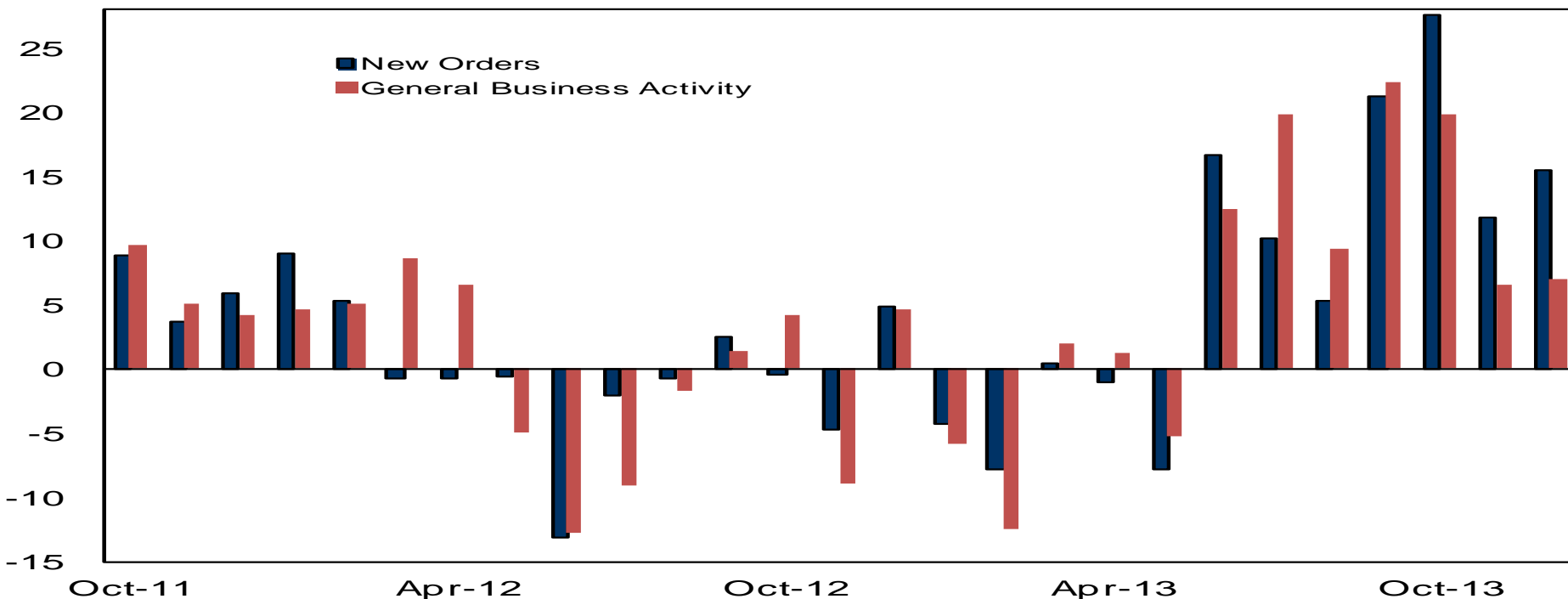
# CAPEX REBOUND

The growth rate of nonresidential fixed investment (also known as capital spending) has slowed from a cycle peak of around 10% in late 2011/early 2012 to just 3% in 2013, and we expect a reacceleration to about 8% over the next year. The predicted acceleration comes from two sources. First, the inputs into the model, specifically consumer spending, look stronger in 2014 than in 2013. This is important because the investment “accelerator”—the lagged feedback from stronger growth in the broader economy to capital spending—plays an important role in our model. Second, the recent performance of capital spending has undershot our model, and we expect a reversal of that undershooting in 2014.



# PHILLY FED SURVEY

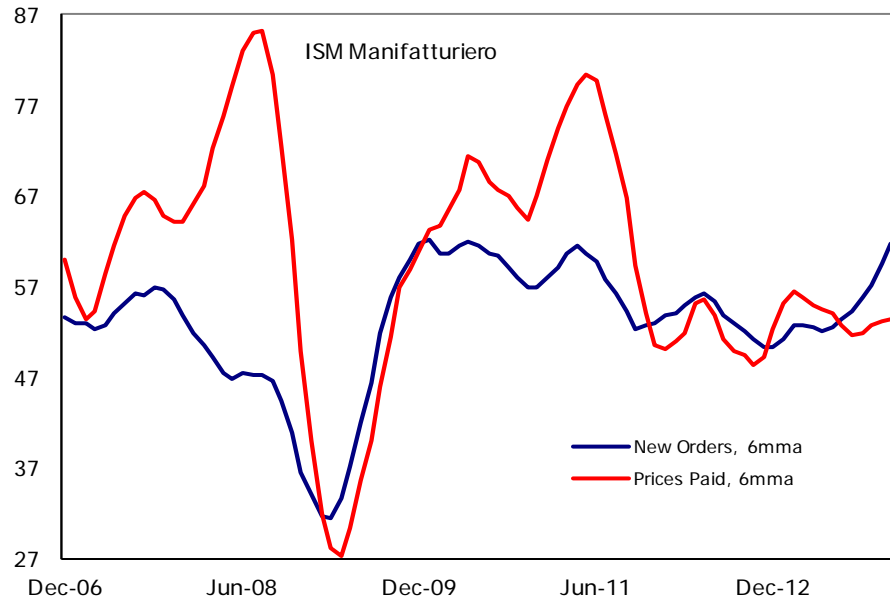
The Philadelphia Fed Business Confidence Indicator only partially recovered in December after its November decrease, due to the uncertainty because of the Shutdown. Indeed, December registered an increase to 7 up from November 6.5, but still below its October level (19.8). The survey thus closed 2013 with an average growth of 6.4, marking an improvement from 2012 average (-0.2) and just below 2011 average (7.7).





# MANUFACTURING ISM

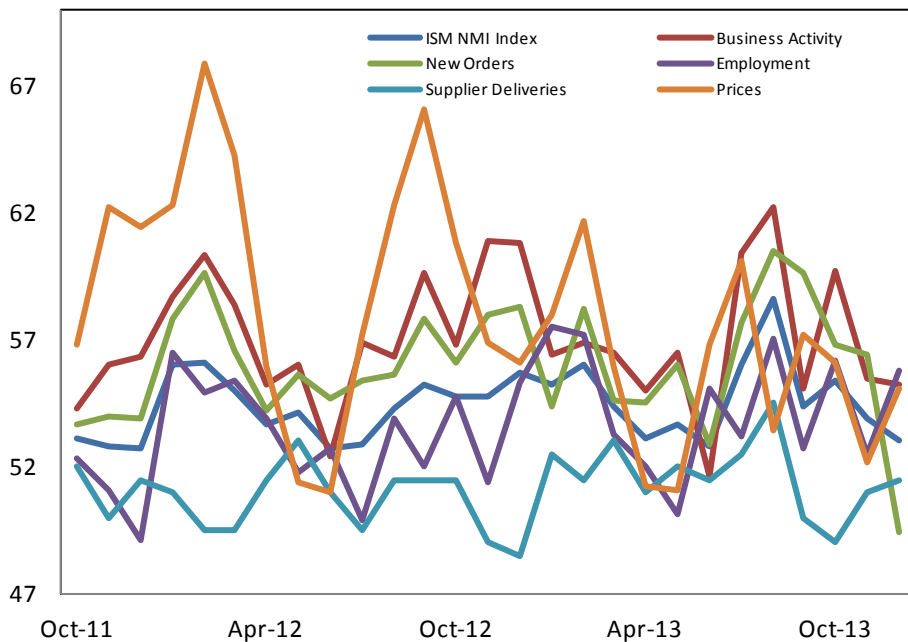
The ISM manufacturing index declined slightly in December to 57.0 from 57.3 in November and suggests that manufacturing activity continued to expand at a steady pace in December. On the details of the survey, most of the sub-indexes were not much changed from November. Indicators of current activity such as the production and new orders sub-indexes remained strong, with the production sub-index declining only slightly to 62.2 from 62.8, and the new orders sub-index up to 64.2 from 63.6. Backlog of orders sub-index, an indicator of future activity, fell by 2.5 points to 51.5, but within expansionary territory (greater than 50). The inventories sub-index fell below 50 in November to 47.0, and corroborates the expected slowdown in inventory building following the strong buildup in the previous quarter.



	ISM Man	New	Prod-	Employ-	Delivery	Invent-	Prices
Month	Index	Orders	uction	ment	Time	ories	
<b>Weights</b>	<b>100%</b>	<b>20%</b>	<b>20%</b>	<b>20%</b>	<b>20%</b>	<b>20%</b>	
Jan-13	53,1	53,3	53,6	54,0	53,6	51,0	56,5
Feb-13	54,2	57,8	57,6	52,6	51,4	51,5	61,5
Mar-13	51,3	51,4	52,2	54,2	49,4	49,5	54,5
Apr-13	50,7	52,3	53,5	50,2	50,9	46,5	50,0
May-13	49,0	48,8	48,6	50,1	48,7	49,0	49,5
Jun-13	50,9	51,9	53,4	48,7	50,0	50,5	52,5
Jul-13	55,4	58,3	65,0	54,4	52,1	47,0	49,0
Aug-13	55,7	63,2	62,4	53,3	52,3	47,5	54,0
Sep-13	56,2	60,5	62,6	55,4	52,6	50,0	56,5
Oct-13	56,4	60,6	60,8	53,2	54,7	52,5	55,5
Nov-13	57,3	63,6	62,8	56,5	53,2	50,5	52,5
Dec-13	57,0	64,2	62,2	56,9	54,7	47,0	53,5

# NON MANUFACTURING ISM

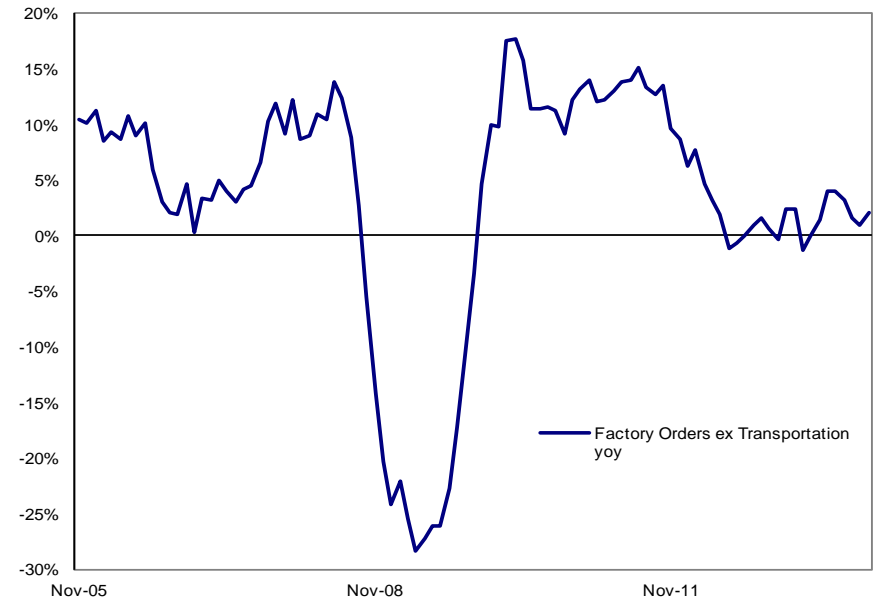
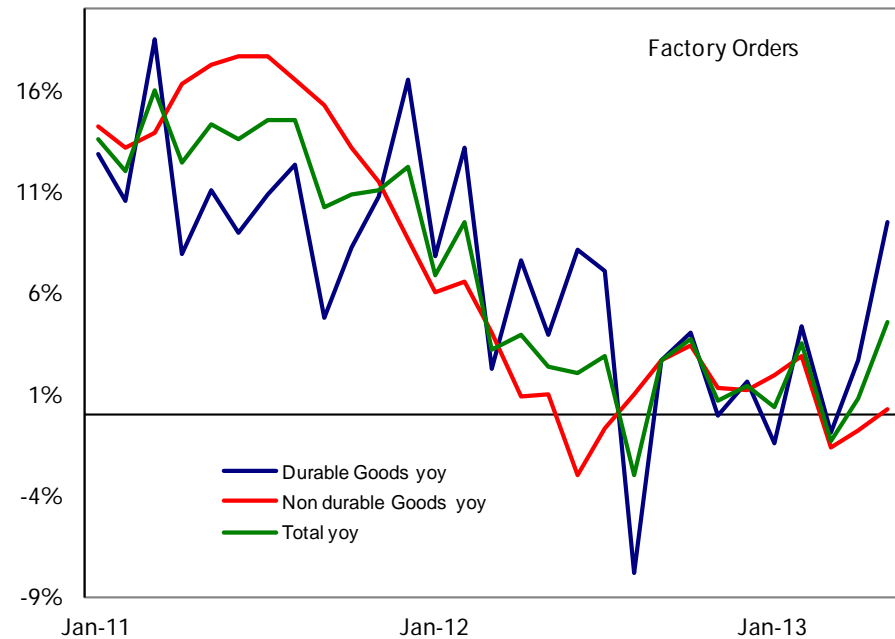
ISM nonmanufacturing index declined to 53.0 in December from 53.9 in November, falling short of expectations. The slight decline in the index suggests continued expansion in the nonmanufacturing sector, but at a slower pace than the prior month. On the details, indicators of future activity such as the new orders and backlog orders sub-indexes declined 7 and 3 points in December to 49.4, and 46.0 respectively, and could suggest some slowdown in activity in the near term. The inventory sub-index also fell below 50, to 48 from 54 previously. Inventory accumulation should slow and is likely to be a drag on growth in early 2014. The employment sub-index increased to 55.8 from 52.5



	ISM NMI	Business	New	Employ-	Supplier	Prices
Mese	Index	Activity	Orders	ment	Deliveries	
Pesi->	100%	25%	25%	25%	25%	
Jan-13	55,2	56,4	54,4	57,5	52,5	58,0
Feb-13	56,0	56,9	58,2	57,2	51,5	61,7
Mar-13	54,4	56,5	54,6	53,3	53,0	55,9
Apr-13	53,1	55,0	54,5	52,0	51,0	51,2
May-13	53,7	56,5	56,0	50,1	52,0	51,1
Jun-13	52,8	51,6	52,9	55,1	51,5	56,8
Jul-13	56,0	60,4	57,7	53,2	52,5	60,1
Aug-13	58,6	62,2	60,5	57,0	54,5	53,4
Sep-13	54,4	55,1	59,6	52,7	50,0	57,2
Oct-13	55,4	59,7	56,8	56,2	49,0	56,1
Nov-13	53,9	55,5	56,4	52,5	51,0	52,2
Dec-13	53,0	55,2	49,4	55,8	51,5	55,1

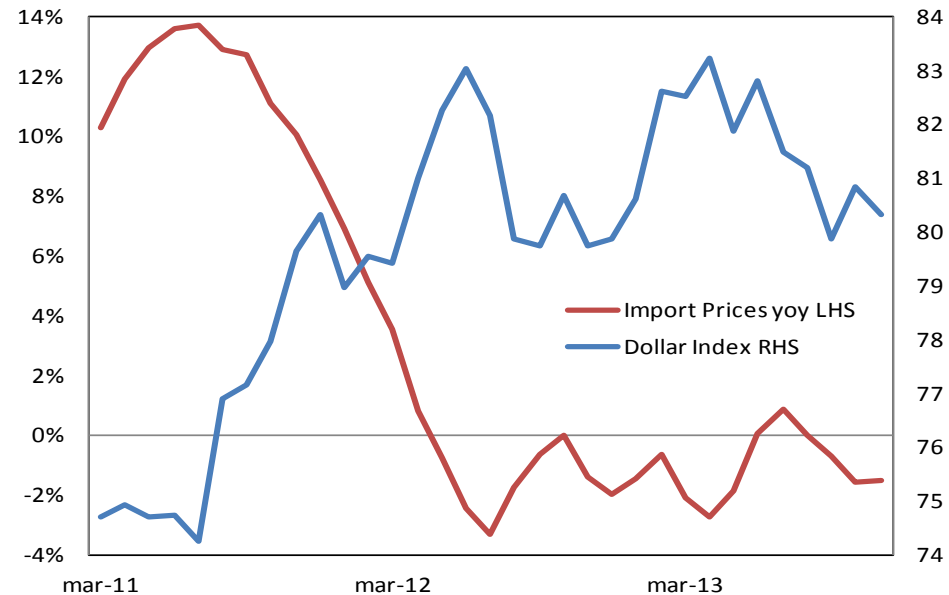
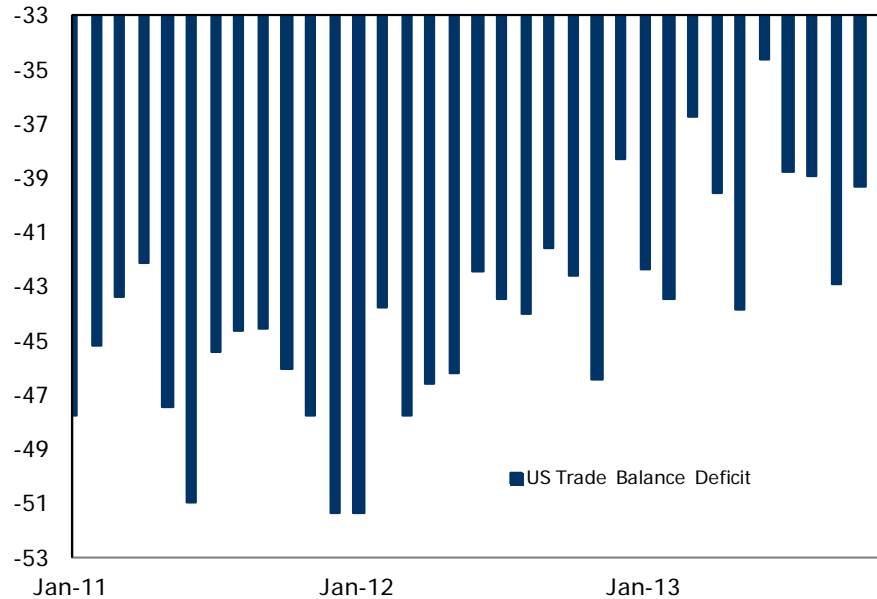
# FACTORY ORDERS

Factory orders increased 1.8% in November after declining a revised 0.5% (previously reported as a decline of 0.9%) in October. Capital goods orders jumped 8.8% in November suggesting stronger fixed investment in early 2014. In particular, orders for nondefense capital goods excluding aircraft were up 4.1% after two months of declines. Shipments rose 1.0% after relatively weak numbers in the prior three months. Nondefense capital goods excluding aircraft shipments jumped 2.7%, the first increase since August. Inventories were flat in November with October's figure revised down to a flat reading from an increase of 0.1% previously.



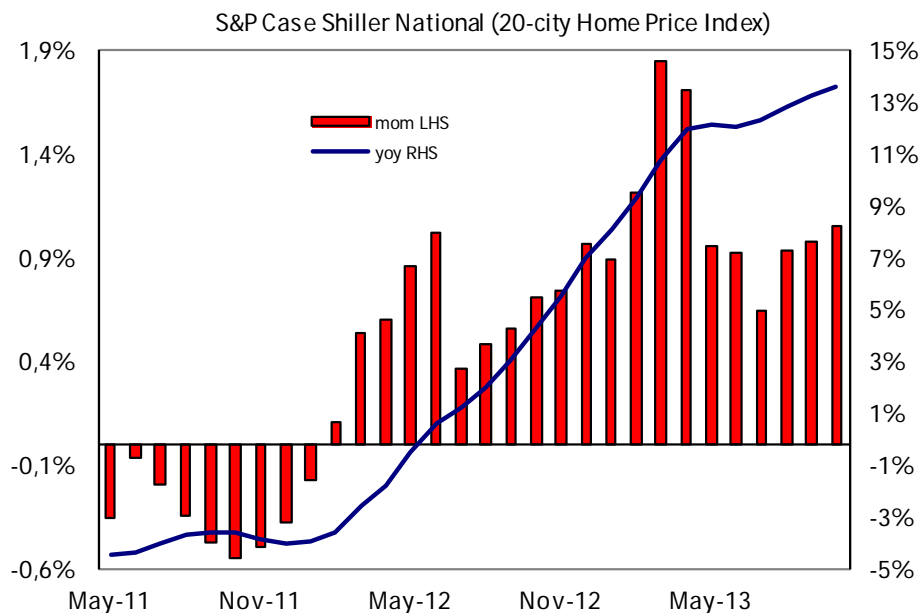
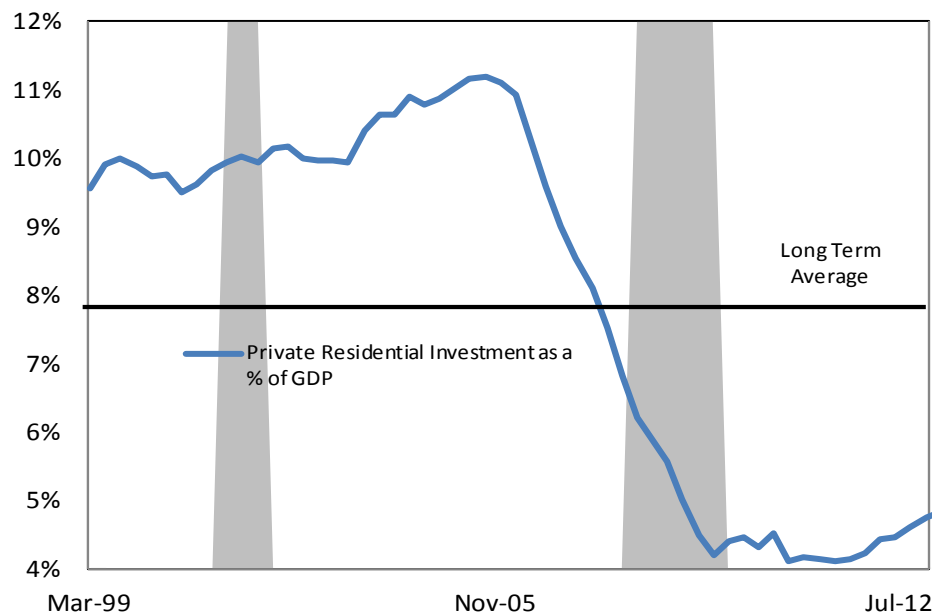
# TRADE BALANCE

November trade balance was definitely better than expected, registering a narrowing to -34.3 bln USD in November from -39.3 bln USD in October, driven by a strong improvement in oil products trade deficit at an all-time low in real terms, with real oil imports at a 17-year low and real exports at a new record level. Total Exports grew by 1.1% m/m and imports registered -1.8% m/m. The improvement is almost completely justified by the 4.3 bln USD contraction in the oil sector trade deficit.



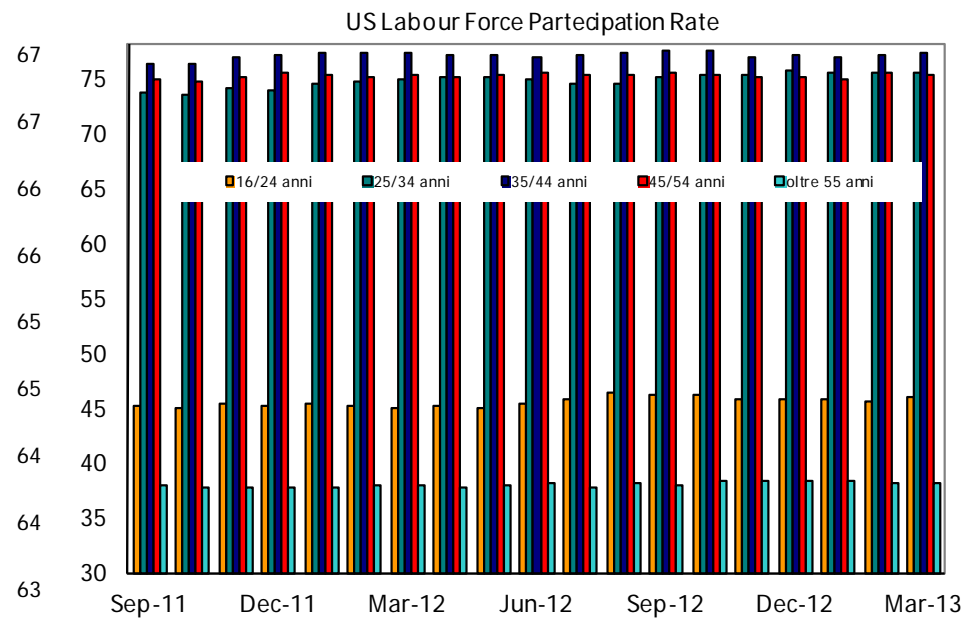
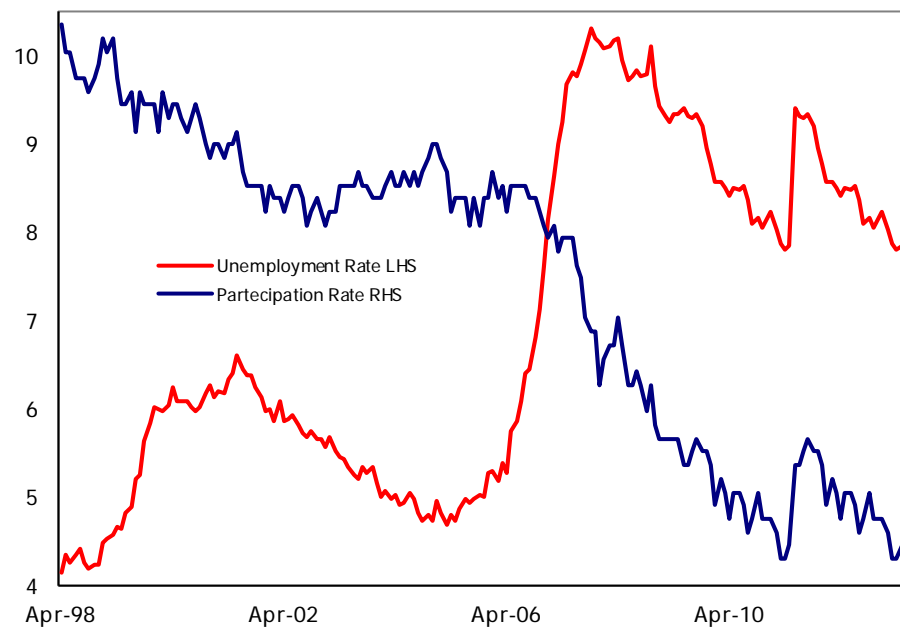
# HOUSING RECOVERY SET TO CONTINUE

We did see some weakness following the 100bp increase in mortgage rates over the summer. New home sales, housing starts, and the homebuilder index all deteriorated, and the bottom-up commentary from the major homebuilders in the third quarter was broadly disappointing. But recently, the housing sector has shown renewed signs of improvement. The recent upturn primarily reflects significant improvements in new home sales, housing starts, and the homebuilders' index, all of which are coincident or leading indicators of housing activity. Barring another sharp increase in mortgage rates, we think that the upward trend should continue in 2014 because the longer-term fundamentals for housing activity remain very favorable.



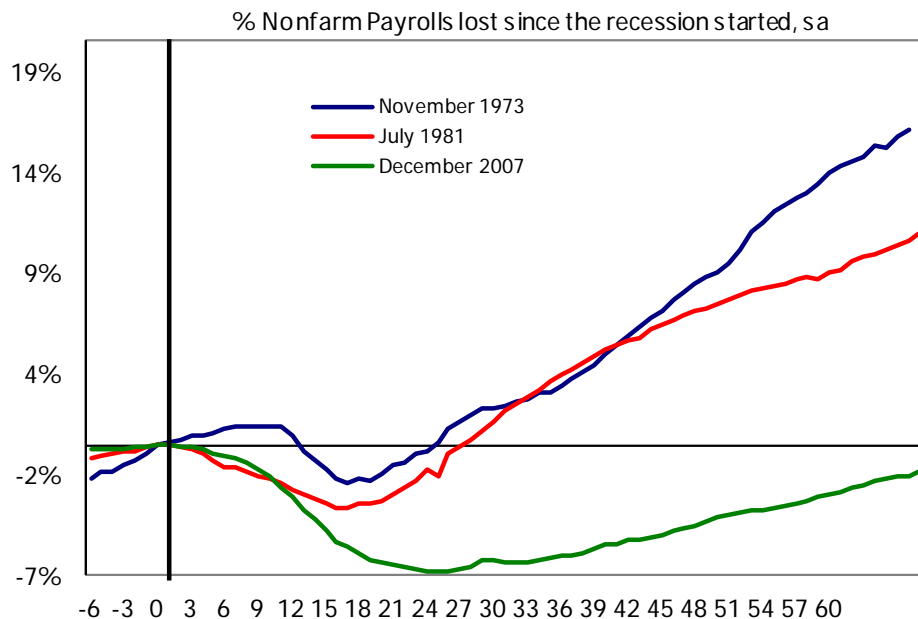
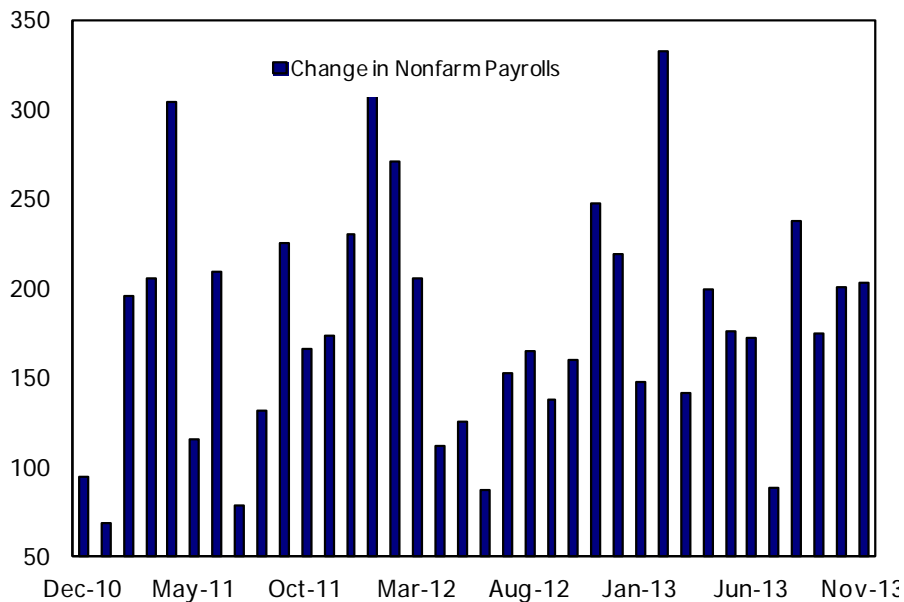
# STABILISATION OF PARTECIPATION RATE

We expect a stabilisation in the participation rate in 2014, although at a rather low level. The post-crisis increase in non-participation due to discouragement or other reasons (economic or not) should invert its recent trend in 2-3 years in order to keep the overall participation rate flat during the same time horizon.



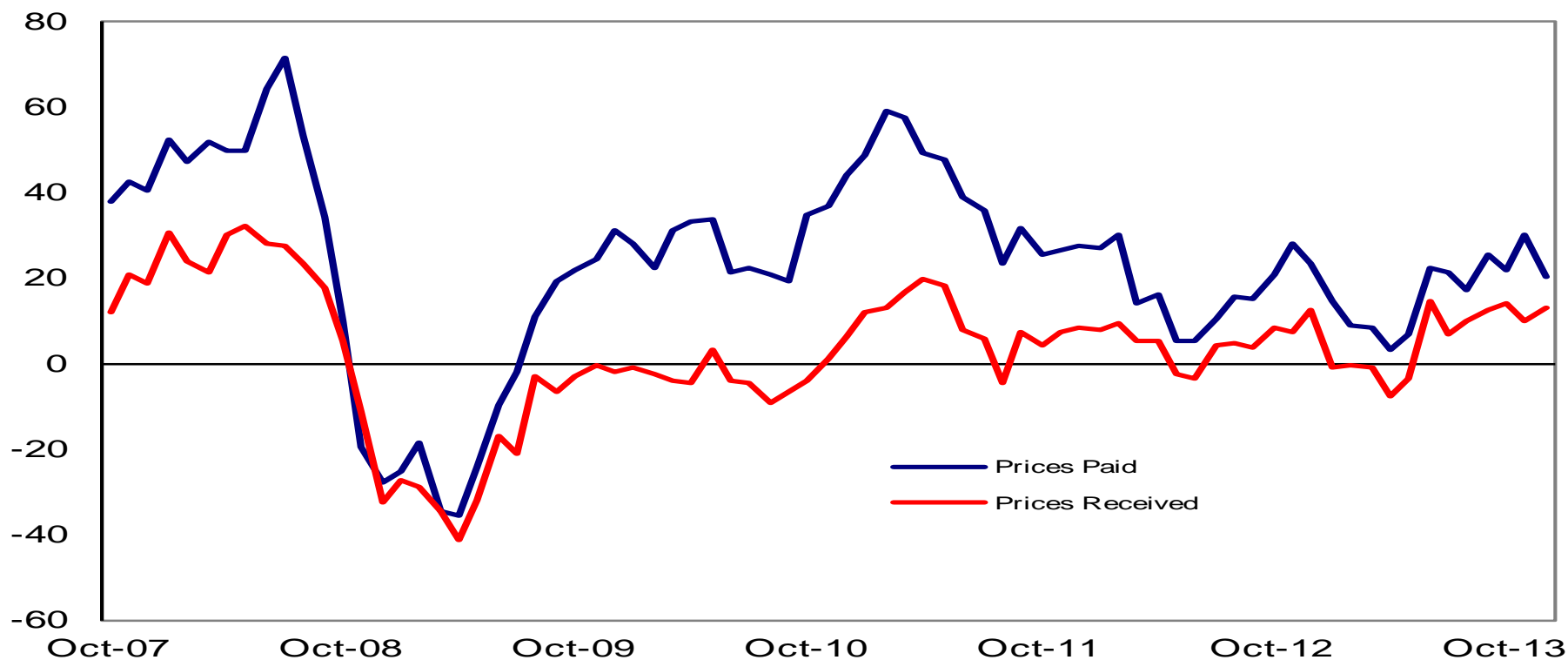
# LABOUR MARKET

The December Employment Report registered only 74K new jobs, below the consensus expectation. This is the lowest monthly gain in payrolls since January 2011 and could suggest some weakness in the labor market. However, some of the weakness might be temporary, primarily due to the inclement weather in December. There was a 38k upward revision to November's payrolls with no revision to October's number. Private payrolls increased by 87k, reflecting a 13k drop in government jobs in December.



# PRICES

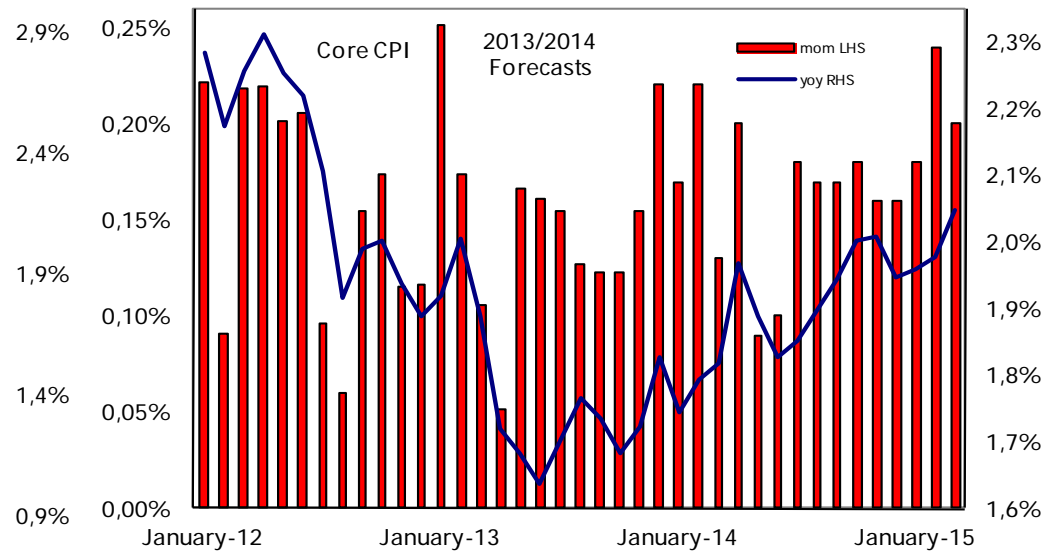
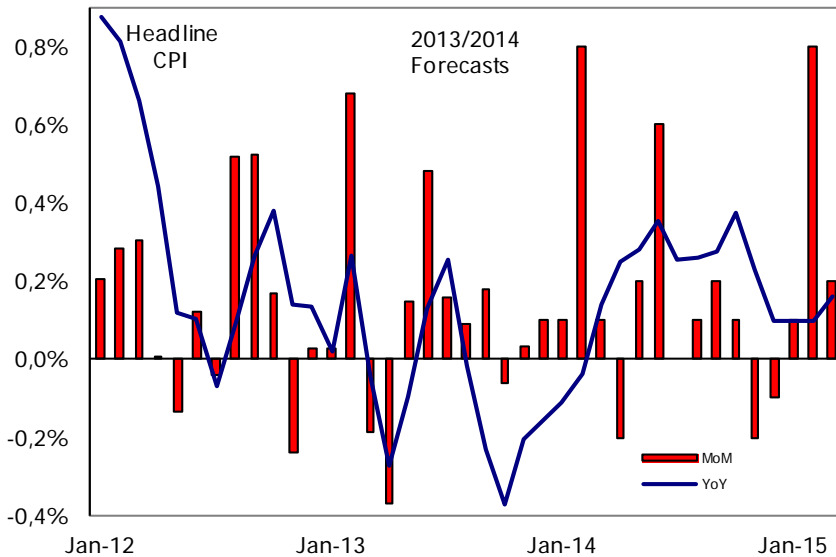
On the prices front, production prices continue to grow but at decreasing rates, while consumer prices are slightly increasing after the November slowdown. As for the next six months' forecast, in December we registered the second decrease in a row, from a strong figure in October, although remaining in positive territory.





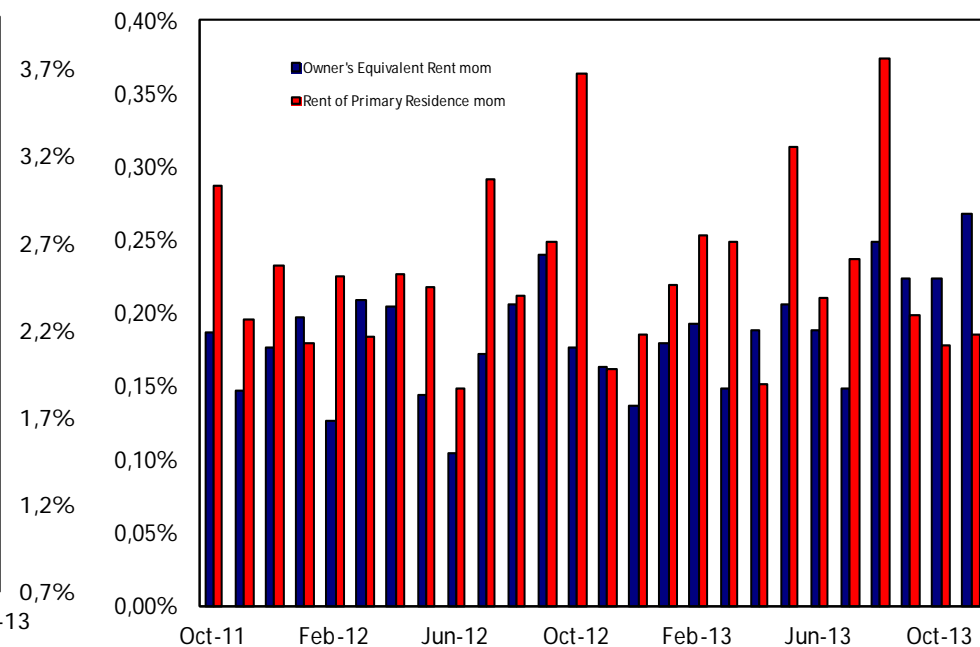
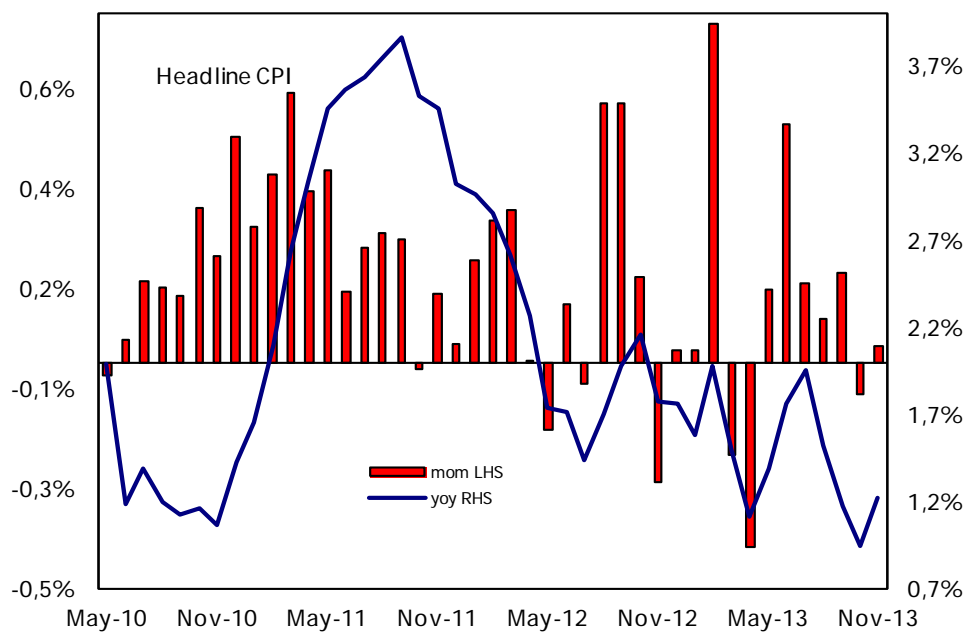
# CORE PCE DEFLATOR STILL BELOW 2%

Core PCE Deflator decreased from 1.6% at the end of 2012 to 1.1% in November 2013. We expect a modest rebound to 1.5% at the end of 2014 for two reasons. First, inflation expectations remain well anchored around 2%, despite significant downward surprises for headline and core inflation during 2013. Secondly, almost half of Core PCE Deflator slowdown for 2013 is due to a temporary slowdown of growth in Healthcare costs. The 2% convergence to the target will be slow, as, when the ULCs are lower than price inflation, meaning that labour market is exerting downward pressures on inflation, or at least slowing its course to target.



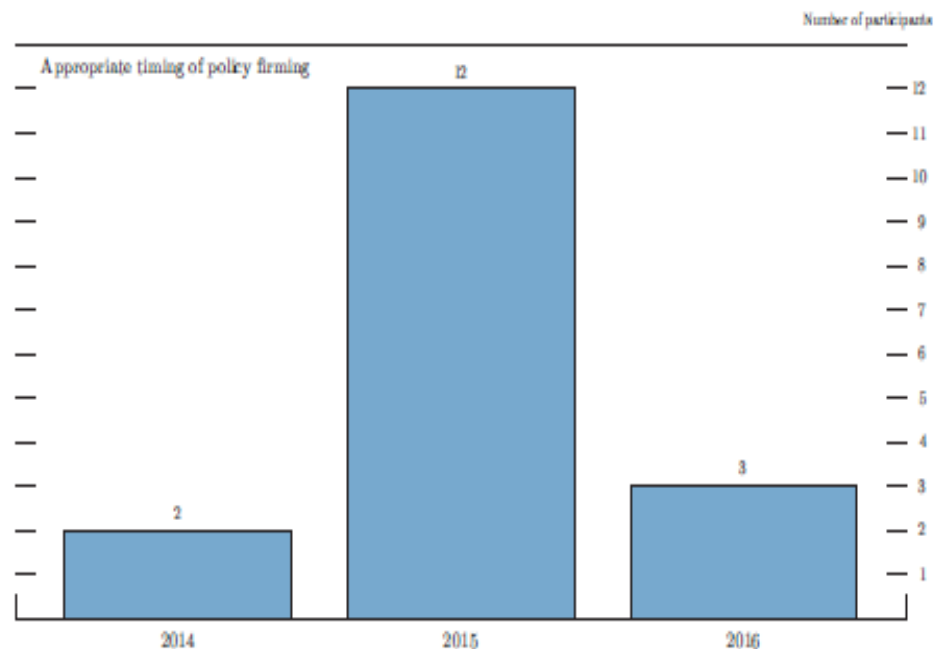
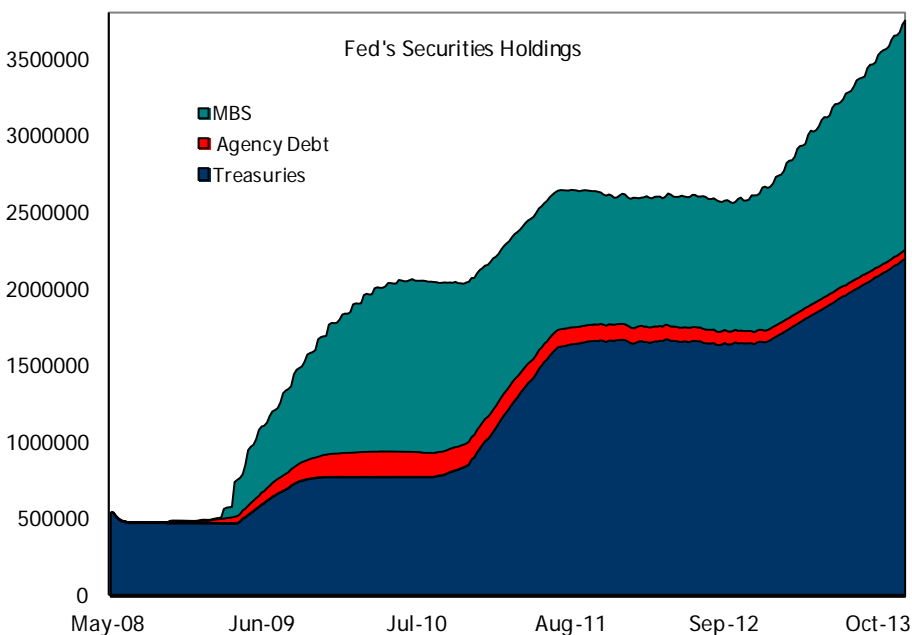
# CONSUMER PRICES

November CPI remained flat m/m in line with our forecasts for the headline index, while core grew by 0.2% m/m. As a trend, headline results growing by 1.2% up from 1.0% y/y in October and at a four year low. Core remains stable at 1.7% y/y, unchanged since September. After a significant slowdown from 2.3% y/y in Spring 2012 to 1.6% y/y in June, core inflation seems stabilised in the last months. As for the core CPI, we register a generalised weakness in prices of core goods and of medical services, more than compensated for by the stability of Shelter components (both OER and Rent of Primary Residence register +0.2% m/m).



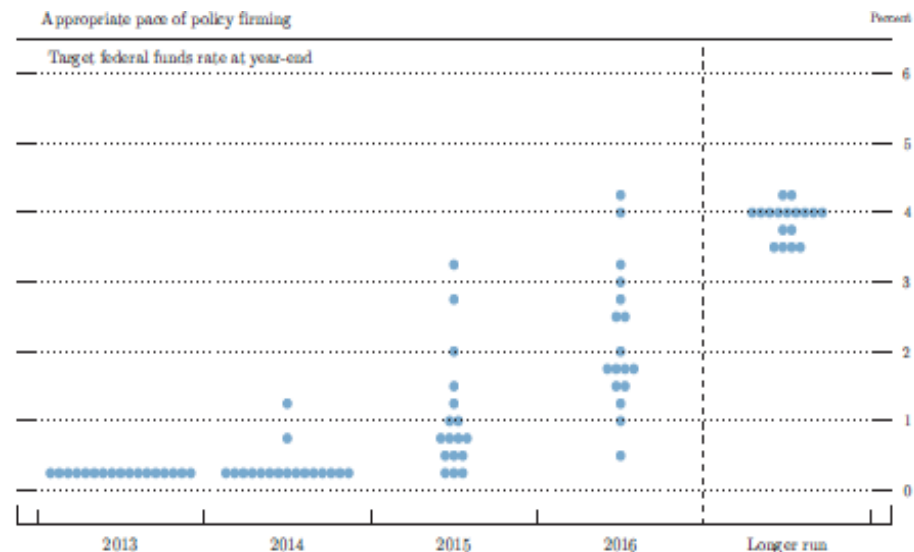
# 2014: END OF QE3

In our view, the probability is high that the FOMC will maintain a 10 bln USD pace in its tapering process for each meeting since its December decision. This would imply the end of QE3 after the October or December FOMC. In particular, after last summer's events, we assume FOMC will be reluctant to signal an increase in its tapering pace, now that the programme is nearing its natural course toward expiration well before the point at which the FOMC expects to hike the funds rate. Slowdown in this Tapering programme are possible in case of surprises in terms of growth, employment or inflation. Fed Funds hikes should not begin before 2015.



New FOMC's members forecasts were released alongside the December Meeting. The unemployment rate forecast was lowered to 7.05% for Q4 2013, to 6.45% for Q4 2014 (6.3-6.6%), to 5.8-6.1% for 2015 and to 5.55% for Q4 2016 (5.3-5.8%). Real growth forecasts were slightly increased by 10 bp to 2.25% at end of 2013 (2.2-2.3%), but forecasts for potential growth were decreased by 0.05% to 2.3%. Forecasts for real growth for 2014 were expanded as far as range, but the median point remains unchanged (2.8-3.2% in December from 2.9-3.1% in September). Core PCE deflator forecasts were revised downward by 0.1% for the end of 2013 to 1.15% (1.1-1.2%) and for the end of 2014 to 1.5% (1.4-1.6%), while forecasts at the end of 2015 and end of 2016 were revised downward at 1.8% (1.6-2.0%) and at 1.9% (1.8-2.0%) respectively. Fed Funds forecasts are unchanged at 0.125% at end of 2013 and 2014, while they were cut by 25 bp to 0.75% for end of 2015 and end of 2016 at 1.75%.

Actual and forecasts (%)	September 2013 Projections								December 2013 Projections				
	2010	2011	2012	2013	2014	2015	2016	Longer Run	2013	2014	2015	2016	Longer Run
<b>Real GDP (Q4/Q4)</b>													
Lower Bound	3,00	1,60	1,70	2,00	2,90	3,00	2,50	2,20	2,20	2,80	3,00	2,50	2,20
Upper Bound	3,50	1,70	1,80	2,30	3,10	3,50	3,30	2,50	2,30	3,20	3,40	3,20	2,40
Actual	3,10	1,60	1,70										
<b>Inflation (CPI nsa till 1999, PCE Deflator sa till 2003, Core PCE Deflator since 2004, Q4/Q4)</b>													
Lower Bound	0,80	1,80	1,60	1,20	1,50	1,70	1,90		1,10	1,40	1,60	1,80	
Upper Bound	1,00	1,90	1,70	1,30	1,70	2,00	2,00		1,20	1,60	2,00	2,00	
Actual	1,00	1,70	1,50										
<b>Inflazione (Headline PCE Deflator, Q4/Q4)</b>													
Lower Bound	1,00	2,70	1,60	1,10	1,30	1,60	1,70		0,90	1,40	1,50	1,70	
Upper Bound	1,10	2,90	1,70	1,20	1,80	2,00	2,00	2,00	1,00	1,60	2,00	2,00	2,00
Actual	1,30	2,60	1,60										
<b>Unemployment Rate (Q4 Average)</b>													
Lower Bound	9,20	9,00	7,80	7,10	6,40	5,90	5,40	5,20	7,00	6,30	5,80	5,30	5,20
Upper Bound	9,50	9,10	7,90	7,30	6,80	6,20	5,90	5,80	7,10	6,60	6,10	5,80	5,80
Actual	9,60	8,70	7,80										



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